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Wharf New T&T Limited
Submission to LegCo Panel on Information Technology and Broadcasting On Interconnection of Local Fixed Networks

10 June 2002

1. Honorable members of the Legislative Council, thank you for your interest in pursuing the progress of various interconnection issues in the local fixed-line industry since our last meeting in November last year.

2. Regrettably all the problems we highlighted at the last meeting remain today. The end result is that PCCW still controls 90% of the local fixed-line market. The dominant operator continues to exert excessive charges, excessive delay and restrictive provisions in implementing interconnection.

3. The trial for increasing the cutover of local access loop (LAL) by PCCW, which was promised last November and scheduled to commence on 2 January 2002, turned out to be an empty promise. PCCW presented a last minute proposal demanding an additional charge for each and every line to be cutover at all collocation exchanges including those that are within the existing quota. This is not a genuine increase in productivity. But ironically, an increase on charges for interconnection. Effectively if the trial were to proceed then for each line cutover PCCW would charge its competitors $513.80, this is at the wholesale level. At the retail level PCCW charges its retail customers $475 (less volume discount). At the moment PCCW runs special promotion waiving installation and reconnection charge for those who switch from competitors. It is impossible to compete on those terms. If this conduct is not an abuse of dominance, then what is?

4. The TA's determination process has slowly unraveled the excessive charges imposed by the dominant operator in the provisioning of various interconnection services. Recent two determinations by OFTA confirm our long-held view that the dominant operator engages in excessive pricing. The recent determinations' outcomes confirm that we have been over-charged by over 400% in one case.

5. The charges for porting of telephone numbers amongst the fixed-line operators remain sky high, notwithstanding that it has come down by more than 60% through a determination by OFTA. This is in stark contrast with the porting of mobile telephone numbers. In the case of porting of mobile numbers the process is fully automatic and there is no charge payable between the mobile operators. As the process with porting of mobile numbers is fully automatic, the failure rate for mobile users to port their numbers to another network is very very low. In the case of porting of numbers between fixed-line operators, the process is cumbersome and consequently the failure rate is unacceptably high, and the charges imposed by the dominant operator are excessive. Excessive charges for porting and a cumbersome procedure impede the free movement of customers. This area remains one of the biggest impediments to the development of long-term sustainability in competition in the local fixed-line market.

6. We invite members to visit our website [www.wharfnewtt.com] where they can learn about the frustrations that consumers often encounter after exercising a choice. We further invite you to express your views in those cases.

7. We remain committed and we continue to invest in rolling out our network and services to reach greater section of the community in Hong Kong. To date we have invested over HK$4Billion in rolling out our network. Our plan is to extend our residential coverage to over 920,000 homes by the end of this year. This represents 45% of households in the Hong Kong SAR.

8. In order for greater sections of the community in Hong Kong to truly enjoy the choice of alternative service providers, greater effort will be required by the regulator to ease the way for customers to move from their existing telephone service provider to their choice of service providers.

9. The instances cited on our website illustrate the various hurdles placed in front of us by the dominant operator. These hurdles stifle competition and harm consumers' interests. This explains the current state of competition in the industry and this in itself, calls for more gut wrenching regulatory reform. So we have the following proposal for the regulator.

10. Our proposal is to separate the wholesale and the retail functions of PCCW into two separate distinct companies that are unrelated to each other in terms of ownership and control.

11. As one company with both the wholesale and retail functions, we believe PCCW is in a huge dilemma. On one hand it has to compete with the other non-dominant operators to retain its market share and to find new market segments, yet on the other hand it has the regulatory obligations to provide interconnection to its competitors so that they can compete with it at the retail level.

12. Typically, the retail function of PCCW is to increase revenue by retaining customers and new acquisitions from end users. The retail arm of PCCW competes in the same markets with other local fixed-line operators. On the other hand the wholesale function of PCCW has to increase revenue in the wholesale market where customers acquire the interconnection for reselling. This conflict is irresolvable in reality as both functions ultimately report to the same board of directors and are accountable to the same shareholders of PCCW.

13. As a result of this conflict, provision of interconnection services by PCCW at the wholesale level is effectively retarded. The wholesale charges must be high in order to make up for the losses at the retail level; the delay is necessary to minimize the losses at the retail level; the excessive restriction is necessary to minimize the impact at the retail level. We end up with a market where buyers and the sole supplier get together not for mutual benefits, rather the supplier gets into the market in order to fulfill its regulatory obligations. Without the regulatory obligations it has absolutely no incentive to do so. Without any choice, it gets into the market to maintain the best commercial position to protect its interests to the detriment of its competitors who are also its customers.

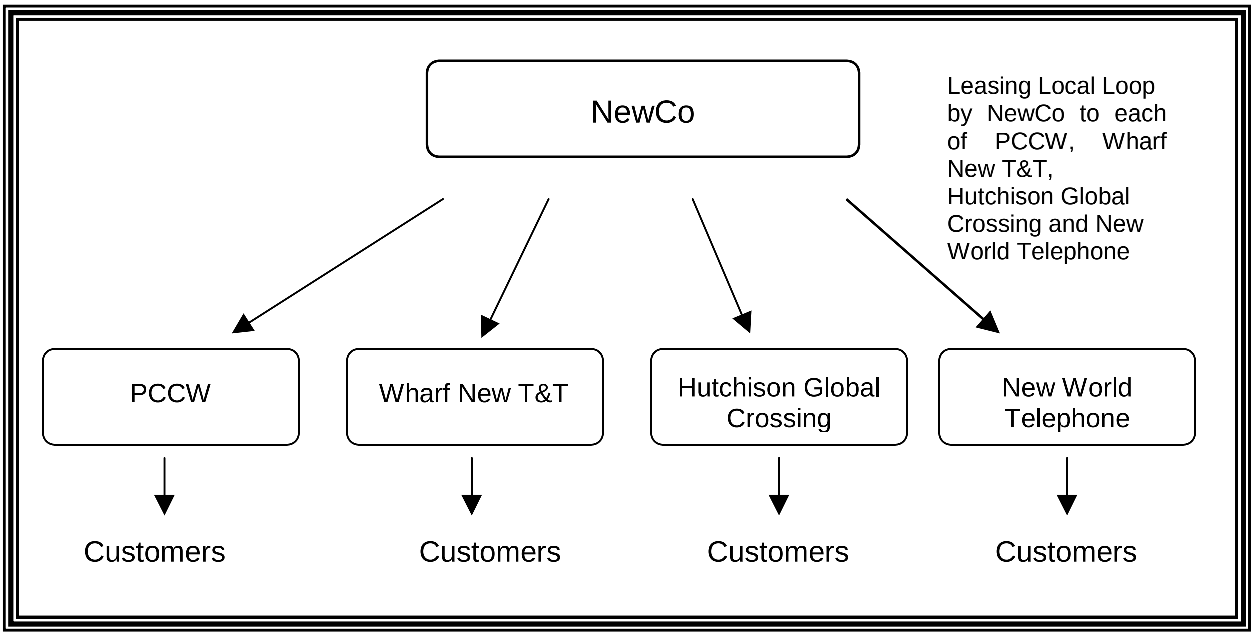
14. Under our proposed separation, PCCW would retain its retail services. PCCW would retain necessary equipment for performing number porting, for billing and metering, to enable it to provide telephony services to its customers. PCCW would divest ownership and operation of its other network infrastructure to a new company that is completely independent of PCCW in terms of ownership and control (”NewCo”).

15. The network infrastructure to be divested by PCCW to NewCo would comprise all the external plants (i.e. ducts and lead-ins), metallic plants (between exchanges and buildings), all optical and electrical transmission plant, and all in-building cables. Effectively, all physical infrastructure (wires and ducts) and related equipment from each local telephone exchange all the way to the customers’ premises.

16. The NewCo would be a licensed FTNS operator with a mandate to provide services to carriers on a non-discriminatory basis and on fair and reasonable terms and conditions. PCCW, having divested its network infrastructure, would lease infrastructure from NewCo to provide telephony services to its customers.

17. Because NewCo would be separate and distinct from PCCW in ownership and management, it would not operate and compete at the retail level. NewCo would have every incentive to improve its products and services; to promote its products and services to its customers, and to provide incentives for its customers in the form of cheaper products and services, and improved quality of products and services. In effect, its offering would be driven by market demand.

18. Following separation we believe the market structure would take the following form:



19. Our proposed separation of PCCW into 2 separate and distinct legal entities would bring about the following benefits:

- it would spur competition in the local fixed-line industry. Consumers would benefit from greater competition in the local fixed-line market and would enjoy cost savings and choices of service providers;

- it would increase efficiency in the cost of provisioning interconnection services. A firm which has every incentive to increase its revenue, will have every incentive to be very conscious of its cost and its sales;

- it would increase productivity as a firm which has every incentive to increase its revenue and would have every incentive to increase its production in order to meet the demand;

- the reduction of cost of provisioning of interconnection services would bring down the costs of goods sold to FTNS operators who acquire interconnection services. The cost saving would mean these operators could compete more effectively and this cost saving would be passed on to the consumers in the form of price reductions and a broader range of innovative products and services; and

- this would reduce instances of regulatory intervention, as markets would operate at a level closer to perfect competition. These flow-on effects would lessen resources constraints at OFTA.

20. Structural separation of PCCW would spur real competition and investment, as well as open access, which is the sort of genuine competition that the industry needs. Structural separation is an effective solution to the long-standing problem of dominance. Structural remedies are in fact widely viewed as an alternative to intrusive, complicated, case-by-case regulatory interventions. Structural separation is also a strong and potent solution to the problem of PCCW's dominance.

Thank you.
Submitted by Wharf New T&T Limited
10 June 2002