

WHARF T&T LIMITED

SUBMISSION IN RESPONSE TO THE CONSULTATION PAPER ON LICENCE FEE REDUCTIONS FOR UNIFIED CARRIER LICENCES, PUBLIC RADIOCOMMUNICATIONS SERVICE LICENCES AND SERVICES-BASED OPERATOR LICENCES ISSUED UNDER THE TELECOMMUNICATIONS ORDINANCE

INTRODUCTION

1. Wharf T&T Limited welcomes the opportunity to submit its views on the Consultation Paper issued jointly by the Communications Authority ("CA") and the Commerce and Economic Development Bureau ("CEDB") on 29 June 2012.
2. The current licence fee structure for the Unified Carrier Licence ("UCL") was proposed by the former Office of the Telecommunications Authority ("OFTA") in 2005 and implemented in August 2008. Such structure includes a fixed component (HK\$1 million) and a variable component, which is comprised of a number fee (HK\$3 per subscriber number), a customer connection fee (HK\$800 per 100 customer connections), a fee for the management of radio frequency and a fee for base station.
3. In anticipating the continued growth of customer connections and the trend of licence administration costs, the Administration proposed in the Consultation Paper to reduce the customer connection fee level for UCL from HK\$800 to HK\$700 for each 100 customer connections per year (i.e. by 12.5%) while leaving all other components of the licence fee structure unchanged. The Administration also proposed to reduce the fee level for mobile stations used by customers of the service for Public Radio-communications Service ("PRS") licences (Paging) and Services-based Operator ("SBO") licences (class 3), subject to the proposed licence fee reduction for UCL. The proposed reduction is to commence from 1 March 2013 subject to the enactment of the proposed amendment regulation.
4. Whilst we welcome the Administration's initiative to reduce the current licence fees, we submit that the proposed reduction is insufficient and bolder steps should be taken by the Administration to reduce the current licence fees to a more reasonable level. The current licence fees are excessive as can be deduced from the OFTA Trading Fund reports. The current licence fees have not reflected the market reality and the latest state of development in the telecommunications market, the required regulatory activities nor the expected operating efficiency gain from the merger of OFTA and the broadcasting division of Television and Entertainment Licensing Authority ("TELA").
5. We set out in the following sections the case for the reduction of the licence fees. Specifically we submit that:
 - a. the fixed component of the UCL licence fee should be reduced from HK\$1million to HK\$0.5million;
 - b. the customer connection fee per 100 customer connections should be reduced from HK\$800 to HK\$500; and

- c. the number fee should be reduced from HK\$3 to HK\$1. The number fee reduction should also extend to SBO licences.

REASONABLE LEVEL OF RETURN OF TRADING FUND OF THE OFFICE OF THE COMMUNICATIONS AUTHORITY (“OFCA”)

6. In accordance with the Trading Funds Ordinance (Cap 430) (“TFO”), the OFTA/OFCA Trading Fund is to be managed with the objectives of:
- providing an efficient and effective operation that meets an appropriate standard of service;
 - 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
 - achieving a reasonable return, as determined by the Financial Secretary, on the fixed assets employed.¹ [Emphasis added]
7. In contrast with the said objectives stipulated by the TFO, OFTA Trading Fund has generated returns significantly above its targeted return as shown in the annual reports of OFTA (from 2006/07 to 2010/11) as published on OFCA’s website:

	2010/11	2009/10	2008/09	2007/08	2006/07
Revenue (\$’000)	355,794	339,448	343,709	348,030	320,955
Expenditure (\$’000)	(249,440)	(242,644)	(271,707)	(246,032)	(228,317)
Profit after tax (\$’000)	90,193	84,301	65,280	90,374	80,060
Return on fixed assets % (a)	44.7%	32.2%	15.9%	25.4%	24.3%
Targeted return % (b)	8.5%	8.5%	8.5%	8.5%	8.5%
Excess return % =(a)–(b)	+36.2%	+23.7%	+7.4%	+16.9%	+15.8%

8. In the period from 2006/07 to 2010/11, the average net fixed assets return of OFTA Trading Fund has nearly doubled (jumped from 24.3% to 44.7%) when it is merely expected to meet a target rate of return on fixed assets of 8.5% per year as determined by the Financial Secretary². Against all fairness, a 44.7% rate of return to OFCA’s fixed asset is significantly higher than most comparable fixed assets managed by sizable enterprises in the private sector. The profiteering rate of return of OFCA Trading Fund should be brought down to a more reasonable level.
9. Since OFCA Trading Fund is merely expected by the Financial Secretary to meet a target rate of return on fixed assets of 8.5% per year, we submit that 8.5% should therefore be a reasonable cap on the future rate of return of OFCA’s fixed asset. As shown in the table below, assuming the levels of OFCA’s fixed asset and operating cost remain the same from 2010/11 onward, bringing the rate of return on OFCA’s fixed assets down to the level of 8.5% per year would mean that OFCA’s licence fee revenue could be reduced from HK\$342 million to HK\$270 million from 2012/13 onward (i.e. comprehensive

¹ Section 6(6) of the TFO.

² OFTA Trading Fund Report 2010 - 2011, p. 75.

income level can be reduced from HK\$90 million to HK\$17 million for the same period). In turn, the estimated Room for reduction of comprehensive income is HK\$72.8 million per year.

	Year 2010/11*	Year 2012/13 and onward
HK\$'000		
Total comprehensive income	90,139	17,380
Turnover	342,364	269,605 ^{Note 1}
Operating cost	249,440	249,440 ^{Note 2}
Return of fixed asset	44.7%	8.5%
Value of fixed asset	201,653	201,653 ^{Note 3}
Estimate of Turnover (assuming the rate of return of fixed asset is 8.5%)		269,605
Room for reduction of comprehensive income		72,759 ^{Note 4}

*Data of Year 2011/12 is not yet available so the data of 2010/11 is the latest data available.

Note 1: Estimate based on 8.5% as the return of fixed asset, corporate tax rate of 15% and the assumptions stated in Notes 2 and 3

Note 2: Assuming operating cost stays the same as the level of year 2010/11; such assumption is considered financially conservative given that OFCA is expected to further benefit from the efficiency gain and cost saving from the merger of OFTA and the broadcasting division of TELA

Note 3: Assuming the value of fixed asset stays the same as the level of year 2010/11; such assumption is considered financially conservative given the prevailing trend of inflation of fixed asset price

Note 4: This figure is obtained by subtracting the Turnover of Year 2010/11 by the estimated Turnover of Year 2012/13 and onward

10. According to OFCA website, the combined number of customer connection for fixed and mobile services is about 18.9 million³. If customer connection fee were reduced to our suggested level (i.e. HK\$500 per 100 customer connections per annum), this would reduce the licence fee turnover of OFCA Trading Fund by HK\$57 million or merely about 76% of our estimate on the Room for reduction of comprehensive income (i.e. HK\$72.8 million).
11. According to OFCA website, as of today, there are a total of 35 UCL holders with each of these licensees liable for HK\$1 million as the fixed component of the UCL licence fee structure. Adopting our suggested 50% reduction of the fixed component of the UCL licence fee would mean the licence fee turnover of OFCA would be lessened by HK\$17.5 million, which represents about 24% of our estimate on the Room for reduction of comprehensive income (i.e. HK\$72.8 million). Combining this with our suggested reduction of customer connection fee (i.e. from HK\$800 to HK\$500 per 100 customer connections), the total reduction will account for 100% of our estimate on the Room for reduction of comprehensive income.

³ 15,332,524 sim cards plus 3,533,093 exchange lines.

THE EXPECTED DECLINE ON REGULATORY ACTIVITIES AND IMPROVED OPERATION EFFICIENCY

12. In 2004, the Administration claimed that:

*"Administering local fixed carrier services involves many labour intensive activities on the part of OFTA, such as interconnection issues, co-location of exchanges, sharing of costs among operators, cross-operator charging, road opening, building access related issues, analysis of tariff applications, complaints and disputes handling etc. After reviewing its costs, OFTA considered that there is no room to reduce the licence fee for general fixed carrier licences at this stage."*⁴

Now that over eight years have passed, evidently many of the activities previously claimed as resource-consuming are no longer applicable, many other regulatory activities have also become or are becoming market-based or self-regulated as we set out in the table below:

Activity	Observations
<i>interconnection issues</i>	<p>No interconnection dispute or request for determination in relation to fixed network interconnection or mobile network interconnection has been submitted to OFTA/OFCA.</p> <p>Fixed-mobile interconnection charges have been deregulated since April 2009.</p> <p>With the transition to UCL, Mobile Number Porting charges and Operator Number Porting charges are no longer payable amongst operators.</p> <p>A market-oriented approach will be adopted for Local Access Charge from 1 July 2013 whereby the level of LAC will be set by commercial negotiations by the interconnecting parties.</p> <p>The deregulation of fixed to fixed interconnection arrangement under exploration. In any event there has not been any request for regulatory intervention since 10 January 2006⁵ as agreements between fixed carriers have been long settled.</p>
<i>co-location of exchanges</i>	<p>Colocation or Type II interconnection at Point A has been deregulated since July 2008.</p> <p>Commercial agreements between fixed carriers have been well and long settled on joint activities and inter-operator charging, without the need for supervision or participation by OFCA.</p>
<i>sharing of costs among operators</i>	
<i>cross-operator charging</i>	

⁴ Paper provided by the Administration to the Legislative Council Panel on Information Technology and Broadcasting, Reduction of Licence Fees under the Telecommunications Regulations (Cap. 106A) and the Telecommunications (Carrier Licences) Regulation (Cap. 106V), for discussion on 25 February 2004, CB(1)1045/03-04(10), 18 February 2004, paragraph 6(b), <http://www.legco.gov.hk/yr03-04/english/panels/itb/papers/itb0225cb1-1045-10e.pdf>.

⁵ Determination under Section 36A of the Telecommunications Ordinance of Charges for Co-location Site Setup in the Exchanges of PCCW-HKT Telephone Limited between Wharf T&T Limited and PCCW-HKT Telephone Limited

<i>analysis of tariff applications</i>	This is no longer applicable, with the removal of ex ante tariff review of PCCW-HKT.
<i>complaints and disputes handling etc.</i>	<p>The industry's adoption of the self-regulated approach such as:</p> <ul style="list-style-type: none"> • The Industry Code of Practice for Telecommunications Service Contracts for Enhanced Consumer Protection • Industry Code for Implementing Self-regulation of Provision of Mobile Television Services (to be released in August 2012) • Code of Practice On Person-to-Person Marketing Calls • Code for the Provision of Chargeable Mobile Content Services

13. To be commensurate with the reduced role and workload of OFCA, the resources required for conducting regulatory activities by OFCA should also be lessened and therefore a reduction of the licence fee is justified. Moreover, given the CA's mission is *"promoting competition and adoption of best practices in the communications market"*, by reducing the fixed component of UCL licence fee structure as a barrier of entry, the Administration can provide an additional incentive to encourage more new entrants to the communications market and in turn would encourage more competition for the benefits of consumers. More importantly, licensees would be able to use the licence fee savings to invest in the rollout and upgrade of their next generation network infrastructures and support the provision of advanced telecommunication services at competitive prices to retail consumers.
14. Furthermore, the Administration has acknowledged that there will be operational efficiencies from the merger of the broadcasting division of TELA and OFTA. In the past, the broadcasting division of TELA has had to rely to a significant extent on OFTA to assist it in handling technical and economic matters. The Administration has stated: *"Since technical and economic regulation of the broadcasting and telecommunications sectors requires largely the same expertise, there is great potential to achieve operational synergy and efficiency by putting these regulatory functions and the requisite experience and expertise in one single organisation."*⁶

FALLACY ON NUMBER FEE

15. According to OFCA, since number fee was implemented as part of the UCL licence fee structure in 2008/09, approximately 0.5 million subscriber numbers that were previously left idle were returned from the fixed and paging operators to OFTA/OFCA. During the same period, about 6.8 million subscriber numbers were assigned or allocated by OFTA/OFCA to the licensees (i.e. net new allocation or assignment of subscriber numbers was about 6.3 million) with the new numbers mostly being used by the mobile

⁶ Communications and Technology Branch, Commerce, Industry and Technology Bureau, Consultation on the Establishment of the Communications Authority, March 2006, paragraph 26, http://www.cedb.gov.hk/ctb/eng/paper/pdf/CA_consultation_paper.pdf.

network operators, which in spite of the increase of their substantially increased inventory of subscriber number, have increased their utilization rate of that inventory from 60% to 70% (reaching 70% is the minimum threshold for applying additional subscriber numbers from OFCA).

16. Despite the purpose of number fee, as stated in the consultation paper titled “The Creation of A Unified Carrier Licence under the Telecommunications Ordinance” dated 21 December 2007, to prolong the current 8-digit numbering plan by encouraging more efficient use of numbers (as licensees would have the incentive to return idle numbers to minimize their payment on number fee and therefore would help prolong the current 8-digit numbering plan), we submit that the implementation of number fee has failed to prolong the 8-digit numbering plan (since the implementation of number fee, an additional 6.3 million subscriber numbers have been allocated or assigned and they were mostly used by the mobile network operators). Maintaining the existing structure or level of the number fee is unjustified as number fee has not served its purpose well. To prolong the 8-digit numbering plan, number fee clearly has not been an effective measure and the Administration ought to explore other policy options as a way forward. On the other hand, given that the licensees’ utilization rate of subscriber numbers has already stayed at 70% (i.e. number utilization is very efficient) and that the minimum threshold for applying additional subscriber numbers from OFCA (a utilization rate of 70%) can continue to serve as a safeguard against the idling of subscriber numbers. Further there is no evidence to suggest that a reduction of number fee would encourage increase in the proportion of idle numbers.
17. From the perspective of the SBOs, our suggestion to reduce number fee is more equitable and fairer than the Administration’s proposal to reduce customer connection fee as the SBOs would not benefit from the Administration’s proposal since they are not subject to any customer connection fees, with the exception of the mobile virtual network operators which can expect same saving from the reduction of mobile station fees⁷. Given that most SBOs are liable for number fee as part of their annual licence fee payable to OFCA and that most of the SBOs are considered small and medium enterprises (“SMEs”), a reduction of the number fee would be a practical measure to lessen their costs and would in turn increase their working capital, which is a key source of fund for their innovations and investment.
18. By adopting our suggested level of number fee (i.e. HK\$1 per subscriber number) OFCA Trading Fund would expect a decrease of its licence fee turnover between HK\$50 million to HK\$60 million⁸. Notwithstanding that this amount, when combined with our suggestions to reduce the fixed component of the UCL licence fee structure and the customer connection fee, would exceed our estimate on the Room for reduction of comprehensive income, to encourage OFCA to fully utilize the potential efficiency gain and cost saving made available by the merger of OFTA and the broadcasting division of TELA, we submit that the Administration should continue to economize its operation and to adopt our suggestions as far as practical.

⁷ The Consultation Paper proposes to reduce the fee level from HK\$800 to HK\$700 for each 100 mobile stations or less used by customers of the service for PRS licences (Paging) and MVNO [which are SBO (Class 3)].

⁸ According to OFCA’s information, the total amount of subscriber numbers that has been assigned or allocated to licensees and is subject to the payment of number fee is between 25 to 30 million.

CONCLUSION

19. We submit that the Administration should take bolder steps to bring the profiteering return of OFCA Trading Fund down to a more reasonable level. The Administration's proposal set out in the Consultation Paper to reduce the customer connection fee level from HK\$800 to HK\$700 for each 100 customer connections per customer connection per year (i.e. by 12.5%) is simply paying lip service to industry's long request for a review of the licence fee.
20. Using the 8.5% rate of return of the fixed asset set by the Financial Secretary as a benchmark return of the OFCA Trading Fund, we believe our suggestions (viz: reducing number fee from HK\$3 to HK\$1, reducing the fixed component of the UCL licence fee structure by 50% and reducing the customer connection fee from HK\$800 to HK\$500 per 100 customer connections) are justified.
21. Notwithstanding that adopting all our suggestions at once might not be feasible in the short run (as it would exceed our estimate on the Room for reduction of comprehensive income by HK\$50 million – HK\$60 million), to encourage OFCA to fully utilize the potential efficiency gain and cost saving made available by the merger of OFTA and the broadcasting division of TELA, the Administration should ceaselessly work to improve its operational efficiency and to adopt our suggestions as far as practical.

SUBMITTED BY WHARF T&T LIMITED
30 JULY 2012