

Consultation on a Licensing Framework for Mobile Broadband Services (MBS) – 700MHz Band

Canada Gazette Notice DGSO-002-12

Reply Comments of Xplornet Communications Inc. and Xplornet Broadband Inc.

July 25, 2012

1. Xplornet Communications Inc. and Xplornet Broadband Inc. (collectively, “Xplornet”) are pleased to submit the following reply comments in response to the Department’s paper, *Consultation on a Licensing Framework for Mobile Broadband Services (MBS) - 700 MHz Band* - as announced in Canada Gazette Notice No. DGSO-002-12. As Canada’s largest rural broadband provider, deploying fixed wireless and satellite broadband services across all regions of Canada, Xplornet welcomes this opportunity to comment on the development of a framework for the licensing of spectrum in the 700 MHz band.

Section 4: Auction Format and Rules

Combined eligibility and revealed preference activity rule in the clock rounds and Revealed preference activity rule in the supplementary round

2. Further to Xplornet’s June 25, 2012 submission (the “Xplornet Submission”) which underlined the potential impact of large combinatorial bids in the clock rounds trumping smaller regional / new entrants’ bids via the CCA price weighting mechanism, Xplornet would like to make the additional points set out below.
3. Xplornet notes that Quebecor Media, SaskTel and Eastlink - amongst other participants - expressed similar concerns to those in the Xplornet Submission. These participants identified the same risk that in supplementary rounds the price of a package already won during the clock rounds could increase considerably. For example, Eastlink stated that the final bid price in the supplemental round for a regional player could be as much as double the final bid price for the package awarded in the clock rounds, while the same increase for the supplementary round for an incumbent would only represent a small percentage increase over its final clock round bid price.

4. SaskTel proposed the following approach to remediate the possibility of a dramatic price increase in the supplementary rounds in the case that non-allocated licences are still available after the clock rounds:

Paragraph 37 of SaskTel's submission:

*"...SaskTel proposes an alteration to the winner determination that ensures that winners in the clock round must only consider the value of unallocated spectrum in the geographic Tiers in which they are the high clock round bidder. Such companies could guarantee successfully maintaining their winning clock round packages by bidding their maximum clock round bid plus the clock price less opening bid amount of unallocated licences **in the corresponding Tier(s)** to win. For example, if a bidder was the high bidder at the end of the clock phase on licences only in Alberta, it could guarantee itself the licences by increasing its bid on those licences by the value of the unallocated licences in Alberta alone. If such a modification were adopted, national bids could contain more unallocated spectrum value but the percentage of the total bid would be similar to that of regional bidders competing in specific areas, thus providing a more level field between regional and national players and potentially maintaining more competition in the market rather than letting the big three wireless companies squeeze the rest of the market players out."*

5. Xplornet agrees with SaskTel's approach and urges Industry Canada to implement this modification within the CCA rules for the Canadian auction.
6. Furthermore, Xplornet submits that a number of uncertainties remain regarding the auction rules and the algorithms that determine winning bids in the clock and supplementary rounds. Individually these uncertainties may be viewed as tolerable business risks in any auction process. However, cumulatively these uncertainties may have significant, unintended consequences on the outcome of the auction. When these uncertainties and risks are combined with the fact that this is a relatively new format for spectrum auctions, and the fact that this format has never been used in Canada, it would appear prudent to encourage further education and preparatory time for all parties.
7. Both the Regulator, as auction manager, and the potential bidders need to have time to carefully consider how all of these elements might play out before proceeding with the auction, in advance of any requirement to declare bid intentions. Xplornet urges Industry Canada to provide additional information sessions on the model and to provide early access to the CCA model software, allowing for adequate preparatory time on an auction that will have a significant impact on the Canadian telecom market.

Second-price rule

8. In the Xplornet Submission, Xplornet suggested using an alternative-weighting scheme based on parameters within the bidders' behaviour (e.g. ratio of final bid prices to reserve, final bid prices, etc.) because bidding is a more accurate determination of value than reserve prices. Parameters based on the bidders' behaviour would result in better approximations of market value.
9. The second price rule proposal has raised many questions about the difficulty of predicting the final prices that a bidder would have to pay. Most of the stakeholders agree with the nearest-Vickrey approach. Moreover, Public Mobile proposed a very intuitive method: 'Nearest-Vickery', weighted by size of the Tier 2 service licence areas for which the bidder has placed a bid:

Paragraph 62 of Public Mobile submission:

"Public Mobile is uncertain about the interpretation of the Department's use of "nearest Vickrey" pricing as outlined in Annex B of the consultation document. The use of the term "nearest Vickrey" suggests an equal sharing of collective common costs. Hence if two bidders jointly have to cover \$1,000,000 in collective common costs and they each have individual opportunity costs of zero, they will pay \$500,000 each. However, the description of the price rule, specifically in paragraph 5 of Annex E, suggests that the Department uses "nearest Vickrey" to signify a sharing of collective common costs that is relative to package sizes.⁸ Hence if two bidders jointly have to cover some collective common costs, a bidder that wins a smaller package will pay a smaller part of these extra costs. In the following, we will refer to "nearest Vickrey" as an equal sharing of costs and to "nearest Vickrey weighted by size" as a sharing relative to package sizes."

10. Xplornet agrees with Public Mobile's Nearest-Vickery' proposal and views it as complementary to its own proposal in the Xplornet Submission. Xplornet urges Industry Canada to consider the Xplornet proposal in this matter reinforced by Public Mobile's proposal.
11. The second price rule as proposed by Industry Canada also raises some concerns about 'THE SOLVER' used by the CCA software. Not having early access to the auction software in a reasonable period before it is required to declare bid intentions, not to mention well in advance of the actual auction takes place, makes it difficult for all stakeholders to understand THE SOLVER functions. Thus, Xplornet urges Industry Canada to take into account the necessity of having early access to the software as critical for understanding all the processes, implications on strategies and financial commitments.

Section 5. Bidder Participation — Affiliated and Associated Entities

The proposal that entities that are deemed associated entities may apply to be treated as separate entities for participation in the auction

12. Xplornet submits that Industry Canada should be transparent and consistent in its application of the rules pertaining to the auction to ensure a fair and competitive process takes place. The proposal that entities that are deemed associated entities may apply to be treated as separate entities in the auction process imposes on Industry Canada an obligation to apply discretion and judgement, which can, at a minimum, lead to perceptions of bias and unfairness. To maximize the integrity of the auction process and the perceived fairness of the outcome, Xplornet encourages Industry Canada to avoid creating rules or exceptions to the rules that require intervention and judgment.
13. In the event Industry Canada does consider such a proposal to allow associated entities to be treated as separate entities, Xplornet reaffirms its original position that appropriate spectrum cap rules need to be implemented to the associated entities.

The proposals that are deemed to be associated entities may request to have the spectrum caps apply to them separately, based on an analysis of their association and of whether they intend to compete in the same licence service area

14. Xplornet submits that the spectrum caps should apply to the associated entities as a whole but that the appropriate spectrum cap will depend on the classification of the entities that are associated: incumbent, new entrant or regional. We believe the differentiation is appropriate given the difference in market power between national and some regional incumbents and new entrants and in light of the importance of the spectrum cap mechanism in controlling spectrum hoarding and warehousing.

The criteria to be considered in determining whether the entities are competing

15. Xplornet believes Industry Canada must treat all parties fairly and equally. In considering whether parties are competing, Industry Canada is encouraged to first examine historical precedents, such as the Network Sharing Agreement between BELL and TELUS, when setting the terms for this auction in order to ensure that equivalent rules apply to all participants. Further, in the interests of fairness, Industry Canada needs to be transparent and consistent when determining if entities are competitive, thereby permitting all participants in the auction the same opportunities. Continued opaque references to

arrangements that Industry Canada finds acceptable or unacceptable from a competitive perspective do not assist in improving the competitive landscape or the perception of a level playing field that is understood by all participants. As a result, Xplornet encourages Industry Canada to set forth the material factors or characteristics that it has used to assess (i) if an arrangement constitutes sharing of spectrum, (ii) if the arrangement renders the parties associated entities, and (iii) if parties are competing with each other.

16. Xplornet agrees with ROGERS' position on this issue in their original submission that network sharing provides a competitive advantage to the associated entities as a result of cost saving and ultimately in spectrum sharing. Network sharing agreements make it less expensive for the associated entities involved to carry their own traffic compared to other carriers who would like to use the same network. The costs for an external carrier would, without doubt, be higher to provide the same service levels to customers (as expressed in service level agreements - SLAs and quality of service QOS agreements). Xplornet strongly encourages Industry Canada to adopt a consistent approach to its position on network sharing arrangements to be fair and transparent thereby allowing all participants equal opportunity and a level playing field.

Industry Canada is seeking comments on the rules prohibiting collusion that would apply to bidders in the 700 MHz auction.

17. Xplornet reiterates its position that Industry Canada should only allow bidders to bid jointly as associated entities or bid separately as non-associated entities. If bidding separately, there can be no sharing of information prior to or during the auction, especially in the case that the separate bidders are actually *de facto* associated entities who were granted separate bidding privileges. If they do share information prior to or during the auction, they should be subject to disqualification from bidding. Logically, there can be no in-between position that would ensure fairness to all bidders.

The proposed wording of the condition of licence related to the spectrum aggregation limits.

18. Xplornet agrees with ROGERS that Industry Canada should prohibit bidding on the upper and lower prime blocks at the same time since it does not make any technological or financial sense to do so unless for gaming purposes to increase prices or/and deny licenses to other bidders.

The proposed wording of the condition of licence related to transferability and divisibility

19. Xplornet's position is that no transfer of licences or issuance of new licences should be authorized for five years following licence issuance – consistent with the period for which spectrum caps will be continue to be in place – unless such transfer is on a MHz-POP for MHz-POP basis and does not place a bidder in excess of its spectrum cap, as determined at the time of the auction.
20. Xplornet notes that all parties agreed with the Department's proposal but TELUS mentioned an interesting point of view. TELUS proposed a small rephrasing. Subordinate licences will not count towards the subordinate licensee's spectrum aggregation limit if the primary licensee and the subordinate licensee demonstrate to the satisfaction of Industry Canada that they will be competing in the licence area. Xplornet supports the changes proposed by TELUS.

The proposed wording of the licence condition related to rural deployment requirements. Specifically, comments are sought on the assessment of "access to two or more paired blocks of spectrum" for the purposes of this condition of licence.

21. As written, any licensee having access to two or more paired block through association has to fulfill the deployment requirements of 90% of the population of the HSPA network footprint within the next five years and 97% within the seven years of the issuance of the initial 700 MHz licence.
22. Xplornet reiterates its prior comments that forced build outs are not useful policy tools to encourage sustainable deployment but rather such build outs only serve to damage smaller competitors and, in the long term, further exacerbate the lack of availability of services in rural areas. It is submitted that, as written, the current build out requirements are neither helpful nor harmful and, as such, should not be modified at this time. Any modification to expand the build out requirements could be seen as an attempt to create a barrier to entry for new entrants, thereby limiting competition in both urban and rural areas of Canada
23. Xplornet also agrees with Eastlink with regard to the rural deployment condition of licence as proposed by the department is unlikely to encourage rural deployment. New entrants are still in the early phase of deployment and as such, do not have access to HSPA extended networks:

Paragraph 53 of Easlink's submission

"Eastlink submits that rural deployment condition of licence as proposed by the Department is unlikely to encourage rural deployment. New entrants still in the early phases of network development will easily meet the requirement based on the proposed language because many operate primarily in urban areas. At the same time, large incumbent wireless service providers will also meet the rural deployment requirements easily as their HSPA networks are built primarily in urban centers and the corridors between them. Considering the propagation characteristics of the 700 MHz spectrum band, these large incumbents will likely cover 90% of the population within their existing HSPA footprint simply by building in urban centers. "

Necessity for further clarity

24. As noted in our comments above there is a cumulative impact of CCA auction rules in terms of complexity and uncertainty and that both the Department and potential bidders need to have sufficient time to consider how these rules might play out in order to ensure a fair and transparent auction process. Therefore, Xplornet suggests that Industry Canada entertain the possibility of delaying the upcoming 700 MHz auction that is proposed to be in 2013 in order to provide bidders with a greater sense of clarity with regards to the auction, including the CCA format and rules, licensing framework, conditions of licence, timelines, spectrum packaging, etc.
25. In support of this claim, Xplornet points to the recent example of the joint decision by The Ministry for Broadband, Communications and the Digital Economy and the Australian Communications and Media Authority (ACMA)'s decision to delay their own Digital Divide (700 MHz, 2.6 GHz) auction by 4 to 5 months in order to provide participants with greater clarity regarding the auction format (timeline, spectrum packaging, etc.). It is Xplornet's belief that the Australian auction, compared to the often-cited European auctions, is a far better proxy, given the two countries similar geographic and demographic characteristics (continental, dispersed population, etc.), and are using the identical auction format (CCA, as developed by Peter Cramton, utilizing the same rules). Arguably, given the similarity between the two auctions, if further clarification is needed in one setting, it is likely to be needed in the other.

26. It should be noted that initially Australian service providers had called on the Government to conduct the auction as quickly as possible in order for them to roll out high-quality services, particularly LTE, and to enable them to keep costs to consumers down due to growing service demands and expectations. This tone quickly changed, however, as prospective bidders came to feel that they lacked the necessary knowledge of the CCA auction format and rules process and how this might impact the business plans and investment decisions related to new mobile infrastructure. For stakeholders the need for transparency and fairness in the auction process trumps early access to spectrum. As such, Xplornet suggests that Industry Canada delay the current auction so that prospective bidders may be provided with adequate time to develop business plans and make the necessary investments in order to utilize, to the full extent, the spectrum that will be acquired during the auction process. Failure to do so will ultimately lead to the acquisition of spectrum without necessary long-term planning, leading to sub-optimal auction results for carriers and Canadians alike.

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