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- **Introduction**

This note provides a briefing to the Sub-committee on:

- Specific topics of the auction design:
 - Key pre-qualification criteria
 - Methodology in resolving tied-bids
 - Results of the consultation on the proposed connected bidder rules
 - Principal reasons for using 4th price auction
- General overview of the auction mechanics and discussion of information which will be made publicly available during each phase of the auction

2. Auction Design – Specific Topics

2.1 Key pre-qualification criteria

- Provision of deposit in the form of cash or letter of credit:
 - Interest earned on deposits will be passed back to applicants
- Provision of certificate:
 - No other bidders under common control
 - Declaration of any known connection
 - Have not deliberately arranged connection with any other bidders
- Provision of sufficient information requested (e.g. corporate structure, etc.)
- Acceptance of licence conditions:
 - Population coverage commitment by all licensees in 5-years' time after licensing
 - Minimum quality of service
 - Commitment by existing 2G operators which are successful winners of the 3G licences to provide roaming to new entrants



**Light pre-qualification criteria to promote entry while ensuring quality of network.
Applicants will have high certainty of pre-qualification when applications are submitted**

2. Auction Design – Specific Topics

2.2 Resolution of tied bids

Various options considered, including:

- Allowing tied bidders to bid up to the next increment – if tie remains unresolved, then draw lots
- All bidders restarting at the tied bid level
- Timing of receipt of bid
- Drawing lots

Considerations:

- Fair and effective
- Reduce gaming opportunities
- Fits overall design

2.2 Resolution of tied bids (cont'd)

Pros and cons of the first two options

Tied bidders bid to bottom of next increment

Pros

- Simple and quick mechanism
- No interruption to the auction process
- Tied bidders who have already withdrawn are allowed to bid one more time and up to the next increment before chosen by random method

Full restart at tied level

Pros

- Random method only used if same tied bidders tie again at same level

Cons

- Higher chance of interruption to the auction process when tie occurs which may create uncertainty to all bidders
- May create gaming opportunities to bidders
- Higher possibility of collusion



Auction design allows for specific bids confirming the last price within each increment, therefore chosen method: tied bidders bid to bottom of next increment

2.3 Connected bidder rules

- Consultation on connected bidder rules completed in April 2001 with six submissions received
- Major comments and questions raised:
 - TA's key considerations in approving joint bids by 2G operators
 - Comments on definition of 2G bidding group and circumstances where TA's consent is required
 - Definitions of connected bidders, indirect interest and participation



Principles of the rules generally accepted by the industry

2.3 Connected bidder rules (cont'd)

Summary of major views from consultation and OFTA's responses

| Views and comments received | OFTA's responses |
|--|---|
| Criteria for approving 2G bidding group and announcement of approvals | <ul style="list-style-type: none"> • TA's main consideration - whether this would adversely affect competition in the mobile services market. TA will not reveal their identities when approved • Definition of 2G bidding group is intended to be broad • If two 2G operators were discussing merger (but no legal binding agreement entered), they can bid separately and TA's consent is not required. But it will be a breach of auction rules if merger agreement is entered into during the auction |
| Definitions of "connected bidder", "indirect interest" and "participation" | <ul style="list-style-type: none"> • TA does not intend to introduce the concepts of financing the bidders, assisting the preparation of bids, etc. to preserve the 15% threshold and also keep the rules simple • 15% threshold is intended to apply to all companies, listed or unlisted, and is considered appropriate after considering market conditions and with reference to European precedents • Use of 20 March 2000 as the cut-off date for conditional interests is sensible as this was the published date of the earliest consultation on Hong Kong 3G • A pre-qualification requirement by bidders that they have not deliberately arranged for connection with other bidders will improve the auction process |
| Other detailed drafting comments | <ul style="list-style-type: none"> • Comments will be carefully considered when finalising the connected bidder rules |

2.4 Principal reasons for confidentiality and 4th price

- The principal entry-promoting benefits of our auction design will be maximised when both the “confidentiality” and “4th price” features are used together

- We again set out below the Government’s principal policy objectives:
 - Promote entry
 - Promote development of telecoms industry
 - Preserve market competition
 - Maximise benefits to the economy
 - Prevent collusion
 - Maximisation of revenue to Government is **not** its primary objective (otherwise bidders could simply be forced to pay upfront cash at the price they bid)



Auction designed to achieve Government’s stated objectives

2.4 Principal reasons for confidentiality and 4th price (cont'd)

Entry promotion is one of the most important Government's policy objectives which would.....

- Further promote the development of the telecoms industry and maximise benefits to the economy
- Preserve market competition in the telecoms industry

..... however, a comprehensive set of strong pro-entry features must exist in order to attract new entrants

- Royalty-based spectrum utilisation fees
 - Confidentiality
 - Light pre-qualification criteria
 - Low cost of bidding
- } **But rules ensure only serious bidders will be allowed to enter auction**



New entrants will only participate if there is a chance to win. Recent experience in Europe shows that open auctions can be vulnerable to manipulation

2.4 Principal reasons for confidentiality and 4th price (cont'd)

Confidentiality and 4th price are not new concepts to Hong Kong.....

Land tenders

- Land tenders by way of sealed bids have been used previously in Hong Kong
- Winners will pay the price of its bid, not the bids of the losing bidders

Other public contracts

- Commonly conducted by way of tender where participants do not necessarily know identities and number of competitors
- Offer accepted is the winning tenderer's – not its nearest competitors

3. Auction Mechanics

3.1 General overview

Application and pre-qualification

- Each applicant will be required to submit its application form, together with necessary supporting documents
- Deposit to be paid at the same time
- Each pre-qualified bidder will be notified upon pre-qualification. Representatives of each qualified bidder will then be required to report to a designated location at a specified time
- Disqualified applicants will also be notified upon disqualification

3.1 General overview (cont'd)

Main phase auction

- Representatives will be required to stay at the auction location until the main phase auction ends (no more than one day)
- Communications equipment will be provided. External communications will not be permitted (vital to prevent collusion)
- Government observers will be present at each auction location

3.1 General overview (cont'd)

Second phase auction (connected bidder phase)

- Provisional winners given a period to certify no connections
- Connected bidders given short period to provide irrevocable undertaking to disconnect. Failure to do so leads to bidding
- Each connected bidder will be notified of the time and location to which a single sealed bid must be submitted (for an upfront cash payment)

Third phase auction (specific licence allocation phase)

- Each bidder will be notified of the time and location of the third phase auction
- Each bidder will be required to submit a sealed bid by way of an upfront cash payment which will be used to determine the priority for choosing a specific licence

3.2 Disclosure of information during each phase of the auction

Key considerations:

- Maximum transparency
- Minimise opportunities for collusion
- Preserve integrity of the process through adequate checks (e.g. observer system, full account of events given)

3.2 Disclosure of information during each phase of the auction (cont'd)

Main phase auction

During the main phase

- Public broadcasting of the progress of bidding increments via OFTA's website with a minimal time lag (similar to the UK auction)

Public announcement immediately after the main phase

- Identities of the provisional winners
- Provisional royalty percentage

3.2 Disclosure of information during each phase of the auction (cont'd)

Second phase auction (connected bidder phase)

Before the second phase

- Identities of connected bidders, if any
- Whether such connected bidders commit to separate (if yes, then no second phase auction will be required)

Completion of the second phase

Public announcement after the second phase

- A full account of the auction process, including:
 - Identities of successful bidders and the applicable royalty percentage
 - Identities of the unsuccessful bidders and their respective bids
 - Outcome of the disconnection amongst bidders and the cash bids, if any, from connected bidders
- If no connection amongst the four provisional winners, the final result will be announced soon after the completion of the main phase

3.2 Disclosure of information during each phase of the auction (cont'd)

Third phase auction (specific licence allocation phase)

Announcement after the third phase

- Amounts of bid by each bidder in this phase
- Specific licence allocated to each winner

Government's goal is to provide maximum transparency without weakening the anti-collusive effects of the "confidentiality" feature