

Increase in Charges for Mobile Network Interconnection by PCCW-HKT Telephone Limited

Statement of the Telecommunications Authority

23 May 2008

Introduction

1. On 17 April 2008, the Telecommunications Authority (TA) received an application from PCCW-HKT Telephone Limited (PCCW) for approval to amend one of its two parallel tariffs for interconnection services between PCCW and mobile network operators (MNOs). The rate in PCCW's long standing tariff for interconnection between the mobile networks and its public switched telephone network (PSTN), which is known as the "Fixed-Mobile Interconnection Charge (FMIC) Tariff", is currently set at 4.36 cents per minute¹. PCCW has applied to the TA for approval to increase the FMIC Tariff to 5.45 cents per minute.

2. PCCW's other tariff for interconnection between the mobile networks and its PSTN is the "Unified Interconnection and Local Access Services" (UILAS) tariff, which has operated as a parallel offering for interconnection charges since August 2007. That tariff is not subject to the TA's prior approval, and its terms are not affected by any increase to the FMIC Tariff.

3. PCCW's application is made pursuant to Special Condition (SC) 3.4 of its fixed carrier licence No 050 (PCCW's Licence), which provides that

Any amendment to any published tariff of the licensee for interconnection, which was in force at 1 December 2004 and continues in force, including those interconnections listed in Schedule 7 [emphasis added], must first be approved by the Authority in writing, and

(a) the Authority shall approve every such amendment where, in the Authority's opinion the amended tariff would not be in contravention of section 7K, 7L or 7N of the Ordinance; and

(b) any such amendment shall be deemed to be approved unless the Authority notifies the licensee in writing, within 30 days after receiving the proposed amendment from the licensee, of the

¹ See tariff published by PCCW in the Hong Kong Government Gazette No. 44/2003 dated 31 October 2003.

Authority's opinion that the amendment would contravene section 7K, 7L or 7N of the Ordinance.

4. Interconnection between PCCW and the MNOs is listed in Schedule 7 to PCCW's Licence. Therefore amendments to any tariff for that interconnection in force at 1 December 2004 is subject to the approval requirement of SC 3.4. The FMIC Tariff was in force at that date and any amendments to it are subject to the TA's prior scrutiny under SC3.4. On the other hand, because the UILAS tariff post dates the issue of PCCW's Licence, its issue and any amendments to it are not subject to the TA's prior scrutiny under SC3.4.

5. By virtue of the operation of SC 3.4(b), the proposed tariff amendment is now deemed to be approved. PCCW has today published in the Hong Kong Government Gazette the revised tariff of 5.45 cents per minute. The revised tariff is effective from 1 June 2008.

6. This statement sets out the background to PCCW's application and the TA's analysis of the application pursuant to SC3.4.

Background

The MPNP regulatory guidance

7. At present, a regulatory guidance is in place in favour of a structure for payment of FMIC based on the "Mobile Party's Network Pays" (MPNP) methodology. That is to say, interconnection charge is paid by a MNO to the interconnecting fixed network operator (FNO) for telephony traffic both from a fixed customer to a mobile customer, and from a mobile customer to a fixed customer².

8. Pursuant to the statement entitled "Deregulation for Fixed-Mobile Convergence"³ dated 27 April 2007 issued by the TA (FMC Statement), the FMIC arrangement in favour of MPNP will be deregulated subject to a transition period of 2 years starting from the issue date of the FMC statement. In other words, the regulatory guidance in relation to the FMIC arrangement will be withdrawn on 27 April 2009. Before 27 April 2009, unless there are new agreements between MNOs and FNOs on alternative and/or transitional FMIC settlement arrangements, the MNOs will continue to settle the FMIC with the FNOs based on the current regulatory guidance.

9. In the FMC Statement, the TA considers that the absence of

² TA Statement, *Interconnection and Related Competition Issues Statement No 7 (Second Revision)* "Carrier-to-Carrier Charging Principles", 18 March 2002

³ TA Statement, *Deregulation for Fixed-Mobile Convergence*, 27 April 2007.

regulatory intervention on FMIC is unlikely to result in a market failure. In other words, the TA considers that the market is likely to settle the FMIC by itself. However, the anniversary of the issuance of the FMC Statement has passed and the TA notices that so far there has been little commercial negotiation between the concerned parties on FMIC.

FMIC payable to PCCW

10. In respect of the level of FMIC payment to PCCW under MPNP guidance, MNOs currently pay a charge of 4.36 cents per minute to PCCW. This charge is a gazetted PCCW tariff which was last revised in October 2003.

11. Historically, the level of FMIC Tariff payable to PCCW was set annually by the TA based on a cost-based approach specified in the TA's statement of 25 October 2000 entitled *Review of Methodologies for Calculation of Interconnection Charges for Value-added Services and Public Mobile Radiotelephone Services and Local Access Charges*. The 4.36 cents per minute charge was set after a review conducted by the TA in October 2003. The same level of charge was maintained after another review conducted by the TA in November 2004⁴. The TA has not conducted any review since then.

12. In paragraph 5 of the statement issued in November 2004 announcing the result of the annual review of the FMIC Tariff, the TA indicated the following:-

The findings of recent three annual reviews have pointed to a higher cost for both VAS and PMRS/PCS interconnection. The main reason is that the traffic and network growth pattern have changed. Both traffic and network costs are decreasing; but as traffic volume has been dropping much faster than network cost, the unit cost would go up. It is expected that this trend will continue if the PSTN traffic of PCCW-HKTC keeps decreasing. As the existing methodology was reviewed in Year 2000 when the traffic pattern and network growth back then were quite different from the present conditions, there is apparently a case for conducting a review. In this respect, OFTA will conduct a consultation to solicit views from the industry regarding the appropriateness of the existing calculation methodology, including the use of fully distributed cost standard and actual interconnection traffic, before he proceeds to review the level of interconnect charges next year.

⁴ TA statements, *Charges for Interconnection between Public Mobile Radiotelephone Services (PMRS), Personal Communications Services (PCS) and Value Added Services (VAS) and the Public Switched Telephone Network (PSTN) Operated by PCCW-HKT Telephone Limited*, 24 October 2003 and 12 November 2004.

The TA then indicated that he was minded to have an outcome on the issues mentioned above in a timely manner to feed into the following annual review in October 2005.

13. Accordingly the TA issued an industry consultation paper entitled “Review of the Need for Regulation, and Methodologies for the Calculation, of Interconnection Charges for Interconnection between Local Fixed Carriers and Value-Added Services and Mobile Services”. A total of 11 submissions were received when the consultation exercise closed on 16 September 2005. However, the TA did not conclude the consultation exercise because it was overtaken by other events, notably the other consultation exercises conducted by the TA in respect of fixed-mobile convergence, which culminated in the issuance of the FMC Statement.

Prior approval requirement under SC 3.4

14. In January 2005, in recognition of the fact that it was no longer proportionate to subject PCCW’s pricing of fixed services to the then *ex-ante* controls, the TA removed such controls which had applied to PCCW only. This entailed the TA lifting the prior approval requirement for new tariffs and amendments to PCCW’s existing tariffs. The only exception was for tariffs in place for certain interconnections, which remain subject to a prior approval requirement under SC3.4 of PCCW’s Licence. The FMIC Tariff is one of the interconnection tariffs which fall into this prior approval category⁵.

15. The largely *ex-post* regime was implemented by the TA issuing a new fixed carrier licence to PCCW on 14 January 2005. SC3.4 of PCCW’s Licence is the operating provision which governs the requirements and process for approval of interconnection tariff amendments that remain subject to *ex-ante* scrutiny. In considering a PCCW’s tariff amendment application under SC3.4, the TA has three options:

- (a) to approve the application where, in the TA’s opinion, the amended tariff would not be in contravention of section 7K, 7L or 7N of the Ordinance (SC 3.4(a));
- (b) within 30 days after receiving the proposed amendment, to disapprove the application if the TA is of the opinion that the amendment would contravene section 7K, 7L or 7N (SC 3.4(b));
- (c) not to form a definitive view on whether the proposed amendment would or would not contravene section 7K, 7L or 7N, with the consequence that the amendment will be deemed to be

⁵ TA statement, *Implementation of ex post Regulation of the Tariffs of PCCW-HKT Telephone Limited under a New Fixed Carrier Licence*, 13 January 2005 (**Ex-post Statement**).

approved after 30 days (SC 3.4(b)).

16. All three options require the TA to consider the impact of the tariff amendment in the context of the competition conduct rules only. Only when the TA is of the opinion that the conduct in question either has, or has not, the purpose or effect of preventing or substantially restricting competition in a telecommunications market will an approval, or disapproval decision, be made.

17. PCCW applied to the TA for approval under SC3.4 to amend the current level of one of its published FMIC tariffs from 4.36 cents per minute to 5.45 cents per minute. In its application, PCCW informed the TA that the rate increase would be temporary and would end on 27 April 2009, when the regulatory guidance in favour of MPNP would be withdrawn.

18. As explained in paragraph 2 of this statement, the UILAS tariff is currently in force in parallel with the FMIC tariff. In relation to these parallel tariffs, the MNOs have three options. They are:-

- (a) the MNOs continue to pay FMIC under the FMIC Tariff while the regulatory guidance in favour of MPNP continues. However, because the regulatory guidance will be removed on 27 April 2009, if the MNOs choose to do nothing else during the transitional period, there will be no new agreed charging arrangements come 27 April 2009;
- (b) the MNOs switch to the UILAS tariff, which provides for a FMIC arrangement which will operate beyond the transition period; or
- (c) MNOs negotiate commercially with PCCW, with a view to reaching different terms over the future FMIC arrangements with PCCW.

An Assessment of the Tariff Increase

19. Under SC3.4, the TA is required to consider PCCW's tariff increase application pursuant to section 7K, 7L and 7N. Because the conduct in question is the unilateral increase of PCCW's own FMIC Tariff, no issue arises under section 7K, in so far as section 7K governs operators acting in concert. Section 7N is also not relevant in this case because the FMIC Tariff is applicable to all fixed-mobile interconnections with PCCW. There is no issue of different charges or terms applying to different operators, which is section 7N's focus.

20. That leaves section 7L, which prohibits unilateral abusive behaviour of a dominant operator. Two elements are required to establish a

contravention of section 7L i.e. that the operator concerned occupies a dominant position in a relevant market, and that its behaviour substantially restricts or prevents competition.

21. In the present case, the behaviour under consideration is the levying of a charge of 5.45 cents per minute for interconnections by MNOs to PCCW's PSTN. This price represents an increase of 1.09 cents, or 25%. PCCW has made it plain that the increase is a strategic move to stimulate the MNOs to commence negotiations with PCCW over transitional FMIC arrangements. Of itself, PCCW's declared motive for the increase is not a relevant consideration in relation to SC3.4, which is strictly confined to considerations under section 7K, 7L and 7N by the TA. The question of cost may or may not be relevant to an assessment under section 7L. Competition assessment under section 7L is not concerned only with whether the price is or is not cost-based *per se*. If costs are relevant at all it is in the context of what the effect of the price is, whether above or below cost, on the process of competition in the relevant market. In fact, the TA has made the following remark in paragraph 25 of the Ex-post Statement:-

*Where a licensee establishes a tariff for an interconnection, there is no ground for the TA to disapprove it under ex ante regulation unless it is in contravention with the competition provisions under the Ordinance. In particular, **if no anti-competitive purpose or effect can be established, that the tariffed charge is not based on the relevant reasonable cost attributable to interconnection is not a ground for disapproving a proposed tariff for an interconnection [emphasis added].***

22. The TA has given some preliminary consideration to the actual market impact the price increase is likely to have on the MNOs. The new price of 5.45 cents represents an increase of 25%, and it is set to last for 11 months to the end of April 2009. In terms of the financial impact that the increase has on the MNOs, the initial view of the TA is that the impact is unlikely to be sufficiently significant and sufficiently long term, to have the character of preventing or substantially restricting competition, even assuming that PCCW's residual but temporary power over the interconnection price with MNOs can be established as a dominant market position.

23. That said, because PCCW submitted its application on a confidential basis, the TA has not been able to solicit the MNOs' comments on the FMIC Tariff increase, especially in terms of actual extent of impact the increase may have on their business operations. Therefore, notwithstanding the TA's initial view that the tariff increase would not offend any of section 7K, L, or N, the TA does not consider that it is appropriate to arrive at a conclusive view at this stage.

Deemed Approval of Tariff Increase

24. Under the tariff approval mechanism of SC3.4, where the TA does not arrive at a definitive view that the tariff increase would, or would not, contravene section 7K, 7L or 7N, and the 30 day period has elapsed, PCCW's application for tariff amendment is deemed to be approved.

25. Since the TA has not given positive clearance to the FMIC Tariff increase under SC3.4 and pursuant to consideration of section 7L⁶, the question of whether the tariff increase, once implemented, contravenes section 7L is an open one which can still be considered under the *ex post* regime i.e. after the increase has come into effect. Any party who considers that the tariff increase has an anti-competitive effect in any telecommunications services market in contravention of section 7L may state its case to the TA. In order that the TA may consider initiating an investigation of section 7L, the requesting party is expected to provide the TA with sufficient information and economic analysis to support a claim of breach of section 7L.

FMIC Negotiations

26. As far as the TA is aware, since the issue of the FMC Statement in April 2007, no substantial negotiations between any of the FNOs and the MNOs have taken place about effecting new FMIC arrangements in anticipation of the withdrawal of the current regulatory guidance. With the two year transitional period set in the FMC Statement entering into its second and final year, the TA considers that the FNOs and MNOs alike should treat the matter of a new arrangement with urgency. The TA is concerned that operators should make genuine efforts at negotiations to achieve a smooth transition to the deregulated era. If necessary, the TA will be happy to facilitate discussions. For the avoidance of doubt, this offer does not imply the TA has any intention of exercising regulatory intervention powers to intervene in the commercial negotiation that will take place.

PCCW's Request for SC3.4 Removal

27. In addition to applying for approval of the tariff increase, PCCW has taken the further step of formally requesting the TA to remove SC3.4 altogether from PCCW's Licence. PCCW considers the tariff approval requirement, which is imposed on PCCW alone and no one else, is discriminatory.

28. In paragraph 120 of the statement entitled "Licensing Framework for Unified Carrier Licence" which the TA issued on 9 May 2008, the following

⁶ Section 7K and 7N are not considered relevant.

was stated:-

Because the present regulatory guidance for FMIC in favour of the MPNP model will be withdrawn on 27 April 2009, the TA will remove the item related to the FMIC from Schedule 7 to the existing ex post licence of PCCW on that day. As the ex post regime has been in place for three years, there may be need for a review of the existing SC 3.4 but until the TA decides to embark on such a specific review he does not intend to remove the SC from the future UCL to be granted to PCCW at this juncture.

If the TA comes to the view that the current application of PCCW to remove SC3.4 altogether deserves further consideration, an industry consultation would be conducted so that the TA may solicit the views and the comments of interested parties before a decision is made.

**Office of the Telecommunications Authority
23 May 2008**