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Legislative Council

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Legislative Council
Panel on Information Technology and Broadcasting

Minutes of special meeting
held on Thursday, 22 February 2001, at 4:30 pm
in the Chamber of the Legislative Council Building

Members present :
Hon SIN Chung-kai (Chairman)
Hon Kenneth TING Woo-shou, JP
Hon Eric LI Ka-cheung, JP
Hon CHAN Kwok-keung
Hon YEUNG Yiu-chung
Hon Emily LAU Wai-hing, JP

Members absent :
Hon Howard YOUNG, JP (Deputy Chairman)
Hon David CHU Yu-lin
Dr Hon Philip WONG Yu-hong
Hon Timothy FOK Tsun-ting, SBS, JP
Hon LAW Chi-kwong, JP

Public officers attending :
Mrs Carrie YAU
Secretary for Information Technology and Broadcasting

Mr A S K WONG
Director-General of Telecommunications

Ms Eva CHENG
Deputy Secretary for Information Technology and Broadcasting

Ms Gracie FOO
Principal Assistant Secretary for Information Technology and Broadcasting (E)

Clerk in attendance : Miss Polly YEUNG
Chief Assistant Secretary (1)3

Staff in attendance : Ms Sarah YUEN
Senior Assistant Secretary (1)SC

I Briefing by the Administration on the licensing framework for third-generation mobile services
(The relevant LegCo Brief (File Ref.: ITBB CR 7/23/10(01), LC Paper No. CB(1)631/00-01 and a set of power-point presentation material tabled at the meeting and circulated thereafter vide LC Paper No.CB(1)655/00-01)

The Secretary for Information Technology and Broadcasting (SITB) informed members that the licensing and regulatory framework of third-generation (3G) mobile services presently announced was the outcome of extensive consultation conducted by the Telecommunications Authority (TA) in March and October 2000, followed by an industry workshop on open network requirement in January 2001. She then briefed members with the aid of power-point presentation on the Government's policy objectives in relation to 3G licensing, the current market conditions, the proposed selection method and number of licences, and the various payment options considered. The Deputy Secretary for Information Technology and Broadcasting (DS/ITB) elaborated on the proposed payment method and the auction design, while the Director-General of Telecommunications (DG Tel) briefed members on the proposed regulatory framework and public consultation conducted. As for the way forward, DS/ITB advised that the Administration aimed at early finalization of the method for determining spectrum utilization fee, the detailed design of the auctioning process and the terms and conditions for inviting applications in time to enable licences to be issued around mid-2001 as planned.

2. Mr Eric LI declared his interest as an independent, non-executive director of SmarTone Telecommunications Holdings Ltd.

The licensing method

3. While supporting the proposed hybrid licensing method of pre-qualification and spectrum auctioning, Miss Emily LAU enquired whether the method was unprecedented. In reply, SITB confirmed that although spectrum auctions had been conducted elsewhere, the presently proposed auctioning of spectrum based on bidding of royalty percentages was a new attempt. She and DS/ITB however assured members that the Administration was well aware of the importance of devising a set of effective rules for this novel licensee selection process, bearing in mind the objectives of the auction and the need to prevent collusive activities. The Administration would work closely with the consultant.

4. In this regard, Miss Emily LAU was keen to ensure that the consultant tasked to advise on this unprecedented licence allocation process had the right calibre, experience and knowledge. In response, SITB pointed out that the consultant was well experienced in spectrum auctions and had provided consultancy in the UK and the Belgian exercises. DS/ITB supplemented that the consultant was a consortium comprising professionals from various sectors to provide a broad range of expert advice ranging from strategy formulation (including "game theory"), financial and economic modeling, detailed design of auction rules and procedures, and related legal, regulatory and technical advice, etc.

5. Mr Eric LI opined that the proposed auctioning method was creative and appropriate under the current market environment where capital raising was difficult. He therefore urged the Government to proceed with the exercise without delay for fear that the method might become inappropriate when the market environment changed.

The market response

6. Regarding members' concern about the market response in consideration of the uncertainty over the business environment of 3G services, DS/ITB said that while the recent adjustments in technology related and telecommunications businesses might affect potential operators' ability and interest in bidding for the 3G licence and that it might be too early to make an estimate on the number of bidders, the auction payment method had already been designed in such a way as to promote entry by minimizing the upfront financial burden on prospective licensees' funding requirement. The Administration believed that most existing second generation (2G) mobile services operators would be interested in bidding for 3G spectrum prior to the expiry of their existing licences. The Administration was also given to understand that a number of overseas companies might be interested.

7. Miss Emily LAU was concerned that the proposal to allow incumbent 2G operators which failed to obtain 3G licences to provide 3G services within their assigned 2G bands might affect 2G operators' interest in bidding for 3G spectrum prior to the expiry of their existing licences. In response, DG Tel stressed that the most important thing was to set out and inform 2G operators of all the rules and conditions for the award of 3G licences to enable them to make an informed decision on whether or not to bid for the 3G licence before their 2G licences expired. As to the question of how to deal with the 2G licences when they expired, it would be the subject of another consultation nearer the time.

The auction

8. In reply to members' questions about the detailed auction design, DS/ITB assured members that the auctioning rules to be adopted would be pro-entry and the details would be spelt out in the information memorandum to be issued by TA after the enactment of the Telecommunications (Amendment) Bill 2001 and its regulations.

Admin

In this connection, members requested early sight of the draft of the memorandum. At the request of the Chairman, the Administration agreed to provide a paper setting out the key issues to be included in the memorandum for the consideration of the Bills Committee set up to scrutinize the Bill. DS/ITB also noted the Chairman's proposal on conducting a simulated auctioning process.

9. Mr Eric LI enquired whether existing 2G licensees could form joint ventures or set up a subsidiary company to bid for a 3G licence and if so, whether such would give rise to difficulties in ascertaining the 3G revenue turnover based on which the royalty was calculated. In reply, DS/ITB said that the requirement on account separation should help address the problem in the case of a subsidiary company. As for the case of joint ventures, the Administration would have to first ascertain that such a move would not result in diminished competition or possible collusion to keep royalty bids low. She however stressed that the detailed arrangements would be set out in the information memorandum and auctioning rules.

10. On safeguards under contemplation to guard against collusion to keep the royalty bids low, DS/ITB explained the requirement of all licensees to pay a guaranteed, minimum royalty payment for the first five years of the licence should help to address this problem. This requirement could safeguard the Government against financial risks resulting from bidders’ failure to honour their commitments. Bidders could also better assess the total investment required.

11. On possible scenarios that 3G licensees failed to operate successfully due to financial problems, DG Tel advised that the Administration would ascertain the financial capability of the bidders through the following arrangements -

(a) The pre-qualification process setting certain minimum criteria on investment, network rollout, financial capability could ensure all qualified applicants would be able to finance, construct and operate a 3G services network. Moreover, since the network rollout commitments of individual licensees would be set out in their licences, their licences might be revoked should they fail to achieve the committed targets.

(b) Throughout the whole licence period, each licensee would need to provide a 5-year rolling guarantee for his guaranteed, minimum royalty payments. As such, in the case of licence revocation, the licensee would have to forfeit the 5-year rolling guarantee to cover the Government's loss for five years, by the end of which the revoked licence should have been re-allocated.

(c) The Administration was also considering requiring bidders to pay a deposit upon entry to the auction to ensure that only serious and competent bidders would be considered.

12. As to the rationale for requiring a 5-year rolling guarantee for the minimum royalty payments, DS/ITB advised that this was because the risks in the first five years of network investment were the highest. Members noted that the five-year period commenced from the award of the 3G licence. In this regard, Mr Eric LI cautioned that licensees might seek to capitalize their profits from 3G investment by selling their 3G licences to a third party. The Administration took note of his concern.

Payment matters

13. On how the level of the guaranteed, minimum royalty payment was set, DS/ITB explained that such would be determined on the basis of the business case of the bidders. The value of the defined payment would be correlated to the percentage bid of royalty and would be set out in a bidding schedule to be included in the information memorandum.

14. Noting that the 3G revenue turnover would form the basis of royalty payment in future (i.e. from year 6 onwards), Miss Emily LAU highlighted the need to provide a clear definition for "turnover" in the relevant legislation. In response, SITB

Admin

undertook to consider the suggestion with a view to removing doubt. In this connection, DG Tel supplemented that only the turnover resulting from the utilization of the 3G network would be taken into account. He said that each licensee would be required to submit to TA quarterly reports prepared according to an accounting manual. As to how the royalties were to be paid, DS/ITB advised that annual payment was being contemplated to minimize administrative costs.

The open network requirement

15. Mr YEUNG Yiu-chung enquired about measurement methods to be used by the TA in determining whether 3G network operators had fulfilled the requirement to open 30% of their network to non-affiliated 3G Mobile Virtual Network Operators (MVNOs) and content providers. In reply, DG Tel advised that criteria for making measurements would include documentary proof of the total capacity sold such as the contracts or agreements with non-affiliated companies, monthly network usage reports which the TA would require network operators to provide, etc. TA was also prepared to accept alternative methods of measurement proposed by operators. In this regard, SITB and DG Tel stressed that progress in fulfilling the 30% open network requirement would be closely monitored to ensure effective competition. The Administration's preference was for the network operators and the non-affiliated MVNOs/content providers to reach commercial agreements. Should such negotiation fail, TA might exercise its reserve power to make a determination based on fair interconnection principles under section 36A of the Telecommunications Ordinance (Cap. 106).

16. On why the threshold was set at 30%, DG Tel reported that the percentage had been set after public consultation and was considered a right balance that could maintain network investment incentives as well as provide business opportunities for innovative but small application houses and service providers. He further advised that the percentage would be reviewed in the light of operational experience. Addressing Mr CHAN Kwok-keung's concern about whether the mandatory requirement was fair on 3G licensees, DG Tel pointed out that since a return on investment of up to 20% would be allowed in determining the interconnection price, the requirement was considered fair.

17. Mr Eric LI and Mr YEUNG Yiu-chung enquired about proposed measures to ensure that the network capacity leased to non-affiliated MVNOs and content providers would be effectively utilized to provide 3G services. In response, DG Tel advised that the MVNOs/content providers would be required to match their capacity forecasts with financial commitments. The regulatory framework and obligations on them would be spelt out in the information memorandum. If TA was satisfied that the mere purchase of network capacity constituted anti-competitive behaviour, he would consider intervention.

The timetable

18. Regarding the legislative timetable, SITB advised that the Administration would hope to pass all the necessary legislation (the Bill and subsidiary legislation) by early April 2001 in order that 3G licences could be issued by mid 2001 as publicly pledged.

19. The meeting ended at 5:50 p.m.

Legislative Council Secretary
27 March 2001