For Discussion

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Panel on Information Technology and Broadcasting

Interconnection Issues

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Executive Summary

1. The Government's policy objectives for the telecommunications industry place primary emphasis on network investment and facilities based competition. This is the case here and elsewhere because infrastructure investment and network competition maximise job creation, encourage service innovation, promote meaningful customer choice and generate long term consumer benefits.

2. The current regulatory framework, however, favours resale competition and thus discourages investment, limits job opportunities, creates the appearance but not the substance of competition and curtails the long term development of the telecommunications industry. This raises the following questions which the Legislative Council and other policy makers must address:

(i) Why should the primary method of promoting competition continue to emphasise the resale of PCCW-HKT's local loops by the other FTNS licensees ? Shouldn't this policy which was introduced in 1995 to jump start competition in the early years of market liberalisation be replaced by one which would encourage infrastructure investment and network competition ?

(ii) Since network competition can easily be achieved in a geographically small market, why, after seven years of market liberalisation, does Hong Kong still favour resale competition ?

(iii) Why does Hong Kong still favour a policy which ultimately depends on government-set resale rates and requires constant government/ OFTA intervention, when it is more appropriate to phase out this *second best* approach ?

(iv) And finally, how do Hong Kong's interconnection practices, interconnection costing standards and rates compare to other developed markets ?

Infrastructure Investment & Network Based Competition

3. Sustainable long term competition in the local market for fixed line services can only be achieved through continued development of alternative infrastructure. An infrastructure based competitive arena will bring about the investment that is needed to boost Hong Kong's economy, create employment, promote innovation and hasten the development of new services. Heavy reliance on resale competition cannot bring about these benefits and is clearly counter-productive. The longer this approach lasts, the harder it will be for the regulator to wean the other operators off their dependence on the incumbent's network. Unfortunately, this is exactly the position in which we find ourselves today.

4. The benefits of infrastructure competition are well supported by OFTEL in the UK, the OECD and our very own Consumer Council who, even in their submission to the Panel today, point out that *facilities based competition was, and still is the best way of promoting competition, and thereby meeting the objectives of the Government*. Dr. Yip Hak-Kwong of the University of Hong Kong sadly proclaimed, at a recent Telecom Infotech Forum, that Hong Kong had slipped from market leader to market follower, that investment in fixed line infrastructure in Hong Kong and the number of jobs in the telecommunications industry were both declining. These alarming statistics act at least, if nothing more, as a warning sign to Hong Kong policy makers that something needs to be done to redress the balance.

5. Consumers at large continue to suffer discrimination at the hands of the second carriers who do not have substantial networks and who selectively provide service to, principally, those customers residing in the more profitable areas of Hong Kong. The recent **Audit Report**[1] issued by the Audit Commission exposed their cream-skimming activities and limited commitment to users when it found that some 30% of the residential addresses (supposedly served by exchanges in which the other operators had colocated) were refused to be served by these operators.

6. The reality is that the current interconnection regime gives these carriers little incentive to substantially develop their own independent networks. Why seek to invest and build when you can simply buy cheap from the incumbent and resell its facilities ? The problem lies firstly, in mandating the resale of PCCW-HKT's local loops and secondly, in the mandating of such resale at unreasonably low interconnection rates.

[1] Report on *Liberalisation of the Local Fixed Telecommunications Market* issued by the Audit Commission on 20 March 2002

Encouraging the second carriers to resell PCCW-HKT's facilities and sending the wrong build v. buy signal to investors directly cause the establishment of a services based rather than network based competitive environment, force the incumbent to subsidise the interconnecting operators and ultimately confer few long term benefits to the consumer.

7. This is precisely why countries such as Singapore and the Netherlands phase out unbundled local loops, why Canada does not mandate unbundling in urban areas and why the USA has initiated a proceeding which is likely to end forced unbundling. Whilst this form of subsidised access was enjoyed by the new entrants in the early years of market liberalisation, the respective administrations have clearly felt the need to wean them off the incumbent's network before they became too dependent. In a geographically small market like Hong Kong, where a plethora of fixed and wireless alternatives to PCCW-HKT's local service are already available, the need for PCCW-HKT to open up its facilities seems superfluous and the case for early termination of local loop unbundling seems even stronger. Simply stated, it is very easy to build out networks in geographically small markets. It should be done here, now.

Costing of Interconnection Charges

8. By international standards, Hong Kong's interconnection rates are exceptionally low. In a recent survey performed by Ovum, PCCW-HKT's fixed network termination charges were shown to be well below those of all major European and American telephone operators. The problem stems from the manner in which the interconnection charges are determined in Hong Kong.

9. The TA has chosen to adopt a fairly punitive and arbitrary costing standard which allows the use of the *lower of historical or current costs* in computing the interconnection rates that may be charged by the incumbent. This results in an exceptionally low level of charges that merely induces the second carriers to continue buying PCCW-HKT's local loops, does not permit PCCW-HKT to fully recover its costs, forces PCCW-HKT to subsidise the operations of the other operators and ultimately acts as a strong deterrent to network investment for both the incumbent and the competing operators.

10. The costing standard adopted by the TA makes little economic sense and suggests a motive of price suppression which, as the Consumer Council has pointed out, is counter-productive and harms users. PCCW-HKT is not aware of any administrations around the globe that use this

approach and it is easy to see why, given its unjustly punitive effect on the incumbent and the negative impact on investment and users. This standard needs to be urgently reviewed and changed before consumers are irreparably harmed.

The TA's Role in Achieving the Government Objectives

11. The TA is responsible for regulating the telecommunications industry and ensuring that the Government's policies are carried out. Part of this role is to ensure that a level playing field exists in the market place so that the right kind of competition is fostered and consumers can enjoy sustainable long term benefits. In this regard, PCCW-HKT continues to be disappointed with the TA's failure to open up Hong Kong Cable Television Limited's ("**HKCTV's**") monopoly network for interconnection in spite of HKCTV's clear licence requirements and the competition law provisions of the Telecommunications Ordinance.

12. HKCTV possesses a network with an extensive home-pass. The TA has, nevertheless, still not required it to provide open access to its network even though extensive local loop unbundling requirements have been imposed on PCCW-HKT. At the same time, HKCTV does permit its network to be used by its affiliate, i-CABLE, thereby violating both the non-discrimination and no undue preference requirements of its licence and the Telecommunications Ordinance. This more lenient attitude taken by the TA towards HKCTV is unjust and cannot be conducive to the achievement of a level playing field. Simple fairness would dictate that either both or neither networks be unbundled.

Conclusion

13. The Government's policy objectives for the telecommunications industry clearly support the need to incentivise infrastructure investment and facilities based competition. On this basis, the TA's present interconnection regime which:

- still mandates PCCW-HKT to unbundle its facilities even after seven years of competition;
- penalises the incumbent by imposing an arbitrary interconnection costing standard that sends the wrong build v. buy signal to the other operators;
- prevents PCCW-HKT from fully recovering its costs; and
- asymmetrically regulates the market place,

cannot possibly facilitate the achievement of these policy objectives and must surely be viewed as flawed. A comparison with international benchmarks further reinforces the necessity for the current interconnection framework to be critically re-examined.

14. A policy debate on how and when local loop unbundling should be terminated is long overdue. At the same time, it is appropriate to re-visit how interconnection is priced in order to send the correct build v. buy signal to the marketplace. If sustainable infrastructure competition is to occur, these questions must be addressed now. Hong Kong can no longer afford to be stuck in the policies of the mid-1990's. PCCW-HKT invites the Legislative Council to lead this urgently needed debate.

Introduction

15. PCCW-HKT Telephone Limited ("**PCCW-HKT**") welcomes the opportunity to present its views on whether the current interconnection arrangements promote sustainable competition in the Fixed Telecommunications Network Services ("**FTNS**") market and the regulatory role of the Telecommunications Authority ("**TA**").

16. PCCW-HKT is convinced that the present interconnection regime, created in the mid-1990's when competition was initially introduced, no longer facilitates achievement of the Government's policy objectives for the telecommunications industry and, in fact, is detrimental to the development of Hong Kong as a leading telecommunications centre.

17. The current regulatory framework discourages investment, limits job growth, creates the appearance but not the substance of competition, endangers the growth of the telecommunications industry and, in the long term, harms users. This situation needs to be urgently addressed. PCCW-HKT therefore invites the Legislative Council, the Information Technology and Broadcasting Bureau, the public and the new Minister to thoroughly review the FTNS market and, in particular, the existing interconnection regime.

18. As emphasised by the Consumer Council and policy makers around the world, infrastructure investment and network competition is the preferred mechanism to maximise investment, job creation, service innovation, speed to market, sustainable competition, customer choice and consumer benefits.

19. This is the touchstone with which all policy decisions must be consistent as this is the fundamental principle that will maximise consumer benefits. Given that, the questions which need to be asked are:

(i) Why should the primary method of promoting competition continue to emphasise the resale of PCCW-HKT's local loops by the other FTNS licensees ? Shouldn't this policy which was introduced in 1995 to jump start competition in the early years of market liberalisation be replaced by one which would encourage infrastructure investment and network competition ?

(ii) Since network competition can easily be achieved in a geographically small market, why, after seven years of market liberalisation, does Hong Kong still favour resale competition ?

(iii) Why does Hong Kong still favour a policy which ultimately depends on government-set resale rates and requires constant government/ OFTA intervention, when it is more appropriate to phase out this *second best* approach ?

(iv) And finally, how do Hong Kong's interconnection practices, interconnection costing standards and rates compare to other developed markets ?

The Government's Policy Objectives for the Telecommunications Industry

20. The Government's telecommunications policy objectives are to facilitate the development of the telecommunications industry, enhance Hong Kong's position as a leading telecommunications hub and maximise long term user and economic benefits. Critical to this development is the need to attract infrastructure investment, the achievement of a network coverage, elevation of service quality and a strong focus on service innovation that are worthy of international comparison.

21. It is clear that investment in network rollout by PCCW-HKT and the other entrants is critical to achieve and maintain these goals. However, the existing interconnection framework does not provide sufficient inducement for PCCW-HKT or the other entrants to build out their networks in order to facilitate the infrastructure competition that is necessary to raise service standards, create service innovation and bring the benefits of competition and new technologies to the consumers in Hong Kong.

The Development of Infrastructure Competition in Hong Kong

22. Infrastructure competition has always been an express policy of the Government and is the policy preference of most competitive markets. However, this policy objective has consistently given way to the short term objective of promoting the appearance of competition through below cost interconnection rates that encourage resale competition but discourage infrastructure investment and network competition.

23. As noted in the **Audit Report**[2] issued by the Audit Commission recently, it was found that some 30% of the residential addresses served

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[2] Report on *Liberalisation of the Local Fixed Telecommunications Market* issued by the Audit Commission on 20 March 2002

by six selected colocation exchanges were refused service from all three second carriers. It is therefore apparent that the regulatory regime has purposely or inadvertently limited investment, permitted cream-skimming, allowed new entrants to ignore users outside of the central business districts and produced limited sustainable benefits to users.

24. It is not PCCW-HKT's intention to criticise the business plans of the second carriers. These business plans are an inevitable outcome of a regulatory regime that has sought to encourage competition through the resale of PCCW-HKT's local loops rather than through positive economic incentives such as the setting of efficient cost based resale and interconnection charges in order to encourage network investment by the competing operators.

The Need for Infrastructure Rollout

25. On an international basis, the benefits of infrastructure competition are well supported. This means that independent networks compete, and of course interconnect, to permit full user-to-user connectivity. In Hong Kong, this is referred to as Type I interconnection. This also means that the mere resale of PCCW-HKT's local loops by other carriers, or Type II interconnection, is a second best solution and is either discouraged or phased out.

26. In the UK, facilities based competition has been the foundation of the telecommunications policy set by the Office of Telecommunications ("**OFTEL**"):

> *This [object of promoting network competition] is OFTEL's most important work. OFTEL remains strongly committed to the development and maintenance of competition from and between network operators (infrastructure competition). Competition from service providers and between service providers and network operators can provide additional choice for consumers and is therefore to be welcomed. Network services are, however, a crucial element in delivering OFTEL's goal. Without network competition, there is a risk of consumers being disadvantaged by any inefficient and/or expensive provision of network services which are an essential input to any services provider over the network.*[3]

[3] *OFTEL Management Plan 1996/97 and Beyond,* May 1996, Chapter 4: *Promoting Network Competition*

27. OFTEL's view is also shared by Hong Kong's own Consumer Council, the champion of consumer interests. In its submission to the Panel in November 2001[4] as well as the submission today, the Consumer Council rightly points out that:

> *[…] facilities based competition was, and still is the best way of promoting competition, and thereby meeting the objectives of the Government.*[5]

28. In a similar vein, the OECD also concluded that competing infrastructure will generally be more beneficial for competition and therefore good for social welfare:

> *It is also important to note that the deployment of alternative infrastructures can confer considerable benefits on subscribers in the countries in question, and more generally upon their economic development … The development of alternative infrastructures creates immediate opportunities for the introduction of competition, not present when a country or region is served exclusively by a single fixed link network. There is already evidence from several studies of OECD countries and elsewhere that the introduction of competition is associated with lower prices, higher quality of service and higher and faster rates of penetration.*[6]

29. Sustainable long term competition in the Hong Kong telecommunications market for all fixed line services will only be achieved through the continued development of alternative infrastructure. This will ensure that competitors have differential and increasingly more efficient cost bases and are better able to deploy enhanced features and functions within their networks. The heavy reliance on resale competition is counter-productive. The longer this approach lasts the harder it is for the regulator to wean the other entrants and the more likely the regulator becomes entrapped in its own policy bias. Unfortunately, this is where we are today.

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[4] Consumer Council, *Submission to LegCo Panel on Information Technology and Broadcasting, Implementation of the Full Liberalisation of the Local Fixed Telecommunications Network Services Market from 1 January 2003*, November 2001

[5] Consumer Council, *Submission to LegCo Panel on Information Technology and Broadcasting, Interconnection Arrangements in Promoting Competition and the Role of the Telecommunications Authority*, June 2002

[6] Cave, *Alternative Telecommunications Infrastructures: Their Competition Policy and Market Structure Implications*, OECD, 1995

30. At the Telecom Infotech Forum held on 13 November 2001, Dr. Yip Hak-Kwong (Director of Policy 21 Ltd, University of Hong Kong) presented some interesting facts on the level of investment in network development in Hong Kong, Taiwan, Singapore and South Korea. In particular, recent research and international studies reveal that Hong Kong has slipped from market leader in the number of lines relative to the number of homes, to third place behind Taiwan and Singapore, that investment in fixed line infrastructure in Hong Kong continues to decline and that the number of jobs in the telecommunications industry was also declining. These statistics should serve as a real warning sign to Hong Kong policy makers to go back to first principles of promoting infrastructure investment and network competition.

31. Past experience in Hong Kong has shown that the second carriers have tended to focus on the most profitable service areas and to rely on the mere resale of PCCW-HKT's local loops. The current interconnection regime gives these carriers little incentive to substantially develop their own independent network infrastructure. PCCW-HKT believes that the manner in which the interconnection regime has been currently implemented is inconsistent with the objective of encouraging network investment. The present regime has sent the wrong build v. buy signal to the new entrants and has produced a service led, rather than network based, competitive environment. The interconnection regime has been implemented in such a way as to primarily encourage the resale of PCCW-HKT's services which will produce no long term consumer benefits, penalise those carriers who do have substantial investment plans and require PCCW-HKT to subsidise its competitors.

32. An interconnection regime that encourages infrastructure competition over resale competition will produce multiple networks deployed throughout Hong Kong. This will result in greater investment in the telecommunications industry that will best support Hong Kong's economy. An infrastructure based competition regime will also create the maximum number of jobs, promote innovation, enhance service quality, hasten the development and roll out of new services and provide the best value for money. In a market as geographically small as Hong Kong, resale competition should have been phased out years ago.

Local Loop Unbundling

33. The TA's reliance on the resale of PCCW-HKT's local loops to create the appearance of sustainable competition is also reflected in the extent of the local loop unbundling that has been made mandatory in Hong Kong. Whilst in the major overseas administrations, the incumbent

may be required to provide full local loop or upper bandwidth local loop unbundling, PCCW-HKT has been made to provide four different types of local loop configuration, each requiring significant OFTA intervention.

34. It is interesting to note that just as Hong Kong's local loop unbundling requirements are becoming more stringent, we understand that countries such as the USA, Canada, Singapore and the Netherlands are phasing out the need to provide unbundled local loops in an effort to wean the new entrants off the subsidised access which they have enjoyed since market liberalisation and force them to roll out their own infrastructure before they become overly dependent on the incumbent's network. We understand that in Singapore, mandatory local loop resale is phased out after two years. In a geographically small market like Hong Kong, this weaning process should have occurred a long time ago.

35. This brings us to the obvious question as to whether local loop unbundling is necessary in order to achieve the Government's policy objectives on competition. The answer is clearly no.

36. There is an extraordinary level of competition already existing in the local market:

- In 1992, Hong Kong issued four digital cellular mobile telecommunications licences.
- On 1 July 1995, three new FTNS licences were issued.
- In 1996, the Government issued a further six licences for mobile personal communications services. There are now more mobile subscribers than fixed lines and the local calling market (fixed and mobile combined) is highly competitive.
- In 1998, the TA issued a further five local carrier licences for Local Multipoint Distribution Services (Local Fixed Wireless FTNS licences). This allowed the use of new wireless technologies to achieve complete bypass of the local fixed telecommunications networks. Further, Hong Kong Cable Television Limited ("**HKCTV**") was authorised to become the fifth FTNS licensee by virtue of its ability to provide telecommunications services over its Hybrid Fibre Coaxial ("**HFC**") cable network.
- In 2001, the third generation mobile licences were issued and earlier this year, the TA announced its intention to issue new fixed carrier licences with effect from 1 January 2003 and the process has already started.

37. In this respect, the local calling market is fully liberalised and highly competitive, with 10 local FTNS operators (5 wireline based and 5 wireless based) providing local service. The wireless local calling service is a very good substitute for the fixed local calling service. In this market, PCCW-HKT's market share is about 35% and yet it remains heavily regulated.

The Audit Commission recognised the level of competition in the local market. In the Audit report, it commented that:

> *[…] the progress of development in competition in local fixed telecommunications services in Hong Kong is comparable to, or even better than, other countries where similar market liberalisation has been implemented.*[7]

38. Taking into account the obvious size constraints of the Hong Kong market which has a population of less than 7 million and a geographical area of only 1,100 square kilometres, it becomes obvious that nowhere else in the world can boast such a concentration of licences, technologies and service providers serving the market.

39. Whilst in the initial years of market liberalisation the new entrants may have had to rely on the incumbent's network on a resale basis, a plethora of fixed and wireless alternatives to PCCW-HKT's local service are clearly now available and there is no longer a need to mandate resale of its facilities. The existence of other networks negate any conclusion that PCCW-HKT's network is an essential facility. There should therefore be no obligation on the part of PCCW-HKT to resell its local loops. Whilst Type I interconnection should be allowed to continue, Type II interconnection should be swiftly terminated.

Impact of Costing Standards on Infrastructure Investment

40. PCCW-HKT is committed to developing an appropriate and balanced regulatory framework. This was reflected in its submission to the TA in respect of the *Consultation Paper on Review of the Telecommunication Authority's Statements No.4, 5, 6, 7 (Revised) and 8 on Interconnection and Related Competition Issues*[8] ("**Interconnection Statements**"), which focused on achieving an optimal outcome for market participants and consumers, based on efficient pricing in a

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[7] Paragraph 3.6(c) of the Audit Report

[8] Finalised in set of revised Interconnection Statements being published by the TA on 18 March 2002

competitive environment that is in the long term best interests of consumers.

41. The relationship between network investment and interconnection pricing has been described by the International Telecommunications Union ("**ITU**") as follows:

> *The Regulator needs to strike a careful balance: if it unduly shields the entrant by regulating artificially favourable terms for interconnection, this will reduce the entrants' incentive to invest in its own network or attract uneconomic entrants. The new entrant may become dependent on the regulator to an unnecessary and undesirable degree. This in turn may have the effect of not producing effective competition in the long run.*[9]

42. This point has also been made by the Consumer Council. PCCW-HKT strongly endorses the approach of establishing an appropriate interconnection regime that establishes sufficient investment incentives for the existing FTNS operators and future fixed carrier licensees. The direct relationship between interconnection prices and infrastructure investment incentives has been recognised as follows:

> *If regulations designed to promote the "correct" prices today dissuade investors from building new infrastructure tomorrow, then the long term dynamic costs of the regulation can easily outweigh the transitory benefits. Investment in new facilities may be curtailed as a result.*[10]

43. In spite of this, the costing standards that have been adopted for interconnection pricing act as a strong disincentive to infrastructure investment to both PCCW-HKT and the other FTNS operators. In the TA's revised set of Interconnection Statements, PCCW-HKT's recovery of costs continues to be restricted to the *lower of historical or current cost* standard when setting interconnection charges, thereby deliberately suppressing interconnection pricing. The effect of this, as noted by the Consumer Council, is to discourage PCCW-HKT from investing in its network on the basis that it would not be able to fully recover its costs, and to dissuade the second carriers from making their own infrastructure

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[9] Pages 16 and 21, *The Changing Role of Government in an Era of Telecom Deregulation – Interconnection: Regulatory Issues,* Report of the Fourth Regulatory Colloquium, ITU, Geneva, Switzerland 19-21 April 1995

[10] King and Maddock, *Unlocking Infrastructure: The Reform of Public Utilities in Australia*, Allen & Unwin, 1996 at page 72

investment as it is clearly cheaper to seek interconnection to the incumbent's network.

44. PCCW-HKT has serious objections to the use of the lower of historical or current cost basis. Combining historical costs with current costs creates an overall price which has little meaning and cannot be used to direct investment efficiently. This arbitrary and totally subjective approach is punitive and reflects the continued preference of resale entry over facilities based entry. The inability of OFTA to move toward a rational competition regime even after seven years of competition is a major policy failure which needs to be reviewed.

International Comparisons

45. It is the generally accepted *economic best practices* view that only current costs, applied consistently to all assets, can correctly present the right build v. buy choice to the market. Historical costs are irrelevant to the investment decision making process of investors in that they simply represent the price recorded by the incumbent in its accounting records when the network assets were acquired in the past.

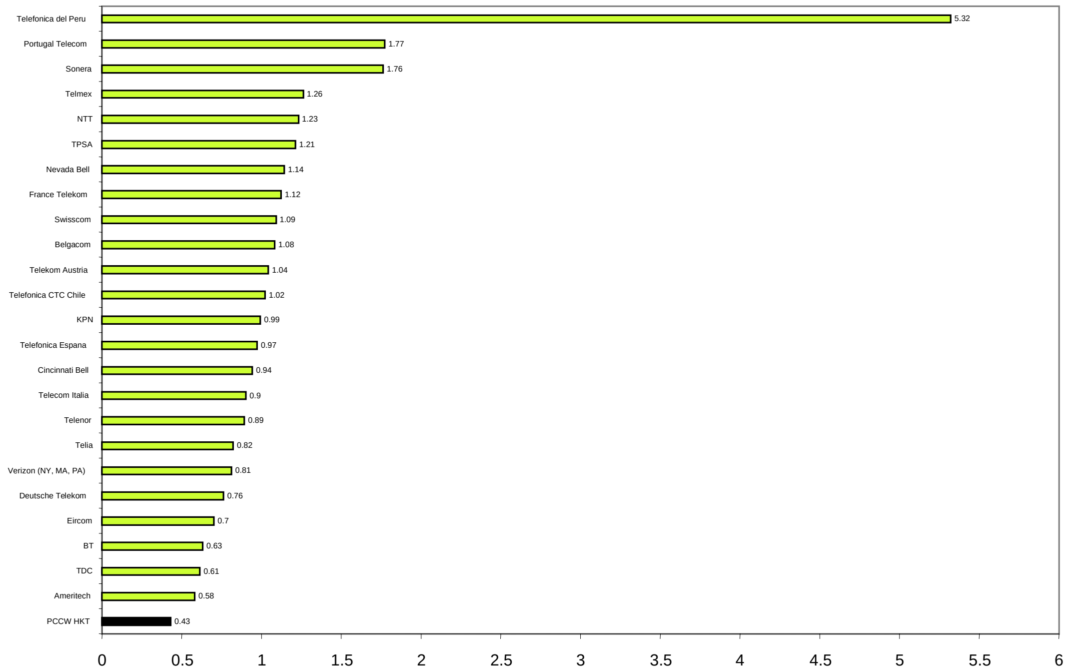
46. On a worldwide basis, the clear trend in costing is to use current costs in interconnection pricing. The historical costing standard, if it exists, seems to be slowly being phased out in place of a more forward-looking current costing methodology. No country that we are aware of uses the punitive approach of the *lower of historical or current cost*.

47. In a document entitled *Principles of implementation and best practice regarding FL-LRIC cost modelling* published by the Independent Regulators Group ("**IRG**")[11] on 24 November 2002, it recommended that the National Regulatory Authority ("**NRA**") of each member state in the European Union ("**EU**") adopt the *Forward Looking Long Run Incremental Cost* approach to interconnection pricing. It also noted that most of the EU members had already introduced the current costing standard to their interconnection pricing or were in the process of doing so. The USA, Australia and Canada also adopt forward-looking costs in their interconnection pricing methodology.

48. Not surprisingly, the punitive interconnection costing standard adopted by the TA has resulted in Hong Kong having the lowest overall interconnection prices compared with other countries around the world.

[11] The IRG was established in 1997 as a group of European NRAs to share the experience and points of view of its members on issues of common interest such as interconnection and pricing.

The following diagram shows the fixed network termination charges (in US cents per minute) of major telecommunications operators around the world: (PCCW-HKT's rate is indicated as a solid block in the chart)



Source: Interconnect@Ovum May 2002

49. It is clear that PCCW-HKT's rates are significantly lower than those for the average telecommunications operator in other developed markets. Unless we believe that PCCW-HKT is tremendously more efficient than the average service provider, it must be the case that the interconnection rates are being artificially suppressed to the extent that PCCW-HKT is not able to recover its relevant costs, the wrong build v. buy signals are being sent and carriers are being incentivised to merely resell the local loops of PCCW-HKT rather than build their own infrastructure.

50. Deliberately suppressing interconnection pricing is not the right answer even if the Government's aim is to maximise consumer benefits, including the reduction of consumer prices through sustainable competition. This merely penalises PCCW-HKT and stops it from fully recovering its costs. At the same time, the second carriers are being encouraged to virtually *free ride* on the incumbent's infrastructure. Keeping interconnection prices at such an unreasonably low level is tantamount to mandating PCCW-HKT to *subsidise* its competitors. The competing operators should be incentivised to invest and build out their own networks. This is a more long term pro-consumer solution that will create the competitive market sought by the Government.

The TA's Role in helping to meet the Government's Policy Objectives

51. The TA is responsible for regulating the telecommunications industry and ensuring that the policies set by the Government are carried out. Yet, the telecommunications area is often complex and the TA has been granted substantial autonomy and power. If the proper checks and balances are not in place, the TA, by default, assumes the role of policy maker as well as that of policy implementer.

52. The existence of the new Competition Tribunal provides some comfort that the regulator's powers will not be too broadly applied when dealing with matters of competition and interconnection. Policy makers must, however, be vigilant to ensure that the TA does not manipulate various processes to limit the scope of the Competition Tribunal and undermine the system of checks and balances. In fact, in an interconnection matter recently brought by PCCW-HKT to the Appeal Board, OFTA's first argument was that the Board lacked jurisdiction and should not hear the appeal. Yet, interconnection directly relates to competition and interconnection requirements are traditionally established to limit the market power of dominant firms or to prevent the abuse of dominant position.

Over-Regulation of the Market

53. As we have seen, the manner in which the telecommunications industry has developed over the past ten years and the present liberalised state of the market indicates that the need for a heavy handed regulator has long since passed. A greater degree of mandated local loop unbundling does not equate to a greater level of competition nor enhanced consumer benefits. As was recognised in the recent court case in the USA *United States Telecom Association v. Federal Communications Commission ("**FCC**")*[12], the regulator should seriously consider whether *completely synthetic competition* of the sort resulting from forced local loop resale actually promotes the Government's policy objectives on competition and delivers the required benefits to the investment community and the consumer. The court went on to find that the FCC had shown a *naked disregard of the competitive context* of the market in blindly requiring local loop resale. PCCW-HKT would hope that Hong Kong does not fall into the same trap.

[12] United States Court of Appeals for the District of Columbia Circuit, No. 00-1012, argued 7 March 2002 and decided 24 May 2002

Level Playing Field

54. PCCW-HKT continues to be concerned that a level playing field does not exist and that the regulator appears to be taking a more lenient approach to the activities of the other operators, in particular, HKCTV.

55. HKCTV operates the sole pay television service in Hong Kong and has a network which has passed around 1.8 million homes with close to 1.3 million homes being broadband internet ready. Through its sister company, i-CABLE, it offers broadband internet services to residential customers through its cable television network. HKCTV is clearly a dominant operator. However, whilst PCCW-HKT:

(i) is required to unbundle all aspects of its local loop with disregard, in some cases, to the operational difficulties experienced by PCCW-HKT in doing so; and

(ii) is forced to subsidise its competitors through the use of irrational costing methodologies,

HKCTV is still not required by the regulator to provide unaffiliated carriers interconnection to its network despite both a licence and statutory obligation to do so.

56. HKCTV's claims (that there are technical difficulties in opening up its network) are baffling and totally unsatisfactory. Firstly, experience with similar HFC networks overseas indicates that the claimed difficulties are unfounded or, at least, resolvable. Secondly, the TA, by exempting HKCTV from providing interconnection to its network creates an asymmetric regulatory regime, permits HKCTV to violate both its licence and the Telecommunications Ordinance without penalty, and denies other licensees the ability to use the HKCTV network. Providing access only to i-CABLE is clearly discriminatory and demonstrates undue preference, both of which are violations of Section 7 of the Telecommunications Ordinance.

57. In the Statement on Broadband Interconnection issued by the TA, he clearly admitted the need for operators to interconnect to both PCCW-HKT and HKCTV's networks:

> *The responses to the second consultation paper have not changed the view of the TA that, compared with the networks of PCCW-HKT and HKCTV, the alternative customer access networks are still being rolled out and the coverage in the initial years would be small. As many of the end-users would be accessible only through one of the two incumbents' networks in the initial years,*

interconnection to these two networks would be the most effective means of bringing the benefits of competition to consumers at an early date.[13]

58. Whilst the TA appears to support the simultaneous opening up of HKCTV's network in principle, this has not yet happened. The *Ad Hoc Working Group on Type II Interconnection to Coaxial Cable Distribution Systems for Broadband Service* ("**Ad Hoc Working Group**") established by OFTA in April 2001 to discuss interconnection to HKCTV's In-Building Coaxial Cable Distribution Systems was initially welcomed by the industry as being a positive step towards opening up HKCTV's network. However, although the TA's interest was at first keen, this has somehow waned. Since the first meeting of the Ad Hoc Working Group over a year ago (19 April 2001), so far there has only been one further meeting. Worst still, the proposed third meeting of the Ad Hoc Working Group has, as of today, already been postponed *twice* by OFTA and is currently scheduled to take place on 11 June 2002.

Conclusion

59. The Government's policy objectives for the telecommunications industry clearly support the need to incentivise infrastructure investment and facilities based competition. On this basis, the TA's present interconnection regime which:

- still mandates PCCW-HKT to unbundle its facilities even after seven years of competition;
- penalises the incumbent by imposing an arbitrary interconnection costing standard that sends the wrong build v. buy signal to the other operators;
- prevents PCCW-HKT from fully recovering its costs; and
- asymmetrically regulates the market place,

cannot possibly facilitate the achievement of these policy objectives and must surely be viewed as flawed. A comparison with international benchmarks further reinforces the necessity for the current interconnection framework to be critically re-examined.

60. The TA must be careful to ensure a level playing field as this is crucial to the creation of sustainable competition, the generation of long

[13] Paragraph 2.11 of the TA's Statement on *Broadband Interconnection* issued on 14 November 2000

term consumer benefits and ultimately, the development of Hong Kong as a leading telecommunications centre.

61. A policy debate on how and when local loop unbundling should be terminated is long overdue. At the same time, it is appropriate to re-visit how interconnection is priced in order to send the correct build v. buy signal to the marketplace. If sustainable infrastructure competition is to occur, these questions must be addressed now. Hong Kong can no longer afford to be stuck in the policies of the mid-1990's. PCCW-HKT invites the Legislative Council to lead this urgently needed debate.