
TELSTRA CORPORATION LIMITED

Spectrum Pricing – Response to DOCA Consultation paper

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Executive summary

Telstra's vision is to be a world class technology company that empowers people to connect. An inherent part of achieving this vision involves using spectrum to provide new and innovative mobile and wireless-based services to consumers on an ongoing basis. Given the importance of spectrum to our business, we have a deep interest in the current Spectrum Review and the associated Spectrum Pricing consultation.

While spectrum pricing is largely a function of the allocation mechanism used, we support the aspiration for future spectrum pricing arrangements to be consistent and transparent so that efficiency in the use of spectrum is promoted and instances of market distortions avoided. To these ends, the main points of our submission are as follows:

- **Increased transparency** – We support the proposals for the ACMA to be more transparent through the publication of guidelines on how it approaches spectrum pricing decisions and the inclusion of band planning information in its annual work program. Details on the ACMA's cost recovery activities and its approach to the application of opportunity cost pricing could also be included in the annual work program.
- **Allocation mechanisms** – Our preference is for market based processes to be used wherever possible as we consider these to be the best means for promoting efficiency. Where these are not suitable, administrative allocations using the opportunity cost approach or a price formula updated to better approximate opportunity cost, would be appropriate. Bespoke allocations should only be used for a limited set of pre-defined circumstances.
- **Consistency in pricing approaches** – We strongly support the proposal for users of similar spectrum to be charged at the same rate, and by extension general adherence to opportunity cost as a pricing principle. These are important principles which underpin ongoing integrity in the spectrum management framework, with deviations resulting in unhelpful allocative and pricing distortions.
- **Reserve prices** – The ACMA should have primary responsibility for spectrum pricing matters including the setting of reserve prices. In practice reserve prices should be modest and aligned with conservative estimates of market value to encourage bidding, the discovery of market prices and enable consumer welfare benefits to flow from both investment and competition.
- **Administrative formula** – We support the ACMA undertaking a review of the administrative pricing formula's parameters, and updating this so it better approximates the opportunity cost of given spectrum resources. We look forward to participating in the future review process.
- **Legislative and cost-recovery framework** – We support the proposals to simplify the current legislative and cost recovery frameworks, but are strongly of the view that all cost-recovery charges must be transparent and kept separate from the value-based charges (or prices) which are attached to spectrum resources.

01 Introduction

Telstra welcomes the current review of Spectrum Pricing — as a part of the broader Spectrum Review process — and the associated focus on ensuring there is consistency and transparency in pricing activity so that the efficient use of spectrum resources is supported.

As Australia's largest provider of mobile broadband services Telstra has made significant investments in spectrum resources over recent decades so we can compete in the market and provide our customers with new and innovative services which meet their needs. For these reasons we are committed to supporting high levels of integrity in Australia's spectrum management framework and any measures which will reinforce this.

We believe that the pricing principles identified in the consultation paper — efficient, cost recovery, consistency, simplicity and transparency — are appropriate, noting that certainty is also an important consideration for market participants such as ourselves. Accordingly these factors have guided the development of our responses within this submission.

02 Allocation decisions

This section contains our responses to draft proposals 1 to 3, covering the proposed spectrum pricing guidelines and the use of bespoke pricing arrangements.

Draft proposal 1

The ACMA should publish guidelines on how it approaches its spectrum pricing decisions.

We support the proposal for the ACMA to publish guidelines on how it approaches spectrum pricing decisions.

We note that only two of the allocative scenarios canvassed in the consultation paper require *active decisions* on price to be made — bespoke allocations and administrative situations where the opportunity cost approach is used. In contrast, prices in auctions and other market-based processes are determined by the ‘market’ (especially when reserve prices are set in a way which promotes price discovery), while in some administrative situations prices are set via the application of a price formula. Thus, we anticipate that the guidance material will be focussed on price decisions linked with bespoke allocations and administrative allocations using the opportunity cost approach.

With bespoke allocations, we consider that these should only be used for a limited set of pre-defined circumstances. While these ‘circumstances’ will vary it is possible that bespoke allocations, in some instances, will draw upon the opportunity cost approach. With any bespoke allocation of unsold auction lots for example — assuming there is insufficient demand for a second auction event — the preceding auction event is likely to be a useful point of reference for the price which is to be charged, especially where multiple similar lots have already been sold (i.e. the value of the next alternative use is clear). Renewal processes could also be similarly informed by opportunity cost sentiments, especially where multiple similar licences are being renewed. We anticipate that these scenarios (including their links to the opportunity cost approach) could be part of any future guidance material, potentially alongside other principles relevant to bespoke allocations (i.e. consistency with the principle of opportunity cost pricing).

With administrative allocations using the opportunity cost approach, we would welcome the provision of increased guidance material including details on the criteria which the ACMA consider to be relevant for the use of this pricing approach and the process which will be applied in these situations.

Noting the imminent transition of ‘broadcasting spectrum’ from coverage under the Broadcasting Services Act to coverage under the Radiocommunications Act, it would be useful for the forthcoming guidelines to explicitly outline the pricing framework which will be applicable in this area, and its consistency or otherwise with the broader spectrum pricing framework. The recent waiver of annual licence fees for commercial broadcasters is of concern because it is inconsistent with the spectrum management framework, alters the opportunity cost of all similar spectrum as a whole (to the ultimate detriment of end users) and risks creating a precedent for both the user group in question and other users more broadly. Given these numerous downsides, we strongly consider that any waiver of annual licence fees should be avoided in the future.

Draft proposal 2

To ensure efficient use of spectrum, the Government and the ACMA should endeavour to charge users of similar spectrum at the same rate.

Telstra agrees with this draft proposal, in the context of both bespoke allocations and spectrum allocations more broadly.

Charging users of similar spectrum the 'same rate' — irrespective of whether the user is a commercial entity, not-for-profit in nature or part of the Government sector — is a principle central to ongoing integrity of the spectrum management framework. Deviations from this approach can result in market distortions, and could also encourage other parties to secure differential treatment and/or more favourable price outcomes. Charging users of similar spectrum the 'same rate' does not necessarily mean that charges have to equal the value which that party attaches to given spectrum resources. Under the principles of opportunity cost pricing, which we support for the pricing of spectrum, spectrum charges should be equal to the value of the next best alternate use. Bespoke allocations should seek to be consistent with the principle of opportunity cost pricing, and any claims for special treatment based on arguments of high value and/or public goods should not be countenanced in the context of spectrum pricing decisions.

In the interests of transparency, certainty and consistency the proposed pricing guidelines should also detail the circumstances where bespoke allocations might be considered and — importantly — the processes which will be applied to these allocations (including renewals) so that the resultant decisions are robust and support the ongoing integrity of the spectrum management framework. Establishing clarity upfront around the use of bespoke allocations will also help to mitigate against arbitrary outcomes, which can cause both allocative and pricing distortions as noted in the consultation paper.

Draft proposal 3

Bespoke pricing arrangements will sometimes be necessary. Where spectrum fees are determined other than by auction or by the administered pricing formula, the ACMA, or the Government where it directs the ACMA on pricing, should publish the reasons for this decision.

While we generally prefer spectrum to be allocated via either via a market based or administrative process as opposed to a bespoke process (because of the potential for prices to be arbitrary, and therefore inconsistent with the underlying value of the resource), we support publication of the reasons associated with any instance where the Government or Minister makes a price direction to the ACMA in respect of a bespoke allocation. As outlined above, we also consider that there is scope more broadly for detailing both the circumstances where bespoke allocations might be considered and the process which is to be followed.

03 Market based allocations

This section contains our responses to draft proposals 4 to 6, covering the transition to market-based allocations, reserve prices and payment terms.

Draft proposal 4

The ACMA should further identify bands to transition from administratively set fees to competitive market-based allocations in its annual work program.

Telstra is supportive of the ACMA identifying bands for transition from administratively set fees to competitive market-based allocations within its annual work program. We understand the annual work program will provide detailed information in respect of transitions over immediate 12 month periods, with information on transitions over the subsequent two to four years to also be included. We support this approach, noting the inclusion of information on transitions in future years will be of particular benefit.

In addition to supporting planning by stakeholders such as Telstra, this future-looking information could also enable the ACMA's consideration of efficiency-promoting multiband auctions.

Draft proposal 5

In setting reserve prices, the ACMA and the Government should consider the influence of the reserve price on competitive behaviour, and the scope for price discovery through upward movement toward the market value of the spectrum.

We consider that the main effect of reserve prices on competitive behaviour is via the creation of incentives to bid. As such, reserve prices should be modest and aligned with conservative estimates of market value in order to encourage bidding and eventual 'discovery' of the market price. Modest reserve prices are also important in terms of creating scope for consumer welfare benefits to flow from subsequent investment and competition, noting observed price outcomes will also be influenced by auction design and the associated level of 'supply'.

A further consideration associated with reserve price decisions is the risk of having unsold lots at the end of an auction process. Although unsold lots tend to be allocated at a later date, their incidence is fundamentally undesirable because spectrum delivers no benefits whatsoever whilst unallocated and subsequent allocations may result in outcomes that create tension with draft principle 2 above (i.e. similar spectrum being allocated at similar prices). While the incidence of unsold lots can be attributable to the constraints of auction processes (i.e. the recent 1800 MHz auction), they can also result from reserve prices that are in the proximity of, or above, the value which the market attaches to given lots. As such, 'high' reserve prices should be avoided noting they also preclude price discovery and can imply a prioritisation of short term revenue gains above longer term (and broader) consumer welfare benefits.

We also note the reference in the consultation paper to setting reserve prices at a level to dissuade anticompetitive behaviour. This is a peculiar linkage — anticompetitive behaviour such as collusion is a serious issue, but reserve prices are not an appropriate mechanism for targeting or dissuading it. We note that major spectrum auctions of recent years have been accompanied by an extremely onerous 'associates' disclosure process and collusive activity is prohibited under the provisions of the Competition and Consumer Act 2010. It is also the case that spectrum, and access to it, is of critical importance for companies such as Telstra so great care is taken to avoid anything which might endanger

our ongoing use of spectrum or access to it. Based on the above, we consider that concerns about anticompetitive behaviour should not have any bearing on future decisions regarding reserve prices, especially those adopted for major spectrum auctions.

We consider that the ACMA should have primary responsibility for spectrum pricing matters including the setting of reserve prices, oversight of the formula which is used in administrative allocations (including periodic updating of this) and where required application of the opportunity cost approach.

Draft proposal 6

For spectrum access charges determined by auction, the ACMA should generally require upfront lump-sum payments. There may be circumstances where instalment payments are warranted shortly after the beginning of a licence term. In considering use of instalments, the ACMA should assess the risks to the state of default and the potential impact on competition.

Where spectrum is allocated by auction, it is fundamentally important that equal payment arrangements are applied to all successful bidders. These equal arrangements could be upfront lump-sum payments, due on a common date within a 12 month period before the licences in question begin, or they could involve a series of payment instalments. Equal arrangements are desirable because they preclude the potential for one or more parties obtaining commercial advantage via differentiated payment arrangements.

While the sentiments above are expressed in the context of a single auction event, they are also applicable to sequential allocations of similar spectrum — if for example there are unsold lots at the end of an auction event, the payment arrangements which applied to lots auctioned (i.e. upfront payment due 60 days before licence commencement) should also apply to the unsold lots at the time of their allocation, noting an adjustment for a shorter licence duration may be required. Where such adjustments are required, the discount rate should reflect the purchaser's WACC, not some arbitrarily chosen discount rate. This approach is important for avoiding any adverse impacts on competition, as the use of the purchaser's WACC — in the context of both duration adjustments and any instalment calculations — would make that party neutral to the timing of the payment. By contrast the use of a discount rate which was, for example, below the purchaser's WACC would confer financing advantages to the purchaser.

04 Administered allocations

This section contains our responses to draft proposals 7 and 8, covering the pricing formula and opportunity cost approach to pricing.

Draft proposal 7

The ACMA should undertake a detailed review of the administrative pricing formula's parameters, including density areas, the number of pricing bands, and the number of power categories. The ACMA should implement regular updates to the location and band weightings to reflect changes in density, demography and demand.

Telstra supports the ACMA undertaking a review of the administrative pricing formula's parameters. Updating the formula so it better approximates the opportunity cost of given spectrum resources should be a key objective of the forthcoming review. We anticipate that band weighting parameters in particular could be central to enabling a better approximation of opportunity cost (possibly differentiated on an upper band/lower band basis), as spectrum value is often linked to frequency bands and by extension the potential uses of those. More broadly though, and consistent with our earlier comments, we also consider that an updated (and improved) formula could support the increased use of price formulas in future administrative allocations. In addition to having the advantages of simplicity and certainty, the price formula approach is considerably more time effective than the alternative administrative price technique, namely the opportunity cost approach.

Telstra will provide further comments on the construct of the price formula and the frequency with which its parameters should be updated as a part of the upcoming review process, noting that managing instances of potential spectrum denial and/or congestion are important elements of all administered allocations.

Draft proposal 8

The ACMA should apply opportunity cost pricing to a greater number of spectrum bands, especially where it is impractical to competitively allocate spectrum. This work should be identified in the ACMA's annual work program. The ACMA should consider more time effective approaches to implement these, and review fees as market conditions change over time.

Telstra agrees that opportunity cost pricing should be used in instances where demand is likely to exceed supply, but market based processes are not suitable. In practice there may be a fine balance between these alternate approaches, noting reserve prices can be set to conservatively approximate opportunity cost with any subsequent price discovery being the function of an efficient allocation.

Given this potential fine balance, information on future application of the opportunity cost approach — encompassing criteria for application and the proposed process for application — could usefully be included in the ACMA's annual work program along with details on improving timeliness. Consideration should also be given to feeding the results of opportunity cost assessments into the future periodic updates of the administrative pricing formula.

05 Legislative and cost-recovery framework

This section contains our responses to draft proposals 9 to 11, covering the legislative framework, the value-based fee framework and the cost-recovery framework.

Draft proposal 9

The Government should consolidate the three existing spectrum tax Acts into one tax Act. The ACMA should continue to have the power to make determinations on the amount of tax under this Act. There should be no changes to the direct charges framework. In addition to the consolidation of the tax Acts, provisions of the separate *Radiocommunications Taxes Collection Act 1983* and the *Radiocommunications Taxes Collection Regulations 1985* should be consolidated with the remaining legislation.

Telstra supports this proposal, but we note the desirability for all cost recovery taxes to be transparent meaning their key cost components and the associated cost drivers are separately and consistently reported. Detail on the ACMA's cost-recovery approach could be included in the annual work program.

Draft proposal 10

The apparatus licence taxes and spectrum licence spectrum access charges should be combined into a single spectrum access charge. This existing apparatus licence tax formula should become the administered incentive pricing formula and should dictate the price paid for administered prices under the spectrum access charge. This formula would be adjusted to remove the minimum tax constraint.

Telstra supports the proposal to combine current apparatus licence taxes and spectrum licence spectrum access charges into a single spectrum access charge on the understanding that this will be the price paid for the use of/access to given spectrum resources. That is, price is value-based, as determined through a market based process or via the application of an administrative formula.

While we are supportive of the moves to simplify the legislative and cost recovery frameworks, we also consider that there must be a transparent distinction between cost-recovery charges on the one hand and value-based pricing on the other. To this end we are unsure why the discussion under draft proposal 10 links value-based fees to management costs when the discussion under draft proposal 9 indicates that cost-recovery taxes are intended to reflect (and presumably recover) spectrum management costs. Consistent with our views above, costs and value should not be priced into a fee for spectrum — they should be kept separate. Given the term 'fees' is associated with cost recovery, a term such as charges may be more appropriate for the value-based component or 'price' of spectrum resources. We suggest that the ACMA seek to clarify the terminology in this area.

Draft proposal 11

The spectrum licence tax and the minimum tax constraint of the apparatus licence taxes should be subsumed into one radiocommunications licence tax. The ACMA may choose to set the amount of this tax to cover where the spectrum access charge would not otherwise recover the costs of managing the spectrum. The ACMA should continue to recover direct costs through charges. The ACMA should explore if there are any additional costs that can be recovered through the direct cost mechanisms.

As outlined above, Telstra does not support cost-recovery charges being mixed with the price (or charge) which is paid for the use of/access to given spectrum resources. Accordingly we do not support the proposal for spectrum access charges — which we interpret to be the ‘price’ — to be the means for the recovery of any direct or indirect spectrum management costs. On this basis, we support the current spectrum licence tax and the minimum tax constraint of the apparatus licence taxes being subsumed into one ‘radiocommunications licence tax’, noting this tax is to support the recovery of indirect costs. In the interests of transparency the ACMA should provide information on the indirect costs which are being recovered via the new radiocommunications licence tax in its annual report, and articulate how these are both prudent in nature and related to spectrum management.