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Subject: Mobile phone license allocation - time of recording

Reference: Your letter of 27/1/2016 n°03/DG75-G401/

Dear Mr Mahieu,

Thank you for the letter requesting Eurostat opinion on the time of recording of revenue from the mobile phone licenses allocation that took place in France in Dec 2015. After examining your request, please find below Eurostat's view on the time of recording to be followed for these transactions.

1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED

The French post and electronic communications regulatory authority (Autorité de régulation des communications électroniques et des postes – ARCEP) issued four Decisions (2015-1566, 2015-1567, 2015-1568 and 2015-1569) on 8 December 2015, allocating specific frequencies of the 700MHz band for use to four mobile phone companies. The decisions concern the use of these frequencies in metropolitan France (the overseas departments are not concerned).

The text of the decisions was not sent to Eurostat. The four decisions are available online at the website of ARCEP (<http://www.arcep.fr/>). The relevant points of the decisions are summarized below:

- On 8 Dec 2015 the French authorities (ARCEP) took four decisions to allocate to four different mobile phone operators specific frequencies in the 700MHz band, giving to them the right ("licence") to use specific frequencies to provide 4G mobile telephony services in metropolitan France.
- The decisions clarify that the licensees have the right to use the frequencies only from April 2016 onwards. As mentioned on the ARCEP website, currently the frequencies are used for television broadcasting.

- As specified in the decisions, frequencies become available for use progressively in specific areas of the French metropolitan territory starting April 2016 and until July 2019. According to the plan, by July 2019 the frequencies will be available for use in the entire metropolitan France (Annex 2 of the four decisions provides the details).
- The decisions specify the terms under which a licence can be transferred by the licensee to another company (Annex 1, par. 1.3.1 of the decisions), with reference to relevant national regulation.
- The four companies will pay a lump-sum totalling 2,798 mn EUR (payable in four equal instalments, the first of which must be paid upon issuance of the licence, and the others in successive intervals of 12 months). Additionally, the companies must pay an annual "frequency utilization fee" equal to 1% of their annual turnover coming from the exploitation of the allocated frequencies (Decree 2007-1532 of 24 Oct 2007 as modified).

The main methodological question (aside from which transaction should be treated in government accounts) concerns when should the revenue from these transactions be recorded in government accounts: at the time of the auction, when the licences become sellable, or later on?

2. METHODOLOGICAL ANALYSIS

1. Applicable rules

Under ESA 2010, the electromagnetic spectrum is recognised as a natural resource (AN.2151). Resource leases contracts concerning radio spectra are also explicitly referred to in ESA 2010 paragraphs 15.05 and 15.25. Applicable ESA 2010 rules for the recording on permits to use a natural resource (i.e. resource leases) are treated in paragraph 15.26 and 15.27 mainly (and ESA table 15.3), with supplementary considerations in paragraphs 15.28 to 15.30.

The case of allocation of mobile phone licences (also known as UMTS, "3G", or "4G" licences) is also treated in the MGDD VI.1.3.4 Box 1. Mobile phone licences can be treated as a sale of a non-produced non-financial asset or a rental depending on the following conditions.

If the licence is not transferable then the operation is treated as rent of the frequency. In this case, the proceeds are recorded as rent (D.45) spread over the entire duration of the contract.

If the government issues a permit which gives control of the frequencies for an extended period, and the transfer of risks and rewards results in a separate and transferable permit with a realisable value (ESA 2010 15.28), then the operation gives also rise to a non-produced non-financial asset (ESA 2010 15.27).

If the licence allows the "use to extinction" of the natural resource, then it is the underlying natural resource which is actually sold. In practice, this case is not likely to be applicable for the electromagnetic spectrum.

In any case, proceeds are recorded as net revenue at the time that the asset is allocated or during the period of lease, regardless of when payments are made.

2. Availability of the frequency for use

In many cases, the license holder has the right to actually use the frequency immediately upon allocation of the licence: the frequency is immediately available for use. However, in some cases, the licence specifically stipulates that the right to use the frequency is postponed until a later point in time. Typically, this is necessary because the frequencies are still in use for other purposes or by other corporations.

INSEE nonetheless appropriately remarks that the licence held by the holders acts as “*a sort of legal assurance*” which has “*immediate economic effect*” and which may be sold, such that the companies “*support the risks and rewards associated with potential holding gains and losses*”.

Under such a situation, in Eurostat's view, following the accrual principle, the moment when, or from when, net revenue can be recorded is the point in time when the frequencies become available. In case the transaction implies a rent recording, the rent can only commence when the frequencies are available for use by the licensee (this can be likened to when the tenant can access the premises). The licensees nonetheless hold a transferrable contract, which they record in their balance sheet, as a manifestation of their exposure to risks and rewards, under the category *Contracts, leases and licences* (AN.22), subcategory *Permits to use natural resources* (AN.222), (ESA 15.27).

When the transaction implies the disposal of a nonfinancial asset, the moment when the transaction actually takes place (i.e. when the asset changes economic owner) is not the moment when the “legal licence” is issued but the actual moment in time when the licensee becomes in practice the economic owner, and can reap benefits from the associated frequencies. The time when the licence is “legally” allocated, or the time when the licence becomes sellable, or the time of actual payment of the “fee”, is not relevant. If any payment takes place before the time when the frequencies become available for use, then this is treated as a financial advance.

The contract holder certainly owns an economic asset that acts as a sort of reassurance. This may be captured by a derivative contract (forward sale) if it is considered that the financial claims which the holder has do not sufficiently or adequately represent this reassurance.

Therefore, the time of recording of any revenue from allocating mobile phone licenses is the time when, or from when, the allocated frequencies actually become available for use by the licensee for commercial purposes under the license – and neither the time of auction, nor the time when the licence becomes sellable, nor the time of payment.

3. Application of the rules to the specific case

Transferability

As regards the specific cases of the aforementioned four licences allocated in December 2015, the first issue to be analysed is the transferability of the licences. As mentioned in the MGDD, typically in such cases some specific conditions on transferability may be imposed by the national law or regulation, namely:

- The transfer must not infringe market competition rules;
- Government (usually the market regulator) may want to impose conditions to ensure an uninterrupted service; therefore the technical and financial capability of the applicant should be reviewed.

Another term that has also been encountered in similar cases is the possibility that a transfer can be rejected for reasons of national security or public order.

If however, government has the right to unilaterally reject a transfer without providing a specific reason, or if the operator is obliged under the terms of the agreement to hold the licence until expiration, then the licence is deemed as not transferable.

As mentioned in Annex 1, par. 1.3.1 of the 700MHz licences in question, the licences are transferable subject to the conditions defined in articles R20-44-9-5 and L42-3 of the Code of Post and Electronic Communications¹. Licences for use of frequencies in the 700MHz band are defined as transferable both entirely as well as partially (art. L42-3 of the Code). Any transfer project is subject to the pre-authorization of ARCEP which can only refuse a transfer for one of the following reasons (see art. R20-44-9-5 and L42-1 of the Code):

1. Safeguarding public order, the needs of national defence, or public security;
2. To ensure the technically appropriate usage of the frequencies;
3. The lack of technical or financial capacity of the applicant to ensure the obligations under the licence;
4. The previous or current conviction of the applicant to sanctions from ARCEP, or the non-respect of terms of the procedure by the applicants;
5. The transfer must ensure that the original terms of the licence will still be met after the transfer;
6. Competition rules regarding access and utilisation of the spectrum.

Therefore, the four licences could be seen as transferable, under the authorization of ARCEP. In Eurostat's understanding, ARCEP may only refuse a transfer for one of the reasons mentioned above. These reasons are specific, and they pertain to ensuring quality and availability of the service (e.g. the technical/financial expertise of the applicant), reasons of national security, and satisfying the competition rules.

Therefore, based on the information available, Eurostat may accept INSEE's view that the four mobile phone licences in question (2015-1566, 2015-1567, 2015-1568 and 2015-1569) are transferable.

The operation therefore gives rise to a non-produced non-financial asset. The proceeds from the sale should be recorded at the time that the transaction takes place, which cannot be before the frequencies under the licence become available for use by the licensee.

Availability of the frequencies

The next question to be analysed is when to record the revenue from the sale of the licenses.

As noted in the four decisions, the allocated frequencies can actually be used by the operators progressively across France, from April 2016 onwards. The French metropolitan territory is

¹ The Code is available on-line at: <https://www.legifrance.gouv.fr/>

divided into 8 areas, and the frequencies become available for use in each area on the following dates (the same schedule is applicable for all four licences, as defined in Annex 1 and Annex 2 of the licences):

| Area | Effective Date of frequency allocation in the area |
|------|--|
| 0 | 6 Apr 2016 |
| 1 | 1 Jan 2018 |
| 2 | 1 Apr 2018 |
| 3 | 1 Jul 2018 |
| 4 | 1 Oct 2018 |
| 5 | 1 Jan 2019 |
| 6 | 1 Apr 2019 |
| 7 | 1 Jul 2019 |

It is planned that as of 1 July 2019 the frequencies will be available for use in the entire metropolitan France.

Eurostat considers that the economic value of a licence is not necessarily directly proportional to the surface of each area. A more relevant indicator is rather the population living in each area, since the economic benefit will depend on the number of mobile phone connections established under the licence, and this can be reasonably expected to be roughly proportional to the number of inhabitants in the area.

Therefore, the percentage of population living within each area may be a good estimate for the percentage of the revenue that should be allocated each time that the frequencies become available in an area.

The final recording of revenue will depend on the actual realisation of the plan, and the dates when frequencies will become available for use by the operators in each area (theoretically, an area may become available earlier or later than planned, e.g. due to previously unforeseen technical difficulties or other reasons).

Fee on turnover associated to the frequencies

According to applicable national law (Decree 2007-1532 of 24 Oct 2007 as modified), all license holders must also pay annually a fee of a non-fixed nature, which depends on the turnover from exploiting the licences. For the 700MHz frequencies this fee is equal to 1% of the annual turnover from exploiting the specific frequencies. The amounts could represent a significant fraction of the fixed (lump-sum) payment.

Eurostat holds the view that this fee should rather be treated as a rent of natural resources. A similar fee is applicable by law for the use of any frequency (i.e. this rule is not specific to the 700MHz band only).

3. CONCLUSION

Based on the above analysis, Eurostat considers that the proceeds (lump-sum amount) from selling the licenses should be recorded as a financial advance until the corresponding frequencies become available for use by the operators, under the license terms. Since

frequencies become available progressively in specific areas of metropolitan France (starting in April 2016 and onwards), the percentage of the population living in each area is a good estimate for the percentage of proceeds to be recorded per year/quarter when an area becomes available.

4. PROCEDURE

This preliminary view of Eurostat is based on the information provided by the French authorities and the information available to Eurostat. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information currently available and the assumptions made above, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-ante advice. Eurostat therefore publishes all official methodological advice (ex-ante and ex-post) given to Member States on its website. In case you have objections to the publication of this specific case, we would appreciate if you would let Eurostat know *before 21 March 2016*.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director