COMMERCIAL RADIO
AUSTRALIA

ACMA PAPER ON IMPLEMENTATION OF THE SPECTRUM PRICING REVIEW

SUBMISSION BY COMMERCIAL RADIO AUSTRALIA

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Commercial Radio Australia (**CRA**) is the peak industry body representing the interests of commercial radio broadcasters throughout Australia. CRA has 260 member stations, comprising 99% of the Australian commercial radio industry.

CRA welcomes this opportunity to respond to the ACMA's discussion paper *Implementation of the Spectrum Pricing Review - proposed guidelines and focus areas* (**Paper**).

The Paper focuses on three recommendations from the 2018 Spectrum Pricing Review:

- The ACMA should publish guidelines on how it approaches spectrum pricing decisions (*Recommendation 1*).
- The ACMA should undertake a detailed review of the administrative pricing formula's parameters including density areas, the number of pricing bands and number of power categories (*Recommendation 7*).
- The ACMA should apply opportunity cost pricing to a greater number of spectrum bands (*Recommendation 8*).

CRA's key concern is that, in seeking to achieve consistency of treatment between spectrum users, the pricing principles do not acknowledge the broader public benefits delivered by broadcasters' use of public spectrum.

An opportunity cost approach to the valuation of broadcast spectrum will artificially increase the costs of access to spectrum if there is competition for access to spectrum in the future, placing additional pressure on the sector when it is already under significant commercial stress.

1. Summary

The ACMA's guidelines are overly focused on economic efficiency and fail to appreciate broader public benefits delivered through spectrum

- There is a strong risk that the commercial broadcasting business models will be unduly disadvantaged compared to user pay business models in scenarios where competition for spectrum emerges in the future.

- The ACMA must take better account of the intangible social value benefits that are provided by the commercial broadcasting sector and advertising based business models.

Opportunity cost approaches to spectrum pricing are heavily biased against commercial radio broadcasters and fail to recognise intangible benefits

- An opportunity cost approach to the valuation of broadcast spectrum will artificially increase the costs of access to spectrum if there is competition for access to spectrum in the future, placing additional pressure on the sector when it is already under significant stress.

- Critically, the use of an opportunity cost approach would fail to take account of the intangible, social value related benefits that flow from the use of that spectrum to provide commercial radio broadcasting services, along with the significant regulatory costs that are borne by commercial broadcasters under the *Broadcasting Services Act 1992* (**BSA**). Such an approach also has limited utility in circumstances where there is no alternative demand for spectrum, as is currently the case with radio broadcast spectrum.

- Spectrum fees for commercial radio broadcasters should be calculated based on an administrative cost recovery based approach, consistent with overseas approaches.

- CRA submits that the ACMA should not focus on Recommendation 8 of the 2018 Spectrum Pricing Review without also considering Recommendation 3: '*bespoke pricing arrangements will sometimes be necessary*'. CRA's view is that bespoke arrangements are necessary for radio broadcasters.

The pricing formula has a number of flaws that should be addressed

- A critical flaw arises because the reliance on the apparatus licence fee density maps creates a miss-match between the designated density of the site and the population density of the area being served from that site. This means that broadcasters serving lower density areas adjacent to higher density areas may have very high spectrum fees.

- This outcome will not promote an efficient use of spectrum, as the spectrum fees that result do not reflect the value of the spectrum in providing services to end-users.

2. <u>Legislative and policy environment relevant to pricing issues (Question 2)</u>

CRA is keen to ensure that commercial broadcasting business models will not be unduly disadvantaged compared to user pay business models in scenarios where there is potential competition for spectrum.

Accordingly, the legislative and policy environment must not expose spectrum users to a regulatory decision making bias that will always favour spectrum decisions that support the highest value use, even where this may disrupt established uses for that spectrum or otherwise devalue other public benefits that flow from that spectrum use.

The legislative objectives must expressly include the intangible, social value benefits that are provided by the commercial radio sector and advertising based business models.

The *Radiocommunications Act 1992* (**Radcoms Act**) provides that spectrum management should:

> '*maximise, by ensuring the efficient allocation and use of the spectrum, the overall public benefit derived from using the radiofrequency spectrum'*.

This objective does, by reference to 'overall public benefit', implicitly cover social value benefits provided by spectrum users. Nevertheless, in the context of the 2018 Spectrum Pricing Review's proposal '*to charge users of similar spectrum at the same rate*' (Recommendation 2), CRA would like to see an express recognition of the public benefit value of broadcasting spectrum use, in any revised legislative and policy framework.

Objects are particularly important given the discretion afforded to ACMA in spectrum planning and management.

Instead of focusing on the use which has the highest financial value, the legislative objectives need to be expanded to acknowledge that these broader social benefits exist, and in doing so, permit regulatory decisions (including spectrum pricing decisions) to take account of these additional considerations.

CRA recommendation:

1. The legislative objectives should be re-cast to take greater account of other factors that are relevant to users of spectrum, including the public and social value benefits.

2. The legislative objectives should also recognise that certain users of spectrum have related obligations under the BSA that need to be considered.

3. <u>Guiding Principles (Question 3)</u>

CRA has concerns regarding the absence of specific reference to public and social value benefits offered by the spectrum user.

The guiding principles set out in the Paper focus on:

- efficiency;
- consistency;
- simplicity;
- flexibility;
- transparency; and
- cost recovery.

The above criteria are important but must be accompanied by an additional principle of public benefit.

Guiding principles based primarily on economic efficiency would reinforce a belief that spectrum is best allocated to the use that produces the most surplus to society, and that the most efficient way of measuring that surplus is through price-based mechanisms. That is, spectrum is best used by whoever is willing to pay the most for it.

However, this rationale fails to consider the other public benefits that flow from spectrum use and which are, at least partially, covered in the objects section of the Radcoms Act (see above). This includes public and private benefits that flow from advertising based business models and from commercial radio broadcasting services specifically, such as:

- access and inclusion, promotion of community and education through free broadcasting services;
- the benefits that flow to the community and the local creative sector from the production and broadcasting of local content; and
- the continued social importance of free to air services in the community.

CRA recommendation:

3. The Guiding Principles should recognise that the spectrum pricing regime should take account of the public benefit and social value of the spectrum use.

4. Assessment of the public benefit and social value will include consideration of the spectrum users' other obligations. In the case of commercial radio broadcasters, this will include local content, Australian content and emergency broadcasting.

4. Opportunity Cost Pricing (Question 9)

Recommendation 8 of the 2018 Spectrum Pricing Review states:

> *The ACMA should apply opportunity cost pricing to a greater number of spectrum bands, especially where it is impractical to competitively allocate spectrum.*

CRA has significant concerns regarding the application of opportunity cost pricing to commercial radio broadcast licences.

Opportunity cost pricing reflects the value of spectrum to the best alternative use or to alternative users. This is said to mimic the signal that would come from a competitive market allocation. If applied to broadcast spectrum this could see an increase in the spectrum fees to reflect the financial value from other uses.

Any proposal for opportunity cost based pricing for broadcast spectrum should be rejected for commercial radio broadcasting and other analogous broadcasting services as it will provide a value that does not reflect:

- the social nature of the services that it delivers, its public character and the external benefits it delivers; or
- the significant and costly regulations that are imposed on commercial radio broadcasters by Government to deliver social and public policies.

Even setting aside the social nature of spectrum and the cost of regulations, opportunity cost based pricing for broadcast spectrum would not lead to more efficient outcomes due to the lack of demand for this spectrum.

Opportunity cost based pricing of spectrum would be inconsistent with current broadcast policy under the Radcoms Act in that it would not promote '*the overall public benefit derived from using the radiofrequency spectrum*'.

Instead, CRA submits that a fee based on the costs incurred by the ACMA in administering spectrum should be the default model for commercial radio broadcast spectrum.

CRA recommendation:
5. Commercial radio broadcast spectrum should be exempt from any opportunity cost based pricing framework, as it does not take account of the public benefit and social value of the spectrum use.

5. Bespoke pricing for commercial radio broadcasters (Questions 2 and 9)

Recommendation 2 of the 2018 Spectrum Pricing Review states that:

> *Bespoke pricing arrangements will sometimes be necessary*

CRA submits that any application of opportunity cost pricing mechanisms (Recommendation 8) must be accompanied by bespoke pricing arrangements for commercial radio broadcasters.

Public good and external factors

Such bespoke arrangements will incentivise the production of a public good and may result in similar spectrum being charged at different rates, to take account of external and social value factors.

Without adequate bespoke pricing mechanisms – and pricing principles that reflect the importance of the public good – radio broadcast spectrum charges may end up based on the modelled efficient cost of alternative uses. This would not take into account the social benefit of using the spectrum for commercial broadcast radio nor the costly regulations imposed on commercial radio broadcasters.

It is of serious concern if external and social considerations are not considered in setting spectrum fees, as this will distort the efficient use of spectrum.

The need to account for service externalities when spectrum is allocated and priced is highlighted by Cave and Pratt as follows:[1]

> *"Spectrum should be allocated among the various services which use it to maximise the aggregate incremental value (private and external) of those services minus the (nonspectrum) costs of supply. The external value of services such as broadcasting*

[1] M Cave and N Pratt, Taking account of service externalities when spectrum is allocated and assigned, Telecommunications *Policy* (2016), see: http://dx.doi.org/10.1016/j.telpol.2016.04.004i

and mobile communications may be significant, yet we know that spectrum assignment by auction, for example, does not take them into account, because the successful bidder cannot monetise the value of the externality".

The delivery of commercial radio broadcasting has many public and social features that create additional benefits to consumers and third parties beyond the monetary value to commercial broadcasters. In economic terms, these effects are referred to as externalities. The commercial radio broadcasting model is beset by externalities. Radio is not paid for directly by listeners, but is funded by advertising time that is inserted within the programming that attracts listeners.

It is useful to set out some definitions in respect of the different types of value that spectrum may generate:

- Private value: this is the value that accrues to consumers or producers. It is typically quantified based on willingness to pay. A consumer will purchase something at a specific price if his private value is equal or exceeds the price of the product. Similarly, a producer will bid for spectrum up to a certain price that reflects the future revenues and costs of using that spectrum, suitably discounted in future to reflect time preferences and alternative uses of his money;

- External value: this is the additional benefit that accrues to consumers/producers or uninvolved third parties. These benefits are not reflected in the private value. External value may be further broken down into:

  - private external value: the net private value of the service to individuals and that do not use it but are affected by positive or negative externalities; and

  - broader social value: the value of the service to citizens from its impact on social goods such as social capital, political freedoms, national culture, security and inequality (not reflected in private use or private external value).

The components of the value to society from services using spectrum is illustrated in the following figure from Cave and Pratt:[2]

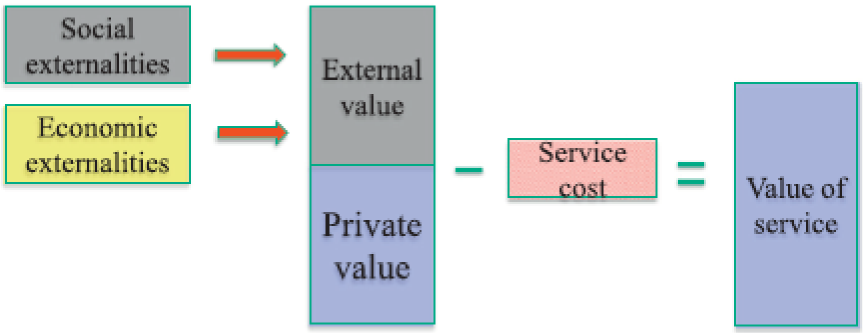

Figure 1: The value to society of spectrum-sharing services

[2] Ibid.

Commercial radio broadcasting provides a service that is near to ubiquitous: in analogue format, commercial radio is nearly universally available across Australia. Radio is a highly appreciated source of entertainment for listeners, but also a key source of news, political dialogue, emergency and community information, educational material and cultural programming.

Ofcom has identified several elements of what it terms the "broader social value" of broadcasting spectrum to reflect the value derived from the service because of its broader contribution to society, including: access and inclusion, belonging to a community, educated citizens, cultural understanding, informed democracy – for example value from services which provide information which facilitates democratic debate, and social "bads".

The broader social benefits delivered by the commercial radio sector include:

- all regional commercial radio stations must broadcast specified levels of material of local significance, being 3 hours per day of such content for most licensees;
- additional obligations to broadcast local news (12.5 minutes per day), local weather, community services announcements and emergency warnings, along with local presence requirements where there is consolidation or a change in control in the local market;
- emergency broadcast requirements; and
- Australian music requirements, which must be observed by all commercial radio stations. The applicable percentage of Australian music and new Australian music depends on the format of the station. For example, contemporary hit stations and top 40 stations must play 25% Australian music, of which not less than 25% must be new Australian performances.

In addition, commercial radio confers wider economic benefits that are important to the Australian creative sector by producing original Australian content which, in itself, is important. The industry employs and trains people in the creative sector.

Opportunity cost based pricing of radio broadcast spectrum would create a serious risk of weakening the public delivery of commercial radio broadcasting in Australia. It would also be inconsistent with the objective that broadcasting policy should facilitate the development of local and original content. Higher spectrum charges would also be inconsistent with maintaining the current level of regulation imposed on commercial radio broadcasters.

Because of the significant uncertainties over the social value of radio broadcast spectrum and the inherent bias in estimating non-monetary benefits, there is a significant risk the spectrum charge will be too high. This will likely:

- lead to valuable spectrum being returned and being idle until re-allocated, which could risk a reduction in competition if commercial radio broadcasters exit the market; or
- force commercial radio broadcasters to incur unnecessary and wasteful investments to minimise use of spectrum.

The limited ability of commercial radio broadcasters to pass on higher spectrum charges through higher advertising rates in a very competitive environment would inevitability mean less investment in local and original content. This will also restrict the ability of CRA members to invest in talent, studio facilities and to further improve technology, such as on-channel repeaters to address coverage blackspots that impact digital radio services.

This will be detrimental to citizens and consumers. It will reduce the private value they accrue from listening and reduce the broader social benefits from commercial radio broadcasting, including less diverse content and the negative knock-on effects on the creative industry and on the wider economy.

Considering these difficulties, we consider that the better approach is for the pricing principles to recognise that broader social values are important and must be given due prominence in the pricing framework for commercial radio broadcasting services.

Value based pricing will not work for radio spectrum

In addition to the social value issues, there are three conditions that suggest that value-based pricing does not even warrant investigation for radio broadcast spectrum:

- the absence of alternative demand for the radio broadcast spectrum from other uses – this means that the alternative-use value of the spectrum is zero; and
- the absence of a timetable and detailed plans for a digital switchover from analogue radio; and
- the existence of tradability in relation to excess digital radio capacity – this means that incentives and mechanisms already exist to transfer excess capacity rights to the highest value users. Value-based pricing would not increase incentives for efficiency in relation to the trading of spectrum between commercial radio broadcasting licensees.

These conditions are discussed below.

First, the International Telecommunication Union has allocated the frequency band between 535 KHz and 1606.5 KHz for the sole purpose of broadcasting across all three international regions. The 88 MHz to 108 MHz has also been designated for the sole purpose of broadcasting for the Africa, Americas and European regions. Only the Asian region has allocated the 87 MHZ to 100 MHZ band for both broadcasting and fixed mobile.

The requirement for international harmonisation means that there is little commercial interest in the manufacturing of equipment within these bands for uses other than broadcasting.

An evaluation of digital radio switchover in the UK concluded that the there was no alternative demand for the use of analogue AM and FM spectrum. In an external report conducted on behalf of Ofcom, Analysys Mason concluded that the band occupied by commercial radio broadcasting was not a viable alternative for either local or national television.[3] This means there are no alternative uses for the spectrum currently occupied by

[3] Analysis Mason, Opportunity cost of spectrum used by digital terrestrial TV and digital audio broadcasting, Final report for Ofcom, 12 March 2013, Ref: 35200-95. See, https://www.ofcom.org.uk/__data/assets/pdf_file/0018/33345/report.pdf

commercial radio broadcasting licensees. As the Ofcom review indicates, opportunity cost pricing should not be used when there is no excess demand.

Ofcom stated:[4]

> *Our Consultation set out the reasons why we believed AIP should not be levied on either DAB radio or local TV. We said an independently commissioned study had identified excess capacity in the spectrum assigned for DAB radio and that this showed there was no evidence of excess demand. AIP is therefore not applicable to DAB radio. Similarly, there is currently no excess demand for spectrum deployed for secondary, interleaved use by local TV. AIP is therefore not applicable for local TV broadcasting. We remain of this view.*
>
> *However, we acknowledge that this may not always be the case in future, and that AIP may become an appropriate pricing mechanism at some time for either DAB radio and/or local TV. For the present though, we have seen no persuasive argument that anything other than cost-based fees should apply, for the reasons already stated in relation to DTT.*

Given the lack of excess demand for the AM and FM spectrum, Ofcom found it was inappropriate to use opportunity cost based pricing as there is no opportunity cost given the lack of alternative uses. Ofcom recommended "the fees reflecting the cost of spectrum management should apply instead i.e. cost-based fees."

Second, there is no timetable for a digital switchover for radio in Australia. Whilst uptake of digital radio in Australia has been progressing, there would be significant disruption to listeners and the broadcasting sector from a digital switchover (i.e. analogue switch-off).

Any future digital switchover will require substantial lead time for consumers, equipment manufacturers and coordination amongst industry participants. In the meantime, spectrum charges levied on individual radio broadcasters would not serve to incentivise the switchover.

Third, in terms of spectrum used for digital radio, there are already incentives to use this spectrum efficiently. The ability for broadcasters to trade excess capacity provides incentives for broadcasters to use a proportion of existing spectrum efficiently, through trading of that capacity to users who value it more highly. Value-based pricing would not add to the incentives for efficiency in own-use of spectrum used for commercial radio broadcasting.

On this basis, CRA's very strong preference is to use an administrative cost recovery based approach to the pricing of radio broadcast spectrum for commercial radio services.

CRA recommendation:

6. Considering the broader social value delivered by commercial radio broadcasters and the difficulties in quantifying those benefits for the purposes of determining any external subsidy, along with the limited alternative uses (and therefore limited

[4] Ofcom, Spectrum pricing for terrestrial broadcasting, Statement, Publication date: 24 July 2013, p. 14. See, https://www.ofcom.org.uk/__data/assets/pdf_file/0015/37320/statement.pdf

alternative financial value from other uses) associated with radio broadcast spectrum, that:

(a) opportunity cost pricing should not be used to value radio broadcast spectrum; and

(b) an administrative cost recovery based approach to the pricing of radio broadcast spectrum should be used.

6. Flaws in pricing formula (questions 9 to 14)

Recommendation 7 of the 2018 Spectrum Pricing Review is that the ACMA should undertake a detailed review of the administrative pricing formula's parameters including density areas, the number of pricing bands and number of power categories

The per transmitter fee formula has a number of elements that can be further improved to ensure that members are treated more fairly and can be better off in the future.

This includes the current reliance on the apparatus licence fee density maps, which create a mismatch between the designated density of the site and the population density of the area being served from that site. This means that broadcasters serving lower density areas adjacent to higher density areas may have very high spectrum fees (if the site being used to transmit is in the higher density area).

This outcome will not promote an efficient use of spectrum, as the spectrum fees that result do not reflect the value of the spectrum in providing services to end-users. For example, it results in a broadcaster serving a smaller population paying the same fee as a broadcaster serving a much larger population. This distribution may lead to inefficiencies, as fees are not reflective of the value of the spectrum to users.

The per transmitter fee formula may also be further improved by applying a reduced licence fee for secondary transmitters, known as 'translators', in licence areas. In many regional licence areas, the licensee broadcasts from a number of different transmitters to serve the full licence area. Without such translators, there would be 'blackspots' in the licence area and people living within those blackspots would not be able to receive the licensee's signal. A reduced fee should apply to these translators to enable licensees to continue to serve as much of their licence areas as possible, to the benefit of the local community.

The flaw in the per transmitter licence fee formula can be addressed by revising the density offset adjustment to reflect the density of the areas served by each broadcaster.

CRA recommendation:

7. The flaw in the per transmitter licence fee formula should be addressed by revising the density offset adjustment to reflect the density of the areas served by each broadcaster.

8. Licensees should not pay full licence fees for secondary transmitters.

Please contact Joan Warner, on 02 9281 6577, for clarification on any aspect of this submission.

Commercial Radio Australia