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URGENT

20 January 2000

By fax (2121 0420)

Miss Polly Yeung
Secretary to LegCo Panel
Information Technology and Broadcasting

Dear Miss Yeung,

LegCo Panel on Information Technology and Broadcasting
Simultaneous Price Changes of Mobile Telephone Operators

Following the Panel meeting on 10 January 2000 in relation to the issue of “Simultaneous Price Changes of Mobile Telephone Operators” and having completed the investigation, a copy of the report setting out my findings is attached. Due to the urgency of this matter, the report is only available in English at this stage. I would be grateful if it could be forwarded to the panel members for their information as a matter of urgency.

I would like to point out that the report only relates to the investigation on whether the simultaneous price adjustments were in compliance with the competition conditions of the licences held by the mobile operators. As regards the issue on whether consumer interest is adequately protected in the manner in which the operators announced and implemented the price adjustments, I will continue to look, in co-operation with other appropriate bodies such as the Consumer Council, into the current state of protection of consumers in the mobile telephone industry and consider what, if anything, could be done within the powers given to me in the Telecommunication Ordinance and the applicable licences to improve any problems that might exist.

Yours sincerely,

(K S WONG)
for Director-General
of Telecommunications

c.c. SITB (Attn: Ms Gracie Foo)

**REPORT ON THE
INVESTIGATION BY THE TELECOMMUNICATIONS AUTHORITY
INTO THE SIMULTANEOUS PRICE CHANGES
OF MOBILE TELEPHONE OPERATORS**

20 January 2000

Background

On 3 January 2000, the Telecommunications Authority (“TA”) noticed that all mobile telephone services operators had simultaneously adjusted their prices the day before. Most of the adjustments made appeared to be price increases although some price reductions had apparently also been made. The TA also noticed that according to the information available the adjustments made were in most cases very similar or identical.

2. In view of the information available to the TA at the time and his knowledge of the mobile telephone market - that is to say the nature of the market and the way it has been behaving in economic terms - he became concerned about two issues:

- (a) whether the simultaneous price adjustments were in compliance with the competition conditions of the licences held by the mobile telephone operators; and
- (b) whether consumer interest was adequately protected in the manner in which the operators announced and implemented the price adjustments.

3. The current report and the findings of the TA only relate to the investigation of the first issue. In view of the findings of the TA on the competition aspects of the case and the responses of the operators, the issues in relation to the adequacy of the protection of consumers concerning the manner in which the operators announced and implemented the price adjustments became less urgent.

4. The TA has decided to proceed to announce his decision concerning the competition investigation in that he considered that delaying his announcement would have a detrimental effect on both the consumers and the industry.

5. On the issue of consumer protection, the TA will continue to look, in co-operation with other appropriate bodies such as the Consumer Council, into the current state of protection of consumers in the mobile telephone industry and will consider what, if anything, could be done within the powers given to him in the Telecommunication Ordinance and the applicable licences to resolve any problems that might exist.

Investigation

6. In view of the information available to the TA from the press, on 3 January 2000, he decided that an immediate investigation should be launched to establish whether the reports on the price changes were accurate and, if so, whether the price adjustments made were in compliance with the mobile telephone operators' licence obligations. On the same day letters were sent to all six mobile telephone licensees asking them for information.

7. Letters were sent to (in alphabetical order):

- **Cable & Wireless HKT CSL Limited** (“CWHKTCSL”)-holder of Public Radiocommunication Service (PRS) Licences number 007,012, and 060;
- **Hutchison Telephone Company Limited** (“Hutchison”) - holder of PRS Licences number 009,010 and 058;
- **Mandarin Communications Limited** trading as Sunday (“Sunday”)-holder of PRS Licence number 061;
- **New World PCS Limited** (“New World”)-holder of PRS Licence number 057;
- **Peoples Telephone Company Limited** (“Peoples”)-holder of PRS Licence number 056; and
- **SmarTone Mobile Communications Limited** (“SmarTone”)-holder of PRS Licences number 011 and 059.

8. The questions asked of the licensees were made pursuant to their respective licence condition which requires them to:

“... furnish to the Authority, in such manner and at such times as the Authority may request in writing, such information related to the business run by the licensee under this licence, including financial information, accounts and other records as the Authority may reasonably require in order to perform his functions under the Ordinance and this licence.”

9. All the licensees supplied answers to the questions of the TA. However, because in all the cases clarifications were required of the answers given and because some of the information given appeared to be in conflict with the information supplied by other licensees, the TA decided to request the attendance of each and every licensee to give oral clarifications and or additional explanations.

10. Meetings were arranged for the period 10-12 January 2000. Each licensee was represented by the Chief Executive or Managing Director of the company and was accompanied by such staff or advisors as he considered appropriate. The meetings were tape-recorded and copies of the tapes were given to each company at the end of the meeting.

11. After the meetings letters were sent again to the licensees requiring copies of documents which had been referred to during the meeting, written clarifications about certain statements made and information that was not available to them at the time of the meeting.

12. Each licensee was also invited to submit any other material that it wished the TA to take into account in considering the case.

Legal Basis of Investigation

13. The investigation was conducted pursuant to the licence conditions of the Public Radiocommunication Service Licences held by the mobile telephone operators. It focused at the first stage on the competition aspects of the case. In particular whether the price adjustments made were as a result of independent decisions made by each licensee or whether they were part of an agreement or arrangement which prevented competition in relation to the operation of the mobile telephone market.

14. The mobile telephone licensees in Hong Kong hold different types of licences; the “new” ones issued to operators using the PCS standards and the “old” ones issued to operators using other cellular radio standards.

15. The “old” licences are licences number 007, 009, 010, 011, 012 and the “new” ones are licences number 056, 057, 058, 059, 060 and 061. Both types of licence include in General Condition 9 the following provision:

“The licensee shall not enter into any agreement or arrangement whether legally enforceable or not which shall in any way prevent or restrict competition in relation to the operation of the Service or any other telecommunication service licensed by the Authority”.

16. In the case of the “new” licences, Special Condition 12 also provides that:

“(1) (a) A licensee shall not engage in any conduct which, in the opinion of the Authority, has the purpose or effect of preventing or substantially restricting competition in the operation of the Service or in any market for the provision or acquisition of a telecommunication installation, service or apparatus.

(b) Conduct which the Authority may consider has the relevant purpose or effect referred to in subparagraph (a) includes, but is not limited to-

(i) collusive agreements to fix the price for any apparatus or service;

...

(2) In particular, but without limiting the generality of the conduct referred to in subcondition (1), a licensee shall not

(a) enter into any agreement, arrangement or understanding, whether legally enforceable or not, which has or is likely to have the purpose or effect of preventing or substantially restricting competition in any market for the provision or acquisition of any telecommunication installations, services or apparatus;

...”

17. Even on the basis of the more “strict” wording of General Condition 9 it is clear that licensees are prohibited from entering into any agreements or arrangements which shall in any way prevent or restrict competition in relation to the operation of the Service. The Service being defined in each licence as a public mobile radiocommunications service using cellular communication technology within given ranges of spectrum.

18. There is no doubt, and no licensee has tried to argue, that if the TA was to be satisfied that an agreement or arrangement was found to exist between the licensees in relation to the adjustments made to the prices for consumers that such an agreement or arrangement would constitute a breach of the relevant licence condition.

19. In addition, Special Condition 12 of the “new” licences expressly states that “*collusive agreements to fix the price for any apparatus or service*” could be considered by the TA to have the purpose or effect of preventing or substantially restricting competition in the operation of the mobile telephone market.

20. Although the meaning of the word “*agreement*” does not appear to require any further elaboration the TA considers that the term “*arrangement*” could be interpreted - but not necessarily in an exhaustive form - as meaning a form of co-operation between the parties where parties “have communicated with one another in some way and that as a result of that communication each has intentionally aroused in the other an expectation that it will act in a certain way”¹.

21. The TA wishes to make it clear that every licensee not subject to price control is free to change its prices taking into account the conduct of its competitors and the prevailing situation of the market. However, any form of co-operation in determining the level and date of price changes in advance so as to eliminate or reduce the risk of competition is contrary to the competition provisions of the licence.

Overseas Experience

22. In considering the application of General Condition 9 and Special Condition 12, the TA had looked for information purposes to overseas experience on similar issues but taking into account, among other things, the differences in the market, the laws of Hong Kong and the powers available to him in carrying out this investigation. In particular, the TA was aware of the fact that most overseas experiences were based on court proceedings whereas the current investigation was over a consideration on whether a licence condition had been breached.

23. The TA was particularly interested in regard to overseas cases on:

- (a) whether the behaviour under investigation could be considered as behaviour that constitutes an agreement or arrangement which prevents or restricts competition, and
- (b) whether the evidence available to him, including circumstantial evidence, would have been adequate for a finding that the relevant conditions in the licence had been breached.

¹ Re British Basic Slag Ltd’s Agreements [1963] 2 All ER 807 at 819

24. Although other jurisdictions may use different terminology to describe similar types of behaviour, the TA has found of assistance decisions of The Commission of the European Communities (the Commission) and The Court of Justice of the European Communities (the ECJ) in relation to cases concerning possible infringements of Article 81 of the European Community Treaty (ex Article 85 of the Treaty establishing the European Economic Community) which provides among other things that “*all agreements between undertakings,...and concerted practices... which have as their object or effect the prevention, restriction or distortion of competition..., and in particular those which (a) directly or indirectly fix purchase or selling prices or any other trading conditions;...*” are prohibited.

25. It is clear from the European jurisprudence that although a licensee is entitled to determine independently its pricing policy, it is prohibited from having any “arrangement” through direct or indirect contact or communications with its competitors, the effect of which is to induce the other to act in a particular way as regards the essential elements of that action, such as the amount, subject-matter, date and place of the increase.

26. For example in the *Dyestuffs* case² the Commission found that the companies concerned were guilty of concerted practices and imposed fines. The companies claimed that the price increases merely reflected parallel behaviour in an oligopolistic market where each producer followed the price-leader, which initiated the increase. This behaviour, was argued by the companies concerned, to be quite natural in a closely-knit industry where all producers were equally affected by the continual erosion of margins.

27. In dismissing the appeal against the decision, the ECJ held that whilst parallel behaviour by itself did not constitute a concerted practice, it may, however, amount to strong evidence of such a practice if it leads to conditions of competition which do not correspond to the normal conditions of the market. The ECJ having taken into account, among other things, that there 80% of the market was supplied by about ten producers, that their cost structures and production patterns were different that the simultaneous price increases concerned the same range of products and the price changes was simultaneously introduced by all producers without any differences concerning the range of products. The ECJ went on to say

“Although a general, spontaneous increase on each of the national markets is just conceivable, these increases might be expected to differ according to the

² Decision 69/243/EEC and Case 48/69 ICI v Commission [1972].

particular characteristics of the different national markets.

Therefore, although parallel conduct in respect of prices may well have been an attractive and risk-free objective for the undertakings concerned, it is hardly conceivable that the same action could be taken spontaneously at the same time, on the same national markets and for the same range of products.”

Relevant Market

28. The TA considers that the relevant market for the purpose of this investigation is the market for mobile telephone services through the use of portable or other mobile handsets.

29. Mobile telephones offer a range of functions and facilities which are not available from fixed line telecommunications (i.e. mobility) or other forms of mobile communications (such as radio paging). Thus, these other products are not close substitutes for mobile telephones, even though to varying degrees they compete with aspects of the service provided by it. The TA therefore considers it appropriate to view the mobile telephone market as a distinct market.

Competition in the Mobile Telephone Market

30. Competition at the network level is limited to six players because lack of available spectrum means that no further mobile licences will be granted ahead of the third generation mobile services. There is therefore a barrier to any further market entry at the present time.

31. In such an oligopolistic market, whether a high degree of competition could be sustained in the market or not could vary considerably depending on a number of factors. Looking at some of these factors below it indicates that although competition is viable collusion is equally viable.

32. The facts that:

- (a) the licensees are selling a product that cannot be differentiated, other than that on brand, even though there may be some differences in coverage, quality of service and brand image. However a call minute made on one operator's network is very similar to a call minute made over a competing network;

- (b) prices are made public, although some secret discounting for large corporate customers may occur;
- (c) demand is growing rapidly; and
- (d) there was strong evidence of competition in the past,

are encouraging signs. However, barriers to entry are very significant, in particular because of limitations on spectrum availability. Although these factors tend to show that competition is more likely, it does not preclude some kind of concerted price in such an oligopolistic market to be both viable and profitable for those taking part in that a concerted increase in the prices will not create a threat of new competition. In addition to the barrier of entry in place, any concerted behaviour is more viable when the market became more mature and operators have established a steady market share after fierce competition brought about by number portability introduced in March 1999.

Evidence

33. It is inherent in cases of this nature that the evidence on which the decision of the TA is based is to a great extent circumstantial. Each piece of evidence looked in isolation may not raise any grounds for concern or may appear to explain and substantiate what each company has claimed to be correct. Some facts can only be proved by logical deduction from other proven facts.

34. However, it is only when one looks at all the facts together with the surrounding circumstances that like a jigsaw puzzle one can see the full picture. One also needs to keep in mind that unlike other competition or sectoral regulators the powers of the TA are far more limited. For example, he has no power to enter the premises of a licensee and search for documents, computer files etc., nor could he ask for sworn statements to be made or order discovery or all relevant documents. Therefore, in a number of the European cases, the most important body of the Commission's evidence was based on written accounts, including notes and records of meetings found on the operators' premises. Thus, in considering overseas authorities one should bear in mind the differences that can result in the amount and type of evidence that would be available to them in a case.

35. The evidence, of which a very brief summary is set out below aims to show the overall picture that was available to the TA at the end of the investigation and why his findings led him to the conclusions he has reached.

A. Price Adjustments

36. Licensees were asked about the actual details of the adjustments made to their tariffs. Each licensee produced the relevant information.

37. The TA found that nearly all the adjustments were the same - even those that were said to have been calculated independently by each operator based on their own analysis.

38. All increases were by \$20 with the exception of CWHKTCSL that its only increase was for one package by \$10 and Hutchison's for its CDMA packages by the same amount. However, all decreases were by \$50 apart from some isolated instances.

B. Timing of Decisions Taken Internally:

39. Each company was asked about the first time that the price adjustment was discussed and the date at which the decision was taken to adjust the prices at the levels announced on 2 January 2000. The six operators claimed that they had made the decision or had considered increasing prices during the November to December 1999 period. However, the TA was informed that in most cases there was no record for the first time that the price change was discussed. Even where evidence was produced in some cases, this was in relation to price adjustments based on figures different than the ones by which the adjustments were actually made.

40. In most cases, crucial documentary evidence to prove dates on which important discussions or decisions were made was stated that it did not exist.

C. Timing of Announcement of Changes:

41. The timing of the changes was exactly the same - starting in the morning of the 2 January 2000.

42. The TA was not satisfied that it was a coincidence that each licensee came to adjust its prices on the 2 January 2000 or that this was parallel behaviour in an oligopolistic market. There was not a single licensee that had decided to implement its price changes earlier or later than the 2 January 2000 even though some stated that the adjustments were planned for some time. Also, there appears to have been no

licensee wishing to take advantage of the increases of the other operators so as to expand its market share.

43. Each licensee was asked when did they make the details of the changes of the tariffs known to their staff and outside dealers.

44. All licensees stated that their figures had not been made public until the 2 January but had released them to dealers and internal staff during the period 15-30 December 1999. In some cases Q&A material for staff handed out on the 30 December 1999 already included a Q&A on whether the “simultaneous tariff increases” was a collusive arrangement.

D. Basis of Level of Changes:

45. On being asked about the basis upon which the level of the adjustment was calculated, the TA found that financial models prepared by some of them only days before the adjustment made no reference to the figures finally used by them. Also in some cases where licensees stated that they were planning independent increases their calculations showed a positive churn and a positive intake of new customers.

46. No licensee was able to provide the TA with a proper detailed basis for the calculations for the adjustments.

E. Information about Others' Changes:

47. Each company was also asked how and when did they find out about the changes that the other operators were effecting in that from the initial material submitted it was obvious that a number of them had advance knowledge of the others' exact tariffs that were to be announced on 2 January 2000.

48. Four companies stated that they had initially heard rumours about the price changes by late December. Three of them submitted that on 30 December 1999 they had accurate details of the changes that the others were implementing where two stated that they only found out about them after the public announcements were made.

49. No licensee was surprised that information about its prices were leaked in the market even though they stated that pricing information was treated as confidential within their companies.

F. Meetings of CEOs or Senior Management:

50. The TA was told that the CEO's of the licensees had been meeting to discuss issues that were of common concern to the industry. The companies on being asked about the meetings accepted that over the period November to December 1999 there were two or three meetings, which were attended by CEOs or other senior staff from the companies.

51. On at least one of the meetings, the issue of passing the licence fee to customers was discussed. No notes were kept of these meetings.

Considerations of the TA

52. The TA on being *satisfied that*:

- between the six licensees there have been contacts, exchanges or “soundings out” at the level of the Chief Executive Officers or Managing Directors of the respective licensees;
- during these contacts discussions had taken place relating to state of the market, which could remove in advance uncertainty as to the future behaviour of the others; and

and taking into account

- the nature of the market;
- that all the price changes have taken place on the same date;
- that the price changes whether increases or decreases were the same or very similar, in particular the most substantial change of an increase in monthly subscription of \$20 were exactly the same for 5 operators;
- that in nearly all cases they have admitted that they knew a few days before any formal announcement by their competitors of price changes that the others would effect;

- that on many crucial questions no satisfactory answers could be given or documentary evidence produced to substantiate oral statements;

he has formed the opinion that on the evidence available to him at the very least some kind of understanding must have existed which led to the simultaneous price adjustments that have taken place on 2 January 2000. This is tantamount to an “arrangement” as stipulated under General Condition 9 and Special Condition 12 of the PRS licence.

53. The TA was also satisfied that every mobile telephone licensee was party to such an “arrangement” although some were involved to a lesser extent than others. As among them they control 100% of the market for mobile telephones, he has also formed the opinion that this arrangement prevented or restricted competition in relation in the mobile telephone market.

54. On the evidence and for the reasons set out above the TA was satisfied that all six licensees had to a certain extent an agreement or participated in an arrangement, whether legally enforceable or not, which prevented or restricted competition in the operation of the mobile telephone service and that the agreement or arrangement was in breach of General Condition 9 of their respective licences. He also considered that there would be no need in complicating the present analysis by further referring to Special Condition 12 of the “new” licences even though he was also satisfied that an agreement or arrangement such as the one he has found to exist would constitute conduct which had the purpose or effect of preventing or substantially restricting competition.

Decision - Outcome

55. In view of his findings and conclusions the TA wrote to all licensees on 15 January 2000 attaching a copy of the draft report. In his letter he explained that on the basis of the information available to him he was minded to issue a direction and invited them to make representations why he should not do so.

56. The contents of the proposed direction were:

- a. licensees are to terminate with immediate effect the breach to refrain from entering into any agreement or arrangement with any other holder of a PRS

licence, whether legally enforceable or not, which shall in any way prevent or restrict competition on the basis of which the price adjustments of the 2 January 2000 have taken place;

b. In relation to customers that have been subscribers to the Service on or before 1 January 2000 not put into effect the price adjustments it announced on 2 January 2000;

c. In relation to customers that became subscribers to the Service on or after 2 January 2000 and up to the date of this report to charge the customer the monthly rental and usage charge applicable to that package prior to the price adjustment on 2 January 2000.

57. In their representations to the TA, all the operators have agreed to rescind the price adjustments made on 2 January 2000 and to revert back to the pre-January prices for both new and existing customers and or give the customers the option to choose from any new plans that may be available to them.

58. In view of the prompt decision of all the licensees to cancel the 2 January 2000 price adjustments, the TA decided that there would be no need for him to proceed to issuing a direction. He has however written to all of them warning them that in the future they should ensure that they comply with their licence obligations and that they should have adequate compliance systems to ensure that their actions are within what is permitted by their licence.

Telecommunications Authority

20 January 2000.