

1<sup>st</sup> June, 2001

Our ref.: TG/PM/010601/01

Legislative Council Secretariat,  
3/F Citibank Tower,  
Garden Road,  
Central,  
Hong Kong

**By fax (2121 0420) and email**

Attn: Hon. James Tien  
Chairman of Subcommittee

Dear Hon James Tien,

**Re : Supplementary information for the Sub-committee Meeting held on 29 May 2001 on draft Telecommunications (Method for Determining Spectrum Utilization Fees) Third Generation Mobile Services) Regulation and draft Telecommunications (Designation of Frequency Bands Subject to Payment of Spectrum Utilization Fees) Order**

Regarding the captioned meeting, it was found that some of the views presented by the Government's consultant on 4<sup>th</sup> leaver rule and the overall 3G license auction design are not at all complete. SmarTone therefore would like to submit further information for the Subcommittee's consideration.

SmarTone would also like to take this opportunity to re-state that SmarTone has always been in support of the Government's policy objectives such as promoting entry, promoting telecom industry development, preserving market competition, preventing collusion and maximizing benefits to the economy. However, SmarTone is also equally concerned that the current proposed auction design unfortunately will not meet the above objectives.

As always, SmarTone would be happy to provide any further clarification or information and further discuss with the Subcommittee of the Legislative Council.

Yours faithfully,  
For and on behalf of  
SmarTone Mobile Communications Limited

Ian C. Stone  
Chief Executive Officer

Encl.

**SmarTone's View on Verbal and Written Information Released by ITBB/OFTA/Rothschild during the 29 May 2001 Subcommittee Meeting**

Item	Written and verbal information released by ITBB/OFTA/Rothschild during 29 May 2001 LegCo Sub-committee meeting	Our Views
1.	<b>Policy Objectives:</b>	
1.1	Promote entry	Will not promote entry since the current auction design is complex, not transparent, look secretive, experimental and untested.
1.2	Promote development of telecom industry	The 4 <sup>th</sup> leaver rule will allow the royalty rate to be pushed artificially to an inefficiently and unpredictably high level. The extra amount of royalty derived represents a transfer (tax) from future consumers to the Government. The higher cost base for operators may also slow down 3G rollout and development.
1.3	Preserve market competition	The “Open Network Requirement” has already provided such protection. Simple, proven and robust open auction design should be used instead.
1.4	Maximize benefits to the economy	<p>The 4<sup>th</sup> leaver rule will only serve to maximize the royalty rate. However, it is not clear how the Government will plough the money back to the industry and the economy. The Singapore Government will set aside up to S\$200 million from the 3G auction to support a programme called the “Wired with Wireless”. The programme will stimulate the development of wireless technology, infrastructure, products and services, as well as industry and consumer adoption. However, there is no similar policy from the Hong Kong SAR Government.</p> <p>Moreover, 3G licensees have to pay profit tax on top of the royalty payment anyway. It will be a benefit to the overall economy if the industry and the consumers do not need to pay the extra amount</p>

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		generated by exploiting the 4 <sup>th</sup> leaver rule; hence enabling deeper 3G innovation and development.
1.5	Prevent collusion	The “cure” of depriving bidders of all information about other bidders is far worse than the perceived problem of collusion.
1.6	Maximization of revenue to Government is not its primary objective	The 5 <sup>th</sup> leaver rule will serve to find the market price when supply = demand.

2.	Overall Auction Design:	
2.1	All mobile operators agreed the overall auction design except the 4 <sup>th</sup> leaver rule since what the operators want is to pay less to the Government.	<p>All the mobile operators have been requesting for an open, fair and transparent auction which can determine the fair market price. They are not asking for getting a lower price. All international auctions conducted so far adopted the approach of achieving a fair price when supply = demand. Any price above market price is a tax.</p> <p>All 6 mobile operators have submitted their comments that they are not just against the 4<sup>th</sup> leaver rule but also</p> <ul style="list-style-type: none"> <li>• against the dark room approach.</li> <li>• request for more information to be released regarding the detailed auction design.</li> </ul>
2.2	The citizens of Hong Kong may suffer if the 3G licensees get the licensee and then resell to others to make profits	It is up to the Government to design measures to control the resale of the licence. This part of the design rule has not been released by the Government yet.

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		<p>In its previous response submission to OFTA's consultation, SmarTone also suggested that measures should be added to discourage any mere arbitragers. Such arbitragers may have no commitment to 3G in Hong Kong but only intend to exploit the weaknesses in the auction design to ludicrously overbid a committed operator who would be forced to acquire a licence after the auction.</p>
2.3	<p>Qualified bidder should have one value in their mind for the valuation of the licence and that value should become his bid ceiling during the auction.</p>	<p>3G business case is recognized internationally as highly uncertain. As 3G is such a new and untried technology, an open auction process would help bidders fairly value the licence based on the market information generated by the auction.</p>
2.4	<p>There have been many rounds of public consultation, industry workshops and all important information has been released by the Government.</p>	<p>Only high level auction design has been released so far, not the entire draft Information Memorandum (IM). The piecemeal information released by the Government so far is just the tip of an ice-berg.</p> <p>It is international practice for the governments to release the draft IM for public consultation (e.g. Singapore, UK, Australia).</p> <p><u>UK:</u></p> <ul style="list-style-type: none"> <li>• First round consultation started in July 1997</li> <li>• Preliminary Information Memorandum released for public comment in June 1999</li> <li>• A very long consultation period on the Preliminary Information Memorandum was provided and a Question and Answer service was provided by the Government. 101 questions and answers</li> </ul>

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		<p>were posted on the following website as a result of the public consultation on the Preliminary Information Memorandum:</p> <p><a href="http://www.spectrumauctions.gov.uk/Information%20Memorandum/index.htm">http://www.spectrumauctions.gov.uk/Information%20Memorandum/index.htm</a></p> <ul style="list-style-type: none"> <li>• Final Information Memorandum Published: 1<sup>st</sup> Nov 1999</li> <li>• Application deadline: 1 January 2000</li> <li>• Auction completed in March 2000</li> </ul> <p><u>Australia:</u></p> <ul style="list-style-type: none"> <li>• Information Memorandum released: Nov 2000</li> <li>• Opening of applications: 6 December</li> <li>• Closing of applications: 12 February 2001</li> <li>• Auction started: 15 March 2001</li> </ul> <p><u>Singapore:</u></p> <ul style="list-style-type: none"> <li>• Draft Information Memorandum released: 22 Jan 2001</li> <li>• Consultation on Draft Information Memorandum ended: 12 Feb 2001</li> <li>• Final Information Memorandum released and start of application:</li> </ul>

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	8 weeks will be given to the potential bidders to comment on the IM.	<p>8 March 2001</p> <ul style="list-style-type: none"> <li>• End of application: 26 March 2001</li> <li>• 3G licensing completed on 11 April</li> <li>• No auction carried out since only 4 applicants for 4 licences</li> </ul> <p>In summary, these 3 countries’ Governments have been much more responsive and receptive to the industry’s views.</p> <p>The 8 weeks mentioned by the Government is for bidders to prepare for the bidding, and not for commenting on the draft IM as suggested by the Government in the meeting.</p>
2.5	The auction will be transparent since the Government will disclose information during each phase of the auction	The display of information is only a replay. Activities are only known or exposed after the auction and may become controversial or too late to change. The auction looks secretive and inconsistent with open government decision-making, and it may subject to high risk of post-auction challenge by unsuccessful bidders.
<b>3.</b>	<b>4<sup>th</sup> Leaver Rule:</b>	
3.1	Hong Kong is not the first place to conduct “4 <sup>th</sup> leaver rule”. Denmark will also use the 4 <sup>th</sup> leaver rule.	<p>The Denmark auction is totally not a relevant case.</p> <ul style="list-style-type: none"> <li>• Hong Kong auction is a multi-round auction which is dynamic and 4<sup>th</sup> leaver rule can drive the royalty rate to an artificially and unpredictably high rate; but Denmark auction is a one round</li> </ul>

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		<p>sealed bid which is static and will not drive up the price. In Denmark, all winners will pay the lowest of the winning bids.</p> <ul style="list-style-type: none"> <li>• Moreover, Denmark's auction has not even started and will be held only in August 2001.</li> </ul>
3.2	<p>Confidentiality and 4<sup>th</sup> price are not new concepts to Hong Kong since there are precedent cases in land tenders:</p> <ul style="list-style-type: none"> <li>• Land tenders by way of sealed bids have been used previously in Hong Kong</li> <li>• Winners will pay the price of its bid, not the bids of the losing bidders</li> </ul>	<p>Land tenders and spectrum auction are not comparable cases:</p> <ul style="list-style-type: none"> <li>• In land tender, all the bidders have relatively good information about the valuation of the land before the auction. However, 3G business case is still uncertain and there has not been any precedent case locally in Hong Kong.</li> <li>• If one fails in a land tender, one can bid for other lots in the future. In 3G arena, it is unsure when the Government will issue further 3G licences and when 2G refarming will be technically feasible.</li> <li>• In land tender, winner will pay the price of its bid because there is only one winner for one lot of land. In 3G auction, there are 4 spectrums for 4 winners.</li> </ul>