

BY POST & FAX (2121-0420)

The Hon. James Tien Pei-Chun, JP,
Legislative Council Building,
8 Jackson Road,
Central,
Hong Kong



7 June 2001

Dear Mr. Chairman,

Subcommittee on draft telecommunications (Method of Determining Spectrum Utilization Fees) (Third Generation Mobile Services) Regulation

We write further to the Subcommittee meeting on 4 June 2001 to clarify a possible misunderstanding on CSL's position which might have taken place in the said meeting.

We understand that the Subcommittee noted that CSL, among some of the other operators, has not given any further response to the views presented by the Telecommunications Authority on 29 May 2001 in respect of the two stage screening process. We are concerned that this might have been taken as an indication that CSL is satisfied with the arguments presented by the Telecommunications Authority. We would therefore like to clarify that our silence does not constitute an agreement with the Administration's views, and we maintain our reservations on the proposed auction rules, in particular, the fourth leaver rule and two stage screening process. We are also firmly of the view that full details of the auction process and license conditions should be disclosed for industry consultation.

To allow you a more comprehensive understanding of CSL's position, we have set out our views on these issues in the summary attached herewith for your information. If we can be of any further assistance, please do not hesitate to contact us.

Yours sincerely,

Hubert Ng
Chief Executive Officer

CSL'S VIEWS ON THE PRESENTATION HELD BY THE ADMINISTRATION ON 29 MAY 2001

1. Fourth Leaver Rule

The TA believes that the fourth leaver rule method represents the fair market price, and is comparable to land auctions where the winner will pay the price of its bid. CSL's views are as follows:

- The TA's statement that the operators object to the fourth leaver rule because they want to pay less to the government is incorrect. CSL maintains that the fifth leaver method represents fair market value and calls for a fair auction where normal transparent market forces determine the price, not the complex auction rules which can result in an artificially inflated royalty rate. Bearing in mind the current, relatively shattered financial state of the mobile industry, it is evident that imposing an extra financial burden on the industry will result in mobile operators having no choice but to transfer excessive fees to consumers. This is clearly contradictory to the government's policy to promote the development of the telecom industry and maximize benefits to consumers and the overall economy. Fair market price should also be in the interest of the government as the repercussions of a handicapped mobile industry will reflect to the entire Hong Kong economy.
- Denmark is not comparable to the proposed 3G auction for Hong Kong as it is a one round sealed bid auction and its potential success or failure is unknown as it is scheduled for September 2001. Furthermore, a sealed bid process is not comparable to an ongoing process where a bidder is placed in the position of making the spot decision of whether to unknowingly bid against itself.
- Whether or not land auctions are comparable to the proposed spectrum auction is not necessarily at issue. The question which is raised however, is that if the proposed methods for spectrum auction are required to both prevent collusion and to determine fair market value for a public asset, then it stands to reason that the government will introduce this method for other auctions, eg. for land. It would seem difficult to argue that the property industry is any less prone to collusion than the telecommunications industry and, if it is believed that fair market value is best determined by having a bidder continue bidding against itself in a dark room, then this is equally applicable in auctioning any public asset, whether it be a single asset or multiple assets. If the government has no intention to adopt the proposed spectrum auction method for other industries, by what reasoning does it single out the telecommunications industry for such treatment?

2. Further Consultation

The administration has represented that all mobile operators have agreed to the overall auction design and that no further consultation is necessary as the Information Memorandum will contain no surprises. CSL strongly disagrees in that:

- CSL among the other operators has voiced its concerns over the lack of transparency and full disclosure of the licensing framework. The TA has not released the full details of the Information Memorandum for consultation, only one detailed industry workshop on licence conditions (open network) and one on the auction process itself (connected bidders) have been conducted. Instead, the TA has categorically ignored the industry's requests.
- It is impossible to make a complete and justifiable business case and preparations for auction based on the information available presently. The consultation papers contain vague draft provisions on such crucial elements as performance bonds and the method for measuring the 3G network revenue which will be subject to royalty. Details of these provisions have not been released to the industry for their consideration and yet they irrefutably affect the way the licensee operates his business. For example,
 - How is the bidder going to approach its bankers in sufficient time to secure necessary backing for any required pre-qualification performance bonds
 - How is the potential bidder able to prepare and present its business case to its board in sufficient time for approval to participate in the auction
- The TA defends by saying that auction rules in other jurisdictions have also faced criticism. That may be true but it is an established practice in other developed jurisdictions that the administration provides full details of the licensing framework for consultation before the licensing process begins. These administrations have found this useful and indeed, valuable comments from industry have resulted in changes to the licensing framework in these jurisdictions.
- Bearing in mind the technical and commercial uncertainties relating to 3G, it is of utmost importance to have all relevant information available in sufficient detail and with sufficient notification in order for the potential bidders to plan their business case and make decisions and arrangements for pre-qualification to auction. The licensing framework in its current form is complex, insufficient in its details and experimental, and will hardly promote entry to the Hong Kong telecommunications market.

3. Dark Room and Two Stage Screening for Connected Bidders

The administration insisted on the dark room method and a two stage screening process under confidentiality to ensure that no collusion takes place. CSL's views are as follows:

- Availability of information which is necessary to assess the business value of a licence is not collusion. The value of a licence cannot be determined in a vacuum but requires knowledge of the identity and credentials of the other bidders entering and remaining in the auction. Knowledge of the identity of other bidders for 3G licences is essential for a bidder to assess the competitive landscape within which the successful bidder must later compete. Bidders must determine if the price to be paid for a licence can be borne in a marketplace where they are competing with the other active bidders, likely being winners. No responsible company will enter into a marketplace without reasonable knowledge of its competitors.
- The two stage screening process and dark room do not allow transparency and are prone to result in a controversial aftermath. For example, the TA has discretionary powers to decide behind closed doors whether the combined forces of two 2G licencees bidding and winning a

3G licence represents a change to the competitive marketplace. Indeed, such decisions will affect the state of competition in the telecommunications marketplace of Hong Kong and this represents information which **all** bidders have the right to know before bidding in auction. Furthermore, there is no opportunity to challenge the TA's decision during the auction process. A recourse, if any, is available only after the auction has been carried out. This can lead to prolonged and complicated judicial review of the TA's decision and will certainly impair Hong Kong's international reputation as an attractive and transparent telecommunication hub.

- The proposed means to overcome the potential problem of collusion are excessive given that the bidders are not allowed to access information which is necessary to prepare their business cases. As far as international experiences are concerned, collusion in open auction is rare. Also, the dark room and two stage screening system do not guarantee an environment which would not be open for manipulation. The government should be fully capable of determining and resolving connected bidder issues prior to the start of the auction. All other jurisdictions throughout the world have dealt with competition and collusion concerns without having to resort to the unusual licence auction practices currently proposed in Hong Kong.