VODAFONE ESSAR MOBILE SERVICES LIMITED (VE) RESPONSE TO TRAI CONSULTATION PAPER ON REVIEW OF LICENCE TERMS AND CONDITIONS AND CAPPING OF NUMBER OF ACCESS PROVIDERS (CONSULTATION PAPER NO. 7/2007)

VE thanks the TRAI for the opportunity to respond to this important Consultation Paper and for granting an extension to prepare this response.

While the Indian telecommunications sector is currently enjoying unprecedented growth rates, we must not lose sight of the challenges that lie ahead. Mobile subscriber numbers are increasing at a rate of 6 million plus per month but the overall level of national teledensity has not yet reached 20%. This lags well behind most other countries in the world and still leaves the majority of Indian citizens without access to information and communication opportunities that can transform their lives for the better. As the market evolves, policy adjustments will inevitably be required to anticipate new challenges. Therefore, this Consultation comes at an opportune time and the objective should be to create a Licensing Regime that will underpin the next phase of growth in the sector – to 500 million connections and beyond. We applaud the DoT and the TRAI for taking the initiative to review the Licensing Regime at this juncture.

VE endorse the response submitted by the COAI. However, VE wish to provide the following additional comments with respect to some of the questions posed in the Consultation. The comments reflect both VE's experience of the Indian telecommunications market and Vodafone Group's international experience.

VE's main comments are:

1. We strongly support the continuation of clear ex-ante regulation provided by the Merger & Acquisition Guidelines. The guidelines are a critical component to ensure that the efficiency benefits of potential consolidation can be realised while ensuring that the conditions for healthy competition are maintained.

2. The current separate allocation mechanisms of GSM or CDMA spectrum must be retained. Similarly spectrum should continue to be issued on a "first come, first service" basis.

We provide more detailed comments in the below responses to the TRAI's specific questions.

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Merger and Acquisition

Our specific responses to the questions posed in the Consultation relating to Merger and Acquisition are:

Q1. How should the market in the access sector be defined?

We agree with the TRAI's recommendations that mobile and fixed should be treated separately but we are of the opinion that this needs to be reviewed periodically. This limited market definition is inextricably linked to the response to Q3 and the specific recommendations on market definition and the percentage limit must be considered together.

Q3 As per the existing guidelines, any merger/acquisition that leads to a market share of 67% or more, of the merged entity, is not permitted. Keeping in mind our objective and the present and expected market conditions, what should be the permissible level of market share of the merged entity? Please provide justifications for your reply?

We are of the opinion that the 67% limit is appropriate when applied to a narrow mobile market definition, in the answer to the Question 1 above. It is worth noting that under the regime of the current M&A Guidelines, not a single intra-circle merger between licensees has taken place to date and it cannot be said that the current guidelines have produced an environment of undue consolidation. The guidelines therefore remain appropriate.

Q4. Should the maximum spectrum limit that could be held by a merged entity be specified?

No, the merged entity should not have a limit as we believe that spectrum caps are an unnecessary layer of restrictions on mergers and acquisitions. Adequate mechanisms to protect competition are provided for by the 67% monopoly market share test and number of licensed access provider limitations. Furthermore, the spectrum cap can create anomalous situations which could act against the interests of the consumer.

Specifically, the consolidation of spectrum may yield one of the most significant synergy benefits for merging licensees and it would not be in the public interest to block such gains in circumstances where the market is still healthily competitive. The TRAI states (Consultation 2.45) that "the central rationale for having limits on the amount of spectrum held by any entity and especially for merged entity is to prevent anti-competitive access to spectrum." However, an absolute spectrum cap is an inappropriate measure of the relative competitive position of a licensee in terms of spectrum and it is only an indirect measure of effective competition. Therefore, we are of the opinion that the spectrum cap is an arbitrary construct which creates an unnecessary layer of restrictions. The 67% monopoly market share test for Mergers and Acquisitions and three licensed access service provider limits are sufficient to ensure healthy competition.

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Furthermore, spectrum caps will also become more cumbersome and unworkable through time. For example, the spectrum caps are currently applied to aggregate GSM spectrum holdings of the merging licensee company across both GSM 900 and GSM 1800 bands. However, such an approach will become increasingly inappropriate and difficult in an environment of new 3G/Wimax spectrum allocations in the near term and potential re-farming in the longer term. Whether combined 2G/3G/WiMax spectrum caps or separate spectrum caps are applied, the thresholds and results are arbitrary and only tangentially relevant to the real issue – ensuring healthy competition in the relevant market. The TRAI should recognise the limitations of spectrum caps in an increasingly complex spectrum environment and convergence

Q5. Should there be a lower limit on the number of access service providers in a service area in the context of M&A activity? What should this be, and how should it be defined?

We believe that the lower limit of three service providers should be retained. This should be interpreted as a limit that applies to separately to the mobile market (consistent with Q1, Q2, and Q4 above).

Q6. What are the qualitative and quantitative conditions, in terms of the review of potential mergers and acquisitions and transfers of licenses, which should be in place to ensure healthy competition in the market?

We are of the opinion that the monopoly market share test (by subscriber numbers) and the number of licensed access service provider limit provide adequate ex ante protection for healthy competition in the context of Mergers and Acquisitions. In the context of there having been no intra-circle mergers to date, it would be inappropriate to change these guidelines.

In terms of Transfer of Licences, clause 6 of the UASL provides sufficient clarity on the rules for transference or assignment of licences.

In terms of the Substantial Equity provision in clause 1.4 of the UASL, we believe that 10% limit on cross-holding of licensees in the same service area should be retained (see responses to questions 8 to 14).

Q7. As a regulatory philosophy, should the DoT and TRAI focus more on ex post or ex ante competition regulation, or a mix of the two? How can such a balance be created?

The unifying regulatory philosophy should be the principles of competition law. All regulation, whether ex post or ex ante, should be founded in these principles – market definition, market evaluation and identification of appropriate remedies.

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We agree with the TRAI's statement in Paragraph 1.10 of Chapter 1 of the Consultation Paper: "There is a need to ensure a clear and stable regulatory structure, especially with regard to spectrum policy, investment norms, competition policy, and the licensing regime in the era of convergence. It is no doubt important to ensure that the regulatory framework is pre-defined and transparent to reduce risk and maximise the potential for growth". We are of the opinion that the cornerstone of the TRAI's regulatory philosophy should be that regulatory decisions should be based on clear and transparent competition law-based assessments of the level of competition in the relevant product and service market.

We are strongly of the opinion that ex-ante provisions such as the M&A Guidelines guidance provide essential clarity to licensees and provide a valuable foundation to strategic and operational decision making. The Indian market is highly competitive and growing rapidly. Licensees require a clear view of the regulatory framework in order to justify such large capital programs and ex-ante provisions such as the M&A Guidelines provide this clarity.

VE fully support the current approach in the M&A Guidelines and the Unified Access Service Licence which sets clear ex-ante conditions and processes which will determine the approval of mergers, acquisitions, and the transfer of licences. The value of this approach has been clearly demonstrated by the level of competition between players, which has contributed to the significant growth of mobile subscribers described by the TRAI in Chapter 1 of the Consultation Document.

VE is of the opinion that similarly clear and predictable decision-making processes should be used to govern other regulatory interventions as would significantly enhance the development of the Indian communications market. This framework should be founded on clear and transparent processes and criteria to determine in what circumstances ex-post and ex-ante competition regulation may be imposed. This would be consistent with other jurisdictions, such as European Union and Malaysia.[1]

The continuation of clear ex-ante regulation in the M&A Guidelines and the Licences, supplemented by the introduction of a clear and transparent product and service market competition law-based regulatory mechanism, will facilitate the achievement of the objectives of healthy competition and a level playing field, guaranteed under National Telecoms Policy 1999. Consistent with these objectives, we also submit that the DoT and TRAI should continue to address significant asymmetries in the market relating to BSNL that impair competition on a level playing field, such as the Access Deficit Charge and refunds of licence fees.

[1] We broadly agree with the descriptions of ex-post ("addressing anti-competitive behaviour") and ex-ante ("anticipatory regulation to prevent socially undesirable actions or outcomes in markets, mainly concerned with market structure") provided by the TRAI in paragraphs 2.12 – 2.14 of the Consultation Paper. These are consistent with descriptions provided by the ITU/InfoDev ICT Regulation Toolkit: http://www.ictregulationtoolkit.org/en/Section.1678.html.

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Substantial Equity

Our specific responses to the questions posed in the Consultation relating to Substantial Equity are:

Q8. Should the substantial equity clause (1.4 of UASL) continue to be part of the terms and conditions of the UAS/CMTS license in addition to the M&A Guidelines?

Yes. However, the substantial equity provision should be integrated with the M&A Guidelines.

In circumstances where one party holds substantial equity in another entity within the same license area that is in excess of the Substantial Equity threshold, it is not necessarily against the public interest. The party should still be permitted to directly or indirectly hold stakes in more than one access Licence Company in the same service area provided that the M&A Guidelines are not breached. The Significant Equity provisions and the M&A Guidelines should operate in a consistent framework. A shareholder should be able to hold Significant Equity in two licensees in circumstances where those two licensees were they to merge, and would satisfy the M&A Guidelines.

We note that one of the features of the Indian Licensing Regime is that the restrictions on Substantial Equity and Promoters apply to the shareholders in the licensee company but the remedies and consequences of breaching the provisions fall upon the licensee company. Where the licensee company is a joint venture between multiple shareholders, this can create significant complications in the relationships between the shareholders. We are of the opinion that the Licensor should, where possible seek to target the remedies on the shareholders, not the licensee company. While we recognise that shareholders also have an incentive to address these issues through the shareholders' agreements, in circumstances where issues arise, the Licensor should make a pragmatic assessment of the circumstances looking at the facts and circumstances of the situation before specifying the appropriate remedies.

Q9. If yes, what should be the appropriate limit of substantial equity? Give detailed justification.

We are of the opinion that a 10% limit is appropriate.

Q11. Whether a promoter company/legal person should be permitted to have stakes directly or indirectly in more than one access License Company in the same service area?

We are of the opinion that the promoter provisions in Clause 1.4 of the UASL that a "Promoter Company/Legal Person cannot have stakes in more than one Licensee company for the same service area" are unnecessary and can be adequately and more effectively addressed through the combination of the Substantial Equity provisions and the M&A Guidelines.

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The concept of a "Promoter Company/Legal Person" is not defined specifically in the context of telecommunications licensing and we are of the opinion that the potential issues of common control are already adequately dealt with through the Substantial Equity provisions. We therefore recommend that these provisions relating to "Promoter Company/Legal Person" be removed.

Q14. Whether the Central government, State government and public undertakings be taken out of the definition for the purpose of calculating the substantial shareholding?

There is no justification for exempting government and public organisations from the calculation of substantial shareholding.

Permitting Combinations of Technology under the same License

Our specific responses to the questions posed in the Consultation relating to Combinations of Technology are:

Q15. In view of the fact that in the present licensing regime, the initial spectrum allocation is based on the technology chosen by the licensee (CDMA or TDMA) and subsequently for both technologies there is a separate growth path based on subscriber numbers, please indicate whether a licensee using one technology should be assigned additional spectrum meant for the other technology under the same license?

No, any attempt to even consider a cross allocation of spectrum would offer parties a backdoor entry to create another network (without obtaining a new license). This would have the potential to destroy the structure of the sector.

We have witnessed the disruption and prolonged litigation which resulted from the "WLL argument". This ultimately led to the one-time regularisation of the transformation of fixed licensed providers into mobile licensed providers through the UASL regime. There are sufficient parallels between the scenario of transformation in the WLL situation to the potential transformation from CDMA to GSM or vice versa to suggest that this could lead to a similar debacle. Such an outcome is not in the public interest and should not be enabled by the Spectrum Allocation Policy or Licensing Regime.

To do otherwise would expose the sector to considerable uncertainty and potential litigation at a time when further investment in building out coverage in the country is so critical. The ultimate result could be a proliferation of networks – six to eight operators with a network each as exist today could mutate into six to eight operators but with two networks each in every circle, which will prove certainly most detrimental to the public interest.

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Once one operator exercised the option to operate two networks, it would be difficult for the Licensor to deny the next, and the next and the next. It seems inconsistent that on one hand, the Consultation Paper raises the potential merits of capping the number of operators, yet here we are raising the prospect of a spectrum allocation policy that has the potential to effectively double the number of networks (operators).

Q17. What should be the priority in allocation of spectrum among the three categories of licensees given in 4.16 of the chapter?

The classification suggested in Paragraph 4.16 of the Consultation Paper needs to be revised to put licensees awaiting additional spectrum and those awaiting an initial allotment on exactly the same footing. Annexure IX to the Consultation Paper correctly identifies licensees awaiting an initial allotment as having a contractual right to that spectrum.

Once the license has been granted, all licensees are equally eligible to receive spectrum as per their technology choice. The spectrum should be allotted by the Licensor on a "first-come, first served" basis, based strictly on the date of application for spectrum.

We reject the distinction drawn in Paragraph 4.16 between licensees awaiting additional allotments of spectrum and those awaiting an initial allocation. All licensees should be treated on an equal basis.

If licensees awaiting additional allotments are given priority over the other licensee who is awaiting his initial allocation **by jumping the queue** then it will have following severe implications:

- It will be a gross violation of the existing "first come first serve" policy, which is the very fabric of our existing spectrum allocation policy based on fairness and transparency.

- The licensee (A) waiting in the queue for his initial spectrum will be denied as the other licensee (B) who was even though registered later in the queue will get the spectrum allocation earlier than licensee (A). A policy regime not in the interest of natural justice.

- A licensee who is not even entitled for the next tranche of spectrum allocation (as not qualified for the laid down criteria) will want reservation of spectrum up to 15 MHz even though he is not even in the queue since not met the subscriber / traffic criteria. A situation where hoarding of spectrum would become prevalent and would be against the public interest.

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§ Take the example of "C" circles. As of now, at best only 30 MHz (20 MHz in 900 and 10 MHz in 1800 for GSM) is coordinated. Even if we consider additional 20 MHz (in 1800MHz is made available), it will lead to a total of 50 MHz altogether for GSM operators. Now consider the situation wherein 4 existing GSM operators demand up to 15 MHz to be reserved, then this 50 MHz will also be inadequate for these 4 GSM operators and hence, the licensee who is legitimately waiting in the queue for his initial allotment will never get the spectrum allocation despite having paid the entry fee / licence duly awarded by the Government. The issue gets further amplified in view of the fact that these "C" circles are border-states and hence, total availability of the spectrum will become even more scarce and difficult. Hence, there is no justification, whatsoever, for any claim by any existing operator to jump the queue over the other existing operator waiting for spectrum after the award of licence.

Determining a cap on number of Access Providers in each service area

Our specific responses to the questions posed in the Consultation on capping the number of Access Providers are:

Q30. Should the issue of deciding the number of operators in each service area be left to market forces?

Yes. The M&A Guidelines provide an important assurance, through clear and transparent ex-ante regulatory rules, that healthy competition will be maintained in circumstances where market forces drive the sector towards consolidation.

A further important consideration to the issue of the number of Access Providers is spectrum management. The Licensor should be responsible in considering the case for incremental entry whether sufficient spectrum exists to support another licensee without further compromising spectral efficiency (this argument is explained further below).

There is a simple trade-off between the number of licensees and the maximum tranche of spectrum available to each individual licensee. The TRAI in the Consultation also allude to the relationship between the number of licensed access service providers and the level of competition. The nature of these two key relationships is central to the optimal policies towards the number of licensees in each service area.

The market power of competitors reduces (and of competition in a market increases) as the number of competitors increase but in a non-linear fashion. Each incremental competitor reduces market power less. Assuming that each competitor achieves an equal market share, the relationship between the number of competitors and market power (as indicated by the market concentration ratio) is as follows:

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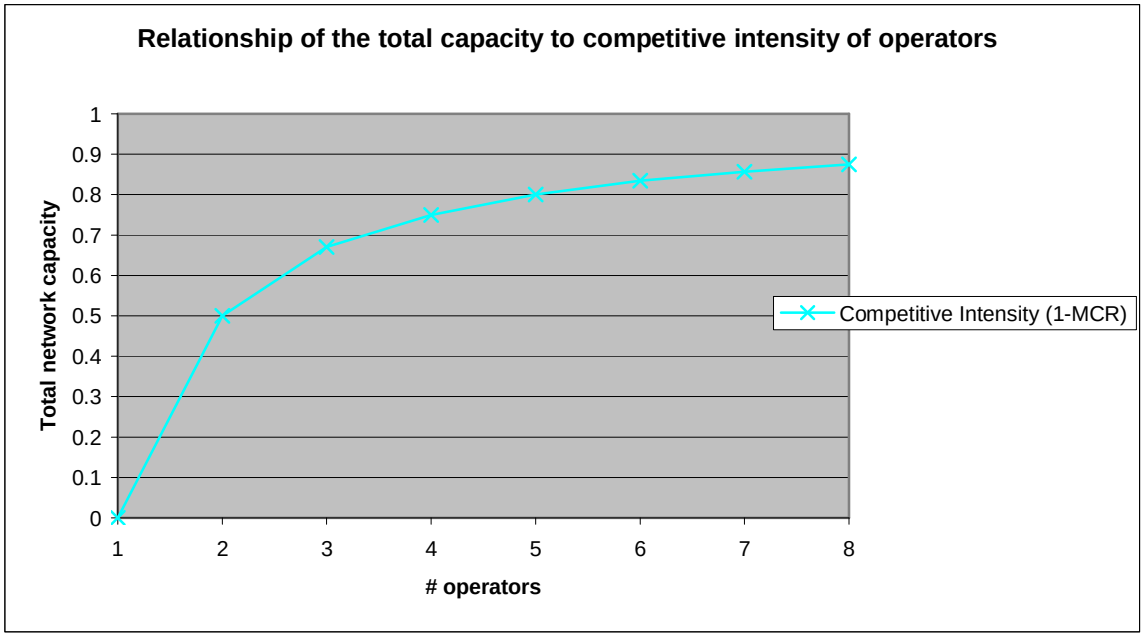
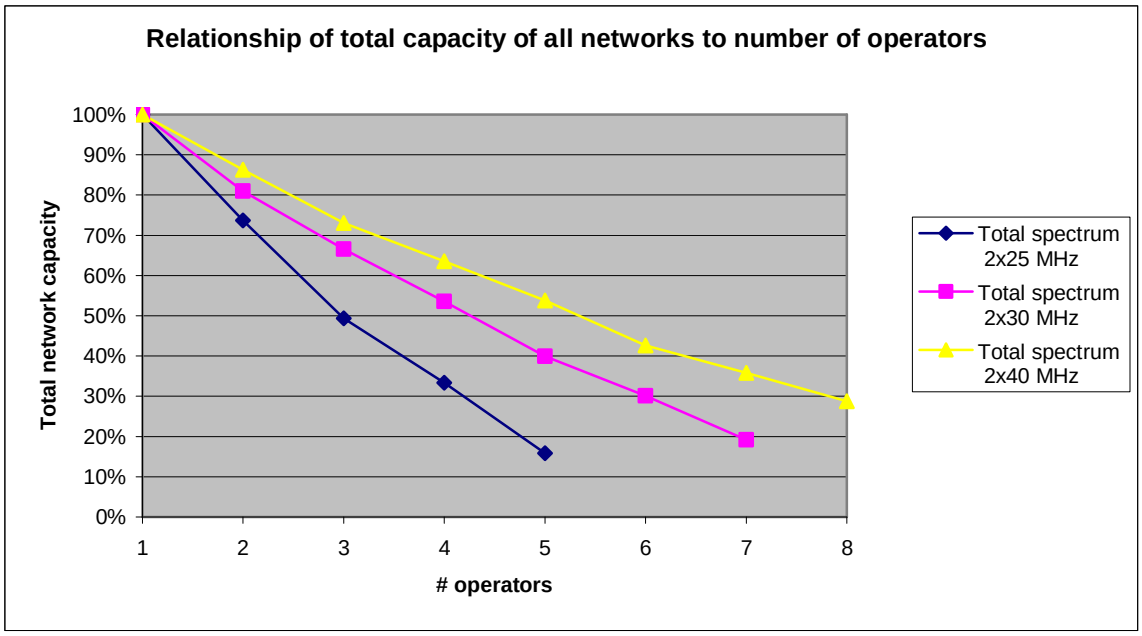
Number of Competitors	Market Concentration Ratio (MCR)
1	1
2	0.5
3	0.33
4	0.25
5	0.20
6	0.16
7	0.14

Note: Market concentration in a measure of the market power of the players. It declines as the number of competitors increases. [Note: in chart below, the above data is plotted as (1-MCR) to provide a measure of market competitiveness]



The Licensor must also judge the optimal number of licensees in the context of the relationship between the number of licensees and spectral efficiency. The critical concept is that spectral efficiency is maximised by unifying spectrum allocations for technical reasons. Subdividing spectrum between licensees diminishes overall spectral efficiency. This phenomenon arises principally because of the requirements of each operator to provide bandwidth-consuming signalling and interference management. The relationship between overall network capacity (the sum of the capacities of the individual licensees) and the number of licensees (assuming all licensees have equal spectrum allocations and traffic) is illustrated in the following chart:



Thus, if the total spectrum available in a country is 40 MHz, the network capacity of the mobile industry if each of five licensed access service providers holds 8 MHz of spectrum may be less than 55% of the capacity of a network operated by a single monopoly provider with 40 MHz of spectrum.

The consequence of spectral inefficiency is higher costs for all licensees. The effect is further accentuated by the duplication of networks – the more licensed access service providers, the more the potential economies of scale of integrated operations are lost. In the Indian context, the recent rapid growth in mobile subscriber numbers has increased the importance of this trade-off – the less the aggregate amount of spectrum, the greater the spectral inefficiency of multiple licensees.

Market forces will ensure that these inefficiencies do not persist. Market consolidation is an important route whereby efficiencies can be realised. It is important that clear ex-ante framework as provided for by the M&A Guidelines exist to enable such market forces to operate in an environment of clarity and predictability.

It is important that the implications of these fundamental relationships are taken into account by the Licensor in addressing the issues of the number of licensees and the M&A Guidelines.

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