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Paper for the House Committee meeting on 16 June 2006

**Report of the Subcommittee on
Broadcasting (Revision of Licence Fees) Regulation 2006**

Purpose

This paper reports on the deliberations of the Subcommittee on Broadcasting (Revision of Licence Fees) Regulation 2006.

Background

2. The Broadcasting (Licence Fees) Regulation provides that holders of television (TV) programme service licences under the Broadcasting Ordinance¹ (BO) (Cap. 562) shall pay an annual licence fee. The fee levels are prescribed in Schedules 1 to 4 to the Regulation. It is government policy that fees should in general be set at levels sufficient to recover the full costs of providing the services. The existing fees have taken effect since February 2001, reflecting the Television and Entertainment Licensing Authority (TELA)'s administrative costs of assisting the Broadcasting Authority (BA) in regulating the TV industry.

3. There are four categories of TV programme service licence under the BO, as follows:

- (a) Domestic free TV programme service licence;
- (b) Domestic pay TV programme service licence;

¹ The BO was enacted in 2000. It repealed the Television Ordinance (TO) (Cap. 52) to provide a new regulatory regime for the provision of TV programme services. Under the repealed TO, TV programme service licensees were required to pay royalties. With the repeal of TO and the abolition of royalties, licensees are required to pay licence fees.

- (c) Non-domestic TV programme service licence (This is primarily satellite TV service uplinked from Hong Kong targeting the regional market. It is sub-divided into two types: Type A refers to free service, while Type B refers to subscription service); and
- (d) Other licensable TV programme service licence (It is subdivided into two types: Type A refers to TV service provided for an audience of not more than 5,000 specified premises, while Type B refers to TV service provided for hotel rooms).

4. The amount and structure of the fees differ, reflecting the differences in the nature of service and the costs of administering different licences. Most of the fees comprise a fixed fee and a variable fee calculated on a per subscriber/channel/hotel basis. According to the information provided by the Administration, the fixed fee reflects the costs incurred by general licence administration including the preparation and regular revision of codes of practice issued by the BA. The variable fee primarily reflects the costs of handling complaints, which is assumed to relate proportionally to the number of viewers served or the number of programme channels provided by a licensee, as the case may be. TELA normally conducts fee reviews once every four years to gauge changes in costs.

The Revision of Licence Fees Regulation

5. Based on the result of a recent costing exercise conducted by TELA at the 2005-06 price level, the Administration proposes to revise the various licence fees. To give effect to the fee revision, the Broadcasting (Revision of Licence Fees) Regulation 2006 (the Revision of Licence Fees Regulation) was tabled at the Legislative Council (LegCo) on 17 May 2006. The revision in fees ranges from -24% to 13% and would apply to about 40 existing licensees. Commencement date for the revised fees is 7 July 2006. Details of the existing and new fees and the cost computations are set out in **Appendices I and II** respectively.

The Subcommittee

6. The House Committee agreed at its meeting on 19 May 2006 to form a Subcommittee to study the Revision of Licence Fees Regulation. The membership list of the Subcommittee is in **Appendix III**. Under the chairmanship of Hon SIN Chung-kai, the Subcommittee held two meetings including one with the licensees to be affected by the Revision of Licence Fees Regulation. The list of organizations which have provided submissions to the Subcommittee is in **Appendix IV**.

7. To allow more time for the Subcommittee to examine the Revision of Licence Fees Regulation, the scrutiny period has been extended to 5 July 2006 by resolution of LegCo on 7 June 2006.

Deliberations of the Subcommittee

8. According to the Administration, the two domestic free TV programme service licensees and the three domestic pay TV programme service licensees are opposed to the fee increases. Before the Subcommittee was formed, letters stating objection to the increase in licence fees from two domestic pay TV programme service licensees were circulated to LegCo Members. The Subcommittee has received submissions from two domestic pay TV programme service licensees and one licensee providing TV service for hotel rooms which oppose to the increase in fees. In examining the Revision of Licence Fees Regulation, the Subcommittee has therefore studied the concerns expressed by these licensees and exchanged views with the Administration on how their concerns relating to the increase level and the adjustment mechanism could be addressed. In gist, these licensees' concerns over the Revision of Licence Fees Regulation are as follows:

- (a) The increase in fees, which are over 10% in general, are much higher than the general Consumer Price Index and will impose additional financial burden on licensees in the current business environment characterized by increasing competition and high operating costs;
- (b) The opening up of the TV market and emergence of new forms of broadcasting media in recent years have resulted in intense competition requiring substantial investments from licensees to enhance their services and competitiveness;
- (c) There is a decline in annual hotel pay-movies access rate as majority of hotel guests belong to the low-spending group who seldom patronize the pay-movies service; and
- (d) The fee increases run contrary to the trend in the telecommunications and film sectors where the licence fees have been reduced.

Fee revision mechanism

9. As mentioned in paragraph 4, there are primarily two components in the licence fees payable by each licensee: a fixed fee and a variable fee. According to the Administration, the existing fee charging mechanism for TV service licence is based on the principle of cost recovery. As the costs for administration and other services, such as complaints handling, for each category of licences are different, the adjustment levels for each type of fees also vary.

Fixed fee to recover administrative costs

10. The Administration explains that in the current fee revision, the fixed fees of some licences will be reduced due to reduction in general administrative costs as a result of improvement of efficiency and streamlining of work procedures of TELA. For instance, there will be reduction in fixed fees for Type A non-domestic TV licence and Type A of other service licence by 0.4% and 24% respectively to reflect reduction in costs in general licence administration.

11. However, the Administration also points out that the intensified competition in the TV market and technological convergence in the communications industry have led to increased workload and complexity of regulatory issues. Very often, the BA needs to commission market and economic analyses as well as obtaining external legal and technical opinions in resolving regulatory matters, resulting in increase in administrative costs. Besides, the BA needs to conduct benchmarking exercises from time to time to ensure that the regulatory practices are on par with international best practices. Costs incurred in these areas are reflected in the fixed fee component. Rises in costs in relation to handling regulatory issues have offset savings in administrative costs and therefore lead to increase in the fees of some categories of licences. For instance, the fixed fees for the domestic free and pay TV programme service licences would increase by 13% and 12% respectively to recover the rise in administrative costs which include increase in workload arising from the implementation of digital terrestrial television (DTT) broadcasting, as well as the costs of commissioning professional services and market analyses to deal with regulatory issues. The Administration is of the view that since licence fees only constitute a small proportion of the total operating costs of the licensees, the fee increases would not impose any significant burden on the licensees.

12. The Subcommittee considers that whilst costs incurred in general licence administration should be recovered from licence fees, the costs involved in the formulation of policy for the long-term development and regulation of the television industry, such as the policy on DTT, should be absorbed by the Government. The Administration clarifies that the cost recovery principle aims at recovering the full costs in administering the regulatory regime for the provision of TV programme services which underpins long-term sustainability of the regime. Costs incurred by the Administration for policy development of the regulatory framework of the broadcasting industry are not recovered from licence fees.

13. Given that monitoring of licensees' compliance with the licensing conditions forms part of the general licence administration work of TELA, the Subcommittee notes some licensees' complaint about the unfairness for all licensees in the same licence category to share out TELA's cost of investigative work. Some members share the licensees' suggestion that the administrative costs relating to the investigation into non-compliance with licence conditions should be recovered either from the offenders via fines or forfeitures, or from the complainants who made frivolous and vexatious complaints. In this regard, two domestic pay TV programme

service licensees consider it unreasonable for TELA to recover the increase in administrative costs for handling regulatory matters (including associated complaints) relating to competition and firewall provisions² in the licences of Television Broadcasts Limited and TVB Pay Vision Limited through the fixed fee component of the licence fee. They are of the view that the Administration should have taken into account the costs for enforcing the provisions when devising the regulatory framework of the broadcasting industry during the enactment of the BO in 2000.

14. The Administration re-iterates that the licences fees are charged and reviewed based on the principle of cost recovery. The suggestion of recovering costs via fines or forfeitures is not in line with the existing licence fee charging mechanism. The Subcommittee notes the Administration's view that while the fee charging mechanism may undergo review in future, the Administration should follow the cost recovery principle in determining the licence fee unless and until the existing mechanism is modified. As regards the concern about costs for handling regulatory issues in relation to the competition and firewall provisions, the Subcommittee notes that given such provisions are in connection with the regulatory issues relating to competition in the market and the provision of a level-playing field for market participants, such enforcement costs are generally regarded as general administrative costs.

15. The Subcommittee notes that for the hotel pay-movie industry, the fixed fee for Type B other TV licences would be increased by 11% (or \$1,600 in absolute figure) while the regulatory issues involved in administering these licences are relatively simple. The Administration explains that the validity period of most of the existing Type B licences ranges from one to three years as opposed to 12 years for other categories of TV licences. The increase in fixed fee is to recover costs in administration work related to licence renewal. For reference, the BA renewed 16 and 7 such licences in 2004 and 2005 respectively. The Subcommittee notes that such TV services are non-pervasive, targeting residents in hotels only. Hence, not much regulatory work will arise and it is doubtful if licensing of such services can be justified. The Subcommittee has suggested that consideration should be given to adopting other light-handed approaches for such services, such as issuing class licence which may reduce both regulatory burden borne by the industry and administrative work of the regulator. The Administration advises that TELA is actively pursuing a proposal of extending the validity period of these Type B licences to 12 years in order to reduce administration work related to licence renewal. It will also consider the Subcommittee's view on streamlining the existing licensing regime.

² The competition and firewall provisions are applicable to the licences of Television Broadcasts Limited (a domestic free TV programme service licensee) and TVB Pay Vision Limited (a domestic pay TV programme service licensee). The provisions require the independent operation of the licensees to safeguard free competition in the market.

Variable fee to reflect costs in complaints handling

16. The Subcommittee notes that the variable fee of domestic free TV licence (charged on a per channel basis) will be adjusted downward by 9% to reflect reduction in administrative cost due to improved efficiency and streamlining of workflow in handling complaints. As for other TV licences, the existing rate at \$4 per subscriber will remain unchanged as the rate is considered a fair share of the administrative cost of handling complaints related to pay TV services.

17. The Subcommittee notes that domestic pay TV licensees have referred to the growth in licence revenue in recent years resulting from increase in the number of subscribers. They are of the view that with continuous growth in the market, increase in administrative costs could be offset by the increased revenue generated from future revenue arising from projected rise in the number of licences and subscribers. The Administration maintains its view that the fee charging mechanism is based on the principle of cost recovery. Revenue increases arising from the rise of the number of licences and subscribers, if any, would be reflected in future costing exercises.

18. As for the applicability of the cost recovery principle to complaints handling, some members are concerned that it may result in self-censorship in programme contents by licensees with a view to minimizing the number of complaints, thus avoiding increase in variable fees. Members consider that it is the Government's responsibility to ensure the provision of broadcasting services to achieve the objectives of protection of freedom of speech and widening programme choice for the community. As such, the Administration should not seek to recover the regulatory costs fully from licence fees. Members are concerned that increase in the licence fees may become a barrier discouraging potential operators to enter into the market.

19. In this regard, TELA advises that given the large number of TV programme channels available, the BA has been relying on a complaint-driven system in regulating broadcast contents. The BA does not preview any programmes. Instead, licensees are required to comply with the Generic Code of Practice on Television Programme Standards which set out the programme standards. To help enhance the efficiency in handling complaints, TELA will screen out trivial and frivolous complaints and those which do not fall within the jurisdiction of the BO are referred to other appropriate agencies for follow-up. With TELA's vigorous efforts in improving efficiency, the complaint handling procedures have been streamlined which results in cost saving in the variable fees.

Review of the licence administration system and licence fee structure

20. The Subcommittee notes that the licensees were consulted on the cost recovery principle in setting licence fees in the context of the public consultation on the 1998 Review of Television Policy in which licensees agreed to the principle in general. Nonetheless, members note the concerns of some licensees about the basis of the fee charging mechanism and calculation in respect of the fixed fee and variable fee

components. In particular, the level of increase in the fixed fee is directly related to the operating costs of TELA. Members are therefore keen to see that TELA has implemented measures to enhance efficiency and reduce operating costs.

21. According to the Administration, the cost recovery rates of TELA's services in 2002-03, 2003-04, 2004-05 and 2005-06 were 80%, 83%, 97% and 98% respectively. The increasingly high recovery rates are the results of continuous efforts on the part of TELA in reducing administrative costs. Specifically, the estimated staffing cost decreases from about \$24 million in 2001-02 to about \$18 million in 2005-06, and the departmental expenses and other costs also decrease from about \$11 million to about \$5.7 million during the same period, presenting 25% and 48% reduction in the two items respectively in five years. These reductions are attributed to measures including retrenchment of staff number and reduction in accommodations costs, and efficiency improvement through streamlining work procedures. The efficiency improvement measures include simplifying the complaint handling procedures, rationalizing regulatory approval procedures, appropriate delegation of authority, and streamlining procedures of renewing licences.

22. In exploring other fee charging mechanisms, some members have suggested that consideration should be given to apportioning costs for administering different licences taking into account the market share of individual licensees in a licence category, for instance, the viewer-ship of the licensee in the domestic free TV licence category. While the Administration welcomes suggestions to improve the fee charging mechanism, it points out the principle of cost recovery for determining licence fees is in line with Government's established policy. The apportioning of costs according to viewer-ship is similar to the former royalty arrangement under the repealed TO. In the former TO regime, licensees of TV programme service were required to pay royalties which to a certain extent reflected the market share of the licensees. Royalties were abolished with the repeal of the TO upon the enactment of the BO in 2000.

23. In the light of the Administration's proposal of merging the BA and the Telecommunications Authority to set up a Communications Authority (CA) as the unified regulator for the broadcasting and telecommunications sectors and amalgamating the Broadcasting Division of TELA and the Office of Telecommunications Authority to form the new Office of the Communications Authority (OFCA), some licensees have requested that the present fee revision be withheld and revisited in the context of the merger proposal which would have impact on the licence administration system. Some licensees believe that further liberalization of the broadcasting and telecommunications market and a more relaxed regulatory approach under the new regulatory structure will bring about fundamental changes to the cost structure of OFCA to enable enhancement in efficiency and savings in costs, thus creating room for reduction in licence fees. In this regard, the Administration stresses that it is essential to adhere to the cost recovery principle in determining the licence fee unless and until the existing mechanism is modified.

24. The Subcommittee recognizes the potential for the new OFCA to achieve operational synergy and efficiency, but it notes the Administration's view that it is imprudent at this stage to predict any reduction in licence fees. According to the Administration, the new OFCA would need resources to employ staff with the necessary expertise to tackle complicated cross-sectoral competition and regulatory issues in a convergent environment, in particular during the initial stage. The impact of the new regulatory structure on the licence fees would be assessed in greater detail after the commencement of the operation of the CA, if established.

25. Referring to the reduction of licence fees in the telecommunications and film sectors, the Subcommittee notes the Administration's view that it is inappropriate to compare the fees of broadcasting licences with those in other sectors because the regulatory regimes and costing structure applied to them are different.

26. Regarding the view of domestic free TV licensees that their licence fees should be reduced having regard to the substantial costs of carrying government programmes and announcements in the public interest and contribution to DTT, the Subcommittee accepts the Administration's view that such requirements have been included as licensing conditions and were accepted by licensees when they entered into agreement with the Government.

Conclusion and recommendation of the Subcommittee

27. The Subcommittee has completed the scrutiny of the Revision of Licence Fees Regulation and expressed support for the fee revision which is in line with the cost recovery principle and the current fee adjustment mechanism.

28. Regarding the concerns about the complaint handling mechanism of TELA and issues relating to the investigative procedures, such as the criteria and factors taken into account by TELA in screening complaints against licensees and guidelines in handling complaints, the Subcommittee agrees that they should be referred to the Panel on Information Technology and Broadcasting for further discussion.

Advice sought

29. The House Committee is invited to note the deliberations of the Subcommittee.

Appendix I

Proposal for Revision of Licence Fees under the Broadcasting (Licence Fees) Regulation

Licence Category	Existing		Proposed	
	Fixed Fee	Variable Fee	Fixed Fee	Variable Fee
Domestic Free TV Programme Service Licence	\$3,811,000	\$1,566,000 per programme channel	\$4,308,900 (+13%)	\$1,421,600 per programme channel (-9%)
Domestic Pay TV Programme Service Licence	\$1,371,000	\$4 per subscriber	\$1,533,000 (+12%)	\$4 per subscriber (No change)
Type A Non-domestic TV Programme Service Licence (free service)	\$56,600	N.A.	\$56,400 (-0.4%)	N.A.
Type B Non-domestic TV Programme Service Licence (pay service)	\$69,600	\$4 per subscriber	\$74,000 (+6%)	\$4 per subscriber (No change)
Type A Other Licensable TV Programme Service Licence (for an audience of not more than 5,000 specified premises)	\$224,000	\$4 per subscriber	\$171,200 (-24%)	\$4 per subscriber (No change)
Type B Other Licensable TV Programme Service Licence (for hotels)	\$15,200	\$5,400 per hotel	\$16,800 (+11%)	\$5,400 per hotel (No change)

(Source: Annex B to LegCo Brief (File Ref: CTB/B/203/14(05)VI).)

COST COMPUTATION
Television and Entertainment Licensing Authority
Annual Television Programme Service Licence Fees
under Broadcasting (Licence Fees) Regulation
Unit Cost at 2005-06 Price Level
Domestic Free Television Programme Service

	Fixed	Variable
	\$	\$
Staff cost	3,508,653	2,162,212
Departmental expenses	306,564	354,295
Accommodation cost	219,472	161,716
Depreciation	6,488	NA
Central administrative Overheads	267,646	164,937
Total Cost	4,308,823	2,843,160
Estimated number of programme channels per licence for 2005-06		2 programme channels
Unit cost at 2005-06 prices	\$4,308,900	\$1,421,600 per programme channel
Proposed licence fee formula under the Regulation		\$4,308,900 + \$1,421,600 per programme channel
Computed Licence fee		\$7,152,100

Domestic Pay Television Programme Service

	Fixed	Variable
	\$	\$
Staff cost	1,138,496	1,686,709
Departmental expenses	233,719	907,288
Accommodation cost	69,634	194,164
Depreciation	4,325	NA
Central administrative Overheads	86,846	128,665
Total Cost	1,533,021	2,916,825
 Total number of subscribers of domestic pay TV service		 828 631 subscribers
 Unit cost at 2005-06 prices	 \$1,533,000	 \$4 per subscriber
 Proposed licence fee formula under the Regulation	 \$1,533,000 + \$4 per subscriber ¹	

¹ The variable fee of \$4 per subscriber to domestic pay TV programme service remains unchanged.

Non-Domestic Television Programme Service

	Type A Non-Domestic (Free) Licence Fee	Type B Non-Domestic (Pay) Fixed	Variable
	\$	\$	\$
Staff cost	43,205	55,629	10,879
Departmental expenses	5,947	6,425	1,556
Accommodation cost	2,635	3,426	730
Depreciation	1,298	4,325	NA
Central administrative Overheads	3,296	4,243	830
Total Cost	56,380	74,049	13,994
Estimated number of subscribers per licence			3 333 subscribers
Unit cost at 2005-06 prices	\$56,400	\$74,000	\$4 per subscriber
Proposed licence fee formula under the Regulation	\$56,400	\$74,000 + \$4 per subscriber ²	

2 The variable fee of \$4 per subscriber to non-domestic pay TV programme service remains unchanged.

Type A Other Licensable Television Programme Service

Type A Other Licensable (for not more than 5 000 specified premises)

	Fixed	Variable
	\$	\$
Staff cost	135,002	12,846
Departmental expenses	4,360	4,069
Accommodation cost	8,602	872
Depreciation	12,976	NA
Central administrative Overheads	10,298	980
Total Cost	171,238	18,767

Estimated number of subscribers per licence 5 000 subscribers

Unit cost at 2005-06 prices \$171,200 \$4 per subscriber

Proposed licence fee formula under the Regulation \$171,200 + \$4 per subscriber³

³ The variable fee of \$4 per subscriber to Type A other licensable TV programme service remains unchanged.

Type B Other Licensable Television Programme Service

Type B Other Licensable (for hotel)

	Fixed	Variable
	\$	\$
Staff cost	13,929	4,544
Departmental expenses	423	173
Accommodation cost	891	305
Depreciation	519	NA
Central administrative Overheads	1,063	347
Total Cost	16,824	5,369

Unit cost at 2005-06 prices \$16,800 \$5,400 per hotel

Proposed licence fee formula under the Regulation \$16,800+ \$5,400 per hotel⁴

⁴ The variable fee of \$5,400 per hotel provided with Type B other licensable TV programme service remains unchanged.

(Source: Annex C to LegCo Brief (File Ref: CTB/B/203/14(05)VI).)

Subcommittee on Broadcasting (Revision of Licence Fees) Regulation 2006

Membership List

Chairman	Hon SIN Chung-kai, JP
Members	Hon Fred LI Wah-ming, JP
	Hon Jasper TSANG Yok-sing, GBS, JP
	Hon Howard YOUNG, SBS, JP
	Hon Emily LAU Wai-hing, JP
	Hon Ronny TONG Ka-wah, SC
	(Total : 6 members)
Clerk	Ms Connie SZETO
Legal Adviser	Ms Bernice WONG
Date	30 May 2006

**List of organizations which have provided submissions to the
Subcommittee on Broadcasting (Revision of Licence Fees) Regulation 2006**

- * 1. Hong Kong Cable Television Limited
- 2. Movielink (Hong Kong) Limited
- 3. PCCW Media Limited

* organization which has met the Subcommittee