

Review of Local Access Charge

A Consultation Paper by the Telecommunications Authority

Executive Summary

Introduction

Local Access Charge (“LAC”) is the interconnection charge payable to the local network operators by external telecommunications service (“ETS”) providers for the conveyance of ETS traffic to and from the end users of the local network operators. The Telecommunications Authority (“TA”) first introduced the LAC regime when the ETS market was liberalised in 1999.

2. Under the current regulatory regime, the LAC levied by fixed network operators (“FNOs”) is regulated but that for mobile network operators (“MNOs”) is not. The existing level of LAC payable to the incumbent FNO, i.e. PCCW-HKT Telephone Limited and Hong Kong Telecommunications (HKT) Limited, was prescribed by a determination made by the TA in December 1998 and was subsequently adjusted downward in June 2001. LAC levied by other FNOs is subject to commercial negotiation, but the industry has been adopting the level determined by the TA as a benchmark.

Problems and challenges of the existing LAC regime

3. When the LAC regulatory regime was formulated in 1998/1999, it aimed to provide a fair compensation to the FNOs for use of their local network facilities by ETS operators and to encourage the FNOs to roll out their networks so as to enhance competition in local fixed service market. Since then, the telecommunications market has undergone significant changes in respect of technological advancements, market developments and changes in the regulatory environment. These changes raise questions as to whether the existing LAC regime is still relevant, proportionate and conducive to the sustainable development of the industry and the consumer welfare. Problems and challenges of existing LAC regime include:

- Whether asymmetric regulation of LAC on FNOs and MNOs remains appropriate under the fixed mobile converging environment?
- Whether the LAC regime should be applied to Voice over Internet Protocol (“VoIP”) traffic?
- Whether the LAC regime continues to be relevant for the current and the

next generation network environment?

- Whether LAC should be regulated for the incumbent only?
- Whether a more predictable LAC scheme for the MNOs is necessary after deregulation of fixed mobile interconnection charge in April 2009?
- Whether the existing costing methodology is outdated?
- Whether the universal service contribution scheme should continue to take into account the over-compensation paid to the incumbent FNO under the LAC regime, which has been the arrangement over the last decade?
- Whether there is a more effective solution to combat illegal bypass?
- Whether the recent developments in international settlement should be considered?
- Whether there is a room for deregulation?

Options for development of LAC

4. In the light of the technological, market and regulatory developments in the telecommunications market and the problems of the existing LAC regime identified, the TA considers it timely to conduct a full review of the LAC regime. Based on consideration of the initial views provided by the industry and having reviewed the latest market environment, the TA has identified the following four options for possible development of the existing LAC regime:

- Option 1: Maintain *status quo*
- Option 2: Maintain the obligation to pay LAC and align regulation on the FNOs and MNOs
- Option 3: Maintain the obligation to pay LAC and deregulate the level of LAC
- Option 4: Deregulate fully the LAC regime

Option 1: Maintain status quo

5. Option 1 is to keep the current LAC regime unchanged. However, if this option is adopted, the problems associated with the existing LAC regime will remain unaddressed. The TA considers that this option is not the optimal option unless it is proven that any change to the existing LAC regime will result in negative consequences that are demonstrably worse than maintaining the *status quo*.

Option 2: Maintain the obligation to pay LAC and align regulation on the FNOs and the MNOs

6. Under Option 2, the existing obligation of the ETS operators to pay LAC to the FNOs will be maintained while similar obligation to pay LAC to the MNOs will be imposed on the ETS operators. The level of LAC determined by the TA will be averaged out on a macro basis for the whole industry instead of for individual local network operator.

7. If Option 2 is pursued, the TA will consider how the LAC should be set, including whether the levels of LAC for the originating and terminating ETS traffic should be different, whether the levels of LAC payable to the FNOs and MNOs should be unified, whether the LAC should be applied to the VoIP traffic, the settlement mechanism, and the costing methodology.

8. For implementation of Option 2, the TA will make a new determination on the level of LAC payable to the FNOs and the MNOs, the parties required to pay and settle the LAC and the parties entitled to receive the LAC. The TA will set a transition period in order to allow sufficient time for operators to adjust their business plans for adaptation to the new regime.

Option 3: Maintain the obligation to pay LAC and deregulate the level of LAC

9. Under Option 3, only the obligation of the ETS operators to pay LAC to both the FNOs and the MNOs is regulated but the level of LAC is subject to commercial agreement among the connecting parties. The TA will issue regulatory guidance including the charging principles of the LAC to facilitate commercial negotiations between operators. In order to facilitate market negotiations on the level of LAC, three sub-options are proposed:

- (a) *Option 3A* – The ETS operators and the originating/terminating network operators negotiate and agree the level of LAC. The ETS operators pay the LAC directly to the originating/terminating network operators.
- (b) *Option 3B* – The hosting operators and the originating/terminating network operators negotiate and agree the level of LAC. The ETS operators pay the LAC directly to the originating/terminating network operators.
- (c) *Option 3C* – The hosting operators and the originating/terminating

network operators negotiate and agree the level of LAC on a wholesale basis. The hosting operators pay the LAC directly to the originating/terminating network operators on a wholesale basis. The hosting operators recover the LAC from the ETS operators under separate commercial arrangement.

10. If Option 3 is implemented, the TA will set a transition period in order to allow sufficient time for operators to negotiate a new commercial arrangement of the LAC applicable to their ETS traffic and adjust their business plans for adaptation to the new regime. The TA would like to stress that such commercial negotiations should not jeopardize the normal flow of ETS traffic across networks or the existing any-to-any (“A2A”) connectivity requirement which allows customers to access the ETS of their choice.

Option 4: Deregulate fully the LAC regime

11. Option 4 is to fully de-regulate the LAC regime. Under this option, the TA will not issue regulatory guidance on interconnection charge for the ETS traffic. Whether such charge should be paid and the level will be purely the result of commercial negotiations between operators.

12. If Option 4 is pursued, the TA will further consult the industry regarding the implementation and transitional arrangements. Same as for Option 3, the TA stresses that A2A connectivity for access to ETS should be safeguarded under this Option.

Invitation of Views and Comments

13. The TA invites views and comments on the issues and questions raised in this consultation paper. All submissions should be made in writing and should reach OFTA, preferably in electronic form, on or before **6 March 2010**. Submission should be addressed to:

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213 Queen’s Road East
Wanchai, Hong Kong
[Attention: Senior Telecommunications Engineer (R31)]
Fax: 2803 5112
E-mail: lacreview@ofta.gov.hk

Comments may also be sent by fax to 2803 5112 or by email to lacreview@ofta.gov.hk.

Way forward

14. The TA is open to any one of the four options, or other options that may be proposed by the industry, that should be pursued for the future LAC regime. He will consider whether a particular option will adequately address the problems identified with the existing LAC regime, ensure that consumer interests be safeguarded, be consistent with the telecommunications policy objectives of the Government and the regulatory principles propounded by the TA, and be able to cope with the future technological and market developments. Taking into account the views received from the consultation, the TA will decide whether additional issues need to be further consulted with the industry before finalising any changes to the existing LAC regime.

Office of the Telecommunications Authority
31 December 2009