Consultation Paper issued by
The Office of the Telecommunications Authority

Draft Telecommunications Authority Guidelines

Anti-Competitive Conduct
In Hong Kong Telecommunications Markets

28 February 2004

Introduction

1. The Telecommunications Authority (TA) intends to issue new guidelines dealing with sections 7K, L and N of the Telecommunications Ordinance. These sections deal with anti-competitive conduct by licensees. The new guidelines will replace the Guidelines to Assist the Interpretation and Application of the Competition Provisions of the FTNS Licence issued in June 1995. Since the publication of the 1995 Guidelines, the anti-competitive conduct provisions of the Ordinance have come into force and the TA wishes to provide practical guidance on the statutory prohibitions which have largely superceded the equivalent provisions in the FTNS licences.

2. The draft guidelines seek to explain how the TA applies and enforces the anti-competitive conduct provisions of the Ordinance. The guidelines set out the analytical framework which the TA adopts to assess any potentially anti-competitive conduct and also summarise the procedures which the TA follows in investigating cases.

3. This consultation exercise is independent of any on-going consideration of competition cases or applications. The proposed new guidelines will only come into effect when published in their final form. The guidelines will be issued in due course under section 6D of the Ordinance. By virtue of section 6D(4)(a) the TA is required to consult the licensees in the relevant telecommunications market before issuing any guidelines on the test of dominance prescribed in section 7L(2).

4. Before the new guidelines are issued, the TA will continue to refer to the existing

guidelines in the performance of his functions under section 7K to 7N or the equivalent licence conditions.

Timing

5. The TA will allow a period of eight weeks for consultation. Responses to the consultation paper should reach the Office of the Telecommunications Authority on or before **26 April 2004**.

Invitation to Comment

6. Views and comments on this consultation paper should be sent to the Office of the Telecommunications Authority. Any person who submits views and comments should be aware that the TA may publish all or any part of the views and comments received and disclose the identity of the source in such manner as the TA sees fit. Any part of the submission which is considered commercially confidential should be marked, together with the reasons for such claims. The TA will take such markings into account in making his decision as to whether or not to disclose such information. Submissions should be addressed to:

Office of the Telecommunications Authority
29/F Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong

Attention: Mr. Edward Whitehorn,
Head, Competition Affairs Branch

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Office of the Telecommunications Authority

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CONTENTS Page

1. INTRODUCTION

1.1 These guidelines ("the Guidelines") are issued by the Telecommunications Authority ("TA") under section 6D(1) of the Telecommunications Ordinance (Cap. 106) ("the Ordinance") for the purpose of providing practical guidance on:

(a) section 7K, relating to anti-competitive practices of licensees;

(b) section 7L, relating to abuse of a dominant position; and

(c) section 7N, prohibiting discrimination,

("the anti-competitive conduct provisions").

1.2 The Guidelines explain how the TA will apply and enforce the provisions of these sections and, in particular, the matters he will take into account when deciding whether any conduct has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. The TA will not depart from these Guidelines without providing reasons in writing for doing so[1].

1.3 The Guidelines cannot, and do not aim to, provide a definitive response to any particular conduct, but rather they are a guide as to when conduct may fall within the prohibitions contained in the relevant sections. Determining whether any particular conduct contravenes these prohibitions requires a consideration of the specific facts of each case.

1.4 The Guidelines state the TA's current views and procedures in relation to the enforcement of the anti-competitive conduct provisions. They are not exhaustive and will be updated and reviewed in the light of changing circumstances. The Guidelines should not be seen as a substitute for the Ordinance and anyone who believes they may be affected by sections 7K, L or N should consider seeking legal advice.

1.5 When interpreting the meaning of the anti-competitive conduct provisions, the TA may have regard to previous TA decisions as well as the interpretation and application of similar provisions in other jurisdictions, as has been the practice

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

with other TA decisions. This will enable the TA to consider how issues have been addressed and resolved in other jurisdictions and to take account of international best practice. The TA will obviously be mindful of the circumstances prevailing in Hong Kong. The TA will form his opinion on any anti-competitive conduct on reasonable grounds and having regard to relevant considerations, as required by the Ordinance[2].

[2] Section 6A(3)(a) of the Ordinance.

2. SECTIONS 7K, 7L AND 7N

2.1 The substantive provisions are sections 7K, 7L and 7N of the Ordinance which read as follows:

Section 7K. Anti-competitive practices

(1) A licensee shall not engage in conduct which, in the opinion of the Authority, has the purpose or effect of preventing or substantially restricting competition in a telecommunications market.

(2) The Authority in considering whether conduct has the purpose or effect prescribed under subsection (1) is to have regard to relevant matters including, but not limited to-

(a) agreements to fix the price in a telecommunications market;

(b) an action preventing or restricting the supply of goods or services to competitors;

(c) agreements between licensees to share any telecommunications market between them on agreed geographic or customer lines;

(d) the conditions of relevant licences.

(3) Without limiting the general nature of subsection (1), a licensee engages in conduct prescribed under that subsection if he-

(a) enters into an agreement, arrangement or understanding that has the purpose or effect prescribed by that subsection;

(b) without the prior written authorization of the Authority, makes the provision of or connection to a telecommunications network, system, installation, customer equipment or service conditional upon the person acquiring it also acquiring or not acquiring a specified telecommunications network, system, installation, customer equipment or service, either from the licensee or from another person;

(c) gives an undue preference to, or receives an unfair advantage from, an associated person if, in the opinion of the Authority, a competitor could be placed at a significant disadvantage, or competition would be prevented or substantially restricted.

Section 7L. Abuse of position

(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 from 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.

(5) The Authority may consider conduct to fall within the conduct referred to in subsection (4) as including, but not limited to-

(a) predatory pricing;

(b) price discrimination, except to the extent that the discrimination only makes reasonable allowance for differences in the costs or likely costs of supplying telecommunications networks, systems, installations, customer equipment or services;

(c) making conclusion of contracts subject to acceptance by other parties of terms or conditions which are harsh or unrelated to the subject of the contract;

(d) arrangements (other than arrangements the subject of an authorization referred to in section 7K(3)(b)) requiring a person seeking the provision of or connection to a telecommunications network, system, installation, customer equipment or service conditional upon the person acquiring it also acquiring or not acquiring a specified telecommunications network, system, installation, customer equipment or service either from the licensee providing the service or from another person;

(e) discrimination in supply of services to competitors.

Section 7N. Non-discrimination

(1) Subject to subsection (4) and without prejudice to the operation of section 7K, a licensee who is in a dominant position in a telecommunications market shall not discriminate between persons who acquire the services in the market on charges or the conditions of supply.

(2) Subject to subsection (4), an exclusive licensee or a carrier licensee shall not discriminate between a person who lawfully acquires and uses telecommunications networks, systems, installations, customer equipment or services to provide services to the public and any other person who is not providing a service to the public.

(3) Discrimination includes discrimination relating to-

(a) charges, except to the extent that the discrimination only makes reasonable allowance for difference in the cost or likely cost of

supplying the service;

(b) performance characteristics; and

(c) other terms or conditions of supply.

(4) The prohibitions in subsections (1) and (2) apply only where in the opinion of the Authority such discrimination has the purpose or effect of preventing or substantially restricting competition in a telecommunications market.

Conduct of licensees

2.2 All three of the above sections of the Ordinance relate to the conduct of licensees. This conduct includes both direct and indirect conduct and includes acts and omissions. Types of conduct falling within the ambit of each prohibition are set out in the relevant section[3]. However, these lists are not exhaustive and it remains open to the TA to consider any types of conduct which meet the elements of the anti-competitive conduct provisions.

Section 7K

2.3 Section 7K prohibits conduct by licensees where that conduct has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. This is the broadest prohibition, but the same test is also to be found in sections 7L and 7N. This test is considered in detail in chapter 3.

2.4 The prohibition in section 7K relates to agreements and collusive conduct but also applies to unilateral conduct by a single licensee. Certain conduct by a licensee is deemed to be in breach of the prohibition by section 7K(3). Specific types of conduct which infringe the prohibition in section 7K are considered in chapter 5.

Section 7L

[3] See s7K(3), s7L(5) and s7N(3).

2.5 This section relates to licensees which are in a dominant position. There is nothing objectionable about a licensee being in a dominant position. It only means that the licensee must ensure that it does not abuse its dominant position. Conduct by a dominant licensee that prevents or substantially restricts competition is deemed to be an abuse[4]. However, it is not necessary for this test to be satisfied in order to establish a breach of section 7L. Other conduct can also be abusive. The concept of a dominant position is explained in chapter 6 and conduct which may constitute an abuse of a dominant position is considered in chapter 7.

Section 7N

2.6 The third prohibition concerns a licensee which has engaged in conduct involving discrimination between persons who acquire the services in the market, where that conduct has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. Discrimination can relate to charges (except where the discrimination makes reasonable allowance for the difference in cost or likely cost of supplying the service), performance characteristics or the conditions of supply. The section applies to both dominant and non-dominant licensees and consequently this type of conduct may constitute a breach of all three prohibitions. The prohibition of discrimination is considered further in chapter 8.

2.7 Section 7N was originally drafted to be an absolute prohibition on discrimination but during the debate in the Legislative Council on the proposed provision it was amended by inserting the competition test. Consequently there is an overlap between this section and sections 7K and L.

Application of Overlapping sections

2.8 These Guidelines cannot, and do not aim to, provide hard and fast rules on which provision or provisions the TA will use in dealing with conduct which infringes more than one of the sections. Nevertheless, the following general guidance can be provided regarding the TA's general approach:

[4] Section 7L(4)

- Section 7K potentially applies both to unilateral conduct of a licensee and also to collusive behaviour (either between the licensee and other licensees, or the licensee and non-licensees). From a perspective of effective competition, unilateral conduct typically gives rise to concerns only where the licensee in question possesses market power on the relevant market. This is because a licensee with market power may not be subject to the constraints which are usually found under normal conditions of competition, and so may be able to engage in anti-competitive conduct. For that reason, the TA envisages that it is most likely to be appropriate to examine unilateral conduct where the licensee is in a dominant position under section 7L (although the TA does not rule out an investigation under section 7K). Conversely, the TA considers it more likely to be appropriate to examine collusive conduct engaged in by two or more licensees (or by a licensee and non-licensees) under section 7K.

- Where an overlap arises in the application of the prohibition in section 7N and those in sections 7K and 7L as described above, and the conduct consists solely or principally of discrimination, the TA will initially assess whether the conduct constitutes an infringement of the Ordinance under section 7N.

Licence conditions

2.9 It is the TA's intention, so far as possible, to provide a clear framework and to remove uncertainties about the potential application of other provisions that might apply to anti-competitive conduct. Consequently, when the TA is considering anti-competitive conduct, he will usually rely primarily on the anti-competitive conduct provisions in the Ordinance rather than seeking to rely on any similar condition in the relevant licence. However, the licence conditions remain in force and licensees are obliged to comply with them.

Mergers and acquisitions

2.10 With respect to scrutiny of mergers and acquisitions, it is the TA's intention to apply section 7P of the Ordinance [when it comes into force] relating to changes in control exercised over carrier licensees, rather than to rely on

sections 7K or 7L. This is dealt with further in the TA's Guidelines on mergers and acquisitions in Hong Kong telecommunications markets.

Burden and standard of proof

2.11 The burden of proving that there is an infringement of the anti-competitive conduct provisions rests with the TA. The civil standard of proof applies: the TA is required to decide on a balance of probabilities. In other words, 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 breach of one of the prohibitions. However, when the parties to a transaction raise an issue which, in their view, shows that there is no infringement, then it is for them to substantiate their claim. The TA will consider any such claims and verify them to the extent possible, but it is not for the TA to "prove" that the claims are unfounded in the event that they are rejected.

3. THE COMPETITION TEST

3.1 The competition test that the TA is required to apply when assessing potential liability under sections 7K, 7L and 7N of the Ordinance is whether the licensee's conduct has the **purpose or effect** of **preventing or substantially restricting competition** in a **telecommunications market**.

Purpose or effect

3.2 The conduct of licensees will breach the anti-competitive conduct provisions if it has either the purpose or the effect of preventing or substantially restricting competition. Where the TA considers that conduct has as its **purpose** the prevention or substantial restriction of competition within a telecommunications market, it is not necessary for the TA to reach an opinion on whether the conduct of the licensee actually had that effect. Only where the purpose of the conduct in question is unclear is the TA required to look at the effects of the conduct in order to reach an opinion as to whether any of the anti-competitive conduct provisions are infringed. In adopting this approach, the TA is following the jurisprudence of the European Union where the European Court of Justice, in considering whether conduct has the object or effect of adversely affecting competition (under Article 81 of the EC Treaty, which is similar to section 7K), has held that the words "object or effect" are to be read disjunctively[5].

3.3 The purpose in question does not refer to the subjective intention of the parties when engaging in the conduct, but to the objective meaning and purpose of the conduct when considered in its economic context. This approach has often been confirmed by the European Court of Justice. In the TA's view, purpose is to be determined at the time that the conduct occurred and it will be enough for the anti-competitive purpose to be a substantial purpose among a number of purposes of the conduct[6].

3.4 In this regard, the TA considers that certain conduct has as its purpose the prevention or substantial restriction of competition within a

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[5] Societe Technique Miniere v Maschinenbau Ulm, Case 56/65 [1966] ECR 235, p 249

[6] Note that this is the position in Australia by virtue of section 4F of the *Trade Practices Act 1974 (Cth)*.

telecommunications market, contrary to section 7K. This type of anti-competitive conduct includes the following:

- agreements to directly or indirectly fix prices (including resale prices), charges, discounts, allowances or rebates;
- sharing markets on agreed geographic or customer lines;
- bid rigging.

These types of anti-competitive conduct are discussed further in chapter 5.

3.5 In evaluating whether conduct has the **effect** of preventing or substantially restricting competition, the TA will look at the state of competition in the market and compare that to the nature and extent of competition which would exist in the relevant telecommunications market or markets but for the conduct in question. The TA will assess the conduct by examining it in its market and economic context.

Preventing or substantially restricting competition

3.6 The TA considers that "prevent" and "restrict" in the context of the anti-competitive conduct provisions have their ordinary meanings and further clarification is unnecessary.

3.7 The meaning of "substantial" is more ambiguous. The test for deciding whether competition is substantially restricted requires both a quantitative and a qualitative assessment. In the context of section 7N of the Ordinance which prohibits discrimination, the Telecommunications (Competition Provisions) Appeal Board has held that an effect on competition "will restrict '*substantially*' for the purpose of the section of the Ordinance in question if it is large enough to be '*worthy of consideration for the purpose'* of the particular section"[7]. The Appeal Board went on to observe that for an effect on

[7] Following a UK House of Lords case, *R v Monopolies and Mergers Commission ex p South Yorkshire Transport Ltd* [1993] 1 WLR 23, HL.

competition to be substantial, it "must be at least *'significant'* but need not be *'big'*"[8].

3.8 In the US, the pro-competitive effects of agreements can be relevant in a substantial lessening of competition test, and are an accepted part of the analysis under the "Rule of Reason" (that is, where conduct is not *per se* unlawful). If a defendant succeeds in producing evidence of pro-competitive benefits, the burden shifts back to the plaintiff to establish that the restraint at issue was not necessary to achieve those benefits. If the plaintiff cannot meet that burden, and if, on balance, the pro-competitive benefits outweigh the anti-competitive effects (or the balance is even), a restraint is lawful under the Rule of Reason. Pro-competitive justifications that have been credited under US case law include enhanced efficiencies, improved quality, increased output, introduction of new products or otherwise expanding choices available to consumers. On the other hand, that one activity is "more profitable" than another does not mean it is "pro-competitive".

3.9 In Australia, where conduct is being investigated to determine whether it has the purpose or effect of preventing or substantially lessening competition, pro-competitive effects of that conduct in the same market will be relevant to determining the overall effect on competition.

3.10 The TA intends to take account of any pro-competitive effects of the conduct in coming to an opinion on the overall effect on the relevant market. While the TA does not rule out considering pro-competitive effects in telecommunications markets other than the market under investigation, these effects are likely to be given less weight than they would be accorded if they were present in the market under investigation.

Telecommunications market

3.11 A telecommunications market, as defined in section 2 of the Ordinance, is any market for the provision or acquisition of telecommunications networks, telecommunications systems, telecommunications installations, or customer equipment or services. Conduct in a telecommunications market falling within section 2 which has as its purpose or effect a substantial restriction of

[8] PCCW-HKT v TA, Appeal No. 4 of 2002, paragraphs 19 and 20.

competition in either the same telecommunications market where the conduct occurred, or in another upstream, downstream or related telecommunications market falling within section 2, may fall within the anti-competitive conduct provisions.

3.12 In addition, the TA considers that conduct in other markets (that is, markets which might not fall within the definition contained in section 2) but where the conduct has as its purpose or effect a substantial restriction of competition in a telecommunications market may breach the anti-competitive conduct provisions (since the restriction of competition occurs in a market falling within section 2).

4. MARKET DEFINITION

4.1 The concept of a market is a term of art in competition analysis. Competition is a process of rivalry between firms, where each firm constrains the prices of other firms by supplying closely substitutable products: if a firm attempts to raise its price, consumers will switch to the cheaper alternative and make the price rise unprofitable.

4.2 Firms that constrain each other through the supply of close substitutes are said to compete in the same market. The process of market definition thus involves the identification of close substitutes, from both the supply side and the demand side. However, market definition is not an end in itself: it is only a step on the way to deciding whether the conduct in question prevents or substantially restricts competition.

4.3 The market will generally be defined in four dimensions:

- product or service, i.e., the goods and/or services supplied and/or purchased;
- geographic, i.e., the geographic area to or from which the goods and/or services are supplied or purchased;
- functional, i.e., the level in the production or distribution chain at which the goods and/or services are supplied or purchased; and
- temporal, i.e., the supply and purchase of goods and/or services with reference to time.

4.4 The described approach to market definition is a conceptual framework and is not intended to be applied mechanically. Accordingly the TA will not necessarily follow each step indicated below in each case. The TA will look at the evidence which is relevant to the case in question (and, to an extent, will be constrained by the evidence available). In particular it may be clear in certain cases that, although there is potentially more than one market definition, on any sensible market definition the conduct would not be considered a breach of the anti-competitive conduct provisions. In such cases it will not normally be necessary to establish which of the potential market definitions is correct.

The hypothetical monopolist test

4.5 The "hypothetical monopolist" test is generally accepted to be an appropriate tool for defining a market for competition law purposes. Under this approach, a market is defined as a product (or group of products) supplied in a particular geographical area such that a hypothetical profit-maximizing firm that was the only present and future supplier of that product (or group of products) in that area would be able to impose a **s**mall but **s**ignificant and **n**on-transitory **i**ncrease in **p**rice ("SSNIP") without suffering any adverse consequence.

4.6 This is commonly referred to as the "SSNIP" test. Under this test, a price increase of five to ten per cent lasting for the foreseeable future has been widely used as the standard for measuring the magnitude of a small but significant and non-transitory increase in price. Depending on the circumstances of each case, however, a higher or lower figure than five to ten per cent may be used and in some cases the prevailing market price is not a good starting point (see the discussion of the "cellophane fallacy" in paragraphs 4.20–4.23). It is difficult to quantify in a general sense how long is the "foreseeable future" but one year is considered to be a reasonable period. In other words, substitution responses that would undermine a price increase would be expected to take place before one year was out. This period is only a rule of thumb however, and may vary depending on the circumstances of the case.

4.7 The market can be viewed as the narrowest product category, supplied in the smallest geographical area, over which a hypothetical monopolist could exercise market power (that is, profitably maintain a SSNIP). This would only be possible if all sources of close substitutes have been included in the definition of the market. Substitutes do not have to be identical products to be included in the same market.

4.8 The process of establishing the relevant market boundaries starts with:

- those products (either goods or services) supplied by the firm under investigation in respect of which there is some competition concern; and

- the geographical area within which the products are supplied.

4.9 The **product** is described in terms of particular characteristics or features from which one can assess the extent of its substitutability with other products. This usually includes a description of the functionality or the purpose for which it is

supplied (for example, a local circuit to carry telecommunications services) and the functional level in the supply chain at which it is supplied (for example, at the wholesale level to service providers or at retail level to end-customers). Products may be defined by reference to time (for example, telephone calls at peak and off-peak hours) or particular groups of customers (for example, business and residential customers). The geographical area of supply will vary depending on the circumstances of the case but may, for example, be on a wide global or regional basis or limited to supply within the Hong Kong Special Administrative Region.

4.10 This description establishes the initial market boundary in both the product and geographic dimensions. In determining whether a hypothetical monopolist would be in a position to impose a price increase or otherwise exercise market power in relation to the product so described, it is necessary to assess two types of responses:

- the likely response of consumers to a price increase ("**demand-side**" responses): a price increase could be made unprofitable by consumers switching to other products; and

- the likely response of suppliers to a price increase ("**supply-side**" responses): a price increase could be made unprofitable by other firms switching their production lines at relatively short notice to supply switching customers.

4.11 If in response there is a level of substitution that is large enough to make the price increase unprofitable, these products are considered to be close substitutes and are identified as being in a group of closely substitutable products that are supplied in the same market. The responses to a price rise by a hypothetical monopolist supplier of this new expanded group of products are then assessed.

4.12 In this iterative fashion, the initial market boundary is progressively extended to include all those sources of close substitutes that would make it non profit-maximizing for a hypothetical monopolist to impose a price increase. The TA will typically then consider the relevant market to be the smallest group of products that satisfies the SSNIP test.

4.13 The market should not normally be expanded beyond this group of products. If the market is defined too broadly then any anti-competitive effect of the conduct is likely to be understated because of the inclusion in that market of firms and products that do not effectively constrain the exercise of market power. Conversely, a market defined too narrowly is likely to overstate the anti-competitive effect. This is particularly relevant in the telecommunications sector where services may be bundled together which cannot economically be provided separately. Attempts to define such individual services as separate markets could over emphasise any anti-competitive effects.

4.14 The process described above focuses on defining the boundaries of the market in its product/service dimension. An analogous process is used for defining the **geographic** boundaries: the market boundaries are expanded to include those geographic areas where consumers may source close substitutes and from where firms may supply close substitutes in the event of a price increase.

4.15 In telecommunications markets, the geographical scope of the relevant market is usually defined by reference to the area covered by a network and the existence of legal and other regulatory restrictions. Since the Hong Kong telecommunications market is now fully liberalised, the geographic market is likely to be determined primarily by the extent of the network coverage.

Functional Level

4.16 The production, distribution and sale of goods and services typically occur through a series of functional levels. It is useful to identify the relevant markets at each functional level that is affected by the conduct, e.g., manufacturing, wholesale or retail, to assess the competitive impact, especially in relation to any vertical integration.

Temporal markets

4.17 A market may also be defined by reference to time. Temporal markets might include the provision of peak and off-peak services (for instance where customers are not able to substitute between the time periods), seasonal products (where the demand arises only during a certain time period) or inter-generational products (where customers defer expenditure on present products because they believe innovation will soon produce better substitutes).

Temporal markets are, to a certain extent, an extension of the product market, e.g. the supply of product X at a certain time.

Evidence of substitution responses

4.18 Being a hypothetical test, the necessary evidence is unlikely to be available from the market on demand-side and supply-side responses to a small but significant and non-transitory increase in price by a hypothetical monopolist. However, the importance of the SSNIP test is that it imposes a disciplined objective framework on the analysis of market definition.

4.19 Despite the hypothetical nature of the test, evidence can be obtained from which one can draw reasonable inferences about substitution possibilities and, therefore the boundaries of the relevant market. In applying the SSNIP test and assessing substitution possibilities, the TA will take into account relevant evidence, including:

- past evidence that customers have switched between telecommunications service suppliers in response to relative changes in price or in other competitive dimensions (such as quality, service levels, innovation, etc);

- past evidence that suppliers of telecommunications services have responded to the prospect of customers switching suppliers in response to relative changes in price or in other competitive dimensions;

- evidence that potential suppliers of telecommunications services can rapidly respond and supply a close substitute service in response to relative changes in price or in other competitive dimensions without incurring significant investment costs (see discussion below on supply-side substitution and market entry);

- evidence on the timing and costs of switching, as incurred by both consumers and potential suppliers;

- in relation to wholesale markets, evidence that a reseller is influenced by downstream competition to switch between wholesale suppliers because a wholesale price increase cannot be passed on to end-customers; and

- views from competitors, suppliers and customers on their likely response to a price increase.

The competitive price level and the "cellophane fallacy"

4.20 Under the SSNIP test, an increase in price is assumed to be an increase above the competitive price level prevailing in the market. Of course, not all markets are perfectly competitive. In monopolistic or oligopolistic markets characterised by co-ordinated activities (which can occur in deregulated telecommunications markets), the prevailing market price is likely to be higher than competitive levels and may approach the limit of what the market will bear.

4.21 In such a situation it may not be possible for even a hypothetical monopolist to further increase prices. This lack of an ability to increase prices does not reflect the availability of close substitutes around which the market boundaries should be drawn. A danger exists that, when applied to a price that is already monopolised, the SSNIP test could lead to the inclusion of products or geographic areas that are not, in fact, close substitutes. Such a market would be inappropriately broad in view of the market power already present in a more narrowly defined market.

4.22 The dangers of using current prices as the base price for market definition where that price reflects limit pricing was highlighted by a US case involving cellophane products[9]. Mistakenly applying current prices that are above competitive levels as a base price has become known as the "cellophane fallacy" after the case.

4.23 Bearing in mind the cellophane fallacy, the TA will exercise care in determining the appropriate base price in markets that are already less than competitive and it may be necessary to have regard to other methods of assessment when determining the scope of the relevant market. Telecommunications markets can raise particular issues due to the fact that prices or other related prices may be regulated. Nevertheless, even if pricing controls are in place, it may still be the case that some prices are above competitive levels. In particular, the TA will not automatically adopt the

[9] *United States v E.I. du Pont de Nemours & Co* [1956] 351 US 377

current prices in the market as the base price where there is a concern that the current prices may reflect market power. If there is considered to be market power, the TA will use a price more reflective of a competitive price.

Supply-side substitution v. market entry

4.24 Confusion sometimes arises between what is considered to be a supply-side substitution (a factor relevant to market definition) and entry into a market (a factor usually taken into account in competition analysis once the market has been defined).

4.25 Supply-side substitution concerns the ability of firms to switch their production lines at relatively short notice in response to a price increase and supply a close substitute to the product in question. Firms with this ability may not actually be in the market. However, if they are considered likely to enter rapidly in response to a price increase, they are considered to be market participants because of the constraints that their rapid entry places on a hypothetical monopolist.

4.26 On the other hand, market entry may involve significant sunk costs of entry and exit. Sunk costs are capital costs that can only be used in the production of the product in question and which, once incurred, cannot easily be recouped. An example in telecommunications is the cost of network facilities, which cannot easily be recouped if the investing firm decides to exit the market.

4.27 It is acknowledged that there can be a fine line between supply-side substitution and new entry. Both are forms of market entry and both represent a constraint on market power. The important consideration is to take them both into account at some stage in the analysis. In the interests of consistency of analytical approach, the TA will assess the constraining effect of any potential market entry when assessing the effect on competition between closely substitutable products in the market once that market is defined by reference to, inter alia, supply-side substitution possibilities. The TA will also adopt this approach to market definition when calculating market shares for the purpose of assessing dominance.

Previous cases

4.28 In many cases, a market may already have been investigated and defined by the TA or another competition or regulatory authority. Sometimes, earlier definitions can provide useful guidance in a subsequent case. However, in the light of the dynamic nature of telecommunications markets, although previous cases can provide useful information, the market definition used may not always be the correct one for future cases. Technological changes may make substitution between products easier or more difficult and, therefore, broaden or narrow the market definition.

4.29 In this regard, the TA notes the comments of the European Court of First Instance and its clearly stated view that " ... a market definition in an earlier decision of the [European] Commission could not be binding in the case of a subsequent investigation, … each case must turn on the particular facts and circumstances at the time."[10] The TA takes the view that while previous cases can be informative, they should not be regarded as binding with respect to future decisions.

[10] *Coca-Cola v Commission* [2000] All ER (EC) 460

5. SPECIFIC TYPES OF ANTI-COMPETITIVE CONDUCT UNDER SECTION 7K

5.1 Section 7K includes examples of conduct that may be caught by the prohibition; however, these are non-exhaustive and do not set a limit on the investigation activities of the TA. Section 7K(3)(a) provides that conduct may include "an agreement, arrangement or understanding". The TA takes the view that the concepts of agreement, arrangement and understanding may overlap but will cover different types of conduct. For example, in order for there to be an "agreement", the TA envisages that it will be necessary for there to be something binding at law and enforceable by the parties (although there need be no writing). In contrast, it will not be necessary for there to be any contract binding at law and enforceable by the parties for there to be an "arrangement" or "understanding". Rather, what is required will be something less; a meeting of minds and a consensus as to what is to be done although there must be more than a mere hope that something will be done[11].

5.2 The following paragraphs set out the TA's view of certain common types of anti-competitive conduct, including those specifically mentioned in section 7K. However, it should be noted that any conduct engaged in by a licensee that has as its purpose or effect the prevention or substantial restriction of competition can fall within the section 7K prohibition.

Agreements to fix the price in a telecommunications market

5.3 Agreements between competitors which directly or indirectly fix prices, or agreements between suppliers and distributors which directly or indirectly fix resale prices are likely to infringe section 7K. In the TA's opinion, the **purpose** of such price fixing conduct is to prevent or substantially restrict competition. It follows that the TA will not need to decide whether the conduct has the effect of preventing or substantially restricting competition.

5.4 There are many different types of price fixing activity that may fall within the section 7K prohibition. Price fixing may involve, for instance, fixing the components of a price, setting minimum prices below which prices are not to be reduced, agreeing an increase in prices (by a specified amount, percentage

[11] See, for example, the Australian Federal Court in *ACCC v Amcor Printing Papers Group Ltd* (2000) 169 ALR 344 at 359-60.

or otherwise), or establishing a range outside of which prices are not to move (independent of any regulatory requirements).

5.5 Price fixing may arise indirectly; for instance, it may cover discounts, costs, margins between service grades, transport charges or credit terms. Such indirect price fixing may relate to the actual amount of any charge, discount or term or to the means by which such charges, discounts or terms are calculated.

An action preventing or restricting the supply of goods or services to competitors

5.6 Actions by one or more licensees which prevent or restrict the supply of goods or services to competitors may fall within the prohibition in section 7K. Where such conduct involves, for instance, an express agreement or a form of understanding involving two or more parties where at least one party is a licensee, the TA envisages taking action under section 7K to the extent that such conduct is likely to have either the purpose or the effect of preventing or substantially restricting competition.

5.7 However, where such conduct is engaged in by only one licensee acting unilaterally, it will usually only give cause for concern where the licensee is in a dominant position in the telecommunications market in question[12]. An example of the type of action likely to give rise to concerns is where a licensee which is a large network operator prevents or restricts access to the network to its competitors. Actions by a dominant licensee which prevent or restrict the supply of goods or services are discussed further in chapter 7.

5.8 The TA does not, however, rule out taking action under section 7K against a non-dominant licensee acting unilaterally where the conduct in question might, nevertheless, have the purpose or effect of preventing or substantially restricting competition.

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[12] Whilst this will usually only give rise to concern where the operator is in a dominant position, US authorities also try to capture unilateral misconduct even absent monopolization, in circumstances such as mail or wire fraud or as a violation of Section 5 of the *FTC Act*.

Agreements between licensees to share telecommunications markets

5.9 Where licensees agree to share telecommunications markets, whether by geographic area, type or size of customer or some other way, the TA will usually consider that such agreements have as their **purpose** to prevent or substantially restrict competition. The same considerations apply as with price fixing agreements (see paragraph 5.3).

5.10 On the other hand, some agreements may have the effect of sharing a telecommunications market to some extent, but only as a consequence of (that is, ancillary to) a lawful, efficiency-enhancing object of the agreement. For instance, when providing domestic roaming services, licensees may agree that particular operators will cover particular remote areas. Such an agreement may not have the purpose of substantially restricting competition. However, in situations where the purpose of the agreement is less clear, it may still be necessary for the TA to inquire as to the need for, and basis of, an agreement between licensees in this context.

Collusive tendering/bidding

5.11 Tendering or bidding processes are designed to provide competition where it might not otherwise exist. Any tendering process that involves any form of restriction on submission of tenders submitted by licensees as a result of joint activities (including agreements not to bid, to bid at specified prices, or to share information concerning prospective bids) is likely to fall within section 7K. Such agreements are likely to have the **purpose** of preventing or substantially restricting competition and the same considerations apply as with price fixing agreements (see paragraph 5.3).

Bundling/tying

5.12 Bundling or tying generally involves an agreement to sell one product or service on the condition that the buyer also purchases a different product either from the same supplier or a third party supplier. It may also take the form of a refusal to sell one product or service separately from another product or service from which it is practically or technically distinct. Bundling typically does not raise competition concerns when it is carried out by one individual licensee without market power. Bundling is most likely to give rise to concerns when conducted by a dominant licensee. However, the TA does not

rule out taking action under section 7K against a licensee where the conduct in question results in a substantial restriction of competition (for example, where a number of licensees in the telecommunications market engage in similar bundling arrangements which cumulatively give rise to a substantial restriction of competition). Bundling is discussed further in chapter 7.

5.13 Section 7K(3)(b) specifically states that a licensee may, with the TA's prior written authorization, make the provision of, or connection to, a telecommunications network, system, installation, customer equipment or service conditional upon the person acquiring it also acquiring or not acquiring a specified telecommunications network, system, installation, customer equipment or service, either from the licensee or from another person. In making his assessment whether to give such authorization, the TA will consider whether the conduct in question would adversely affect competition in the telecommunications market in question. The TA would only withhold his authorization if he is of the opinion that the conduct would have the purpose or effect of preventing or substantially restricting competition in a telecommunications market.

Undue preference/unfair advantage

5.14 An undue preference given to, or an unfair advantage received from, an associated person (as defined in the Ordinance) which could place a competitor at a significant disadvantage, or gives rise to a prevention or substantial restriction of competition, will fall within the ambit of section 7K(3)(c). The TA will treat this as two separate tests. Consequently if a competitor could be placed at a significant disadvantage, there will be no need to show that competition would be prevented or substantially restricted.

5.15 An example of this type of anti-competitive conduct could be where a licensee shows undue preference in respect of the quality of interconnection services it provides to interconnecting operators[13]. In determining whether this results in an infringement of section 7K, the TA will look at the quality of the service offered to itself (where the licensee is vertically integrated) and other

[13] That this non-discrimination principle is important is recognised in Australia's *Trade Practices Act* which makes it a requirement that access providers "*take all reasonable steps to ensure that the technical and operational quality of the [service] supplied to the service provider is equivalent to that which the access provider provides to itself*" (section 152AR(3)(b) & (5)(d))

operators, or the quality of service delivered by the licensee to different operators. Not all differences in the quality of service would, however, constitute an infringement. Factors of relevance to the TA's assessment would include whether there was a statistically significant difference in the quality of service offered, whether the difference places a competitor at a competitive disadvantage and whether the cause of the difference was the behaviour of the licensee (rather than that of the competitor, or an external, uncontrollable event).

Information-sharing agreements

5.16 In general, the more information that is made publicly available to market participants and customers, the more effective competition is likely to be. In the normal course of business, licensees may exchange information on a variety of matters legitimately and with no risk to the competitive process. Indeed, the sharing of information, for instance, on new technologies or market opportunities, may enhance competitiveness.

5.17 However, exchange of information may restrict competition where it serves to remove uncertainties in the market place and eliminate competition between participants in the market. Information exchange may facilitate tacit collusion and result in licensees conducting their affairs in such a way that competition is substantially restricted. Whether or not information exchange results in such a substantial restriction of competition will depend on the circumstances of each individual case: the market characteristics; the type of information; and the process by which the information is exchanged. In general, the TA's view is that information exchange is more likely to result in a substantial restriction of competition where a smaller number of licensees operate in the market, the information is commercially sensitive and where the exchange of information is frequent or regularised.

5.18 With respect to price information, current or prospective prices or elements of a pricing policy, such as discounts, are likely to be of concern if exchanged between competitors. Historical information or the collation of price trends is less likely to be of concern, depending on the precise nature of the information exchanged.

5.19 The exchange of information on matters other than price may also result in a substantial restriction of competition. The exchange of such information is,

however, unlikely to affect competition provided that it is sufficiently historic and cannot influence future competitive market behaviour.

Trade associations

5.20 Trade associations and co-operative bodies can often be regarded as beneficial to the competitive process. For instance, they can encourage new technology and innovation and can facilitate the adoption of good practices. The adoption of common standards in many cases may be desirable, particularly where they produce net economic benefits. Agreements that relate to technical or design standards (for example relating to interconnection or interoperability) may lead to an improvement in services by reducing costs or raising quality, or they may promote technical or economic progress. The TA may encourage the adoption of codes of conduct which provide a transparent benchmark for the industry.

5.21 In certain circumstances, however, the rules of membership and operation of trade associations may have the purpose or effect of preventing or substantially restricting competition.

5.22 Exclusionary membership rules can act as a barrier to entry to new competitors or can be used as a vehicle for exclusionary conduct (for instance, where admission to the association can easily be blocked by the existing members). Generally, the TA will expect rules of admission to membership of trade associations to be based on objective criteria, with a proper appeal procedure in the event of refusal of membership.

5.23 The dissemination of information through a trade association may also give rise to concerns where it results in a substantial restriction of competition. Recommendations by trade associations, for example, may cause competition concerns, either because they give rise to a direct exclusionary effect, or they amount to, or facilitate, collective or collusive behaviour. A trade association may also be used as a vehicle to disseminate confidential business secrets between licensees. Information exchange is discussed further at paragraphs 5.16 to 5.19 above.

Vertical agreements

5.24 A vertical agreement entered into by a licensee (that is, an agreement made between firms operating at different stages in the supply chain) may contain

restraints whereby one or more parties restrict their commercial freedom. For instance, an agreement between a network operator and a telecommunications services provider may contain an exclusive purchasing restriction whereby the service provider agrees to purchase the network services of only one operator.

5.25 Vertical agreements are generally pro-competitive and do not typically give rise to competition concerns unless one or more of the licensees involved possess market power in the relevant market, such as through control of an essential facility (discussed further in paragraphs 6.30-6.31), or the agreement forms part of a series or network of similar agreements which together have the effect of preventing or substantially restricting competition. Where a vertically integrated licensee is in a dominant position, however, it may not lawfully use its position in the market in which it is dominant to distort competition in a related market upstream or downstream. This type of conduct is discussed further in chapter 7.

5.26 A licensee may also enter into an agreement with a customer whereby the licensee agrees or imposes a minimum resale price on the customer. It is the TA's opinion that such resale price maintenance can be presumed to have as its **purpose** the substantial restriction of competition, since it has the direct effect of reducing, or even eliminating, competition between the resellers and leads to higher prices for consumers. It may also facilitate horizontal price fixing between licensees.

6. DOMINANT POSITION

6.1 Section 7L prohibits a licensee in a dominant position in a telecommunications market from abusing its position. This is a two stage test: whether a licensee is **dominant** in a relevant telecommunications market; and, if so, whether it is **abusing** that position.

Dominance

6.2 Before assessing whether a licensee is dominant, it is necessary to identify the relevant market, in terms of product and geographical area, functional level and temporal aspects. The process of defining the relevant market is discussed in Part 4 above.

6.3 Section 7L(2) sets out the circumstances in which a licensee is in a dominant position. Section 7L(2) states:

"*A licensee is in a dominant position when, in the opinion of the Authority, it is able to act without significant competitive restraint from its competitors and customers.*"

6.4 This definition, which is comparable to the definition of dominance adopted in other jurisdictions[14], indicates that a licensee will be in a dominant position if it possesses a substantial level of market power. The essence of dominance is the power to behave, to some extent, independently of competitive pressures. A dominant position may enable a licensee to charge higher prices than if it faced effective competition, or to restrict output. A licensee may also use its market power to engage in anti-competitive practices and exclude or deter competitors from the market place through strategic behaviour intended to raise barriers to market entry. In assessing dominance, the TA will take into account a number of factors, including those set out in section 7L(3).

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[14] See, for example, the definition of dominance adopted by the European Court of Justice in *United Brands v EC Commission*, Case 27/76 [1978] ECR 207: "*a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers*". This definition has also been followed by the UK competition authorities. It is also analogous to the standard for market power in the US.

The market share of the licensee

6.5 In general, dominance is more likely to exist in circumstances where the licensee has (or licensees combined have) a persistently high market share. Conversely, dominance is less likely to exist if the licensee has (or licensees combined have) a persistently low market share. In assessing market share, the TA will look at the recent history of the market share of all licensees within the relevant telecommunications market. This generally provides a more accurate picture of the competitive position on the market, rather than taking market share at a single moment in time.

6.6 Section 7L does not set any market share thresholds for defining dominance. The TA considers that a licensee with a market share persistently above 50 per cent may be considered to be dominant in the absence of evidence to the contrary. This view is in accordance with the definition of dominance in other established anti-trust jurisdictions[15]. In addition, the TA considers it unlikely that a licensee with a market share of less than 40 per cent. will be individually dominant in the absence of factors suggesting otherwise (for example, the weak position of competitors or high barriers to entry).

6.7 Market share is an important factor but does not, on its own, determine whether a licensee is dominant. For example, it is important to examine the position of other licensees operating in the same telecommunications market and how each licensee's respective market share has changed over time. A licensee is more likely to be dominant if its competitors have relatively small market shares or if it has enjoyed a high market share for a sustained period of time. A licensee with a high market share may not have significant market power if:

- the licensee is likely to be constrained by potential entrants if it tries to act anti-competitively, for example where the sunk costs associated with entry into and exit from the particular telecommunications market are low; or

[15] See, for example, the European Court of Justice's judgment in *AKZO Chemie BV v Commission* [1993] 5 CMLR 215, which has also been followed by the UK competition authorities. See also the European Commission's Guidelines on Market Analysis, OJ 2002/C 165/03, paragraph 75.

- the high market share is a result of successful innovation on the part of the licensee, which regularly improves the quality of its product.

6.8 The dynamic nature of certain telecommunications markets, in particular, means that the TA will use market share as an initial point of reference, but will consider all relevant factors before reaching his assessment as to whether dominance exists.

6.9 The TA envisages that he will typically measure market share either in terms of value or volume of sales. The TA will use whichever measure of market share is more appropriate for the case in hand, although it will generally be useful to obtain information in respect of both the value and volume of sales. In telecommunications, the number of subscribers, call minutes and data volume are obvious measures of sales volume. Transmission capacity or bandwidth may be a relevant form of volume measurement particularly when the transmission service is largely commoditised or undifferentiated. Capacity or reserves may also be useful as a measure of market share in markets where there is volatility in market shares measured in terms of sales volume or revenue.

6.10 When calculating a licensee's share of the relevant telecommunications market, the TA will take into account the market share of entities:

- over which the licensee exercises control, directly or indirectly; and

- which exercise control[16] over it, directly or indirectly.

6.11 The TA may collect information on market share from a number of sources, including information provided by licensees themselves, customers or suppliers who may be able to provide estimates of market share, and market research reports.

6.12 The process involved in defining markets is complex. The TA is, therefore, likely to look at market share data under a number of potential definitions of

[16] Control is defined in the Ordinance as meaning, "in relation to an associated corporation, means having: (a) a beneficial interest in or control over the exercise of 15% or more of the voting power at a general meeting of the corporation; or (b) control over the composition of 15% or more of the directors of the board of the corporation".

the market. In particular, entry conditions and changes in market share over time may differ substantially according to market definition. In such circumstances, the TA will consider carefully the implications of the conceivable alternative definitions and may seek more detailed evidence. Information submitted by licensees will, therefore, be of most use if it includes market share under plausible alternative market definitions and an explanation of why one definition might be more relevant than another, rather than providing information using only the market definition most favourable to the licensee's cause.

The licensee's power to make pricing and other decisions

6.13 A licensee's ability to behave to an appreciable extent independently of competitive pressures in making pricing or other decisions may result from its position relative to the position of existing or potential competitors.

6.14 However, countervailing buyer power can represent a significant competitive constraint on a licensee from raising prices, permitting one or more buyers to exert influence on the price, quality or terms of supply of goods or services. Buyer power typically arises where the buyer is large in relation to the relevant market, knowledgeable about other potential sources of supply and readily able either to switch to other suppliers or even to commence production of the products or services itself. Buyer power may, therefore, benefit the competitive process by exerting downward pressure on suppliers' prices or generate efficiency gained from being a large purchaser.

Barriers to entry

6.15 Entry barriers are relevant both for the purpose of establishing dominance and for assessing the likelihood that conduct will lead to a substantial restriction of competition in the relevant telecommunications market. Any attempt by the licensee to raise prices may attract new entrants and force prices back down to their original level. The TA will, therefore, consider the barriers which exist to entering the relevant telecommunications market.

6.16 The lower the entry barriers, the greater the likelihood that potential competition will prevent firms within the market from raising prices above competitive levels. Even a large market share held by a licensee in a market with low entry barriers is unlikely to result in the licensee having market

power and, therefore, being able to behave anti-competitively. Nevertheless, the existence of entry barriers may reduce the scope for competition, enabling incumbent licensees, for example, to maintain prices above competitive levels.

6.17 Cost advantages derived solely from the efficiency of the licensee will not be treated as barriers to entry. The TA, in assessing entry barriers, will aim to distinguish between such efficiency-based cost advantages and other cost advantages which might be barriers to entry

6.18 To assess entry barriers, the TA will typically seek information on the costs of entering the telecommunications market from firms already operating in the market and from potential entrants. For instance, the TA may ask for an estimate of the cost of obtaining a 5 percent share of the market, or an estimate of the cost of operating at the "minimum efficient scale" (that is, the size of operation that an entrant would need to obtain the same economies of scale as firms already operating in the telecommunications market). The TA will also look at historical figures for evidence of entry to, or exit from, the relevant telecommunications market.

6.19 The level of growth or future growth in the telecommunications market will also be relevant, since new entry is more likely in a growing rather than a static or declining market. The TA will also consider the rate of innovation in the telecommunications market, since markets which are characterised either by high rates of innovation or predicted innovation, may enable entry barriers to be overcome in any event. Profits that result from an entry barrier created by successful innovation may themselves create an incentive to innovate.

6.20 Entry barriers can be characterised in a number of different ways. However, for ease of reference, structural barriers are distinguished from strategic behaviour as a barrier to entry.

Barriers to entry – Structural

6.21 An important structural factor influencing the level of competition in a market is the height of barriers to entry, for the threat of entry is often viewed as the ultimate regulator of competitive conduct.

Sunk costs

6.22 Market entry in telecommunications involves significant sunk costs of entry and exit. Sunk costs are the costs of acquiring capital and other assets that:

- are uniquely incurred in entering the market and supplying the services in question;
- once incurred, cannot easily be physically recovered and redeployed in another market; and
- cannot be economically recouped within a short period of time (at least one year in view of the time period allowed for supply-side substitution but considerably longer for large infrastructure investments).

6.23 Because of their sunk nature, sunk costs create entry risks which increase with the significance of the costs. In turn, significant risks can create significant barriers to entry. The extent of sunk costs depends on a number of factors such as the proportion of capital involved, how that capital is sourced (for example, equity ownership or lease) and the requirements for advertising and promotion to create brand awareness.

6.24 An example of significant sunk costs typically incurred in telecommunications is the cost of network roll-out, a cost which cannot be recovered nor can it easily be recouped if the new entrant decides to exit the market within a short period. Accordingly, firms considering entry into the market with significant sunk costs must assess the profitability of entry on the basis of long-term participation in the market until the "sunk" capital and assets are economically depreciated. In certain circumstances, the cost of providing a new service may also involve costs which cannot be recovered or easily recouped.

Economies of scale and scope

6.25 With economies of scale and scope, average costs fall as the supply of services or range of services supplied increases respectively. Falling costs are likely to increase barriers to entry where there are minimum efficient scales of entry.

6.26 When combined with sunk costs and excess capacity, the effect of economies of scale in particular can create significant barriers to entry. Having "sunk" the infrastructure costs, there are incentives for incumbents in situations of

excess capacity to reap the economies of scale to drop prices and gain necessary revenue flows. Even without any strategic purpose, such action can significantly deter new entrants (as discussed below, such action may indeed be accompanied by that strategy).

Network effects

6.27 Closely related to economies of scale are network effects. By its nature, telecommunications is essentially a network industry and a feature of networks is that they generate network effects (or externalities). Network effects arise when the value a consumer places on connecting to a network (as measured by the price it is willing to pay) depends on the number of others already connected to it. They are a form of economy of scale, generated on the demand side of the market.

6.28 Network effects generate positive feedback whereby the bigger networks get bigger (and, on the negative side, the weak get weaker). Unrestrained positive feedback can result in the market "tipping" in favour of one competitor and a dominant "winner-takes-all" market outcome. While the interconnection regime under the Ordinance provides for any-to-any connectivity and thus alleviates any negative network effects for new entrants on the demand-side, when combined with economies of scale on the supply side, network effects can create significant barriers to entry.

Reputational barriers

6.29 Reputational barriers established by brand loyalty to incumbents may add to the sunk costs faced by a new entrant in the form of advertising and promotion costs. The ongoing investment in advertising and promotion that is required to maintain a differentiated product will accentuate sunk costs. The nature and extent of the barriers created by brand loyalty and product differentiation can be conceptualised as an investment in sunk costs that is required to shift demand to an unknown brand and create a new differentiated market niche.

Essential facilities

6.30 In some cases, entry to a market might require the use of an essential facility. This is an asset or infrastructure where: (1) access to it is indispensable in order to compete on the market; and (2) duplication of the facility is

impossible or extremely difficult owing to physical, economic or legal constraints, or is highly undesirable for reasons of public policy.

6.31 Denial of access to essential facilities is thus capable of constituting a significant barrier to entry, particularly in telecommunications where access to customers in certain situations has to go through a "bottleneck" or "essential facility". However, the potential for essential facilities to act as a barrier to entry is alleviated by the interconnection and sharing of "bottleneck" facilities regimes under the Ordinance.

Regulatory barriers

6.32 Regulatory barriers can create absolute barriers to entry (for example, a moratorium on new licences). Nevertheless, in Hong Kong, from January 2003, all sectors of the telecommunications market have been fully liberalized and there is no pre-set limit on the number of licences unless physical constraints (such as spectrum availability) exist to limit the number of operators.

Barriers to entry – Strategic behaviour

6.33 The most important non-structural factor for assessing barriers to entry, is what is generally referred to as strategic behaviour. Strategic advantages can arise from being in the market first (also known as first-mover advantage). First-mover advantage can allow a firm to shape the way the market develops, for example, by reducing or eliminating entrants to the market.

6.34 Strategic behaviour is broadly defined as any actions by a firm to alter the market structure, and so alter the conditions and levels of competition (for example, by raising barriers to entry). As such, it goes beyond the normal competitive rivalry between firms.

6.35 An example of strategic behaviour is where an incumbent firm or first mover in the market decides to build excess capacity so as to send credible signals to potential entrants that it could profitably (with economies of scale and low marginal costs) push prices down to levels such that new entrants would not earn sufficient revenue to cover their sunk costs.

6.36 It can be seen from the example that being the incumbent or first mover can create advantages that can be used strategically to create barriers to entry

which can be as effective as any traditional structural barriers to entry described in the previous section. They are sometimes described as strategically erected barriers to entry.

6.37 Strategic behaviour may also be directed at competitors currently in the market. For example, rather than raising barriers to entry, it may be used to raise rivals' costs.

Degree of product differentiation and sales promotion

6.38 The degree to which the products of a licensee are viewed as different from those of a competitor and the degree to which they are promoted are also relevant. A high degree of product differentiation will generally confer some market power since the supplier of the differentiated product offers the consumer a product which is perceived to be somewhat different and less substitutable for other similar products.

6.39 A high level of sales promotion activity will normally indicate that the market is competitive. A supplier with little market power will usually be obliged to promote its products in order to sell them. On the other hand a dominant licensee may have less incentive to engage in expensive sales promotion activity, although a high level of sales promotion activity is not inconsistent with a dominant position in the market.

Past conduct

6.40 Prior evidence that a licensee has, for example, raised prices in excess of costs or persistently earned an "excessive" level of profit may provide evidence that a licensee has market power. However, high profits in themselves are not sufficient evidence that a licensee has market power; for instance, they may simply be a result of innovation on the part of the licensee or changing demand conditions.

Collective dominance

6.41 Section 7L can apply in circumstances where two or more licensees collectively abuse their dominant position. Although section 7L refers to "a" licensee, under the Interpretation and General Clauses Ordinance (Cap 1), words and expressions in the singular include the plural, and therefore the section can apply to more than one licensee collectively.

6.42 The TA may consider that a collective dominant position exists where the following situation can be demonstrated:

- there is sufficient market transparency for a group of collectively dominant licensees to be aware of the way in which each others' market conduct is evolving;
- adequate deterrents exist to ensure that there is a long-term incentive in not departing from a common policy; and
- the foreseeable reaction of current and future competitors, as well as of consumers, would not jeopardise the results expected from a common policy."[17]

6.43 A reference in these Guidelines to a dominant licensee should be construed as a reference to a single dominant licensee, or two or more collectively dominant licensees.

[17] This three stage test is based on the European Court of First Instance decision in *Airtours v. Commission* Case T-342/99 [2002] ECR II 2585.

7. ABUSE OF A DOMINANT POSITION

7.1 If the TA forms an opinion that a licensee is in a dominant position and:

- has engaged in conduct which has the purpose or effect of preventing or substantially restricting competition; or

- has otherwise done (or not done) something constituting an abuse of its dominant position,

then section 7L will have been breached.

7.2 Section 7L(1) states that a licensee in a dominant position "shall not abuse its position". Although section 7L(4) provides that conduct which has the purpose or effect of preventing or substantially restricting competition is deemed to be an abuse of position, the scope of section 7L(1) is not limited by this provision. Conduct, such as excessive pricing, can be abusive as such, without any need to show that there is the purpose or effect of preventing or substantially restricting competition.

7.3 When forming an opinion as to whether conduct has the purpose or effect of preventing or substantially restricting competition, the words "purpose" and "effect" will be read as alternatives, as noted in paragraph 3.2 above. When the TA is satisfied that the **purpose** of the conduct of a dominant licensee is to prevent or substantially restrict competition, it will not be necessary for the TA to decide whether the conduct has the effect of preventing or substantially restricting competition.

7.4 Section 7L(5) identifies certain types of conduct which the TA may consider to have the purpose or effect of preventing or substantially restricting competition in a telecommunications market, which would thereby be deemed to be abusive under section 7L(4). The conduct identified is as follows:

(a) predatory pricing;

(b) price discrimination;

(c) unfair terms;

(d) bundling and tying; and

(e) discrimination in supply of services to competitors.

This conduct will constitute an abuse of a dominant position if it has the purpose or effect of preventing or substantially restricting competition, by virtue of section 7L(4). However, other types of conduct can also amount to an abuse of a dominant position since section 7L(5) does not limit the conduct which can be considered abusive.

7.5 In addition to providing guidance on types of conduct specifically listed in Section 7L, the following paragraphs also give guidance on the following other types of conduct which the TA considers may be an abuse of dominant position:

(a) cross subsidisation;

(b) leveraging dominance into upstream and downstream markets;

(c) excessive pricing;

(d) price squeezing; and

(e) refusal to supply.

Predatory pricing

7.6 Predation occurs where the dominant licensee sets prices so low as to eliminate competitors and threatens the competitive process itself. In these circumstances consumers may benefit from lower prices in the short term but, in the long run, weaker competition is likely to lead to higher prices, lower quality and/or less choice. The TA will seek to draw a distinction between low prices which result from predatory behaviour, and low prices which result from legitimate competitive behaviour[18]. Predatory pricing can also be relevant in assessing whether conduct by a dominant licensee amounts to a price squeeze (see discussion on price squeezing in paragraphs 7.32-7.33).

[18] Some guidance on how to apply this often fine distinction in the context of predatory pricing is to be found in the decision of the Australian High Court in *Boral Besser Masonry v ACCC* [2003] HCA 5.

Because cost structure is highly relevant to predation (for example, below-cost pricing will in some cases be conclusive), before considering when pricing may be considered predatory, it is necessary to provide guidance on how the TA will measure the costs of providing telecommunications services.

Background

7.7 The supply of telecommunications services is characterised by economies of scale in the provision of networks and economies of scope in the provision of services. As such, telecommunications companies tend to be multi-product firms and their pricing policies have to take into account the need to recover both the fixed and variable costs[19] of supplying a service and common costs[20]. In particular, the combination in telecommunications markets of low marginal costs[21] (that is, the cost of producing an additional unit is often close to, or even, zero) and significant common costs means that a licensee involved in a number of markets has significant freedom (subject to regulatory constraints) to offer a range of prices and choose the markets from which it recovers its costs. This can put a licensee at a significant advantage over competitors that do not have such freedom because of their size and/or more limited range of services. There is nothing wrong with a dominant licensee having such advantages provided it does not abuse its dominant position.

Long run average incremental cost

7.8 In considering the appropriate cost base against which prices should be assessed, it is necessary in the first instance to distinguish between short run and long run costs. In the short run, some costs, in particular capital costs, are fixed. In the long run, however, all costs, including capital costs, are variable. When assessing pricing issues in the telecommunications sector, the TA considers that long run average incremental cost ("LRAIC") is a more satisfactory base than marginal or variable cost as the provision of telecommunications services is characterised by high levels of capital costs. The LRAIC is defined as the difference in a licensee's total costs (i.e. both

[19] A fixed cost is an expense that does not vary with the level of output. Variable costs are costs that change with the level of output

[20] Common costs are costs of production that are shared between two or more products.

[21] Marginal cost is the increment, or addition, to cost that results from producing one more unit of output.

capital and operating costs) with and without the services or facilities supplied, divided by the total output of the services or facilities. The increment could thus refer to the provision of a new service and/or facility. If the price of a service or facility covers its LRAIC, including a reasonable level of the costs of capital, and the directly attributable common costs, it will generally be profitable for the licensee to offer the service.

7.9 By contrast, short run marginal cost excludes capital costs (including only the short run costs of producing an additional unit of output). The use of short run marginal cost as a cost base tends, therefore, to result in prices that are very low. Where costs of production include a large proportion of costs that do not vary with output, as is the case in telecommunications, the short run marginal cost of an additional unit of output could even be zero. Setting prices in relation to short run marginal cost would therefore tend to underestimate the cost of supplying telecommunications services, whereas prices derived from incremental cost reflect the actual cost of supply.

Common costs and LRAIC

7.10 The existence of economies of scope in telecommunications markets means that if the prices of a licensee's services are all equal to each service's LRAIC, the licensee will not recover its common costs. To ensure such a situation does not result in an anti-competitive effect, the licensee would need to demonstrate that:

- its individual prices are set at or above LRAIC; and

- the combined prices of services in groups that share common costs cover both LRAIC and the common costs of supplying those services.

Assessment of predatory pricing

7.11 In assessing whether a licensee is engaging in predatory pricing, the TA will consider whether:

- in the short run, the licensee will make an incremental profit[22], which will

[22] An incremental profit is the change in profit that results from a particular decision, e.g. a price reduction

enable it to recover its costs[23];

- it is the licensee's intention to eliminate a competitor; and
- it would be possible for the licensee to recover its losses.

7.12 The TA will presume that a dominant licensee, which prices below LRAIC, is intending to engage in predatory pricing. In other words, such conduct will be considered to have the **purpose** of preventing or substantially restricting competition. However, the TA recognises that it will be possible for a licensee to rebut this presumption in certain circumstances, for instance where a licensee has excess capacity that has not been reflected in existing prices.

7.13 The existence of economies of scope in telecommunications markets means that if the prices of a licensee's services are all equal to each service's LRAIC, the licensee will not recover its common costs. Thus, to ensure individual prices set at LRAIC will not result in an anti-competitive effect, the licensee would need to demonstrate the combined prices of services in groups that share common costs cover both LRIAC and the common costs of supplying those services, i.e., total revenue covers total cost. Where a licensee's prices are above LRIAC, but overall revenue does not cover total costs, the TA will consider this conduct to be predatory pricing if the intention of the licensee is to eliminate a competitor. Such intention might be evidenced, for instance, by internal written documentation of the licensee indicating the predatory nature of the pricing strategy. Intention might also be evidenced in circumstances where the only objective reason for the licensee's policy could be as part of a plan designed to eliminate a competitor.

7.14 In assessing whether a licensee's pricing strategy would result in an incremental profit that would enable it to cover its costs, the TA may consider it appropriate to use a net revenue test, which compares the profitability of a particular decision (for example, to adopt a lower price) with the alternative "benchmark" strategy (for example, to maintain prices at their existing level). If profitability were not adversely affected by the reduction in price because

[23] It should be noted that a licensee could respond to competition by reducing its prices, thereby lowering its level of profitability. Although such a licensee would be making an incremental loss, it might still be recovering its costs.

the demand increased sufficiently to offset the price reduction and, at the same time, the price remained sufficiently high to cover the incremental costs of the increase in output, the price reduction might be viewed as legitimate competitive behaviour. If, however, an undertaking had no realistic expectation that a profit would be made, or had made no attempt to assess the impact of the pricing strategy on profitability, the price reduction is likely to be taken as evidence of an intention to eliminate a competitor.

7.15 The TA will also take into account the extent to which there is strong complementarity between two or more services in respect of which there are different supply and demand conditions. Where there is strong complementarity, in applying the relevant tests it may be more appropriate to take into account the costs and revenues of all the complementary services rather than require each individual service to cover its costs. For example, access and calls are likely to be strong complements in that customers would probably have a demand only for access services because they wished to make and receive calls. Nevertheless, the TA would still expect each individual service to be priced above LRAIC because, although a consumer may require two or more services, they need not be obtained from the same supplier.

Price discrimination

7.16 Price discrimination involves applying different prices (or other conditions) to equivalent transactions. It may consist of:

- charging different prices to different customers, or categories of customers, for the same product or service where the differences in price do not reflect corresponding differences in quantity, quality or other characteristics of the products or service supplied;

- charging the same price to different customers, or categories of customers for the same product or service, even though the costs of supplying the product or service are very different.

7.17 Price discrimination raises complex economic issues and, therefore, the TA will not consider all cases of discriminatory pricing as an abuse. There are many situations in which price discrimination in a telecommunications market is a usual and legitimate commercial practice; for example a licensee may otherwise be unable to recover its fixed costs where these are very high. In

these circumstances, it may be more efficient to set higher prices to customers who are willing to pay. Price discrimination in telecommunications markets is unlikely to be an abuse where it leads to higher levels of output than a licensee could achieve by charging every customer the same price.

7.18 However, discriminatory pricing can be an abuse where, for example, a dominant licensee exploits its market power by charging excessively high prices to certain customers. Price discrimination will also be an abuse where it has the effect of excluding competitors from the market in question.

Unfair contract terms

7.19 There are a wide range of contractual terms or conditions which are harsh or unrelated to the subject of the contract, and which may potentially prevent or substantially restrict competition and, therefore, constitute an abuse of dominance. These could include, for example: quantity forcing, where the customer is required to purchase a minimum quantity of a product or service or exclusive purchasing, where the customer agrees to purchase goods or services only from the licensee. An unduly long contractual period could also be an unfair contract term which would have the effect of preventing competitors from gaining access to that potential customer for the duration of the contract. Quantity forcing can result in a restriction of competition since it may prevent entry by small-scale competitors of the licensee. Exclusive purchasing may foreclose the market if a significant proportion of potential customers is tied to the licensee. Such arrangements can, however, be normal business practice in telecommunications markets and, as such, they will only be an abuse if they lead to the prevention or substantial restriction of competition.

7.20 A licensee may also abuse its dominant position by only granting access to an essential facility subject to unreasonable terms and conditions. Access to essential facilities is discussed further in paragraphs 6.30-6.31.

Tying/bundling

7.21 Tying or bundling (also discussed in paragraphs 5.11 and 5.12) may in certain circumstances represent an abuse of dominance. Such practices occur when a licensee makes the purchase of a product or service conditional on the purchase of a second product or service. A set of tied products or services is

known as a bundle. These arrangements are common in telecommunications markets and will only constitute an abuse where there is the purpose or effect of preventing or substantially restricting competition. The tying of products by non-dominant licensees typically does not raise competition concerns. In fact, it may be pro-competitive since it may allow two or more products or services to be offered at a lower combined price than if they had been supplied separately, or may result in the availability of products or services which would not otherwise have been produced.

7.22 There are two key elements to be considered in assessing whether bundling amounts to anti-competitive conduct. Firstly, it is necessary to consider whether the non-price effects of the conduct are anti-competitive, where, for example, they involve the leveraging of market power from non-competitive to competitive markets, or where the conduct increases barriers to entry. Secondly, it is necessary to assess whether the price for the bundled services involves any elements of predatory pricing or a vertical price squeeze in the relevant market. The TA will consider both of these potential concerns, but the bundling is only likely to prevent or substantially restrict competition when the licensee has market power in the supply of at least one of the bundled products.

7.23 In telecommunications markets, an example of tying or bundling likely to fall within section 7L is where a dominant operator ties the supply of access to its network to the supply of its own telephone equipment. Such a tie could have the effect of foreclosing the market to other suppliers of the competitive product, even where the dominant licensee also offers to supply the different parts of the bundle separately.

Discrimination in supply of services to competitors

7.24 As with price discrimination, other types of discrimination in the supply of services to competitors may result in an abuse of dominance. Discrimination in the supply of services can arise where the licensee applies different terms and conditions to equivalent transactions. For instance, a licensee may impose discriminatory terms for access to an essential facility. Whether such discrimination amounts to an abuse will depend on whether it has the purpose or effect of preventing or substantially restricting competition.

Cross-subsidies

7.25 A cross-subsidy may occur where a licensee uses revenues from one telecommunications market to subsidise losses in another telecommunications market. Where a licensee uses revenues from a market where it is dominant to subsidise losses in another market, there may be a breach of section 7L where this conduct has the purpose or effect of preventing or substantially restricting competition.

7.26 The TA will normally judge a cross-subsidy to have occurred where a licensee's revenues from an activity, for example, the provision of a new service, may be expected to fail to cover the costs associated with that activity over its economic lifetime. The TA will consider whether the revenue over the lifetime of a service would exceed the LRAIC. If revenues exceed LRAIC, the TA will normally take the view that the service is sustainable in the long term[24]. However, there may still be concerns if the initial low price has the effect of foreclosing the market to potential competitors.

Leveraging dominance into upstream or downstream markets

7.27 Licensees who are dominant in one market and are also vertically integrated into markets upstream or downstream of that market may have the ability to adversely affect competition in the upstream or downstream markets. The TA will look closely at conduct by such a vertically integrated licensee to ensure that it does not abuse its dominance by leveraging its position of dominance into the upstream or downstream market in which it is not dominant. An example of such leveraging would be a licensee engaging in a price squeeze (see discussion on price squeezing in paragraphs 7.32-7.33).

Excessive pricing

7.28 A further example of abuse by a dominant licensee is when the licensee engages in excessive pricing, that is charging prices higher than it would do if it faced effective competition. The principle that an abuse may be committed

[24] In other jurisdictions, for example, cross-subsidies have been used in the short term to encourage take up of new technologies. For example, text messages were offered free of charge by leading mobile service providers to encourage use of the technology. Charges were introduced once this market education goal was achieved.

where an excessive price is charged (that is, the price has no reasonable relation to the economic value of the product or service supplied) has been established in other jurisdictions[25].

7.29 The key point is whether a price charged is excessive. This typically means that the price must be higher than it would normally be in a competitive market. Excessive prices will generally only be abusive where they have persisted in the absence of continuing innovation and/or without stimulating new entry. The TA recognises that licensees must earn a level of profits in order to finance investments. However, where the difference between costs actually incurred and the price actually paid is excessive, the TA will need to consider whether a price has been charged which is unfair either in itself or when compared to competing products.

7.30 Excessive prices charged by a dominant licensee who is a network operator for the supply of network inputs which are needed by competitors in a downstream market may be of concern to the TA. Such excessive prices could make it more difficult for others to compete and could deter market entry at the downstream level (as well as having no relation to the economic value of the product supplied). However, such excessive prices may be of less concern where they attract entry at the network level (that is, at the level of the dominant licensee) although this in itself would depend on the barriers to entry that exist.

7.31 Objective justifications may nevertheless exist for profits which appear excessively high:

- in competitive markets, given varying prices and costs over time, there are likely to be periods when a licensee earns high profits. Therefore, high profits may simply be the result of normal competitive processes;

- licensees in competitive markets may be able to sustain high profits for a period of time if they are more efficient than their competitors (for example, if a licensee provides higher quality products or services or is more effective at identifying market opportunities). Abusive prices

[25] See for example in the EU (Case 27/76 *United Brands v EC Commission* [1978] ECR 207). This approach has also been adopted by the UK competition authorities.

which are persistently excessive without stimulating new entry or innovation would not constitute an objective justification.

Price squeezing

7.32 Price squeezing may occur in circumstances where a licensee which is dominant in one market is also vertically integrated, for example, in a downstream market. A licensee in such a position may abuse that position by discriminating in favour of its own downstream operations and against potential downstream competitors by cross-subsidising its own operations whilst charging competitors at a price level which leaves insufficient margin for them to compete effectively in the downstream market.

7.33 The TA will assess any such conduct carefully to see if it amounts to an abuse. For instance, a price squeeze might be demonstrated where it could be shown that a dominant network licensee's own downstream operations could not trade profitably on the basis of the upstream price charged to its competitors by the upstream operating arm of the dominant licensee. A price squeeze might also be demonstrated by showing that the margin between the price charged to competitors on the downstream market for access and the price which the dominant network licensee charges downstream is insufficient to allow a reasonably efficient service provider in the downstream market to achieve a normal profit.

Refusal to supply

7.34 A refusal by a dominant licensee to supply a product or service to an existing customer may amount to an abuse where the licensee can provide no legitimate justification for the behaviour[26]. The TA considers that legitimate justifications would include, for instance, poor creditworthiness of a customer, safety reasons, protection of network integrity or a lack of capacity.

7.35 A refusal to grant access to an "essential facility" may also result in an abuse of dominance. The TA considers that a facility will generally be viewed as

[26] This view is in accordance with established precedents in antitrust law in other jurisdictions, for instance, in the EU, see *Commercial Solvents v EC Commission*, Cases 6&7/73 [1974] ECR 223; in the US, see *Oahu Gas Service v. Pacific Resources Inc.*, 838 F.2d 360 (9th Cir.), *cert. denied*, 488 U.S. 870 (1988).

essential if access to it is indispensable in order to compete in a telecommunications market and duplication is impossible or extremely difficult owing to physical, geographic or legal constraints (see paragraphs 6.30-6.31). In general, ownership of an essential facility will confer a dominant position, to which refusal of access might constitute an abuse.

7.36 The TA considers that a discriminatory refusal by a dominant licensee to grant access required by a competing operator in the downstream market which has the purpose or effect of preventing or substantially restricting competition may well constitute an abuse of dominance. A discriminatory refusal might not be an abuse if the licensee can provide an objective justification for the refusal.

7.37 In limited circumstances, the TA may also consider that a refusal to grant access required to supply new services falls within the anti-competitive conduct provisions, for instance where such refusal is likely to eliminate all competition on the part of the firm that is seeking access in the downstream market and the refusal is incapable of objective justification. A withdrawal of access from an existing customer is very likely to be abusive unless the licensee can show that there are objectively justifiable reasons for the refusal to continue supplying.

8. DISCRIMINATION

8.1 Section 7N deals with discrimination by a licensee in circumstances where such discrimination has the purpose or effect of preventing or substantially restricting competition in a telecommunications market. Such discriminatory conduct may also fall within the prohibitions contained in sections 7K and/or 7L.

8.2 Examples of discriminatory conduct that might fall within section 7N have already been discussed in relation to sections 7K and 7L. However, the following paragraphs give further examples of conduct that is likely to be of concern to the TA.

8.3 In general, discrimination could take the form of imposing different conditions, including the charging of different prices, or otherwise differentiating between the terms of supply in telecommunications markets. However, discrimination might not fall within section 7N where it is objectively justified, for example where there are cost or technical considerations or where the end-users are operating at different levels. Discrimination may also take the form of treating in the same way situations that are objectively different in relevant respects.

8.4 A licensee might discriminate between parties to different agreements, where the discrimination is based on the use that is made of the product or service (for example whether the product or service is to be provided to the public). Discrimination based on whether the customer provides the product or service in question to the public or not is specifically referred to in section 7N(2).

8.5 Discrimination relating to access is of particular concern in telecommunications markets. Discrimination on access can restrict competition in the downstream market on which the firm requesting access was seeking to operate, in that it might limit the possibility for that operator to enter the market or expand its operations on that market.

8.6 Discrimination issues relating to access may also arise in respect of the technical configuration of the access (for instance, the degree of technical sophistication of the access or the number and/or location of connection points). Whether such discrimination is objectively justifiable could depend on a number of factors relating to the actual operation of the network owned by the licensee, or licensing restrictions consistent with, for example, intellectual property rights.

8.7 A licensee may also engage in conduct that discriminates between operators on closely related downstream markets. For instance, charging higher interconnection prices to mobile telephony operators as compared to fixed telephony operators may have an effect on competition.

8.8 Discriminatory pricing issues have already been discussed in Part 7 above. However, a further form of price discrimination may be the provision of discounts. Discounts often reflect lower costs involved in supplying certain customers or groups of customers and, therefore, typically do not involve a restriction of competition. Discounts offered to certain customers, which do not reflect underlying cost differences are, however, a form of price discrimination. Nevertheless, there are often legitimate reasons for offering such discounts, for example where they represent an efficient way of recovering fixed or common costs.

8.9 However, some discounts may give rise to competition concerns in a telecommunications market, for example:

- loyalty rebates, where the discount is dependent on the customer not taking (or restricting) supplies from competitors;

- discounts which are calculated across, and applied to products offered in, a range of markets;

- volume rebates that are calculated on the basis of total telecommunications expenditure across a range of markets even though the discounts are applied to spending only in certain markets (eg. those which are competitive); and

- discounts that are targeted at a narrow group of customers, particularly where the group consists of only those customers which have the ability to switch to alternative suppliers.

8.10 Discounts such as those mentioned above which lead to a substantial restriction of competition may fall within section 7N.

9. PROCEDURES

Complaints

9.1 Anyone who believes a licensee is, or has, engaged in conduct which is in breach of the anti-competitive conduct provisions may complain to the Office of the Telecommunications Authority ("OFTA"). Further information about how to make a complaint can be found on the OFTA web site. A guide is also available on the web site on "How complaints related to sections 7K to 7N of the Ordinance are handled by OFTA". The TA will follow the procedure set out in the Guide, unless there are exceptional circumstances which justify a departure from the established procedures.

9.2 In summary, on receipt of a complaint OFTA will decide whether the complaint merits a formal investigation. If so, the subject of the complaint will be informed and will be asked to respond to the allegations. OFTA will often ask for specific information from the subject of the complaint, which may include obtaining evidence under the TA's formal powers of investigation (see below).

9.3 The TA, in deciding whether a complaint is substantiated under the anti-competitive conduct provisions, will consider the material gathered during an investigation, including any responses from the licensee. A draft decision by the TA will be provided to the licensee which will be given an opportunity to comment on the TA's reasoning before a final decision is made. Where the TA considers that there has been a breach of the anti-competitive conduct provisions, the licensee will also be given an opportunity to comment and put forward submissions in relation to the penalty that the TA is considering.

Own initiative investigations

9.4 The TA may carry out investigations on his own initiative where he believes that an infringement of one or more of the anti-competitive conduct provisions has occurred.

Powers of investigation

9.5 The TA's powers of investigation are contained in sections 7I and 35A 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 an

infringement of one or more of the anti-competitive conduct provisions. An investigation may include the TA entering the premises of a licensee and inspecting and making copies of documents. It is the TA's intention only to exercise these powers where, in the opinion of the TA, there is a reason to suspect that there has been an infringement. Matters which the TA will consider in making his assessment of whether there are reasonable grounds for suspecting an infringement include, for example, the existence of a complaint, or a statement from an affected party.

9.6 In any event, the TA may obtain information about licensees, agreements, practices and markets at any time through informal inquiries. Such inquiries, which may be made at a meeting, in written correspondence or in a telephone conversation, may be made in addition to, or instead of, using the formal powers of investigation under the Ordinance.

Penalties

9.7 There are various penalties that the TA may impose on a licensee following a finding that the licensee has breached the anti-competitive conduct provisions.

Directions

9.8 The TA may issue such directions to the licensee as he considers appropriate under section 36B of the Ordinance to bring an infringement to an end where the TA takes the view that any of the anti-competitive conduct provisions have been infringed.

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

Financial penalties

9.10 Under section 36C of the Ordinance, the TA may impose financial penalties on the licensee for failure to comply with the anti-competitive conduct 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. If the TA considers that such a penalty is inadequate, section 36C of the Ordinance enables the TA to make an application to the Court of First Instance, which may impose upon the licensee in breach, a financial penalty of a sum not exceeding 10% of the turnover of the licensee in the relevant telecommunications market in the period of the breach, or $10,000,000, whichever is the higher.

Warnings

9.11 The TA will issue a public warning to a licensee which has breached the anti-competitive conduct provisions when, in the opinion of the TA, a stronger penalty is not justified by the circumstances of the case. The warning will be published on the OFTA website.

Damages

9.12 Under section 39A of the Ordinance, a person suffering loss or damage from a breach of any of the anti-competitive conduct provisions may bring an action for damages, an injunction or other appropriate remedy, order or relief against the licensee in breach.

9.13 In order to bring a claim for damages under section 39A, a breach of the anti-competitive conduct provisions must have occurred, and the party claiming damages must have, as a result, suffered loss or damage.

Factors considered by the TA when imposing a penalty

9.14 Although there is no defence to a breach of the anti-competitive conduct provisions, there are a number of factors, set out below, which the TA will take into account when imposing a penalty. These factors are additional to those set out in the TA's Guidelines on Penalties (available on OFTA's website) which explain how the TA will take account of the nature, seriousness and duration of the infringement.

Action of the licensee post breach

9.15 The TA will look more favourably on a licensee who has co-operated with the TA in addressing the TA's concerns and has itself taken action to remedy a breach.

Compliance programs

9.16 The TA will take into account any evidence of the existence of a compliance program, which the licensee is operating, when imposing penalties. Licensees are encouraged to develop in-house compliance programs so that management and staff understand the requirements of the anti-competitive conduct provisions.

9.17 The existence of in-house compliance programs and structures will assist licensees in discovering potential breaches early, enabling licensees to prevent breaches of the anti-competitive conduct provisions, and to remedy breaches at the earliest opportunity.

9.18 The TA is willing to discuss and advise licensees during the development of their compliance programs, although there is no formal process by which the TA will approve a particular programme.

Appeals

9.19 Decisions of the TA in relation to section 7K to 7N may be appealed to the Telecommunications (Competition Provisions) Appeal Board in accordance with Part VC of the Ordinance.

Further information

9.20 OFTA documents referred to in these Guidelines, such as the Guide to How Complaints are Handled, the Guidelines on the Imposition of Penalties and the Ordinance, and previous case summaries and decisions on anti-competitive conduct can be obtained from OFTA's web site at www.ofta.gov.hk.

9.21 The industry and members of the public may also write to:

Office of the Telecommunications Authority
29/F, Wu Chung House
213 Queen's Road East
Wanchai
Hong Kong