

ANNEXURE W

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SECRET

F.No. 3/11/2011 - Inf (Part)
Ministry of Finance
Department of Economic Affairs


New Delhi, March 25, 2011,

Office Memorandum

Sub: Allocation and pricing of 2G spectrum

A copy of basic facts prepared on allocation and pricing of 2G spectrum is enclosed.

2. This has been seen by the Finance Minister.


(Dr. P.G.S. Rao) 25/3/11
Dy. Director,
Infrastructure and Investment Division

Ms. Vini Mahajan,
Joint Secretary,
Prime Minister's Office
South Block, New Delhi - 110001



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Chronology of basic facts related to pricing and allocation of 2G spectrum

Facts of the case

1. Based on the decision of the Union Cabinet dated October 31, 2003, guidelines for the Unified Access Service (UAS) were issued on November 11, 2003 which allowed for UAS licences to provide basic and / or cellular licences using any technology in the defined service area.
2. The Union Cabinet had authorized DoT to finalise, with the approval of the Minister-in-charge, the details of implementation of the UASL regime, including the calculation of the entry fee¹ depending upon the date of payment based on the principles given by TRAI in its recommendations. In the context of the release of adequate spectrum needed for the growth of the telecom sector, the Union Cabinet in October 2003 had decided that the Department of Telecommunication and Ministry of Finance would discuss and finalise spectrum pricing formulae which would include incentive for efficient use of spectrum as well as disincentive for sub-optimal usage.
3. The licence fee for UAS licences was reduced by 2%, across the board, with a further reduction by 2% of AGR for the first two cellular licensees (for a period of 4 years with effect from April 01, 2004) in order to spur investment and growth, and, ultimately yield more revenue to Government. The financial implication of the proposal was estimated at ₹ 968 crore for the first four years, and, ₹ 885 crore per annum thereafter. The proposal to the above effect, initiated by the then Minister of Communications and Information Technology (Shri Arun

Shourie) was approved by the then Minister of Finance (Sri Jaswant Singh) on December 12, 2003, without any examination as regards financial implications.

4. TRAI, in its recommendations dated May 13, 2005, has indicated that in the existing licensing framework, entry fee includes onetime spectrum charge. TRAI recommended that as in the existing framework the spectrum charges should have two components: onetime spectrum charges and annual spectrum charge. It was recommended that there should be no one time spectrum charges for allocation of IMT-2000 spectrum to the existing service providers. As regards the new entrants, the onetime spectrum charges would be equal to UASL entry fee in that services area minus the component of registration charge based on the entry fee paid by new BSO (entered in/after 2001), specified by TRAI in its recommendations on Unified licensing regime dated January 13, 2005. TRAI also recommended that the existing method of annual spectrum charge in terms of percentage of revenue share should continue.

5. In response to the TRAI recommendation dated May 13, 2005, DEA as per relevant notings and in letter December 21, 2005 to DoT indicated that, for allocation of additional spectrum, while price discovery through auction may not be appropriate, the hybrid option of a base fee, combined with revenue share, appears to be the most appropriate. It was also recommended by DEA that the issues should be put up for consideration and appropriate decision by the Committee of Secretaries (CoS) and thereafter, by a Group of Ministers (GoM). DEA did not question the methodology suggested by TRAI on issues of one time and annual spectrum charges.

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6. The thrust of the Union Cabinet decision of October 31, 2003, in regard to spectrum pricing was for MoF and DoT to "...discuss and finalize spectrum pricing formula, which will include incentive for efficient use of spectrum as well as dis-incentive for sub-optimal usages...". Though there was no basic disagreement between the two Departments on the basic thrust of the TRAI recommendations on pricing in 2005, DEA had advised DoT to take up the matter in CoS and thereafter, by a GoM. This was presumably not done by DoT. The matter was also not followed up further by DEA.

7. A Group of Ministers (GoM) was constituted by Cabinet Secretariat on February 23, 2006, on the issues of vacation of Defence spectrum and raising of resources for the purpose. DEA, vide D.O. letter dated March 28, 2007 asked DoT to include issues relating to 'spectrum pricing' within the ambit of the GoM. It was, however, not specifically communicated whether 'spectrum pricing' meant only spectrum usage charges or entry fee and spectrum usage charges. The view of DoT was that the spectrum pricing is within the normal work carried out by that Ministry as indicated in their letter dated April 02, 2007. In a D.O. letter, dated April 19, 2007, to the Cabinet Secretary, Finance Secretary had indicated that since these issues would have economic and financial ramifications, they need to be discussed in the GoM. The contention of the DoT that these issues are within the normal work was not entirely correct. It was explained that a sound policy on spectrum allocation and pricing will not only result in optimal utilization of spectrum, but would also have revenue implications. Vide OM dated May 17, 2007, Cabinet Secretariat advised DEA that Finance Secretary and Secretary(DoT) may discuss for resolving the issue of inclusion of spectrum pricing in the

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in the matter. DEA sent an OM to DoT on 18.05.2007 indicating that technology neutrality and spectrum price must be included in the ToR of the GoM. In its letter dated June 06, 2007 Finance Secretary requested Secretary, DoT to include spectrum pricing in the ToRs for the GoM. It was also said that the methodology to be followed for 'spectrum pricing' would logically follow the vacation of spectrum which is the main task of GoM. A view was taken in DEA then that the matter may be resolved through correspondence, failing which meeting with DoT could be held. In its letter dated June 15, 2007 on the subject, DoT indicated that since spectrum pricing and charges for the use of spectrum is a dynamic issue, it is to be reviewed and considered from time to time in the context of the changing technology and international best practices in consultation with TRAI. Thus DoT precluded the role of MoF, if any, in finalizing spectrum pricing. This letter however does not appear to have been received and processed on the file of DEA. Thereafter, DEA did not take up the issue further, either with the DoT or with the Cabinet Secretariat. A chronology of events is enclosed at Annex- I.

8. DEA explicitly took up the issue of fixation of entry fee on November 22, 2007. In the context of the three crossover licenses for CDMA operators issued by DoT, DEA had argued that it is not clear how the rate of ₹ 1600 crore determined as far back as in 2001, has been applied for a license given in 2007 without any indexation, let alone current valuation. It was also said that all further action to implement the said licenses may be stayed. While the intent of DEA was to settle this issue in a generic sense for all licenses, the letter itself referred only to the crossover licenses. In response, DoT vide their letter dated November 29, 2007 indicated that the decision to allot the dual

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decisions taken in the Cabinet meeting held on October 31, 2003 and TRAI recommendations dated August 28, 2007. (The TRAI recommendation of August, 2007 was not placed before the Full Telecom Commission). This was also not further responded to by DEA. No follow up appears to have been done from DEA/DoT as per the available records.

9. As a response to the DoT letter dated November 29, 2007, the then Director (Infra) initiated a note highlighting the need to revise the entry fee. This note, dated December 17, 2008, while it was marked to Joint Secretary (On tour)/Additional Secretary (Economic Affairs [AS (EA)] does not seem to have been put up to the next level of consideration. Records also indicate that the then AS (EA) put up on 09.01.2008, in a separate file, a comprehensive concept paper on the extant telecom sector policy. The subject header of the note mentioned the references of the DEA letter of November 22, 2007 and the DoT reply of November 29, 2007. The note recommended both revision of the entry fee fixed in 2003 as well as adoption of an auction methodology for determination of the spectrum usage charges. The position paper was prefaced with a note of the then AS(EA) dated January 09, 2008, which *inter alia* mentioned that she had been directed to attend the meeting of the full Telecom Commission, which had been scheduled to be held on January 09, 2008 and had now been postponed to January 15, 2008. This position paper was used by the then FM as a basis of his 'secret note' to the Prime Minister on January 15, 2008 wherein, an auction based mechanism was recommended for future allocation of spectrum (beyond the "start up" spectrum), with the spectrum allocations having been made in the past to be treated as a

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closed chapter. The recommendation was in the context of spectrum usage charges and not with regard to the entry fee.

10. A Full Telecom Commission meeting took place on January 15, 2008. One of the agenda item was pricing of spectrum. However, it only included annual spectrum charge (revenue share) and not the entry fee. MoF representative who attended the meeting did not raise the issue of revision of entry fee.

11. The conclusions arising from the paras 9 and 10 *ante* can be summarized as follows: the DoT response of November 29, 2007 was brought to the notice of the then Finance Minister on 09.01.08, along with suggestions to argue for revision of the entry fee and adoption for auction with spectrum usage charges as the bid parameter; the fact that a Telecom Commission meeting on the issue was scheduled on January 15, 2008 was also mentioned; no response, however, was sent by DEA to DoT either on the issues raised by DoT in the communication dated November 29, 2007, or with reference to the impending meeting of the Telecom Commission; no intervention on entry fee were suggested in this meeting by DEA representatives; and, finally, a note was sent by the then Finance Minister to the Prime Minister on January 15, 2008 wherein auction of spectrum was argued, but only with reference to spectrum beyond the 'start up' spectrum. The licenses allotted in 2007 and 2008 only carried the 'start up' spectrum embedded with them. The note of the Finance Minister did not deal with the need, if any, to revise entry fee or the rate of revenue share. The issue of revision of entry fee was taken up by the MoF subsequently in November 11, 2008.

12. Subsequently, in a meeting held on January 30, 2008 between the then Ministers of Finance and Telecommunications...

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then Finance Minister that he was for now not seeking to revisit the current regimes for entry fee or revenue share.

13. Secretary DoT formally wrote to DEA on February 8, 2008 enclosing an approach paper², wherein, DoT proposed to price allocation of spectrum beyond 4.4 MHz and, enhancement of spectrum usage charges. It is indicated in the approach note that Secretary(Finance) was of opinion that auctioning is legally possible for initial allotment of spectrum of 4.4 MHz. DoT indicated that as 4.4 MHz is a part of the licence agreement, no spectrum acquisition charge is supposed to be levied. The approach paper states that even if it is priced, it will also disturb the level playing field and the present Lol holders who have already paid entry fee are likely to go for litigation. Initial entry fee for licence may be construed as the de-facto price of initial spectrum i.e. ₹ 1650 crore for pan-India licence. Based on the DoT letter, an internal note on the subject was prepared in DEA on February 11, 2008, wherein the entire range of spectrum was proposed to be charged for both new and old operators, using the entry fee as the price of embedded spectrum and indexing it with the increase in the AGR of the telecom sector between 2003-04 and 2007-08. The note also ruled out the option of auctioning spectrum for various reasons explained therein. A note for discussion was put up by the Finance Secretary on April 07, 2008, outlining the proposals in respect of both 2G and 3G spectrum bands. After subsequent discussions with DoT, and, in response to a draft note for Cabinet of DoT, for financial approval for creation of the Air Force Network (AFNET), DoT were informed with the approval of FM on April 08, 2008 that all allotments of spectrum, beyond 4.4 MHz, may be specifically priced and charged for and the spectrum

usage charges may be calibrated with regard to circle specific "scarcity value" of spectrum instead of basing it on bandwidth as has been the practice. [The then Finance Minister sent a "non paper" to the then Minister of Telecommunications on April 21, 2008 conveying that an 'in principle' decision may be taken to price the spectrum beyond 4.4 MHz, as had been suggested by DoT.]

14. [In a meeting between the then Finance Secretary and Secretary, DoT on April 24, 2008 DEA adopted the following position: spectrum usage charge may be linked to circle specific "scarcity value"; spectrum upto 6.2 MHz may not be priced; and, spectrum beyond 6.2 MHz may be priced using the base price of ₹ 375 crore per MHz indexed to growth in Adjusted Gross Revenue (AGR) with reference to the year 2003-04. In subsequent meetings DEA presented its stand that spectrum usage charge may be revised as a percentage of AGR; spectrum upto 6.2 MHz may not be priced; and, spectrum beyond 6.2 MHz may be priced using the base price of Rs 266 crore per MHz indexed to growth in Gross Domestic Product (GDP) with reference to the year 2003-04. This position was thereafter communicated to DoT vide DO letter dated June 27, 2008 of the then AS(EA). Further meetings were held between the then Finance Minister and the Minister of Telecom on May 29, 2008 and June 12, 2008. Subsequently, in a meeting held under the Chair of the Prime Minister, on July 4, 2008 (as recorded in the note of the then Finance Secretary dated July 6, 2008), the then Finance Minister and Minister of Telecommunications agreed to the proposals on enhancement of spectrum usage charges and pricing of spectrum based on indexing the base price (₹ 266 crore per MHz) and compounding using SBI PLR from existing allottees of spectrum beyond 6.2 MHz.

However, the issue of revision of entry fee was not discussed in the meeting.

15. A meeting of the Telecom Commission was convened on November 11, 2008 to discuss issues relating to one time spectrum charge and spectrum usage charges. Approval of the then FM was taken on the same lines as had been agreed to in the PMO meeting on July 4, 2008. The enhancement of spectrum usage charges was expected to yield revenue of ₹ 4,149 crore annually, an increase of ₹ 1,270 crore over the annual revenue yield (~ ₹ 3,000 crore) on the current rate structure. However, in addition, DoT were also asked vide OM dated November 11, 2008 to suggest a mechanism for updating the entry fee of ₹ 1,658 crore (fixed in 2003-04), for all allotments of licences after January 01, 2009. Thus MoF raised the issue of updating the entry fee albeit only for the licences allotted after January 01, 2009. Thus MoF implicitly agreed to imposition of same entry fee as that prevailing in 2001 for licences allotted upto December 31, 2008.

16. It is, therefore, clear that there were consultations between MoF and DoT in the first half of 2008, on the formula for charging 2G spectrum based on indexation to the PLR of the SBI, which related only to the allocations beyond 6.2 MHz. In the matter presently under consideration (i.e., allotment of 2G licenses in 2007-08) spectrum allocations were not made beyond 6.2 MHz, on the pricing of which, DoT and MoF were in agreement. On the other hand, the new licensees have only got 4.4 MHz of spectrum each.

17. Secretary (Finance) had suggested to go for auction for initial spectrum of 4.4 MHz in early February, 2008. DoT was not keen to do

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for litigation. DoT opined that 4.4 MHz is a part of the licence agreement and initial entry fee for licence may be construed as the de-facto price of initial spectrum. There was a way out by invoking clause 5.1 of the UAS license, which *inter alia*, provide for modification at any time the terms and conditions of the Licence, if in the opinion of the Licensor it is necessary or expedient to do so in public interest or in the interest of the security of state or for the proper conduct of the telegraphs. DoT could have invoked this clause for cancelling licences in case MoF had stuck to the stand of auctioning the 4.4 MHz spectrum. Perhaps some litigations would have arisen as a consequence. It may be mentioned that while the UAS licenses were signed between February 27 and March 07, 2008, spectrum allocations were done starting only in April, 2008, almost 4 months after the Lols were issued. However, these were not charged (beyond the normal spectrum usage charges) since there was consensus, at the levels of the Ministers concerned, that spectrum beyond the 'start up' levels only should be charged.

18. Detailed replies on the issues raised by the Members of the PAC during the oral evidence of the Finance Secretary were sent to the Lok Sabha Secretariat on July 21, 2010. Comments of the Department of Economic Affairs on the draft performance audit report on the issue of licences and allocation of 2G spectrum were sent to the Director General of Audit on August 11, 2010. These were put up for the first time to the FM for information when copies of these were forwarded to the Cabinet Secretary under intimation to the Prime Minister's Office (PMO) on January 05, 2011.

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Annex - I

Exchange of correspondence on the issues relating to spectrum pricing being a part of the GoM

S No	Date	Item
1.	February 23, 2006	Cabinet Secretariat issued a notification for constitution of GoM on vacation of spectrum etc. (including the issue of 'spectrum pricing')
2.	February 28, and November 16, 2006	Minister-in-charge of DoT (then) wrote to Prime Minister for deletion of the issue of 'spectrum pricing' from the terms of reference (ToR) of the GoM; and, to restrict the ambit of the GoM to vacation of spectrum.
3.	December 07, 2006	Cabinet Secretariat issued revised ToR, deleting the issue of 'spectrum pricing'.
4.	March 28, 2007	Finance Secretary wrote to Secretary (DoT) for inclusion of 'spectrum pricing' in the TOR of the GoM.
5.	April 02, 2007	Secretary (DoT) wrote to Finance Secretary stating that spectrum pricing is within the normal work carried out by his Ministry and ToRs have been amended following the then Minister's letter to the Prime Minister.
6.	April 19, 2007	Finance Secretary wrote to Cabinet Secretary for inclusion of 'spectrum pricing' in the ToR of the GoM. In the D.O. letter the Finance Secretary had indicated that since these issues would have economic and financial ramifications we feel that they need to be discussed in the GoM.
7.	May 17, 2007	Cabinet Secretariat replied to Finance Secretary suggesting that Finance Secretary and Secretary (DoT) may discuss for resolving the issue and advise the Cabinet secretariat about the decision taken in the matter.
8.	May 18, 2007	DEA sent an OM to DoT on 18.05.2007 indicating that technology neutrality and spectrum price must be included in the ToR of the GoM.
9.	June 06, 2007	Finance Secretary wrote to Secretary (DoT) for reconsideration of inclusion of the issue of 'spectrum pricing' in the TOR of the GoM.
10.	June 15, 2007	DoT informed the Ministry of Finance that the issue of spectrum pricing and charges for the use of spectrum is a dynamic issue. It depends, <i>inter-alia</i> , on the region, type of telecom services, band of spectrum used. It is to be considered from time to time in consultation with TRAI. This was not received in the DEA as per DEA's records.

List-2

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List of correspondence between PMO and Ministry of Finance on 2G spectrum/license matter from April, 2004 onwards

S. no.	Detail
1.	Department of Economic Affairs' letter dated 13.6.2005
2.	Prime Minister's Office ID dated 29.7.2005
3.	Prime Minister's Office ID dated 16.8.2005
4.	Prime Minister's Office ID dated 26.8.2005
5.	Prime Minister's Office ID dated 2.9.2005
6.	Prime Minister's Office ID dated 14.1.2006
7.	Finance Minister's note dated 15.1.2008
8.	Prime Minister's Office ID dated 10.6.2008
9.	Department of Economic Affairs' note dated 4.7.2008
10.	Prime Minister's Office ID dated 8.7.2008
11.	Prime Minister's Office ID dated 24.7.2008
12.	Prime Minister's Office endorsement dated 12.8.2008
13.	Department of Economic Affairs' OM dated 14.8.2008
14.	Prime Minister's Office ID dated 3.9.2008
15.	Prime Minister's Office endorsement dated 8.10.2008
16.	Department of Economic Affairs' OM dated 13.10.2008
17.	Prime Minister's Office ID dated 29.10.2008
18.	Department of Economic Affairs' OM dated 3.11.2008
19.	Prime Minister's Office ID dated 25.11.2008
20.	Prime Minister's Office endorsement dated 1.12.2008
21.	Department of Economic Affairs' OM dated 25.3.2011