Telecommunications (Competition Provisions) Appeal Board

Appeal No. 30

PCCW-HKT Telephone Limited v The Telecommunications Authority

Date of appeal	:	16 November 2010
Appellant	:	PCCW-HKT Telephone Limited ("PCCW")
Nature of appeal	:	Against the Decision of the Telecommunications Authority ("TA") issued in November 2010, which dismissed the complaint of SmarTone Mobile Communications Limited pursuant to sections 7K, 7L and 7N of the Telecommunications Ordinance (Cap. 106), in respect of PCCW's increase of fixed-mobile interconnection charge tariff from 4.36 cents per minute to 5.45 cents per minute, effective during the period from 1 June 2008 to 28 April 2009.
Hearings	:	After having considered written submissions from parties concerned and their oral submissions made at the case management conference held on 21 February 2011, the Chairman ruled that PCCW was not a “person aggrieved” within section 32N(1) of the Telecommunications Ordinance (Cap. 106) for lodging of an appeal to the Appeal Board. The Decision of the Chairman dated 7 April 2011 is attached.
Outcome of Appeal	:	Appeal was dismissed.

Appeal Nos. 29 and 30 of 2010

IN THE MATTER OF THE TELECOMMUNICATIONS ORDINANCE (CAP. 106)

AND

IN THE MATTER OF AN APPEAL TO THE TELECOMMUNICATIONS (COMPETITIONS PROVISIONS) APPEAL BOARD PURSUANT TO SECTION 32N OF THE TELECOMMUNICATIONS ORDINANCE (CAP. 106)

BETWEEN:

SMARTONE MOBILE COMMUNICATIONS LIMITED ("SmarTone")

Appellant in Appeal No. 29

and

THE TELECOMMUNICATIONS AUTHORITY ("TA")

Respondent in Appeal Nos. 29 and 30

and

PCCW-HKT TELEPHONE LIMITED ("PCCW")

Appellant in Appeal No. 30

DECISION

INTRODUCTION

1. On Monday, 21 February 2011, I heard the above parties through their respective counsel at a Case Management Conference ("CMC") that lasted approximately seven hours. The issues raised were complex and lengthy and no less than 50 authorities were cited from Hong Kong, United Kingdom, European Union, Australia and New Zealand. Although I do not know the parties' response to the matters contained in this Decision, it is not unlikely that one or more of them will wish to apply to me to state a case for the Court of Appeal and that I may do so. In that event, the hearing of SmarTone's appeal will inevitably be adjourned for many months and will unlikely to be heard until well into 2012.

2. I doubt very much that the legislature had in mind, when constituting this Board, that appeals would be so costly and lengthy and fraught with a wide variety of jurisdictional issues, some of which have already been to the Court of Appeal. Nevertheless, substantial issues of competition law, economic evidence as well as a wide raft of legal issues are the norm in appeals to this Board, and as long as these legal issues of substance and procedure are raised, the Board has to deal with them. The Board has taken the view that where in an appeal there is a serious challenge to its jurisdiction, it needs to address this issue before embarking on a costly and lengthy investigation into the merits. It has been agreed that I should hear all these applications arising out of both appeals together and publish a composite Decision which I hereby do.

RELEVANT BACKGROUND FACTS

3. On 1 November 2010, the TA dismissed a complaint by PCCW made by SmarTone on 18 June 2008 (the "TA's Decision"). To save repetition, I attach hereto paragraphs 2 - 3.20 of the TA's Decision as **Annex**. Paragraph 2 contains a useful glossary for this acronym heavy industry and I will hereafter use the appropriate acronyms.

4. On 18 June 2008, SmarTone had submitted a complaint to the TA requesting the TA to commence an investigation under the Competition Provisions into the FMIC increase which became effective from 1 June 2008.

5. SmarTone appeals to this Board against the dismissal of its complaint against PCCW. That is Appeal 29.

6. PCCW has sought leave to intervene in Appeal 29 and I have given that leave. An issue now arises in relation to the extent and scope of PCCW's intervention.

7. On 16 November 2010, PCCW itself appealed against the "*various opinions and/or decisions of the [TA]…reached on 2 November 2010…"*. This is Appeal 30.

8. The Department of Justice, for the TA, took the view that PCCW was one day late in commencing its appeal. I received written submissions on this issue and on 2 February 2011, I published a Decision holding that PCCW was not out of time with the commencement of its appeal.

9. The TA now takes the view that PCCW's appeal is not competent because it is not *"a person aggrieved"* within the meaning of section 32N(1) of the Telecommunications Ordinance (Cap. 106) (the "TO").

10. SmarTone seek disclosure of documents against both the TA and PCCW and both are contested.

IS PCCW *"A PERSON AGGRIEVED"* IN APPEAL 30*?*

11. In one sense, the answer to this question is obvious. If SmarTone's appeal is allowed and PCCW's tariff is quashed, PCCW will suffer and in that sense, will be aggrieved. On the other hand, they are not aggrieved because they are happy with the result because SmarTone's appeal was dismissed and their tariff survives.

12. However, PCCW argue that despite the fact that SmarTone's appeal was dismissed, nevertheless, there were statements in the TA's Decision which are adverse to them and which they would like to be in a position to correct and set aside. In essence, the complaint is that the TA found that, at the relevant time, PCCW was in a dominant position. Although the TA did not find any abuse of that dominant position, PCCW, nevertheless, object to the methodology by which the TA arrived at the conclusion, that at the relevant time, PCCW was dominant in the market.

13. Ms Ismail for the TA relied heavily on the wording of section 32N(1) which provides:

"(1) Any person aggrieved by -

(a) an opinion, determination, direction or decision of the Authority relating to -

(i) section 7K, 7L, 7M or 7N; or
(ii) any licence condition relating to any such section; or

(b) any sanction or remedy imposed or to be imposed under this Ordinance by the Authority in consequence of a breach of any such section or any such licence condition,

may appeal to the Appeal Board against the opinion, determination, direction, decision, sanction or remedy, as the case may be, to the extent to which it relates to any such section or any such licence conditions, as the case may be."

14. Section 7L deals with "*abuse of position*" and states:

"(1) A licensee in a dominant position in a telecommunications market shall not abuse its position.

(2) A licensee is in a dominant position when, in the opinion of the Authority, it is able to act without significant competitive restraint upon its competitors and customers.

(3) In considering whether a licensee is dominant, the Authority shall take into account relevant matters including, but not limited to -

(a) the market share of the licensee;
(b) the licensee's power to make pricing and other decisions;
(c) any barriers to entry to competitors into the relevant telecommunications market;
(d) the degree of product differentiation and sales promotion;

> *(e) such other relevant matters as may be stipulated in guidelines referred to in section 6D(4)(a).*
>
> *(4) A licensee who is in a dominant position is deemed to have abused its position if, in the opinion of the Authority, the licensee has engaged in conduct which has the purpose or effect of preventing or substantially restricting competition in a telecommunications market."*

15. Ms Ismail contends that as the TA did not find any abuse of PCCW's dominant position, it cannot be said that the opinion or decision that PCCW was dominant can relate to section 7L because there was no finding of abuse of that dominant position. She submits that there are two limbs to section 7L – dominance and abuse. Abuse has not been found. She submits that there is no stigma attached to being dominant - in fact, many companies aspire and strive to be dominant.

16. Mr Beresford for PCCW contends that the very finding of dominance places PCCW at a disadvantage and they would like to attempt to correct it. There are authorities that make clear that those in a dominant position need to act with added responsibility and that there is a risk that third parties might latch onto the finding to PCCW's detriment.

17. Mr Beresford referred me to section 39A of the TO which states:

> *"(1) A person sustaining loss or damage from a breach of section 7K, 7L, 7M or 7N, or a breach of a licence condition, determination or direction relating to that section, may bring an action for damages, an injunction or other appropriate remedy, order or relief against the person who is in breach.*

> *(2) No action may be brought under subsection (1) more than three years after -*
>
> *(a) the commission of the breach concerned referred to in that subsection; or*
> *(b) the imposition of a penalty in relation to the breach by the Authority under section 36C, or, as the case may be, by the Court of First Instance under section 36C(3B),*
>
> *whichever is the later."*

18. Mr Beresford submits that it is possible that the third party, by which I take to mean a competitor of PCCW, might attempt to utilise the finding of dominance in the TA's Decision to mount a claim for damages against PCCW. I have to say that I find this fear quite remote. Firstly, there has been no finding against PCCW of any breach of any of the competition provisions as Ms Ismail was at pains to emphasise. I was reminded that there is, in Hong Kong, no equivalent to section 58A of the Competition Act 1998 in the United Kingdom which provides that a court is bound by a decision of infringement by the Office of Fair Trading. Further, the TA's Decision relating to PCCW's dominance is time-specific, i.e. it relates to the period that was then under review and the time limit for bringing actions under section 39A is fast expiring. Accordingly, I do not think that PCCW's fear that someone might somehow use the finding of dominance against them is justified. The TA has made quite explicit before me and in writing that if the matter is raised in any future inquiry, the question of dominance will be looked at de novo. PCCW will then be in a position similar to that in which it was in this inquiry, namely, that it had and will have full ability to contend that the TA had fallen into error in concluding that PCCW was dominant.

19. Ms Ismail contends that the oft-quoted passage in the Court of Appeal judgment in PCCW et cetera v the TA (CACV274/2003) makes clear that PCCW is not a party aggrieved. Because so much reliance was placed on these paragraphs, I will set them out again:

> *"In my view, the effect of section 32N(1)(a)(i) of the TO is as follows:*
>
> *(1) It is not enough simply for the relevant opinion, determination, direction or decision of the TA to have some connection (however strong) to competition (or anti-competition), abuse of dominant position, misleading or deceptive conduct or non-discrimination. If this were the only criterion, the phrase 'relating to' would refer to exactly such terms rather than specifically to sections 7K, 7L, 7M and 7N. Something else must therefore be required.*
>
> *(2) What is required is that the person who is aggrieved by the relevant opinion, determination, direction or decision of the TA must also establish that one or more of sections 7K to 7N have been truly engaged. This means that the TA (in issuing or making the relevant opinion, determination, direction or decision) must, expressly or by implication, have arrived at an opinion that the licensee concerned has engaged or will (if the relevant opinion, determination, direction or decision is not complied with) engage or continue to engage in conduct that contravenes one or more of sections 7K to 7N. I put it in these terms to emphasise that not only is past or present conduct covered, but also future conduct. The language of sections 7K to 7N is sufficiently wide (and for good reason) to cover such situations. A good measure of flexibility is therefore given to the TA.*
>
> *(3) Whether or not in issuing or making an opinion, determination, direction or decision, the TA has arrived at such opinion, is in any given case a question of fact. In his submissions, Mr Roth raised the spectre*

of the possibility of there being cross-examination to establish whether or not the TA has indeed reached such an opinion. In my view, it will in most (if not all) cases be fully evident whether or not the TA has arrived at such an opinion. I note here the duty on the part of the TA to provide reasons for any opinion, determination, direction or decision: see section 6A(3)(b) of the TO. This will no doubt facilitate the exercise.

(4) As to Mr Gordon's point that breaches of section 7K, 7L, 7M or 7N are required to be shown before an appeal under section 32N(1)(a) can be triggered, this is really a matter of semantics. Section 32N(1)(a)(i) does not use the word 'breach' (although section 32N(1)(b) does). This matters not. The important point to remember is an appeal to the Appeal Board under section 32N(1)(a)(i) is possible only where the relevant opinion, determination, direction or decision involves an opinion on the part of the TA along the lines mentioned in subparagraph (2) above. Whether or not one chooses to refer to this as a past, present or future breach is immaterial. The important requirement is the TA's opinion under sections 7K, 7L, 7M or 7N.

(5) I am prepared to accept that opinions, determinations, directions or decisions made or issued by the TA may not necessarily engage sections 7K to 7N, but the important point for present purposes is that they may, depending on the facts.

(6) I have found the legislative history to be of limited assistance. The legislative background referred to the material shown to us is already evident for the terms of the Ordinance itself."

20. I have considered all of the arguments most put attractively by Mr Beresford on behalf of PCCW and I mean no disrespect by not setting them out fully in this Decision but they are contained in his written submissions which were placed before me. However, I have considered all

of the arguments and I find it impossible to conclude that a decision which supports PCCW's tariff and does not make any finding of abuse of its dominant position can possibly give PCCW a right of appeal as a *"person aggrieved"*. It seems to me that PCCW's position is best protected by its intervention in Appeal 29, and thus it is to that issue that I now turn.

SCOPE OF INTERVENTION IN APPEAL 29

21. I have made an order permitting PCCW to intervene, and neither SmarTone nor TA have objected to this in principle. However, a rather strange situation has arisen because SmarTone now take the view that it could not really support a position that restricted PCCW from raising the issue of dominance in its appeal. On the other hand, the TA objects most strongly to PCCW doing so.

22. There is nothing in the Ordinance relating to intervention, but in Guidelines that I settled in November 2010 after wide and lengthy consultation within the industry, the following provision was made:

> *"Paragraph 12 - Interveners.*
>
> *(1) Any person wishing to intervene ("the intervener") in the appeal shall seek the leave of the Chairman or the Appeal Board to do so at the earliest opportunity and in any event not later than 28 days of publication of the announcement of the Notice of Appeal on the website of the Commerce and Economic Development Bureau. The Chairman and Appeal Board may grant leave to intervene later in the appeal proceedings if the intervener can demonstrate that it was not feasible for it to have sought leave within the time limit.*

> *(2) The intervener should make his request for leave in writing explaining why it has sufficient interest which is directly related to or connected with the matters in the Appeal.*
>
> *(3) The clerk should give notice of the request for leave to intervene to the parties to the Appeal and invite their observations on that request; and if granted, the documents to be made available to the intervening person, within the specified period.*
>
> *(4) If the Chairman or Appeal Board is satisfied, having taken into account the observations of the parties, that it is appropriate to grant leave, it should make such directions as he or it sees fit relating to the participation of the intervener in the appeal in the stages of case management and preparatory issues ... as appropriate."*

23. I should also refer to section 32O(7) of the TO which provides:

> *"The Chairman may determine any matter of practice or procedure relating to the hearing of appeals where no provision governing such matters is made in this Ordinance or in Regulations made thereunder."*

24. All parties have agreed that PCCW's intervention should not result in unnecessary duplication of material and they have agreed that I should make an order along the lines of the Competition Appeal Tribunal in the case of *BAA Ltd v Competition Commission [Case No. 1110/6/8/09]* where the Intervener was ordered to conduct itself so as to avoid unnecessary expenditure of time and effort in duplicating submissions whether oral or written.

25. Mr Alder, after very careful consideration, submitted that he could not contend that PCCW should be prevented from raising the dominance point in the SmarTone's appeal. He pointed out, as was the case, that PCCW had strongly argued this point before the TA in the SmarTone Inquiry, and had placed evidence before the TA to the effect that it was not dominant on the basis of the test for which it contended. He accepted that PCCW's intervention on that point would increase the cost and length of the SmarTone's appeal, but he felt, I think, that there would be a sense of injustice if PCCW were forced to intervene with its hands tied behind its back. His frankness and sense of fair play are to be commended.

26. The TA, on the other hand, contends most strongly that PCCW should not be so entitled. Ms Ismail points out that if PCCW is permitted in this appeal to raise the dominance issue and lead evidence in support of its position, this will add a substantial length of time to the appeal with additional cost. I am quite sure that her submissions are well-founded, but that really is beside the point. What I have to decide is whether, having regard to what is set out in the Guidelines and the discretion given to me in relation to practice and procedure contained in the Ordinance, I think it appropriate for PCCW to be able to raise this point. It seems to me that if this point is going to be raised at all, then it is far more appropriate for it to be raised in the SmarTone's appeal, given the discretion that I have. It would not, as I found above, be right to do violence to the language of section 32N(1) in order to contrive a situation where PCCW would have a freestanding appeal against a decision which was ex facie in its favour.

27. I cannot but feel that if PCCW were not allowed to raise this issue in this appeal, it would suffer a serious sense of injustice. Furthermore, it is always difficult at such an early stage of a case such as this (which will

involve complex economic evidence) to form a view whether in fact the finding of dominance had any, and if so, what, effect upon the TA's Decision. It would be an unfortunate position to find oneself in if, at the end of the day, it was clear that this finding influenced the TA's Decision but there was no way in which the Appeal Board could alter it or the reasoning leading thereto.

28. It seems to me to be a wholly artificial approach to try and compartmentalise SmarTone's appeal without having regard to the situation of PCCW which would be looming large in the background. It may well be that at the end of the day the Board finds that the decision on dominance was of no relevance to the ultimate finding the subject matter of this Appeal. However, I cannot at this stage possibly foresee the result of this Appeal and it would seem to me to be unjust to force PCCW to intervene without being able to raise the very point which concerns it and which could possibly impact on the result of the Appeal. I have approached this matter from my overall feeling of the justice of the situation and I believe that by using the intervention route, justice can be done to all sides. If it means that this Appeal lasts longer and is more expensive, then that is something which the parties will have to accept. The Board, too, will have to accept facing a more complicated hearing than might otherwise be the case.

29. Accordingly, I give leave to PCCW to intervene and to raise the issue of dominance, but at all times to obey the order set out in paragraph 24 above, that there shall be no unnecessary duplication of material as supplied in this Appeal. This order is without prejudice to PCCW's right to raise the dominance issue. At a further CMC, I may consider taking more concrete steps to attempt to avoid this duplication.

30. I have come to the above conclusion on the basis of what I consider to be a fair and just and efficient way to manage this dispute in the exercise of the discretion given to me by the TO.

DISCLOSURE IN APPEAL 29

31. I now turn to the issue of disclosure of documents. SmarTone has, by letter dated 21 December 2010, sought disclosure by the TA of:

(1) The Frontier Report;

(2) The TA's Fully Distributed Costs (FDC) Model; and

(3) The PCCW-HKT Costs Data.

32. In response to this application, the TA has:

(1) Produced a redacted version of the Frontier Report;

(2) Confirmed that Frontier did give the TA certain further advice which it considers not discoverable; and

(3) Referred SmarTone's attention to a public document snappily entitled "Review of Methodologies Calculation of Interconnection Charges for Value Added Services and Public Radio Telephone Services and Local Access Charges" dated 25 October 2000 which the TA explains contains the relevant cost model.

Frontier Report and Advice

33. SmarTone has been informed by the TA that the only part of the Frontier Report that has been redacted relates to market definition and dominance. This approach by the TA was perfectly consistent with the TA's approach that Appeal 30 was legally unsupportable and that the scope of intervention should be limited to the issues that strictly arise in Appeal 29. Now that I have found that I have no jurisdiction to entertain Appeal 30, but that the scope of PCCW's intervention in Appeal 29 is to be more extensive than hitherto envisaged by the TA, I fail to see why the redacted version of the Frontier Report should not be produced.

34. Two grounds lead me to the above conclusion. Firstly, the issues of dominance and market definition will be canvassed in this Appeal and thus the redacted parts of the Frontier Report are clearly relevant to issues arising in this appeal and should thus be disclosed. Secondly, it seems to me that if the TA based his decision on the Frontier Report on advice contained therein, then good and transparent administration requires its full disclosure. I so order.

35. The TA has confirmed that in addition to the report itself, Frontier did give the TA further advice which it has declined to disclose. I am not prepared at this stage to order disclosure of this additional material. However, I do require the TA to set out clearly in writing the answers to the following questions:

    (1) Did Frontier give any advice or expert opinion to the TA concerning the conclusions contained in the report;

(2) If so, how was that advice given and when;

(3) To which specific issue did the advice relate?

(4) If any issue of proportionality arises, it must be set out.

36. I will accordingly reserve making a decision on the Additional Frontier material request until the TA has had time respond. It may be that when a response is at hand, the parties may be able to settle this issue. If not, they are free to return to me for a final ruling.

FDC Model

37. I now turn to the issue of the FDC model. Mr Alder made it clear that SmarTone was not seeking the PCCW costs data which was used to run the FDC model. What SmarTone want is to see the model itself. The decision itself refers to a PCCW margin of 15 to 20 per cent over the FDC figure (see TA's Decision paragraph 7.125). SmarTone believes that the FDC model is not reliable and will seek to contest its appropriateness in this case. I assume SmarTone will contend that the use in this case of the FDC model resulted in an over-estimate of PCCW's costs and thus will affect the level of the tariff.

38. The TA submits that it is unnecessary and disproportionate to disclose the model, and in any event, it is submitted the model is in the public domain because it has been adopted by OFCOM in the United Kingdom.

39. SmarTone contend that the FDC model was flawed because:

(1) It was based on the recovery of historical rather than current costs and therefore did not reflect the costs that operators would efficiently incur in a competitive environment and recover in the context of an industry such as the present which is characterised by rapid technological change; and

(2) It allows the recovery of non-traffic related overheads, which it is inappropriate to recover through interconnection charges in the context of a competitive market.

40. Further, SmarTone contend that it is unsafe to assume that when OFCOM uses an FDC cost standard, this incorporates exactly the same set of assumptions as the TA's FDC model.

41. It seems to me that the FDC model used by the TA is clearly an issue in this Appeal. By seeking the model, SmarTone is not seeking any confidential or sensitive information. What it seeks to use, in layman's terms, is what is done with the information which is fed into the model. This raises, for example, what assumptions are made and whether they are appropriate in the circumstances of this case. In my judgment, the FDC model is clearly relevant and should be disclosed.

PCCW-HKT Costs Data

42. I now turn to the claim relating to the PCCW costs data which, not surprisingly, is strongly objected to by PCCW. The class of documents which SmarTone seek under this heading is statutory papers, financial

modelling documents, meeting notes, internal compliance, et cetera, showing PCCW's purpose in (a) making the original proposal to increase its MPNP FMIC tariff to 9.5c/m; and (b) the final decision to increase it to 5.45c/m. SmarTone contend that the increases were not cost-related and they want to establish PCCW's true purpose and how that should be characterised for the purposes of the competition provisions.

43. This issue is clearly highly contentious. Mr Beresford made a detailed submission based on *Ashton v IRC [1975] 1 WLR 1615*, that the documents relating to PCCW's subjective purpose in implementing the increase are completely irrelevant. He relied on various cases which he said supported the proposition that "*purpose*" is assessed not by intention, but in every case is to be inferred from conduct.

44. Mr Alder contends that this dichotomy is very interesting but submits that I need not decide it for the present purposes of deciding this application for disclosure of documents. He concedes it may be relevant at the hearing of the substantive appeal, but that I should not decide it at the moment.

45. In addition to his legal points, Mr Beresford contends that no evidence has been placed before me to substantiate that such documents do in fact exist.

46. Noting the sensitivity of these documents and the very early stage of this appeal, I propose to take the following course:

(a) PCCW shall state in writing whether any documents within the class requested do in fact exist, and if so, in what form; and

(b) I will reserve the final determination of this part of the application for disclosure until PCCW have answered (a) above and have set out what points as intervener they wish to raise in Appeal 29.

CONCLUSION

(a) PCCW has leave to intervene in Appeal 29;

(b) PCCW will so conduct itself in Appeal 29 so as to avoid unnecessary expenditure of time and effort in duplicating submissions, whether oral or in writing, made by the TA or SmarTone;

(c) PCCW is at liberty to contest the TA's finding of market dominance as an intervener in Appeal 29;

(d) The TA must produce the unredacted version of the Frontier Report within 14 days of the date of this Decision;

(e) The TA shall within 14 days of the date of this Decision answer in writing the following questions:

(i) Did Frontier give any advice or expert opinion to the TA concerning the conclusions contained in the report;

(ii) If so, how was that advice given and when;

(iii) To which issue did the advice relate?

(iv) If any issue of proportionality arises, it must be set out.

(f) The TA must produce within 14 days of the date of this Decision the FDC model relied upon in this case;

(g) PCCW shall within 14 days of the date of this Decision answer in writing the following question, namely, whether any documents within the class requested by SmarTone relating to the purpose of the tariff increase exist, and if so, in what form;

(h) SmarTone's application for disclosure of documents relating to PCCW's "purpose" is adjourned;

(i) The parties shall endeavour to agree a procedural format which acknowledges the orders made herein, failing which I will address such issues at a further CMC to be convened;

(j) I have no jurisdiction to entertain Appeal 30, which is accordingly dismissed; and

(k) I make the following costs order nisi:

(i) costs of the CMC in Appeal 29 shall be in the appeal; and

(ii) the TA and PCCW are at liberty to address me in writing relating to the costs of Appeal 30.

Dated this 7th day of April 2011 in Hong Kong

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Neil Kaplan CBE QC SBS

(Chairman of the Board)

Annex

Relevant Background Facts

Paragraphs 2 – 3.20 of TA's Decision

2. GLOSSARY

"2000 FMIC Calculation Methodology" means the calculation methodology set out in the TA statement *Review of Methodologies for Calculation of Interconnection Charges for Value-added Services and Public Mobile Radiotelephone Services and Local Access Charges* dated 25 October 2000. It was based on FDC and actual traffic;

"2004 Draft Competition Guidelines" means the draft Competition Guidelines issued for consultation by the TA in February 2004;

"2007 Draft Competition Guidelines" means the draft Competition Guidelines issued for consultation by the TA in May 2007;

"2010 Draft Competition Guidelines" means the draft Competition Guidelines issued for consultation by the TA in February 2010;

"ARPU" means average revenue per user;

"Authority" or **"TA"** means the Telecommunications Authority and **"OFTA"** means the Office of the Telecommunications Authority;

"BAK" means bill and keep;

"Case Report" means the expert economics report prepared by Case Associates, which was engaged by PCCW to provide an expert opinion based on economic analysis, and **"Case Associates"** means the consultancy firm;

"CBP" means countervailing buyer power;

"China Mobile" means China Mobile Hong Kong Company Limited, an MNO;

"Competition Provisions" means all or any of sections 7K, 7L, and 7N of the Ordinance, as the context requires, which are reproduced in **Annex 1** [of TA's Decision];

"CSL" means CSL Limited, an MNO;

"D-Day" means 27 April 2009, the day on which the TA's withdrawal of the legacy regulatory guidance in favour of MPNP took effect;

"EBITDA" means earnings before interest, tax, depreciation, and amortisation. This is a measure of profitability of a firm without taking cost of capital into account;

"ECJ" means the European Court of Justice (replaced by the Court of Justice under the Treaty on the Functioning of the European Union, which came into force in December 2009);

"**Ex post Statement**" means the statement *Implementation of ex post Regulation of the Tariffs of PCCW-HKT Telephone Limited under a New Fixed Carrier Licence* issued by the TA on 13 January 2005;

"**FCL**" means fixed carrier licence;

"FDC" means fully distributed cost, defined as the total unit cost attributable to the service in question, plus some sharing of common costs incurred for the service in question and other services provided by the operator;

"FMC Statement" means the statement *Deregulation for Fixed-Mobile Convergence* issued by the TA on 27 April 2007;

"FMIC" means fixed mobile interconnection charge;

"FMIC Increase" means the increase of FMIC from 4.36 cents to 5.45 cents per minute;

"FNO" means fixed network operator;

"Frontier" means Frontier Economics Limited, which was engaged by the TA to provide an expert opinion based on economic analysis;

"FTF" means fixed to fixed;

"FTM" means fixed to mobile;

"FTNS" means fixed telecommunications network services;

"HKBN" means Hong Kong Broadband Network Limited, an FNO;

"HKCTV" means Hong Kong Cable Television Limited, an FNO;

"Hutchison" refers to the relevant company or companies within the group of companies controlled by Hutchison Whampoa Limited [1] which the context requires, including Hutchison Global Communications Limited and Hutchison Telephone Company Limited;

"Hutchison Fixed" refers to the fixed network services operation controlled by Hutchison, and as the context requires, the licensed FNO of that operation, namely Hutchison Global Communications Limited;

"Hutchison Mobile" refers to the mobile network services operation controlled by Hutchison, and as the context requires, the licensed MNO of that operation, namely Hutchison Telephone Company Limited;

"Hutchison Mobile Complaint" means the complaint filed by Hutchison Mobile described in paragraph 4.3 below;

"Increased FMIC" means the increased FMIC tariff with effect from 1 June 2008 to 28 April 2009;

"LRAIC" means long run average incremental cost, defined as the difference in the operator's total costs with and without the service supplied, divided by the total output of the service in question;

"MNO" means mobile network operator;

"MPNP" means mobile party's network pays;

"MTF" means mobile to fixed;

"MTM" means mobile to mobile;

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[1] Hutchison Fixed is operated by Hutchison Global Communications Limited. Hutchison Mobile is operated by Hutchison Telephone Company Limited. Hutchison Global Communications Limited and Hutchison Telephone Company Limited are respectively 100% and 75.9% held by Hutchison Telecommunications Hong Kong Holdings Limited, which belongs to the Hutchison Whampoa group and is 60.4% held by Hutchison Whampoa Limited.

"New World" means New World Telecommunications Limited, an FNO;

"off-net" means between different networks;

"on-net" means within the same network;

"Ordinance" means the Telecommunications Ordinance (Cap 106);

"Oxera Report" means the expert economics report prepared by Oxera Consulting Ltd, which was engaged by SmarTone to provide an expert opinion based on economic analysis, and **"Oxera"** means the consultancy firm;

"PCCW" refers to the relevant company or companies within the group of companies controlled by PCCW Limited which the context requires, including PCCW-HKT, HKT and PCCW Mobile HK Limited;

"PCCW Fixed" refers to the fixed network services operation controlled by PCCW, and as the context requires, the licensed FNO of that operation[2];

"HKT" means Hong Kong Telecommunications (HKT) Limited;

"PCCW-HKT" means PCCW-HKT Telephone Limited;

"PCCW FMIC Tariff Statement" means the statement *Increase in Charges for Mobile Network Interconnection by PCCW-HKT Telephone Limited* issued by the TA on 23 May 2008, reproduced in **Annex 2** [of TA's Decision];

"PCCW Mobile" refers to the mobile network services operation controlled by PCCW, and as the context requires, the licensed MNO of that operation[3]**;**

"PSTN" means public switched telephone network;

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[2] PCCW's FTNS were, at the material time, provided under FCL No 050. The licence was held by PCCW-HKT alone before 28 November 2008. From 28 November 2008, the licence was held jointly by PCCW-HKT and HKT.

[3] PCCW's 2G and 3G mobile network licences (but not its CDMA licence) were held by PCCW Mobile HK Limited until 28 November 2008. From that date those licences were in the name of HKT. PCCW's CDMA licence is held in the joint names of PCCW-HKT and HKT.

"Relevant Period" means the roughly 11 months period from 1 June 2008 to 28 April 2009;

"SAC" means stand alone costs;

"SC" means Special Condition;

"SmarTone" means collectively SmarTone Mobile Communications Limited and SmarTone 3G Limited, both of which are MNOs;

"SmarTone Complaint" means the complaint filed by SmarTone described in paragraph 4.1 below;

"SmarTone Fixed" means SmarTone Communications Limited, an FNO;

"UILAS tariff" means unified interconnection and local access services tariffs of PCCW Fixed described in paragraph 3.15 below;

"WTT" means Wharf T&T Limited, an FNO;

"Yarrow and Decker Report" means the expert economics report prepared by Professor George Yarrow and Dr Chris Decker, who were engaged by CSL to provide an expert opinion based on economic analysis, and **"Yarrow and Decker"** means Professor Yarrow and Dr Decker.

3. BACKGROUND TO FMIC

Hong Kong's Unique MPNP Policy

3.1 The FMIC arrangement, which applied until 27 April 2009, was introduced in 1984. In the early years of this arrangement, mobile services were perceived to be a premium "value-added service". The local fixed telephony service was provided by the franchised FNO and the concerned tariff was regulated in the form of a flat-rate monthly package, which was below operating cost. The resulting loss was cross-subsidised by the provision of the profitable international telephony service. The retail price of mobile services was not regulated from the very beginning. As MNOs charged their customers on a per-minute basis for both incoming and outgoing calls, it was considered reasonable for the MNOs to pay the franchised FNO an interconnection charge for a call between a customer of the mobile network and a customer of the fixed network, irrespective of the

direction of the call. If this asymmetric MPNP arrangement had not been adopted at that time, the franchised FNO would almost inevitably have had to increase the flat monthly fees of their customers to cover the costs for carrying the calls to or from the MNOs[4].

3.2 Before July 1995, fixed mobile interconnection was a service provided by PCCW Fixed[5] to the MNOs, the tariff for which was approved by the Legislative Council after vetting by the TA[6]. Under the MPNP arrangement, a charge was payable by MNOs to PCCW Fixed[7] for every call made from the franchised fixed network to a mobile customer, as well as for every call made from a mobile customer to the franchised fixed network. The manner in which the FMIC charge at the network level was reflected in the retail prices for mobile services. The level at which the retail prices for the mobile services were set have never been regulated in Hong Kong and have been left entirely to the commercial decision of the MNOs[8].

3.3 In July 1995, some ten years after the establishment of the MPNP policy for the FMIC, the Government ended PCCW's historical local fixed line monopoly with the TA granting three additional fixed carrier licences. With the new FNOs also requiring interconnection with the MNOs, it was necessary for the TA to generalise his policy on mobile carrier interconnection.

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4 Paragraph 34, FMC Statement.

5 PCCW Fixed has undergone various changes of ownership. It was known as Hong Kong Telephone Company Limited then and operated under an exclusive franchise under the repealed Telephone Ordinance (Cap. 269)

6 See **Annex 4** [of TA's Decision] referred to in paragraph 3.10.

7 In 1985, one of the MNOs, CSL, was owned by PCCW. PCCW ended its ownership of that business in 2002.

8 Traditionally the MNOs have not itemized FMIC in subscriber invoices. The market structure for FNOs and MNOs, from the introduction of MPNP through to 2009, is illustrated in **Annex 4** [of TA's Decision] referred to in paragraph 3.10.

3.4 Consequently, the TA issued Statement No 7 in June 1995[9] stipulating that the settlement of the interconnection charges between fixed and mobile networks should continue to follow the MPNP arrangement. Legislative Council's oversight of all PCCW's tariffs under the Telephone Ordinance (Cap 269) also ceased at that point and *ex ante* supervision of the company's tariffs, including the FMIC rate level, became the sole responsibility of the TA under the terms and conditions of PCCW's FTNS licence.

3.5 Prior to 14 January 2005, PCCW Fixed was the only FNO subject to the *ex ante* tariff supervision due to its presumed dominant position as the incumbent operator in the market of local fixed telecommunications services. From July 1995 to January 2005, under the terms and conditions of its FTNS licence, PCCW Fixed was presumed dominant and was obliged to apply to the TA for prior approval for every individual discount, promotion or change in tariff of its fixed telephony services. For each application, PCCW Fixed was required to submit relevant cost information to allow the TA to carry out a profitability analysis and determine whether or not there was any prohibited pricing behaviour. Under the relevant licence conditions, the TA was obliged to approve or reject any tariff revision within 30 days and any tariff for new services within 45 days of receipt of the application.

3.6 On 13 January 2005, the TA issued the Ex post Statement. In this statement, the TA decided to implement the *ex post* regulation of the tariffs of PCCW Fixed by means of an FCL replacing the company's FTNS licence. Under the terms and conditions of the replacement FCL, PCCW Fixed no longer needs to obtain prior approval of tariffs or discounts that concern retail services.

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[9] TA Statement *Interconnection and Related Competition Issues Statement No 7 "Carrier-to-Carrier Charging Principles"* dated 10 June 1995. Statement No 7 was revised on 18 November 1997, 18 March 2002 and 27 April 2009. The MPNP regulatory guidance was maintained in both the November 1997 "Revised" version and March 2002 "Second Revision" version of the statement. In the Third Revision of TA Statement No 7 of 27 April 2009, the MPNP regulatory guidance was removed.

3.7 However, while the *ex post* tariff approval arrangement was to be applied in general to all retail services of PCCW Fixed, the TA continued to maintain *ex ante* control on certain then ongoing interconnection related tariffs with a view to preventing their use in a manner which offended the Competition Provisions, which was a concern raised by a number of respondents to the consultation on the new *ex post* arrangements. As a result, a special condition (SC 3.4) was incorporated into the *ex post* FCL granted to PCCW Fixed, specifying that any amendment to the published interconnection tariffs of PCCW Fixed which were in force at 1 December 2004 and listed in Schedule 7 to the FCL must first be approved by the TA in writing. FMIC was one of the items listed in Schedule 7 to PCCW's FCL.

3.8 FCL No 050, issued to PCCW Fixed, is reproduced in **Annex 3**[10] [of TA's Decision]. SC 3.4 of this licence is the operative provision governing the requirements and process for the TA's supervision of FMIC tariff revisions. It provides that –

> *Any amendment to* ***any published tariff of the licensee for interconnection, which was in force at 1 December 2004 and continues in force, including those interconnections listed in Schedule*** *7 [emphasis added], must first be approved by the Authority in writing, and*
>
> *(a) the Authority shall approve every such amendment where, in the Authority's opinion the amended tariff would not be in contravention of section 7K, 7L or 7N of the Ordinance; and*
>
> *(b) any such amendment shall be deemed to be approved unless the Authority notifies the licensee in writing, within 30 days after receiving the proposed amendment from the licensee, of the Authority's opinion that the amendment would contravene section 7K, 7L, or 7N of the Ordinance.*

PCCW Fixed's FMIC pre-dated 1 December 2004 and the interconnection between PCCW Fixed and the MNOs was, until 27 April 2009, listed in Schedule 7.

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[10] FCL No 050 was updated on 27 April 2009 to remove the FMIC from Schedule 7.

3.9 Thus under the *ex ante* approval scheme, the TA may disapprove an amendment of the interconnection tariff if the TA forms a view that it is in contravention of the Competition Provisions. However, that decision must be made within a period of 30 days from the day of the application submitted by PCCW Fixed. If the TA is not able to decide whether or not to approve the amendment of the interconnection tariff, it would be deemed approved after 30 days from the day of the application being made.

3.10 **Annex 4** [of TA's Decision] outlines the development of the mobile and fixed line market structures from 1984 through to 2009, and references the changes to the powers of the Government and the TA to give effect to MPNP policy and to control the level of the FMIC rate.

FMIC Deregulation

3.11 In September 2005, the TA commenced a public consultation on issues associated with telecommunications convergence[11]. On 27 April 2007, the TA issued the FMC Statement announcing the regulatory changes to be made following the review. In respect of the FMIC arrangements, the regulatory guidance in favour of MPNP was withdrawn, subject to a two year transitional period from that date. No replacement regulatory guidance was proposed. If market conditions were to change, or there were other indications of likely market failure, the need for new regulatory guidance on FMIC would be considered afresh.

3.12 The TA explained the decision to deregulate interconnection pricing in the following terms:

> *... the primary concerns for the regulator are the effects on competition, investment and innovation; and ultimately better services and wider choices from the perspectives of end users/consumers*[12].

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[11] The fixed mobile convergence (FMC) consultation commenced with the issue of a consultation paper *Revision of Regulatory Regimes for Fixed-Mobile Convergence* on 21 September 2005. The FMIC arrangement was not amongst the areas reviewed by the September 2005 consultation paper. Consultation on the FMIC arrangement was conducted in the second FMC consultation paper *Deregulation for Fixed-Mobile Convergence* issued on 14 July 2006.

[12] The quotation is from paragraph 53 of the FMC Statement.

The MPNP arrangement involves a cross-subsidy between FNOs and MNOs (ultimately between fixed and mobile users). MNOs are required by regulation to pay FMIC regardless of their bargaining power. There are two principal consequences. MNOs have fewer resources to invest in innovation in order to compete against the FNOs and the MPNP guidance distorts the investment decisions of FNOs and MNOs. Withdrawing the MPNP guidance would leave the telecommunications industry to compete, invest and innovate on the basis of market incentives, instead of having to adapt to prescriptive regulatory distortion of the market[13].

PCCW Fixed's FMIC Tariff

3.13 As explained in paragraph 3.5 above, historically, only the FMIC rate of the incumbent PCCW Fixed was ever subject to the TA's *ex ante* supervision[14]. In regulating the level of PCCW Fixed's FMIC tariff, the TA conducted periodic reviews of costing data supplied by PCCW Fixed and established an acceptable price based on an FDC model[15]. After each review, the TA would announce the level of the FMIC tariff of PCCW Fixed in the form of a TA statement.

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13 The quotation is from paragraph 54 of the FMC Statement.

14 Paragraph 5 of the TA statement *Charges for Interconnection between Public Mobile Radiotelephone Services (PMRS) and Value Added Services (VAS) and the Public Switched Telephone Network (PSTN)* dated 1 June 1996 stated, "*The revised charges only apply to HKTC's published interconnect tariffs. The other three fixed telecommunication network services (FTNS) operators are free to offer their own interconnection arrangements and charges to PMRS and VAS operators. The charging principles stated in Statement No 7, "Carrier-to-Carrier Charging Principles" issued on 10 June 1995, will apply if the TA is requested to make a determination on interconnection between FTNS operators in relation to such interconnection services. In such an eventuality the TA would expect the charges applying between FTNS operators to be no greater than HKTC's published interconnection tariffs. The TA will continue to allow the FTNS operators to negotiate commercially the charges between them but he is prepared to intervene if resolution of these charges is not forthcoming in a timely manner.*"

15 See TA statement *Review of Methodologies for Calculation of Interconnection Charges for Value-Added Services and Public Mobile Radiotelephone Services and Local Access Charges* dated 25 October 2000.

3.14 Between June 1996 and November 2004, the TA conducted eight reviews in total and approved the levels of PCCW Fixed FMIC tariff as follows:

Date of TA statement	**FMIC tariff level (per minute basis)**	**Effective date of revised tariff**
Immediately before June 1996	9.0 cents	NA
1 June 1996	6.7 cents	1 June 1996
15 May 1998	6.4 cents	1 June 1998
8 October 1999	5.9 cents	1 October 1999
25 October 2000	5.1 cents	1 October 2000
29 September 2001	4.8 cents	1 October 2001
30 September 2002	4.5 cents	1 October 2002
24 October 2003	4.36 cents	1 October 2003
12 November 2004[16]	4.36 cents (no change)	NA

[16] In the statement of 12 November 2004, the TA stated that "*The findings of recent three annual reviews have pointed to a higher cost for both VAS and PMRS/PCS interconnection. The main reason is that the traffic and network growth pattern have changed. Both traffic and network costs are decreasing; but as traffic volume has been dropping much faster than network cost, the unit cost would go up. It is expected that this trend will continue if the PSTN traffic of PCCW-HKTC keeps decreasing. As the existing methodology was reviewed in Year 2000 when the traffic pattern and network growth back then were quite different from the present conditions, there is apparently a case for conducting a review. In this respect, OFTA will conduct a consultation to solicit views from the industry regarding the appropriateness of the existing calculation methodology, including the use of fully distributed cost standard and actual interconnection traffic, before he proceeds to review the level of interconnect charges next year*" (paragraph 5). As a result, on 8 July 2005, the TA issued an industry consultation paper *Review of the Need for Regulation, and Methodologies for the Calculation, of Interconnection Charges for Interconnection between Local Fixed Carriers and Value-Added Services and Mobile Services*. The TA did not conclude the exercise because it was overtaken by other events, notably the other consultation exercises conducted by the TA in respect of fixed-mobile convergence, which culminated in the issue of the FMC Statement.

PCCW Fixed's FMIC Increase in 2008

3.15 On 10 August 2007, PCCW Fixed published the UILAS tariff[17] providing for, *inter alia*, a new tariff for interconnection between PCCW Fixed and the MNOs. As the UILAS tariff was new and therefore not one "*in force at 1 December 2004*", it was not required, by SC 3.4, to be submitted for prior approval by the TA. The UILAS tariff was presented as the basis for negotiating an alternative to the interconnection terms in the FMIC tariff. It involved a progressive discount of the existing FMIC rate over a five year period from 2007 so as to lessen the impact on PCCW of an abrupt revenue loss which would take effect from April 2009, and which was estimated to amount to $390 million[18] *per annum*.

3.16 On 17 April 2008, PCCW Fixed applied to the TA under SC 3.4 for approval to increase the FMIC from 4.36 cents per minute to 9.5 cents per minute. PCCW Fixed stated that the rate increase was temporary and would end on 28 April 2009. On 7 May 2008, PCCW Fixed submitted an amendment to its proposal reducing the proposed rate from 9.5 cents per minute to 5.45 cents per minute.

3.17 On 23 May 2008, the TA published the PCCW FMIC Tariff Statement, announcing that PCCW Fixed's application to increase FMIC was deemed to be approved by the TA pursuant to SC 3.4. The approval was "deemed" because the TA did not arrive at a definitive view as to whether the tariff increase would or would not contravene any of the Competition Provisions. Therefore, by operation of SC 3.4(b), the tariff was deemed to be approved after the 30 day period had elapsed.

3.18 The TA's views on the tariff increase were set out in paragraphs 19 to 23 of the PCCW FMIC Tariff Statement. The same statement also explained that since the TA was not giving positive clearance to the FMIC Increase, the question of whether the tariff increase was anti-competitive was an open one under the Competition Provisions[19].

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17 PCCW Fixed first published the UILAS tariff on 10 August 2007 (Gazette No 32/2007). PCCW Fixed published revision to the UILAS tariff on 6 June 2008 (Gazette No 23/2008) and further revision on 22 April 2009. None of the MNOs took the UILAS tariff.

18 PCCW's 2009 Annual Result Presentation (http://www.pccw.com/staticfiles/PCCWCorpsite/About%20PCCW/Investor%20Relations/Presentations/2009/20100309_presentation.pdf).

19 See paragraph 25 of the statement.

3.19 In the Hong Kong Government Gazette of 23 May 2008[20], PCCW Fixed announced that the FMIC would be revised to 5.45 cents per minute with effect from 1 June 2008. On 21 April 2009, PCCW Fixed published an amendment to its FMIC tariff, reducing the tariff level to 4.36 cents per minute with effect from 28 April 2009[21]. The FMIC tariff of 5.45 cents per minute was thus applicable for a period of approximately 11 months.

3.20 PCCW Fixed's increase of its FMIC from 4.36 cents to 5.45 cents per minute is the subject matter of this investigation."

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[20] Gazette No 21/2008.

[21] The reversion of the FMIC tariff to 4.36 cents per minute coincided with the deregulation of MPNP on D-Day, when the MPNP regulatory guidance was withdrawn. The MNOs responded to PCCW's purported claim for an MPNP payment after D-Day with their own tariff for fixed network connection to the MNO's network. As far as OFTA is aware, no MNO is paying interconnection charges to any FNO on the basis of MPNP since D-Day. The actual outcome following D-Day appears to be that by default, the operators are adopting the same BAK approach to call termination costs, as applies within the mobile sector.