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- **Introduction**

**This note provides a briefing to the Sub-committee on:**

- Specific topics of the auction design:
  - Key pre-qualification criteria
  - Methodology in resolving tied-bids
  - Results of the consultation on the proposed connected bidder rules
  - Principal reasons for using 4<sup>th</sup> price auction
- General overview of the auction mechanics and discussion of information which will be made publicly available during each phase of the auction

## 2. Auction Design – Specific Topics

### 2.1 Key pre-qualification criteria

- Provision of deposit in the form of cash or letter of credit:
  - Interest earned on deposits will be passed back to applicants
- Provision of certificate:
  - No other bidders under common control
  - Declaration of any known connection
  - Have not deliberately arranged connection with any other bidders
- Provision of sufficient information requested (e.g. corporate structure, etc.)
- Acceptance of licence conditions:
  - Population coverage commitment by all licensees in 5-years' time after licensing
  - Minimum quality of service
  - Commitment by existing 2G operators which are successful winners of the 3G licences to provide roaming to new entrants



**Light pre-qualification criteria to promote entry while ensuring quality of network.  
Applicants will have high certainty of pre-qualification when applications are submitted**

## **2. Auction Design – Specific Topics**

### **2.2 Resolution of tied bids**

#### **Various options considered, including:**

- Allowing tied bidders to bid up to the next increment – if tie remains unresolved, then draw lots
- All bidders restarting at the tied bid level
- Timing of receipt of bid
- Drawing lots

#### **Considerations:**

- Fair and effective
- Reduce gaming opportunities
- Fits overall design

## 2.2 Resolution of tied bids (cont'd)

### Pros and cons of the first two options

#### Tied bidders bid to bottom of next increment

##### Pros

- Simple and quick mechanism
- No interruption to the auction process
- Tied bidders who have already withdrawn are allowed to bid one more time and up to the next increment before chosen by random method

#### Full restart at tied level

##### Pros

- Random method only used if same tied bidders tie again at same level

##### Cons

- Higher chance of interruption to the auction process when tie occurs which may create uncertainty to all bidders
- May create gaming opportunities to bidders
- Higher possibility of collusion



**Auction design allows for specific bids confirming the last price within each increment, therefore chosen method: tied bidders bid to bottom of next increment**

## 2.3 Connected bidder rules

- Consultation on connected bidder rules completed in April 2001 with six submissions received
- Major comments and questions raised:
  - TA's key considerations in approving joint bids by 2G operators
  - Comments on definition of 2G bidding group and circumstances where TA's consent is required
  - Definitions of connected bidders, indirect interest and participation



**Principles of the rules generally accepted by the industry**

## 2.3 Connected bidder rules (cont'd)

### Summary of major views from consultation and OFTA's responses

Views and comments received	OFTA's responses
Criteria for approving 2G bidding group and announcement of approvals	<ul style="list-style-type: none"> <li>• TA's main consideration - whether this would adversely affect competition in the mobile services market. TA will not reveal their identities when approved</li> <li>• Definition of 2G bidding group is intended to be broad</li> <li>• If two 2G operators were discussing merger (but no legal binding agreement entered), they can bid separately and TA's consent is not required. But it will be a breach of auction rules if merger agreement is entered into during the auction</li> </ul>
Definitions of "connected bidder", "indirect interest" and "participation"	<ul style="list-style-type: none"> <li>• TA does not intend to introduce the concepts of financing the bidders, assisting the preparation of bids, etc. to preserve the 15% threshold and also keep the rules simple</li> <li>• 15% threshold is intended to apply to all companies, listed or unlisted, and is considered appropriate after considering market conditions and with reference to European precedents</li> <li>• Use of 20 March 2000 as the cut-off date for conditional interests is sensible as this was the published date of the earliest consultation on Hong Kong 3G</li> <li>• A pre-qualification requirement by bidders that they have not deliberately arranged for connection with other bidders will improve the auction process</li> </ul>
Other detailed drafting comments	<ul style="list-style-type: none"> <li>• Comments will be carefully considered when finalising the connected bidder rules</li> </ul>

## 2.4 Principal reasons for confidentiality and 4<sup>th</sup> price

- The principal entry-promoting benefits of our auction design will be maximised when both the “confidentiality” and “4<sup>th</sup> price” features are used together
  
- We again set out below the Government’s principal policy objectives:
  - Promote entry
  - Promote development of telecoms industry
  - Preserve market competition
  - Maximise benefits to the economy
  - Prevent collusion
  - Maximisation of revenue to Government is **not** its primary objective (otherwise bidders could simply be forced to pay upfront cash at the price they bid)



**Auction designed to achieve Government’s stated objectives**



## 2.4 Principal reasons for confidentiality and 4<sup>th</sup> price (cont'd)

Entry promotion is one of the most important Government's policy objectives which would.....

- Further promote the development of the telecoms industry and maximise benefits to the economy
- Preserve market competition in the telecoms industry

..... however, a comprehensive set of strong pro-entry features must exist in order to attract new entrants

- Royalty-based spectrum utilisation fees
  - Confidentiality
  - Light pre-qualification criteria
  - Low cost of bidding
- } **But rules ensure only serious bidders will be allowed to enter auction**

**New entrants will only participate if there is a chance to win. Recent experience in Europe shows that open auctions can be vulnerable to manipulation**

## 2.4 Principal reasons for confidentiality and 4<sup>th</sup> price (cont'd)

Confidentiality and 4<sup>th</sup> price are not new concepts to Hong Kong.....

### Land tenders

- Land tenders by way of sealed bids have been used previously in Hong Kong
- Winners will pay the price of its bid, not the bids of the losing bidders

### Other public contracts

- Commonly conducted by way of tender where participants do not necessarily know identities and number of competitors
- Offer accepted is the winning tenderer's – not its nearest competitors

## 3. Auction Mechanics

### 3.1 General overview

#### Application and pre-qualification

- Each applicant will be required to submit its application form, together with necessary supporting documents
- Deposit to be paid at the same time
- Each pre-qualified bidder will be notified upon pre-qualification. Representatives of each qualified bidder will then be required to report to a designated location at a specified time
- Disqualified applicants will also be notified upon disqualification

### 3.1 General overview (cont'd)

#### Main phase auction

- Representatives will be required to stay at the auction location until the main phase auction ends (no more than one day)
- Communications equipment will be provided. External communications will not be permitted (vital to prevent collusion)
- Government observers will be present at each auction location

### 3.1 General overview (cont'd)

#### **Second phase auction (connected bidder phase)**

- Provisional winners given a period to certify no connections
- Connected bidders given short period to provide irrevocable undertaking to disconnect. Failure to do so leads to bidding
- Each connected bidder will be notified of the time and location to which a single sealed bid must be submitted (for an upfront cash payment)

#### **Third phase auction (specific licence allocation phase)**

- Each bidder will be notified of the time and location of the third phase auction
- Each bidder will be required to submit a sealed bid by way of an upfront cash payment which will be used to determine the priority for choosing a specific licence

## 3.2 Disclosure of information during each phase of the auction

### Key considerations:

- Maximum transparency
- Minimise opportunities for collusion
- Preserve integrity of the process through adequate checks (e.g. observer system, full account of events given)

### 3.2 Disclosure of information during each phase of the auction (cont'd)

#### Main phase auction

##### During the main phase

- Public broadcasting of the progress of bidding increments via OFTA's website with a minimal time lag (similar to the UK auction)

##### Public announcement immediately after the main phase

- Identities of the provisional winners
- Provisional royalty percentage

## 3.2 Disclosure of information during each phase of the auction (cont'd)

### Second phase auction (connected bidder phase)

#### Before the second phase

- Identities of connected bidders, if any
- Whether such connected bidders commit to separate (if yes, then no second phase auction will be required)

### Completion of the second phase

#### Public announcement after the second phase

- A full account of the auction process, including:
  - Identities of successful bidders and the applicable royalty percentage
  - Identities of the unsuccessful bidders and their respective bids
  - Outcome of the disconnection amongst bidders and the cash bids, if any, from connected bidders
- If no connection amongst the four provisional winners, the final result will be announced soon after the completion of the main phase



### 3.2 Disclosure of information during each phase of the auction (cont'd)

#### Third phase auction (specific licence allocation phase)

##### Announcement after the third phase

- Amounts of bid by each bidder in this phase
- Specific licence allocated to each winner

**Government's goal is to provide maximum transparency without weakening the anti-collusive effects of the "confidentiality" feature**