

Response to TRAI's consultation paper on definition of AGR

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Introduction

This note is a brief response to the Telecom Regulatory Authority of India (TRAI) on its [Consultation Paper on Definition of Revenue Base \(AGR\) for the Reckoning of Licence Fee and Spectrum Usage Charges](#) issued on 31 July 2014. It argues against the use of Adjusted Gross Revenues to determine levies on telecom operators. It is the author's work in progress and could be fine-tuned further. I would be happy to offer more details and analysis.

The note asserts that basing levies e.g. licence fees, spectrum usage charges on individual operator revenues is retrograde and harmful. The present approach is a barrier to many reforms such as e.g. the introduction of spectrum trading, mobile virtual networks operators (MVNOs) etc. The current practice of computing fees as a percentage of an operator's AGR (adjusted gross revenues) must be replaced by a system that is simpler, objective and transparent. This note proposes such an alternative which retains the benefits of the revenue sharing approach, protects government revenues and yet creates new incentives for reform and promotes regulatory flexibility.

The revenue sharing approach has important advantages. For instance it

- Requires low upfront payments from service providers since levies are spread over the tenure of licences.
- Encourages risk taking and innovation since the burden of levies is usually low till businesses take off
- Provides an incentive to government to ensure businesses remain profitable

These are significant advantages especially in a greenfield industry where business and regulatory risks can be high. **However, there are several disadvantages in the manner it has been implemented.**

Problems with computing telecom levies based on revenue of individual operators.

There are several weaknesses in the current approach. They include:

Barrier to meeting key regulatory goals

This is the most important reason for a comprehensive review of current rules relating to levies. In recent times, the government has used 'revenue neutrality' as an important criterion while evaluating TRAI recommendations. This is arguably a key reason for delay in implementation of several important decisions such as mobile virtual network operators, spectrum trading etc. which are pending for years.

There is a concern that the decision poses a risk to government revenues or allow companies to escape liabilities.

Similarly, many Internet Service Providers (ISPs) face levies which are unknown in almost any part of the world. They contribute a tiny proportion of sector levies and probably presumably because it hurts government revenues.

Almost all responses of the Telecom Commission (TC) to TRAI's recommendations on licensing, spectrum management seem focused on their potential impact on government revenues. Most changes proposed by TC seem connected to maximising government revenues.

Serious constraints in design of spectrum auctions

India cannot avoid auctioning spectrum given the mismatch between demand and supply. However, revenue maximisation as a key objective limits options in design. For example, a design that focuses on expanding broadband access or increasing rural penetration could result in lower bids and therefore be unacceptable to exchequer struggling with huge fiscal deficits. However, the option to revise revenue targets through the new levy mechanism could mitigate the potential loss.

Reduced incentive for efficient use of resources like spectrum, rights of way etc.

The rate at which companies pay licence fees or spectrum usage charges does not depend on its efficient use. This is a serious concern since India has unique stake in spectrum efficiency. Over 90% of Indians make calls or access the internet using mobile phones, which cannot run without spectrum.

Reduced punishment for inefficient use of resources like spectrum, rights of way etc.

The system does not deter hoarding sufficiently. A company that hoards spectrum without using it, will generate little revenue and consequently pay little in fees.

High cost of compliance

The cost of collecting data and its scrutiny is high in view of the number of players, the number and type of licences and players, the mix of public and private ownership of licensed companies.

Increased incentive for 'creative accounting' or underreporting of revenues

With revenues running in billions of rupees, the system encourages companies to underreport revenues. Several companies have faced charges on this score.

Opportunity for arbitrage

There have been reports that companies have attempted to reclassify revenues under heads which attract lower fees. The unified licence will admittedly reduce these but not fully.

Prone to controversy

The specific type of revenues of any operator that must or included or excluded in its AGR has been a source of much debate and controversy in the past.

Alternative Approach to computing fees

The proposal is that the government should:

- 1. Delink fees or levies from the AGR of an individual operator**
- 2. Combine all recurrent/annual fees into one 'telecom levy'**
- 3. Set a revenue target from levies, as a proportion of the total revenues of the sector.**
- 4. Make up this this revenue target in the form of fees from licensed telecom operators**
- 5. The levy payable by an operator holding spectrum should be directly proportion its share of scarce spectrum resources in use by it.**

(A company with say 10% of spectrum should contribute the corresponding proportion of revenue target as fees.)

- 6. Charge no fees – or a token amount- from licensed operators that do not hold spectrum.**

Advantages of the alternative approach

- 1. Recognises the legitimacy of the concerns of government exchequer as well as licensed players**
- 2. Proposes a simpler, objectively based, verifiable method of computing government levies**

3. **Consolidate all telecom levies into one single fee**
4. **Allows greater flexibility in regulatory decisions**
5. **Recognises and addresses the importance of spectrum efficiency**
6. **Rewards efficiency, deters inefficient hoarding of spectrum**
7. **Provides incentives to smaller companies, especially those without spectrum to expand services**
8. **Promotes wireless broadband by encouraging efficient use of spectrum**

Answers to some possible reservations about the new approach

1. Is the proposed system more arbitrary since the government is able to set a revenue target?

A. No. It is much less arbitrary than the current system where there is no formal justification for the percentage of revenues charged as licence fees or spectrum usage charges. Linking fees to spectrum holdings makes regulatory sense since spectrum is scarce and valuable and efficient use of spectrum is an important goal

2. Does the proposed system burden spectrum users more than other types of licensees?

Even now, and more so after the introduction of unified licence, wireless players already pay over 75% of levies which will increase to over 90% if NLD and ILD licences are merged in the UASL.

3. Wouldn't the present system allow companies without spectrum to escape levies?

There are two ways to look at it. First, most mature regulatory regimes do not levy any fees on players that do not need spectrum or rights of way. So not charging them is on lines of best practices in regulation. Second, the present approach can accommodate a token fee for non-spectrum users to deter non-serious

4. Would it increase burden on newer players with lower revenues who pay less now and increase it on more established players with larger revenues.

This is possible but preventable or possible to mitigate. One way to reduce level the field would be to have a threshold revenue below which a company will not incur fees.

Another approach is to attempt a one-time settlement to facilitate a movement to the new system of levying fees.

5. What impact would the current system have on spectrum auctions?

The approach concerns levies like licence fees, spectrum usage charges but not how spectrum is acquired or allocated. However, it will have a positive influence on spectrum auctions by allowing greater flexibility in auction design. For instance, objectives such as maximising broadband access instead of revenue maximisation could force spectrum prices down. However, with the option to set a revenue target from levies, government has a handle to 'prevent unearned profits'.

6. Would it mean all types of spectrum can be treated at par?

No. The TRAI could undertake to establish some kind of equivalence based on say propagation characteristics e.g. 1 MHz of 900 MHz = 1.5 MHz of 1800 MHz. The equivalence does not need to be as crude as this. One can factor in several other factors such as fragmentation of spectrum, maturity of ecosystem etc. Clearly this would require a careful analysis and wide consultation.

Implementation challenges of the new approach

1. Facilitating a smooth transition to the new system.

TRAI is competent to deal with any concerns or dramatic change in company liabilities. As discussed above, it can devise one time settlements to prevent unearned profits or unjustified liabilities, if any.

2. Allowing another settlement after a trial period.

The transition could be further smoothed by committing to a review after say 5 years to mitigate any instances of unfair impact.