

## CTK Associates Advocates & Legal Consultants

### Comments on the TRAI Consultation Paper on Valuation and Reserve Price of Spectrum dated 23<sup>rd</sup> July 2013

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We would first like to congratulate TRAI for bringing out very well researched and comprehensive consultation paper on the important topic of valuation and reserve price of Spectrum in such a short time. Considering present circumstances, this is the right time for all stakeholders to deliberate on the issues of quantum of spectrum to be auctioned, eligibility, rollout obligation, review of reserve price / spectrum usage charge, spectrum trading policy etc. and come up with recommendations and subsequent policy decisions which can withstand the technology changes and market developments in the future.

We would like to offer our comments as per following

**Q.1. What method should be adopted for refarming of the 900 MHz band so that the TSPs whose licences are expiring in 2014 onwards get adequate spectrum in 900/1800 MHz band for continuity of services provided by them?**

**Q.2. In case spectrum is to be “reserved” for such TSPs, should it be restricted to licences expiring in 2014 (metros) or include licences expiring afterwards (LSAs other than metros)?**

**R.1&2:** We would like to point out that the authority has taken consistent stand on the topic of refarming and adoption of method to carry out this refarming of the 900 MHz band, as can be seen from the recommendations dated 11<sup>th</sup> May 2010, its response to DOT dated 3<sup>rd</sup> November 2011, recommendations dated 23<sup>rd</sup> April 2012. Even the Government, through its press release dated 15<sup>th</sup> February 2012, has accepted the principle of refarming. The same has also been reflected in the Spectrum Management Strategies of National Telecom Policy – 2012 which states as *“To refarm spectrum and allot alternative frequency bands or media to service providers from time to time to make spectrum available for introduction of new technologies for telecom applications.”*

In view of above, we don't see any reason for the Authority to reconsider its earlier policy decision on the refarming and the entire spectrum in the 800 MHz and 900 MHz bands should be refarmed progressively at least before the due date of renewal of the licences. As reiterated by the Authority in its response to DOT dated 30<sup>th</sup> October 2012, there is no need to reserve any spectrum within 900 MHz band for incumbent operators and total refarming should be carried out rather than partial refarming. Such partial refarming will seriously hamper the true competition in the proposed auction. In addition, inadequate amount of spectrum will be left in the action to attract any new operator to participate in the auction. Therefore the authority should maintain its stand for total refarming.

If at all the Government still decides to refarm spectrum partially, it should be made clear that in the event the incumbent operator fails to acquire additional 2.5 MHz spectrum in the proposed auction, such operator will have to vacate the retained spectrum of 2.5 MHz which will be assigned to the next bidder in 900 MHz spectrum auction.

**Q.3. Is any restriction required to be imposed on the eligibility for participation in the proposed auction?**

**R.3:** In view of stated principle of National Telecom Policy for having robust competition at consumer end and lack of adequate participation in last 2 auctions, we don't see any justification for amending the existing policy and impose any restriction on the eligibility for participation in the proposed auction.

**Q.4. Should India adopt E-GSM band, in view of the diminishing interest in the CDMA services? If yes,**

- a) How much spectrum in the 800 MHz band should be retained for CDMA technology?**
- b) What are the issues that need to be addressed in the process?**
- c) What process should be adopted for migration considering the various issues involved?**

**R.4:** We are of the firm opinion that the open market competition with fair chance to every player should be the sole criteria for deciding fate of any technology or service rather than any policy decision. In addition, since the spectrum acquired through the auction is and will be liberalised in nature permitting deployment of any technology, we fail to understand the need for E-GSM band or reconsideration for spectrum bands for CDMA service.

**Q.5. Should roll out obligations for new/existing/renewal/quashed licenses be different? Please give justification in support of your answer.**

**Q.6. Is there a need to prescribe additional roll-out obligations for a TSP who acquires spectrum in the auction even if it has already fulfilled the prescribed roll-out obligations earlier?**

**R. 5 & 6:** There is no need for the Authority to amend the existing policy on the rollout obligation for all types of service providers like new/existing/renewal/quashed. The operators participated in the auction with the full knowledge about the rollout obligation and it may be unfair for them to request for amendment of the auction condition. Additionally if this criterion is amended by the Government only for the forthcoming auctions, there would be demand by the winners of the earlier auctions to extend the same benefit to maintain level playing field which in turn will raise the issue of legal validity for prospective amendment of NIA conditions. Therefore if at all the Governments wants to take decision on relevance of rollout obligation for the spectrum obtained through auction process, the same should be done in holistic manner for all types of spectrum obtained through auction till date, rather than taking this view only for forthcoming auctions.

**Q.7 What should be the framework for conversion of existing spectrum holdings into liberalised spectrum?**

**R.7:** Any spectrum that has been obtained by the licensee not through the auction process (and has been allocated administratively) should be liberalised only after payment of market determined prices. For deciding the current market price following framework should be adopted

a. For those licensees who have combination of liberalised and non-liberalised spectrum, they should be permitted to deploy any technology only when they pay market price for the entire non-liberalised spectrum (i.e. even the liberalised spectrum should be treated as non-liberalised spectrum till such time).

b. The Government has already issued demand notes to operators for one time spectrum charges based on prices discovered in earlier auctions. Therefore there is no question of reconsideration of the current market price wherever these demands were based on the auction discovered price.

c. Only in those Service Areas where current market price could not be established on the basis of auction, the price levied by the Government can be treated as provisional price and the price discovery in the forthcoming auction may be treated as current market price in such cases.

d. In order to end continued uncertainty over the issue of current market price and to have fair participation in the auctions, the Government should also take policy decision that in the event no auction based price gets established in any service area / spectrum band in the forthcoming auction, the provisional price in these service areas will be treated as final market discovered price, irrespective of subsequent price discoveries in future auctions.

**Q.8. Is it right time to permit spectrum trading in India? If yes, what should be the legal, regulatory and technical framework required for trading?**

R.8: We think that the policy on the spectrum trading can lead to major changes in the Indian telecom sector. Right now most of the stakeholders might not have complete visibility on the issue of spectrum trading and its likely impact. Therefore considering importance of this issue, rather than including this as one of the point in the current consultation, the Authority should come up with detailed a separate consultation paper on the subject of spectrum trading. Such comprehensive consultation paper, as always done by the Authority, covering all potential upsides and downsides of the spectrum trading based on international experiences will enable stakeholders to form informed opinions and provide meaningful inputs on this topic.

**Q.9. Would it be appropriate to use prices obtained in the auction of 3G spectrum as the basis for the valuation in 2013? In case the prices obtained in the auction of 3G spectrum are to be used as the basis, what qualifications would be necessary?**

R.9: With respect to the reserve price of the spectrum we would like to bring to your notice following points

a. **Objective of the Auction:** If one has to look at the recent controversies in the telecom sector in last few years, it can be seen that it was all about distributing spectrum at a very low price without reflecting the true economic value of the spectrum –scarce and precious natural resource. This was the main reason behind quashing of the licenses by the Hon’ble Supreme Court in February 2012. The Government has already recognised the importance of reserve price in discovery of true value of spectrum and therefore took a policy decision during auctions of 3G / 4G spectrum that for any subsequent auction of spectrum, the reserve price for such auction will be at least equal to the winning price of last auction. Similarly, NIA for the auction of the spectrum in 800, 900 and 1800 MHz band clearly mentions objectives of the Auctions as

*“The Government has set itself the following objectives for the Auctions:*

- *Obtain a market determined price of Spectrum in 1800MHz, 900MHz and 800MHz bands through a transparent process;*
- *Ensure efficient use of spectrum and avoid hoarding;*
- *Stimulate competition in the sector;*
- *Promote rollout of the respective services;*
- ***Maximise revenue proceeds from the Auctions within the set parameters.”***

Therefore the auction structure should be such that it should always lead to maximum pay-out for the Government.

**B. Role of the Reserve price in maximising the pay-outs:** Lower reserve price makes sense only if there is perfect competition in the market. Due to the external factors, if it is perceived that the auction results will not reach near the true economic value of the spectrum, it is always prudent for the Government to set the reserve price nearer to the true economic value of the spectrum. Considering the response from the last two auctions, it may be safer to assume that such risk will be quite high for this auction as well on account of following reasons;

- The incumbent operators are always going to be the main participants in these auctions. However they are aware about the fact that the price discovered through this auction will also be used as basis for charging one time spectrum charge for the current spectrum that has been allocated to them on administrative basis. Therefore there is very little incentive across the sector to participate in this auction with full vigour and establish true market price of the spectrum.
- In order to protect their interests, it may be true that these incumbent operators have aligned their interests with each other and are acting in tandem. The near coordinated hike in the consumer tariffs by most of the operator can also establish this fact.
- In addition, these incumbent operators have intra-circle roaming (ICR) arrangement with each other, which requires only one of the operator from the group of operators to participate in the auction and other operators can start service in partnership with such operator without even participating in the auction, as seen recently in the case of 3G services. Even though, the Government has objected to this scheme, we are not sure whether it is successful in stopping these arrangements.

As a result of this, in order to minimize the payouts to the Government, there will be a deliberate attempt by the incumbent operators to reduce the reserve price as low as possible and in the absence of effective competition, ensure that the auction gets concluded at the reserve price itself irrespective of the reserve price amount. Thus any reduction in reserve price will result into benefit of incumbent private operators at the cost of exchequer.

**C. Impact of high reserve price on the consumer tariffs:** The fear created by the incumbent operators regarding adverse impact of reserve price on subscriber tariff is only to mis-guide decision makers. The Authority has already proved, through a very elaborate and detailed study that the subscriber tariff impact cannot be more than mere 5 paise / minute. From the analysis presented by

the Authority it can be seen that, it has considered all possible scenarios for spectrum refarming, re-pricing of existing spectrum, revenue growth projections and has demonstrated that there will be a marginal impact on subscriber tariff and additional cost impact per minute does not have to be fully passed on to the subscriber in the form of tariff increase. The subsequent reductions in the reserve price by the Government (post tariff impact analysis done by the TRAI) will definitely lead to almost negligible impact on the consumer tariffs. Therefore impact on consumer tariff can no more be the valid basis for reconsideration of the reserve price.

**D. Financial health of the industry is improving:** Contrary to the bleak picture presented by the Authority in the consultation paper, we see that financial health of the telecom industry is rather improving. For reference we are quoting few extracts from the recent analyst reports

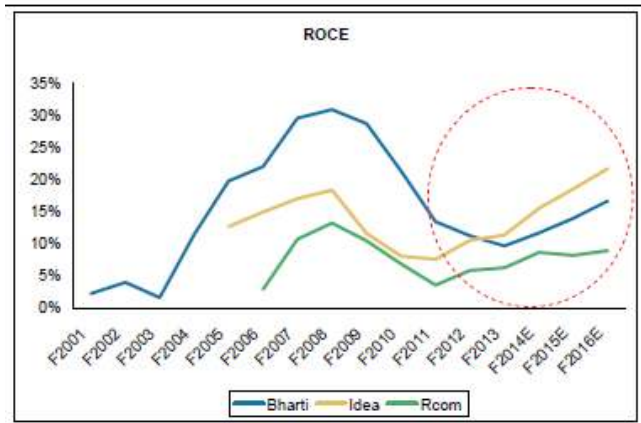
*“Amidst Tough Macro, Telco Returns Finally Improving*

*Raising sector earnings; returns to finally reach normalised levels by F2016e. Higher traffic, voice ARPMs, data contribution should lead to expanded EBITDA margins, stronger profit growth, and FCF.*

*F1Q14 showed the power of increasing ARPMs – Voice ARPMs improved 4% QoQ, the highest quarterly increase ever and the first increase across the board by all the operators. Traffic grew 2%, albeit slower than expected due to the early seasonal slowdown. Overall revenues grew 5% QoQ, while EBITDA margins improved 200 bps. The EBITDA of the three incumbents increased by an average 11.4% QoQ (vs. 6.5% in F4Q13).*

*Cancellation of 2G licenses in February 2012 has led to a reduction in the overall number of players in each circle from ~10 to ~6-7 currently. Barring the top 5 incumbents, players like Tata’s, Aircel, Sistema, and Telewings have all reduced their footprints across India. As discussed above, voice tariffs are now moving up and we expect them to reach December 2010 levels by F2016e.*

**ROCE for Indian Telcos to Finally Move to Normalised Levels**



Source: Company Data, Morgan Stanley Research estimates

Considering the above factors, we do not see any merit or justification for reconsideration of the reserve price or the basis of the reserve price. These reserve prices were recommended by the

Authority on the basis of 3G prices only after detailed techno-commercial analysis and industry wide consultation and there is absolutely no merit for the TRAI to take stand which will be contrary to its own earlier decisions. We rather see the present situation in which the incumbent operators are waiting for the Government to blink first and reap benefits at the cost of national exchequer. Only firm and consistent stand of the Government on the reserve price will induce these operators to participate in the forthcoming auctions and facilitate realising true economic value of the spectrum through these auctions.

**Q.10. Should the value of spectrum for individual LSA be derived in a top-down manner starting with pan-India valuation or should valuation of spectrum for each LSA be done individually?**

**Q.11. Is indexation of 2001 prices of 1800 MHz spectrum an appropriate method for valuing spectrum in 2013? If yes, what is the indexation factor that should be used?**

**Q.12. Should the value of spectrum in the areas where spectrum was not sold in the latest auctions of November 2012 and March 2013 be estimated by correlating the sale prices achieved in similar LSAs with known relevant variables? Can multiple regression analysis be used for this purpose?**

**Q.13. Should the value of spectrum be assessed on the basis of producer surplus on account of additional spectrum? Please support your response with justification. If you are in favour of this method, please furnish the calculation and relevant data along with results.**

**Q.14. Should the value of spectrum in the 1800 MHz band be derived by estimating a production function on the assumption that spectrum and BTS are substitutable resources? Please support your response with justification. If you are in favour of this method, please furnish the calculation and relevant data along with results.**

**Q.15. Apart from the approaches discussed in the foregoing section, is there any alternate approach for valuation of spectrum that you would suggest? Please support your answer with detailed data and methodology.**

**Q.16. Should the premium to be paid for the 900 MHz and liberalised 800 MHz spectrum be based on the additional CAPEX and OPEX that would be incurred on a shift from these bands to the 1800 MHz band?**

**Q.17. Should the valuation of spectrum and fixing of reserve price in the current exercise be restricted to the unsold LSAs in the 1800 MHz band, or should it apply to all LSAs?**

**R. 10 to 17:** As detailed in our response to question No. 9 above, we strongly recommend the Authority to continue with the earlier reserve price without any reconsideration for the downward revision. Therefore the various options for setting up the reserve price as discussed in the consultation paper may be considered by the Government for setting up reserve price for the new spectrum band but certainly not for the spectrum in 800, 900 and 1800 MHz band.

Irrespective of our stand on this matter, we also do not see any reason for changing the valuation of the spectrum for all the LSAs if the Government wants to maintain the level playing field and offer fair treatment to the operators who participated in earlier auction with fair expectation of consistent

policy stand by the Government. Therefore if at all the Authority wants to recommend new basis for valuation of the spectrum, the same should be restricted only for the unsold LSAs.

For such cases, we would also like to bring to your attention that the Authority has already done this exercise in terms of recommending spectrum value vide its expert committee report dated 31<sup>st</sup> January 2011 that values the spectrum in 1800 MHz band for the year 2010. This report was done with bottom up approach and by adopting both engineering and economic modelling approaches to determine the value of the spectrum in the 1800 MHz band.

In view of existence of such detailed analysis already done by the expert committee to do the spectrum valuation and recommended by the Authority in its earlier reports, unless TRAI comes forward with justification for not using those findings, we feel all the alternate approaches suggested by the Authority as theoretical and unnecessary. We therefore of the view that if at all spectrum valuation is to be reconsidered, the same should be restricted to the unsold LSAs and the expert committee findings for valuing spectrum above 6.2 MHz should be considered as basis for these LSAs.

**Q.18. a) Should annual spectrum usage charges be a percentage of AGR or is there a need to adopt some other method for levying spectrum usage charges? If another method is suggested, all details may be furnished.**

**b) In case annual spectrum usage charges are levied as a percentage of AGR, should annual spectrum charges escalate with the amount of spectrum holding, as at present, or should a fixed percentage of AGR be applicable?**

**c) If your response favours a flat percentage of AGR, what should that percentage be?**

**R.18:** In our opinion, this issue is similar to the proposed reconsideration on the roll-out obligation as discussed in Question 5 & 6 above. All the operators participated in the auction with the full knowledge on the policy for spectrum usage charge and its potential upsides and downsides. By participating in the auction, these operators had agreed for all terms associated with the spectrum including spectrum usage charge and therefore no reconsideration on this issue is justified once the spectrum is acquired in the auction. Considering legal challenges in amending NIA terms of previous auctions, we do not see any merit in analysing this subject further.

Even if any change in the spectrum usage charge is proposed only for the forthcoming auctions, practically it may be impossible for the Government to implement the same. There will be cases of operators acquiring spectrum in the previous regime as well as in new regime and in such cases it will be impossible for the Government or the operator to differentiate revenue accrued from spectrums acquired under different regimes.

Taking this into consideration there is no merit in adopting some other method for levying spectrum usage charges.

**Q.19. What should be the ratio adopted between the reserve price for the auction and the valuation of the spectrum?**

**R.19:** The consultation paper has stated very aptly that “Traditional auction theory advocates the use of reserve price for two reasons: (a) increase in revenue (b) avoidance of collusion”. As detailed out in our response to the question No. 9 above, the Government has already stated ‘Maximise revenue proceeds from the Auctions within the set parameters’ as one of the objective of the spectrum auction. Unfortunately the current market developments and results of the earlier rounds of the auctions give reasonable indications that there is strong possibility of collusion amongst the auction participants. Taking this into consideration, in order to give strong and firm signal to auction participants about the Government’s intents, the ratio adopted between the reserve price for the auction and the valuation of the spectrum should be continued as 0.8 or can even be made 0.9.