Hutchison Telephone Company Limited

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

Date: 6 August 2018

I. Introduction

1. Hutchison Telephone Company Limited ("**Hutchison**") makes this submission in response to the "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" (the "**Consultation Paper**") jointly issued by the Secretary for Commerce and Economic Development ("**SCED**") and the Communications Authority (the "**CA**") on 8 June 2018.

2. Hutchison welcomes this long-awaited consultation on licence fee issued by the SCED and the CA (collectively the "**Government**'). However, we are very concerned about the methods of review and the proposed level of reduction.

3. We explain our views in Part II of this submission.

II. Response to the Proposals in the Consultation Paper

Background

4. The Office of the Communications Authority ("**OFCA**") is the executive arm of the CA, assisting the CA in administering and enforcing the relevant ordinances governing both telecommunications and broadcasting sectors. Under the Trading Fund Ordinance, Cap 430 ("**TFO**"), the licence fees are collected to recover the administrative costs and paid to the OFCA Trading Fund ("**the Fund**")[1] based on a cost recovery principle. The main source of OFCA's revenue (over 80%) comes from licence fees[2].

5. The last review of licence fees was conducted six years ago, and the Government issued a statement on licence fees reduction on 27 November 2012 ("**2012 Joint Statement**"). For unified carrier licences ("**UCLs**"), the Government simply reduced the customer connection fee from \$800 to \$700 for each 100 customer connections, i.e. \$1 per customer connection per year ("**2012 Reduction**").

6. In the Consultation Paper, the Government pointed out that due to the level of the retained earnings of the Fund, i.e. projected to be \$166.2 million for the coming five

[1] Its predecessor OFTA Trading Fund was established by resolution of the Legislative Council on 10 May 1995.
[2] According to the Trading Fund Reports, licence fees accounted for 84.8% of revenue in 2012/13, 86.5% in 2013/14, 85.8% in 2014/15, 85.9% in 2015/16, and 87.1% in 2016/17. The Trading Fund Reports are available at: https://www.ofca.gov.hk/en/pub_report/trading_fund/index.html.

years from 2018-19 up to 2022-23, it considers there is room to reduce the licence fees.

7. On 27 December 2017, the Court of Final Appeal handed down a decision in *PCCW-HKT Telephone Ltd and Hong Kong Telecommunications (HKT) Limited v. The Secretary for Commerce and Economic Development and The Communications Authority (FACV No. 11 of 2017)* ("**CFA Judgment**"), ruling that the Government was wrong in the 2012 Joint Statement on fixing the licence fees. The case was initiated by a judicial review application against the Government arguing that the 2012 Reduction did not go far enough and the Fund had earned far in excess of its statutory level ("**JR Case**"). For instance, the Fund accumulated reserves amounted to $690,165,000 by 2008. As of today, the reserve of the Fund still stands at the same level.

CFA Judgment

8. In the CFA 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 <u>errors of law</u> specified below.

"(b) it was an <u>error of law</u> 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 <u>error of law</u> to construe the Trading Funds Ordinance (Cap 430) ("the TFO") as permitting the inclusion in budgets of the OFTA Trading Fund of <u>projections for notional tax or dividends</u> to be treated as surplus funds under s10(1) of the TFO." [Emphasis added]

9. We are stunned that the Government has totally omitted this important CFA Judgment from the Consultation Paper, which was issued six months after the court decision. The Government should have sufficient time to review the judgment. Nonetheless, there is no mention whatsoever of the highest court ruling and how the decision is being dealt with in the Consultation Paper, particularly how the proposed licence fee reductions take into account the requirement to exclude from the budgets of the Fund "*projections for notional tax or dividends*".

10. The current licence fee levels for carrier licensees in respect of customer connections are prescribed in the Telecommunications (Carrier Licences) (Amendment) Regulation 2012, effective from 1 March 2013. This regulation implements the 2012 Joint Statement that is now impugned by the CFA Judgment. As such, it is imperative

that the Government re-assesses the current licence fee levels, being excessive and unlawful, in accordance with the law and as required by the CFA Judgment.

11. According to the Consultation Paper, the proposed licence fees reduction would mainly come from the "retained earnings". The Government gave the reason: "*As the retained earnings of OFCATF for the coming five years from 2018-19 up to 2022-23 are projected to be $166.2 million (details at Appendix A), it is considered that there is room to reduce the licence fees.*"[3] The financial projections in Appendix A of the Consultation Paper shows that the "retained earnings" brought forward to 2018-19, i.e. $98.3 million, represents the surplus retained by the Fund from 2016-17 to 2017-18.

12. The CFA Judgment makes clear that the past practice for setting the licence fee levels paid by licensees contain errors of laws. As such, we opine that the unlawful overpayments obtained by the Fund, to the extent accumulated through the intentionally excessive licence fees, should be **refunded immediately** to licence holders without further delay. It is unjust for the Government to still withhold such unlawful excessive licence fees and treat it as the source of future reduction.

13. For a proper consultation exercise, we suggest that the Government should conduct a thorough and in-depth review of the structure of licence fees and the financial performance of the Fund, particularly the expenditures incurred by OFCA which has been on the rise in the recent years.

Review of the Licence Fee Structure

14. We consider that the current licence fee review is piecemeal and the proposed reduction is trivial. For the carrier licences, for example, the Government literally uses only one paragraph to set out the reason and conclusion for its proposal:

> *"According to the records of the Office of the Communications Authority ("OFCA"), the number of customer connections for UCLs has increased by 16.1%, from 14.9 million in 2012-13 to 17.3 million in 2017-18, and it is anticipated that the number of customer connections for UCLs will continue to grow in the coming years. Taking into account the projected growth rate, the SCED proposes to reduce the customer connection fee under UCLs from $700 to $500 for each 100 customer connections. The other fee components in Appendix B will remain unchanged."*[4]

15. The Consultation Paper does not provide any calculations to support the $2 reduction. Nor does it explain why other fee components should remain unchanged.

[3] Para. 4 of the Consultation Paper.
[4] Para. 6 of the Consultation Paper.

16. For UCLs, the annual licence fee actually consists of a number of fee components, i.e. a fixed fee of $1,000,000 and variable fees based on the number of customer connections, the numbers in use ("**Subscriber Number Fee**"), the number of base stations ("**Base Station Fee**") and a fee for the management of radio frequency assigned ("**Spectrum Management Fee**").

17. The current licence fee structure for the UCLs was proposed in 2005 and implemented in August 2008. We wonder - has the Government ever conducted a thorough review of the Subscriber Number Fee, Base Station Fee and Spectrum Management Fee? Why should these fee components remain unchanged? If the Government has studied these fee components, review analysis and results should at least be disclosed in the Consultation Paper, so that the consultees understand why these fee components be kept in status quo.

Review of OFCA's Operation

18. While a thorough assessment of the licence fee (main revenue source) is important, a comprehensive review of the operation of OFCA (the expenditure driver) is equally crucial. From Appendix A of the Consultation Paper, we noted that the expenditure for operation of OFCA has been increasing and projected to be on the rise[5], as follows:

Financial Projections of OFCATF
2018-19 to 2022-23
(based on the existing level of licence fees)

	18-19 $M	19-20 $M	20-21 $M	21-22 $M	22-23 $M
Revenue	458.2	470.1	472.4	473.0	478.1
Expenditure	(453.5)	(464.2)	(475.8)	(487.0)	(502.4)
Operating surplus / (deficit) before interest income	4.7	5.9	(3.4)	(14.0)	(24.3)

19. According to the Trading Fund Report 2016/17, the expenditure for the year amounted to $419.3 million. The financial projections in the above table, however, show a significant increase of expenditure from 2018/19 to 2022-23. Regrettably, the Consultation Paper does not provide adequate information, including the composition of the expenditure, for the industry to provide meaningful comments and responses. On this basis, seven UCLs holders jointly submitted a letter[6] to the Government requesting, among others, for the evidential base for its proposal and financial assumptions made, if any.

[5] This is an extract of the table in Appendix A of the Consultation Paper. For the complete financial projections, please refer to page 7 of the Consultation Paper.
[6] The joint letter was issued to the Government on 27 June 2018 by China mobile Hong Kong Limited, Hong Kong Broadband Network Limited, Hong Kong Telecommunications (HKT) Limited, HGC Global Communications Limited, HTCL, SmarTone Mobile Communications Limited, and WTT HK Limited.

20. Regarding the expenditure, we specifically enquired about the basis for the projection of expenditure from 2018-19 to 2022-23, bearing in mind that expenditure in the past has been more or less constant, and section 6(3) of the TFO bars the variation of services without a Legislative Council Resolution.

21. It was revealed in the Government's subsequent reply that "*staff cost amounts to over 80% of the total expenditure*." Increase in expenditure over the five-year forecast period is mainly due to inflationary adjustment of staff cost.

22. In this juncture, we would refer to the merger of the Broadcasting Authority and the Telecommunications Authority. On 1 April 2012, the Communications Authority Ordinance, Cap 616 came into operation, and the CA was created as a unified regulator to service the broadcasting and telecommunications industries, with OFCA being its executive arm and secretariat. Operational efficiency was anticipated from the merger. The authorities stated that

> *"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 in one single organisation… We envisage streamlined practices, operational synergy, and deregulatory measures will eventually result in savings.*"[7] [Emphasis added]

23. Like other industry players, we share the same expectation as the authorities, i.e. a drop, instead of an increase, in staff costs. Given the de-regulation of a number of telecom policies, such as interconnections, and the market-based approach taken by OFCA, lots of resource-consuming tasks are no longer applicable. Streamlining measures should be in place. For instance, unnecessary review process and documentation in areas such as filing of tariffs and interconnection agreements should be eliminated. Hence, we suggest that OFCA should take a proactive approaching to conducting a thorough review of its expenditure like staff costs, and kick-start the streamlining measures in order to improve its operational efficiency.

24. In light of the CFA Judgment, an assessment of the levels of licence fees paid by telecommunication and broadcasting licensees should also be conducted. The licence fees collected should be proportional to the expenses used in the respective sector; otherwise the excessive amount could be seen as "a tax", which was ruled illegal in the JR Case. It is stated in the CFA Judgment that:

[7] Annex A of the Legislative Council Brief (File Ref: CTB(CR)9/19/13(05)Pt4. "*Consultation Paper on the Establishment of the Communications Authority*" dated 3 March 2006 by Communications and Technology Branch and Commence, Industry and Technology Bureau. Available at http://www.legco.gov.hk/yr05-06/english/panels/itb/papers/ctb_cr_9_19_13_05_pt4-e.pdf.

"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, whereas a tax is rather a means of obtaining revenue for governmental purposes. When the power to license is an element in a regulatory scheme, the power does not extend to authorise the imposition of a fee which in substance is a tax upon the activity to be conducted under cover of the licence. If the licensee as a practical matter has no choice in the conduct of its affairs as to whether it acquires the licence and <u>there is an insufficient relationship between the "fee" for the licence and the administration of the scheme, then, at least to the extent of the excess, the "fee" may properly be seen as a tax</u>."[8] [Emphasis added]

25. Upon review of the Fund reports, we found that licence fees paid by telecommunication licence holders have been consistently and substantially higher than those of the broadcasting sector. Please refer to the table in Appendix I for details. Necessary actions should be taken for the sake of equity and compliance with the CFA Judgment.

International Practices

26. Reference should be made to international practices like Ofcom, the communications regulator of the UK. For the annual budget, Ofcom will prepare in advance and publish an outline of its proposed budget for the immediately following financial year. Based on that budget, Ofcom will apply a set of published charging principles to determine the level of administrative fees payable by electronic communication providers for the following financial year. The charging principles include a requirement that, on a year by year basis, the aggregate amount of the charges payable is sufficient to meet, but does not exceed, the annual cost to Ofcom of carrying out its relevant functions. Any surplus funds arising at the end of the financial year are required to be returned to stakeholders through a reduction in the annual charges raised in the subsequent years.[9]

Structured Annual Review

27. As part of the future licence fee setting process, we suggest that OFCA and the licensees be engaged in regular meaningful discussion regarding the overall costs of the Fund. To ensure future annual reviews on the licence fees are transparent and

[8] Para. 59 of the CFA Judgment.

[9] For example, Ofcom achieved efficiency saving in 2008/09 and passed back the money to stakeholders by reduced charges. Please refer to"Ofcom reduces cost of regulation for fifth consecutive year; £3.5m to be refunded to stakeholders". Available at : https://www.ofcom.org.uk/about-ofcom/latest/media/media-releases/2009/ofcom-reduces-cost-of-regulation-for-fifth-consecutive-year-3-5m-to-be-refunded-to-stakeholders

equitable, we suggest a structured approach to the annual review whereby a review of licence fees is conducted by OFCA at a specified time, and the industry is informed of the review and given the opportunity to submit its views.

III. Conclusion

28. The Government must take into account the CFA Judgment in setting the levels of future licence fees. A thorough assessment of the fee structure is imperative.

29. OFCA should take a proactive approach to conducting a comprehensive review of its expenditures and implement streamlining measures in order to improve its operational efficiency.

30. Future licence fees need to be determined in a more transparent, reasonable and fair manner fully in accordance with the law and the cost recovery principle.

31. Compensation should be made for past unlawful overpayments of licence fees as soon as possible. As of today, licence holders still have no knowledge of how the Government would handle the $690 million development reserve in the Fund. We are of the view that OFCA should take the lead on arranging a series of meetings with stakeholders for the purpose of reaching a mutually acceptable and prompt settlement.

~ THE END ~

Appendix I

Table 1: OFCA Trading Fund 1995-96 to 2016-17 (HK$ '000)

A	B	C	D	E	F	G
Year	*Develop-ment Reserve Balance*	*Average Net Fixed Assets (ANFA)*	*Revenue ('Turnover' + 'Other Income')*	*Operating Costs*	***Telecom Licence Fees***	***Broadcasting Licence Fees***
1995-96	55,323	206,366	243,016	136,239	196,337	
1996-97	115,030	206,220	286,755	178,089	224,590	
1997-98	202,985	207,260	346,038	204,057	274,992	
1998-99	332,794	210,427	402,815	220,517	321,962	
1999-00	446,962	210,166	400,408	234,927	325,563	
2000-01	530,196	209,788	373,256	245,554	294,389	
2001-02	555,245	231,100	328,211	262,279	274,881	
2002-03	500,397	242,485	317,576	269,581	275,598	
2003-04	526,381	228,054	319,841	263,889	281,653	
2004-05	559,425	217,459	318,554	242,750	282,617	
2005-06	593,700	210,477	310,025	235,675	266,531	
2006-07	656,264	205,837	320,955	228,317	269,788	
2007-08	690,165	200,747	348,030	246,032	286,495	
2008-09	690,165	192,954	343,709	271,707	287,366	
2009-10	690,165	183,146	339,448	242,644	286,125	
2010-11	690,165	173,080	355,794	249,440	322,065	
2011-12	690,165	166,293	411,615	274,169	348,076	
2012-13	690,165	170,199	485,759	374,862	**366,447**	**45,766**
2013-14	690,165	174,017	473,447	378,313	**363,354**	**46,291**
2014-15	690,165	167,211	484,574	398,119	**368,868**	**47,105**
2015-16	690,165	159,616	501,074	424,468	**377,601**	**52,624**
2016-17	690,165	150,624	491,261	419,303	**372,721**	**55,344**
TOTAL	690,165		**8,202,161**	**6,000,931**	**6,668,019**	**247,130**