State Bank of India

State Bank of India – Suggestions/ Comments on Pre-Consultation on "Allocation of Spectrum in 2G band in 22 Service Areas by auction"

The Hon'ble Supreme Court through its judgement dated 2nd February 2012 has ordered a fresh auction of the licenses which were allotted in 2008. In light of the Supreme Court judgement, TRAI through its notification dated 3rd February has sought stakeholder views on "Allocation of spectrum in 2G band in 22 Service Areas by auction".

In this connection, the Telecom Regulatory Authority of India, through its Recommendations on 'Spectrum Management and Licensing Framework' dated 11th May 2010 has submitted its views on the licensing framework, spectrum allotment & pricing. TRAI had also subsequently in Feb 2011 submitted a report to the Department of Telecommunications on the value of spectrum in the 1800 MHz Band. Further Draft Guidelines for Unified Licensing Regime were released by TRAI on 16th January 2012.

Please find below our views on the various recommendations made by TRAI and also safeguards required to protect stakeholder interests in the licenses that have been cancelled:-

1) License Allotment

We agree with the TRAI's recommendation to create a unified licensing regime and de-linking of the spectrum from the license. However following issues as discussed in the Draft guidelines may be further reviewed:-

Timing of allotment - The licenses should be open for allotment only for a limited period prior to any auction of spectrum i.e. allotment of licenses to be auction specific. This shall entail that companies who propose to bid in the auction shall only obtain the licenses. Also, any licensees which are unable to win spectrum during the auction shall have to surrender their licenses and their entry fees may be refunded. This shall better enable assessment of market demand and the reserve prices can be decided accordingly.

Minimum Net-worth Requirement – The Net-worth requirement has been pegged at Rs 25 Crs for a National level Unified Licence with lower levels required for circle & district level licenses. As per our analysis of a pan-India telecom project of a new licensee, the total project cost is estimated at Rs 16,500 Crs (funded at a debt to contributed equity ratio of 1:1) implemented over a four year period with breakeven occurring at a subscriber base of 55 Mn with ARPU of Rs. 150 per month. However, recent market trends have indicated that new operators were unable to achieve the ARPU levels and hence the projected revenues thus extending the breakeven period further. Older operators have also seen a significant fall in the ARPUs achieved. The recent trend in ARPU is as indicated below:-

(Rs per month)

ARPU	Mar ' 09	Jun ' 09	Sep ' 09	Dec ' 09	Mar ' 10	Jun ' 10	Sep ' 10	Dec ' 10	Mar' 11	Jun' 11
GSM	205	185	164	144	131	122	110	105	100	98
CDMA	99	92	89	76	76	74	73	68	66	64

Source: TRAI

Thus any service roll-out entails a significant financial investment by the sponsor (equity or quasi-equity to a limited extent) as well as market risk. Our experience suggests that only promoters with high net-worth and financial strength capable of investing several thousand crore by way of own funds are able to present bankable business plans and sustain in this sector. Hence, we suggest an upwards revision in the net-worth criteria for the allotment of licenses in view of the envisaged investment (to approx. Rs 2,500 Crs). This will also ensure that companies which have the necessary financial strength & seriousness of intent to be in the sector only apply. However, circle level or district level net worth criteria should be suitably lowered and adjusted for the capex requirements or the estimated project costs.

Entry Fee – A fixed Entry Fee as recommended is considered appropriate. However, for the reasons mentioned earlier, the focus of the various terms should be to screen ineligible/ non-serious candidates and not a means of revenue generation.

Financial Conditions – As per draft guidelines an annual Licence Fee as a percentage of Annual Gross Revenue (AGR), as defined in the licence agreement shall be applicable. A uniform license fees across services, service areas, technologies and service bands, as proposed, is considered appropriate. However, considering that the new licensees are able to ramp-up their revenue gradually and hence face high losses in the initial years, a staggered increase in the annual license fees (as % of AGR) vis a vis the years for which the licensee is in operations, shall improve the viability of the operations. The maximum level could become effective at the end of a specific period of operations.

Duration & Renewal – A fixed validity period of 20 years with a possible renewal for a further period of 10 years subject to Licensee's request has been proposed by TRAI. However, considering that the licenses and spectrum are proposed to be de-linked and spectrum may be auctioned on a periodic basis (if available) with its own tenure, there may occur mismatches in the residual life of the licenses and the spectrum. Hence the duration of a license may linked to the duration of the spectrum that has been acquired, as suggested earlier, to avoid such mismatches.

For eg. A license may be allotted to a player just prior to a spectrum auction. In case the licensee is not able to acquire the spectrum, then the license should stand cancelled with the entry fees refunded. However in case the licensee is able to acquire spectrum, then license should be co-terminus with duration (say 20 years) of such spectrum. At the end of the 10th year if a licensee acquires another block of spectrum (of duration say 20 years), the duration of the license should automatically stand extended to cover the period of the additional spectrum. However, the spectrum which was originally acquired shall have to be returned at the expiry of its validity. In case the validity of all the spectrum acquired by the licensee expires, then the license should also be terminated or cease to exist.

This shall ensure that the license and the spectrum are always co-terminus and licenses which are operational shall only exist.

Roll-out obligations – Since roll-out obligations are monitored/ triggered from the date of allotment of spectrum, the Roll-out obligations shall need to be enumerated at the time of allotment of spectrum. However, these roll-out obligations need to be unambiguous with well defined milestones & penalties for non-performance. A statutory body (or a reputed independent consultant) should monitor the fulfilment of these obligations and provide relevant certifications in case of fulfilment which can be used to assess the performance of the licensee.

2) Spectrum Assignment

Methodology – As per the Hon'ble Supreme Court judgement, the licenses/ spectrum allotted in 2008 (in 1800 MHZ band) have been cancelled and fresh spectrum shall have to be granted by way of auction. In this context, TRAI may make a public notification on the amount of available spectrum and the timelines for their auction. Also, the entire spectrum which was released (est. 464 MHz) due to the cancellation of licenses should be made available at the time of the next auction with auctioning of 6.2 MHz blocks (contracted spectrum as per earlier license agreements).

Service – TRAI may prior to the proposed auction create a roadmap for spectrum allocations and identify services which need a priority focus. In this context, TRAI may also consider re-farming the spectrum over a period of time.

Eligibility Criteria – An eligibility criteria shall have to be defined so that only serious bidders are eligible. In our view following all companies fulfilling the following criteria need to be considered:-

1) The bidder shall have a valid unified service license.
2) Networth criteria to be made applicable keeping in view the estimated cost of roll-out & spectrum cost.

Reserve Price - TRAI in its report dated May 2010 had concluded that it was not feasible to auction spectrum in the 800, 900 and 1800 MHz i.e. spectrum used for 2G services. However, TRAI was of the view that the 3G spectrum (2100 MHz) could be auctioned. TRAI had also recommended that the prices arrived at as per 3G auction in 2010 should be adopted as the 'Current Price' for the spectrum in 1,800 MHz band. Post 3G auction the price would have been Rs 16,750 Crs for a pan-India block of 5 MHz. Subsequently, in its report dated January 2011, TRAI had recommended a price of Rs 10,972 Crs for the pan-India 6.2 MHz block ('contracted spectrum') and a price of Rs 4,571 Crs for a pan-India 1 MHz block (incremental spectrum over and above contracted spectrum) for 2G licenses.

Our views on the reserve price are as follows:-

i) Reserve Price for the spectrum should be set considering the expected demand in the industry. If the reserve price is set too high, there may not be off-takers for the spectrum, whereas a low reserve price may lead to lower realizations to the Govt. The reserve price should be such that it enables a successful bidder to have an economically viable & bankable business plan within a reasonable period of time. The experience in this regard has been that even at a level of Rs 1,650 Cr entry fees paid by new operators, the operators have not been able to breakeven. The experience of 3G auction at Rs 16,750 Cr for a pan-India spectrum has also not been encouraging so far.

ii) In this context the experience of the 3G auction may be considered wherein a reserve price of Rs 3,500 Crs (for 5 MHz – Pan India) was set, which not only enhanced the interest of telecom players in the auction but also lead to competitive bidding. A reserve price at similar price range adjusted for the spectrum bandwidth to be auctioned may be considered along with fixed annual spectrum usage & license fees charges related to the AGR.

iii) No other fees should be recoverable from the incumbent telecom players on account of the auctioned spectrum block such as Excess spectrum fees, etc. since the price has been arrived at through market mechanism.

iv) Considering the amount of the spectrum (est. 464 MHz) that has been released due to the cancellation of the licenses and the number of players likely to bid, supply is expected to be more than the demand. As a result it is expected that the reserve price and actual sale price of the spectrum may not be appreciably different. We also expect that only a few of the new operators whose licenses have been cancelled may bid due to their pan-India ambitions, capex already incurred and financial strength of their promoters.

3) Other Major Issues

(i) The licensees whose licenses have been cancelled, based on license agreements issued by the authorized Government entity, entered into third party contracts as well as raised finances from the Lenders for part funding of their business plans requiring substantial investments. The following table indicates approximately the investments made in the licensees whose licenses have been cancelled:-

Company	No. of licenses cancelled	Amount of Investments impacted due to cancellation – as reported
Videocon Telecommunications Ltd.	21	Approx. Rs 8,000 Crs
STel	6	Approx. Rs 1,750 Crs
Unitech Wireless	22	Approx. Rs 13,700 Crs
Sistema Shyam	21	Approx. Rs 12,000 Crs
Etisalat DB	13	Approx. Rs 4,100 Crs
Tata Teleservices Ltd.	3	Rs 10 Crs (License fees)
Idea Cellular	9 (in addition 4 licenses of Spice have been cancelled)	Rs 1,900 Crs
Loop Telecom	21	Approx Rs 2,200 Crs

The above investments have been utilized to fund capital expenditure, license fees as well as cash losses. Lenders in turn have funded the business plan based on a valid license agreement. Considering that substantial funds have been lent by banks to the affected licensees, to protect their interests, we suggest attaching/ clubbing of the assets of the licensees to the spectrum proposed to be auctioned and any consideration received thereof used to set-off dues to the lenders. Also, given the sensitive nature of these assets it is in the national interest to ensure their secure disposal/ sale to valid license holders by encouraging such clubbing as well as through enabling M&A provisions.

(ii) Well-established operators who over a period of time received spectrum allotment on a subscriber linked criteria, have gained in terms of lower capital expenditure requirement. Also, considering the time for which it has been in business the older operator may have recovered a major part of its investments and is in a better position to bid for the additional spectrum as against a licensee whose licenses have been cancelled or a new entrant. The well-established operator may try to out-bid the new licensees not only to acquire spectrum but also eliminate competition resulting into greater pricing freedom for itself. As a result, the perceived value of spectrum by a well-established operator as against an operator whose license has been cancelled or any new entrant shall be significantly different. Hence, an auction mechanism needs to be followed in order to keep a level playing field for both the existing operators as well as licensees re-bidding for the licenses. In this connection it would be important to note that in 2008 the incumbent players were not considered for additional spectrum.

(iii) As per the terms of allotment of the 3G spectrum, in case of termination/ cancellation of the underlying 2G licenses the attached 3G spectrum shall also stand cancelled. Considering that the Supreme Court judgement has observed irregularities only in the 2G license allotment in 2008, the right to use the 3G spectrum should be restored to the licensees.

(iv) The allocation of licenses in Jan' 2008 has been quashed by the Hon'ble Supreme Court. Considering that the licenses have been cancelled on account of irregularities observed in the allotment process, the licensees may be refunded the Entry fees paid by them at the time of allotment. Also, since the affected licensees have raised debt for their business plan and created security over their assets, any refunds should be routed directly in favour of the lenders, even if in some cases assignment of licenses in favour of lenders has not been completed.

(v) Efficient utilization of spectrum should be the primary aim of any allotment/ auction process. Also, it is important that inefficient/ unprofitable operators are moved out of the market through enabling provisions in terms of M&A. In this context, we suggest that TRAI may consider permitting sharing of spectrum by licensees as also defining the M&A regulations in light of the changed market scenario. The merger norms shall also allow secure disposal of sensitive equipments in case the licensee is unable to continue operations on account of various reasons. Also, spectrum sharing shall also allow a continuous discovery of the market price of the spectrum.

(vi) The license/ spectrum fees paid by the licensees is considered as an intangible asset in the books of the licensees. Also, as per RBI instructions, the licenses/ spectrum fees are to be treated as intangible assets. Spectrum is a primary asset of any telecom operator and is an essential requirement for any operator to implement its business. Since spectrum is classified as intangible asset, when banks provide funds for roll-out of business plan or for meeting entry fee/ BG requirement, the loans to that extent have to be treated as unsecured loans, even though the licenses are assigned in favour of the lenders. Holding unsecured assets on the banks books have in turn several implications in terms of lower ratings, higher provisioning, etc. In case the future spectrum is priced at higher levels, as in the case of 3G spectrum (approx. Rs 67,000 Crs) , then lenders may not be in a position to fund these business plans considering the unsecured nature of the lending. Hence, we suggest that TRAI may initiate a consultation process with RBI for treating the Spectrum fees as a tangible asset for the purpose of lending by banks.

****