

For information on 29 May 2001

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

Rules on “Connected Bidders”

Background

In making submissions to the meeting of the Subcommittee on Draft Telecommunications (Method of Determining Spectrum Utilization Fees)(Third Generation Mobile Services) Regulation on 19 May 2001, representatives of the six mobile network operators requested the Administration to provide more information on the aspects of the auction process and regulatory framework for 3G services that would affect their business plans.

2. On 23 March 2001, the Office of Telecommunications Authority (“OFTA”) issued a consultation paper on the proposed rules on “Connected Bidders” regarding the auctioning of spectrum for third generation mobile services, inviting comments and views from the public on the proposed rules. The mechanism to deal with “Connected Bidders” is considered necessary to:

- ◆ prevent collusion which would be against public interest and affect the integrity of the auction; and
- ◆ ensure that the market structure produced by the auctioning exercise would not adversely affect competition in the market for mobile services.

3. By the end of the consultation period, the Telecommunications Authority (“TA”) received six submissions from the existing second generation mobile services (“2G”) operators. Individual submissions can be found on OFTA’s website (www.ofta.gov.hk). This Statement presents and analyses the views and comments raised by the industry on the proposed rules on “Connected Bidders” and the TA’s responses.

4. A TA Statement summarizing the findings and conclusion of the consultation was issued on 25 May 2001. This Statement is attached to this paper for members’ information.

Office of the Telecommunications Authority
25 May 2001

Auctioning of Spectrum for Third Generation Mobile Services - Proposed Rules on “Connected Bidders”

Statement of the Telecommunications Authority

25 May 2001

Background

On 23 March 2001, the Office of Telecommunications Authority (“OFTA”) issued a consultation paper on the proposed rules on “Connected Bidders” regarding the auctioning of spectrum for third generation mobile services (“3G”) (“Consultation Paper”), inviting comments and views from the public on the proposed rules. The mechanism to deal with “Connected Bidders” is considered necessary to:

- (a) prevent collusion which would be against public interest and affect the integrity of the auction; and
- (b) ensure that the market structure produced by the auctioning exercise would not adversely affect competition in the market for mobile services.

2. The proposed rules are set out in Annex 2 of the Consultation Paper. By the end of the consultation period, the Telecommunications Authority (“TA”) received six submissions from the existing second generation mobile services (“2G”) operators. The respondents were:

- (a) Hong Kong CSL Ltd;
- (b) Hutchison Telephone Company Limited;
- (c) New World Mobility;
- (d) Peoples Telephone Company Limited;
- (e) SmarTone Mobile Communications Limited; and
- (f) SUNDAY.

Individual submissions can be viewed on OFTA’s website (www.ofta.gov.hk). This Statement presents and analyses the views and comments raised by the industry on the proposed rules on “Connected Bidders” and the TA’s responses.

Criteria for approving 2G bidding groups and announcement of their identities when approved

3. In the Consultation Paper, the TA proposes that various forms of joint bids or co-operation in a bid by more than one 2G operator require his consent and approval before such a bidding group is allowed to enter into the main auction phase. Some operators requested that the TA should spell out the criteria pursuant to which the TA will approve joint bids by 2G operators.

4. As stated in the Consultation Paper, in giving such consent, the TA's main consideration would be whether the collaboration between the 2G operators in the 3G bidding exercise and the subsequent rollout and operation of the 3G network would adversely affect competition in the mobile services market. The giving of consent by the TA for the purpose of the 3G bidding exercise will not prejudice in any manner any future decision of the TA with regard to proposals on merger or acquisition involving the 2G operators. The TA will review each submission, if any, on a case-by-case basis on its own merits by reference to such criteria.

5. There was comment that the definition of 2G bidding group is rather vague. Admittedly, the definition is intentionally drafted to be broad enough to cover any group with one bidder and two or more 2G operators, the purpose or effect of such grouping being that the 2G operators could cooperate or collaborate in the 3G bidding process. The TA would like to retain some flexibility in determining whether there are other circumstances involving a 2G bidding group which may have an impact on competition. Hence, it should be noted that the circumstances as set out in the definition are only illustrative examples of situations which TA may have a concern, and any applicant potentially involved in a 2G bidding group is advised to consult OFTA in advance if in doubt. To better reflect the TA's intention, paragraph (k) in the definition of 2G bidding group will be refined in the course of finalising the rules on "Connected Bidders".

6. Whilst this requirement to seek the TA's prior approval for any 2G bidding group has generally been accepted by the respondents, various operators requested that the TA should reveal the identities of such 2G bidding groups, if any, when consent and approval is given. In light of the importance of preservation of bidders' identities to our auction design, the TA has decided that he will not reveal the identity of any such 2G bidding

group when consent and approval is granted. However, such bidding groups will not be prevented from publishing such information themselves, if required by law or some other regulatory process.

7. If two 2G operators were discussing a merger (or acquisition) prior to submission of applications to bid, but had not entered into any legally binding agreement for such merger, they would be permitted to bid separately, without the need to seek TA's consent (subject to pre-qualifying). However, it would be a breach of the auction rules for two 2G operators to merge or agree to merge after submission of their respective applications to bid. In addition, bidders should not be in possession of confidential information in relation to each other with respect to the Hong Kong auction. Accordingly, as a precaution, any such discussions should therefore either be concluded and, where applicable, approved by the TA before the submission of applications, or suspended or terminated until after the entire auction process has ended.

Definitions of “connected bidder”, “indirect interest” and “participation”, etc.

8. A number of comments were received on these definitions. The wording of the ownership rules is still in draft and under consideration. The TA would like to highlight the principal comments of substance (as opposed to detailed drafting) and the TA's current intentions with respect to these comments as follows:-

- (a) Respondents suggested that the tests for determining whether a party falls within any of the aforesaid definitions should be objective (e.g. only using the 15% threshold in assessing indirect interests and participation). The TA is currently considering whether to extend the definition of Participation and Indirect Interest to include situations where an interest of less than 15% would, by contractual arrangements or otherwise, have the effect of creating a 15% or greater interest.
- (b) It was suggested that the rules should adopt the concepts of financing the bidder, assisting in the preparation of the bid, and the holding of confidential information in the definition of “Connected Bidder”. After considering the submissions, the TA maintains the view that it is not appropriate to introduce such concepts as the objective is to keep

the rules on “Connected Bidders” simple and with a degree of certainty to assist potential bidders.

- (c) There were requests that the 15% threshold used in the definitions should be raised. The TA does not intend to follow this suggestion. It should be noted that the relevant definitions including the use of the 15% threshold have been considered appropriate by the TA with reference to European precedents and after considering the market environment. In particular, 15% is considered the right level representing a significant minority interest at which one can assume a level of influence.
- (d) There were views that the definition of Participation should be amended to carve out all interests under 15%, whether held in listed or unlisted companies. The TA will take this into account in the course of refining the rules on “Connected Bidders”.

9. A number of other comments on detailed drafting were submitted, which have been noted and are under consideration. Some of these are highlighted below: -

- (a) As requested by some respondents, the definition of Confidential Information will be set out in the detailed auction rules.
- (b) There was also comment that the meaning of “voting power” should be defined by reference to a right to vote in a particular circumstance (such as the right to vote on an election of directors at a general meeting). The TA considers that it is not appropriate to confine the meaning of “voting power” in such a restrictive manner as suggested by the respondent and maintains the view that the definition should remain as currently drafted.
- (c) There was also a suggestion to include conditional entitlements created before 20 March 2000. The TA considers that this “cut-off” date is sensible as this is the date on which the earliest consultation paper on 3G licensing was published by OFTA and therefore arrangements created prior to that date could not have been entered into with a view to avoiding the application of the rules on “Connected Bidders”.

- (d) It was suggested by one respondent that the definition of “Connected Bidder” should be clarified as it was unclear whether the situations outlined in paragraphs (a) to (e) of the definition were meant to be exhaustive. The TA confirms that the definition is intended to be exhaustive and, for the sake of clarity, appropriate drafting changes would be made to refine the definition.

Conclusions

10. After due and careful consideration of the submissions received, the TA does not envisage any major changes to the rules on “Connected Bidders” regarding the auctioning of spectrum for 3G, except for those as discussed in this Statement. The TA will take into account drafting comments and other suggestions contained in the submissions, as appropriate, in the course of finalising the rules on “Connected Bidders”.

Office of the Telecommunications Authority
25 May 2001