

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 Carrier Licences

Submission by

SmarTone Mobile Communications Limited

1. SmarTone Mobile Communications Limited (“SmarTone”) welcomes the above Consultation Paper issued jointly by the Commerce and Economic Development Bureau (Communications and Creative Industries Branch) (“CEDB”) and the Communications Authority (“CA”) on 8 June 2018. This is a long-awaited consultation exercise as the last licence fee review was conducted back to 2012.
2. The Court of Final Appeal handed down its judgment in the case of *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) on 27 December 2017 (the “CFA Judgment”). The Judgement has significant and far-reaching implications on the licence fee levied under the OFCA Trading Fund (“OFCATF”). It is therefore to our surprise that the Consultation Paper has not mentioned the CFA Judgement until the OFCA’s response to the joint operators’ letter of 27 June 2018 and the publication of the “Additional information and clarification” on 16 July 2018 (“Additional Information”).
3. In the CFA Judgment, the Court of Final Appeal has made the following declaration (in paragraph 77):

(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.”

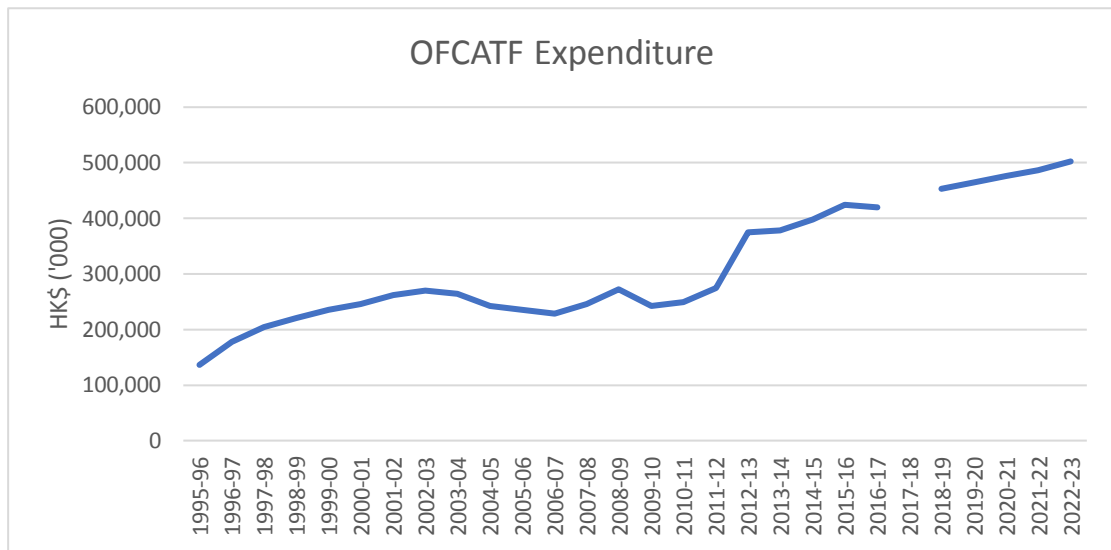
4. With this background, SmarTone would like to provide its comments on the following issues for the CEDB and CA’s consideration.

Retained Earnings of OFCATF

5. As stated in paragraph 4 of the Consultation Paper and paragraph 2 of the Additional Information, the proposed licence fee reduction is based on the retained earnings of OFCATF, which is projected to be \$166.2 million for the coming five years from 2018-19 to 2022-23. The retained earning of 2018-19, which amounts to \$98.3 million, represents the surplus retained by OFCATF brought forward from 2016-17 to 2017-18.
6. Since the retained earnings represent the surplus retained by OFCATF from the excessive licence fees levied in the past, the amount of retained earnings of 2018-19 should in principle be returned to the industry immediately in light of the CFA Judgement. The current consultation exercise should therefore not only return all the amount of retained earnings, but also conduct a detailed review of the licence fee levied under the OFCATF with regards to the principles set out in the CFA Judgement. We will elaborate the relevant issues that we would expect the CEDB and CA to review in the following sections.

Expenditure of OFCATF

7. In appendix A of the Consultation Paper, there is a projection of OFCATF expenditure for 2018-19 to 2022-23. It was also clarified by OFCA that about 80% of the expenditure is staff cost. There is however no further information available regarding the basis for the projection of expenditure from 2018-19 to 2022-23.
8. The following table shows the actual expenditure of OFCATF from 1995-96 to 2016-17 (data extracted from past OFCATF Reports) as well as the projected expenditure from 2018-19 to 2022-23 put forth in the Consultation Paper.



9. It is shown that between 1998-99 to 2011-12, the annual expenditure of OFCATF was rather constant and maintained within the range of HK\$220 to 274 million. In particular, it is noted that the annual expenditure between 2004-05 to 2007-08 was lower than that of 2003-04. The same also occurred in 2009-10 to 2010-11 as compared to 2008-09.
10. In contrast, the projected expenditure from 2018-19 to 2022-23 shows a rather different pattern as compared to the past. First, there is an increase of about 8% in the expenditure of 2018/19 as compared to that of 2016/17 (the data of 2017/18 is not yet available). Also, it is assumed that the annual expenditure of OFCATF will be increased at an average growth rate of about 2.6% from 2018-19 to 2022-23. While it is difficult to comment on these projections without an understanding of the assumptions behind, the uprising trend of OFCATF expenditure projection is alarming.
11. In this context, we wish to refer to the practice of OFCOM, the regulator of UK's communications industry. OFCOM is subject to a framework agreement with the UK Government by which OFCOM is required to ensure that its expenditure is controlled so that value for money is achieved through the economical, efficient and effective use of OFCOM's resources¹. We believe it is a general principle that would be applicable to any public body or institution operating on public funds.
12. In view of the above and the projection of OFCATF expenditure put forth in the Consultation Paper, we have the following questions:
 - a. Is there any internal or external audit of OFCATF accounts and expenditures that would examine the efficiency of OFCATF operations?

¹ Office of Communications (Ofcom) Framework Document, June 2016

- b. It is revealed that 80% of OFCATF cost are staff cost. We wish to understand whether there is any review of OFCATF's remuneration policy?
- c. It is noted that there was a sharp increase of OFCATF expenditure in 2012/13, which was probably due to the transfer of the broadcasting functions of the TELA to OFCA in 2012. We wish to understand whether there is any efficiency gain from the consolidation of the two operations under the CA.
- d. Would there be any review of cost control measures that OFCATF may adopt, such as streamlining some of the regulatory measures that may not be necessary. For example, some requirements such as filing of tariff and interconnection agreements may no longer be necessary given the competitiveness of Hong Kong's telecommunications market. The requirement of accounting practice may also be phased out if payment of Spectrum Utilization Fee is not based on the calculation of network revenue of licensees.
- e. Besides streamlining regulatory requirements, would OFCA consider adopting other measures or reviews that would reduce its operating costs, such as office rental expenditure or day-to-day running costs?

Imbalance in OFCATF's Licence fee Structure

- 13. According to the latest OFCATF Report 2016-17, the total amount of licence fee paid by broadcasting and telecommunications licensees was about \$55.3 million and \$372.8 million respectively. In other words, the broadcasting sector had contributed about 13% of OFCATF's revenue while the telecommunications sector had contributed about 87% in 2016-17. It is also worth noting that the largest contributing sector to OFCATF's revenue is the mobile industry. There were nine mobile service licensees in 2016-17, which together paid HK\$182 million or contributed 42.6% of the total revenue of OFCATF.
- 14. The above strongly suggests that there is a significant imbalance in the existing structure of licence fee levied under the OFCATF.
- 15. We wish to highlight paragraph 59 of the CFA Judgement, which says:

"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 authorize 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 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”.

16. As the majority of OFCA’s revenues are coming from licence fee paid by telecommunications licensees, and in particular the mobile service licensees, we cast serious doubt whether there is a sufficient relationship between the licence fee levied and the administration work of particular class of licensees.

Development Reserve of OFCATF

17. The OFCATF has a development reserve of \$690 million, which was accumulated from past licence fee surplus and frozen at the current level since 2007-08. It is believed that the development reserve has also generated interest incomes to OFCATF throughout the years.
18. Given that the development reserve is a result of past excessive licence fees, OFCA should return the development reserve to the industry in view of the CFA Judgement.

Refund of Past Excessive Licence Fee

19. The Consultation Paper has only made proposal on future licence fee which will take effect from January 2019, without addressing the implications of the CFA Judgement on past licence fee paid that was made upon the errors of law as identified by the Court of Final Appeal. We would therefore urge CEDB and the CA to also make proposals on the refund arrangements for past excessive licence fee in light of the CFA Judgement.

SmarTone Mobile Communications Limited

6 August 2018