**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**

**Joint Statement of**
**the Secretary for Commerce and Economic Development and**
**the Communications Authority**

**12 October 2018**

## INTRODUCTION

On 8 June 2018, the Secretary for Commerce and Economic Development ("SCED") and the Communications Authority ("CA") jointly issued a public consultation paper[1] ("the Consultation Paper") to seek views and comments from the industry and interested parties on the proposals to reduce the licence fees payable by holders of five types of licences[2] issued under the Telecommunications Ordinance (Cap. 106) ("TO"), and to introduce a new fee component under unified carrier licences ("UCLs") to facilitate the development of Wireless Internet of Things ("WIoT") services ("the Proposal").

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[1] The Consultation Paper is available at -
https://www.coms-auth.hk/filemanager/en/content_711/cp20180608_e.pdf or
https://www.cedb.gov.hk/ccib/eng/paper/pdf/2018_licence_fee_eng.pdf

[2] To recap, under the proposed licence fees reduction, the customer connection fee under UCLs is proposed to be reduced from $700 to $500 for each 100 customer connections; and the mobile station fee of public radiocommunications service licences for public radio paging services ("PRS-Paging") and services-based operator licences (Class 3) (mobile virtual network operators) ("SBO-MVNO") is proposed to be reduced from $700 to $500 for each set of 100 mobile stations. For mobile radio system mobile station ("MRS") licences and private mobile radio system ("PMRS") licences, the licence fee for each mobile station is proposed to be reduced from $270 to $220.

2. Having regard to the requirement stipulated under section 7 of the TO[3], the consultation period was originally set to close on 9 July 2018. In response to the request from the industry, the consultation period was extended to 6 August 2018 to provide more time for the industry to consider the Proposal and to express their views. The Office of the Communications Authority ("OFCA") has also sent a letter to provide clarification/additional information ("Additional Information") in response to the requests of certain stakeholders to facilitate better understanding of the issues involved. The Additional Information[4] was also posted on the websites of the Commerce and Economic Development Bureau and the CA for public information.

3. At the close of the extended consultation period, seven submissions[5] were received from the following parties ("the Respondents") (listed in alphabetical order) –

(a) China Mobile Hong Kong Company Limited ("CMHK")
(b) HGC Global Communications Limited ("HGC")
(c) Hong Kong Broadband Network Limited ("HKBN")
(d) Hong Kong Telecommunications (HKT) Limited ("HKT")
(e) Hutchison Telephone Company Limited ("HTCL")
(f) SmarTone Mobile Communications Limited ("SmarTone")
(g) WTT HK Limited ("WTT")

4. Having considered the submissions received and other relevant factors, SCED and the CA set out in this Joint Statement their responses to the submissions and promulgate their decisions on the Proposal. For the purpose of this Joint Statement, any reference to "the Administration" shall mean both SCED and the CA. For the avoidance of doubt, SCED and the CA are fully aware of their specific powers under

[3] Before making a regulation on the fees payable for UCLs, SCED is required to, by notice in the Gazette, invite members of the public who are interested to make representations by a date not less than 21 days after the notice is published and as specified in the notice.

[4] The Additional Information is available at -
https://www.coms-auth.hk/filemanager/en/content_711/cp20180716_e.pdf or
https://www.cedb.gov.hk/ccib/eng/paper/pdf/Announcement_on_additional_info_provided_Eng_20180717.pdf

[5] The submissions are available at –
https://www.cedb.gov.hk/ccib/eng/paper/ucl_submission2.htm

section 7 of the TO to determine licence fees for UCLs, PRS licences, SBO licences, MRS licences and PMRS licences.

## SUBMISSIONS RECEIVED AND THE ADMINISTRATION'S RESPONSES

5. All the Respondents are holders of UCLs. Some also hold SBO licences. While they generally support the Administration's initiative to reduce licence fees for UCLs and to introduce a new fee component for WIoT service, they express further views and comments on the Proposal. The Administration has considered all of the submissions received. A summary of the views and comments of the Respondents, as well as the responses and decisions of the Administration are set out below. Readers will appreciate that it is not practicable to respond to the Respondents on a point-by-point basis, and that where submissions are not expressly summarised below, that does not mean that the Administration has not considered them.

### Licence Fees Review and Refund of Past Licence Fees in Light of the CFA Judgment

Respondents' Views and Comments

6. HKT and HTCL note that the Consultation Paper did not mention how the Court of Final Appeal ("CFA") Judgment[6] handed down on 27 December 2017 has been taken into account in determining licence fees. HKT, HTCL, SmarTone and WTT request the Administration to make a proposal on refund of past licence fees in light of the CFA Judgment.

The Administration's Response

7. The Administration has taken into account the CFA Judgment in determining licence fees and the fact that claims for restitution of past licence fees are the subject of legal proceedings being handled separately by the Government.

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[6] PCCW-HKT Telephone Limited and Hong Kong Telecommunications (HKT) Limited v The Secretary for Commerce and Economic Development and the Communications Authority FACV No. 11 of 2017 (the "CFA Judgment")

8. The CFA case is related to the licence fee review conducted in 2011-12. Having regard to the outcome of the review, the Administration issued a joint statement in November 2012 to promulgate the decisions to, among other things, reduce the customer connection fee of UCL from $800 to $700 for each set of 100 customer connections. In February 2013, PCCW-HKT Telephone Limited ("PCCW") and HKT filed an application for leave to apply for judicial review ("JR") against the decisions of the Administration. The JR proceedings ultimately reached the CFA, which handed down its judgment on 27 December 2017 allowing the appeal of PCCW and HKT. The CFA ruled that a licence fee could not include an element of what in substance was a tax upon the licensees and that the OFCA Trading Fund ("OFCATF") could not include in its budget notional tax and dividends to be treated as surplus funds to be transferred to the general revenue.

9. While the target return required by the Government pursuant to section 6(6)(c) of the Trading Funds Ordinance ("TFO") has been included in the financial projections in working out the Proposal, notional profits tax and dividends have **not** been included and will not form **any** part of the new proposed fees. This is clearly shown in Appendices A and C to the Consultation Paper and is reaffirmed in the Additional Information. Effect has therefore been given to the CFA Judgment in working out the proposed reduction in licence fees. Further, in line with the cost recovery principle, the Administration has been regularly monitoring whether the expenses incurred in the provision of the service and financing liabilities of OFCATF are met by the income paid into OFCATF and is minded to adjust the relevant licence fees should there be room to do so. The current review has been conducted in accordance with the revised financial arrangements as advised by the Financial Services and the Treasury Bureau, which has taken into account the CFA Judgment.

10. As for the refund of past licence fees, following the CFA Judgment, claims for restitution of excessive licence fee payments in the past years have been made by licensees. In fact, all the Respondents have issued their writ of summons for such purposes. The legal proceedings for the restitution claims are being handled separately by the Government and the claims for restitution of excessive payments (except for those retained in OFCATF after the CFA Judgment), if so justified, will be funded by the general revenue instead of by the OFCATF. The issue is thus being addressed, but is a separate matter and outside the scope of the current licence fee review exercise. Taking into account Respondents' views, the Administration will not use the dividend and provisions for

taxation withheld (which are retained in OFCATF in light of the CFA Judgment) for licence fee reduction, but will instead set the relevant amount aside for refund of the alleged excessive licence fees for 2016-17 and 2017-18 as per paragraph 18 below, pending resolution of the claims for restitution.

**Methodology and Approach of the Licence Fees Review**

Respondents' Views and Comments

11. HKT, HTCL, SmarTone, and WTT submit that a comprehensive review of licence fee structure should be conducted regularly or annually, covering other fee items such as subscriber number fee, base station fee and spectrum management fee. HKT, CMHK, HTCL and WTT also consider that there is a lack of detailed explanation and inadequate disclosure on the financial projections, methodology, principle and formula for the proposed reduction in customer connection fee in the consultation paper for their consideration.

The Administration's Response

12. In conducting the fee review exercise, the Administration has reviewed all the fee components of all the relevant licences. In identifying fee components for fees reduction, the Administration essentially looks for those which contribute to the surplus, unless there are other policy considerations which call for alternative treatment. For example, the customer connection fee component under the UCL is considered appropriate for reduction as it is a major fee component and contributes to the surplus of OFCATF. On the other hand, the fixed annual fee component of UCL has not been considered for reduction as the resources for basic administration of the licence remain largely the same and the fixed annual fee accounts for less than 10% of the total licence fees. Number fees have also not been considered for reduction since there is a need to promote the efficient use of the finite amount of telephone number resources.

13. As a trading fund department, OFCA is required to manage its financial affairs to ensure that within a reasonable time, it has the capacity to meet expenses incurred in the provision of its services[7] to the

[7] The service is set out in Schedule 3 to TFO.

CA, licensees and other stakeholders out of its income, taking one year with another, and to achieve the target return on fixed assets employed as determined by the Financial Secretary. As shown in Appendix A to the Consultation Paper, the overall retained earnings over the five-year period from 2018-19 to 2022-23 are projected to be $166.2 million and the Administration has proposed to allocate this sum for licence fees reduction as much as possible. As licence fee reviews are conducted on a regular basis, the Administration is prepared to consider whether there is room for further adjustment in licence fees in the next review exercise should there be any substantial variation in the key parameters used for the financial projections.

14. The Administration considers that sufficient information relevant to the consultation has been provided to the industry to enable them to offer their views. Specifically, details including the estimated income, estimated expenditure, target return and retained earnings over the five-year period have already been provided in the Consultation Paper. Key assumptions based on which the financial projection is made have also been provided in the Additional Information in response to the request from the industry. All along, OFCATF has published its annual Trading Fund Reports, together with the audited financial statements, for public information. The financial statements therein provide details of the financial positions, changes in equity and cash flows of OFCATF.

## Retained Earnings Brought Forward

Respondents' Views and Comments

15. With the exception of CMHK, all Respondents assert that as the retained earnings of $98.3 million brought forward to 2018-19 ("the REBR") is derived from licence fees prescribed under the prevailing Telecommunications (Carrier Licences) Regulation (Cap. 106V) ("Regulation") and contains unlawful elements in light of the CFA Judgment, they should be refunded immediately to licensees instead of through reduction of licence fees. HKT, HGC and HKBN further consider that the use of the REBR for fees reduction is unfair to those licensees who have paid excessive licence fees in the past. HKT submits that any licence fee reductions should be sustainable in the long term rather than having to deal with a level of licence fee which fluctuates over time. WTT requests the Administration to prepare a budget for the return of the entire retained earnings to the licensees promptly, and on that basis to identify a sustainable licence fee reduction thereafter, even if it may be

less than the proposed reduction of $700 to $500 per 100 customer connections.

<u>The Administration's Response</u>

16. As seen from Appendix A to the Consultation Paper, the $98.3 million REBR represents the surplus retained by the OFCATF for 2016-17 and 2017-18. Within this amount, $17.9 million is the projected target return entrusted to be retained in OFCATF. It belongs to the Government pursuant to section 6(6)(c) of the TFO and is not subject to OFCATF's disposal. The remaining $80.4 million comprises the dividend and provisions for taxation withheld and was originally planned to be transferred to the general revenue but the act of transfer was withheld in light of the CFA Judgment.

17. In working out the Proposal, consideration had been given to the option of setting aside the amount of $80.4 million for refund of the alleged excessive licence fees. Taking into account the fact that the proceedings on restitution claims brought by some UCL holders in respect of the alleged excessive licence fees have just commenced and it would take time to resolve the issues involved; and considering that how the issue of restitution would be resolved in the ongoing proceedings would have a bearing on the use of the REBR for refund of the alleged excessive licence fees for 2016-17 and 2017-18, the Administration therefore proposed in the Consultation Paper to use the REBR upfront for reduction of licence fees payable by telecommunications licensees, who could then benefit from the outcome of the CFA Judgment in a more timely manner.

18. Nevertheless, having considered the Respondents' comments, the Administration **decides not to use the REBR for licence fees reduction. Instead, the amount of $80.4 million will be set aside for refund of the alleged excessive licence fees for 2016-17 and 2017-18, pending the resolution of the claims for restitution**. Taking into account the OFCATF's capacity to meet expenses incurred in the provision of its services out of its income within a reasonable period, the Administration further decides to maintain the proposed fees reduction (see Footnote 2 for details).

**Development Reserve**

<u>Respondents' Views and Comments</u>

19. SmarTone, HKT, HTCL and WTT submit that the Development Reserve has been established from past licence fees and should be returned to the industry in view of the CFA Judgment. HKT also submits that the Development Reserve should be taken into account when deciding whether or not to levy further licence fees or computing the level of the licence fee reduction.

The Administration's Response

20. As authorised by section 5(3) of the TFO, the Development Reserve was set up in 1995 and has been accumulated from the surpluses of the OFCATF. In response to the recommendation of LegCo Members of the LegCo Subcommittee to study the resolution to establish the Office of the Telecommunications Authority Trading Fund ("OFTATF"), the then Secretary for Economic Services agreed that excessive surpluses of the trading fund will be transferred to a development reserve within the trading fund accounts and will be used for reducing the need for future fee increases. In his speech at the Council meeting on 10 May 1995 moving the motion to establish the OFTATF, the Secretary reaffirmed this objective of the Development Reserve. The Development Reserve now stands at $690.2 million, and no further injection into the Development Reserve has been made since April 2008. As shown in Appendix C to the Consultation Paper, it was projected that starting from 2023-24, OFCATF would exhaust almost all retained earnings and that transfers out of the Development Reserve would be used for reducing the need for licence fee increase from 2023-24.

21. Regarding the Respondents' view that the Development Reserve should be taken into account in determining licence fees, the Administration maintains that the use of the Development Reserve should adhere to its objective of reducing the need for future fee increases. By setting aside the amount of $80.4 million in the REBR for refund and maintaining the proposed licence fees reduction, the latest projection is that OFCATF will exhaust its retained earnings in 2020-21, three years earlier than envisaged in the original projection. In order to obviate the need to increase licence fees to meet expenses incurred, transfers out of the Development Reserve is expected from 2020-21. The Administration is of the view that the above transfers are justifiable to cater for setting aside the $80.4 million in the REBR for refund on a one-off basis and to maintain the fees reduction in the Proposal. After the above transfers, it is projected that the Development Reserve will still be reasonably sufficient to sustain the operations of OFCATF until 2025-26. The Administration

will take into account the financial projections and the balance of the Development Reserve in conducting regular licence fee reviews in future.

## Expenditure of OFCATF

Respondents' Views and Comments

22. All Respondents request OFCA to review its expenditure level and operations in order to improve its operational efficiency and pass on the benefits to licensees. Citing the increase in headcount, excessive regulatory requirements and high office rental, HKT, WTT and HKBN express doubt on synergy and cost savings previously envisaged in the merger of the former Office of the Telecommunications Authority and the former Broadcasting Authority and opine that there is little incentive for OFCA to minimise cost.

The Administration's Response

23. Issues concerning expenditure and operational efficiency of OFCA are matters of internal control and management. They are outside the scope of the current review. That said, the Administration wishes to highlight that as a Government department, OFCA is subject to the same strict financial control and discipline applicable across the Government. For example, creation of additional civil service posts have to undergo the Government's resource allocation exercise process; creation of directorate civil service posts is further subject to the approval of LegCo. As a trading fund department, OFCA is also required to meet the financial objectives set by SCED and approved by the Secretary for Financial Services and the Treasury.

24. Contrary to the views of some the Respondents that OFCA's workload has been diminishing, the workload of OFCA has been on the rise in recent years. The emergence of new technologies and applications in the telecommunications sector in recent years and the increasing complexity in handling the licensing and regulation of these new and emerging services calls for increased regulatory efforts. Licence administration work has also been on the rise due to the increased number of services-based and facilities-based licensees; the increasing number of applications for radio base stations submitted by mobile network operators for expansion of their existing network capacity; and the resulting increase in monitoring and complaint handling work. Enhanced efforts in making available radio spectrum for public mobile services,

including fifth generation ("5G") mobile services; increased need to work with the industry on regulatory or self-regulatory measures to meet consumers' aspirations on the use of telecommunications services; handling of complaints and enquiries from the public; enhancement in consumer education and publicity campaigns, etc. have all resulted in the need for extra manpower resources. As stated in the Additional Information, staff cost amounts to over 80% of the total expenditure of OFCATF. Apart from the standard inflationary adjustment adopted by all Government departments, the staff cost reflects the manpower required to cope with the increasing workload over the past years.

**Cross-subsidization between Telecommunications and Broadcasting Functions**

Respondents' Views and Comments

25. SmarTone, HKT and HTCL submit that licence fees collected should be proportional to the expenses used in the respective sectors, otherwise the excessive amount could be seen as "a tax". WTT, HGC and HKBN submit that separate accounts for telecommunications and broadcasting functions should be established to avoid cross-subsidization.

The Administration's Response

26. Over the past years, rapid advancement in telecommunications, broadcasting and information technology has blurred the traditional boundaries between telecommunications and broadcasting, leading to the convergence of the two markets. Against this background, the CA was established on 1 April 2012 with the enactment of the Communications Authority Ordinance (Cap. 616) ("CAO") as the unified regulator for a converging and fast developing communications sector.

27. OFCATF was established to manage and account for the operation of the prescribed public functions and services of the CA. As set out in Schedule 3 to the Office of the Communications Authority Trading Fund (Cap. 430D), the scope of services to be provided by the OFCATF has since 2012 expanded to cover those related not only to the TO, but also the Broadcasting (Miscellaneous Provisions) Ordinance (Cap. 391), the Broadcasting Ordinance (Cap. 562), the Unsolicited Electronic Message Ordinance (Cap. 593) and the CAO. The total

income received for the provision of service as set out in Schedule 3 to the OFCATF has since been used to meet the overall expenses for provision of such types of services. There are no separate accounts for the broadcasting and telecommunications operations of the CA. Indeed, this is not required under the CAO or any of the abovementioned ordinances. Furthermore, a separation of the telecommunications and broadcasting functions would obviate many of the efficiency gains behind the establishment of the CA, thus frustrating the purpose of the CAO in the first place.

28. Due to technological advancement and market convergence, regulation of telecommunications and broadcasting no longer fit neatly into the conventional sectoral delineation. The Administration is of the view that to a reasonable extent, the CAO allows certain flexibility and is intended to empower the OFCATF to manage its resources with certain degree of flexibility and discretion.

## Backdating of Fees Reduction

Respondents' Views and Comments

29. Both HKT and WTT opine that the licence fee reduction should be backdated. The effective dates submitted by HKT and WTT were 1 January 2018 (i.e. immediately followed the handing down of the CFA Judgment) and 8 June 2018 (i.e. the date when the Consultation Paper was issued) respectively.

The Administration's Response

30. While the Administration endeavours to effect the proposed licence fees reduction as soon as possible, the implementation of such is subject to the enactment of the relevant amendment regulation. In determining the date of the implementation of the proposed licence fees, the Administration needs to take into account the necessary legislative process, which includes consulting the Panel on Information Technology and Broadcasting of the Legislative Council ("ITB Panel of LegCo"); gazetting the proposed amendment regulation; tabling the amendment regulation in LegCo; and subject the amendment regulation to the negative vetting procedures of LegCo. Taking into account the commencement of the new term of LegCo in October 2018 and the meeting dates of the ITB Panel, the earliest possible time for consulting the ITB Panel would be in November 2018 while that for tabling the

proposed amendment of the regulation at a Council meeting of LegCo would be in December 2018. Subject to the negative vetting procedures of LegCo, the earliest possible time for implementation of the Proposal will be January 2019. The Administration therefore considers it appropriate to effect the licence fees reduction in January 2019, subject to the enactment of the proposed amendment regulation.

**WIoT Device Fee under UCL**

Respondents' Views and Comments

31. HKT agrees with the proposal to introduce a new fee component of WIoT device fee under UCL at a level aligned with that of the WIoT Licence. HKT further submits that changes should be made to the current UCL licence conditions to align the other disparities between the licence conditions under the existing UCL with those under the WIoT Licence such as conditions regarding number portability, accounting practices, universal service contribution, etc. CMHK requests for more details and justification for the proposal for clarification and further review, as it considers that the total amount of WIoT device fee may be huge in light of the large volume of such devices.

The Administration's Response

32. The Administration notes that there is support in general for the proposal to introduce a new fee component of WIoT device fee under the UCL at $200 for each 100 WIoT devices used by customers. The Administration considers that with the advent of the 5G era, massive scale implementation of WIoT services and applications over the 5G platforms can be realized, with the potential of supporting concurrent operation of millions of WIoT devices in a small area. This revolutionary development could imply a substantial expansion of customer base of mobile network operators ("MNOs") and create tremendous business potential and revenue. The much reduced device fee (proposed at $200 as compared with the existing $700 per 100 WIoT devices) will bring substantial savings to MNOs offering IoT services.

33. The Administration recognises that there are different sets of licence conditions prescribed under the existing UCL and those under the new WIoT Licence applicable for the provision of WIoT services, and this is due to the two licensing regimes adopted for carrier licences and

non-carrier licences respectively. However, the Administration considers that the matter is outside the scope of the current review. It may be addressed in future reviews to be conducted by the CA within the context of further facilitating the development of WIoT services in Hong Kong.

34. As regards the detailed justifications for the fee proposal, as mentioned in the Consultation Paper, the current proposal for the new fee component of WIoT device fee under the UCL is set by aligning with the existing level of the same fee component under the WIoT Licence so as to facilitate the development of WIoT services in Hong Kong by both MNOs and WIoT licensees. The proposed fee level is determined in line with the cost recovery principle in order to recover the administrative cost for regulating the relevant licences for the provision of WIoT services.

## THE ADMINISTRATION'S DECISIONS

35. Having duly considered the views and comments received during the consultation exercise, the Administration has decided to proceed with the fees reduction as set out in the Proposal and the introduction of the new fee component of WIoT device under UCL at $200 for each 100 WIoT devices.

## WAY FORWARD

36. SCED will proceed to introduce an amendment regulation into the LegCo pursuant to section 7(2) of the Ordinance to implement the proposed licence fees reduction as well as the proposed introduction of the WIoT device fee under UCLs. Subject to the implementation of the proposed licence fees reduction for UCLs, the CA will proceed to reduce the mobile station fees for PRS-Paging licences, SBO-MVNO licences, MRS licences and PMRS licences at the same time.

**Commerce and Economic Development Bureau**
**(Communications and Creative Industries Branch)**
**and**
**Communications Authority**

**12 October 2018**