

**APPLICATION FOR A DECLARATION OF NON-DOMINANCE  
IN THE RETAIL EXTERNAL CALL SERVICES MARKETS  
FOR CATEGORY B OBSERVATION LIST ROUTES  
BY PCCW-HKT TELEPHONE LIMITED**

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

**10 August 2001**

**INTRODUCTION**

**Background**

1. On 23 February 2001, the Telecommunications Authority (TA) received an application (the Application) by PCCW-HKT Limited<sup>1</sup> (PCCW-HKT) on behalf of PCCW-HKT Telephone Limited<sup>2</sup> (PCCW-HKTC) for a declaration of non-dominance in the retail market for external call services for the following eight routes on the Category B Observation List (the Routes):

- (1) India;
- (2) Indonesia;
- (3) Malaysia;
- (4) Pakistan;
- (5) South Africa;
- (6) Sri Lanka;
- (7) Thailand; and
- (8) Vietnam.

2. PCCW-HKT provided the following justifications for the Application:

- (a) recent structural changes - brought about by the acquisitions of 100%

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<sup>1</sup> Formerly known as Cable & Wireless HKT Limited. It wholly owns PCCW-HKTC. It also indirectly holds a 50% share interest in REACH Ltd. which has an indirect 100% share interest in Reach Networks Hong Kong Limited (formerly known as PCCW-HKT International Limited and, before that, as Cable & Wireless HKT International Limited). Reach Networks Hong Kong Limited holds an external FTNS licence

<sup>2</sup> Formerly known as Cable & Wireless HKT Telephone Limited. It holds a Fixed Telecommunication Network Services (FTNS) Licence

share interest in Reach Networks Hong Kong Limited<sup>3</sup> (Reach Networks) by REACH Ltd.<sup>4</sup> - has made direct linkage between Reach Networks wholesale and PCCW-HKTC retail markets inappropriate. PCCW-HKTC is fully separated from Reach Networks and in essence, simply resells Reach Networks services;

- (b) retail price competition on the Routes is vigorous and PCCW-HKTC is not a price leader but rather a price follower;
- (c) PCCW-HKTC's statistics demonstrate that retail market shares for each of the Routes have been consistently below 50% since early February 2000;
- (d) there is no indication of high market concentration; and
- (e) based on the level of external traffic bypassing the Reach Networks, there are highly viable alternatives to the Reach Networks gateway and therefore, no wholesale supply constraints apply.

3. In response to the Application, the TA published on 16 March 2001 a consultation paper together with the actual application of PCCW-HKT, after the excision of such information as the TA considered commercially confidential. As stated in the consultation paper, the TA proposed to apply similar considerations as applied to the previous applications by PCCW-HKT. The TA invited comments on the Application and in particular, on:

- (a) impact of PCCW-HKTC's structure separation from Reach Networks on the competition of retail international call services markets;
- (b) the level of competition of the Routes as expressed by PCCW-HKT;
- (c) market trends and the level of by-pass of the Reach Networks gateway; and
- (d) what, if any, conditions should the TA impose if he considers that PCCW-HKTC is no longer dominant on one or any of the Routes.

4. The consultation paper also stated that the Application should be read in conjunction with the previous TA statements, in particular "*Reclassification of Category B Routes on the Observation List*" dated 4 August 1999 (the August 1999 Reclassification Statement) and "*Application for a Declaration of Non-Dominance in*

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<sup>3</sup> Formerly known as PCCW-HKT International Limited and before that, as Cable & Wireless HKT International Limited. It, from 30 March 1998 till 30 January 2001, together with PCCW-HKTC and PCCW-HKT CAS Limited held jointly and severally a FTNS licence issued on 29 June 1995. As from 31 January 2001, it holds an external FTNS licence.

<sup>4</sup> Its 50% share interest is indirectly held by PCCW-HKT and the other 50% by Telstra Corporation Limited which is a company incorporated in Australia.

*the International Call Services Market for Non-China Routes by Cable & Wireless HKT Telephone Limited*" dated 4 August 1999 (the August 1999 Non-Dominance Statement). These documents, and past documents issued by the TA concerning PCCW-HKT's applications for declaration of non-dominance in the external call services market and reclassification of Category B routes on the Observation List, are available on the web site of Office of the Telecommunications Authority at [www.ofta.gov.hk](http://www.ofta.gov.hk).

#### Category B Routes on the Observation List

5. On 1 January 1999, following the liberalisation of the external telecommunications services market, interconnection arrangements between external services operators and local network operators changed and external traffic routes were divided into Category A and Category B routes. Category A routes include those with genuine competition at a wholesale level and Category B are those reliant on a single external gateway operated by PCCW-HKT (now operated by Reach Networks).

6. The TA set out the criteria and procedures for route categorisation in his statement entitled "*Local Access Charge and Modified Delivery Fee Arrangements*" dated 25 November 1998 (paragraph 7-14). According to these criteria and procedures, the Routes, together with others, were classified as "Category B Routes on the Observation List" in the TA's statement "*Local Access and Modified Delivery Fee Arrangements – Classification of Routes into Categories A & B*" on 24 December 1998. "Category B Routes on the Observation List" are the potentially competitive external traffic routes through indirect International Simple Resale (refile) as evidenced by the call-back rates currently offered in the market<sup>5</sup>.

7. In January and April 1999, PCCW-HKT filed two applications to the TA respectively for re-classification of eleven routes, including the Routes, on the Category B Observation List. However, the applications were rejected but control of gateway prices in the outgoing direction for all routes, except Vietnam, was removed on the basis that genuine price competition could be established in the outgoing direction. However, delivery fee on these routes should continue to be payable because competition in the incoming direction had not been established<sup>6</sup>.

8. On 27 March 2001 (after submitting the Application), Reach Networks submitted an application to the TA for reclassification of the Routes as Category A routes. On 24 July 2001, the TA decided that the gateway price control for Vietnam route should be lifted and the Indonesia and Malaysia routes re-classified as Category A routes. The TA statement entitled "*Application for Reclassification of Category B*

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<sup>5</sup> TA statement entitled "*Local Access Charge and Modified Delivery Fee Arrangements*" dated 25 November 1998 (paragraph S3).

<sup>6</sup> TA statement entitled "*Reclassification of Category B Routes on the Observation List*" dated 4 August 1999

*Observation List Routes as Category A Routes by Reach Networks Hong Kong Limited*" was issued on 24 July 2001 to this effect.

#### Previous Applications for Declaration of Non-Dominance in the External Call Services Market

9. On 15 April 1999, PCCW-HKT sought a declaration of non-dominance for the external call services market for non-China routes. On 4 August 1999, the TA issued the August 1999 Non-Dominance Statement that with the exception of Mainland China, where a route has been classified as Category A in the wholesale external telecommunications services market, PCCW-HKTC should also be regarded as non-dominant in the associated retail external call services market. The retail market for Category B routes, except the Mainland China routes, would continue to be regarded as markets in which PCCW-HKTC was dominant. On this basis, PCCW-HKTC is regarded as dominant in the retail market of the routes on the Category B Observation List. The approval for non-dominance given to Category A routes in the August 1999 Non-dominance Statement was subject to conditions which were stipulated in the Direction attached to the Statement. The TA also imposed a time limit of 12 months for the approval.

10. On 1 September 2000, PCCW-HKTC made an application for an indefinite and unconditional extension of the above approval for non-dominance of Category A routes. The TA subsequently agreed to extend the approval subject to the same conditions and the TA agreed to review this situation in 18 months. The TA issued a statement entitled "*Application for the Extension of the Direction issued to Cable & Wireless HKT Telephone Limited on 4 August 1999 pursuant to General Condition 44 of its Fixed Telecommunications Network Services Licence in response to 'Application for Declaration of Non-Dominance in the International Call Services Market for Non-China Routes' by Cable & Wireless HKT Limited*" on 28 September 2000 to this effect.

#### **The Submissions**

11. The TA considered three submissions considered three submissions in respect of the application and no late submissions or additional comments were received. The comments came from the following (in alphabetical order):

- (a) New T&T Hong Kong Limited (New T&T);
- (b) PCCW-HKT Limited (PCCW-HKT); and
- (c) SmarTone Mobile Communications Limited (SmarTone).

12. The three submissions responded to the specific issues raised by the TA. At annex 'A' are summaries of the main arguments in the submissions reflecting, as closely as possible, the statements made.

13. Of the submissions, only PCCW-HKT considers that the TA should accede to the Application. New T&T and SmarTone consider that the recent structural separation of PCCW-HKTC and Reach Networks does not remove concerns that PCCW-HKTC has significant competitive advantages over other retail operators. New T&T and SmarTone consider that the markets on some of the Routes are highly concentrated. SmarTone considers that PCCW-HKTC should not be declared non-dominant on the Routes until the Routes are re-classified as Category A routes. New T&T considers that PCCW-HKTC's dominance in the local fixed line market has an overwhelming influence in the external call services market. New T&T also suggests that similar controls as those imposed by the TA, when he acceded to PCCW-HKTC's application on 4 August 1999, should be imposed should the TA accede to the current Application.

## **ANALYSIS**

### **General**

14. The TA in considering the Application has followed the approach set out in the "Guidelines to Assist the Interpretation and Application of the Competition Provisions of the Fixed Telecommunications Network Services (FTNS) Licence" issued by the TA in June 1995 and the August 1999 Non-Dominance Statement.

15. The TA considered the relevant markets are assessed whether PCCW-HKTC is dominant. The TA examined the market share of PCCW-HKTC, the fluctuation of the market share, market concentration, barriers to entry, pricing of the services over time and any vertical relationships that may exist. After the TA established the position of PCCW-HKTC in the relevant markets, he considered whether the Application could be acceded to with or without any conditions.

16. The TA considered PCCW-HKTC's submissions whether or not the structural changes brought about by the acquisition of Reach Networks by REACH Ltd. has made a continued linkage between the Reach Networks wholesale and PCCW-HKTC retail markets inappropriate. The TA also considered the effect of the structural changes on the TA's position in the August 1999 Non-Dominance Statement which stated that, except for Mainland China, where a Route has been classified as Category A in the wholesale market, PCCW-HKTC should also be regarded as non-dominant in the associated retail market.

### **Legal Basis**

17. General Condition (GC) 44 of the FTNS Licence issued to PCCW-HKTC (reflected in all FTNS licenses) provides that if the TA considers that the licensee is non-dominant, with respect to any market for telecommunications services provided under the licence, he may exempt that licensee 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.

18. The TA therefore in considering the Application had to determine whether:

- (a) PCCW-HKTC is dominant in respect of the market(s) under consideration;
- (b) if it is dominant, he should lift all, some or none of the licence obligations to which GC 44 applies; and
- (c) any new conditions should be imposed and for what, if any, specific period.

### **Relevant Market**

19. In the August 1999 Non-Dominance Statement, the TA accepted that the general scope of the "external call services market" is:

*"...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". (paragraph 19 and 20)*

The TA considers that this is still valid in considering the Application.

20. As stated in the August 1999 Non-Dominance Statement, the TA, having examined cross elasticity of demand and supply, product characteristics, price difference, judgement by participants and distinct sellers/buyers, found that the main market for external call services is subdivided into two markets (excluding China) - those liberalised at the wholesale level (i.e. Category A routes) and the markets that have not (i.e. Category B routes). The TA also stated 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.”* (paragraph 18)

21. The TA notes that the characteristics of the traffic on the Category B Observation List Routes are different from those routes classified as Category A or Category B routes. Apart from Indonesia and Malaysia, re-classified as Category A routes on 24 July 2001, price competition exists in the wholesale market of the remaining Routes in the outgoing but not the incoming direction. That means that the way by which traffic of the Routes is being delivered is different from that of Category A or Category B routes. Therefore, the way that retail service providers price or market the services over the Routes may be different from that for mere Category A and B routes. The TA notes that some service providers would include individual Category B Observation List Routes in promotional offers together with Category A Routes from time to time but some would market Category B Observation List Routes together with Category B routes.

22. The TA considers that the demand for external call services is driven by relatively price conscious customers prepared to shop around for the cheapest prices, especially for frequently called external destinations. Customers would appear to switch among the service providers for lowest offer for calls to different destinations and in different time periods (although calls to one destination are not a substitute for a call to another destination). Similarly, on the supply side, the delivery of a call to one country is generally not a good substitute for the delivery of a call to another country. Therefore, the TA considers that in assessing the Application, it is appropriate to look at the markets of the Routes on an individual route by route basis.

## **ASSESSMENT OF DOMINANCE**

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

23. The TA considered a number of factors in assessing whether PCCW-HKTC is in a position of dominance in the relevant markets on the relevant Routes including:

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

### **Market Share**

24. The TA 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. While a very large market share will ordinarily be given a high weighing, the TA will not presume that it alone indicates a position of dominance. The TA will look at the market share of the competitors (collectively and individually) and at other behavioural and conduct factors in making his determination of whether a licensee is dominant."*

25. The TA stated in the August 1999 Non-Dominance Statement that:

*"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."* (paragraph 44)

26. The TA has, like in previous applications, looked at volumes of traffic to examine market share. Based on the figures of the traffic reported by each licensee in the external call services market over the past 6 months, the TA calculated the actual market share of each of them in each of the Routes. The traffic figures used are supplied by each licensee on a monthly basis and were not supplied specifically for the Application.

27. The TA examined the market shares of PCCW-HKTC and all the licensees over each of the Routes for the period from November 2000 to April 2001 inclusive. The TA also examined the market concentration. In respect of market concentration, the TA stated in the August 1999 Non-Dominance Statement 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)

### India

28. For the India route, the market share of PCCW-HKTC was consistently below 30% with small fluctuations during the period from November 2000 to April

2001. The second biggest market player, Operator A (name withheld), and the third biggest market player Operator B (name withheld) had a steady total market share of above 30%. Each of them had a market share of below 20%. During the period, the gaps between PCCW-HKTC and both Operator A and Operator B were below 10%.

### Indonesia

29. For the Indonesia route, the TA noted that till February 2001, the market share of PCCW-HKTC was above 20%, however, since then, it fell below 20%. The TA also noted that during two-thirds of the time period from November 2000 to April 2001, PCCW-HKTC was not the biggest player in the market. There were two market players, Operator C (name withheld), and Operator D (name withheld), having a very near market share to PCCW-HKTC's. Other than Operator C and Operator D, there was two other market operators having respective market shares of approximately 10%.

### Malaysia

30. For the Malaysia route, the market share of PCCW-HKTC was consistently below 35% with small fluctuations during the period from November 2000 to April 2001. The second biggest player, Operator E (name withheld), and the third biggest player, Operator F (name withheld) had a total market share of above 30%. Both Operator E and Operator F had respective market shares of above 10% but below 20%. The market share of Operator E had been steadily increasing during the period. The gaps between PCCW-HKTC and Operator E and Operator F were above 10% and below 20% for the period.

### Pakistan

31. For the Pakistan route, PCCW-HKTC had a market share of below 15%. It was the second biggest player in the market throughout the period from November 2000 to April 2001. The biggest market player, Operator G (name withheld), had a consistent market share of above 30%. The third biggest player had a market share near to that of PCCW-HKTC. The gap between PCCW-HKTC and the biggest player was between 20% and 30%.

### South Africa

32. For the South Africa route, the market share of PCCW-HKTC was consistently below 40% during the period from November 2000 to April 2001. The second biggest player, Operator H (name withheld), the third biggest player, Operator J (name withheld) and the fourth biggest player, Operator K (name withheld) had a total market share of above 40%. The respective market shares of Operator H, J and L are above 10% but below 20%. The gap between PCCW-HKTC and Operator H was approximately 15%.

### Sri Lanka

33. For the Sri Lanka route, the market share of PCCW-HKTC was consistently below 45% with fluctuations during the period from November 2000 to April 2001. The second biggest player, Operator M (name withheld), had a fluctuating market share between 10% and 20%. The third biggest player, Operator N (name withheld) had a market share of below 15%. Operator M and Operator N had a total market share of below 30%. The gap between PCCW-HKTC and Operator M was above 20% but below 30%.

### Thailand

34. For the Thailand route, the market share of PCCW-HKTC was consistently below 45% during the period from November 2000 to April 2001. The second biggest player, Operator P (name withheld), had a consistent market share of above 10% and below 20%. The third biggest player, Operator Q (name withheld) had a market share of below 15%. Operator P and Operator Q had a total market share of above 20%. The gap between PCCW-HKTC and Operator P was above 20% but below 30%.

### Vietnam

35. For the Vietnam route, the market share of PCCW-HKTC was consistently above 55% during the period from November 2000 to April 2001. The second biggest player, Operator R (name withheld), and the third biggest player, Operator S (name withheld) had a total market share of below 25%. Each of them had a consistent market share of below 15%. The gap between PCCW-HKTC and Operator R was above 40%.

### **Barriers to entry**

36. Barriers to entry may be constituted in a number of forms, including regulatory, technological, cost and blocked access to certain critical facilities. The TA considers there are no regulatory restrictions on the number of operators that can offer external call services.

37. As the Routes were classified as Category B Observation List Routes on the basis that there are alternative wholesale services available at competitive prices in the outgoing direction (paragraph 6 and 7 of this Statement), the TA is satisfied that there are no barriers to entry at the retail level arising from any lack of alternative wholesale service suppliers.

## **Prices**

38. As stated in the August 1999 Non-Dominance Statement, in examining the competitiveness of a market and whether a firm is dominant, the TA would look at the power of a licensee in making decisions as to pricing or other strategic matters. The TA has said he would examine 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.

39. On the information supplied by PCCW-HKTC in the Application, New T&T's response to the consultation paper, and other market information, the TA notes that (apart from Indonesia and Malaysia) most of the Routes are not popular ones that service providers regularly include in promotional offers (although it is apparent, from the differential in prices charged by different operators, that there is price competition on the Routes). Nevertheless, the TA notes that PCCW-HKTC is not among those offering the lowest prices on the Routes. Further, taking into account that PCCW-HKTC's prices and/or promotional offers on the Routes are subject to the TA's approval, the TA considers that PCCW-HKTC does not appear to be the price leader. Competing operators consider it profitable or otherwise commercially wise to offer lower products on some of these Routes and this fact likely points to a degree of consumer choice and price competition on the salient Routes.

## **Vertical Relationship**

### **Additional Conditions on Customer Information**

40. PCCW-HKTC, like other operators, is subject to the competition provisions in the Telecommunications Ordinance and its FTNS Licence<sup>7</sup>. It is also subject to the conditions imposed in the approval for the declaration of its non-dominance in the Category A Routes market and any extension of this approval (paragraph 9 and 10 of this Statement). The conditions mandate proper compliance systems and robust pricing arrangements are in place to ensure the promotion of competition. The conditions, among others, include:

#### **"Information**

*CWHKTC and CWHKTI should establish systems and controls so as to ensure that any information concerning*

- a) *the wholesale and retail traffic of CWHKTC's competitors;*
- and*

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<sup>7</sup> copies of FTNS licence and Telecommunications Ordinance are available at OFTA's web site : <http://www.ofa.gov.hk>

- b) *the usage patterns and/or usage information of customers connected to CWHKTC's fixed network but who use CWHKTC's competitors for overseas calls*

*was not made available nor used by it in any way by CWHKTC so as to obtain, in the opinion of the TA, an unfair advantage."*

41. When the condition above was imposed, CWHKTC (now PCCW-HKTC) and CWHKTI (formerly Cable & Wireless HKT International Limited and now Reach Networks) together with PCCW-HKT CAS Limited jointly and severally held the FTNS Licence. The condition ensures the retail arm (CWHKTC) could not use information available to the wholesale arm (CWHKTI) in respect of the traffic of competitors of the retail arm (CWHKTC) under the same licence. As from 31 January 2001, CWHKTI became Reach Networks and operates under a separate external FTNS Licence. Reach Networks is 100% held by REACH Limited, the share interest of which is held 50% by PCCW-HKT and the other 50% by Telstra Corporation.

42. PCCW-HKT argues these structural changes make a continued direct linkage between the Reach Networks wholesale and PCCW-HKTC retail markets inappropriate. PCCW-HKT considers that it and Reach are separate and different structures, shareholders and management of REACH (and thereby, Reach Networks) and PCCW-HKTC and this separation is emphasized by the requirement for Reach Networks and PCCW-HKTC to file their connectivity agreements with the TA under Direction 35A of the Telecommunications Ordinance. PCCW-HKT also stated that PCCW-HKTC simply resells Reach Networks services like many of its resale competitors. In its response to the consultation paper, PCCW-HKTC said the structural change should ease any remaining concerns that the TA may previously have had about the relationship between PCCW-HKTC and Reach Networks and therefore does not see any justification for further conditions to be imposed upon PCCW-HKTC.

43. GC 12(1) of FTNS licence prohibits the licensee from disclosing information of a customer except with the consent of the customer, which form of consent shall be approved by the TA. GC 12(2) of FTNS licence prohibits the licensee from using information provided by its customers or obtained in the course of provision of service to its customers other than or in relation to the provision by the licensee of the service. In view of the fact that at present, PCCW-HKTC and Reach Networks individually and separately holds a FTNS Licence, the TA considers that they are both bound by GC 12(1) and GC 12(2) of their respective FTNS Licence that no customer information should be disclosed to and/or used by the other. The TA also takes into account the provisions contained in the Telecommunications Ordinance and the FTNS Licence in relation to anti-competitive conduct and considers that they are adequate to ensure the protection of competition under the current circumstances. The TA is therefore satisfied that additional conditions in relation to disclosure and use of customer information are no longer necessary.

### Automatic Non-Dominance for Category A Routes

44. The TA considered whether structural changes between PCCW-HKTC and Reach Networks would have any effects on the TA's position stated in the August 1999 Non-Dominance Statement that where a route has been classified as Category A in the wholesale market, PCCW-HKTC should also be regarded as non-dominant in the associated retail market. The conclusion drawn in the August 1999 Non-Dominance Statement (paragraph 37) that the main retail external call services market was divided into two markets, namely the Category A routes and Category B routes except China, was based on an economic analysis of the retail market including the behavioural characteristics of the suppliers as well as the consumers, product differentiation etc. The TA considers that all the factors in defining these markets have no relevance to whether or not PCCW-HKTC and Reach Networks hold the same licence. Further, the reclassification of Category B routes into Category A routes is subject to tests on whether effective competition can take place in the wholesale external telecommunications services market over the routes to and from the locations concerned<sup>8</sup>. Again, whether or not PCCW-HKTC and Reach Networks jointly or separately hold a FTNS Licence does not make any differences in applying the reclassification test. Therefore, the TA is satisfied that the reclassification of a route at the wholesale level should be continued to be used as an automatic trigger for moving the route from the non-competitive market to the competitive one thus lifting wholesale and retail level constraints.

45. SmarTone stated in its submission to the consultation paper of the Application that PCCW-HKTC should first apply for reclassification to Category A routes, and only after such application was approved by the TA, PCCW-HKTC should then be declared non-dominant at the retail level.

46. The TA considers that wholesale supply is a key factor in analysing the barriers in the corresponding retail market. The market analysis, detailed in August 1999 Non-Dominance Statement, also indicates that should the wholesale market of a route be competitive, its retail market would also be competitive. On this basis, the TA proposed in the Statement that reclassification of a particular route into Category A can be used as an automatic trigger for declaring the route non-dominant in the retail market. The TA considers that as PCCW-HKTC and Reach Networks are now separate entities, it is appropriate that they make decisions independently on non-dominance or reclassification applications. PCCW-HKTC should be able to seek a declaration of non-dominance, should it consider itself no longer dominant on a particular route rather than relying on Reach Network's application for reclassification. For OFTA to maintain a policy that encourages the two entities to rely upon each others application is contrary to the maintenance of separate wholesale and retail commercial entities and therefore good policy. The TA considers it is open for PCCW-HKTC to apply for non-dominance in the retail market for routes in the

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<sup>8</sup> TA statement entitled "Local Access Charge and Modified Delivery Fee Arrangements" issued on 25 November 1998 (paragraph 7)

Category B Observation List as the outgoing direction of the markets of these routes are already competitive before the route was classified to Category A.

### **Other Relevant Factors**

47. For the incoming traffic over the Routes (except Indonesia and Malaysia routes re-classified into Category A routes), Reach Networks is required to pay delivery fees to local network operators at whom the incoming traffic terminates. According to the traffic reported by the licensees in the external call services market, the TA notes that above 80% of the incoming traffic of the Routes is terminated at PCCW-HKTC's local fixed network. That is, PCCW-HKTC receives most of the delivery fees of the incoming traffic on the Routes. In view of the fact that the delivery fee arrangement is based on the profit sharing between the sole external network operator (Reach Networks) and the local network operators collaborated in the routing of the incoming traffic<sup>9</sup>, the TA has examined whether PCCW-HKTC, as a dominant operator in the fixed exchange line services market, could use the profits generated in the incoming call services markets to finance deep discounts in the outgoing call services market.

48. The following conditions (in addition to those stated in paragraph 40 of this statement) were imposed in the approval for the declaration of non-dominance in the Category A routes market of PCCW-HKTC:

#### *"Pricing*

- i) To establish systems and controls so as to ensure its compliance with its pricing obligations but also so as to monitor its behaviour on an ongoing basis;*
- ii) To ensure that necessary information regarding the provision of the services declared to be non-dominant (i.e. breakdown of costs, business case, etc) should be kept on file in full details so that CWHKTC could respond within 48 hours to requests for information by the TA in investigating complaints about pricing;*
- iii) CWHKTC could not impose a minimum period of contract between itself, or any other affiliated company, and the customer for offering any tariff or package of tariffs or discount to a customer"*

The TA considers that the above condition, coupled with the provisions of the Telecommunications Ordinance and the FTNS licence relating to abuse of dominance, are sufficient for the TA to proactively examine prices and offers to ensure PCCW-HKTC complies with its licence obligation in relation to prices.

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<sup>9</sup> TA statement entitled "Local Access Charge and Modified Delivery Fee Arrangements" issued on 25 November 1998 (paragraph 53)

49. In its submission to the consultation, New T&T stated that:

*"Lifting retail price control will likely to have an adverse impact upon the competition. We urge the TA to draw analogy with the recent lack of alternatives to PCCW-HKTC for the Philippines route following the reclassification to Route A and lifting the price constraints at both retail and wholesale levels as set out in the TA statement dated 3 October 2000."*

The TA, on the basis of the traffic reported by the licensees in the external call services market, examined the market situation of the Philippines route. The TA that PCCW-HKTC does not have the largest market share and that the market is not concentrated. Therefore the TA does not consider New T&T's statement is substantiated.

## CONCLUSION

50. The TA is satisfied that the previously used definition of the general scope of the relevant market is still valid and in considering the Application, it is appropriate to look at the markets of the Routes on a route by route basis.

51. Upon reclassification of the Indonesia and Malaysia routes to Category A, in accordance with the August 1999 Non-Dominance Statement, PCCW-HKTC has already been classified as non-dominant in the retail external call services market of these routes. In fact, the non-dominance analyses on these routes also demonstrate that PCCW-HKTC is not dominant in the retail market on these routes.

52. For the remaining Routes, considering that:

- (a) for all the Routes except the Vietnam route, the market shares of PCCW-HKTC were consistently below 45% for the period from November 2000 to April 2001;
- (b) for the Vietnam route, the market share of PCCW-HKTC was consistently higher than 55% for the period from November 2000 to April 2001;
- (c) there are no entry barriers to the markets of the Routes;
- (d) PCCW-HKTC does not appear to be the price leader in the Routes;
- (e) recent structural changes of PCCW-HKTC and Reach Networks,

additional conditions in relation to disclosure and use of customer information are no longer required;

- (f) the reclassification of a destination at the wholesale level should be continued to be used as an automatic trigger for moving from the non-competitive market to the competitive one and thus lifting the constraints both at wholesale as well as the retail level;
- (g) the additional conditions imposed in the approval for the declaration of non-dominance in the Category A routes market of PCCW-HKTC coupled with the provisions of the Telecommunications Ordinance and the FTNS licence are sufficient for the TA to investigate and/or proactively examine prices and offers so as to ensure PCCW-HKTC complies with its licence obligation in relation to prices issues,

the TA is satisfied that:

- (1) for the India, Pakistan, South Africa, Sri Lanka and Thailand routes, PCCW-HKT should be declared non-dominant in the retail external call services market; and
- (2) for the Vietnam route, PCCW-HKTC should remain dominant in the retail international call services market.

53. The TA has therefore issued today a Direction to PCCW-HKT FTNS to that effect subject to the conditions stated in paragraph 48 of this statement. The new Direction shall take effect immediately and will continue to be in force until such date as it may be revoked, in full or in part, in writing by the TA.

54. As stated in the August 1999 Non-Dominance Statement, the licence obligations of PCCW-HKTC concerning abuse of dominance remain. Should the TA find in the future that PCCW-HKTC is dominant in the international call services to the Routes, and that it has abused its position, the TA can take necessary action either under the licence conditions of its licence or the Telecommunications Ordinance. A prior declaration of dominance is not a pre-requisite. The declaration is required where the TA wishes to impose additional conditions such as the requirement to obtain prior approval for price changes. Even where prior approval is not required, dominant licensees in any market must not abuse their position. It is therefore a matter for each licensee to monitor, and where necessary, adjust its behaviour depending on its market power.

**Office of the Telecommunications Authority**  
10 August 2001

## SUMMARY OF SUBMISSIONS RECEIVED

### 1. New T&T Hong Kong Limited ("New T&T") – does not support the Application

- If the statement of the Application that "*[t]he holding of a 50% share interest in REACH by the Telstra Corporation Limited (Telstra) means that there are distinctly separate and different structures, shareholders, and management of REACH (and thereby Reach Networks) and HKTC*" were true, PCCW-HKT/PCCW-HKTC would need to provide a satisfactory explanation as to how PCCW-HKT/PCCW-HKTC collected the outbound traffic through Reach Network's gateway as set in the Application. Based on the information which PCCW-HKT has provided in the Application, it is reasonable to conclude that PCCW-HKTC must have access to, either via PCCW-HKT or Reach Networks, information relating to customers, such as traffic pattern, traffic duration, customers base information and other critical market information to which operators in general do not have access.
- New T&T believes that some of the personnel who previously worked for Reach Networks are the ones now working for PCCW-HKTC. These people possess a lot of existing information which they have carried over to PCCW-HKTC as well as receiving information from the employees of Reach Networks. In practice there will always be an exchange of information between the employees of PCCW-HKTC and that of Reach Networks given the proximity in the relationships.
- New T&T believes Reach Networks and PCCW-HKTC have a similar strategic view and PCCW-HKTC is simply not a reseller of Reach Networks services. The arguments are:
  - ✧ The directors proposed by PCCW-HKT to the board of REACH are also the board members of PCCW-HKT which owns 100% in PCCW-HKTC. New T&T is concerned that while these directors exert significant influence in the decision making process of the board of REACH, they are at the same time also the directors of PCCW-HKT.
  - ✧ New T&T questions whether PCCW-HKTC would bypass Reach Networks' gateway for any of the Routes at all and whether PCCW-HKTC has ever entered into any negotiation with other carriers or refilers to demonstrate that they do consider other carriers other than Reach Networks' gateway.
  - ✧ PCCW-HKTC and Reach Networks are supported by the same legal and regulatory team.
- PCCW-HKTC still enjoys entrenched and deep-seated dominance in the local fixed lines market with 95% of the market share. This dominance has an overwhelming influence in the external call services market as the product is often acquired together with fixed line service or proposed together to the

customer.

- The Routes are considered as non-main stream and a lack of liberalisation of telecom market in these countries. Most of the sizable IDD operators in Hong Kong do not have a very strong focus on the Routes.
- There must be a gap of 40-50% of market share between PCCW-HKTC and the second operator.
- New T&T believes to confer non-dominant status on to PCCW-HKTC will in effect enable PCCW-HKTC to leverage upon its economies of scale and scope in advertising, promotion and provision of costs as well as taking full advantages of any potential cross subsidy from provision of IDD services for other routes to the provision of these non main stream routes to effectively reduce the level of competition.
- New T&T submits that as of 30 March 2001 the retail price offered by other sizable operators is very much on level with that set by PCCW-HKTC. The proposition that PCCW-HKTC is not a price leader would only be true if other operators set their price quite significantly below and/or above that set by PCCW-HKTC. But it is not the case. New T&T urged the TA to draw analogy with the recent lack of alternatives to PCCW-HKTC for the Philippines route following the reclassification to Route A and lifting the price constraints at both retail and wholesale levels.
- New T&T stressed that a lower refile cost than that offered by Reach Networks does not necessarily mean that operators would transit via these refilers. Operators offering IDD retail services compete with each other on a number of elements, primarily, pricing, quality of calls, consumer's accessibility to the services. Operators' traffic may still transit Reach Networks' gateway despite an assumption that there may be other transit gateways. Hence, the current outbound traffic of other operators go through Reach Networks' gateway in PCCW-HKT's Application may not give a conclusive and accurate indication of the level of future outbound traffic of these operators going through Reach Networks' gateway.
- There is no alternative gateway to Reach Networks' gateway for the outbound traffic to Vietnam.
- PCCW-HKT's submission has not provided any evidence to substantiate the statement "*[c]learly there are none as HKTC's competitors use Reach Networks' external gateway service for only a small proportion of their traffic on the routes (see Attachment 3)*".
- Similar controls as that imposed by the TA when he acceded to PCCW-HKTC's application on 4 August 1999 should be imposed should the TA accede to the Application.
- New T&T submits that PCCW-HKTC is still dominant for all the Routes

given their high market share and the significant gap in market share between PCCW-HKTC and other operators, the competitive advantages enjoyed through its dominance in local fixed lines, its interdependency with Reach Networks, the existing difference reflected in market price, the lack of good quality service offered by other wholesalers and the uniqueness in the characteristics of this segment of the IDD market. This segment of the market is still unstable and lifting retail price control will enable PCCW-HKTC to prompt a reduction in the number of its competitors, mainly the smaller ETS operators offering alternative services to the consumers.

## **2. PCCW-HKT Limited ("PCCW-HKT") – supports the Application**

- The creation of REACH Ltd. ("REACH") and Reach Networks established an arm's length and non-discriminatory relationship between PCCW-HKTC and Reach Networks. The different shareholder structures of PCCW-HKTC and Reach Networks is demonstrated by:
  - ✧ the filling of the connectivity agreements between PCCW-HKTC and Reach Networks with the TA and;
  - ✧ these connectivity agreements encapsulate – in recognition that competitors can offer lower rates – provisions for independent benchmarking of charges between Reach Networks and PCCW-HKTC against competitive offerings.
- PCCW-HKTC is simply a reseller onto the External Call services market and contracts wholesale capacity and services (e.g. minutes) from Reach Networks.
- PCCW-HKTC's direct competitors are FTNS, EFTNS and ETS licensees, the first 2 types of which may own their own facilities and be vertically integrated.
- PCCW-HKT would refer to previous statements by the TA that the regulatory measures already in place are more than adequate safeguards against potential abuse arising from vertical integration – which no longer exists with the formation of Reach Networks.
- PCCW-HKT maintains that there is active and vigorous retail competition on the Routes.
- PCCW-HKT, in the Application, has already demonstrated that PCCW-HKTC's share has been below 50% since at least February 2000.
- PCCW-HKTC's market share loss has been driven by price competition led by PCCW-HKTC's competitors.
- There are no wholesale supply side constraints upon entrants into the retail markets for the Routes.

- While PCCW-HKT does not know the exact form and prices in which alternatives to the Reach Networks gateway manifest themselves, that they exist in a viable and sustainable form is proven by the limited use which PCCW-HKTC's competitors make of the Reach Networks gateway. Such routing alternatives are not a short-term phenomenon as price competition has been consistent over time and PCCW-HKTC's market share has consistently been falling over time.
- The trend of both accounting rates and refile/hubbing rates is downward, and this makes price competition sustainable.
- Supply side barriers to entry have disappeared for both resale entry (i.e. new capacity available and significant reductions in IPLC prices) and facility entry (i.e. APCN-2, Asia Global Crossing, Level 3 and C2C).
- The Reach Networks gateway is not a bottleneck and has a strong incentive to sell to the entire market.
- PCCW-HKT does not see any justification for further conditions to be imposed upon PCCW-HKTC. The creation of REACH and structural separation of Reach Networks would ease any remaining concerns that the TA may previously have had about the relationship between PCCW-HKTC and Reach Networks. The statistics show that on routes where PCCW-HKTC has previously been declared non-dominant, competition has not decreased.

### **3. SmarTone Mobile Communications Limited ("SmarTone") – does not support the Application**

- PCCW-HKTC should first apply for reclassification to category A routes, and only after such application was approved by the TA, PCCW-HKTC would then be declared non-dominant at the retail level.
- The new structure of PCCW-HKTC and Reach Networks cannot totally ease the concerns on the vertical relationship between the two companies. PCCW-HKT is holding indirect interest of 50% in Reach Networks, which means PCCW-HKTC can still exercise significant control over the management of Reach Networks. Therefore SmarTone disagrees with PCCW-HKT's view that there are no longer any grounds for concern about the relationship of the two companies.
- There is no information provided by PCCW-HKT on its market share in the incoming direction of the Routes. SmarTone considers that it is an essential consideration as to whether PCCW-HKTC has significant market power over the Routes.

- Although PCCW-HKT claimed that PCCW-HKTC's retail market shares for all the Routes have been consistently below 50%, it also pointed out that its highest market share of some of the Routes is about 42%. Hence the market, at least for some of the Routes, is still highly concentrated. The remaining market share is distributed amongst over 180 ETS operators and the 3 new FTNS operators, which means each of them in fact takes up a very small percentage of the market.
- PCCW-HKTC should not be declared non-dominant on the Routes until the Routes are classified as Category A routes.
- The level of competition in the incoming direction of the Routes is a relevant consideration of whether PCCW-HKTC is dominant.