HKT

CONSULTATION PAPER ON LICENCE FEE REDUCTIONS FOR UNIFIED CARRIER LICENCES (UCL), PUBLIC RADIOCOMMUNICATIONS SERVICE LICENCES AND SERVICES-BASED OPERATOR LICENCES ISSUED UNDER THE TELECOMMUNICATIONS ORDINANCE

Introduction

1. Hong Kong Telecommunications (HKT) Limited ("**HKT**") welcomes the opportunity to provide its comments on the proposals outlined in the consultation paper jointly issued by the Commerce and Economic Development Bureau and the Communications Authority ("**CA**") on 29 June 2012 concerning licence fee reductions for Unified Carrier Licences ("**UCLs**"), Public Radiocommunications Service ("**PRS**") Licences and Services-Based Operator ("**SBO**") Licences ("**Consultation Paper**").

2. At the outset, a reduction in the licence fees is a welcomed proposal as it will directly flow through to users in competitive markets. This will be good for both users and the economy. However, as explained below, a greater fee reduction is warranted, consistent with the Trading Funds Ordinance ("**TFO**") and the Communications Authority Ordinance ("**CAO**"), and in the public interest.

The Proposal

3. In the Consultation Paper, the Secretary for Commerce and Economic Development ("**Secretary**") proposes to reduce the customer connection fee component of the UCL from $800 per annum for each 100 customer connections to $700 per annum for each 100 customer connections, i.e. a reduction from $8 to $7 per annum for each customer, with effect from 1 March 2013. Similarly, for PRS and SBO licences, the CA proposes a corresponding reduction in the mobile station fee[1] from $8 to $7 per annum per mobile station.[2] The other fee components (e.g. flat fee of $1 million, allocated subscriber number fee of $3 per number, base station fee and radio frequency management fee per the UCL) however, are to remain unchanged. Thus, based

[1] "Mobile station fee" refers to the fee for mobile stations used by customers of the services. The number of mobile stations used by customers is effectively the same as the number of customers using the service.

[2] Note that under Section 7(2) of the Telecommunications Ordinance ("**Ordinance**"), it is the Secretary who prescribes the annual fees pertaining to carriers licences (e.g. UCLs) whereas, under Section 7(6) of the Ordinance, it is the CA who determines the annual fees in relation to non-carrier licences (e.g. PRS and SBO licences).

on the number of customer connections in respect of UCLs for 2010/11[3], the licence fee reduction proposed by the Secretary will only amount to $13.6m, representing a mere 3.8% of the total 2010/11 revenue.

Justification for Reducing the Licence Fees

4. In paragraph 7 of the Consultation Paper, it is stated that the number of customer connections in respect of UCLs has increased significantly and is expected to continue in the future. Spreading a substantially fixed cost over more consumers logically warrants a fee reduction. In addition, the Consultation Paper states that the cost trend associated with administering the licences also creates room for a rate reduction.

HKT's Comments

5. On behalf of its customers, HKT is pleased to see a reduction in licence fees. However, it is clear that a substantially larger fee reduction is warranted, is consistent with the TFO and CAO, and would be in the public interest.

6. OFCA and its predecessor, OFTA, are trading fund entities who recoup their expenses primarily via licence fees. There is no legal or public interest justification to extract from users a level of licence fees that would significantly and consistently exceed OFCA's costs. To do so would be a form of tax and would be beyond the scope and purpose of both licence fees and the applicable laws.

7. Under the TFO, the purpose of a trading fund is to "finance" the activities of certain services of the Government. Section 3(1) of the TFO states:

> *The Legislative Council may, on the recommendation of the Financial Secretary, by resolution establish a trading fund to manage and account for the operation of a government service for which* <u>*the Government has the financial objective that the service shall fund itself from the income generated from the government service*</u> *[…]* [Emphasis added]

8. In addition, Section 6(6) specifies how the trading fund is to be controlled and managed:

[3] Per paragraph 7 of the Consultation Paper, the number of customer connections for UCLs in 2010/11 was 13.6 million.

> *The general manager shall manage a trading fund with the objectives of-*
>
> *(a) […]*
>
> *(b) within a reasonable time, meeting expenses incurred in the provision of the government service and financing liabilities of the trading fund out of the income of the trading fund, taking one year with another; and*
>
> *(c) achieving a reasonable return, as determined by the Financial Secretary, on the fixed assets employed.* [Emphasis added]

9. Further, under Section 25 of the CAO, the OFTA Trading Fund became the OFCA Trading Fund whose functions are: to support the CA in administering and enforcing the Telecommunications Ordinance, the Broadcasting Ordinance, the Unsolicited Electronic Messages Ordinance and the CAO; to support and assist the CA in the performance of its functions under any Ordinance; to support the administrative functions relating to telecommunications, broadcasting and anti-spamming matters; and to support any services incidental to or conducive to the provision of the aforementioned specific services. The costs of setting up and running the CA and OFCA are to be paid out of the trading fund.

10. Thus, it is clear that the trading fund is only intended to cover OFCA's expenses and liabilities, along with a reasonable rate of return which is set at 8.5%. It is not intended to make substantial profits or earn a high rate of return.

11. A review of OFTA's Trading Fund Reports ("**Reports**") for the past few years, however, shows that it has consistently returned a very substantial profit and a very high rate of return. The key financials for the past three years of available data are as follows:

	2010/11	**2009/10**	**2008/09**
Revenue	$355.8m	$339.4	$343.7m
Expenditure	$249.4m	$242.6	$271.7m
Pre-tax profit	$106.4m	$96.8m	$72.0m
Return on Average Net Fixed Assets (a)	44.7%	32.2%	15.9%
Target rate of return on fixed assets (b)	8.5%	8.5%	8.5%
Excess return earned by OFTA (a)-(b)	+36.2%	+23.7%	+7.4%

12. As can be seen from the above table, the return on Average Net Fixed Assets for the three years has consistently well exceeded the target rate set by the Financial Secretary.[4] OFTA has therefore been earning well in excess of its targeted revenue even though there is no statutory or public policy basis to be excessively profitable (and to further tax consumers via these unnecessary levels of licence fees).

13. Over 90% of OFTA's revenue comes from licence fees. Per Appendix E of the Report for 2010/11, which lists out the revenue collected by OFTA in respect of each type of licence for the year, the licence fees collected by OFTA in respect of UCLs (i.e. just one type of licence) alone totaled some $218m, representing 61% of the total revenue earned by OFTA for the year. While it is proper to meet expenditures, and it is prudent to set licence fees conservatively to ensure that anticipated expenditure levels are met, it goes beyond the TFO and the CAO to set licence fees that generate consistently high and excessive profits.

14. In justifying a reduction of the customer connection fee from $8 to $7 per customer for UCLs, the Consultation Paper does not provide any calculations to support the $1 reduction. Yet, it is clear just from the above table that licence fees have been much too high for at least the last three years, with revenue exceeding costs by almost $300m on a cumulative basis. On this basis, HKT would suggest a substantial fee reduction. Indeed, based on the level of over-earnings and costs for just the last three years, a refund of past licence fees and/or a total fee/tax holiday would be appropriate. In addition, it is not clear why the licence fee reduction will only be applied from 1 March 2013 onwards. Even if certain regulations need to be amended to effect the change in licence fees, and this takes time, the reduction could still be back-dated to the earliest possible date, perhaps back to 1 April 2012 when the CA was established. A substantial fee reduction and/or refund for the current year, 2012/13, is certainly in order.

15. Finally, the Consultation Paper does not explain whether the implied fall in licence administration costs would also affect the other components of the UCL, PRS and SBO licence fees, i.e. flat fee, allocated subscriber number fee, base station fee, radio frequency management fee. If there are cost savings arising from the administration of licences by OFCA then HKT would expect such cost savings to also apply to other fee components such as the allocated

[4] The data for 2011/12 is not yet available but it is anticipated that for this year the pre-tax profit and return on Average Net Fixed Assets will both be excessive again.

subscriber number fee, which makes up a significant part of the total licence fee payable by the UCL, PRS and SBO licence holders.

Conclusion

16. HKT welcomes the proposed reduction in the customer connection fee and mobile station fee as these reductions can be passed onto users. However, based on the TFO and the CAO, HKT considers it more appropriate for the Secretary and the CA to refund past licence fees and/or create a fee/tax holiday. The sooner such a fee/tax holiday is declared, the better. Certainly, a licence fee reduction for the current 2012/13 year would be justified. In the alternative, any licence fee reductions should be across all licences and licence components, and the extent of the reductions should be more substantial. This is required in the interests of the public and to comply with the language in the statutes.

Submitted by
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