

**GEORGIA: Communications Policy & Regulation Development
(Extension)**

Digital Broadcasting Switchover, Implementation Support

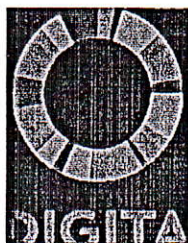
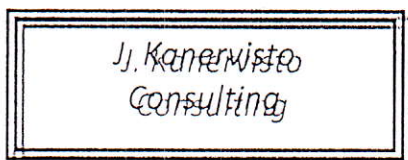
**Advice to GNCC on spectrum charging for digital
broadcasting switchover**

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Purpose of this paper

Georgian National Communications Commission (GNCC) has asked the consultant team for advice regarding the initial price or reserve price that the winning bidders should pay in competitive contest to be held soon for the award of spectrum to enable digital broadcasting platform to be constructed in Georgia.

Under the Georgian Government's decision on 7th February 2014, an open competitive contest will be organised and run by GNCC. Amendments to the Law on Electronic Communications are currently being presented to Parliament in order for GNCC to be able to conduct the contest in the way outlined in the Government decision. The proposal is for a competition run as a "beauty contest" with bidders allowed to submit simultaneous multiple bids for single Lots or combinations of Lots. Each Lot represents a set of frequencies that will allow national coverage of digital broadcasting in Georgia.

The purpose of this paper is to provide advice on the charges to be made to the winning bidders in the contest for the spectrum authorised for digital broadcasting.

Proposed amendment to the Law on Electronic Communications

The proposed amendments to the Law on Electronic Communications include the following passage¹ regarding the initial price to be paid by the winning bidders;

"Article 52¹

2. decision of the commission on the contest shall contain the following:

c. initial price of scarce resource placed for bidding, adopted by the commission separately in every individual case, based on international practice and opinion of the reputed international organisation"

Our advice

Being a scarce resource, there are two main approaches to make the best use of spectrum in electronic communications;

1. An economic approach, which awards the spectrum in an auction to the bidder who is best suited to make efficient use of it. The bidder with the best business plan is able to place the highest bid in the auction. The price achieved in the auction corresponds to the market value of the spectrum. This regulatory approach awards spectrum as service neutral and technology neutral as possible, to give the bidders flexibility to use the most efficient technology and to provide the services for which the end users are most willing to pay.
2. An administrative approach, which awards the spectrum for certain services that are in the public interest. This approach gives the operators less freedom to use the spectrum, because they have to implement the public interest objectives (like providing free-to-air TV instead of pay TV, must carry obligations, etc.). The operator might still be willing to pay a price for the spectrum, but the price will naturally be lower than the price for spectrum that can be used without any public interest

¹The passage quoted is an unofficial translation

restrictions.

Georgia has so far used auctions for electronic communications networks and has awarded spectrum to broadcasters against an administrative fee.

Under the Government of Georgia's decision of 7th February 2014, spectrum will continue to be awarded free of charge to certain broadcasters for digital broadcasting, in particular the Georgian Public Service Broadcaster ("TeleRadioCentre") and also local broadcasters who wish to establish local multiplex platforms. These broadcasters will get the spectrum for free, but are under certain public interest objectives (free-to-air transmission, must carry, and for TeleRadioCentre also nationwide coverage).

Also under the Government's decision, bidders will be invited to make a financial contribution to state funds to help cover the cost of the establishment of the state network and the costs of providing consumer equipment "set top boxes" to vulnerable households in Georgia. This financial contribution will be taken into account, together with a range of non-financial factors to decide the contest winner(s).

With regard to the additional frequencies that will be awarded in the open competitive contest, the Government of Georgia has decided on an award method which is somewhat in the middle between the two main approaches above. On the one hand the financial contribution offered by the bidder will be an important criterion for the award. On the other hand it is not a fully economic approach, because the winners will be subject to significant obligations in the public interest, in particular coverage obligations and the obligation to carry free-to-air programmes.

The rationale for awarding the spectrum not in an auction, but in an open competitive contest which also takes non-monetary criteria into account, was that the spectrum should be cheaper for interested operators, to attract more bidders for the award and to make the transmission cheaper for the broadcasters that will be carried on the new digital platforms.

The calculations which we undertook in component I of our project showed that the business case for commercial operators of digital terrestrial multiplex platforms is tight. The operator(s) that will win the contest will face significant investments, will have to compete with the state platform (which gets the frequencies for free, and the capital investment from the state budget), with the local platforms (which will also get the frequencies for free) and with other technologies (satellite, cable, IPTV). Also the time pressure is now very high.

It cannot be expected that the bidders in the open competitive contest will make a significant contribution to the state budget. There is a risk that setting an initial fee for the contest will cause some interested bidders not to participate in the contest.

There is no established formula to set the initial price (reserve price) for such an award. Even for auctions with only financial criteria, the reserve price is often set at a more or less arbitrary value - for example half the estimated market value of the spectrum. If the auction is a fair and transparent procedure and everybody who could be interested in the auctioned item can participate, the final price will be the market price, no matter whether bidding starts from zero, or a third of the final price, or 80% of the final price. The main criterion for the success of the award is that everybody who could be interested in winning participates in it.

Several countries set a reserve price of spectrum auctions at the price of the normal spectrum fees, which would have to be paid if the spectrum had not been auctioned. If there is more demand than spectrum available, the final price of the auction will be higher. If demand is less than spectrum is available, the auction is over after one round and the bidder(s) get the spectrum for the normal price, which they would have paid if the spectrum

would have been awarded first-come first-served and not in an auction.

The question to ask for setting the initial price is not: "What is the value of the spectrum?", the factors are more complex. Let us assume that there are only a few companies that would be willing to participate in the contest. They are willing to do all the necessary investments, they would provide Georgian citizens with dozens of free-to-air and pay TV programmes and they would give Georgian media the possibility to distribute more content.

However, the potential bidders will not see a business case if they also have to make a significant payment for the spectrum. Therefore they will only offer a very low amount in their bids. By setting any initial price ("reserve price") it may tend to exclude these bidders. It may be that in the face of an initial fee, there is no commercial terrestrial TV network at all. It is best to ask the market how much they are prepared to pay as a contribution to the state budget.

Recommendation

Using the above argumentation, we would recommend to set the initial price of the upcoming open competitive contest at zero:

In summary, the justification for this is that;

- Many EU countries do not charge spectrum fees in the broadcasting bands or only very low administrative fees for handling the applications (see examples at Annex).
- The Georgian Government decision foresees the direct awards (without participation in the auction) to the new platform operator(s) - the Public Service Broadcaster (TeleRadioCentre) and the local platform operators - also do not pay spectrum fees.
- Setting the initial price at zero does not mean that the winner(s) will get the frequencies for free. All bidders will calculate their business cases, they will offer some amount for their bids and the winner(s) will have to pay the offered amount(s).
- Any initial fee may put off potential bidders from bidding.
- It is best to ask the market how much they are prepared to pay as a contribution to the state budget.

Regarding the proposed amendments to the Law on Electronic Communications

In the end this is a political decision and it is best solved by writing the answer directly into the law. Therefore we would recommend to write into the changed article 52¹ that "***the initial price shall be set at zero, instead of the proposed wording to base it on "international practice and opinion of the reputed international organisation".***

The international practice in many countries is that there are no significant spectrum fees for broadcasting frequencies. And there is no international organisation that is competent to say something on this.

In our view, the proposed wording would only cause procedural difficulties for GNCC - how to assess the international practice and how to achieve an "opinion of a reputed international organisation"? Therefore the wording should be changed anyhow.

Annex

Broadcasting spectrum charges – selected countries

France, UK: There is no spectrum fee for broadcasting

Italy and Spain: there are no one-off fees, but annual fees are charged

Austria: Initial fee €6.50

Finland: Initial fee €1,000

Germany: €125 per 10 km² of covered area and per DVB-T channel -
(we estimate that to cover an area like Georgia would cost about €800,000 (one-off) per
Mux)

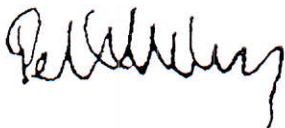
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The information contained in this report is intended solely to provide general guidance on matters of interest for the use of GNCC, who requested the information and who must accept full responsibility for its use. Given the changing nature of laws, rules and regulations, and the inherent complexity of the electronic communications market, the advice is only relevant to the situation found by the consultants at the time of the report's submission.

In no event will the consultants, or their partners, employees or agents, be liable to GNCC or anyone else for any decision made or action taken in reliance on the information in this report or for any consequential, special or similar damages.



Peter Lundy,
Project Team Leader

Dated 20th February 2014