

**Safeguarding Measures for the Prevention of  
Practices which Distort Competition  
in the Market for External Telecommunications Services**

**INDUSTRY CONSULTATION PAPER**

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**Introduction**

The Telecommunications Authority (“TA”) has noted that a number of licensees for the operation of external telecommunications services (“ETS”), in the provision of services between Hong Kong and places outside Hong Kong, have entered into agreements or arrangements<sup>1</sup> with carriers which operate as a monopoly at the distant end or where international simple resale (“ISR”) of international private leased circuits (“IPLC”) is not permitted by the authorities at the distant end.

2. Under the Fixed Telecommunication Network Services (“FTNS”) and Public Non-exclusive Telecommunications Service (“PNETS”) Licences for ETS, there is a condition prohibiting the licensee from entering into any agreement or arrangement with a service supplier of international public switched services in a place outside Hong Kong the purpose or the effect of which is to effectively and substantially distort competition in the supply of external services between that place, or another place, and Hong Kong. The purpose of the prohibition is to safeguard against activities (such as “one-way accounting rate bypass”, etc.) which would distort competition in the market of ETS in Hong Kong.

3. For the reasons set out below, the TA is concerned that in certain cases, the terms of the agreements or arrangements entered into with some overseas carriers may cause licensees in Hong Kong to be in breach of their licence obligations in that these agreements or arrangements may distort competition. Being mindful of the problems that the industry may encounter in negotiating agreements or arrangements with certain distant carriers, and the fact that these carriers may be able to impose terms on the licensees, he has decided

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<sup>1</sup> “Agreements or arrangements” include the agreement, arrangement, understanding or the like in relation to payments between service suppliers whether by way of the international accounting methods or establishing rates, revenue divisions, terminating charges, or any other like charges.

to consult all interested parties with a view to issuing a Statement giving licensees guidance in this area. If, after the issue of the Statement, the TA considers that certain agreements or arrangements could be in breach of licence obligations, he will take the necessary steps, including giving directions in accordance with the procedure given under the relevant licence conditions, to secure the compliance with licence conditions.

### **Practices which Distort Competition and “Whipsawing”**

4. “One-way bypass of accounting rate system” refers to the practice where a monopoly (or dominant) carrier in one jurisdiction uses its market power to distort competition in jurisdictions which have open markets (e.g. the ETS market of Hong Kong). Typically, the monopoly carrier will seek to use its market power at the far end by routing its outgoing traffic via the lowest cost arrangement (e.g. through ISR) but arranging its incoming traffic to be conveyed over the higher cost route and requiring the inpayment for the traffic to be settled under the conventional accounting rate system. As traffic is deliberately routed to bypass the accounting rate system in *one direction*, the practice is referred to as “one-way accounting rate bypass”.

5. One form used to achieve “one-way bypass of accounting rate system” is for the distant end monopoly carrier to establish a subsidiary in the overseas location with open market (e.g. Hong Kong) and arrange to make the outgoing calls originated from the monopoly carrier’s home country to the overseas location to be completely terminated at its subsidiary’s facilities. Under such an arrangement, the monopoly operators will just need to pay a minimal intra-company settlement rate for these outgoing calls. However, for traffic in the reverse direction, the monopoly carrier will continue to receive incoming traffic from the overseas location via other carriers and require that payments for this traffic be settled under the higher rates of the accounting rate system.

6. One consequence of the “one-way accounting rate bypass” would be substantial inpayment/outpayment imbalance unfavourable to the country/territory which has a competitive open market. Another consequence of the practice is “price squeeze” resulting in distortion of competition in the open market. The overseas subsidiary of the monopoly carrier operating in the market with open competition would be able to charge lower prices, compared with its competitors, for outgoing traffic from the open market to the home country of the monopoly carrier, since the payment under the accounting rate system between the overseas subsidiary and monopoly carrier in the home country would just represent intra-company payment. However, by maintaining a high settlement rate in the direction to the home country of the monopoly carrier, the competitors in the open market would not be able to compete fairly

with the subsidiary of the monopoly carrier as the high settlement payment represents the cost of an essential input in the sending of outgoing traffic to the monopoly country. Since the competitors have to bear higher costs than the subsidiary of the monopoly carrier, the former are not able to compete fairly for international traffic to the home country of the monopoly carrier.

7. Another tactic that can be employed by an overseas carrier with market power in its home country which could also lead to distortion of competition in the open market is the practice known as “whipsawing”. In this case, the monopoly carrier may play competing operators at the far end against each other to unfairly “bargain” for the lowest cost for terminating its outgoing traffic but at the same time getting the highest possible price for terminating the incoming traffic in its own non-competitive market. As the competing operators have little option but to use this monopoly carrier for the delivery of the traffic destined for the monopoly carrier’s country, they are forced to participate in this bargaining and agree changes in settlement rates or uneven division ratio’s that are to the advantage of the monopoly carrier and to the detriment of the operators and consumers in the liberalised market.

### **The TA’s Concerns**

8. The TA does not have any concern about the entry into agreements or arrangements with overseas service suppliers of international public switched services where the overseas jurisdictions permit competition in the operation of international gateways or ISR. Such alternative agreements or arrangements can stimulate competition, reduce the operating cost of service operators and benefit consumers. However, where the overseas suppliers operate as a monopoly or where ISR is not permitted at the overseas end, the TA is mindful of the need to prevent the above activities which are detrimental to the operators and consumers at the Hong Kong end.

9. The TA has considered the agreements and arrangements which have been entered into so far between ETS operators in Hong Kong and overseas suppliers operating as monopolies or in jurisdictions which do not permit ISR. The TA did observe differentials in settlement rates and division ratio’s which depart from what one might normally expect, i.e. the norm of 50:50 split, with no apparent cost justifications. The TA therefore considers it necessary to consult the industry on whether practices that could distort competition (as envisaged in the licence condition set out in paragraph 2) have occurred, or are likely to occur, and whether additional measures to safeguard against such practices should be implemented.

### **Filing of Agreements or Arrangements and Traffic Statistics Reporting**

10. In order to monitor whether the agreements and arrangements established between the FTNS or PNETS licensees in Hong Kong and their overseas partners contain elements leading to distortion of competition, the TA has already requested all licensees for FTNS and PNETS in Hong Kong to supply, within one week of the conclusion of the agreement or arrangement, a copy of the agreement or arrangement to the TA for examination. For the reasons stated in paragraph 8 above, such a filing requirement at present only applies to those agreements or arrangements established with overseas operators where:

- (a) the operator at the distant end operates as a monopoly; or
- (b) ISR is not permitted by the authorities at the distant end.

11. In addition, the TA has also requested from the ETS operators, under the relevant licence conditions, reports of traffic statistics over IPLCs. The purpose of such statistics is to monitor the traffic flows to identify possible “one-way accounting rate bypass” activities.

### **Proposed Measures that Could be Implemented Relating to the Establishment of Agreements or Arrangements with Overseas Partners**

12. The TA is now considering whether he should require the introduction of the following safeguarding measures for the prevention of “one-way accounting rate bypass” or other unfair practices that are in breach of the licence obligations of the operators and disadvantageous to the consumers of Hong Kong.

13. For the reason explained above, the TA, if in due time he decides that any additional requirements are necessary, would consider the taking of the following steps only in relation to routes where the operator at the distant end is a monopoly, or, for reasons due to the regulatory environment at the distant end, a *de facto* monopoly, and where competition from alternative connections through ISR is not permissible. The proposed requirements are applicable to the provision of ETS. The proposed requirements will not apply to agreements or arrangements related to the provision of other types of telecommunications services, for example the international value-added network services (“IVANS”).

### Parallel Accounting

14. For the establishment of agreements or arrangements with an overseas operator which is a monopoly, or *de facto* monopoly<sup>2</sup>, or where competition from alternative connections through ISR is not permissible, all ETS operators in Hong Kong would be required to adopt the *same* and the *lowest* accounting rate and division ratio for the settlement of traffic to/from Hong Kong with that overseas country/territory.

### Proportionate return

15. In the establishment of agreements or arrangements with an overseas operator which is a monopoly, or *de facto* monopoly, or where competition from alternative connections through ISR is not permissible, the contracting ETS operators in Hong Kong would be required to set up, as appropriate, an arrangement with the distant operator concerned based on proportionate return. Under the proportionate return arrangement, the distant operator would be required to allocate the volume of traffic originated from its country to Hong Kong among the operators with which it has established an agreements or arrangements *in proportion to* the volume of traffic that it receives from those operators in Hong Kong.

### Existing agreements and arrangements

16. The way the TA would consider implementing the proposed safeguarding measures, the parallel accounting and proportionate return arrangements, is for these to be incorporated into all agreements and arrangements within the scope stated in paragraph 13. Suitable transitional periods may be required to be given to the operators to modify existing agreements or arrangements to conform to the new policy and to ensure that they are equally protected. Should the proposed safeguarding measures be implemented, the ETS operators would have to ensure that they incorporate into their agreements or arrangements any necessary terms needed to comply with their licence obligations and to make clear to their overseas partners during the negotiation what are their regulatory obligations.

### Possible drawbacks of proposed measures

17. The TA is aware of certain possible drawbacks associated with the proposed measures:

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<sup>2</sup> It is intended that the TA will declare the routes for which the measures of parallel accounting and proportionate return will apply.

- (a) The measures may remove the incentive for operators to bargain hard for lower settlement rates as whatever the outcome of the bargaining would have to be extended to other competitors.
- (b) The measures may remove the incentive of the overseas monopoly carrier to enter into alternative agreements or arrangements with operators in Hong Kong and thus make it more difficult for operators in Hong Kong to conclude such agreements or arrangements with a closed market.
- (c) The administration of the proportionate return arrangement may be complicated.

In taking a final decision on whether, and what, measures should be adopted, the TA would have to balance the drawbacks against the harm that would be caused to the operators and consumers in Hong Kong had the measures not been introduced.

### **Invitation of Comments**

18. The TA invites comments from the telecommunications industry and interested parties on whether the above proposed safeguarding measures should be implemented in Hong Kong, particularly on the following questions:

- (a) Do you consider that problems exist that warrant additional safeguarding measures to be introduced (paragraph 9)?
- (b) Do you agree that the proposed measures of parallel accounting and proportionate return would be effective to ensure that licensees can comply with their licence obligations (paragraphs 14 and 15)?
- (c) What should be the intervals for the measurement of traffic as the basis for the calculation of the proportionate return, if introduced (monthly, quarterly, biannually, annually) (paragraph 15)?
- (d) How long should the transitional periods last so that the parallel accounting and proportionate return arrangements could eventually be incorporated into all agreements and arrangements within the scope stated in paragraph 13 (paragraph 16)?
- (e) Do you consider that the proposed safeguarding measures, if implemented, will bring about the drawbacks identified in paragraph 17, or any other drawbacks not already identified, and if so, whether there are any remedial measures? Do you believe that

the benefits of what is proposed outweigh the drawbacks (paragraph 17)?

19. Views and comments on the proposed safeguarding measures should be made in writing and should reach the Office of the Telecommunications Authority **on or before 7 May 1999**. The TA reserves the right to publish all views and comments and to disclose the identity of the source. Any part of the submission, which is considered commercially confidential, should be clearly marked. The TA would take such markings into account in making his decision as to whether to disclose such information or not. Submissions should be addressed to:

Office of the Telecommunications Authority  
29/F Wu Chung House  
213 Queen's Road Central  
Wanchai  
Hong Kong  
[Attn.: Senior Controller of Telecommunications  
(Competitive Services)]

Fax comments can be sent to: 2803 5112

**Office of the Telecommunications Authority**  
1 April 1999