

**Summary of views on
Draft Telecommunications (Method for Determining Spectrum Utilization Fees)
(Third Generation Mobile Services) Regulation**

Issue	Views of mobile services operators on the proposed sections	Legal Service Division's comments on legal issues	Administration's response
Section 1 - Interpretation	<p><u>"Highest common royalty percentage"</u> SmarTone, in disagreeing with the 4th leaver rule, (see views on section 3 below), suggests to replace the term by "final common royalty percentage" as follows - "final common royalty percentage", in relation to an auction, means the royalty percentage bids offered by all the successful bidders at the auction when the number of remaining bidders is first equal to or less than four". Accordingly, the term "highest common royalty percentage" should be replaced by "final common royalty percentage" whenever it appears in the draft</p>	Whether the 4 th leaver rule or the 5 th leaver rule is to be adopted is a matter of policy.	<p><u>"Highest common royalty percentage"</u> Please see our response to section 3 below concerning the 4th leaver rule. The proposed definition serves to give effect to the Government's proposition to get the fair market price of the 3G licences.</p>

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	<p>Regulation.</p> <p><u>"Network turnover"</u></p> <p>There are concerns about the treatment of payments received from MVNOs and the obligations on MVNOs which are not yet spelt out.</p> <p>Hutchison considers that the turnover arising from or attributable to content and/or service provisioning should be excluded.</p> <p>Peoples considers that the term should only apply to the transmission of voice and data services and not any revenues associated with the content applied to such transmission.</p> <p>SmarTone seeks a clearer definition of the term in view of the complex revenue profile of future 3G operators.</p>	<p>The term "network turnover" is defined in the draft Regulation to mean the revenue arising from or attributable to the provision of any telecommunications services over any telecommunications network using the frequency bands assigned to a licensee.</p> <p>Section 2 of the Telecommunications Ordinance defines "telecommunications service" and "telecommunications network" as follows:</p> <ul style="list-style-type: none"> ● "telecommunications service" means a service for the carrying of communication by means of guided or unguided electromagnetic energy or both. ● "telecommunications network" means a system, or series of systems, for carrying communications by means of 	<p><u>"Network turnover"</u></p> <p>Our policy is that the royalty-based spectrum utilisation fee should be levied on network turnover only. Revenue from content and/or value added service provision should not be subject to royalty payment. (See LC Paper No. CB(3)592/00-01(01) on the Administration's response to industry deputations to the Bills Committee).</p> <p>Network turnover as defined will include all receipts by the licensee for use of the 3G network that transmits signals over the relevant frequencies. We agree with Legal Service Division's analysis on our proposed definition.</p> <p>Under the proposed definition, network turnover would include receipts from the following parties (whether internal, group, affiliated or independent):</p> <ol style="list-style-type: none"> (a) MVNOs (b) Content and service providers (c) Interconnecting carriers (interconnection

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	<p>New World also supports a clearer definition.</p>	<p>guided or unguided electromagnetic energy or both.</p> <p>"communication" is defined in the Ordinance to include any communication-</p> <p>(a) whether between persons and persons, things and things or persons and things; and</p> <p>(b) whether in the form of speech, music or other sounds; or text; or visual images whether or not animated; or signals in any other form or combination of forms.</p> <p>When the definition of "telecommunications service", "telecommunications network" and "communication" are applied to interpret "network turnover", it would appear that only revenue generated from a service for the carrying or transmission of communications over a telecommunications network will be taken into account in calculating the</p>	<p>charges for origination and termination of traffic)</p> <p>(d) Other operators for roaming onto the relevant network and frequencies</p> <p>It would <u>not</u> include:</p> <ol style="list-style-type: none"> 1. Receipts for provision of value-added content and applications (i.e. the portion attributable to the transmission of the signals would count as network turnover, but not the value-added element or premium for specific content or services) 3. Provision of other value-added services which do not use the 3G spectrum 4. Use of 2G spectrum or any other frequencies (even if they are used for 3G purposes or in conjunction with the 3G spectrum now being licensed) 5. Revenue from the sale or leasing of handsets or terminals.

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		network turnover.	
Section 3 - Auction to determine annual spectrum utilization fee payable (implemented as the "4 th leaver rule")	<p>All the 6 mobile services operators object to the proposal that the auction will continue until the 4th last bidder also withdraws and that the fees will be set at the bid of the 4th last bidder upon its withdrawal. The main reasons are -</p> <ul style="list-style-type: none"> ✧ The proposed auctioning method contradicts the underlying principles of an open auction, which by its nature and design should achieve the most economically efficient price by eliminating the bidders in excess of the intended number of successful bidders. ✧ Exacerbated by the "Dark Room" approach, the 4 remaining bidders will not know the identity of their competitors and will be bidding against each other. This can bring about inflammatory prices for the 	This is a policy issue.	<p><u>'4th leaver rule'</u></p> <p>We maintain that our prime objective is <u>not</u> to maximize revenues. Had the Government chosen to maximise revenue, it would have elected for an upfront cash payment auction by way of sealed bids where winners will be paying their respective bids. The Government noted the adverse changes in market environment and therefore decided to use royalty as the payment method.</p> <p>Our proposal must be assessed in its entirety to arrive at a balanced view. A royalty-based scheme fee will be more entry-promoting given the changing market environment. We will only require a 5-year rolling guarantee, as opposed to a full 15-year guarantee, during the 15-year licence period. We propose in our Draft Regulation that there would be an auction if there are five or more qualified bidders after the Pre-qualification Phase, and to award the spectrum at reserve price if only four or less bidders are pre-qualified.</p>

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	<p>licences above the fair market price.</p> <ul style="list-style-type: none"> ✧ The increment extracted by this 4th leaver rule unduly increases the financial burden of the 3G operators (one operator has expressed concern that the price may be pushed up by some 100% under the proposed approach). ✧ As revealed in overseas experience, the high cost of obtaining a licence will result in reduced capital available for network investment/expansion and delay the launch of 3G services. The additional financial burden on operators may be translated into high tariffs to be borne by 3G consumers. ✧ The 4th leaver rule is inconsistent with the Government's stated objective that revenue is not the primary concern. The proposed method is useful in yielding a 		<p>Against this background, the 4th leaver rule, when we conduct an auction under section 3 of the Draft Regulation, will strike a fair balance between the objectives of minimising the burden on licensees and obtaining a fair price for a scarce public resource. Moreover, the royalty percentage offered by the 4th leaver will set the <u>common</u> royalty percentage by all successful bidders, bearing in mind that the other successful bidders may be willing to offer higher royalty percentage. We therefore do not agree with the operators' view that the 4th leaver rule is unfair.</p> <p><u>'Confidentiality' feature</u></p> <p>The confidentiality feature of the auction design helps guard against collusion and promote entry by weaker bidders and new entrants.</p> <p>In terms of auction design, the 4th leaver rule cannot apply to an open auction. But we cannot emphasise more the importance of the confidentiality feature to achieve our auction objectives. Moreover, sealed bid tenders (such</p>

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Section 3(b)(ii)	<p>substantial windfall for the Government but lacks transparency and clarity.</p> <p>In general, the 6 operators consider that the fee level should be set at the current bid being offered by the last 4th bidder when the 5th bidder withdraws and that the auction should end upon withdrawal of the 5th bidder.</p> <p>CSL suggests that to address concerns about the Government's "public interest" expectations, a "reserve price" may be set as in the case where there are 4 or fewer bidders. It also queries whether the Government will apply similar rules when auctioning other Government-held assets.</p> <p><u>Licence fee to OFTA vis-à-vis the spectrum utilisation fee</u></p> <p>Since spectrum utilization fee will be charged based on the relevant</p>	<ul style="list-style-type: none"> ● Under section 7(2) of the Telecommunications Ordinance, 	<p>as in land tender) have been well accepted and widely practised. Its confidentiality feature does not affect its fairness or raise questions on transparency, whether from the bidders' angle or from the Government's.</p> <p><u>Licence fee to OFTA vis-à-vis the spectrum utilisation fee</u></p> <p>The fee components referred to in (a), (b) and (c) comprise the different bases for charging</p>

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	<p>minimum fee (for the first 5 years) and thereafter on the network turnover, Hutchison considers that the following fees for the carrier (mobile) licence should not be charged as they will constitute double charging and penalization of performing operators :</p> <p>(a) Fees based on the no. of base stations, (b) fees based on the no. of mobile stations, (c) fees based on the frequency spectrum assigned.</p> <p>SmarTone submits that the licence fee currently charged for the carrier(mobile) licence should not be levied in addition to the spectrum utilization fee.</p>	<p>SITB may by regulation prescribe the fees payable including for the grant and renewal of a carrier licence and by way of annual fees. It is a matter of policy for SITB to decide what should be included in the licence fees.</p> <ul style="list-style-type: none"> ● In section 32I(9)(a) of the Telecommunications Ordinance, as added by the Telecommunications (Amendment) Bill 2001, which was passed by LegCo on 16 May 2001, it is expressly provided that a spectrum utilization fee payable is a fee payable in addition to any fee prescribed by SITB under section 7(2) of the Ordinance. 	<p>the <u>licence fees</u> of mobile carrier licences, which is devised on a <u>cost-recovery</u> basis, as stipulated in Schedule 3 to the Telecommunications (Carrier Licences) Regulation. As OFTA incurs administration costs in issuing licences and ensuring compliance with licence conditions, it is necessary for OFTA to recover such cost from the licence fees.</p> <p>The spectrum utilization fees, on the other hand, are charged on a different basis, i.e., network turnover (subject to the minimum guaranteed payments as specified by SITB) for the use of spectrum which is a scarce public resource.</p>
Section 5 - Auction to remove connected bidders	<p><u>Resolution of Connected Bidders</u></p> <p>CSL considers that the issue of connected bidders should be resolved before the auction starts</p>	Section 32I(5) of the Telecommunications Ordinance, as added by the Telecommunications (Amendment) Bill 2001, which was passed by LegCo on 16 May 2001,	<p><u>Resolution of Connected Bidders</u></p> <p>Our rules are designed to achieve the objective that the same economic group will not have substantial interests in, or otherwise control,</p>

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	<p>as removal of connected bidders after the pre-qualification stage will inevitably increase the bidding price. CSL considers that the term "connected bidders" should be defined in the Regulation. Alternatively, the Regulation should at least specify who will be empowered to determine its meaning and the form in which such determination should be made.</p> <p>Hutchison suggests that resolution of connected bidders should be moved forward to the pre-qualification stage.</p> <p>SmarTone considers it unfair if a connected bidder is penalized by losing the licence or having to pay more by bidding in the cash auction under the "Dark Room" approach where the bidders may not even know they are connected. It believes that only when two connected bidders are unable to</p>	<p>provides that the criteria for determining whether 2 or more bidders are connected will be set out in the terms and conditions of the auction specified by TA. This arrangement is also reflected in section 5 of the draft Regulation.</p>	<p>more than one 3G licences. The rules provide the incentive for bidders to sort out the connection before the auction, rather than resort to the conduct of the cash auction under section 5 of the Draft Regulation.</p> <p>It would be in the interest of bidders' to take appropriate steps to remove connections before they submit their applications. Experience in Europe indeed shows that bidders will sort out their connections beforehand.</p> <p>To minimize the chances of having connected bidders and gaming opportunities, we will require bidders to submit a certificate at the Pre-qualification phase that they have not deliberately created any connections for the bidding exercise, and a declaration on any known connections to their best of their knowledge.</p> <p>That said, we must design our auction to cater for all eventualities. If there are indeed connected bidders among the successful bidders bidding, they will be given another chance to disconnect after the main auction. It is only when they fail to disconnect will they enter into</p>

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	<p>disconnect themselves should a cash auction be held. SmarTone suggests that the following provision should be added after section 5(a) -</p> <p>(b) In the first instance, connected bidders shall collaborate to cease being connected;</p> <p>(c) In the event that the collaboration mentioned in paragraph (b) fails, a cash auction would then be held to determine the successful bidder.</p> <p>Peoples considers that the pre-qualification should expressly forbid such association. Bidders who contravene the rule against connection should be required to forfeit deposits and the licence, if awarded.</p>	<p>This is a policy issue.</p>	<p>a cash auction to select the winner out of them.</p>

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	<p><u>Filling of Vacancy left by Unsuccessful Connected Bidders</u></p> <p>SmarTone points out that there is no clear provision in the draft Regulation to address the issue on how to allocate the licence(s) that is (are) returned from the unsuccessful connected bidder(s) after the cash auction has been held.</p>	<p>The draft Regulation sets out how the successful bidders in an auction are to be selected. TA will then issue the licences to the successful bidders. The 3G licence(s) and set(s) of frequency bands which have not been allocated may be allocated through another auction held in accordance with the draft Regulation.</p>	<p><u>Filling of Vacancy left by Unsuccessful Connected Bidders</u></p> <p>A connected bidder who has lost in the cash auction conducted under section 5 of the Draft Regulation will cease to be a successful bidder. The vacancy will be taken up by the next highest qualified bidder. This replacement bidder, in order to be qualified to take up the vacancy, must not be connected with the other three successful bidders, or if it is connected, must agree to disconnect. The ‘highest common royalty percentage’ will then be set, and indeed lowered, by this new replacement bidder. The definition of “highest common royalty percentage”, sections 3, 4 and 5 have already provided for the arrangement.</p>
<p>Section 6 - Auction to determine respective priority rights of successful bidders in the allocation of sets of</p>	<p>SmarTone seeks clarification on whether a minimum fee for spectrum allocation is payable for this cash auction, i.e. whether a successful bidder indifferent to the 4 sets of frequency may submit a \$0 bid.</p>	<p>Section 7 of the draft Regulation empowers SITB to specify the minimum fee of any spectrum utilization fee mentioned in a provision of the draft Regulation. The application of section 6 of the draft Regulation is subject to section 7. Accordingly, SITB's power to specify the minimum fee is equally</p>	<p>SITB will publish the reserve price for the cash auction to allocate the four sets of spectrum to the four successful bidders by notice in the Gazette. We consider that bidders should be allowed to bid any amount, including HK\$0, in this cash auction. All matters relating to the bidding schedule and the reserve price will be set out clearly in the Gazette.</p>

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frequency bands Section 6(b)(ii)	Peoples is of the view that the spectrum utilization fee to which the auction relates should not be payable before the licensee commences commercial service due to the uncertainty of obtaining commercially available/market proven infrastructure and handsets which may delay the launch of service.	applicable to the cash auction referred to in section 6 of the draft Regulation. This is a policy issue.	We do not think it appropriate to allow licensees to pay spectrum utilization fees only after the launch of commercial services. Bidders should have financial commitment to rollout the 3G service and bid in accordance with their own business plans.
Section 7 - Secretary may specify minimum fee of spectrum utilization fee	SmarTone considers that there should be explicit provision requiring SITB to conduct consultation before specifying the minimum fee. CSL considers that SITB should specify the minimum fee in consultation with the telecommunications industry and other affected persons.	This is a policy issue which has been discussed by the Bills Committee on the Telecommunications (Amendment) Bill 2001. The Administration has explained to the Bills Committee that having regard to the fact that the regulation made by SITB is subsidiary legislation subject to the scrutiny of the legislature, it is not appropriate to subject SITB to the	The industry's preference to have a low reserve price has already been taken into account. It is for the Government to determine the minimum price at which a scarce public resource is allocated, taking into account the interests of the public and the development of the telecommunications market. For the 3G licensing exercise, SITB will set the following minimum fees under section 7 of the draft regulation:-

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Section 7(b)(i) to (vii)	Peoples requires clearer explanation on these provisions.	<p>statutory obligation of consulting the industry on the exact level of the fee she would charge.</p> <p>Section 7(b)(i) to (vii) of the draft Regulation sets out the means by which SITB may specify the minimum fee of a spectrum utilization fee.</p>	<p>(i) the minimum royalty percentage, and the spectrum utilization fee payable over the 15-year licence period based on that minimum royalty percentage – they, as a whole, constitute what is commonly known as the ‘reserve price’; and</p> <p>(ii) the series of minimum payments of spectrum utilization fee over the 15-year licence period based on the highest common royalty percentage set by the fourth winner.</p> <p>The formulation in section 7(b)(i) to (vii) aims to sufficiently empower SITB to prescribe the said minimum fees. It is the same as the provision in section 32I(4)(a)(ii) in the Telecommunications (Amendment) Bill 2001 passed by the Legislative Council.</p>
Section 8 - Authority may promote, etc. an auction to which the method	SmarTone considers that there should be explicit provision requiring TA to conduct consultation before specifying the terms and conditions of an auction by notice published in the Gazette.	<p>(a) The notice that specifies the terms and conditions of an auction is not subsidiary legislation.</p> <p>(b) Section 6C of the Telecommunications Ordinance</p>	The issue was discussed by the Bills Committee. The TA has already carried out two rounds of consultation in March and October 2000 on the licensing framework for 3G. In January 2001, the TA has further conducted an industry workshop on open network requirement.

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mentioned in section 2 relates	CSL, Hutchison, New World and Sunday considers that TA should publish the full details of the auction design and process for consultation.	<p>provides that before performing any function or exercising any power under the Ordinance, TA may consult with (a) the persons who may be affected by the performance of that function or the exercise of that power or (b) members of the public.</p> <p>(c) This issue has been discussed by the Bills Committee on the Telecommunications (Amendment) Bill 2001. The Administration has agreed that the Government would consult as appropriate on the important principles of the terms and conditions of an auction or tender.</p>	<p>Recently in March 2001, the TA has consulted the public on the rules on connected bidders. We believe that there are sufficient consultation on all the important terms and conditions of the auction.</p> <p>Members may also wish to note that after the publication of the Information Memorandum, there will be sufficient time for bidders to prepare their applications before the start of the auction. The present plan is to allow eight weeks for the preparation.</p>
Other concerns	In submitting views on the draft subsidiary legislation, the operators have urged for the early release of the detailed process and rules of the spectrum auction. They also stress the importance of thorough consultation, particularly on issues relating to connected bidders,	This is a policy issue.	<p>Concerning the consultation on the auction rules and the Information Memorandum, please see our response above.</p> <p>As promised at the sub-committee meeting on 19 May, we would examine the release of more information and report to Members at its meeting on 29 May.</p>

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	confidentiality of the auction process (the unprecedented "Dark Room" approach), the arrangements for MVNOs etc. The industry also considers it necessary to be consulted on the Information Memorandum.		

Note :

CSL - Hong Kong CSL Limited

Hutchison - Hutchison Telecommunications Hong Kong Limited

New World - New World PCS Limited

Peoples - Peoples Telephone Company Limited

SmarTone - SmarTone Mobile Communications Limited

Sunday - Sunday Communications Limited

MVNOs - mobile virtual network operators

SITB - Secretary for Information Technology and Broadcasting

TA - Telecommunications Authority