

**Guidelines to Assist Licensees to Comply with
the Competition Provisions
under the Telecommunications Ordinance**

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1. INTRODUCTION

Purpose of the Guidelines

- 1.1 These guidelines (the “Guidelines”) are published by the Telecommunications Authority (the “TA”) under section 6D(1) of the Telecommunications Ordinance (Cap. 106) (the “Ordinance”). Their purpose is to assist licensees to comply with their obligations under the Ordinance in relation to **Section 7K : Anti-competitive practices, Section 7L : Abuse of a dominant position** and **Section 7N : Non-discrimination** (the “competition provisions”).
- 1.2 The Guidelines provide a general explanation of how the TA is likely to interpret and apply the competition provisions. The Guidelines also provide an account of how the TA is likely to exercise his related powers and functions.
- 1.3 However, nothing in the Guidelines would pre-empt the TA’s subsequent consideration of particular events on their merits. If any licensee has concerns or questions arising from the contents of the Guidelines or the competition provisions in the Ordinance, they should seek professional advice.
- 1.4 The Guidelines outline the TA’s standing policies and procedures in relation to the competition provisions as in December 2010 and replace the related guidelines he has issued concerning the competition obligations of licensees either under their licences or under the competition provisions, including the “Guidelines to assist the interpretation and application of the competition provisions of the FTNS licence” issued in June 1995. The TA is not bound by the specific terms of the Guidelines in every eventuality, but a material departure from them would be accompanied by reasons he would provide in writing¹. The Guidelines themselves will be reviewed and updated from time to time in consultation with the industry, as the circumstances require.

¹ Section 6A(3)(b)(ii) of the Ordinance.

Role of the Competition Provisions

- 1.5 The statutory prohibitions in sections 7K, 7L and 7N of the Ordinance concerning conduct which damages competition are an integral part of the Government's policy for the deregulation and opening up of the telecommunications industry to market forces.
- 1.6 Under this policy, allocative efficiency, productive efficiency and dynamic efficiency in the provision of telecommunications services to the public are no longer economic outcomes within the realm of direct supervision by the Government. Instead, they are to be resolved by those who have chosen to enter the business of providing such services, in competing strongly with each other for the patronage of Hong Kong businesses and consumers.
- 1.7 The competition provisions seek to ensure that this market-driven approach will create a level playing field such that big and small players in the market will compete on the basis of efficiency, thereby enabling consumers to benefit in terms of lower prices, higher output, service quality and innovation levels.
- 1.8 In particular the competition provisions, in conjunction with section 7P of the Ordinance which regulates mergers and acquisitions, aim to prevent the abuse of market power and other conduct that prevents or substantially restricts competition in the telecommunications market².
- 1.9 Market power of that kind comes about when a firm, or a number of firms acting in concert, have the ability to produce and price their products without effective constraint from any other firms or the buying public.

Application of the Competition Provisions

- 1.10 Persons who are "licensee(s)" within the meaning of section 2(1) of the Ordinance are subject to legal sanction in respect of the competition provisions.

² Under section 2(1) of the Ordinance, "*telecommunications market*" means any market for the provision or acquisition of telecommunications networks, telecommunications systems, telecommunications installations, or customer equipment or services.

- 1.11 The competition provisions are capable of application in respect of all aspects of business “conduct”, which include acts of commission and acts of omission.

General Effect of the Competition Provisions

- 1.12 The general effect of the competition provisions is, firstly, to require every licensee to determine, without prejudice to legitimate business conduct such as that discussed in Section 3 of the Guidelines, the services that it provides, how it provides them and at what prices it provides them in a way that does not involve co-ordination with its rivals. Secondly, any licensee that has a dominant position is under a special duty not to act to inhibit the competitive activities of other licensees and potential entrants or to behave exploitatively towards customers/consumers.
- 1.13 The competition provisions seek to ensure that consumer welfare will be protected and enhanced through effective competition. If the market is sufficiently competitive, consumer welfare will be safeguarded. It is generally recognised that the retail telecommunications markets in Hong Kong are among the most competitive in the world, and that effective competition is likely to maximise consumer welfare. There may however be certain segments of the telecommunications markets where competition may be less than effective or where there is evidence of anti-competitive conduct. In such cases, the TA may intervene under the competition provisions or other relevant provisions of the Ordinance.
- 1.14 Even though conduct by licensees can contravene more than one of the competition provisions at the same time, usually the primary impact will be under either **section 7K** or **section 7L** of the Ordinance, and the TA will examine the conduct in its market and economic context and is likely to apply whichever of the two sections that is most relevant to the particular circumstances.
- 1.15 For example, if a new market entrant is being offered worse terms for network access service than others, and there is a suspicion of collusion among the established operators, then the discrimination issue is likely to be pursued under section 7K of the Ordinance. On

the other hand, if in an access agreement there are discriminatory terms imposed by a single licensee, and it appears that the concerned licensee is in a dominant position in a relevant market, then the matter is likely to be investigated as a possible abuse of a dominant position under section 7L of the Ordinance.

- 1.16 Section 7N of the Ordinance deals with certain discriminatory conduct. Generally, however, conduct which is in contravention of this section will have first contravened one or other of the prohibitions under section 7K and section 7L. It is therefore likely that allegations concerning discriminatory prices or contract terms will be pursued under one or other of these two sections. In a case where the discriminatory conduct is found to have contravened neither section 7K nor section 7L, but has the purpose or effect of preventing or substantially restricting competition, it will be dealt with under section 7N.

Prohibited Conduct

- 1.17 Any conduct which has “*the purpose or effect of preventing or substantially restricting competition in a telecommunications market*” is prohibited by section 7K of the Ordinance.
- 1.18 Section 7K targets mostly collusive arrangements among licensees, such as an agreement to fix market prices. The TA may also take action under section 7K against a non-dominant licensee acting unilaterally in the event that it has significant market power though not to the extent of dominance or a non-dominant licensee acting in collusion with a non-licensee where the conduct may have the purpose or effect of preventing or substantially restricting competition.
- 1.19 Section 7L of the Ordinance applies only to a licensee which is in a dominant position. The section does not prohibit a licensee from having a dominant position, but it does prohibit the licensee from abusing its dominance to inhibit the competitive activities of other licensees and potential entrants, or to behave exploitatively towards customers/consumers.

- 1.20 Conduct by a dominant licensee that prevents or substantially restricts competition is deemed to be an abuse. The kinds of conduct which may constitute an abuse of a dominant position are considered in Section 3 of the Guidelines, and the concept of a dominant position is considered in Section 4.

Mergers and Acquisitions

- 1.21 Generally, mergers and acquisitions involving carrier licensees will be wholly dealt with under section 7P of the Ordinance, which provides for *ex ante* consideration of “changes in relation to carrier licensees” on competition grounds. Section 7P aims to ensure that collusion by way of mergers and acquisitions, which have the effect of substantially lessening competition in a telecommunications market, will be effectively dealt with.
- 1.22 Nevertheless, it should be noted that agreements and arrangements involving licensees which are ancillary to or which implement mergers and acquisitions remain subject to *ex post* scrutiny under section 7K, in the absence of a formal consent from the TA under section 7P(7).
- 1.23 The TA has issued separate guidelines in relation to the regulation of mergers and acquisitions and these are available on the website of the Office of the Telecommunications Authority (OFTA) at :
http://www.ofa.gov.hk/en/c_bd/guidelines.html.

Burden and Standard of Proof

- 1.24 The burden of proving that there is a contravention of the competition provisions rests with the TA. As contravention of any of sections 7K, 7L, or 7N of the Ordinance is not a criminal matter, the applicable evidentiary standard of proof is the civil standard, i.e. “the balance of probabilities”. This means that the TA will decide, on the basis of the evidence available, whether it is more likely than not that the conduct in question constitutes a contravention of the competition provisions.
- 1.25 A complainant alleging a contravention by a licensee must, as per the request of the TA, provide information and evidence in support of his allegation for the TA’s consideration. If a complaint is accepted for a

formal investigation and the TA has adduced evidence in support of a finding of contravention by the accused licensee, it is for that licensee to provide evidence in support of his claim of no contravention. The TA will consider any such claims and verify them to the extent possible before making a final judgement on whether a contravention has occurred.

2 HOW THE COMPETITION TEST WORKS

2.1 The statutory test that the TA is required to apply when assessing a licensee's liability under any of the competition provisions is whether the licensee's conduct has the **purpose or effect of preventing or substantially restricting competition** in a **telecommunications market**. Each of these elements is explained below.

Purpose or Effect

2.2 Because the same liability can arise from the purpose of conduct as well as the effect of the conduct, licensees are equally at risk of contravening the competition provisions, whether or not their conduct actually succeeds in modifying existing or anticipated levels of competition. The Ordinance makes clear that if a licensee has the "purpose" of performing some anti-competitive conduct then the TA can intervene at the stage of the formulation of the purpose, and need not wait until harm actually occurs to the marketplace. Equally, even in cases where harm has actually occurred to the marketplace, the TA might condition liability upon one or both of the "purpose" and "effect".

2.3 The test whether the conduct of a licensee has a particular "**purpose**" involves an objective consideration of the nature of the conduct in its market setting, and does not require establishing the *mens rea* or "guilty mind" of the licensee concerned. Where the purpose of the conduct by a licensee is at issue independent of its actual effect, it will not be relevant that the licensee did not intend for a competition constraint to result from that conduct. Nor will it be relevant to the question of liability that the conduct did not actually result in any adverse effect. The TA, nevertheless, will take into account other

potentially legitimate purposes of conduct in order not to stifle otherwise pro-competitive purposes. However, if the anti-competitive purpose of the conduct turns out to be a substantial one among a number of other purposes, it will be regarded as a contravention.

- 2.4 An unlawful purpose can nevertheless also be attributed to particular conduct by evidence that in fact the licensees concerned had the “guilty mind” of inhibiting competition. In the situation where the purpose of the conduct in question is unclear, the TA will look at the effect of the conduct in order to reach an opinion as to whether any of the competition provisions have been contravened.
- 2.5 The “**effect**” which the conduct has on the overall competitive process will be inferred by the TA from salient facts concerning the market entry conditions and other aspects of market structure. The TA may also examine the counterfactual, i.e., what the position would have been in the absence of the conduct in question. It should, however, be noted that the competition provisions are concerned with protecting the process of competition in the telecommunications markets and not the individual licensees or any established business models.

Preventing or Substantially Restricting Competition

- 2.6 In assessing whether the conduct of a licensee has the effect of preventing or substantially restricting competition, the TA will find an adverse effect only where there is clear evidence that the conduct will have a net adverse impact on the competitive process or customers/consumers. He will not take action that could inhibit healthy, robust competition among licensees that leads to lower prices, better services or other benefits to consumers.
- 2.7 Generally the TA will regard competition among licensees as being “**prevented**” when there is a foreclosure of an actual or potential service from another source, whether or not that source is a fully equivalent substitute, and whether or not the prevention is permanent.
- 2.8 In the situation where the foreclosure of an alternative source of supply is not absolute, but the constraint in terms of impact on existing competitors and entry by potential competitors is nevertheless one that

is not immaterial, the TA may still regard it as “**substantially restricting**” competition.

- 2.9 Overall, the concept of a prevention or substantial restriction of competition is a relative one. The TA’s approach is that the injury to competition needs to be of such a magnitude, character and of such importance that it is worthy of consideration under the Ordinance and from the public interest angle. That in turn requires an understanding of the market and the nature of competition in it.
- 2.10 Competition is a process which concerns the dynamics of how potential buyers and sellers interact. It includes the specifics of how different telecommunications services are provided and purchased; the circumstances in which certain services, technologies, and operators may or may not displace other services, technologies and operators, especially from the perspective of the buyers of services; and how licensees are able to distinguish themselves and their products in the marketplace as well as the channels they can use to distribute those products.
- 2.11 The TA would not intervene unless he is satisfied that there is a likelihood that the conduct of a licensee could lead to injury to the competitive process or be harmful to customers/consumers, with the consequence that there could be an increase in market prices, a reduction in service output or quality, or a loss of innovation.
- 2.12 Examples of the TA’s approach to the identification of the competitive process and competition injury can be found in the previously published competition decisions (the “CDN” numbered series documents, obtainable on OFTA website at : http://www.ofta.gov.hk/en/c_bd/completed-cases/main.html).

Telecommunications Market

- 2.13 The competition provisions are concerned only with adverse impacts in the telecommunications sector. However, telecommunications services in Hong Kong are now often provided by licensees in conjunction with other services such as pay-TV and other content provision. Accordingly, it is possible that a licensee’s conduct in

relation to non-telecommunications sectors can nevertheless impact on competition in respect of the telecommunications sector, and thus gives rise to a liability under the competition provisions.

- 2.14 Similarly, conduct which occurs in relation to one telecommunications market can adversely impact on competition in another telecommunications market.
- 2.15 A special characteristic of the telecommunications market is that the conduct of sellers in an upstream wholesale market may also affect competition in a downstream retail market. Under certain circumstances anti-competitive practices in a wholesale market, such as the provision of interconnection services, may be even more detrimental to consumer welfare than those in the retail market, as choices are usually more widely available for retail telecommunications services. The TA is therefore concerned about anti-competitive conduct in both the wholesale and retail telecommunications markets.
- 2.16 The TA's approach to determining the parameters of the relevant market in the context of considering possible competition injury or abuse of market dominance is outlined in Section 4 of the Guidelines.

3 CONDUCT WHICH DAMAGES COMPETITION

Collusion among Licensees

- 3.1 The TA regards section 7K of the Ordinance as imposing a general obligation on licensees to act independently, and while subsection 2 specifically identifies the kinds of unlawful coordination among competitors which are most at risk, the list is not exhaustive in terms of the collusive conduct that is capable of contravening section 7K. Section 7K, however, does not prohibit licensees from taking individual action in response to the actual or anticipated conduct of their competitors.
- 3.2 Importantly, subsection 3(a) applies the prohibitions to arrangements and understandings as well as "agreements". An "**arrangement or**

“understanding” is something less formal than a written or oral **“agreement”**, whether or not they are legally enforceable. It is any sort of communication between two or more parties which results in each party expecting the other to act in a particular way. Arrangements and understandings apply to any communications which result in a meeting of minds to behave in a way that has the purpose or effect of preventing or substantially restricting competition in a telecommunications market.

3.3 The TA does not believe that there is a legal or formal distinction between the concepts of “agreements”, “arrangements” and “understandings”, and will not in practice attempt to distinguish among them. Conduct of a licensee that is attributable to an agreement, arrangement or understanding is to be distinguished from its unilateral conduct. The TA will act against agreements, arrangements and understandings which have a general objective to prevent or substantially restrict competition in a telecommunications market, not just those which are made in specific terms.

3.4 Section 7K, however, does not cover agreements that result in mergers and acquisitions of carrier licensees. As elaborated in paragraphs 1.21-1.23 above, they are regulated by section 7P of the Ordinance in terms of “changes in relation to carrier licensees”. However, section 7P applies only to the merger transaction itself and the competition provisions under sections 7K, 7L and 7N of the Ordinance remain in force and licensees remain obliged to comply with the competition provisions.

Price Fixing

3.5 Price fixing among licensees is normally considered to be harmful to the competitive process in the telecommunications markets because, in the opinion of the TA, the purpose of such conduct is to prevent or substantially restrict competition.

3.6 Any arrangements among licensees which directly or indirectly fix the prices for services or products sold by those licensees, or those

acquired by them, may be regarded by the TA as having the purpose of preventing or substantially restricting competition³.

3.7 In relation to telecommunications services, price fixing does not necessarily refer to agreements, arrangements and understandings that directly fix prices to be imposed on the customers/consumers. It also covers situations in which prices are indirectly fixed, for example companies agreeing the recovery of certain cost components in prices; agreeing the elements of the service to be charged for or to be included in product offerings; setting percentage or monetary margins of profit; agreeing to increase prevailing prices and the timing thereof; setting minimum prices or a price range; agreeing the amount of or incidence of discounts, rebates or the value and character of promotional benefits; or regulating the distribution channels for particular service offerings or the mode and extent of product marketing.

3.8 As a real-life example, on the morning of 2 January 2000, all six mobile network operators implemented substantially similar adjustments to their respective tariffs for mobile phone subscription services. Financial modelling of prices prepared by individual companies just before the increases and produced to the TA subsequently bore no resemblance to the pricing actually implemented. The TA accepted the operators' prompt return to their previous prices and the adjustment of payments by the affected customers. If this had happened only a few months later, after the competition provisions had been introduced into the Ordinance, the mobile network operators would likely have been found to be engaged in illegal price fixing and hence in contravention of section 7K(2)(a) of the Ordinance.

Preventing or Restricting Supply to Competitors

3.9 Coordinated exclusionary conduct can also damage competition in the telecommunications markets. Action by licensees who are direct competitors which restricts the basis on which those licensees can (or cannot) deal with other licensees may be regarded by the TA as

³ Commercial agreements between licensees in regard to interconnection charges and charges for the use of other network facilities, nevertheless, would not in general be regarded as "price fixing" and constrained by section 7K(2)(a).

conduct which has the purpose of preventing or substantially restricting competition.

Market Sharing

- 3.10 Agreements, arrangements and understandings that pertain to market sharing may be regarded by the TA as having the purpose or effect of preventing or substantially restricting competition regardless of their actual impact on market prices.
- 3.11 These could include any arrangements about the geographic coverage of networks; about the kinds of customers or business each of the licensees will pursue; and about the kinds of services licensees will offer or the kinds of technologies to be deployed.
- 3.12 On the other hand, arrangements that involve licensees sharing facilities because of economic efficiency considerations (such as cost saving or the development of innovative services, or addressing the problem of genuine technical constraints due to a lack of physical space or aesthetic consideration) are not generally to be regarded as “market sharing” in the sense of paragraphs 3.10 and 3.11 and would not be condemned under section 7K of the Ordinance. A common example in the specific environment of Hong Kong is the provision of mobile service coverage inside the underground railway stations and tunnels as well as shopping malls. However, in other cases which are less clear, the TA will examine the arrangements to ensure that they would not result in a prevention or substantial restriction of competition.

Unilateral Anti-competitive Conduct of a Market Dominant Licensee

- 3.13 The TA will not normally seek to enforce any of the provisions of section 7K of the Ordinance against the unilateral conduct of an individual licensee. This is because unilateral conduct is unlikely to prevent or substantially restrict competition in any telecommunications market unless the licensee concerned is in a dominant position. However, as pointed out in paragraph 1.18 above, the TA may sometimes find it necessary to take action under section 7K against a

non-dominant licensee acting unilaterally in the event that it has significant market power though not to the extent of dominance or a non-dominant licensee acting in collusion with a non-licensee where the conduct may have the purpose or effect of preventing or substantially restricting competition.

- 3.14 In cases where the licensee concerned is in a dominant position, the TA is more likely to pursue the matter as a case of abuse of a dominant position under section 7L of the Ordinance.

Abusive Conduct

- 3.15 Section 7L of the Ordinance prohibits a licensee in a dominant position in a telecommunications market from abusing that position. The section however does not prohibit a licensee from having a dominant position nor does it prohibit any licensee from seeking such a position. How the TA will ascertain whether a licensee is in a dominant position is discussed in Section 4 of the Guidelines.

- 3.16 In terms of section 7L(4), a market dominant licensee is deemed to have abused its position if it has engaged in conduct which has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. However, the scope of section 7L(1) is not limited by section 7L(4) and other provisions under that section. Section 7L should be construed as a whole having regard to the object and purpose of the competition provisions to prohibit both exclusionary and exploitative abuse. An abuse can be exploitative without being exclusionary, that is to say, customers/consumers can be harmed without there being any harm to the process of competition. Excessive pricing is probably the most common form of exploitative abuse and it can be dealt with under section 7L.

- 3.17 The meanings which the TA attaches to the concepts of conduct having the “**purpose or effect**” of “**preventing or substantially restricting competition**” in a “**telecommunications market**” are discussed at paragraphs 2.2 to 2.16 above.

- 3.18 Section 7L(5) lists particular conduct of a dominant licensee which the TA may consider as having the purpose or effect of preventing or

substantially restricting competition. The list, however, is not exhaustive, and the TA will also examine whether other types of conduct not listed in section 7L(5) may amount to an abuse.

- 3.19 With reference to section 7L(5), the TA considers the following to be the main considerations to which licensees need to pay special attention in so far as potential abuse of dominance is concerned.

Predatory Pricing

- 3.20 As part of the competitive process, firms compete for business by reducing prices. In general, the TA welcomes vigorous price competition among licensees, which is seen as delivering benefits to consumers. However, there may be circumstances under which substantial price cuts by a licensee in a dominant position might be seen as a predatory strategy intended to eliminate or discipline competitors in the market. Such conduct, which is specifically listed as an example of abuse in section 7L(5)(a) of the Ordinance, will be closely examined by the TA to determine its lawfulness.

- 3.21 Where a licensee is in a dominant position and there is a suggestion that it may be charging predatory prices, the TA will begin his analysis by examining the relevant costs for the service in question.

- 3.22 In every case the TA will consider what the appropriate measure of cost is. In general, the TA will ask the licensee to provide information about the average variable cost (AVC) and the long run average incremental cost (LRAIC) of the service in question⁴. AVC is considered as the minimum amount of cost that a licensee should recover from the sale of each unit of service under the alleged predatory pricing conduct. If the price of a service does not cover

⁴ Variable costs are costs that vary directly with the volume of output and do not include any element of fixed costs which do not vary with output volume. Average variable cost is obtained by dividing the total variable cost by the units of output. Long run incremental costs include all costs (fixed or variable) attributable to the production of a defined increment of output. In particular, they include attributable fixed costs incurred before a firm has engaged in the alleged predatory conduct, and the fixed costs incurred specifically for engaging in such conduct, if any. Long run average incremental cost is obtained by dividing the total long run incremental cost by the units of output within the relevant increment.

even the AVC, the selling of each unit would entail a loss and the TA would presume that the price is likely to be predatory.

3.23 However, since telecommunications networks are characterised by high fixed cost and low variable cost, pricing above AVC alone would most likely not be sufficient to show that such pricing is not predatory. Therefore, the TA will also make reference to the LRAIC of producing the service, which is higher than AVC by the amount of fixed cost. Pricing above AVC but below LRAIC may be regarded as predatory, as the price charged by a dominant licensee that does not contribute to the recovery of all fixed costs attributable to providing the service in question may imply that an equally efficient competitor would be unable to compete effectively in or be foreclosed from the market. However, the requirement on recovery of all fixed costs may be too stringent, as a licensee who carries on production when only part of the fixed costs is covered is in fact reducing its loss in the short run. Thus pricing above AVC but below LRAIC would require detailed analysis of the intent of the concerned licensee and other relevant factors in determining whether it is predatory.

3.24 In view of the benefits of lower prices to consumers, the TA is keenly aware of the need not to deter a dominant licensee from competing on price for fear that it may be found to be an abuse of a dominant position. Thus before condemning a dominant licensee selling below cost as engaged in predatory conduct, the TA will carefully examine whether there would be justifiable reasons for that. Depending on the circumstances, this could include introductory pricing for new services or temporary promotional pricing. On the other hand, the TA will be cautious to consider also, where necessary, the possible effect of the alleged predatory pricing conduct on the dynamics of competition. If a dominant licensee, by selling below cost, constrains the output of its competitors and thereby strengthens further its dominant position or lessens its incentive to innovate due to reduced competition, this may be considered evidence that the pricing could be predatory.

3.25 In the circumstances that the loss due to the alleged predatory price can be recouped in the reasonably foreseeable future, because of the market structure which would prevail after the elimination or weakening of competitors, the TA would likely conclude that the effect

of the low pricing is predatory and that the pricing is an abuse of a dominant position. While recoupment is one of the means for checking whether a price is predatory, the fact that there is no evidence of recoupment or the feasibility of recoupment does not necessarily imply that a price is not predatory. This is because unexpected changes in the market may have rendered recoupment infeasible. With continuous and rapid technological advancement, price reductions tend to feature more prominently in the telecommunications market than price increases. Against this background, recoupment may be difficult to be substantiated if it appears in the form of a smaller or slower decline in prices.

Price Discrimination

3.26 Price discrimination in itself should not be harmful to the competitive process or to consumers. It can in fact contribute to increased consumer welfare in terms of allocative efficiency, as the level of output is normally higher than that under uniform pricing. The TA will examine price discrimination only in circumstances where it is plausible that it may have the purpose or effect of preventing or substantially restricting competition.

3.27 The result that one user of a telecommunications services enjoys a lower price or otherwise gets more benefits than the user next door, who is nonetheless using exactly the same service, is an inherent outcome of the process whereby rival licensees compete for business over time.

Refusal to Deal

3.28 Modern communications require licensees to enter into a host of agreements with other telecommunications companies and, in the case of carrier licensees, there are a variety of reciprocal agreements with direct competitors, including agreements relating to what happens when customers decide to change their service provider.

3.29 In the telecommunications market, a licensee's refusal to deal, whether outright or by virtue of behaviour or terms imposed, can adversely affect the competitive process at the customer level. This is because

some established facilities or services can have the character of “essential facilities” or are “bottlenecks”, and new entrants or competitors must have access to them or interface with them in some way before customer services can be provided. The licensee which owns such bottleneck facilities may have a dominant position in relation to them.

- 3.30 Where a finding is reached that a licensee has a dominant market position by virtue of its ownership of the relevant facilities or services, the TA is likely to conclude that a refusal to allow access to them amounts to an abuse where it could have the purpose or effect of preventing or substantially restricting competition, if the licensee fails to satisfactorily substantiate its rationale for its conduct. For example, in the case of a claim that there have been delays due to a lack of capacity, it would need to be substantiated by the relevant technical data.

Bundling

- 3.31 Competition among telecommunications licensees in Hong Kong is presently characterised by a significant amount of product “bundling”, where traditional fixed line phone services, internet protocol telephony, internet access, mobile phone, and pay TV etc. can be offered in various combinations as individual product sets or “bundles” to business or residential customers.
- 3.32 The TA recognises that where a supplier of goods or services has a dominant position in respect of one product, its “bundling” of that product with other products can sometimes give rise to concern that it is abusing its dominant position. However, given the potential for cost saving and innovation associated with product bundling, the TA will generally apply a cautious approach when assessing whether bundling is anti-competitive. The TA will look into the special situation of individual cases and take into account all the relevant factors to ascertain whether there would be anti-competitive concern. He will consider in particular whether an equally efficient competitor would be able to compete for business or whether consumer welfare would be harmed.

4 MARKETS AND MARKET DOMINANCE

General Principles

- 4.1 Competition takes place in markets and the competition provisions are directed at outcomes in the telecommunications markets. So when considering whether a licensee's conduct has damaged, or is likely to damage, the competitive process by causing prices to rise or service output, quality or innovation to be adversely affected, it will be necessary for the TA to first identify the relevant telecommunications market that is involved.
- 4.2 The TA will adopt a description of the relevant telecommunications market which, at the time enquiries are being made, best assists a thorough analysis of the conduct which is under scrutiny. This means that the TA will treat market definition and the assessment of competition as an integrated exercise, which requires pragmatic judgments to be reached in respect of a range of facts and reasoned inferences based on sound economic and legal analysis.
- 4.3 Defining the relevant market is never precise or wholly scientific, especially when detailed information is not available, or, as in the case of some telecommunications markets, the competing products or services are differentiated and technological changes are rapid. As a result, on occasions some of the relevant market parameters which the TA adopts may be less than clear-cut.
- 4.4 Moreover, because competition is a dynamic process and the telecommunications market undergoes rapid changes locally and internationally, what may be suitable market definition parameters on one occasion may not be appropriate for other enquiries, notwithstanding similarities in terms of the subject-matter under scrutiny and that the enquiries are not so far apart in time. Nevertheless, market definition used in earlier enquiries might depending upon the circumstances provide a useful starting point.

Relevant Market Parameters

- 4.5 On each occasion, the TA's market definition process will aim to identify all the firms whose business acts as a constraint on the licensee(s) whose conduct is under scrutiny, and it will exclude the firms which are not in close competition with them. The description will also be inclusive of all the services which can be effective substitutes in the eyes of buyers (demand-side substitutes), and it will include all the firms which are able to supply any of those substitutes (supply-side substitutes) within a reasonably short period of time.
- 4.6 The TA will usually define the relevant market in terms of the product, the geographic reach, the distribution function, and the factor of time. In addition, the TA may use a specific customer dimension to distinguish different customer types where it is relevant.
- 4.7 In anti-competitive practice investigations, the TA is also likely to apply the tools and other features of traditional competition law market analysis as set out in Sections 3 and 4 of the Guidelines on Mergers and Acquisitions, which are available on the website of OFTA at : http://www.ofta.gov.hk/en/c_bd/guidelines.html.

Market Power and Market Dominance

- 4.8 Section 7L of the Ordinance, which prohibits the abuse of a dominant market position, is not concerned with the normal range of seller influence over equilibrium price and output which is to be found in a market where competition is effective.
- 4.9 The concern of section 7L is with the market power of a dominant licensee which enables it to behave to an appreciable extent in terms of pricing and output without significant restraint from its existing competitors, potential entrants, upstream input suppliers or downstream customers.
- 4.10 The TA's opinion as to whether a licensee is in a dominant market position stems from section 7L(3), which specifies the relevant matters to be taken into account including the licensee's market share, the licensee's power to make pricing and other decisions, any barriers to

market entry, and the degree of product differentiation. These are discussed in detail below.

Market Share

- 4.11 In the context of Hong Kong's telecommunications sector, caution needs to be exercised concerning the weight to be attached to market shares when dominance is being considered and in characterising a licensee's market position by reference to this single dimension.
- 4.12 Deregulation, apart from leading to the establishment of alternative networks, has also blurred the boundaries between different technological platforms and services, such as that between fixed and mobile services. Thus in assessing dominance, factors other than historical sales volumes and market shares may be more relevant.
- 4.13 The TA does not consider it useful or necessary to specify in these Guidelines one "all-purpose" market share threshold for considering whether a licensee is "*able to act without significant competitive restraint from its competitors and customers*", which is how "a dominant position" is defined in section 7L(2) of the Ordinance. "Market share" alone cannot determine the existence or otherwise of dominance. In other jurisdictions where a market share threshold is specified, it is normally cautioned that dominance may be established below that threshold and market share above that threshold may not indicate substantial market power.
- 4.14 Market share is only a signal to the TA that a licensee may be in a dominant position and therefore that certain conduct by it may be anti-competitive. It is recognised that a high market share may not correspond to market power enabling the concerned licensee to act without significant competitive restraint. The establishment of dominance of a licensee in a telecommunications market requires a complex assessment of the market and the position of the licensee in the market. In addition to market share, the TA will take into account also the practical barriers to entry and expansion in the market, the position of the competitors in the market (including the capacity and geographical coverage of their networks, and how closely their products compete with those of the concerned licensee), the existence

of countervailing buyer power, and changes in the market share of the concerned licensee over time.

- 4.15 Where detailed relative market share analysis is relevant, the TA will look to establish the shares of all the market participants by a variety of measures, which may include revenues, subscriber numbers, premises passed, network capacity, subscriber types or traffic volume.

Pricing Power

- 4.16 A firm's ability to maintain or increase its prices, or to constrain its service output, quality and innovation levels over a period of time, notwithstanding the appearance of lower pricing elsewhere in the market, is an indication of a dominant position. Generally therefore, where there is an allegation of dominance, the TA will be concerned to examine the history of the service provision and its pricing and other terms, to ascertain the degree of volatility and downwards price movement.

- 4.17 Where prices have moved and there is evidence of customer switching to effective substitutes, a finding of a dominant position is less likely.

Barriers to Entry

- 4.18 The ease with which new competitors can emerge in a telecommunications market, in which dominance is alleged, is an important factor in determining the character of the market's structure, and whether particular conduct would have the purpose or effect of preventing or substantially restricting competition in it.

- 4.19 The assessment of barriers to entry and expansion is central to the analysis of market dominance as competition is a dynamic process. Where there are low barriers and the market is expanding, established firms must determine their prices and output cautiously, knowing that if their prices are set significantly above the competitive level, or if they fail to innovate, new entrants will come in and existing competitors will expand their output. This process of competition will drive prices down and outdated products out.

- 4.20 Modest barriers to entry and expansion are consistent with effectively competitive markets. In contrast, high barriers to entry and expansion can lead to fewer licensees in a market as well as a lower probability of market entry and therefore, all other things being equal, licensees facing fewer competitive constraints.
- 4.21 The TA will usually assess the importance of potential competition as a competitive constraint by identifying who are the likely entrants and when they might enter, and by measuring the height of the market entry barriers which confront them.
- 4.22 For potential competition to be a real constraint upon those already in the market, it must be likely, sufficient in extent and timely. For entry to be likely, it must be a genuine commercial probability. To be sufficient, it must be capable over time of moving from small beginnings to confronting the core activities of the incumbents. As for timeliness, it would depend on the special circumstances in each case.
- 4.23 Anything which amounts to a cost or a disadvantage, that a new entrant has to face but the incumbent does not, can be an entry barrier. Importantly however, cost advantages derived solely from a licensee's economic efficiencies will not be regarded as a barrier to new entrants.
- 4.24 The telecommunications sector has been fully liberalised since 2003. The Government has adopted an open licensing regime for all telecommunications licences and, as a result of our commitment under the rules of the World Trade Organisation, there is no restriction on foreign ownership either. It follows that there are no regulatory barriers in Hong Kong's telecommunications sector, apart from natural constraints that may limit the number of licensees (such as frequency spectrum availability). There are thus two main types of barrier, namely structural and strategic barriers.
- 4.25 Structural barriers are those which are inherent in the activity itself. In telecommunications, structural barriers normally include, but are not limited to, the substantial sunk costs of the tangible and intangible assets; the substantial economies of scope and scale associated with a ubiquitous telecommunications network; brand loyalty to the

incumbent; and the difficulties in accessing existing telecommunications infrastructure and product distribution channels.

- 4.26 Strategic barriers to market entry are those erected by the participants already in the market, which can effectively add to the natural sunk costs. Strategic behaviour could include an incumbent investing in excess capacity; differentiating its products; sustaining heavy spending on advertising leading to high costs of brand establishment; or raising customer switching costs by locking up significant customer numbers on long-term contracts or on low-margin pricing.
- 4.27 Findings about the specific nature of any market entry barriers and their significance as constraints on competition in any respect will be determined on a case-by-case basis. The TA nevertheless recognises the importance of strategic business behaviour in establishing market power in a competitive market and would not automatically equate it with abusive conduct.

Differentiated Products

- 4.28 Most telecommunications markets comprise only a few firms. In considering the interactions and rivalry between businesses in these kinds of markets, the level of differentiation between the rival brands can be important in ascertaining where market power lies. If the service is a commodity where only price counts in the eyes of buyers, customer switching would be more likely, meaning less market power for an incumbent. With differentiated products, where factors other than price are decisive in the choice made by the customers, rival services may not be perceived as close substitutes for each other and therefore an incumbent may have greater market power.
- 4.29 Generally, most telecommunications services in Hong Kong are differentiated to some extent.

5 PROCEDURES

Alerting the TA

- 5.1 Anyone who has information that a licensee has engaged in conduct which is in contravention of the competition provisions, or that such conduct is imminent, should provide relevant information to OFTA as soon as possible.
- 5.2 The TA will always consider the possibility of giving leniency to a licensee who provides him, on a voluntary basis, with information and evidence that enables him to discover the existence of anti-competitive practice or to prosecute a case more easily. The leniency might result in the licensee being given a complete immunity from financial penalty, or a lower penalty than the one that would have been imposed but for the voluntary provision of information and evidence. The TA will also be prepared to receive information on a confidential basis and to withhold disclosure of an informant's identity.
- 5.3 The guideline entitled "*How complaints related to sections 7K to 7N of the Ordinance are handled by OFTA*" is available on OFTA website. OFTA will follow the procedures set out in that guideline, unless there are exceptional circumstances which justify a departure from the established procedures. This document and further information about how to contact OFTA can be found on OFTA website at : http://www.ofa.gov.hk/en/c_bd/competition-complaints.html.
- 5.4 The TA does not act only on complaints. Investigations into anti-competitive practices can also be commenced on the TA's own initiative when there are reasonable grounds to believe that a contravention may have occurred or may be imminent.
- 5.5 In summary, on receipt of a complaint from an affected party, or where OFTA comes into possession of relevant information, a decision will be made whether the situation merits a formal investigation. If so, the subject licensee will be informed and asked to respond to any specific allegations. OFTA will ask for specific information from the subject party, which may be achieved through invoking the TA's formal powers of investigation (see paragraphs 5.7 to 5.9 below) to obtain evidence. If the evidence does not support any contravention and hence there is no case for conducting a formal investigation, the TA will close the case and inform the complainant and the subject licensee of his decision.

- 5.6 In deciding whether an allegation is substantiated under the competition provisions, OFTA will consider the material gathered during investigation, including any responses from the licensee concerned. A draft decision will be provided to the licensee who will be given an opportunity to comment on the reasoning and the evidence before any final decision is made. Where the TA considers that there has been a contravention, the licensee will also be given an opportunity to comment and put forward submissions in relation to the contravention and the penalty that is being considered.

Powers of Investigation

- 5.7 The TA's powers of investigation are conferred upon him by virtue of sections 7I, 35A and 36D of the Ordinance. Under these sections, the TA may request information from, or carry out an investigation in respect of, a licensee where the TA suspects that there is a contravention of the competition provisions. An investigation may involve OFTA's officers entering the premises of a licensee and inspecting and making copies of documents.
- 5.8 Generally it is the TA's practice to seek a licensee's voluntary cooperation in the provision of relevant information, but he will resort to the formal entry and direction powers if there is a risk of evidence being damaged, or if the licensee is prevented from disclosing information except in response to the exercise of a statutory investigation power.
- 5.9 The TA, in carrying out an investigation, may also use information originated from competitors of the concerned licensee, customers, consumers, trade associations and suppliers, as well as publicly available information such as market research reports.

Directions

- 5.10 A direction to the licensee can be issued under section 36B of the Ordinance to bring contravening conduct to an end.
- 5.11 Such directions may require the licensee to modify an agreement or the manner of the exercise of contractual rights, or to terminate an

agreement or otherwise cease the conduct in question. Directions may require positive action, such as informing third parties that a contravention has been brought to an end and reporting back periodically to the TA on certain matters, such as prices charged.

Warnings

- 5.12 The TA may issue a warning to a licensee when, notwithstanding a finding that there is a contravention of the competition provisions, it is the TA's view that any other sanction is not justified by the circumstances of the case.
- 5.13 Where the TA considers it is in the public interest, the licensee may be required to publish the warning.

Financial Penalties

- 5.14 Under section 36C of the Ordinance, the TA may impose financial penalties on the licensee for contravening the competition provisions. On the first occasion a penalty is imposed, the penalty may be up to and including \$200,000, on the second occasion up to and including \$500,000, and for any subsequent occasions on which the penalty is imposed, the penalty may be up to and including \$1,000,000.
- 5.15 If the TA considers that such a penalty is inadequate, section 36C enables an application to be made to the Court of First Instance, which may impose a financial penalty of a sum not exceeding 10% of the licensee's turnover during the period of the contravention, or \$10,000,000, whichever is the higher.

Factors to be Considered by the TA When Imposing a Penalty

- 5.16 The factors that the TA will take into account when imposing a penalty are set out in paragraphs 5.17 to 5.19 below. These factors are additional to those set out in the TA's "*Guidelines on the imposition of financial penalty under section 36C of the Ordinance*" which explain how the TA will take into account the nature, seriousness and duration of the contravention. This document is available on OFTA website at : http://www.ofta.gov.hk/en/legislation/guideline_6d_1/main.html.

Actions of the Licensee Post Contravention

- 5.17 The TA will look more favourably on a licensee who has promptly co-operated with the TA's investigations and has committed to taking action to end the conduct which is the subject of a contravention finding.

Compliance Programmes

- 5.18 The TA will take into account the compliance programme that the licensee is operating when imposing penalties. However, the TA would like to make it clear that the mere fact that a licensee has a compliance programme will not of itself mean a lower penalty level unless the compliance system is in the TA's opinion comprehensive and serious. Licensees are encouraged to develop in-house compliance programmes so that management and staff understand the requirements of the competition provisions.
- 5.19 The existence of in-house compliance programmes and structures will assist licensees in discovering potential contraventions early, enabling licensees to prevent contraventions of the competition provisions, and to remedy contraventions at the earliest opportunity.
- 5.20 The TA is willing to discuss and advise licensees during the development of their compliance programmes, although there is no formal process by which the TA will approve a particular programme.

Damages

- 5.21 Under section 39A of the Ordinance, a person suffering loss or damage from an anti-competitive practice may bring an action for damages, an injunction or other appropriate remedy, order or relief against the licensee in contravention.
- 5.22 In order to bring a claim for damages under section 39A, a contravention of the competition provisions must have occurred, and the party claiming damages must, as a result, have suffered loss or damage.

Appeals

- 5.23 Any person aggrieved by the decisions of the TA in relation to section 7K to 7N of the Ordinance may appeal to the Telecommunications (Competition Provisions) Appeal Board in accordance with Part VC (sections 32L to 32O) of the Ordinance.

Further Information

- 5.24 OFTA documents referred to in these Guidelines, such as the “*Guidelines on Mergers and Acquisitions*”, “*How complaints related to section 7K to 7N of the Ordinance are handled by OFTA*”, the “*Guidelines on the imposition of financial penalty under section 36C of the Ordinance*”, and previous case summaries and decisions on anti-competitive conduct can be obtained from OFTA website at :
http://www.ofta.gov.hk/en/c_bd/guidelines.html;
http://www.ofta.gov.hk/en/c_bd/competition-complaints.html;
http://www.ofta.gov.hk/en/legislation/guideline_6d_1/main.html; and
http://www.ofta.gov.hk/en/c_bd/completed-cases/main.html.

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