HGC GLOBAL COMMUNICATIONS LIMITED

SUBMISSION IN RESPONSE TO CONSULTATION PAPER ON LICENCE FEES REDUCTION FOR FIVE TYPES OF LICENCES ISSUED UNDER THE TELECOMMUNICATIONS ORDINANCE (CAP.106) AND INTRODUCTION OF A NEW FEE COMPONENT UNDER UNIFIED CARRIER LICENCES

Introduction

1. HGC Global Communications Limited ("**HGC**") welcomes the opportunity to submit its view on the consultation paper jointly issued by the Commerce and Economic Development Bureau ("**CEDB**") and the Communications Authority ("**CA**") on 8 June 2018 ("Consultation Paper").

2. The Consultation Paper sets out (i) the proposed reduction in licence fees payable by holders of five types of telecommunication licences and (ii) the introduction of a new fee component under unified carrier licences ("**UCL**") to facilitate the development of Wireless Internet of Things ("**WIoT**") services.

3. HGC welcomes the initiative of the Administration in reviewing the licence fees, which is legitimate pursuant to the decision of the Court of Final Appeal in *PCCW-HKT Telephone Ltd and Hong Kong Telecommunications (HKT) Limited v. The Secretary for Commerce and Economic Development and The Communications Authority* [2017] HKCFA 105 (FACV No. 11 of 2017) handed down on 27 December 2017 (the "**Judgment**").

4. In the Judgment, the Court of Final Appeal (in paragraph 77) has made a declaration that:

   "(a) the decision of the Respondents expressed in their Joint Statement dated 27 November 2012 to proceed with the proposed fixing of licence fees in exercise the power conferred by s 7(2) of the Telecommunications Ordinance (Cap 106) ("the TO") was made upon the errors of law specified below.

   "(b) it was an error of law to fail to construe s 7(2) of the TO as not permitting the prescribing of a licence fee which included an element of what in substance was a tax upon the licensee.

"(c) it was an error of law to construe the Trading Funds Ordinance (Cap 430) ("the TFO") as permitting the inclusion in budgets of the OFTA Trading Fund of projections for notional tax or dividends to be treated as surplus funds under s 10(1) of the TFO."

5. Accordingly, there is a pressing need not only to review the levels of licence fees but the overall methodology of assessment and charging mechanism including the fee components are required to be thoroughly reconsidered to avoid calculations and payment of upcoming licence fees under mistake of law.

6. As regard the extent of licence fees reduction, notwithstanding the lack of evidential support for the dollar amount proposed to be reduced for the various licence types, we submit that further reduction is warranted on the basis of reasons set out in the following paragraphs.

Licence Fees and Retained Earnings

7. We note in the Consultation Paper that retained earnings amounted to HK$98.3M was brought forward to 2018-19. Such retained earnings "represents the surplus (including dividend and provisions for taxation withheld and interest income) retained by OFCATF [Office of the Communications Authority Trading Fund] from 2016-17 to 2017-18".

8. With the implementation of the proposed licence fees reduction, the retained earnings carried forward to the following financial year will be gradually reduced and by the fifth year, substantially lowered to HK$0.3M at the end of financial year 2022-23. Clearly, retained earnings is used as the funding source to compensate for the loss of revenue resulting from the proposed licence fees reduction. To be more precise, any reduction in licence fees as proposed is taken directly from the pool of retained earnings.

9. By virtue of Section 6(6) of Trading Funds Ordinance (Cap.430) ("**TFO**"), the OFCATF is to be managed, *inter alia*, along the principle of cost recovery. Any retained earnings net of the target return required under Section 6(6)(c) of the TFO, be it in the past or future, is monies collected or to be collected (as the case may be) in excess of the actual or projected expenditure and thus overpayment of licence fees. With due respect, we regret to comment that the proposed reduction in licence fees is no genuine reduction.

10. In particular, the HK$98.3M retained earnings brought forward to 2018-19, being surplus from 2016-17 and 2017-18 as a result of overpayment by licensees in the past, should not be used to give effect to the proposed reduction that concerns upcoming licence fees payment. Circumstances may have changed over the years and licence fees receivable is likely to be contributed by different licensees and/or in different portions as compared to licence fees collected in previous years. The proposed utilisation of the HK$98.3M retained earnings towards reduction of future licence fees will constitute unfair treatment to those licensees who actually paid into such surplus. We submit that the HK$98.3M retained earnings be refunded immediately to the contributing licensees as appropriate. Should the Administration opt to prolong the period of repayment, a reasonable timeframe should be agreed with the concerned licensees and the amount justified for repayment should carry interests at a rate also to be agreed between parties concerned.

11. We further submit that the Administration should conduct a comprehensive review of the methodology of assessment and charging mechanism including but not limited to the levels of fees and fee components for calculations of licence fees payable for upcoming years. For purpose of illustration, we suggest:

    (a) In line with the cost recovery principle, a claw-back mechanism be built into the model to facilitate matching of income and expenses and eliminates the risk of overcharging of licence fees.
    (b) As regard fee components, reduction in the number fee which is not reflective of the cost recovery principle and proven ineffective in prolonging the 8-digit numbering plan as initially intended. On the contrary, there is no evidence suggesting a reduction in number fee would encourage increase in the proportion of idle number or expedite the utilisation rate of the 8-digit numbering plan.

<u>Licence Fees and Costs</u>

12. The operation of OFCATF is primarily funded by licence fees income on cost recovery basis. It is therefore important to look at the costs issue alongside reviewing of licence fees level.

13. According to paragraph 3(b) of the Additional Information and Clarification to the Consultation Paper published on 16 July 2018, the cost of staff represents over 80% of the total expenditure. While we acknowledged that increase in staff cost is partially attributed to the inflationary adjustment in salary at a standard projection rate generally applicable to Government departments, the increase in OFCA staff

headcounts from 395[1] as at 31 March 2013 to 448 as at 31 March 2017 representing an increment of 13.4% during the said period as shown in the below table[2] should not be overlooked.

As at	Civil Servants (a)	Contract Staff (b)	Total OFCA Staff (c) = (a) + (b)	Increase Year-on-Year
31-Mar-17	330	118	448	3
31-Mar-16	330	115	445	14
31-Mar-15	309	122	431	16
31-Mar-14	315	100	415	20
31-Mar-13	282	113	395	68
31-Mar-12	202	125	327	2

14. It is mindful that the establishment of a unified regulator in April 2012 and the subsequent merging of the then Office of the Telecommunications Authority ("**OFTA**") and Television and Entertainment Licensing Authority ("**TELA**") to form the new executive arm that is OFCA today was expected to "reduce administrative work", "enhance working efficiency", as well as "achieve operational synergy and efficiency" of the regulator.[3]

15. Upon the establishment of OFCA in 2012, TELA was practically disbanded, with broadcasting functions transferred to OFCA and funded under OFCATF. Other non-broadcasting related activities are not funded by OFCATF, regardless of whether such functions are handled by OFCA or not.

16. Furthermore, many activities previously claimed by the regulator as resource-consuming have nowadays either ceased to be applicable or become market-based or self-regulated as the industry evolves. These issues include interconnection, co-location of exchanges, sharing of costs among operators, cross-operator charging, analysis of tariff applications, and handling of complaints and disputes etc. just to name a few.

17. In this connection, we are hesitant the initial objective or claimed benefits of establishing a unified regulator for efficiency gain has been met. Rather, we have

[1] Included transferred headcounts from TELA subsequent to merger of the then OFTA and TELA to form OFCA in April 2012 and other staff movements during the period 01-04-2012 to 31-03-2013.
[2] Source: Trading Fund Reports.
[3] Paragraphs 24 – 26 of Legislative Council Brief dated 3 March 2006 provided by the Administration to the Panel of Information Technology and Broadcasting on Consultation Paper on the Establishment of the Communications Authority, CTB(CR) 9/19/13 (05) Pt.4.

concerns over the existence of any costs control measures to avoid overspending that has direct impact on the level of licence fees to be charged in order to fully recover actual expenses incurred regardless of the size of the budget.

18. We strongly urge the Administration to closely monitor the financial performance of OFCATF in the costs aspect and ensure costs saving initiatives are duly implemented for enhanced budget control.

19. We further submit that the Administration should simultaneously review and implement initiatives to uplift efficiency in carrying out its regulatory duties. As a start, we suggest that various streamline measures in the following areas should be considered, including: tariff filing, accounting practices, filing of interconnection agreements, and statistics reporting. Licence conditions in UCL which are either unnecessary or overlap with other legislation should also be repealed.

<u>Licence Fees and Intended Use</u>

20. Paragraph 59 of the Judgement provides a clear interpretation of "Fee":

    "In general, where used in public law a "fee" identifies a payment for or in respect of services rendered or for the administration of a legislatively based licensing scheme to control particular activities by licensees…"

21. The Court of Final Appeal aptly pointed out that the licence fees paid by operators in the capacity of holders of respective telecommunications licences should be used towards funding of regulatory affairs purely related to the telecommunications sector. This is currently not the case on the fact that no separate account is maintained for telecommunications functions under the legacy structure of OFCATF.

22. Furthermore, the fact that no separate accounts are maintained to segregate expenses incurred by activities of the respective sector of telecommunications and broadcasting has undoubtedly led to cross-subsidisation and thus contravene the spirit of payment of licence fees by telecommunications and broadcasting licensees regardless.

23. We submit that the Administration should promptly rectify the undesirable circumstances by introducing separate accounts dedicated to telecommunications and broadcasting functions individually.

Other Comments

24. HGC does not have any comments on the introduction of a new fee component under UCL to facilitate the development of WIoT services.

Conclusion

25. HGC welcomes the review and proposed reduction in licence fees. However, we have reservation over the suggested approach and the extent of reduction. The Court of Final Appeal Judgement in FACV 11/2017 exposes the shortfall of current assessment of licence fees under the OFCATF and calls for a more detailed scrutiny of the methodology, charging mechanism and accounting practices to arrive at appropriate levels of licence fees payable in accordance with the law. The review should cover both sides of income and expenses. In particular, measures to control costs and enhance efficiency must be in place given the nature of OFCATF that operates on a cost recovery basis. The full-scale review of licence fees should be carried out immediately to promptly rectify the mistake of law in association with current licence fees payment. Any reduction in licence fees resulting from review of licence fees should be deemed to have been implemented from 27 December 2017 to give effect to the Judgement being handed down on that same date.

Submitted by
HGC Global Communications Limited
6 August 2018