UPDATES

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Telecom Reforms - A Liquidity Booster for the Sector

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This update covers:

1 Introduction

To boost the distressed telecom sector, the Union Cabinet has introduced various reforms such as the exclusion of non-telecom revenue from the definition of AGR, a moratorium on payment of pending AGR dues, and 100% FDI under the automatic route.

Telecom Services Providers (**TSPs**), under the licenses granting them the right to operate in India, are obligated to share a percentage of their annual gross revenue (**AGR**) with the government as a license fee. These licenses define AGR broadly to include revenue generated from telecom as well as non-telecom activities carried out by licensees. However, certain TSPs disagreed with the view that AGR includes revenue generated from non-telecom activities and chose to litigate the matter before the Telecom Disputes Settlement and Appellate Tribunal and the Supreme Court. During the pendency of this litigation, the dues of some entities were not paid on the extended definition of AGR (i.e. dues were not paid on the revenue component from non-telecom activities). However, the Supreme Court affirmed the view that revenue of TSPs from all sources should form part of the calculation of AGR. Consequently, the Court directed the telecom companies to pay their pending dues towards license fees, along with penalty and interest. As a result, at the end of 2019, the telecom industry was burdened with nearly INR 92,000 crore (approx. USD 12 billion) in arrears, penalty and interest payments. Notably, only 25% of this amount was the actual license fee due and the remaining 75% of liability was on account of penalty, interest and interest on the penalty.

In addition to the hardship imposed by this demand, the TSPs have also endured bloated operational costs and amassed vast debt. The telecom sector has seen a major consolidation and the market has contracted from about twelve telecom operators to three.

To provide relief in the backdrop of the outstanding performance of the telecom sector in meeting challenges faced during COVID-19, the Union Cabinet approved a crucial relief package for the telecom sector, in the form of major reforms, outlined in the Press Release of 15 September 2021 (**Press Release**). We discuss some of these reforms and their impact below.

2 The Reforms

2.1 Rationalisation of various fees and charges

a. AGR

A telecom licensee in India is required to pay 8% of AGR as license fees to the Department of Telecommunications (**DoT**). AGR is broadly defined to include not just revenue from the core telecom activities provided by the operator but also supplementary services, revenue from permissible sharing of infrastructure and any other miscellaneous revenue, without any set-off for related items of expense. This would mean that the income arising out of non-telecom activities of the TSPs would be subject to the license fees, imposing additional liability on the TSPs. This also discourages such entities to foray into other sectors or, to an extent, exit from the telecom sector, as evidenced by the shuttering of various TSPs over the last decade.

Several interventions and representations were made by stakeholders attempting to assist the industry in this regard, including recommendations from the Telecom Regulatory Authority of India (**TRAI**) dated 13 September 2006 and 6 January 2015, in addition to the policy objectives outlined in the National Digital Communications Policy 2018 (**NDCP**), which sought to review the license fee and the definition of AGR. Despite the same, the Supreme Court sealed the issue in 2019, determining that the revenue of TSPs from all sources should form part of AGR.

Through the reforms, the Union Cabinet has rationalized the calculation of the AGR by excluding non-telecom revenue from its purview on a prospective basis. While this may serve as a fillip to new participation in the telecom sector, given that the rationalisation is prospective in nature, the levy imposed on TSPs, following the Supreme Court judgment, will remain payable.

b. Spectrum Usage Charges

Earlier, the DoT levied a spectrum usage charge (**SUC**) of 3%-5% of the AGR (depending on the band of spectrum allotted and the type of authorisation) with an additional 0.5% of the AGR charge levied, if such band of spectrum is shared with another operator. With the current reforms, SUC has been removed altogether for spectrum to be allocated in future auctions. Further, spectrum sharing has been liberalised with the removal of the 0.5% charge as well. While the Press Release does not expressly state as such, this relief is also likely to apply prospectively. We expect to receive more clarity once the DoT notifies the relevant amendments to the license to give effect to these reforms.

The removal of SUC eases a large burden on the TSPs, it being a significant percentage of the AGR. Further, the liberalisation of spectrum usage and spectrum sharing incentivises investment into the sector, due to the reduced operational cost, and promotes proliferation and penetration of more players by encouraging spectrum sharing. Spectrum sharing will also assist large telecom companies in addressing network congestion and encourage smaller players to enter the market.

In combination, these reforms significantly reduce the burden on TSPs as their corresponding licensing fee would be reduced to a large extent and would provide TSPs with much required liquidity, allowing them to channel these financial resources into improving infrastructure and other operational improvements. These reforms also have potential second order impacts, such as in the market for value added services, where the cost of the AGR was often priced into the services, and in corporate restructuring efforts that involved non-telecom assets of telecom companies. Other potential beneficiaries of this are the public sector banks and other debt instrument holders of these telecom operators, who would now be able to realise their borrowings with ease.

2.2 Reforms to the Treatment of Spectrum

a. Spectrum Tenure and Surrender

The tenure of spectrum obtained in auctions has been increased from 20 years to 30 years, and a TSP may choose to surrender spectrum 10 years after it has been acquired, however this is permitted in case of change in business condition or technology changes after 10 years of lock-in and after paying defined surrender charge. Both these changes are effective prospectively, i.e. for spectrum obtained in future auctions.

b. Fixing of Spectrum Auction Calendar

Previously, there was no specific timeline within which spectrum auctions were to be conducted. However, the Union Cabinet has now stated that spectrum auctions will be held in the last quarter of every financial year.

Spectrum is a significant asset for TSPs and these reforms will allow TSPs to utilise the spectrum over a longer period and provide TSPs with more clarity, thereby assisting them with business positioning from an operational and cash liquidity perspective in preparation of the spectrum auction.

2.3 Other Reforms to Promote Liquidity in the Sector

With a view to address the financial health of TSPs, exposure of banks in the telecom sector, promotion of healthy competition and protection of consumer interests, the Union Cabinet has introduced the following reforms.

a. Moratorium on existing AGR and Spectrum Dues

In September 2020, the Supreme Court allowed TSPs to stagger payment of AGR dues determined in the 2019 judgment over a period of 10 years. However, through this reform, TSPs have been granted a moratorium for up to 4 years on (i) annual payments of AGR dues arising out of the AGR judgment, protecting the Net Present Value (**NPV**) of the due amounts; and (ii) spectrum payment dues from past auctions, excluding the 2021 auction, with NPV protected at the interest rate stipulated in the respective auctions. This comes as a reprieve to TSPs that may use the period to improve their cash flows, attract investment and invest in new infrastructure, prepare adequately for the 5G auction, and mitigate the imminent possibility of defaulting on borrowings. The moratorium will also provide TSPs with a window of opportunity to organically increase tariffs to help pay their dues. Moreover, the government has the option to realize the interest amount resulting from the institution of the moratorium by converting the dues into equity which would contribute to the financial viability of the TSP while also signalling faith on the part of the government in this sector.

b. Rationalization of Bank Guarantees, Interest, and Scrapping of Penalties

The Union Cabinet has reduced Bank Guarantee (BG) requirements against license fees (LF) by 80%, allowing furnishing of a single BG for the various licensed service areas that a TSP may operate in, as opposed to the previous requirement of multiple BGs. It has dispensed with the requirement to furnish BG to secure spectrum charges. The government has also reduced the interest for delayed payments of LF and SUC and proposed annual compounding instead of monthly. Further, penalties and interest on penalties have been removed altogether.

Though these measures are prospective in nature, together with the other structural reforms, such as rationalization of AGR and scrapping of SUC, they provide a roadmap to TSPs to tackle issues of cash flows in the medium to long run while pursuing competitiveness. This is likely to alleviate concerns of a duopoly.

2.4 Reforms to the Know Your Customer (KYC) Process

The Press Release specifies that app/web-based process of 'self-KYC' (S-KYC) will be permitted. S-KYC allows customers to conduct self-registration and fill out their customer acquisition form (CAF) online through an app or on the website of the service provider.

This is operationally far easier than the current process under which there is a need to have a physical interaction with the agent of the TSP. This is in line with the government's objective of improving ease of doing business. All stakeholders in the ecosystem would ultimately benefit - for consumers, this would lead to convenience and for TSPs, this would enable them to deliver contactless services reducing operational expenditure.

The DoT has issued a circular dated 21 September 2021 (S-KYC Circular) which implements this suggestion and conceptualises the S-KYC as an alternate process for issuing new mobile connections to individuals and outstation category customers. The S-KYC Circular refers to S-KYC only in the context of delivery of mobile connections, and it is to be seen whether the S-KYC proposed would extend to other services provided by TSPs/internet services providers, including broadband services and also to bulk category customers.

2.5 Reforms to Promote Ease of Doing Business

a. Removal of Foreign Direct Investment (FDI) Restrictions

The Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules) allow 100% FDI in the telecom sector, however, any FDI above 49% is subject to governmental approval.

The government has now decided to fully liberalised FDI in the telecom sector, permitting FDI up to 100% without government approval. The removal of the FDI barrier furthers the policy objective enumerated in the NDCP to attract investment of USD 100 billion in the digital communication sector.

The telecom sector in India has always been a sensitive and regulated sector and the government has been wary of allowing foreign participation. The liberalisation of FDI in the telecom sector is expected to attract more investment, with the increased inflow of FDI directly impacting infrastructure and job creation. This move will also pave the way for foreign operators and investors who have been hesitant to enter the sector, and to drive innovation and competition in the sector. The additional capital secured through FDI will serve as a shot in the arm for TSPs to help them fund crucial infrastructure and services required to deploy 5G networks and generate employment. This may also provide more flexibility to TSPs and enable them to raise investment to pay their existing dues and improve the state of their balance sheet through such deleveraging.

b. **Clearance process for Towers Eased**

To reduce administrative and procedural hurdles, the Union Cabinet has dispensed with the requirement for Standing Advisory Committee on Radio Frequency Allocation to conduct detailed technical evaluation for mobile towers. Instead, the DoT will now accept data on a self-declaration basis. Further, the approval process for installation of towers has been streamlined by linking portals of civil aviation, defence and/or other authorities with the DoT portal.

c. **Requirement of Customs Clearance for Import of Wireless Equipment Removed**

Pursuant to customs notification No. 71 dated 25 September 1953, the Wireless Planning and Co-ordination Wing (**WPC**) was required to grant a license for the import of any wireless equipment (**Import License**). This requirement has been done away with and replaced with a self-declaration process. This will likely address the bottleneck created in the import process and consequent delays in deployment of telecom networks. This should help in removing impediments that were preventing service providers from procuring the large-scale network infrastructure needed for network expansion in India.

3 Conclusion

The structural and procedural reforms provided by the Government should protect and generate employment opportunities, promote healthy competition, protect consumer interest, infuse liquidity, encourage investment and reduce regulatory burden on the TSPs. Additionally, as noted in the Press Release, this will likely also boost the proliferation and penetration of broadband and telecom connectivity throughout India. These reforms demonstrate the Indian government's commitment towards reforming the telecom sector in India, recognising the policy goals provided in NDCP with an aim for *universal coverage rather than revenue maximization*. Overall, this is a step forward and a long awaited relief provided to the industry players. That said, to take full effect, these reforms will need to be incorporated into the license terms issued by the DoT by way of an amendment to the existing licenses and other respective laws such as the NDI Rules.