

CONSUMER COUNCIL

Submission to LegCo Panel on Information Technology and Broadcasting regarding to Implementation of the Full Liberalization of the Local Fixed Telecommunications Network Services Market from 1 January 2003

Introduction

1. The Consumer Council is pleased to provide the following submission to the Panel Committee on issues relating to full liberalization of the local fixed telecommunications networks services (FTNS) market.

2. The Council welcomes the initiative taken to liberalize the FTNS market and that the Telecommunications Authority (TA) seeking consultation on the proposed procedures for full liberalisation in 2003. In September this year, the TA issued a consultation paper reviewing interconnection and related competition issues. The Council believes that appropriate interconnection policy is essential in achieving the competitive objective of the full liberalization in FTNS markets.

3. The Council would like to offer its view on interconnection policy and convergence regulation to assist in the Government's consideration of problems in the new competitive environment.

4. Over the course of the last months the Council has also had representations from industry expressing concern regarding the state of regulation. A submission was also made to this Panel in February 2001 on a related subject. The Council's comments in this paper also reflect and amplify its stance in relation to those representations, and the submission made earlier to this Panel.

Liberalization Policy

Government objectives

5. The Council is keenly aware of the need that existed at the time of liberalisation for the particular level of intervention that was necessary to effect the desired changes to market structure. The pressure for competitive markets to arise as a result of market liberalisation demanded a level of intervention to ensure that efficient interconnection arrangements would arise, which would in turn serve the Government's main policy objectives, as stated in 1994:

- *the widest range of quality telecommunications services should be available to the community at reasonable cost;*
- *telecommunications services should be provided in the most economically efficient manner possible; and*
- *that Hong Kong should serve as the preeminent communications hub for the region now and into the next century.*

6. Further, as stated in the 1994 Position Paper, the existing carrier-to-carrier charging principles reflected the wishes of the Government "*to see the benefits of competition reach all sections of the community as rapidly as possible*" and that "*the TA will be expected to ensure that, from the consumer perspective, sensible and convenient arrangements are put in place so that consumers will be able to access freely competing services and thus exercise choice in service provision*".

7. As stated publicly, the Government expected to achieve market share figures of 50% competitive choice for fixed line services by 2002 (mentioned in the Information Paper,

Coverage of the Networks and Services of the three Wire-line Local FTNS Operators up to the End of 2002 to Legislative Council Technology and Broadcasting Panel).

Transitional measures

8. The Council understands that in order to bring about competition and viable choices in telecommunications service markets faster, it was necessary for the TA to develop interconnection charging principles to mitigate the difference in terms of relative bargaining power amongst carriers in the initial stage of fixed telecommunications market competition. In this respect, as far as the Council is concerned, the degree of intervention was a transitional measure designed to provide safeguards that would enable new entrants to grow to a position where they could match or even overcome the monopoly endowments that the incumbent brought to newly deregulated markets.

Current Market Situation

Government objectives

9. The Council has received representations that two years following the extension of the moratorium, the market share of new FTNS operators has not improved beyond a limited reach into the overall Hong Kong market. Notwithstanding the fact that claimed geographic coverage of residential areas by market participants might appear to provide coverage close to the 50% target set by Government, one FTNS operator has claimed that there is only 5% actual penetration of the market by new entrants. Another claim has been that new entrants' marketing activities concentrate on more profitable commercial users rather than those less profitable users in residential markets. The implication of this is that the regulatory regime designed to promote competition, as stated in its earlier objectives, is not producing all the desired results.

10. This raises questions as to whether a sufficient degree of competition will emerge in the near future based on a critical mass of competitive market participants, serving all telecommunications users. There is a concern that rather having a situation where competitors will negotiate efficient outcomes based on strong competitive positions, a situation will emerge where the industry is perpetually reliant on manipulating the regulatory environment, through using the TA's determinations and intervention powers, to drive commercial objectives.

Appropriate interconnect pricing

11. In addressing this situation, the Council considers that the TA must approach its task by focusing on the assumption that facilities based competition was, and still is the best way of promoting competition, and thereby meeting the objectives of the Government

12. Interconnection policy can play a key role in signalling to firms when to invest in network infrastructure bringing about long run, dynamic efficiency to the economy, thereby benefiting consumer welfare. In principle, this requires that instead of providing a static choice of "build versus buy", interconnection charges should be set at a level that on average compensates operators for efficient investment in network facilities, and encourages market participants to invest in their own networks.

13. Sufficient two-way interconnection only arises when there are separate access networks with comparable size interconnect. However, whether entry occurs on any significant scale providing wide spectrum of services will be heavily influenced by the degree to which dynamic efficiency is favoured over static efficiency, in the policy setting.

14. A high degree of competition amongst networks in the supply of access would reduce the role of the TA in determining interconnection charges. Sufficient competition in this area would also drive the interconnection charge to an efficient market determined level.

15. Accordingly, the Council considers that in reviewing the methodology by which it applies its regulatory powers, emphasis should be placed on ensuring that the Government's objective of facilities based competition for all users emerges in the near future. In particular, the Council believes that the forward-looking cost approach is more appropriate in guiding operators to focus on efficient network investment, which will facilitate competition in the future.

Measuring objectives

16. In the Council's previous submission to the LegCo Panel on Information Technology and Broadcasting regarding the extent of service coverage of telecommunications networks, it was stated that competition goals such as market share figures for new entrants, should be set as a benchmark against which the effectiveness of the interconnection arrangement would be tested. Reporting of the incremental advances of new entrants, in terms of market shares, and area coverage, at regular intervals, would provide a degree of transparency for consumers, to assure them that the regulatory regime designed to facilitate competition is working.

17. In undertaking this task, the Council stressed the need for the TA to recognise the importance of ensuring that competitive advances are made across all sectors of telecommunications users. Despite the fact that market shares are used to measure the extent of competition, geographic and user profile dimensions should also be used to reflect the overall objective of the Government.

Convergence regulation

18. The TA has raised the question of what the anticipated trend is for the PSTN being replaced by broadband or IP networks. In the course of discussions with industry the question of convergence between technologies has also arisen, and suggestions have been made that this is inevitable. Moreover, it would seem that if the Government's objectives are to be met, i.e., providing the widest range of quality telecommunications services to the community at reasonable cost, and in the most economically efficient manner possible, then all possible network infrastructure options should be made available for utilisation. This raises the issue of interconnection policy across different platforms.

19. In the consultation paper the TA has taken the view that the review of interconnection principles for FTNS/mobile and FTNS/PNETS should be handled separately. In an environment with rapid development of technology, it is necessary for the Government to adopt similar principles on interconnection policy across different platforms or different conveyance technologies, where each technology is allowed to compete on equal grounds and not to jeopardize the Government's technology neutral policy.

20. Having regard to the fact that picking a winning technology or platform is a difficult task, the Council believes that the market should be left to determine the issue rather than using differential treatment, such as different interconnection principles, in order to direct the choice of investment corresponding to different technologies.

21. In addition, another important question that arises in this context is in what form should the regulatory regime be assembled so as to enable it to both encourage and provide adequate oversight for such an all-encompassing environment.

22. There have been suggestions by industry that there is a need to move towards reliance on broad based competition law that removes the direct administrative oversight and sector specific approach taken in the current regulatory regime. By implication such

an approach would be to include all market participants, regardless of the particular sector in which they operate. For example, property, broadcasting, content supply.

23. As a matter of principle the Council has supported the introduction of general competition law administered by a general competition authority for Hong Kong since the release of its 1996 report '*Competition Policy - The Key to Hong Kong's Economic Success*'. The Council is still firm in its resolve of the need for such an approach.

24. However, certain features of network industries, because of their unique characteristics, may require the continuance of safeguards specific to the sector in which they operate. For example, the existence of bottlenecks such as the local loop, and other related infrastructure access problems for new entrants and existing market participants. Given these unique characteristics, and without some major structural changes in the FTNS market, continuation of direct administrative oversight would seem necessary, rather than mere reliance on competition law.

25. With regard to questions of allegations of anti-competitive conduct, the Council can appreciate that the dynamic nature of competition in the provision of communications related goods and services might be frustrated by a regulatory regime that is primarily geared to facilitating the development of telecommunications services, and nurturing new entrants.

26. However, the telecommunications and broadcasting sectors are extremely complex, horizontally and vertically integrated industries where competition may not be fully established in some markets. There may be scope for incumbents to engage in anti-competitive conduct because competitors in downstream markets depend on access to networks or facilities controlled by the incumbents. Furthermore, the possibility of anti-competitive cross-subsidies by incumbents from non-competitive markets to markets in which competition exists or is emerging can be a particular threat to the establishment of a competitive environment.

27. In these circumstances, the Council would be reluctant to support the diminution of sector specific safeguards for the broadcasting and telecommunications sectors unless the structural conditions that underpin competition have reached a position where the possibility to leverage market power, and thereby undermine the competitive process is equally diminished.

28. This could be brought about by the continued development of efficient facilities based competition, or by structural corporate reorganisation, whereby the incentives for one part of a company's operations to leverage market power to serve a wider corporate objective are removed.

Consumer Council
November 2001