

**SUNDAY's Response to
OFTA's Consultation Paper in relation to
the Proposed Rules on "Connected Bidders"**

1. SUNDAY is pleased to have the opportunity to consider and comment on the proposed rules on "Connected Bidders" prepared by the Office of the Telecommunications Authority ("OFTA"). SUNDAY concurs with the Telecommunications Authority's (TA's) view that the auction should be designed, inter alia, to prevent collusion not only during the bidding process but also in the post auction market for mobile services in Hong Kong. Given the clear regulatory need to have these rules on "Connected Bidders" settled before the 3G auction commences, SUNDAY would like to support the rules as proposed by the OFTA in its Consultation Paper dated 23rd March, 2001.

2. The need to ensure there is no collusion between bidders during the auction is only one element of the process needed to ensure that the auction delivers an outcome which will lead to sustained competition in the mobile market. As the consultation paper argued, downstream competitive outcomes in a market such as Hong Kong are dependent upon the relationships that may emerge between parties during the auction process. With six 2G operators Hong Kong has already created a highly competitive market that has driven high levels of penetration and delivered unquestioned benefits to consumers. With only four 3G licences on offer and six incumbents, at least two of which could be deemed to have

shareholder connections, there is an obvious concern that competition could be lessened with the introduction of 3G services.

3. The need to sustain competition amongst incumbent operators has led to the TA to set out detailed regulations which limit the scope of 2G licences to act as associated parties during the auction. SUNDAY fully supports the TA's approach to limiting such associations, but must caution against other elements of the rules which may undermine sustainable downstream competition. Specifically SUNDAY is concerned that the proposed structure of the auction may inflate the percentage of royalties bid for 3G spectrum above a level that is in the interests of the consumers and the market in general. In SUNDAY's view the price for 3G spectrum will be determined when there are only four participants left active in the auction i.e. the common percentage of royalties to be paid by all four licencees would be the lowest bid of the four active participants in the round in which the fifth last bidder withdrew.
4. Should the auction continue beyond a point where 4 bidders have been identified, the "European danger" arises, in which the ability of licencees to roll out broad-based and competitively priced services is compromised by their financial burden.
5. A recently released discussion paper by the European Commission has acknowledged that as a result of Europe's inflammatory auction, 3G operators will need to share infrastructure and other costs if 3G services are to be rolled out

in a timely and affordable manner. In the UK and Germany in particular, the danger of lessened competition and more limited development of 3G and 2G markets is now widely recognized.

On April 3 the German regulator, RegTP, asked the country's six 3G license holders to submit plans for co-operation on 3G rollout. The Financial Times noted this could bring a wave of consolidation in the financially stretched 3G sector. The Financial Times said that advisors for the four smaller operators, namely Viag Interkom, E-Plus, MobilCom and Group3G, had already held informal talks on co-operation and possible mergers.

Similarly in the United Kingdom BT Wireless said on Monday 2 April that it had contacted other British mobile operators about sharing the cost of building a national 3G network, estimated to be around £1.5 billion. Vodafone has also said it would be interested in the idea of collaboration.

6. Even carefully structured rules in Hong Kong may be on “Connected Bidders” could lead to collusion and anti-competitive outcomes which might need to be sanctioned by the regulator if the auction led to the artificial inflation of licence prices.
7. It is therefore of concern to SUNDAY that the final structure of the auction may lead to the unwarranted escalation of the percentage royalty payment that is bid.

On SUNDAY's understandings the auction will not stop when the field has been reduced to four bidders i.e. when the number of bidders matches the number of licences that are available. This has been common practice in all other auctions that SUNDAY is familiar with. It is a common principle that an auction will stop at the point where the number of buyers matches the supply of goods on offer.

8. SUNDAY understands that contrary to this normal and accepted practice, further rounds will be held until the fourth bidder withdraws. It is SUNDAY's understanding that the final price bid by the fourth last bidder would then form the common percentage royalty to be paid by all four licencees.

9. SUNDAY notes that should additional rounds of 'blind' bidding be permitted, so that ultimately only three active bidders are left, it can only have one purpose, namely to increase the royalty percentage bid. This is directly contrary to the OFTA's declared interest in securing committed licencees rather than maximizing auction revenue. Whilst artificially prolonging the auction in this manner may appear to maximise the government's return from the auction, it would jeopardize sustainable competition in the mobile market and may ultimately lessen the government's long term royalty receipts. Undue inflation of the auction price could lead to withdrawal by one of the successful licencees or consolidation amongst the four licencees. In the absence of vigorous competition the market would be smaller and consequent royalty payments may be less. More

significantly, the consumer benefit that four viable 3G operators could offer would be lost.

10. SUNDAY notes that auctions are based on certain key premises – simplicity, transparency and selection of most committed and best-equipped licencees. In this spirit, the sustainable market based price should allow all bidders to have full knowledge at the end of each round of the amounts bid by rivals. Should there be additional rounds of blind bidding with no intent other than to lift the government's returns from the auction, then the auction could rapidly dissolve into irrational behavior. SUNDAY stresses that transparency and openness are central to achieving rational and sustainable outcomes.
11. The threat that irrational bidding can pose to sustainable and competitive mobile markets has been amply demonstrated in auctions in which inflated prices have been paid by bidders. As SUNDAY has outlined, a clear outcome of these 'inflated' auctions has been that successful bidders cannot sustain their planned investments. The losers are the consumers as the backwash excessive 3G prices has undermined the viability and financial standing of major 2G operators and even their parent fixed network companies operators.
12. SUNDAY can restate its belief that there is an irreconcilable tension between any proposal to maximise returns from the auctioning of 3G spectrum and the need to sustain a highly competitive mobile market in Hong Kong. With due

respect, SUNDAY cannot reconcile the proposed auction framework with the Government's broader objective of sustainable competition in the consumers' interest. SUNDAY's concerns centre upon the joint dangers that bidding may ultimately be manipulated to maximise revenue, and that the process lacks transparency.

13. In the light of the Government's stated objective that it is not seeking to maximise revenue, it is submitted that the need for transparency at all stages of the auction is paramount so that the auction can eventually reach a fair, rational and desirable market price. There should be no blind bidding and SUNDAY submits that the market price should be determined by reference to the last bid at which the fifth of the remaining bidders is no longer interested and decides to leave the auction.
14. SUNDAY in particular believes there is a need to further refine the rules to deal with the possibility that the fifth and fourth 'last' bidders withdraw simultaneously.
15. With these questions in mind, SUNDAY welcomes further opportunity to participate in the consultation on the terms and conditions of 3G auction in order to simplify and streamline the auction framework.

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