

**Application for a Declaration of Non-Dominance in the  
External Call Services Market for Mainland China Routes  
by Cable & Wireless HKT Limited**

**Statement of the Telecommunications Authority, Hong Kong**

**25 May 2000**

**INTRODUCTION**

**Background**

1. On 4 August 1999, the Telecommunications Authority (TA), having considered an application from Cable & Wireless HKT Telephone Limited (CWHKTC) for a declaration of non-dominance in the “International Call Services” market for non-China routes, issued a statement entitled “Application for a Declaration of Non-Dominance in the International Call Services Market for Non-China Routes by Cable & Wireless HKT Telephone Limited”. The TA in his statement set out his findings and issued a direction that in relation to certain routes (those that had been classified as Category A in the wholesale external gateway services market), CWHKTC was no longer dominant. In relation to the rest of the routes, the TA was satisfied that CWHKTC was still dominant. CWHKTC’s application at the time did not include the Mainland China routes.

2. On 21 January 2000, Cable & Wireless HKT Limited<sup>1</sup> (*CWHKT*) filed an application asking the TA to examine its position in the retail market for call services over the Mainland China routes for which it considers that it is no longer dominant.

3. In response to that, the TA published on 11 February 2000 a consultation document together with the actual application of *CWHKT*, after the excision of such information as the TA considered commercially confidential. As stated in the consultation document, the TA proposed to apply the same economic tests as previously applied to the past applications by *CWHKT*. However, he would give due regard to any new material or arguments that may be raised by the respondents to the consultation. The TA invited comments on the application in general as well as on:

- (a) the market definition as suggested by *CWHKT*;
- (b) the competition analysis;

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<sup>1</sup> The application was submitted on behalf of the group of companies comprising Cable & Wireless HKT Telephone Limited, Cable & Wireless HKT International Limited and Cable & Wireless HKT CAS Limited which jointly hold the Fixed Telecommunication Network Services Licence.

- (c) the current state of the market as expressed by *CWHKT*;
- (d) whether *CWHKT*<sup>2</sup> is dominant or not in the market; and
- (e) what, if any, conditions should the TA consider imposing in the event that he finds that *CWHKT* is not dominant in the relevant market.

### **The Submissions**

4. The TA received within the set deadline five submissions, which he took into account. No late submissions or additional comments and/or withdrawals of comments were received. The comments and/or views came from the following (in alphabetical order):

- (a) Cable & Wireless HKT Limited (*CWHKT*)
- (b) Mandarin Communications Limited (Sunday)
- (c) New T&T Hong Kong Limited (New T&T)
- (d) New World Telephone Limited (NWT)
- (e) SmarTone Mobile Communications Limited (SmarTone)

5. The submissions received responded to the specific issues raised by the TA. Annex A lists the main arguments in the submissions received. This does not aim to be exhaustive nor does it mean to signify that the TA has accepted the arguments as correct. Arguments are summarised, without comment, in a way that reflects, as closely as possible, the statements made.

6. Of the submissions received, only *CWHKT* supported the application it made. All other submissions – for different reasons and/or arguments – suggested that the TA should not accede to the application.

## **ANALYSIS**

### **General**

7. The TA in considering the application by *CWHKT* has followed the approach set out in the “Guidelines to Assist the Interpretation and Application of the Competition Provisions of the FTNS Licence” issued by the OFTA in June 1995 and the TA statement entitled “Application for a Declaration of Non-dominance in the International Call Services market for Non-China Routes by Cable & Wireless HKT

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<sup>2</sup> In this paper, “*CWHKT*” denotes the group of companies comprising Cable & Wireless HKT Telephone Limited, Cable & Wireless HKT International Limited and Cable & Wireless HKT CAS Limited which jointly hold the Fixed Telecommunication Network Services Licence. “*CWHKT*” (*in italics*) denotes Cable & Wireless HKT Limited as the holding company.

Telephone Limited” issued on 4 August 1999.

8. The TA first examined what was the relevant market and then assessed whether CWHKT was dominant in that market.

9. In considering whether CWHKT was dominant in the market, the TA started by examining the market share of CWHKT, the fluctuations of it, the market concentration, any barriers to entry, pricing of the services over time, vertical relationships that may exist, etc.

10. Once the TA has established the position of CWHKT in the market, he considered whether its application for a declaration for non-dominance was justified (with or without any conditions).

### **Legal Basis**

11. General Condition (GC) 44 of the Fixed Telecommunication Network Services (FTNS) Licence issued to CWHKT – which is reflected in all FTNS licences – provides that if the TA forms the opinion that the licensee is not in a dominant position, with respect to any market for telecommunication services provided under the licence, he may exempt it from certain licence obligations. These obligations include the implementation of specified accounting practices, obtaining the prior approval of the TA for the tariffs of new services or the revisions of existing tariffs, and a prohibition on unauthorised discounts from the tariffs approved by the TA. GC 44 also provides that the TA may lift any such obligations either completely or in part and for such period and on such conditions as he may determine.

12. The TA therefore in considering the application of *CWHKT* had to determine whether:

- (a) CWHKT is dominant in respect of the market or markets under consideration;
- (b) if it is not dominant, he should lift all, some or none of the licence obligations to which GC44 applies; and
- (c) any new conditions should be imposed and for what, if any, specific period.

## **Relevant Market**

13. As the definition of the market could significantly affect the outcome of a dominance analysis, the TA invited comments on the appropriate definition of the relevant market. The TA, in reconsidering his previous market definition so as to be satisfied that it is still valid, used the generally accepted test of “substitutability” or “cross-elasticity” in both demand and supply. He examined which services were close enough substitutes to be competing in the same market. He did so by looking at the alternative services which a significant number of customers could at a short notice switch to, or which suppliers would increase the supply of or switch to supply, if the prices rose by 5-10%. These substitute products should be included in the relevant market because they could constraint the price-setting behaviour of the “hypothetical monopolist”.

14. In his statement titled “Application for a Declaration of Non-Dominance in the International Call Services Market for Non-China routes by CWHKTC” dated 4 August 1999, the TA stated that the previous definition of “International Call Services” market, being “...*the market for international call services which exclude those provided by operators of mobile services and through Self-Provided External Telecommunication Systems (SPETS) but include ... International Simple Resale (ISR) services for fax and data and International Virtual Private Network (IVPN) services.*”, was still valid. Nevertheless, he accepted that “*like all other market definitions – in particular in a fast moving market like the telecommunications market – the definition can never be static and that in the future this may no longer be appropriate.*”

15. In the current application, CWHKT has submitted that the relevant market is the External Call Services market for the Mainland China routes offered in Hong Kong. It has also submitted that the relevant market, in line with the previous decisions of the TA, should be the market for external call services excluding those provided by operators of mobile services and through SPETS but include “international residential call services”, ISR services for fax and data and IVPN services for Mainland China from Hong Kong. CWHKT considered Mainland China to be a single market separate from the non-China sector. It was of the view that subdividing each of the three accounting rate regions of Shenzhen, Guangdong and the rest of China into separate markets would be inappropriate. On the supply side, there is no question about the substitutability of calls to different parts of Mainland China because supply issues relate only to the delivery of a call to a landing point in Mainland China. In relation to the geographic market, CWHKT has submitted that it should be the whole of Hong Kong.

16. The TA considered all representations made. In relation to the definition of the market of External Call Services, the TA noted that New T&T was suggesting that the relevant market should include external call services provided by mobile services operators. The TA noted the recent changes in the provisioning of External Call Services by mobile services operators including the high penetration of

mobile phones in Hong Kong, the waiving of local call charges and deposit for External Call Services etc. Taking into account these recent changes, it appears that the International Direct Dial (IDD) services provided by the mobile operators for their subscribers are to a large extent similar to the External Call Services provided by External Telecommunications Services (ETS) and/or Fixed Telecommunication Network Services (FTNS) operators in terms of pricing and service provision and therefore could be said to be substitutes and be in the same market. The TA had therefore considered the inclusion of the mobile traffic in his analysis of this application. He has found that the inclusion or exclusion of mobile traffic would not materially affect the conclusion of the TA's analysis of this application<sup>3</sup>. The TA was satisfied that the scope of External Call Services market could remain as that as set out in the previous reports concerning the past applications by CWHKTC for a declaration of non-dominance.

17. In relation to whether Mainland China should be considered as a single market, both New T&T and NWT are of the view that the market should be sub-divided into three markets: Shenzhen, Guangdong and the rest of Mainland China because Shenzhen, Guangdong and the rest of Mainland China routes have

- (a) different retail, accounting, and gateway rates and different delivery fees;
- (b) they are being promoted as separate routes;
- (c) the delivery is by different means.

The TA noted that there are legitimate reasons for treating all routes to Mainland China as one single market as proposed by *CWHKT* as well as for sub-dividing the Mainland China market into three separate markets as raised by New T&T and NWT. As the TA found that it was not unreasonable to accept the proposal by *CWHKT* to treat the Mainland China routes as one single market, the TA did not consider it appropriate to amend *CWHKT*'s application and therefore he had accepted the definition proposed by *CWHKT* for the sake of assessing this particular application. Nevertheless, he would give consideration to treating Mainland China as three different markets should this be raised in future applications of similar nature.

18. In relation to the geographic market, the TA, having looked into the area that substitution would take place in response to price changes, is of the view that the previously used definition of the geographic market - the whole of Hong Kong - is still valid.

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<sup>3</sup> If the mobile traffic was included in calculating the market share, CWHKT's market share, though consistently under 50%, was in a rising trend as from January 2000. If the mobile traffic of Cable & Wireless HKT CSL Limited, one of the mobile telephone operators and an affiliated company of CWHKT, had been taken into account in calculating CWHKT's market share (on the basis that it is not independent from the group making the application and thus should be treated as one entity), the market share of CWHKT was not much different from that without including the mobile traffic thus did not affect the outcome of the application.

## ASSESSMENT OF DOMINANCE

### **Factors Relevant to Assessment of Dominance**

19. The TA considered a number of factors in assessing whether CWHKT is still in a position of dominance in the relevant market. These included:

- (a) market share;
- (b) barriers to entry – contestability;
- (c) prices;
- (d) vertical relationships; and
- (e) other relevant factors.

### **Market share**

20. The TA has stated in the “Guidelines to Assist the Interpretation and Application of the Competition Provisions of the FTNS Licence” issued in June 1995 that market share is an important, but not the sole determinant, of a licensee’s dominance in a market. The TA has also stated that certain levels of market share will create certain presumptions. Where the market share in a given market is below 25%, then the licensee will be presumed non-dominant. Where the market share is above 75%, the licensee will be presumed dominant. For shares between 75% and 25%, no presumption will be made.

21. The TA has stated in his statement entitled “Application for a Declaration of Non-Dominance in the International Call Services Market for Non-China routes by Cable & Wireless HKT Telephone Limited” issued on 4 August 1999 that *“in the case of a market share between 25% - 75%, no presumption is made and the TA examines the market share of the firm together with the other relevant elements so as to determine if the firm is dominant or not. However, the TA has considered that if a firm has a market share persistently above 50%, it is likely that it is dominant. Therefore, when looking at the other market conditions, he needs to satisfy himself that these demonstrate that the market is competitive and/or contestable before he would classify a firm with market share above 50% as non-dominant. The opposite applies where the market share is consistently below 50%. In these cases, the TA will consider that it is more likely that the firm is not dominant and in examining the other market conditions, he will look to see if these are such that make the market non-competitive and/or non-contestable before he would classify a firm with market share below 50% as dominant. This is not the same as the presumptions. Presumptions shift the burden of proof to those arguing against them. The 50% market share is simply used as a starting point for the TA to examine the market conditions and is based on the experience of other jurisdictions both in relation to the telecommunications related markets but also when applying general competition law”* (paragraph 44).

22. The TA, in assessing the current application, has looked at volume of traffic to examine the market shares. He has also considered whether he should examine the market shares by revenue as well. However, he considered that market share by revenue might not accurately reflect the contestability of the market as the retail prices vary substantially between operators and between different time periods and also different discount plans might be offered to different groups of customers. He has also taken into account that a number of operators in an effort to build market share are offering rates below wholesale costs.

23. Based on the figures of the traffic reported regularly by each licensee, the TA calculated the actual market share of each of them. The traffic figures used are supplied by each licensee on a monthly basis and were not supplied specifically for this application. Therefore, the TA has used the actual figures of traffic for calculation of individual licensee's shares in the Mainland China market.

24. Having examined the market shares of each licensee over a period and in particular from November 1999 to March 2000 inclusive, the TA noted that the market share of CWHKT for the whole Mainland China during the period from November 1999 to January 2000 was approximately 50% but from February to March 2000, it was above 50%.

25. In relation to the trend, the TA noted that CWHKT's market share for the whole Mainland China in December 2000 was a little bit higher than that of November 1999 and remained steady for January 2000. However, the market share in February 2000 increased to above 50% and decreased in March 2000 but was still above 50%. The TA is satisfied that, as from November 1999, CWHKT's market share appeared to have been fluctuating and to have moved to below 50% of the total market on occasions but this was not consistent.

26. The TA has also examined the issue of market concentration. In the statement titled "Application for a Declaration of Non-Dominance in the International Call Services Market for Non-China routes by Cable & Wireless HKT Telephone Limited" issued on 4 August 1999, the TA stated that "*[market] concentration is the combined market share of the leading firms. It shows the degree of oligopoly/concentration in a market but it does not provide a full picture of whether it is competitive or not. An oligopoly market – even a duopoly – can be very competitive. However, the TA wished to stress that, like the market share figures, the concentration in the market by itself does not carry any significance*" (paragraph 51). When the TA looked at the market shares of CWHKT's competitors, the gap between CWHKT and the second biggest market player for the period from November 1999 to March 2000, except February 2000, was quite steady. It had widened in February 2000. The second and third biggest market players, Operator X (name withheld) and Operator Y (name withheld), representing a total of market share of approximately 30%, have respective market shares of below 20% and above 10%. The gap between CWHKT and X is

about 30% for November 1999 to March 2000, except that it increased to approximately 35% in February 2000. The TA noted that the market share of the other major competitors (i.e. excluding X and Y) are quite steady. The TA looked at this as one of the elements of the analysis that may or may not be neutralised by the other considerations.

### **Barriers to Entry**

27. The barrier of entry may be constituted in a number of forms, including regulatory barriers, technological barriers, cost barriers, blocked access to certain critical facilities, etc.

28. In the current case, the TA is satisfied that there are no regulatory restrictions on the number of operators that can offer external telecommunications services. This is evidenced by the number of licences already issued for ETS and the facilities-based competition commenced on 1 January 2000.

29. In its current application, *CWHKT* relied on the number of ETS licenses issued, the fact that facilities-based competition commenced on 1 January 2000, that the intention to issue 12 FTNS licences for satellite-based external facilities were announced on 18 January 2000 as well as the fact that its competitors have already entered into correspondent agreements with China Telecom (CT) and established alternatives to *CWHKT* for carriage into Mainland China as evidence that no substantial barrier exists.

30. The TA has looked at the current status of the market and its future development based on the information available to him. The TA is also aware of the fact that only those external services operators who hold an FTNS Licence can seek to enter into correspondent agreement with carriers in Mainland China, and that non-facilities based ETS operators have to rely on *CWHKT* or the FTNS operators who have interconnected with carriers in Mainland China for delivery of traffic to Mainland China.

31. The TA has noted that the other three wireline FTNS operators which are *CWHKT*'s competitors have already entered into correspondent agreements with China Telecom (CT). The TA has also noted that CT will establish a bilateral relationship with these operators on an equitable basis and on terms no less favourable than that between CT and *CWHKT*. However, the TA has noted that the current interconnection arrangements for bilateral exchange of telecommunication traffic between CT and these operators using the SEA-ME-WE3 (SMW-3) cable are interim arrangements. When the second China-Hong Kong fibre ring which will be used for the future arrangement is ready for service, CT and these operators will negotiate in good faith the migration of the delivery of their bilateral exchange of traffic from SMW-3 cable to the second China-Hong Kong fibre ring. While *CWHKT* stated that

the second China-Hong Kong fibre ring will become operational in the first half of 2000, New T&T stated that it will not become operational until late 2000 or early 2001.

32. In relation to *CWHKT*'s statement that the other FTNS operators have at their disposal more than sufficient capacity today for the carriage of all Mainland China traffic, New T&T stated that it is not correct – *“there is limited capacity in the Indefeasible Rights of Use (IRUs) and it is not sufficient for all its traffic to and from all areas in Mainland China through the IRUs. Whilst New T&T may acquire higher capacity it is not commercially viable given that interconnection via SMW-3 is only for interim arrangement. CT will not return incoming traffic from Mainland China to Hong Kong to New T&T at this stage, other than Guangdong area, because the IRUs are connected to Guangdong’s gateway. It is not commercially viable for New T&T to pass outgoing traffic to Mainland China through the IRUs other than the Guangdong area given that when there is no matching return traffic. CT has reaffirmed its position on this.”* In response to *CWHKT*'s statement that one of its FTNS competitors has contracted for an additional IRU in SMW-3 of 1 STM-1, New T&T stated that it is its understanding that this additional IRU is only allowed to carry traffic which transits through Mainland China and is not for traffic to or from Mainland China.

33. *CWHKT* stated that *“these facilities enhance the other FTNS operators ability to compete at the retail level, and at the wholesale level in supplying capacity to ETS licensees. They also have the ability to offset the inpayment they receive for incoming traffic against the outpayment they make to other administrations for termination of outgoing traffic at the distant end, know as “net accounting”. This could be used to reduce an operators outgoing wholesale traffic costs and in turn, allow operators to offer lower retail prices. Where only one operator is in a position to net account, the TA considers that operator may have an advantage which makes the retail market non-competitive. However, CWHKT does not enjoy such an advantage.”*

34. The TA noted that under the correspondent agreements between CT and *CWHKT*'s FTNS competitors, the details of the full implementation of the Proportionate Return of Traffic principle is still subject to negotiations. On this basis, the TA is satisfied that these operators will not be in a position to enjoy significant “net accounting” before the third quarter of this year. That is, before the third quarter of this year, *CWHKT* is the only one who can receive practically all the incoming traffic from Mainland China and hence the inpayment from CT. In this light, these operators will not be able to compete with *CWHKT* in the wholesale market with the equal status before the third quarter of this year. Furthermore, the TA understands that these operators had not offered wholesale services to other ETS operators. Other ETS operators have to rely on *CWHKT* to deliver their traffic. The TA is therefore led to believe that although the correspondent agreements between CT and some FTNS operators have been in place since late last year and/or early 2000, there is not yet significant competition from these operators in the wholesale market.

## Prices

35. In looking at the competitiveness of a market and whether a firm is dominant, the TA examined the power of a licensee in making decisions as to pricing or other strategic matters. He examined whether there is genuine independent price competition in the market or whether price changes are, for example, better characterised in terms of a leader-follower situation.

36. *CWHKT* is of the view that there was already fierce price competition on Mainland China routes throughout 1999 and this has intensified since the beginning of 2000. It stated that though it has reacted to the service offerings of its competitors by launching promotions to match these offerings, its market share has continued to decline. It is also of the view that it is a price follower rather than a price leader.

37. *CWHKT* has submitted additional information to its application concerning the current offer by Telhope, NWT and China Unicom. It supplied copies of their advertisements to show that they are offering very low rates for calls from Hong Kong to Mainland China. It also pointed out that NWT and China Unicom are offering low rates for calls from China to Hong Kong as well. *CWHKT* was therefore of the view that there is competition for traffic in the incoming direction but the form of competition may not be for the inpayment but rather, the retail revenues associated with this traffic.

38. However, most of the respondents to the TA's consultation document on this application argued that the downward trend of the retail prices for calls to Mainland China are not supported by reductions in underlying costs. This was due to the absence of genuine viable alternatives to *CWHKT*'s external gateway. The price reductions are used as marketing strategies to increase market share and/or because Mainland China routes are major routes of the total external call services market for all operators.

39. The TA has noted from the press and television commercials that competitions in the market for calls to Mainland China is very intense. *CWHKT*'s competitors promote their external call services to Mainland China actively and aggressively by frequent discounted offers and promotions through the media. The TA has also noted that the prices of some of these offers are lower than those of *CWHKT*. Furthermore, in view of the fact that *CWHKT*'s prices and/or promotional offers are subject to the TA's approval, the TA accepts that *CWHKT* may not be necessarily be the price leader. In any event, due to the current regulatory regime (i.e. the need for prices of *CWHKT* to be subject to TA's approval) it is not possible to establish what would the behaviour of *CWHKT* be. Thus the TA cannot be satisfied on whether *CWHKT* would or could be acting as a price leader in the retail market of external call services to Mainland China if it was freed of this control.

## **Vertical Integration**

40. In addition to the provisions in relation to interconnection, provision of service, accounting separation and anti-competitive conduct, the TA imposed additional requirements on CWHKTC as part of the approval in 1999 for the declaration of its non-dominance in the Category A routes market to ensure that proper compliance systems and robust pricing arrangements are put in place so that competition can be protected. The TA is satisfied that these safeguards – if also applied to the market in the application currently considered - are adequate to ensure the protection of competition under the current circumstances.

## **Other Relevant Factors**

41. The TA is concerned whether the position of CWHKT in one market, that is the local exchange line services market, would significantly affect its position in the other market, that is, external call services to Mainland China. The TA has therefore examined whether CWHKT, being the dominant operator in the fixed exchange line services market, could have a cost advantage in the market of retail external telecommunications services to Mainland China. The TA looked at the market share of individual FTNS licensees for the incoming traffic from Mainland China to their respective networks. Currently, over 90% of the incoming traffic from Mainland China is terminated at CWHKT's local fixed network. That is, CWHKT receives most of the delivery fees of the incoming traffic from Mainland China.

42. The TA's statement titled "Local Access Charge and Modified Delivery Fee Arrangements" dated 25 November 1998 stated that "*under the modified delivery fee arrangements, the extra profits would be shared equally between the sole external network operator and the local network operators. The rationale behind this profit sharing proposal is that the sole external network operator and the local network operators collaborated in the routing of the incoming traffic. Therefore, the extra profits generated due to the more than full-cost recovery settlement rates should be shared between the sole external network operator and the local network operators*" (paragraph 53). The delivery fee received by CWHKT for the significant incoming traffic from Mainland China and terminated in its network contributes to CWHKT's profitability. The TA is concerned that whether such profitability would contribute to CWHKT's market power in the market of external call services to Mainland China. Under the current tariff approval process, CWHKT is not allowed to use the profitability derived from the incoming traffic to finance discounts in the outgoing call services. The TA is concerned that should the tariff approval process be lifted, CWHKT is able to use the margin generated from the incoming call services market, which is dominated by CWHKT and in which it is unlikely to have real and effective competition before the third quarter of this year, to finance deep discounts in the outgoing call services market. The TA considers that this situation would possibly change if and when CWHKT's FTNS competitors acquire such volume of traffic to Mainland China and receive proportionate return of incoming traffic so as to be capable to offer competitive wholesale services to other ETS operators. The TA is therefore of the view that under the current market environment, it is not yet

appropriate to lift the tariffing control on the market for retail external call services to Mainland China.

## CONCLUSION

43. On the definition of the market, the TA accepts *CWHKT*'s proposed definition that the relevant market should be the External Call Services market for Mainland China routes and the geographical market is the whole of Hong Kong.

44. On the assessment of the market share, the traffic statistics reveal that *CWHKT*'s market share was not consistently below 50% for the period November 1999 to March 2000. The TA is also satisfied that the market share of *CWHKT* was fluctuating between slightly below and slightly above 50% during the period from November 1999 to March 2000. Therefore, the TA does not accept *CWHKT*'s submission that its market share is in the decreasing trend. In relation to market concentration, the TA is satisfied that the gap between *CWHKT*'s market share and that of its second largest competitor was quite steady during the period from November 1999 to March 2000 except that in February 2000, it widened.

45. In respect of barriers to entry, the TA is aware that only FTNS operators can enter into correspondent agreements with the carriers in Mainland China; other than *CWHKT*, the FTNS operators who have concluded correspondent agreements with CT are interconnecting with CT under an interim arrangement and will not have significant proportionate return traffic until the third quarter of 2000; and currently, there are no wholesale services offered by FTNS operators other than *CWHKT*. In view of the above, the TA is satisfied that *CWHKT* still controls a substantial part of the supply in the wholesale market. However, in view of the current licence obligations and conditions imposed on *CWHKT* by the TA, the TA is satisfied that there is little barrier to entry to the retail market.

46. On the pricing issues, in view of the current prices and frequent low-price promotions offered by *CWHKT*'s competitors and the fact that *CWHKT* is required by its licence to seek approval from the TA for any tariff revisions, the TA cannot be satisfied that *CWHKT*, if free from restraints, would not be the price leader in the retail market.

47. On the vertical integration issues, the TA was satisfied that the licence provisions and requirements in place are sufficient to ensure that competition of the retail market is protected under the current situation.

48. Given that CWHKT is the dominant operator in the fixed exchange line services markets, that over 90% of the incoming traffic from Mainland China is terminated at CWHKT's local fixed network, that the current delivery fee is based on the rationale of extra profit sharing between the external and local network operators, and that the delivery fee received by CWHKT from incoming Mainland China traffic contributes to the profits of CWHKT, the TA is concerned that CWHKT can use the profit to finance discounts on its outgoing call services market while its competitors are unable to do so.

49. Given that CWHKT's market share is not consistently below 50%, that CWHKT has the ability to finance its discounts from revenues relating to incoming traffic, and that the competitors of CWHKT would not have this ability until the third quarter of this year at the earliest, the TA is not satisfied that the application of CWHKT can be granted. The TA considers that at this stage there is not sufficient evidence on which he can be satisfied that CWHKT is no longer dominant. However, the TA will continue to monitor the market closely to assess whether a fully competitive retail market has developed for calls to Mainland China.

**Office of the Telecommunications Authority**  
25 May 2000

**SUMMARY OF SUBMISSIONS RECEIVED**

- a) **Cable & Wireless HKT Limited (CWHKT)**– supports the application:
- The fact that CWHKT's competitors market their China retail services in the same manner as their Category A routes offerings demonstrates that they perceive the China market to be highly competitive.
  - OFTA has issued 14 EFTNS licences for submarine and land cable facilities competition since the application was submitted. There are no regulatory barriers to competitive entry into the wholesale ETS and related external call services markets.
  - New T&T commenced on 21 February 2000 offering IPLCs between Hong Kong and Guangdong at 50% of the CWHKT's tariff. This offer represents not only competition in the wholesale market but also in the IVPN market, which is part of the retail market, for large customers.
  - The inclusion or exclusion of mobile traffic would not materially effect assessment of CWHKT's application for non-dominance.
  - If the definition of the relevant market is to include external call services traffic using voice over Internet protocol (VoIP) technology, CWHKT's estimates overstate its own share of the external call services market as VoIP traffic does not transit CWHKT's external gateway.
  - China routes should be considered as a single market. This is consistent with the TA's application of the single market principle to all locations within other external destinations.
  - CWHKT's market share has been consistently below 50% since November 1999 (almost 5 months) and shows no sign of reversal.
  - Current market shares of CWHKT's competitors show that the market is not highly concentrated.
  - The other FTNS licensees have sufficient capacity available to them for the China routes – on SEA-ME-WE3 alone - to carry all traffic between Hong Kong and any point in China at a cost similar to CWHKT's costs.
  - China Unicom, which has in place cable systems and facilities, is now seeking to enter the Hong Kong external retail and wholesale markets, and its market power in China means it could easily dominate the Hong Kong/China market at both retail and wholesale levels.

- The correspondent agreements which the other FTNS licensees have with China operators ensure fair treatment in accounting rates and return traffic.
- VoIP technology offers a further alternative to CWHKT's external gateway.
- With FBC and the availability of highly competitive alternatives to CWHKT for the carriage of external traffic, particularly on China routes, the TA's concern that CWHKT's supply of both network inputs and downstream services to its competitors and could possibly use its position in one market to influence the other market is no longer a valid concern.
- CWHKT has measures in place to prevent the potential for inappropriate sharing of competitors customer traffic information between CWHKT's international and fixed network arms for marketing purposes.
- Relating to the possibility of its competitors to "game" the recent announcement of the proposed acquisition of a majority interest in *CWHKT* by Pacific Century CyberWorks Limited (PCCW), it would be wrong and inappropriate to apply regulation on the basis of what might happen, rather than the circumstances which actually exist. The various business interests and operations of *CWHKT* and PCCW are sufficiently diverse that combining the two would not make a difference to an assessment of CWHKT's market power in the external call services market – whether the assessment is conducted now or later.
- To apply special "non-dominance" conditions to CWHKT would be asymmetric regulation of non-dominant carriers, and be unfair to CWHKT as the only non-dominant carrier with such obligations.

b) **Mandarin Communications Limited (Sunday)** – does not support the application

- Although CWHKT claims that its market share on the volume of traffic to Mainland China is below 50%, its dominant position in the relevant market, in fact, remains unchanged.
- Share of the volume of traffic among CWHKT's competitors has never been evenly distributed.
- Although the 3 other FTNS operators already came up with China Telecom an agreement in providing alternative gateways, there is still a

period of time for them to be able to head-to-head compete with the incumbent.

- ETS operators do not have the status to establish direct interconnection with Chinese operator, the competitiveness of ETS on China routes would further decrease if CWHKT's dominant position is released.
- Some of the retail prices now available are below costs. They are just some sort of marketing programmes and promotion strategies, with which the operators are to be based on to compete for an additional share in this price-conscious market.
- It is only in the condition that the wholesale offers available in the market are reasonably low enough to be considered healthy and the competitive powers of substantial numbers of operators are well developed to a position that they can stand on its own to find a way to survive, the non-dominant position of CWHKT should not be redefined.

c) **New T&T Hong Kong Limited** – does not support the application

- Its own tracking study does not support CWHKT's claim that its market share in the Mainland China routes is below 50%.
- The downward trend of retail price does not necessary indicate that there are genuinely viable alternatives to CWHKT's external gateway for the delivery of wholesale traffic to Mainland China. It is due to overall intensive competition; that Mainland China are major routes of the total market, some operators have used below cost promotion to increase volume or market share; the importance of Mainland China routes to Hong Kong socially and economically and its close proximity to Hong Kong.
- FBC only commenced on 1 January 2000, it is too early to conclude the effective competition at the retail and/or wholesale levels for Mainland China routes had been "effectively" established.
- Competition from EFTNS licensees has not started.
- The interconnection with China Telecom via the second Hong Kong China fibre ring will not become operational until late 2000 or early 2001 the earliest. Prior to this, New T&T and China Telecom agreed to use SEA-ME-WE3 as an interim arrangement.
- The IRUs purchased by New T&T in SEA-ME-WE3 are for traffic to and

from Guangdong area. It is not commercially viable for passing all traffic other than Guangdong area at this stage as there is no matching return traffic.

- CWHKT's claim that its FTNS competitor has contracted an additional IRU in SEA-ME-WE3 of 1 STM1 which provides them with more than sufficient capacity to carry all its competitors' current traffic, including CWHKT's own traffic is unfounded as the additional IRU in SEA-ME-WE3 is only allowed to carry traffic which transits through Mainland China and is not traffic to or from Mainland China.
- The TA should consider the significant recent structural changes which have occurred in Hong Kong's communications sector and the global implications of convergence and should not adopt an incremental approach in assessing CWHKT's application.
- The relevant market for consideration is the Hong Kong market for *end user access and connectivity to external call services* including external call services provided by mobile services operators, SPETS, ISR and IVPN services.
- If the TA does not agree that the relevant market is that of *access and connectivity* and that the relevant market should be that adopted previously, then it believes that Mainland China market should be further divided into 3 markets: Shenzhen, Guangdong and the rest of Mainland China as they have different rates, different accounting rates, different gateway prices, different delivery fees and have always been promoted as separate routes, contrast to that of other routes.
- When looking at the Mainland China market, the TA should also look at the competitiveness of Mainland China market at the wholesale level.
- If the TA were of the view that Mainland China routes should be reclassified into Category A and given that external call services in Category A routes are usually bundled with calls to other routes and the fact that Mainland China routes represent some 45% of the total external call services market, the TA should immediately proceed to assess CWHKT's dominance in the relevant market comprising of external call services to Category A routes plus Mainland China routes.
- Supply constraint does exist for different Mainland China routes as traffic to and from Mainland China, other than Guangdong area, still go through CWHKT's external gateway.
- The TA should assess the revenue which CWHKT generates from its Mainland China traffic as this would provide CWHKT the resources and

advantages over its competitors in any promotional activities.

- Barrier to entry exists as any interconnection with China Telecom or China Unicom will take considerable time to negotiate and implement.
- Through its joint venture with Star TV and acquisition by Pacific Century Cyberworks, CWHKT is strengthening its vertical integration to the long term detriment of its competitors.
- It has only been about 7 months since the conditions imposed by the TA upon CWHKT as part of the Category A route non-dominance, it is not sufficient long to conclude their effectiveness.
- CWHKT is the only participant in the market who is in a position to know and provide substantial market share information in tacit evidence that CWHKT holds an asymmetric information advantage over its competitors.
- If CWHKT were to be declared non-dominant and were readily able to decrease its prices freely, the competitors will not be able to catch up with the price reduction due to its existing supply constraint in the Mainland China market.
- Creating brands is expensive and takes time. The existence of a service brand that CWHKT was the sole partner of China Telecom and that every other FTNS or ETS licensees have to pass traffic to and from Mainland China through CWHKT's gateway gives the customer a deep impression that CWHKT will provide the best price and quality for traffic to and from the Mainland China. It would be very difficult for the other three FTNS licensees to change the impression of the customers and to compete with CWHKT freely in the Mainland China routes.
- There are quite a number of discrepancies between New T&T's data and CWHKT's data on the price trends.

d) **New World Telephone Limited** – does not support the application

- There are notable differences in terms of tariff for China routes. The means of delivery also differs – operators of external services rely primarily on the external gateway of CWHKT to deliver external calls to south parts of China (i.e. Shenzhen and Guangdong) while they rely on other means, notably ISR with refile, for delivering call to northern China. It is plausible to segregate Mainland China into 3 zones according to the

tariffs, namely, Shenzhen, Guangdong and Rest of China.

- ETS operators lack an effective means to compete with CWHKT, that is the ability to direct interconnect with telecommunications authorities in China.
- With ISR prohibited in China, the only means of delivering traffic is via the CWHKTI's gateway, all operators are required to rely on CWHKTI for outgoing delivery to China and therefore there is simply no effective competition.
- Even after the commencement of facilities-based competition, alternative gateway operators face the same settlement rate under parallel accounting and there is once again no effective competition in the wholesale market.
- The effective cost of delivery, by virtue of the proportion of return traffic, is skewed in favor of CWHKTI, thus allowing CWHKTC a lower net cost of delivery.
- Some of CWHKT's offers were below the settlement rate paid to China Telecom. The offers were approved in light of the prevailing competitive environment. Such checks and balances would no longer exist with the declaration of non-dominance. With only ex-post monitoring, CWHKT can easily drive out its competitors by offering cutthroat pricing.
- Information concerning circuit capacity and overseas operators disclosed by CWHKT's competitors to CWHKTI for co-location capacity planning purpose only was cited in both CWHKT's application for declaration of non-dominance and reclassification of Mainland China route. This clearly demonstrates that commercial sensitive information has been misused by CWHKT against its competitors.

e) **SmarTone Mobile Communications Limited** – does not support the application

- The recent drop in the gateway price of CWHKT gateway to China narrows the gap between the determined price and the wholesale prices of other suppliers. This in a way increases the competitiveness of CWHKT's pricing for the retail service.
- Although CWHKT claims that its market share is below 50%, the remaining market share is distributed amongst over 150 ETS operators.

- CWHKTC still holds an advantage position when compare to its competitors both in terms of actual minutes and percentage of market share.
- The other 3 FTNS operators may have benefited with lower cost of operations but they still have not attained the same status as CWHKT within such short period of time.
- ISR means of delivery is still not permitted in China. ETS operators cannot establish direct corresponding relationship with China Telecom or China Unicom. This in fact is a barrier for ETS operators to enter into China Market.
- The 5 local FTNS licensees and the 25 external FTNS licensees are not in full operation, competition in China route is yet to be proven.
- The existing safeguards are not adequate to prevent CWHKT from gaining first hand information of CWHKTI's delivery costs.
- The current drop in retail price is not supported by the underlying provisioning cost. Significant price drop is mainly observed in the non-peak hours. It is no more than a marketing strategy on the part of the operators to etch onto market share of CWHKT.
- CWHKT having the largest fixed line (98%) customer base, is still the major recipient of modified delivery fee for China inbound traffic. China traffic constitutes 50% of the total Hong Kong outbound traffic and CWHKT would receive the largest subsidies from modified delivery fee to lower its retail IDD price.
- If CWHKT is now declared non-dominant, so that it is no more constrained by the determined gateway price, most ETS operators would be prematurely driven out of the market.