

Office of the Telecommunications Authority

Third Consultation Paper on Draft Competition Guidelines

5 February 2010

Introduction

Competition in Hong Kong's telecommunications sector is safeguarded by the relevant provisions in the Telecommunications Ordinance ("TO"), namely section 7K on anti-competitive practices, section 7L on abuse of a dominant position and section 7N on non-discrimination. Section 6D(1) of the TO empowers the Telecommunications Authority ("TA") to issue guidelines for the purpose of providing practical guidance to the provisions in the TO in general. It is the intention of the TA to issue guidelines to elaborate on how he may interpret and enforce the three statutory provisions on conduct relating to competition by telecommunications licensees.

2. The first consultation paper on Draft Competition Guidelines ("2004 Draft Competition Guidelines") was issued in February 2004. However, in January 2005, the TA granted PCCW-HKT Telephone Limited a new form of fixed carrier licence without provisions relating to presumed dominance. With the migration from an *ex ante* to an *ex post* regulatory regime for the local fixed telecommunications services, the competition landscape of the telecommunications sector has undergone a fundamental change. In view of this, the TA considered that the 2004 Draft Competition Guidelines required substantial adaptation. Accordingly, he issued in May 2007 a second consultation paper on the matter together with revised Draft Competition Guidelines ("2007 Draft Competition Guidelines").

3. In response to the 2007 Draft Competition Guidelines, submissions were received from the following seven organisations/individuals¹:

- BT Hong Kong Limited;

¹ Submissions on the May 2007 consultation are available on OFTA website at <http://www.ofta.gov.hk/en/report-paper-guide/paper/consultation/20070720/table.html>.

- Catherine Ching-yi Fung;
- Hong Kong CSL Limited and New World PCS Limited;
- Hutchison Telecommunications (Hong Kong) Limited;
- PCCW Limited;
- SmarTone Mobile Communications Limited; and
- Wharf T&T Limited.

4. The submissions have provided useful inputs to the TA. The views and comments expressed in the submissions are summarised at Annex 1, which sets out also the TA's responses to the comments.

5. Since May 2007, fixed-mobile convergence has spurred further competition in the telecommunications sector. The Unified Carrier Licence regime was implemented in August 2008. The fixed-mobile interconnection charge (FMIC) was deregulated in April 2009. With the withdrawal of the mobile party's network pays charging principle after deregulation, both the level and direction of payment for the FMIC are left to the market to determine. The rapid rollout of mobile broadband services and the provision of fixed telecommunications services using wireless means over the past year also have impacts on the competition scene of the sector.

6. Having regard to these developments and the submissions in response to the consultation conducted in 2007, the TA considers it necessary to revise the 2007 Draft Competition Guidelines and conduct another round of consultation so that the industry and other interested parties may have the opportunity to express their views before the Guidelines are finalised and issued.

7. The revised Draft Competition Guidelines ("2010 Draft Competition Guidelines"), which are attached as Annex 2 to this consultation paper, have taken into account the feedback received in response to the 2007 consultation exercise and the latest telecommunications market environment. The rationale for the changes introduced to the 2010 Draft Competition Guidelines is explained and the relevant paragraphs in the Guidelines are highlighted for easy reference in Annex 1.

Invitations for comments

8. The industry and other interested parties are invited to express their views and comments on the 2010 Draft Competition Guidelines. The TA will take into account the feedback before finalising the Competition Guidelines.

9. Comments on the 2010 Draft Competition Guidelines should be in writing and reach the Office of the Telecommunications Authority, preferably in electronic format, on or before 26 March 2010. The TA reserves the right to publish all views and comments received as well as to disclose the identity of the source. Any part of the submission which is considered commercially confidential should be clearly marked. The TA would take such markings into account in making his decision as to whether to disclose such information or not. Submissions should be addressed to :

Office of the Telecommunication Authority
29/F., Wu Chung House
213 Queen's Road East
Wan Chai
Hong Kong
(Attention : Head, Economic Analysis and Research)

Fax : 2803 5112

E-mail : guidelines@ofta.gov.hk

Office of the Telecommunications Authority
5 February 2010

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**“Draft Competition Guidelines”
Second Consultation Paper Published on 7 May 2007**

**Summary of Comments and
Responses of the Telecommunications Authority**

Introduction

In response to the 2007 Draft Competition Guidelines published by the TA, submissions were received from the following organisations/individuals¹ :

- BT Hong Kong Limited (“BT”);
- Catherine Ching-yi Fung (“Fung”);
- Hong Kong CSL Limited and New World PCS Limited (“CSL”);
- Hutchison Telecommunications (Hong Kong) Limited (“Hutchison”);
- PCCW Limited (“PCCW”);
- SmarTone Mobile Communications Limited (“SmarTone”); and
- Wharf T&T Limited (“WT&T”).

2. Having considered the views and comments received and taken into account the latest competition environment of the telecommunications sector, the TA has revised the Draft Competition Guidelines for further consultation (“2010 Draft Competition Guidelines” attached as Annex 2 to this Consultation Paper).

3. This Annex summarises the views and comments expressed in the submissions to the second consultation, and sets out the TA’s corresponding responses. They will be discussed under the following headings :

- Hong Kong’s general competition law
- Position of sections 7K, 7L and 7N under the TO

¹ Submissions on the May 2007 consultation are available on OFTA website at <http://www.ofa.gov.hk/en/report-paper-guide/paper/consultation/20070720/table.html>.

- Competition test at work
 - Purpose or effect
 - Preventing or substantially restricting competition
 - Telecommunications market
- Abuse of a dominant position
 - Market dominance
 - Predatory pricing

Hong Kong's general competition law

4. At the time when the 2007 Draft Competition Guidelines were issued, the Government was in the process of planning for the introduction of a cross-sector competition law in Hong Kong. A number of respondents, including BT, CSL, Hutchison and PCCW, expressed concern about the position of the competition provisions under the TO following the enactment of the cross-sector competition law, and about the consistency between the two if they would function together. In view of the uncertainty involved, there were views that the issue of the Competition Guidelines for the telecommunications sector should be postponed.

TA's response

5. It is the Government's proposal that the future Competition Ordinance will apply to all sectors of the economy, including the telecommunications sector. The duplicate competition provisions in the TO will be repealed. The TA will share concurrent jurisdiction with the Competition Commission to enforce the Competition Ordinance in the telecommunications sector². In the light of the proposal, the issue of possible inconsistency between the two laws will unlikely arise. The Government hopes to introduce the Competition Bill into the Legislative Council within the 2009-2010 legislative session³. A new set of competition guidelines will be formulated under the new Competition Ordinance. The TA, sharing concurrent jurisdiction with the Competition Commission to be established,

² Commerce and Economic Development Bureau, *Detailed Proposals for a Competition Law - a Public Consultation Paper*, May 2008, Chapter 6.

³ Policy Address by the Chief Executive dated 14 October 2009.

will enforce the Competition Ordinance (as assisted by the new competition guidelines) in the telecommunications sector.

6. Notwithstanding the Government's plan to introduce the Competition Bill soon, the TA considers it necessary to finalise and issue the Competition Guidelines for the telecommunications sector at this juncture. The competition provisions under the TO have been in operation since 2000, with various drafts of the Competition Guidelines thoroughly discussed and debated. The publication of a set of formal guidelines reflecting how the TA may interpret and enforce the three competition provisions should provide a more certain regulatory environment to the industry, pending enactment of the new law.

Position of sections 7K, 7L and 7N under the Telecommunications Ordinance

7. It may not be entirely clear whether section 7K on anti-competitive practices is intended for dealing with concerted conduct only, or whether it covers also unilateral conduct. While PCCW suggested section 7K should be redrafted to cover just agreements or concerted actions, Fung suggested clarifying that it covers also unilateral conduct. There was also the suggestion by Hutchison and PCCW to repeal section 7N on non-discrimination, as conduct which is found to contravene section 7N would have contravened either section 7K or 7L.

TA's response

8. The legal drafting of the competition provisions may have room for improvement. But this is not something which the Competition Guidelines are supposed to handle, let alone the repeal of any of the provisions. The purpose of the Guidelines is to inform the industry how the TA is likely to interpret and enforce those provisions.

9. The TA is of the view that section 7K is capable of dealing with unilateral anti-competitive conduct of a non-dominant licensee, in addition to agreements or other forms of concerted conduct. Section 7K(3)(a) is only an example of the abuse defined under section 7K(1), but it apparently does not

limit the general nature of this statutory provision.

10. However, as suggested in the 2007 Draft Competition Guidelines and reaffirmed in paragraphs 3.13 - 3.14 of the current Draft, the TA normally will not enforce any of the provisions of section 7K against unilateral conduct, because conduct by a single licensee is unlikely to prevent or substantially restrict competition in a telecommunication market unless the licensee is in a dominant position. It is more likely that the TA would pursue the matter as an abuse of dominant position under section 7L. It is nevertheless necessary to retain the power of section 7K in dealing with unilateral conduct in the event that a non-dominant licensee with significant market power (though not to the extent of dominance) would be able to prevent or substantially restrict competition. The point about enforcement against unilateral anti-competitive conduct under section 7K is clarified in paragraph 1.18 of the 2010 Draft Competition Guidelines.

11. The TA has also taken the opportunity to clarify in paragraph 3.16 of the 2010 Draft Competition Guidelines that the scope of section 7L(1) is not limited by 7L(4). Section 7L(1) should be regarded as the defining provision of 7L and must be interpreted according to its ordinary and natural language to cover a broad and sweeping prohibition on abuse. The deeming provision created under section 7L(4) states that conduct which has the purpose or effect of preventing or substantially restricting competition is an abuse and section 7L(5) sets out some examples of such conduct. But neither section 7L(4) nor 7L(5) states that other conduct cannot constitute an abuse.

12. Similarly, paragraph 1.16 of the Guidelines has been amended to clarify the role of section 7N about non-discrimination. It is more often the case that discriminatory conduct of a dominant licensee or non-dominant licensees acting in concert raises anti-competition concern. Therefore, conduct which is in contravention of section 7N should have already contravened either section 7K or 7L. But in the event that the discriminatory conduct is found to have contravened neither section 7K or 7L, but has the purpose or effect of preventing or substantially restricting competition, it would be dealt with under section 7N.

Competition test at work

Purpose or effect

13. The competition test applied is whether conduct “*has the purpose or effect of preventing or substantially restricting competition*”. Views of the respondents are divergent on the “purpose or effect” test. PCCW found the establishment of contravention based on purpose alone over-regulation, and Hutchison regarded it as a narrow approach. However, BT was concerned that the need to prove demonstrable harm (i.e. effect) of anti-competitive conduct would limit the scope of action and intervention by the TA, such as in the situation of a substantial threat of harm. Fung found the proof of demonstrable harm an exceedingly high threshold. CSL was also supportive of the “purpose only” test. But it suggested the TA to consider all potential purposes of a licensee’s conduct in order not to stifle otherwise pro-competitive purposes.

TA’s response

14. The use of the disjunctive conjunction “*or*” in the competition test “purpose *or* effect of preventing or substantially restricting competition” is clear throughout the three competition provisions of the TO. The TA is entitled to intervene in a market on a prophylactic basis in order to prevent harm from arising. It is always desirable to prevent than to cure harm after it has occurred and consumers have been harmed. In fact, the competition test in the TO is similar to the drafting of equivalent provisions in other jurisdictions and in particular Article 101 of the Treaty on the Functioning of the European Union (“TFEU”)⁴, which prohibits practices which “*have as their object or effect the prevention, restriction or distortion of competition*”. This notwithstanding, the TA is mindful that when the purpose of the conduct in question is unclear, he will take into account the effect as well before reaching an opinion, as has been clarified in paragraph 2.4 of the 2010 Draft Competition Guidelines.

15. It is noted that the finding of “demonstrable harm” as evidence of conduct being anti-competitive, apart from being a high threshold, could

⁴ Article 101 TFEU is in exactly the same terms as the old Article 81 EC prior to the Lisbon Treaty which came into force in December 2009.

contradict with the “purpose only” competition test, and also with the emphasis on prevention of harm wherever possible. Therefore, the requirement of finding “demonstrable harm” as evidence has been removed from the 2010 Draft Competition Guidelines.

16. As to the concern about one-sided focus on curbing anti-competitive purpose may stifle other legitimate and possibly pro-competitive purposes of a licensee’s conduct, paragraph 2.3 of the 2010 Draft Competition Guidelines has been modified to allay the concern. The TA will regard the anti-competitive purpose as a contravention only when it stands out as substantial amongst a number of other purposes.

Preventing or substantially restricting competition

17. Respondents were concerned about what constitute “substantially restricting competition” in the competition test. PCCW suggested going back to the “*Guidelines to assist the interpretation and application of the competition provisions of the FTNS licence*” issued in 1995 (“1995 Guidelines”), where “substantially restricting competition” was defined to mean “*conduct leading to a big, considerable or significant restriction of competition*”. Hutchison urged the TA to adopt the definition of “substantially” from the judgment of the Telecommunications (Competition Provisions) Appeal Board on Appeal No. 4 of 2002 that “... *there is proved a large enough element of anti-competition behaviour, of the type banned under the particular section, as to be sufficient materially and adversely to affect the legislative intention underlying the particular section ...*”. A similar concern about the meaning of “worthy of consideration under the Ordinance” was raised by PCCW and BT. PCCW also commented that this could be interpreted as *de minimus*, without recognising the unique realities of a small market.

TA’s response

18. The word “substantially” may involve certain element of judgement or subjectivity. For the purpose of interpreting the TO, the TA considers it appropriate to make reference to the Judgement of the Appeal Board in Appeal No. 4 of 2002. The Board recommended interpreting the meaning of the word “*substantial*” in the context of the section of the TO under consideration,

instead of taking the general dictionary meaning of the word which had probably formed the basis of interpretation in the 1995 Guidelines. In the Judgement, conduct that “substantially restricts competition” was defined to mean “*the effect in question must be at least ‘significant’, but need not be ‘big’*”, and also “*it is large enough to be ‘worthy of consideration for the purpose’ of the particular section [of the TO]*”. This had formed the basis for interpreting “substantially restrict competition” in the 2007 Draft Competition Guidelines. This is reaffirmed in the 2010 Draft Competition Guidelines with “*public interest*” added to further underpin the meaning of “worthy of consideration”.

19. In a more general sense, incorporation of a substantiality requirement in the competition test is to ensure that conduct which exerts an insignificant or unappreciable effect on a market will not be subject to unnecessary regulatory intervention. So there is a *de minimus* requirement in implementing the competition provisions, but it is made in terms of the effect of the conduct on competition and its scale of harm to consumers, instead of on the size of a market. The priority of the TA is to intervene into conduct that exerts significant adverse effect on competition and consumers.

Telecommunications market

20. Some of the respondents did not agree to the position expressed in the 2007 Draft Competition Guidelines that the retail market for telecommunications services is the most important market to be considered concerning injuries. CSL commented that anti-competitive conduct in the market for wholesale services might result in detrimental effects to end-customers. It quoted the practice of the European Union in regulating mainly wholesale telecommunications services, as competitive wholesale markets are considered important for the generation of vigorous retail competition. BT held a similar view on the relationship between the upstream (wholesale) and downstream (retail) markets in terms of competition. Fung urged the TA to take a holistic view of the upstream and downstream markets.

TA's response

21. To address the concerns raised by various parties, paragraph 2.15 of the 2010 Draft Competition Guidelines makes it clear that the TA is concerned

about anti-competitive conduct in both the wholesale and retail telecommunications markets. In the case of Hong Kong, anti-competitive conduct in a wholesale market could be even more detrimental to consumer welfare than that in the retail market, as choices are usually more widely available for retail telecommunications services.

Abuse of a dominant position

Market dominance

22. Respondents' views are mixed in the discussion about market dominance and market share. Hutchison considered that rapid market liberalisation and technological developments in Hong Kong's telecommunications market had rendered concepts such as "dominance" and "market power" losing their significance, and "market share" becoming irrelevant in assessing the competition landscape. It went on to suggest a light-touch approach to be adopted by the TA in enforcing the competition provisions. PCCW found it a misconception that "dominance" per se can be defined purely by reference to "market share".

23. The other respondents regarded the 70% market share threshold or "*a combined market share of more than 30% [by the competing licensees]*" as proposed in the 2007 Draft Competition Guidelines a high threshold for investigation into alleged abuse of dominance, as compared to the 50% threshold adopted by the Broadcasting Authority and international practices. SmarTone was of the view that such a high threshold would give unfair advantage to the incumbent operator with large market share, and BT found it an insufficient restraint in some instances on the dominant operator. Both of them were also concerned about how the 30% market share is distributed amongst the competing licensees in the assessment of dominance. In addition, both SmarTone and CSL expressed negative views on the inclusion of a specific market share threshold in the Competition Guidelines.

TA's response

24. Section 7L of the TO does not prohibit a licensee from having a dominant position, nor does it prohibit any licensee from seeking such a

position. It only prohibits a licensee in a dominant position in a telecommunications market from abusing that position. Hence the concepts of “dominance” and “market power” are instrumental to the enforcement of section 7L. It is necessary to first establish whether a licensee is in a dominant position. As specified under section 7L(3), “market share” is only one of the relevant matters that the TA would take into account in considering whether a licensee is in a dominant position. The other relevant matters mentioned in the subsection include pricing power of a licensee, barriers to entry and product differentiation, and the list is in no way exhaustive. This was the position of the TA in the 2007 Draft Competition Guidelines, and is reaffirmed in the current Draft.

25. The TA has chosen not to specify an all-purpose market share threshold in the 2010 Draft Competition Guidelines, having taken into account the views of the respondents and the latest competition environment of Hong Kong’s telecommunications markets. It is agreed that “market share” alone cannot be determinative of dominance. Section 7L(2) defines “dominant position” as a licensee able to act without significant competitive restraint from its competitors and customers. It is “market power” that counts, and a high market share may or may not correspond to market power. Thus it may be misleading to specify an all-purpose market share threshold in the Competition Guidelines. The position of the TA in this regard is elaborated in paragraphs 4.13 - 4.14 of the 2010 Draft Competition Guidelines. The role of matters other than market share in defining dominance is discussed in paragraphs 4.16 - 4.29, including pricing power, barriers to entry and product differentiation.

Predatory pricing

26. PCCW was supportive of the stance of the TA in the 2007 Draft Competition Guidelines that lower prices would benefit consumers and generally reflect pro-competitive outcome. It also mentioned the practical needs for setting low prices in some cases, such as introductory prices for new products. Yet BT was concerned about the general presumption made by the TA that low pricing was not predatory would work in favour of the dominant licensee, and regarded the presumption as lack of neutrality. As to recoupment test, while PCCW agreed to taking this as a necessary part of any predatory pricing review, CSL cautioned that views in regard to the position of

recoupment in analysing predatory pricing are diverse in the international arena, and opined that errors almost certainly will result if this is taken as a bright line test. It asked the TA to provide clarity for the application of any recoupment requirement.

TA's response

27. The TA remains of the view that vigorous price competition among licensees delivers benefits to consumers in general. The only concern is when prices are set by a dominant licensee at such a low level that they are not cost recovery, and the sole purpose of the concerned licensee in setting low prices is to eliminate or discipline competitors in the market i.e. a predatory pricing strategy. The 2010 Draft Competition Guidelines have been expanded to elaborate on the costing standards applicable to the assessment of predatory pricing, and to address respondents' concern about the situation of justifiable below-cost pricing and the role of recoupment test in predatory pricing investigations.

28. The 2007 Draft Competition Guidelines adopted average variable cost (AVC) as the benchmark for assessing whether a price is above or below cost and this had attracted no comments from the industry. The TA will continue to use AVC as a benchmark in the analysis of predatory pricing, but would regard it as a starting point of the analysis. This is the minimum amount of cost that a dominant licensee should recover from the sale of each unit of services under the alleged predatory conduct, otherwise the selling of each unit will entail a loss. The TA will presume that a price that is below AVC is likely to be predatory⁵, unless there are justifiable reasons for that. Effectively, AVC is the price floor for screening out those likely predatory

⁵ In the “*Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*”, the European Commission recommended taking average avoidable cost (AAC) as the starting point in assessing whether conduct is predatory. According to the Commission, AAC would be the same as AVC in most cases, as often only variable costs are avoidable. AAC would be higher than AVC if the dominant licensee has to expand its capacity and incur fixed costs in order to predate. The TA decided to stick to AVC (a benchmark that the industry accepted), because it is rare that fixed costs would have to be incurred for predation, given the substantial economies of scale and scope in the provision of telecommunications services. Furthermore, it may not be practicable to isolate the size of the output increment arising from the alleged predatory pricing conduct from normal demand growth, let alone identifying the costs associated with it. On the other hand, the method for calculating AVC is well established.

pricing conduct. This is considered to be a conservative approach in that the use of a lowest possible price floor would help the TA minimise the chance of wrongly condemning conduct as predatory. At the same time, the industry would not be deterred from setting low prices, which are beneficial to consumers.

29. Depending on the circumstances, there could be justifiable reasons for pricing below AVC for a certain period of time. The 2010 Draft Competition Guidelines mention introductory pricing for new services or temporary promotional pricing as possible examples. There could be other reasons as well. It will be the responsibility of the defendant to demonstrate to the TA that there are indeed justifiable reasons for pricing below AVC.

30. However, since the telecommunications industry is characterised by high fixed costs and low variable costs, coverage of variable costs alone would most likely not be sufficient to show that a pricing is not predatory. Therefore, the TA will also make reference to the long run average incremental cost (LRAIC), which is a costing standard commonly adopted for the telecommunications sector⁶. Pricing above AVC but below LRAIC may or may not be predatory. It may be predatory because an equally efficient competitor would be unable to compete effectively in or be foreclosed from the market, given that not all fixed costs attributable to the production of the service in question is covered. But the requirement to cover all fixed costs could be a too stringent price-cost test, as a licensee who carries on production when only part of the fixed costs are covered is in fact reducing its loss in the short run. If it ceases production of the services, the loss will be equivalent to the entire fixed cost. Therefore, pricing above AVC but below LRAIC is a grey area requiring detailed analysis of the intent of the concerned licensee and other relevant factors in individual cases.

31. The TA noted the concern of the industry about recoupment in the analysis about predatory pricing conduct. Recoupment of short-term loss after the exit of competitors or deterrence of entrants is adopted by some competition authorities, notably those in the US, as part of the evidence for proving predation. The TA also finds this a relevant piece of evidence, but he

⁶ See “*Notice on the applications of the competition rules to access agreements in the telecommunications sector*”, Official Journal of the European Communities, 1998; and “*Competition Legislation, Competition Act 1998, the application in the telecommunications sector*”, Office of Fair Trading 417.

would not require this to be a necessary proof. There may be circumstances that the predator has underestimated the strong reaction of customers to price increases, or there are unexpected changes in the market situation rendering recoupment of loss impossible, or simply the predatory pricing strategy has not succeeded. A further complication for the telecommunications sector is that rapid technological changes have contributed to lower prices from time to time. So the recoupment of loss by the dominant licensee may just reflect a slower reduction in prices which, however, is difficult to be proved. Therefore, a basic consideration is whether there would be the chance of recoupment. This in turn depends on the market structure, whether the alleged predator is a dominant licensee and whether entry would be difficult when prices are raised.

32. Reflecting the consideration above about predatory pricing, the views of the TA on the matter are presented in paragraphs 3.20 - 3.24 of the 2010 Draft Competition Guidelines.

- END -

Office of the Telecommunications Authority
5 February 2010

Telecommunications Ordinance

Draft Competition Guidelines

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1. INTRODUCTION

Purpose of the Guidelines

- 1.1 These guidelines (the “Guidelines”) are published by the Telecommunications Authority (the “TA”) under section 6D(1) of the Telecommunications Ordinance (Cap. 106) (the “Ordinance”). Their purpose is to assist telecommunications licensees to comply with their obligations under the Ordinance in relation to **Section 7K Anti-competitive practices, Section 7L Abuse of a dominant position and Section 7N Non-discrimination** (the “Provisions”).
- 1.2 The Guidelines are intended to be a general explanation of how the TA is likely to interpret and apply the Provisions of the three statutory prohibitions and how the TA is likely to exercise his related powers and functions.
- 1.3 However, nothing in the Guidelines pre-empts the TA’s subsequent consideration of particular events on their merits, or stands in place of the Provisions of the Ordinance themselves. If any licensee has concerns about its position because of something written in the Guidelines or in the Ordinance, they should seek professional advice.
- 1.4 The Guidelines outline the TA’s standing policies and procedures in relation to the prohibitions as at [5 February] 2010, and replace all the previous guidelines issued by the TA concerning the competition obligations of licensees either under their licences or under the Provisions, including the “Guidelines to assist the interpretation and application of the competition provisions of the FTNS licence” issued in June 1995. The TA is not bound by the specific terms of the Guidelines in every eventuality, but a material departure from them would be accompanied by reasons in writing¹. The Guidelines themselves will be regularly reviewed and updated from time to time in consultation with the industry, as circumstances demand.

¹ Section 6A(3)(b)(ii) of the Ordinance.

Role of the statutory prohibitions

- 1.5 The prohibitions in sections 7K, 7L and 7N of the Ordinance concerning conduct which damages competition are an integral part of the Government's long-term policy for the deregulation and opening up of the telecommunications industry to market forces.
- 1.6 Under this policy, allocative efficiency, productive efficiency and dynamic efficiency in the provision of telecommunications services to the public are no longer economic outcomes within the realm of direct supervision by the Government. Instead, they are to be resolved by those who have chosen to enter the business of providing such services, competing strongly with each other for the custom of Hong Kong businesses and consumers.
- 1.7 The role of the statutory prohibitions is to ensure that this market-driven approach will create a level playing field such that big and small players in the market will compete on the basis of efficiency, thereby allowing consumers to benefit in terms of lower prices, higher output, service quality and innovation levels.
- 1.8 In particular, these prohibitions, in conjunction with section 7P of the Ordinance which regulates mergers and acquisitions, aim to prevent the abuse of market power, that is to say conduct that prevents or substantially restricts competition in the telecommunications market².
- 1.9 Market power of that kind comes about when a firm, or a number of them acting in concert, have the ability to produce and price their products without effective constraint from any other firms or the buying public.

² Under section 2(1) of the Ordinance, "*telecommunications market*" means any market for the provision or acquisition of telecommunications networks, telecommunications systems, telecommunications installations, or customer equipment or services.

Who and what the prohibitions apply to

- 1.10 Those who are subject to legal sanction in respect of the prohibitions are all those persons who are “licensee(s)” within the meaning of section 2(1) of the Ordinance.
- 1.11 The prohibitions are capable of application in respect of all aspects of business “conduct”, which include acts of commission and acts of omission.

General effect of prohibitions

- 1.12 The combined effect of the three prohibitions is, firstly, to require every licensee to determine what services it produces, how it produces them and at what prices it sells them in a way that does not involve any co-ordination with its rivals. Secondly, any licensee that has a dominant position is under a special duty not to act to inhibit the competitive activities of other licensees and would-be market entrants.
- 1.13 Since the purpose of the prohibitions is to ensure that consumer welfare will be protected and enhanced through effective competition, conduct of licensees that harms consumers will also be caught by the prohibitions. Normally, markets which feature high prices and hence profits would attract new entrants and the resultant competition would be able to safeguard consumer interest. The retail telecommunications markets in Hong Kong are generally of this nature. But in some rare situations where there is less than effective competition, the TA may intervene under the competition provisions or other relevant provisions of the Ordinance.
- 1.14 Even though conduct by licensees can contravene more than one of the three sections at the same time, usually the primary impact will be under either **sections 7K or 7L**, and the TA is likely to apply one of those which is the most relevant to the particular circumstances.
- 1.15 For example, if a new market entrant is being offered worse terms for network access service than others, and there is a suspicion of collusion amongst the established operators, then the discrimination

issue is likely to be pursued under section 7K. On the other hand, if in an access agreement there are discriminatory terms imposed by a single licensee, and it appears that the concerned licensee is in a dominant position in a relevant market, then the matter is likely to be investigated as a possible abuse of a dominant position under section 7L.

- 1.16 Section 7N deals with certain discriminatory conduct. Generally, however, conduct which is in contravention of this section will have first contravened one or other of the primary prohibitions under sections 7K and 7L. It is therefore likely that allegations concerning discriminatory prices or contract terms will be pursued under one or other of these two sections. In the case where the discriminatory conduct is found to have contravened neither section 7K nor 7L, but has the purpose or effect of preventing or substantially restricting competition, it will be dealt with under section 7N.

Prohibited conduct

- 1.17 Any conduct which has “*the purpose or effect of preventing or substantially restricting competition in a telecommunications market*” is prohibited by section 7K, and this is the primary prohibition.
- 1.18 Section 7K is mostly aimed at collusive arrangements amongst licensees, such as an agreement to fix market prices. The TA may also take action under section 7K against a non-dominant licensee acting unilaterally or in collusion with a non-licensee where the conduct might have the purpose or effect of preventing or substantially restricting competition.
- 1.19 Section 7L applies only to a licensee which is in a dominant position. The section does not prohibit a licensee being in a dominant position, but it does prohibit the licensee abusing its dominance to inhibit the competitive activities of other licensees and would-be market entrants.
- 1.20 Conduct by a dominant licensee that prevents or substantially restricts competition is deemed to be an abuse. The kinds of conduct which may constitute an abuse of a dominant position are considered in

Section 3 of the Guidelines, and the concept of a dominant position is considered in Section 4.

Mergers and acquisitions

- 1.21 Generally, mergers and acquisitions involving carrier licensees will be wholly dealt with under section 7P of the Ordinance, which provides for *ex ante* consideration of “changes in relation to carrier licensees” on competition grounds. Those provisions are a necessary adjunct to section 7K, because licensees might otherwise avoid the prohibitions in section 7K and achieve collusion by merging with one another.
- 1.22 Nevertheless, it should be noted that agreements and arrangements involving licensees which are ancillary to or which implement mergers and acquisitions remain subject to *ex post* scrutiny under section 7K, in the absence of a formal consent from the TA under section 7P(7).
- 1.23 The TA has issued separate guidelines in relation to the regulation of mergers and acquisitions and these are available on the website of the Office of the Telecommunications Authority (OFTA) at http://www.ofta.gov.hk/en/c_bd/guidelines.html.

Burden and standard of proof

- 1.24 The burden of proving that there is a contravention of the prohibitions rests with the TA. As contravention of any of sections 7K, 7L, or 7N of the Ordinance is not a criminal matter, the evidentiary standard of proof which applies is the civil standard which is “the balance of probabilities”. This means that the TA will decide, on the basis of the evidence available, whether it is more likely than not that the conduct in question constitutes a breach of the Provisions.
- 1.25 The complainants alleging a contravention by a licensee must provide the information and evidence as requested by the TA for consideration. When a licensee accused of a contravention of the Provisions argues that there is no such contravention, it is for that licensee to show that there is no contravention. The TA will consider any such claims and

verify them to the extent possible, but it is not for the TA to prove that the claims are unfounded in the event that they are rejected.

2 HOW THE COMPETITION TEST WORKS

2.1 The statutory test that the TA is required to apply when assessing a licensee's liability under any of the Provisions is whether the licensee's conduct has the **purpose or effect of preventing or substantially restricting competition** in a **telecommunications market**. Each of these elements is explained below.

Purpose or effect

2.2 Because the same liability can arise from the purpose of conduct as well as the effect of the conduct, licensees are at risk under the prohibitions, whether or not their conduct actually succeeds in modifying existing or anticipated levels of competition.

2.3 The test whether conduct has a particular **“purpose”** involves an objective consideration of the nature of the conduct in its market setting, and does not require establishing the *mens rea* or “guilty mind” of the licensee concerned. Where the purpose of conduct by a licensee is at issue independent of its actual effect, it will not be relevant that the licensee did not intend a competition constraint to result. Nor will it be relevant to the question of liability that the conduct did not actually result in any adverse effect. The TA, nevertheless, will take into account other potentially legitimate purposes of conduct in order not to stifle otherwise pro-competitive purposes. However, if the anti-competitive purpose of conduct turns out to be substantial amongst a number of other purposes, it will be regarded as a contravention.

2.4 An unlawful purpose can nevertheless also be attributed to particular conduct by evidence that in fact licensees concerned had the “guilty mind” of inhibiting competition. In the situation where the purpose of the conduct in question is unclear, the TA will look at the effect of

the conduct in order to reach an opinion as to whether any of the Provisions have been contravened.

- 2.5 The “**effect**” which conduct has on the overall competitive process will be inferred by the TA from salient facts concerning the market entry conditions and other aspects of market structure. The TA may also examine the counterfactual, i.e., what the position would have been in the absence of the conduct in question. It should, however, be noted that the Provisions are concerned with protecting the process of competition in the telecommunications markets and not the survival of individual licensees or any established business models.

Preventing or substantially restricting

- 2.6 In assessing whether conduct has the effect of preventing or substantially restricting competition, the TA will find an adverse effect only where there is clear evidence that conduct will have a net adverse impact on the competitive process or consumers. He will not take action that could inhibit healthy, robust competition between licensees that leads to lower prices, better services or other benefits to consumers.
- 2.7 Generally the TA will regard competition amongst licensees as being “**prevented**” when there is a full foreclosure of an actual or potential service from another source, whether or not that source is a fully equivalent substitute, and whether or not the prevention is permanent.
- 2.8 On the other hand, where the foreclosure of an alternative source of supply is not absolute, but the constraint in terms of impact on existing competitors and entry by potential competitors is nevertheless one that is not immaterial, the TA may still regard it as “**substantially restricting**” competition.
- 2.9 Overall, the concept of a prevention or substantial restriction of competition is a relative one. The TA’s approach is that the injury to competition needs to be of such magnitude, character and importance that it is worthy of consideration under the Ordinance and from the

public interest point of view. That in turn requires an understanding of the market and the nature of competition in it.

Competition

- 2.10 Competition is a process which concerns the dynamics of how would-be buyers and sellers interact. It includes the specifics of how different telecommunications services are produced and purchased; the circumstances in which certain services, technologies, and operators may or may not displace other services, technologies and operators, especially from the perspective of the buyers of services; and how licensees are able to distinguish themselves and their products in the marketplace as well as the channels they can use to distribute those products.
- 2.11 The TA would not intervene unless he is satisfied that there is a likelihood that conduct could lead to injury to consumers or the competitive process, with the consequence that there could be an increase in market prices, a reduction in service output or quality, or loss of innovation.
- 2.12 Examples of the TA's approach to the identification of the competitive process and competition injury can be found in the previously published competition decisions (the "CDN" numbered series documents, obtainable on OFTA website at http://www.ofta.gov.hk/en/c_bd/completed-cases/main.html.)

Telecommunications market

- 2.13 The Provisions are concerned only with adverse impacts in the telecommunications sector. However, telecommunications services in Hong Kong are now often sold by licensees in conjunction with other services such as pay-TV and other media content. Accordingly, it is possible that a licensee's conduct in relation to non-telecommunications sectors can nevertheless impact on competition in respect of the telecommunications sector, and thus give rise to a liability under the Provisions.

- 2.14 Similarly, conduct which occurs in relation to one telecommunications market can adversely impact on competition in another telecommunications market.
- 2.15 A special characteristic of the telecommunications market is that the conduct of sellers in an upstream wholesale market may also affect competition in a downstream retail market. Under certain circumstances anti-competitive practices in a wholesale market, such as the provision of interconnection services, may be even more detrimental to consumer welfare than those in the retail market, as choices are usually more widely available for retail telecommunications services. The TA is therefore concerned about anti-competitive conduct in both the wholesale and retail telecommunications markets.
- 2.16 The TA's approach to determining the parameters of the relevant market in which to consider possible competition injury or abuse of market dominance is outlined in Section 4 of the Guidelines.

3 CONDUCT WHICH DAMAGES COMPETITION

Collusion amongst licensees

- 3.1 The TA regards section 7K of the Ordinance as imposing a general obligation on licensees to act independently, and while subsection (2) specifically identifies the kinds of unlawful coordination amongst competitors which are most at risk, the list is not exhaustive in terms of the collusive conduct that is capable of breaching section 7K.
- 3.2 Importantly, subsection 3(a) applies the prohibitions to arrangements and understandings as well as "agreements". An "**arrangement or understanding**" is something less formal than a written or oral "**agreement**", whether or not they are legally enforceable. It is any sort of communication between two or more parties which results in each party expecting the other to act in a particular way. Arrangements and understandings apply to any communications which result in a meeting of minds to behave in a way that has the purpose or

effect of preventing or substantially restricting competition in a telecommunications market.

- 3.3 The TA does not believe that there is a legal or formal distinction between the concepts of “agreements”, “arrangements” and “understandings”, and will not in practice attempt to distinguish between them. Conduct that is attributable to an agreement, arrangement or understanding is to be distinguished from unilateral conduct. The TA will act against agreements, arrangements and understandings which have a general objective, not just those which are made in specific terms.
- 3.4 Section 7K, however, does not cover agreements that result in mergers and acquisitions of carrier licensees. As elaborated in paragraphs 1.21-1.23 above, they are regulated by section 7P of the Ordinance in terms of “changes in relation to carrier licensees”. However, section 7P applies only to the merger transaction itself and the competition provisions under sections 7K, 7L and 7N remain in force and licensees remain obliged to comply with the Provisions.

Price fixing

- 3.5 Price fixing between competing licensees is fundamentally inimical to the competitive process in telecommunications markets because, in the opinion of the TA, the purpose of such conduct is to prevent or substantially restrict competition.
- 3.6 Any arrangements between competing licensees which directly or indirectly fix the prices for services or products sold by those licensees, or those acquired by them, will be regarded by the TA as having the purpose of preventing or substantially restricting competition, regardless of its actual impact on market prices³.
- 3.7 In relation to telecommunication services, price fixing does not necessarily refer to agreements, arrangements and understandings that

³ Commercial agreements between licensees in regard to interconnection charges and charges for the use of other network facilities, nevertheless, would not in general be regarded as “price fixing” and constrained by section 7K(2)(a).

directly fix prices to be imposed on the end-customers. It also covers situations in which prices are indirectly fixed, for example companies agreeing the recovery of certain cost components in prices; agreeing the elements of the service to be charged for or to be included in product offerings; setting percentage or monetary margins of profit; agreeing to increase prevailing prices and the timing thereof; setting minimum prices or a price range; agreeing the amount of or incidence of discounts, rebates or the value and character of promotional benefits; or regulating the distribution channels for particular service offerings or the mode and extent of product marketing.

- 3.8 On the morning of 2 January 2000, all six mobile network operators implemented substantially similar adjustments to their respective tariffs for mobile phone subscription services. Financial modelling of prices prepared by individual companies just before the increases and produced to the TA subsequently bore no resemblance to the pricing actually implemented. The TA accepted the operators' prompt return to their previous prices and the adjustment of payments by the affected customers. If this had happened only a few months later, after the competition provisions had been introduced to the Ordinance, the mobile network operators would likely have been found to be engaged in illegal price fixing and have contravened section 7K(2)(a).

Preventing or restricting supply to competitors

- 3.9 Coordinated exclusionary conduct can also damage competition in telecommunications markets. Action by licensees who are direct competitors which restricts the basis on which those licensees can (or cannot) deal with other licensees will be regarded by the TA as conduct which has the purpose of preventing or substantially restricting competition, regardless of its actual impact on market prices.

Market sharing

- 3.10 Agreements, arrangements and understandings that share markets may be regarded by the TA as having the purpose or effect of

preventing or substantially restricting competition regardless of their actual impact on market prices.

- 3.11 These could include any arrangements about the geographic coverage of networks; arrangements about the kinds of customers or business each of the licensees will pursue; and arrangements as to the kinds of services licensees will offer or the kinds of technologies to be deployed.
- 3.12 On the other hand, arrangements that involve licensees sharing facilities because of economic efficiency considerations (such as cost saving or the development of innovative services, or genuine technical constraints due to lack of physical space or aesthetic consideration) are not to be regarded as “market sharing” in the sense of paragraphs 3.10 and 3.11 and would not be condemned under section 7K(2)(c). Common examples in the specific environment of Hong Kong are the provision of mobile service coverage inside the underground railway stations and tunnels as well as shopping malls. However, in other cases which are less clear, the TA will examine the arrangements to ensure that they would not result in a prevention or substantial restriction of competition.

Unilateral anti-competitive conduct of a market dominant licensee

- 3.13 Without prejudice to what is discussed in paragraph 1.18 above, the TA normally will not seek to enforce any of the provisions of section 7K against the unilateral conduct of an individual licensee. This is because unilateral conduct is unlikely to prevent or substantially restrict competition in any telecommunications market unless the licensee concerned is in a dominant position.
- 3.14 In cases where the licensee concerned is in a dominant position, the TA is more likely to pursue the matter as a case of abuse of dominant position under section 7L of the Ordinance.

Abusive conduct

- 3.15 Section 7L prohibits a licensee in a dominant position in a telecommunications market from abusing that position. The TA notes that the section does not prohibit a licensee from having a dominant position nor does it prohibit any licensee from seeking such a position. How the TA will ascertain whether a licensee is in a dominant position is discussed in Section 4 of the Guidelines.
- 3.16 In terms of section 7L(4), a market dominant licensee is deemed to have abused its position if it has engaged in conduct which has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. However, the scope of section 7L(1) is not limited by section 7L(4).
- 3.17 The meanings which the TA attaches to the concepts of conduct having the “**purpose or effect**” of “**preventing or substantially restricting**” “**competition**” in a “**telecommunications market**” are discussed at paragraphs 2.2 to 2.16 above.
- 3.18 Section 7L(5) lists particular conduct of a dominant licensee which the TA may consider as having the purpose or effect of preventing or substantially restricting competition. The list, however, is not exhaustive, and the TA will also examine whether other types of conduct not listed in section 7L(5) may amount to an abuse.
- 3.19 With reference to section 7L(5), the TA considers the following to be the main considerations which licensees need to pay special attention to where potential abuse of dominance is concerned.

Predatory pricing

- 3.20 As part of the competitive process, firms compete for business by reducing prices. In general, the TA welcomes vigorous price competition between licensees, which is seen as delivering benefits to end-customers. However, there may be circumstances under which substantial price cuts by a licensee in a dominant position might be seen as a predatory strategy intended to eliminate or discipline

competitors in the market. Such conduct, which is specifically listed as an example of abuse in section 7L(5)(a) of the Ordinance, will be closely examined by the TA to determine its lawfulness.

3.21 Where a licensee is in a dominant position and there is a suggestion that it may be charging predatory prices, the TA will begin his analysis by examining the relevant costs for the service in question.

3.22 The TA will ask the licensee to provide information about the average variable cost (AVC) and long run average incremental cost (LRAIC) of the service in question⁴. AVC is considered the minimum amount of cost that a licensee should recover from the sale of each unit of service under the alleged predatory pricing conduct. If the price of a service does not cover even the AVC, the selling of each unit would entail a loss and the TA would presume that the price is likely to be predatory. However, since telecommunications networks are characterised by high fixed cost and low variable cost, pricing above AVC alone would most likely not be sufficient to show that such a pricing is not predatory. Therefore, the TA will also make reference to the LRAIC of producing the service, which is higher than AVC by the amount of fixed cost. Pricing above AVC but below LRAIC may be regarded as predatory, as the price charged by a dominant licensee that does not contribute to the recovery of all fixed costs attributable to producing the service in question may imply that an equally efficient competitor would be unable to compete effectively in or be foreclosed from the market.

3.23 However, in view of the benefits of lower prices to end-customers, the TA is keenly aware of the need not to deter a dominant licensee from competing on price for fear that by doing so it may be found to abuse a dominant position. Thus before condemning a dominant licensee

⁴ Variable costs are costs that vary directly with the volume of output and do not include any element of fixed costs which do not vary with output volume. Average variable cost is obtained by dividing the total variable cost by the units of output. Long run incremental costs include all costs (fixed or variable) attributable to the production of a defined increment of output. In particular, they include attributable fixed costs incurred before a firm has engaged in the alleged predatory conduct, and the fixed costs incurred specifically for engaging in such conduct, if any. Long run average incremental cost is obtained by dividing the total long run incremental cost by the units of output within the relevant increment.

selling below cost as engaged in predatory conduct, the TA will carefully examine whether there would be justifiable reasons for that. Depending on the circumstances, this could include introductory pricing for new services or temporary promotional pricing. The TA nevertheless will be cautious to consider also, where necessary, the possible effect of the alleged predatory pricing conduct on the dynamics of competition. If a dominant licensee, by selling below cost, constrains the output of its competitors and thereby strengthens further its dominant position or lessens its incentive to innovate due to reduced competition, this may be considered evidence that the pricing could be predatory.

- 3.24 In the circumstances that the loss due to the alleged predatory price can be recouped in the reasonably foreseeable future, because of the market structure which would prevail after the elimination or weakening of competitors, the TA would likely conclude that the effect of the low pricing is predatory and that the pricing is an abuse of a dominant position. While recoupment is one of the means for checking whether a price is predatory, the fact that there is no evidence of recoupment or the feasibility of recoupment does not necessarily imply that a price is not predatory.

Price discrimination

- 3.25 Price discrimination in itself should not be harmful to the competitive process or to end-customers. It can in fact contribute to increased consumer welfare in terms of allocative efficiency, as the level of output is normally higher than under uniform pricing. The TA will examine price discrimination only in circumstances where it is plausible that it may have the purpose or effect of preventing or substantially restricting competition.
- 3.26 The result that one user of a telecommunications services enjoys a lower price or otherwise gets more benefits than the user next door, who is nonetheless using exactly the same service, is an inherent outcome of the process whereby rival licensees compete for the business of end-customers over time.

Refusal to deal

- 3.27 Modern communications require licensees to enter into a host of agreements with other telecommunications companies and, in the case of carrier licensees, there are a variety of reciprocal agreements with direct competitors, including agreements relating to what happens when customers decide to change their service provider.
- 3.28 In the telecommunications market, a licensee's refusal to deal, whether outright or by virtue of behaviour or terms imposed, can adversely affect the competitive process at the customer level. This is because some established facilities or services can have the character of "essential facilities" or are "bottlenecks", and new entrants or competitors must have access to them or interface with them in some way before customer services can be provided. The licensee which owns such bottleneck facilities may have a dominant position in relation to them.
- 3.29 Where a finding is reached that a licensee has a dominant market position by virtue of its ownership of the relevant facilities or services, the TA is likely to conclude that a refusal to provide access to them amounts to an abuse where it could have the purpose or effect of preventing or substantially restricting competition, if the licensee fails to satisfactorily substantiate its rationale for its conduct. For example, in the case of a claim that there have been delays due to a lack of capacity, it would need to be proved by furnishing the relevant technical data.

Bundling

- 3.30 Competition amongst telecommunications licensees in Hong Kong is presently characterised by a significant amount of product "bundling", where traditional fixed line phone services, internet protocol telephony, internet access, mobile phone, and pay TV, can be offered in various combinations as individual product sets or "bundles" to business or residential customers.

- 3.31 The TA recognises that where a supplier of goods or services has a dominant position in respect of one product, its “bundling” of that product in conjunction with other products can sometimes give rise to concern that it is abusing its dominant position. However, given the potential for cost saving and innovation associated with product bundling, the TA will generally apply a cautious approach when assessing whether bundling is anti-competitive. The TA will look into the special situation of individual cases and take into account all the relevant factors to ascertain whether there would be anti-competitive concern.

4 MARKETS AND MARKET DOMINANCE

General principles

- 4.1 Competition takes place in markets and the Provisions are directed at outcomes in telecommunications markets. So when considering whether licensee conduct has damaged, or is likely to damage, the competitive process by causing prices to rise or service output, quality or innovation to be lost, it will be necessary for the TA to identify the relevant telecommunications market that is involved.
- 4.2 The TA will adopt a description of the relevant telecommunications market which, at the time enquiries are being made, best assists the thorough analysis of the conduct which is under scrutiny. This means that the TA will treat market definition and the assessment of competition as an integrated exercise, which requires pragmatic judgments to be reached in respect of a range of facts and reasoned inferences based on sound economic and legal analysis.
- 4.3 Defining the relevant market is never precise or wholly scientific, especially when detailed information is not available, or as in the case of some telecommunications markets, the competing products or services are differentiated and technological changes are rapid. As a result, occasionally some of the relevant market parameters which the TA adopts may be less than clear-cut.

4.4 Moreover, because competition is a dynamic process and the telecommunications market undergoes rapid changes locally and internationally, what may be suitable market definition parameters on one occasion may not be appropriate for the other enquiries, notwithstanding similarities in terms of the subject-matter under scrutiny and that the enquiries are not so far apart in time. Nevertheless, market definition used in earlier enquiries may provide a useful starting point.

Relevant market parameters

4.5 On each occasion, the TA's market definition process will aim to identify all the firms whose business acts as a constraint on the licensee(s) whose conduct is under scrutiny, and it will exclude the firms which are not in close competition with them. The description will also be inclusive of all the services which can be effective substitutes in the eyes of buyers (demand-side substitutes), and it will include all the firms which are able to supply any of those substitutes (supply-side substitutes).

4.6 The TA will usually define the relevant market in terms of the product, the geographic reach, the distribution function, and the factor of time. In addition, the TA may use a specific customer dimension to distinguish different customer types where it is relevant.

4.7 In anti-competitive practice investigations, the TA is also likely to apply the tools and other features of traditional competition law market analysis which are set out in sections 3 and 4 of the Guidelines on Mergers and Acquisitions, which are available on the website of OFTA at http://www.ofta.gov.hk/en/c_bd/guidelines.html.

Market power and market dominance

4.8 Section 7L of the Ordinance, which prohibits the abuse of dominant market position, is not concerned with the normal range of seller influence over equilibrium price and output which is to be found in a market where competition is effective.

- 4.9 The concern of section 7L is with the significant market power of a dominant licensee which enables it to behave to an appreciable extent in terms of pricing and output without constraint from existing competitors, potential entrants, upstream input suppliers or downstream customers.
- 4.10 The TA's opinion as to whether a licensee is in a dominant market position is to be informed by subsection (3) of section 7L, which specifies that relevant matters to be taken into account include the licensee's market share, the licensee's power to make pricing and other decisions, any barriers to market entry, and the degree of product differentiation. These are discussed in detail below.

Market share

- 4.11 In the context of Hong Kong's telecommunications sector, caution needs to be exercised concerning the weight to be attached to market shares when dominance is being considered and in characterising a licensee's market position by reference to a single dimension.
- 4.12 Deregulation, apart from leading to the establishment of alternative networks, has also caused the boundaries between different technological platforms and services to become increasingly blurred, such as that between fixed and mobile services. Thus in assessing dominance, factors other than historic sales volumes and market shares may be more relevant.
- 4.13 The TA does not consider it useful or necessary to specify in these Guidelines one "all-purpose" market share threshold for considering whether a licensee is able to act without significant competitive restraint from its competitors and customers, which is how "dominant position" is defined in section 7L(2).
- 4.14 Market share is only a signal to the TA that a licensee may be in a dominant position and certain conduct by it may be anti-competitive. It is, however, recognised that a high market share may not correspond to market power enabling the concerned licensee to act without significant competitive restraint. The establishment of dominance of

a licensee in a telecommunications market requires a complex assessment of the market and the position of the licensee in the market. In addition to market share, the TA will take into account also the practical barriers to entry and expansion in the market, the positions of the competitors in the market (including the capacity and footprints of their networks, and how closely their products compete with those of the concerned licensee), the existence of countervailing buyer power, and changes in the market share of the concerned licensee over time.

- 4.15 Where detailed relative market share analysis is relevant, the TA will look to establish the shares for all the market participants by a variety of measures, which may include revenues, subscriber numbers, premises passed, network capacity, subscriber types or traffic volume.

Pricing power

- 4.16 A firm's ability to maintain or increase its prices, or to constrain its service output, quality and innovation levels over a period of time, notwithstanding the appearance of lower pricing elsewhere in the market, is an indicator of a market dominant position. Generally, therefore where there is an allegation of dominance, the TA will be concerned to examine the history of the service provision and its pricing and other terms, to ascertain the degree of volatility and downwards price movement.
- 4.17 Where prices have moved and there is evidence of customer switching to effective substitutes, a finding of dominant position is less likely.

Barriers to entry

- 4.18 The ease with which new competitors can emerge in a telecommunications market, in which dominance is alleged, is an important factor in determining the character of the market's structure, and whether particular conduct would have the capacity to prevent or substantially restrict competition in it.
- 4.19 The assessment of barriers to entry and expansion is central to the analysis of market dominance. Where there are low barriers and the

market is expanding, established firms must determine their prices and output cautiously, knowing that if their prices are set significantly above the competitive level, or if they fail to innovate, new entrants will come in and existing competitors will expand their output. This process of competition will drive prices down and old products out.

- 4.20 Modest barriers to entry and expansion are consistent with effectively competitive markets. In contrast, high barriers to entry and expansion can lead to fewer licensees in a market as well as a lower probability of market entry and therefore, all other things being equal, licensees face fewer competitive constraints.
- 4.21 The TA will usually assess the importance of potential competition as a competitive constraint by identifying who the likely entrants are and when they might enter, and by measuring the height of the market entry barriers which confront them.
- 4.22 For potential competition to be a real constraint to those already in the market, it must be likely, sufficient in extent and timely. For entry to be likely, it must be a genuine commercial probability. To be sufficient, it must be capable over time of moving from small beginnings to confronting the core activities of the incumbents. As for timeliness, it would depend on the special circumstances in each case.
- 4.23 Anything which amounts to a cost or a disadvantage, which a new entrant has to face but the incumbent does not, can be an entry barrier. Importantly however, cost advantages derived solely from a licensee's economic efficiencies will not be regarded as a barrier to the new entrants.
- 4.24 The telecommunications sector has been fully liberalized since 2003. The Government has adopted an open licensing regime for all telecommunications licences and, under the WTO commitments, there is no restriction on foreign ownership either. Therefore, there are no regulatory barriers in Hong Kong's telecommunications sector, apart from natural constraints that may limit the number of licensees (such

as frequency spectrum availability). There are thus two main types of barrier, namely structural and strategic barriers.

- 4.25 The structural barriers are those which are inherent in the activity itself. In telecommunications, structural barriers normally include, but are not limited to, the substantial sunk costs of the tangible and intangible assets; the substantial economies of scope and scale associated with a ubiquitous telecommunications network; brand loyalty to the incumbent; and the difficulties in accessing existing telecommunications infrastructure and product distribution channels.
- 4.26 Strategic barriers to market entry are those erected by the participants already in the market, which can effectively add to the natural sunk costs. Strategic behaviour could include an incumbent investing in excess capacity; differentiating its products; sustaining heavy spending on advertisement leading to high costs of brand establishment; or raising customer switching costs by locking up significant customer numbers on long-term contracts or on low margin pricing.
- 4.27 Findings about the specific nature of any market entry barriers and their significance as constraints on competition in any respect will be determined on a case-by-case basis.

Differentiated products

- 4.28 Most telecommunications markets comprise only a few firms. In considering the interactions and rivalry between businesses in these kinds of markets, the level of differentiation between the rival brands can be important in ascertaining where market power lies. If the service is a commodity where only price counts in the eyes of buyers, then customer switching would be more likely, meaning less market power for an incumbent. With differentiated products, where factors other than price are decisive in the choice made by the customers, rival services may not be perceived as such perfect substitutes for each other and therefore an incumbent may have greater market power.
- 4.29 Generally, most telecommunications services in Hong Kong are differentiated to some extent.

5 PROCEDURES

Alerting the TA

- 5.1 Anyone who has information that a licensee has engaged in conduct which is in contravention of the Provisions, or that such conduct is imminent, should provide their information to OFTA as soon as possible.
- 5.2 The TA will always consider adopting leniency towards any licensee who promptly volunteers information and evidence about the event of an anti-competitive practice once it comes to light, even though that licensee is also implicated. The TA will also be prepared to receive information on a confidential basis and to withhold disclosure of an informant's identity.
- 5.3 Further information about how to contact OFTA can be found on OFTA website (see http://www.ofta.gov.hk/en/c_bd/competition-complaints.html). The guideline entitled "*How complaints related to sections 7K to 7N of the Ordinance are handled by OFTA*" is also available on the web site. OFTA will follow the procedures set out in that guideline, unless there are exceptional circumstances which justify a departure from the established procedures.
- 5.4 The TA is not only reliant on complaints however. Investigations into anti-competitive practices can also be commenced on the TA's own initiative where there are reasonable grounds for believing that a contravention may have occurred or may be imminent.
- 5.5 In summary, on receipt of a complaint from an affected party, or where OFTA otherwise comes into possession of relevant information, a decision will be made whether the situation merits a formal investigation. If so, the subject licensee will be informed and asked to respond to any specific allegations. OFTA will often ask for specific information from the subject party, which may include obtaining evidence under the TA's formal powers of investigation (see paragraphs 5.7 and 5.9 below).

5.6 In deciding whether an allegation is substantiated under the prohibitions, OFTA will consider the material gathered during investigation, including any responses from the licensee concerned. A draft decision will be provided to the licensee who will be given an opportunity to comment on the reasoning and the evidence before any final decision is made. Where the TA considers that there has been a contravention, the licensee will also be given an opportunity to comment and put forward submissions in relation to the penalty that is being considered.

Powers of investigation

5.7 The TA's powers of investigation are contained in sections 7I, 35A and 36D of the Ordinance. Under these sections, the TA may request information from, or carry out an investigation in respect of a licensee, where the TA suspects that there is a contravention of the Provisions. An investigation may involve OFTA's officers entering the premises of a licensee and inspecting and making copies of documents.

5.8 Generally it is the TA's practice to seek a licensee's voluntary cooperation in the provision of relevant information, but he will resort to the formal entry and directions powers if there is a risk of evidence being damaged, or if the licensee is prevented from disclosing information except in response to the exercise of a statutory investigation power.

5.9 The TA, in carrying out an investigation, may also use information sourced from competitors of the concerned licensee, consumers, trade associations and suppliers, as well as publicly available information such as market research reports.

Financial penalties

5.10 Under section 36C of the Ordinance, the TA may impose financial penalties on the licensee for breach of the Provisions. On the first occasion a penalty is imposed, the penalty may be up to and including \$200,000, on the second occasion up to and including \$500,000, and

for any subsequent occasions on which the penalty is imposed, the penalty may be up to and including \$1,000,000.

- 5.11 If the TA considers that such a penalty is inadequate, section 36C of the Ordinance enables an application to be made to the Court of First Instance, which may impose a financial penalty of a sum not exceeding 10% of the licensee's turnover during the period of the breach, or \$10,000,000, whichever is the higher.
- 5.12 There are a number of factors, set out below, which the TA will take into account when imposing a penalty. These factors are additional to those set out in the TA's "Guidelines on the imposition of financial penalty under section 36C of the Ordinance" (available on OFTA website at http://www.ofta.gov.hk/en/legislation/guideline_6d_1/main.html) which explain how the TA will take into account the nature, seriousness and duration of the contravention.

Directions

- 5.13 A direction to the licensee can be issued under section 36B of the Ordinance to bring contravening conduct to an end.
- 5.14 Such directions may require the licensee to modify an agreement or the manner of the exercise of contractual rights, or to terminate an agreement or otherwise cease the conduct in question. Directions may require positive action, such as informing third parties that a contravention has been brought to an end and reporting back periodically to the TA on certain matters, such as prices charged.

Warnings

- 5.15 The TA may issue a warning to a licensee when, notwithstanding a finding that there is a contravention of the Provisions, in the TA's opinion, any other sanction is not justified by the circumstances of the case.

- 5.16 Where the TA considers it is in the public interest, the licensee may be required to publish the warning.

Damages

- 5.17 Under section 39A of the Ordinance, a person suffering loss or damage from an anti-competitive practice may bring an action for damages, an injunction or other appropriate remedy, order or relief against the licensee in breach.

- 5.18 In order to bring a claim for damages under section 39A, a breach of the Provisions must have occurred, and the party claiming damages must, as a result, have suffered loss or damage.

Action of the licensee post breach

- 5.19 The TA will look more favourably on a licensee who has promptly co-operated with the TA's investigations and has committed to taking action to ending the conduct which is the subject of a contravention finding.

Compliance programs

- 5.20 The TA will take into account any evidence of the existence of a compliance program, which the licensee is operating, when imposing penalties. Licensees are encouraged to develop in-house compliance programs so that management and staff understand the requirements of the Provisions.

- 5.21 The existence of in-house compliance programs and structures will assist licensees in discovering potential breaches early, enabling licensees to prevent breaches of the Provisions, and to remedy breaches at the earliest opportunity.

- 5.22 The TA is willing to discuss and advise licensees during the development of their compliance programs, although there is no formal process by which the TA will approve a particular programme.

Appeals

- 5.23 Decisions of the TA in relation to section 7K to 7N may be appealed to the Telecommunications (Competition Provisions) Appeal Board in accordance with Part VC (sections 32L to 32O) of the Ordinance.

Further information

- 5.24 OFTA documents referred to in these Guidelines, such as the “Guidelines on Mergers and Acquisitions”, “*How complaints related to section 7K to 7N of the Ordinance are handled by OFTA*”, the “*Guidelines on the imposition of financial penalty under section 36C of the Ordinance*”, and previous case summaries and decisions on anti-competitive conduct can be obtained from OFTA website at http://www.ofta.gov.hk/en/c_bd/guidelines.html; http://www.ofta.gov.hk/en/c_bd/competition-complaints.html; http://www.ofta.gov.hk/en/legislation/guideline_6d_1/main.html; and http://www.ofta.gov.hk/en/c_bd/completed-cases/main.html.
- 5.25 The industry and members of the public may also write to:

Office of the Telecommunications Authority
29/F, Wu Chung House
213 Queen’s Road East
Wan Chai
Hong Kong

Office of Telecommunications Authority
5 February 2010