

OVERVIEW

The legislative framework governing the provision of telecommunications services and facilities in Hong Kong is principally based on the Telecommunications Ordinance. The Telecommunications Ordinance regulates the provision of telecommunications network services, including fixed line services, public mobile telephone services and Internet services.

The TA and OFTA

The TA is the principal telecommunications regulator of the telecommunications industry in Hong Kong. The TA enforces compliance with licences and applicable legislation, and may suspend or revoke licences as enforcement measures or to protect the public interest.

OFTA, the executive arm of the TA, was established in 1993 to assist the TA in administering and enforcing the provisions of the Telecommunications Ordinance. The TA is responsible for overseeing the telecommunications markets in Hong Kong, including the provision of fixed line services, public mobile telephone services, Internet services and satellite services. In addition to being responsible for regulating and licensing of telecommunication network systems, the TA is also responsible for spectrum allocation and the regulation of interconnectivity between the various networks in Hong Kong. The TA has the power to make rules in relation to the provision of telecommunication network services by licensees and the delivery fees for interconnection services payable amongst operators.

Public Mobile Radiotelephone Services (“PMRS”)

The Government progressively introduced more competition in the public mobile radio services sector since the launch of analogue mobile telephone services in 1984. Subsequent rounds of licensing in 1992 (for PMRS licences covering GSM 900 networks) and 1996 (for PRS licences covering GSM 1800 networks, also known as PCS 1800 networks) encouraged further competition in the mobile communications market in Hong Kong.

IDD Services and External Telecommunications Facilities

Following the early termination of what was then HKTI’s exclusive licence, the Government permitted competition for voice IDD services by issuing PNETS (ETS) licences authorising the provision of ETS from January 1999. As at 2 February 2004, there were a total of 223 PNETS (ETS) licences in issue.

With effect from 1 January 2000, the TA authorised the FTNS licensees (with the exception of PCCW whose modified licence issued on 31 January 2001 allows it to provide ETS, but not ETS facilities) to operate ETS facilities under the terms of their FTNS licences. Non-cable based EFTNS licences were issued with effect from 1 January 2000, and licences for submarine and land cables based EFTNS licences have been progressively introduced since then.

The EFTNS and fixed carrier licence for external FTNS authorise the licensee to provide external facilities as well as external services operated over the external facilities. Access to the ETS provided by a fixed carrier licensee for external FTNS is via a public switched network (of local fixed network operators or local mobile network operators) or by leased circuits provided by local FTNS operators or fixed carriers.

IDD operators in Hong Kong operating under PNETS (ETS) licences currently provide external telecommunications services by an arrangement known as ISR, which utilises IPLCs supplied by the holders of external FTNS or fixed carrier licences.

In 1999, the PNETS (ETS) licensees operated the ETS services over the external IPLCs supplied by HKTI. Since 1 January 2000, the PNETS (ETS) licensees have been able to use the external IPLCs provided by any one of the FTNS licensees or fixed carrier licensees which provide external FTNS.

LICENSING REQUIREMENTS FOR OUR BUSINESSES

Under the Telecommunications Ordinance, companies that establish and maintain a means of telecommunication in Hong Kong are required to obtain a licence from the TA. Under the current Hong Kong telecommunications regulatory regime, the Company's mobile communications business, ISP and IDD businesses each requires a separate licence. The Company has obtained all licences, permit or certificates necessary to conduct its operations and complies with all applicable laws and regulations in Hong Kong.

Our Mobile Communications Business Requires a Public Radiocommunications Services (PRS) Licence

This licence permits us to:

- provide a public mobile radiocommunication service using cellular communication technology in accordance with the PCS 1800/GSM standard;
- establish and maintain a PCS 1800/GSM network; and
- sell cellular handsets and other equipment to subscribers.

PRS licences have a duration of ten years, although they may be extended for an additional period of up to three years pursuant to regulations made under the Telecommunications Ordinance. A PRS licence is non-exclusive and the licensee must be able to satisfy the specifications contained in its licence. Under the terms of the PRS licence, each licensee may only operate its PCS network on the radio frequencies assigned to it. We received our PRS licence, which allows us to operate a PCS 1800 network in the 1.7 to 1.9 GHz band, in September 1996.

OFTA is currently considering future arrangements on the licensing of 2G mobile services on the expiry of the existing licences for 2G services. Currently, there are eleven 2G licences held by six operators which are due to expire between July 2005 and September 2006. Our PRS licence is one of these licences and is due to expire in September 2006.

On 1 August 2003, OFTA published a consultation paper on the "Licensing of Mobile Services on Expiry of Existing Licences for Second Generation Mobile Services" and is currently considering the terms of and procedure for licence renewal. According to the consultation paper, OFTA is currently considering attaching certain licence conditions which currently apply to 3G licensees to the renewal of 2G licences in respect of spectrum allocation, spectrum utilisation fees, and open network access for MVNOs as well as an obligation to provide coverage in less populated parts of Hong Kong. After considering the submissions, OFTA intends to launch a further round of consultation before arriving at a decision which is expected to be made in the first quarter of 2004.

OTHER AREAS SUBJECT TO REGULATION

Interconnectivity

FTNS operators are required under the terms of their licences to permit other FTNS and fixed carrier operators to interconnect with their networks for delivering calls within Hong Kong's telecommunications networks. The TA has historically determined interconnection charges between PRS and PCCW which, to date, have included both the local access charges (LAC) and the universal service contributions (USC) that PCCW is entitled to collect from other operators for traffic passing through its network to and from those operators' switches.

International Call Forwarding Services

The TA has recently issued the terms and conditions of interconnection for international call forwarding services. Under these terms and conditions, international call forwarding services providers have to pay an interconnection charge to the mobile network operators so as to compensate the mobile operators for the costs incurred in delivering the call via their mobile networks to their customers.

International call forwarding services allows customers to receive calls made to their Hong Kong mobile numbers while they are overseas and provides an alternative to roaming services.

Competition Regulation

Our PRS licence and the Telecommunications Ordinance place obligations upon us not to engage in anti-competitive practices, abuse a dominant position (if any) or engage in deceptive conduct or discrimination. These anti-trust safeguards which apply to the telecommunications sector are unusual in Hong Kong and do not apply to business in general.

3G

In October 2001, the Government awarded a 15-year 3G mobile licence to each of CSL, Hutchison 3G, SmarTone 3G and SUNDAY 3G under a royalty payment scheme. The 3G licensees are licensed to:

- (i) provide a public mobile telecommunications service using cellular radiocommunications technology operating at frequencies assigned by the TA within the frequency bands 1900–1980 MHz, 2015–2025 MHz and 2110–2170 MHz;
- (ii) establish and maintain a telecommunications network such that coverage of the network is provided to at least 50 per cent. of the population of Hong Kong from time to time and all base stations are configured to be capable of supporting services operating above 144 kbps per second for an individual customer;
- (iii) deal in, import and demonstrate, with a view to selling such apparatus in compliance with the requisite technical standards for radiocommunications as may be necessary.

REGULATION

Subject to the terms and conditions of the licences, the 3G licensees are to operate, maintain and provide good, efficient and continuous services. Further, 3G licensees are required to open up at least 30 per cent. of their capacity for use by non-affiliated MVNOs or by content or service providers (“CSP”) on a non-discriminatory basis. If no such arrangements are in place, a 3G licensee is obliged to:

- (i) interconnect its network and service with, or provide access to, the network and service of an MVNO at charges which are based on reasonable relevant costs; and
- (ii) provide services to a CSP on a tariffed basis.

All 3G licences are non-transferable without the prior written consent of the TA. The relevant royalty payment fees are an aggregate of the bids and a minimum accelerating yearly fee of approximately HK\$50,000,000 to HK\$151,243,000 payable by each of the 3G licensees to the Government.

MVNOs

The TA has provided guidance when it will provide regulatory support to an MVNO seeking access to a 3G licensee’s network in its “Guidelines for the Application for Public Non-Exclusive Telecommunications Service (“PNETS”) Licences”. This document states that in order for an MVNO to be qualified for the TA’s regulatory support, the MVNO must meet certain minimum requirements on network operation infrastructure. The TA will also consider certain other criteria when determining whether or not it will offer regulatory support to an MVNO and make a determination on the terms of interconnection between an MVNO and a 3G licensee.

The TA indicates that it may determine one or more of the following as terms of interconnection between the MVNO and the 3G licensee:

- The terms of the interconnection should be on a cost-plus charge basis, which shall be based on the incremental cost to the 3G operator, determined on a long-run basis, for providing the services to the MVNO.
- This incremental cost would include variable and fixed costs directly attributable to the service being provided, and appropriate cost of capital commensurate with the risk of the investment in the network, and the cost reflecting the spectrum utilisation fees payable by the 3G licensee.
- The cost would exclude indirect fixed costs and that such costs would be incremental to the service being provided.
- It would be expected that the minimum length of the contract will be three years, during which the MVNO will be committed to purchasing a minimum traffic volume (in terms of airtime used or volume of data sent).

Whilst there is no current open network access requirement 2G licences, as outlined under “Regulation — Licensing Requirements for our Business — Our Mobile Communications Business Requires a Public Radiocommunications Service (PRS) Licence”, OFTA has indicated in the recently released consultation paper on the “Licensing of Mobile Services on Expiry of Existing Licences for Second Generation Mobile Services” that the TA is considering imposing an open network requirement upon the 2G operations upon the renewal of the 2G licences which may provide additional opportunities to the MVNOs.

Telecommunications (Amendment) Ordinance 2003

To provide a comprehensive and clear legislative framework for the regulation of merger and acquisition activities in the telecommunications market, the Telecommunications (Amendment) Ordinance 2003 (“TAO”) was published in the Government Gazette on 18 July 2003. The TAO introduced a set of specific regulatory provisions governing merger and acquisition activities within the telecommunications industry. The TAO comes into operation in two stages. Under the first stage, OFTA is required to carry out consultation with persons who may be affected by the operation of the TAO before it publishes guidelines specifying the matters that will be taken into account in considering proposed mergers and acquisitions. With respect to this first stage, OFTA published its second consultation paper on 23 December 2003 and aims to publish guidelines after consideration of any comments received. The second consultation paper publishes the TA’s current views and procedures in relation to the enforcement of the merger and acquisition provisions under the TAO. On completion of the first stage, the Secretary for Commerce, Industry and Technology will publish a notice in the Government Gazette to bring the substantive provisions of the TAO into operation.

Under the TAO, where OFTA is of the opinion that a change in ownership or control over a carrier licensee has, or is likely to have, the effect of substantially lessening competition in the telecommunications market, OFTA will direct the licensee to take such action as OFTA considers necessary to eliminate any such anti-competitive effect. OFTA may direct the licensee to procure modifications to its ownership or control. Such provisions may be triggered if ownership or control of a licensee has crossed any one of the three thresholds as set out in the TAO.

The TAO also provides that a licensee may, on a voluntary basis, seek the prior consent of the TA to a proposed change in ownership or control. OFTA will have the power to give consent, refuse to give consent, or give consent subject to the direction that the licensee takes such actions as OFTA considers necessary to eliminate any anti-competitive effect of the proposed change in ownership or control.