

Verdict of Supreme Court on 2G Spectrum Allocations – Pre Consultation Comments (Preliminary) of CUTS to TRAI

I. Background

- 1.1 The furore following the arrest of the former telecom minister and others for sale of 2G airwaves using the first-come-first-served (FCFS) method has come to a conflagration point with Supreme Court cancelling 122 licences given out in 2008. The Supreme Court has further ordered TRAI to make fresh recommendations for grant of licenses by auction within two months to the government which shall take a decision within the next one month.
- 1.2 Auctions are, therefore, a given after the ruling of the apex court. The Supreme Court gave its own reasons for the ruling, mainly, fair distribution of natural resources of which the State is the legal owner as a trustee of the people and therefore empowered to distribute the same according to Constitutional principles, including the doctrine of equality and larger public good as in a public trust.
- 1.3 The bench also found fault with TRAI for recommending allocation of 2G spectrum on the basis of 2001 price and overlooking one of the main objectives of the National Telecom Policy (NTP) 1999 that spectrum should be utilized efficiently, economically, rationally and optimally with a transparent process of allocation. The FCFS policy was found fundamentally flawed involving ‘an element of pure chance or accident.’ By gifting away an important national asset at throwaway prices, it facilitated off-loading of their stakes by the beneficiaries in the name of transfer of equity or infusion of fresh capital by foreign companies, thereby making huge profits and depriving the enrichment of the nation by thousands of crores.
- 1.4 Effectively, alternatives to auction being recommended by many appear to be out of context for the present.
- 1.5 The companies whose licences have been scrapped include Uninor (a joint venture – JV- between Norway’s Telenor and the Unitech Group), Sistema Shyam (a JV between Russian Sistema and Shyam Telcom), S Tel, Videocon, Idea Cellular, Tata Teleservices, Loop Telecom, and Etisalat DB (JV between UAEs Etisalat and Swan Telecom. As is evident, there are a number of international companies in the list.
- 1.6 The ruling has set in motion a spate of references for analysis of the judgement with the Prime Minister reportedly asking the attorney general to brief him on all possible implications amid growing worries for the business sentiment. DoT, too, is studying legal implications of the order. Initial responses of foreign telcos on the verdict speak of review of the Supreme Court’s decision, other legal actions and even quitting. Videocon might wait for TRAI’s recommendation before deciding on its course of action while Tata might file a review petition.

II. The Bigger Picture

- 2.1 *Impact on other sectors:* FCFS has statutory backing in some natural resources-based sectors. The Mines and Minerals Act (including the proposed new mining law bill) still allows FCFS for prospecting; auctioning is the selection method for known deposits. However, once a natural resource such as iron ore is converted into metal, it ceases to be a natural resource unlike spectrum. What would be the implications on this sector? How would it impact allotment of land and dispensation of other state patronage at national and state levels?
- 2.2 *Impact on policymakers:* The Supreme Court's Vodafone tax judgement was perceived by some as making a strong case for certainty in policy environment for investors by coming down heavily on policymakers. In its 2G verdict also, policymakers have been held in serious error. Will the executive shy away from innovative policy making and strengthen the policy paralysis? Will it help in doing away with government's discretionary powers?
- 2.3 *Impact on investors:* From the viewpoint of telcos, it is an extreme step in view of the fact that they had invested and collaborated in India on the basis of licences procured from the government. That subsequently illegalities have been in the process can not be blamed on the investors. UAE's Etisalat has booked US\$827mn as impairment charges after the verdict and Norway's Telenor has written down US\$721mn in licences and goodwill in India. How would the overall investment climate be impacted? What would that mean for the sanctity of contracts with the Government of India? On the other hand, is it possible that the foreign telcos conducted no due-diligence before entering into partnerships in India? If not, then how come Baharain Telecom (Batelco) which also bought stakes in STel, which was one of the licensees under discussion, sold back its entire stake back to STel at the same price at which it had bought the stake. Was such an exit possibility not considered by others by oversight or by design?
- 2.4 *Impact on the CBI probe:* Companies like Uninor and Etisalat have been charge sheeted by the Central Bureau of Investigation for conspiring with the then telecom minister to get the licences fraudulently and the trial is already underway. How would the trial be impacted? What should be the stand of the government when such companies press for compensation? Should they be allowed to bid again or not or should only these companies be allowed to bid?
- 2.5 *Impact on consistency:* The apex court having struck down licences issued by Raja on the FCFS basis, has not quashed licences issued earlier under the same policy explaining that these companies were not party to the case at hand. Will not the companies now hit by the judgement have reasons to believe existence of arbitrariness?
- 2.6 *Impact on fiscal deficit:* According to an assessment, auction of 122 licenses would result in about Rs80,000crore revenue to the exchequer (at the prices paid last year for 3G spectrum) and even if the government refunds Rs10,000crore to the companies that paid for the spectrum allotted in 2008, Rs70,000crore should go a long way to ease the financial deficit pressure. But

at what cost – what happens to the people hired, infrastructure created and debts raised? Would the tariffs not rise and how would the benefits of fast spread of low-cost telecom be met with? Further, the draft NTP 2011 states that revenue maximisation to the national exchequer is not the policy objective but national inclusion, service affordability, rural and broadband penetrations are. However, another assessment points out that the total spectrum that is likely to be made available upon cancellation of these licences (including spectrum to get vacated by defence forces) is 979.6MHz while the total demand for spectrum as on September 2011 was 616.2MHz.

- 2.7 *Impact on 3 G licensees:* Some of the telcos whose licences have been cancelled also have 3 G licenses. Some of such 3G operators would no longer have 2G licenses to go along with their state-wise 3G licenses. While it may still be legally possible for operators to continue with their 3G services even after their 2G licenses have been scrapped by the Supreme Court, the question is whether it would be commercially viable for the companies to run 3G Services only? If not, then what about those companies, licenses, investments, etc?
- 2.8 *Impact on banking:* It is estimated that approximately Rs300bn has been lent by the banks to five companies whose licenses have now been cancelled. How would this stress on the banking system be dealt with?
- 2.9 *Impact on customers:* While the services to customers would not cease immediately and with number portability they can migrate to other networks, what would be the impact of price increases which would follow auctions?
- 2.10 *Impact on other associated companies:* Companies dealing in manufacture of equipment for these telcos by executed contracts and those in the pipeline would be adversely hit. How would these be addressed?

III. Specific comments on auctioning

- 3.1 Worldwide, spectrum has been allotted using various methods, which broadly fall in three categories: administrative allocation, allocation on the basis of a ‘beauty contest’ (where contestants submit a plan on how they would utilize the asset with their credentials) and market-related processes including auctions. Examples from around the world support the hypothesis that in the initial years of tele-penetration when the need is to increase subscriber base, spectrum is allocated administratively or through beauty contests to keep the entry barriers low.
- 3.2 Auctioneering has become a highly advanced tool and needs to be tread upon carefully – more so in spectrum which has high stakes. The generally accepted fallouts of auction are well-known such as the ‘winner’s curse’ where the bidder may end up overpaying and pass on the burden onto consumers. Like FCFS, an auction can be gamed and if not properly designed, has scope for collusion. In respect of 3G auctions, there are media reports that some firms won licences to provide state-wide services but by agreeing among themselves

are now providing services that were possible only if they had won on all-India basis.

- 3.3 It is also believed that auctions are successful in robust and mature markets; when they do not create monopolies or oligopolies and when the regulators guard against barriers to entry by potential competitors and collusive behaviour. Such mature and robust markets existed in the US (in the 1990s) and in the UK, France and Germany (in 2000) when these countries auctioned spectrum. In all these countries, the auctions were hailed as they brought in record bids. In the US, disaster struck when a number of successful bidders declared bankruptcy. The dotcom bubble burst in 2000 when, in the UK, British Telecom nearly bankrupted owing to the massive debts it had incurred for the bids. France had demanded a flat fee of US\$4.5bn per licence but had to reduce the same by 85 percent.
- 3.4 In 1994, India auctioned telecom licences and chaos followed on account of overbidding and default resulting in a deadlock between the government and operators by 1998. The NTP provided a way out in 1999 by setting aside auction bids in favour of shared revenues. What followed (by finer adjustments in the percentage share) was stupendous in terms of growth of mobile services to 725 million subscribers by 2010. Even if overestimation of subscribers is taken into account, the growth is more than impressive. TRAI estimated that the auction fee foregone till March 2007 was Rs18,000crore whereas actual revenue collections were Rs40,000crore which doubled by March 2010 to Rs80,000crore.
- 3.5 Auctions do play a significant role in allocation of scarce resources and have been found to be one of the best forms of achieving the twin objectives of economic efficiency and optimizing revenues. Competition is the key tool of achieving these objectives. There are essentially two designs of commonly practiced auctions – a) the ascending auction, in which the price is raised successively until one bidder remains and b) sealed bid auction, in which the bidder independently submits a single bid without seeing others' bids and the object is sold to the highest bid. Ascending auctions are likely to encourage collusive behaviour as well as deter entry.
- 3.6 Yet it is important to note that there is no one-size-fits-all approach when designing auctions. A lot depends on the specific details of the situation and economic circumstances and how well it addresses the market imperfections. 3G auction in UK was designed as a hybrid of the ascending and the sealed bid models. The hybrid was chosen with the objective that the ascending auction would minimize efficiency loss and the sealed bid stage (beginning after five bidders remained to bid for four licences) would attract new entry and also raise revenue while making tacit collusion harder to succeed. This hybrid model worked much better in the UK than it did in the Netherlands underlying the point that replicating bidding models will not guarantee the same level of success in every case.
- 3.7 Auctioning, therefore, is a way to determine market demand and price but may not be the only or the best way. Director General (DG), Cellular Operators

Association of India (COAI), rightly points out that the ‘fixation’ on auctions is a consequence of the state of governance in the country with a low level of public trust. Auctioning is, therefore, deemed as the best way to meet the ends of transparency and openness in spectrum allocation and ensuring maximisation of revenue to the government when it parts with this ‘public good.’ It is another matter that the draft NTP 2011 lays down different objectives as noted earlier (2.6). Auctioning could therefore be balanced by reduction in other governmental levies and fees on the industry which are as high as 29 percent. Targeted subsidies could be another tool according to the DG, COAI.

- 3.8 A former Chairman of TRAI has propagated a hybrid model. To facilitate constructive consolidation of telecom service providers and to moderate irrational results from auctions alone, it could be structured as a hybrid model where revenue contribution by licence holders to the government is both as one-time payment and periodic payment of revenue linked with the earnings as spectrum usage charge. It may be noted that the Committee on Allocation of Natural Resources, in its report of May 2011 has also recommended that spectrum should be delinked from the licences.
- 3.9 At the same time the auction procedure also needs to be fine-tuned with market-related mechanism to ensure a level playing field for all service providers. As allocation of spectrum is in small tranches of spectrum quantity, licence holders would require repeat allocation after having peaked the subscribers against allotted spectrum.

IV. Conclusion

Clearly, the issue is far from over – the verdict having raised a host of issues spread over various sectors, overall administration and policymaking all of which is likely to have ramifications in the long run. Much will depend upon the outcome of interpretation of the judgement and the action the various players take thereafter. The detailed consultation paper of TRAI is awaited. At the moment auction as a way forward needs greater analysis to come out with the best fit in terms of its design and implementation.

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