

SUBMISSION BY MACQUARIE CORPORATE TELECOMMUNICATIONS IN RESPONSE TO IDA'S PUBLIC CONSULTATION ON SINGTEL'S REQUEST FOR EXEMPTION FROM DOMINANCE OBLIGATIONS WITH RESPECT TO INTERNATIONAL TELEPHONE SERVICES

INTRODUCTION

Macquarie Corporate Telecommunications Pte Ltd (**Macquarie**) provides this submission in response to the IDA's "Public Consultation On Request By Singapore Telecommunications Limited For Exemption From Dominant Licensee Obligations With Respect To The International Telephone Services Market Pursuant To Subsection 2.6.1 Of The Code Of Practice For Competition In The Provision Of Telecommunications Services" issued on 10 April 2003 (**IDA ITS Consultation**) and the application for same by SingTel (**SingTel Exemption Request**).

Macquarie has a strong interest in the IDA ITS Consultation as the holder of an SBO (Individual) and (Class) Licence. Under these licences, we provide a wide range of telecommunications services to corporate customers in Singapore. Of primary relevance to the current proceedings, we provide ISR and resale of PSTS. As a retailer of international telecommunications services (**ITS**), Macquarie is extremely concerned to ensure that there is effective competition in upstream wholesale and downstream retail supply. The outcome of the IDA ITS Consultation will dictate whether such competition will be allowed to occur in Singapore.

In this context, we thank the IDA for the opportunity to comment as part of the IDA ITS Consultation. Below, we first outline SingTel's current outright domination of ITS markets. We then look at overseas experience with the assessment of dominance in ITS markets, highlight some of the lessons to be learnt and, based on these, suggest what we believe may be an appropriate response under the Code Of Practice For Competition In The Provision Of Telecommunications Services (**Code**) to SingTel attempts to roll back its dominant licensee obligations.

At the outset, we summarise our conclusions on an appropriate response to the SingTel Exemption Request:

- Exemption from dominance obligations generally should not be considered in a rushed and reactive manner but rather only after clear market assessment guidelines have been developed which the IDA can refer to.
- Exemption from dominance obligations applicable to ITS should not even be considered while overall ITS market share is high.
- While market share is high, there is no need to go into a more comprehensive competition analysis of other factors relevant to a dominance assessment such as entry barriers.
- Given SingTel's recently published claim to have 79% ITS market share, IDA should reject outright SingTel's Exemption Request.
- IDA should have a threshold overall ITS market share figure, such as 50%, triggering the point in time when it will more closely examine dominance exemptions.

- At the point where SingTel market share reaches the relevant threshold, IDA should introduce a route by route analysis of dominance, split between wholesale and retail markets.
- It should incrementally remove dominance obligations from SingTel route by route based on SingTel providing verifiable data, rather than just competition rhetoric.
- A starting point would be analysis of market share based on traffic and revenue, as well as market concentration.
- It should then take into account other standard factors relevant to a dominance assessment eg as outlined by Oftel and the EC.
- The IDA should not automatically remove all dominance obligations where it finds a route competitive. It should recognise that competition safeguards may still be necessary and that its right to intervene in future should not be fettered.
- In absolutely no circumstance should IDA provide exemptions from ex post dominance safeguards such as those in section 7 of the Code.
- As a second step after dismissing the SingTel Exemption Request, the IDA should develop market assessment guidelines applicable to all telecommunications markets, consistent with the above.

SINGTEL'S DOMINANCE OF ITS MARKETS

At this nascent stage of telecommunications competition in Singapore, SingTel continues to dominate across all key markets, including ITS. Macquarie submits that SingTel's high level of dominance is unquestionable. Despite reducing since 2000, SingTel's control over the market has not yet reached that 'grey area', which might warrant regulatory investigation of whether effective competition exists. As a result, we strongly urge the IDA to reject the SingTel Exemption Request outright.

Presumption of dominance given very high market share

Assessment of dominance based on proper economic theory is a complicated exercise, particularly where markets have matured to the point where the persistence of dominance is questionable. Proper competition analysis involves detailed examination of a wide range of factors such as barriers to entry, consumer behaviour etc (as outlined later in this paper), with quantitative factors such as market share and concentration being only one part of the equation. However, it has been widely recognised by regulators in developed jurisdictions such as Hong Kong, UK and the EU that, while a 'grey area' exists warranting a proper competition analysis, on either side there are areas where it is safe to either presume dominance or effective competition based on market share, without compelling evidence to the contrary. The typical market share over which dominance can be presumed is **50%**. As discussed later in this paper, these regulators have applied this presumption in ITS markets and requests to roll back dominance obligations have only been considered and accepted where market share is well below this figure.

We believe that the EC has provided sound guidance in this regard. It no longer applies a set 25% market power test but still uses presumptions supported by further competition analysis to assess any special circumstances. Its latest market power guidelines provide as follows:¹

“Market shares are often used as a proxy for market power ... undertakings with market shares of no more than 25% are not likely to enjoy a (single) dominant position on the market ... single dominance concerns normally arise in the case of undertakings with market shares over 40%, although the Commission may in some cases have concerns about dominance even with lower market shares ... According to established case law, very large market shares – in excess of 50% - are in themselves, save in exceptional circumstances, evidence of the existence of a dominant position. An undertaking with a large market share may be presumed to have SMP, that is, to be in a dominant position, if its market share has remained stable over time. The fact that an undertaking is gradually losing market share may well indicate that the market is becoming more competitive, but it does not preclude a finding of significant market power.”

On this basis, we believe the first step in the IDA ITS Consultation should be to look at SingTel’s claimed ITS market share. We submit that for the purposes of quick analysis, it should do so without necessarily accepting SingTel’s market definitions or method of calculation. Market share can vary greatly depending on the definitions and methodology used but one can assume that any share claimed by SingTel will be at the low end and that alternative, perhaps more correct, calculations may produce a higher share. Therefore if the low end figure claimed by SingTel clearly exceeds the typical dominance threshold then there is no need to go further.

In relation to SingTel’s claimed ITS market share, we refer to its financial statements and other material on its website as being sources it cannot dispute. Starting with the most recent:

Share	Date	Source	Comments
79%	Q402	“Management Discussion and Analysis of Unaudited Financial Condition and Results of Operations for the Nine Months Ended 31 December 2002”	Based on volume / traffic minutes; Includes all retail and wholesale ITS; Includes calls from mobiles; Aggregates all routes
83%	Q302		
87%	Q401		

Macquarie notes the glaring absence of a single market share figure in the SingTel Exemption Request, despite the Code requirement for verifiable data to be provided. We believe that this is telling – SingTel is only too aware of the fact that its high market share counters the other arguments it has put forward for exemption. Given that SingTel has not provided data for this proceeding, the above SingTel claims should be used as a starting point.

¹ Para 75, “Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services”.

Macquarie submits that the most recent figure of 79% ITS market share is extremely high and so far in excess of typical dominance thresholds that the IDA can safely presume dominance. There is no evidence that conditions in the Singapore ITS sector, or even telecommunications industry as a whole, are so different from overseas that this presumption should not apply.

Macquarie further stresses that SingTel's real market share is likely to be even higher. We do not agree with the market definition or calculation methodology used to derive the above figures. As detailed later in this paper, SingTel's approach is inconsistent with overseas precedent. We believe it likely that SingTel's approach is designed to dilute as much as possible its market share and reduce the need for it to provide verifiable, granular data to the IDA. Overseas regulators have rejected similar incumbent attempts to distort dominance assessments.

We note the following as possibly reducing SingTel's market share calculations below actual levels:

- *Inclusion of mobile calls:* The mobile market in Singapore is much more competitive than fixed line markets and other operators enjoy a much higher relative market share to SingTel. Inclusion of mobile calls therefore would reduce SingTel's fixed ITS market share. However, a proper substitution analysis and reference to overseas experience eg in Hong Kong and the UK, would indicate that it may be more appropriate to exclude mobile calls.
- *Use of volume data:* It is not unusual for use of volume data or traffic minutes to produce a lower market share than other measures such as revenue. We do not disagree with the use of volume data as it can be easy to collect, however, as outlined later in this paper it should be supplemented with revenue based calculations. This would give a more complete picture of the range of market share possibilities and whether higher than competitive prices are being extracted from customers.

High market concentration supports finding of dominance

Aside from relying on SingTel's high market share to reject the SingTel Exemption Request, it is worth doing a quick check on market concentration, given SingTel's repeated claims that there are so many new entrants that it could not possibly be dominant. We believe this exercise demonstrates that there is no merit to SingTel's claims as the market share of these new entrants is so de minimus that they could not possibly constrain SingTel's dominance to the point of effective competition. In fact, their limited penetration after 3 years of competition could be seen as indicative of market failings.

A quick check reveals that while SingTel claims to have approximately 80%, the obvious second player, StarHub, claims **12%** of the ITS market.² This leaves approximately 8% to be split between the hundreds of new entrants that SingTel refers to.

It is safe to assume that each new entrant would hold a de minimus share and that a further breakdown of the 8% is unnecessary at this stage in assessing SingTel's continued dominance. Macquarie believes that, even if the IDA decides to seek further data on market share, it should target its requests at SingTel, with StarHub data as a check. To request detailed data from operators with de minimus share would be administratively burdensome and of no benefit to the IDA's analysis.

² For example, see StarHub Press Release, "StarHub Wins Best Asian Competitive Carrier Award Again!" 18 June 2002.

SingTel arguments on extent of competition unverified

Aside from the fact that SingTel is clearly dominant based on the above figures, Macquarie submits that IDA should reject the SingTel Exemption Request as it contains no verifiable data as required by the Code. This is in stark contrast to the reviews of ITS dominance conducted in Hong Kong and UK. Aside from absence of market share information, there are a number of other instances where SingTel has made claims but not provided data, including those highlighted in this section.

Wholesale competition requires more than new entrants

As mentioned above, SingTel places too much reliance on the existence of new operators. It stresses the hundreds of retail entrants without providing supporting data as to how far these operators have penetrated the market. It also comments that the availability of wholesale offerings from a handful of other FBOs and SBOs shows that the wholesale market is competitive. Again, there is no evidence provided in relation to the wholesale market share still retained by SingTel. Further, SingTel has omitted to comment on the degree to which it is able to offer more extensive wholesale products than available from other operators.

At para 5.8, SingTel points to a 2001 OFTA statement (detailed later in this paper) that in Hong Kong there are alternative wholesale services such that there were no barriers to entry at the retail level from lack of alternative wholesalers. It suggests this as evidence for a similar lack of barriers to entry in Singapore without further verifiable data being provided. What it omits to point out was that OFTA's statement was made in the context of specific international routes found to be competitive and after an analysis of data such as:

- the incumbent's wholesale market share, in turn used to show the viability of alternatives such as transit and refile
- route by route refile costs as compared to HKT's gateway prices.

Also key to OFTA's finding of no wholesale barriers to entry impacting the retail market was that there were regulatory obligations to supply wholesale gateway services to all retail operators over the relevant routes at prices set by OFTA.

Industry improvements not necessarily from competition alone

SingTel points to ITS traffic growth, price declines and tariff diversity as showing competition is strong. However, as the IDA will be aware, such improvements are a natural consequence of market liberalisation even in countries where ITS competition is not yet entrenched (eg. India). They simply demonstrate how unreasonable the situation was before liberalisation rather than showing that the point of best practice has been reached. They are only a starting point and regulators need to give the market time to show whether such improvements will continue and be sustained.

SingTel claims strong price competition, including at the wholesale level, but does not provide examples of its declining wholesale rates nor does it provide any data showing that there are others in the market that play a price leader role.

SingTel further alleges that there is strong tariff diversity at the wholesale level but then only cites its own products, which are currently driven by the obligation to provide wholesale services. If this

obligation is removed, there is no guarantee of continued supply by SingTel or of true substitute products being offered by others.

No explanation for why specific Code provisions unnecessary

SingTel has simply asserted it is not dominant and thus should not be subject to the various dominance obligations in the Code. It has not gone through each provision to show why it is unnecessary, in contrast to the IDA's request for respondents to make comments on a specific basis. For example, SingTel has not indicated why it wants to be allowed to offer end users unfair terms or predatory price and, more importantly, has not explained why such conduct is not damaging. We believe IDA should question SingTel further in this regard.

SingTel suggests at para 6.3 that it is only seeking removal of ex ante dominance regulation. However, it has also sought exemption from section 7 dominance provisions, which are Singapore's only current form of ex post dominance protection. It would be unprecedented for a regulator to handcuff itself from using such provisions as a back up protection even if it were to remove ex ante protections of a more administrative nature such as tariff approval. It is incorrect for SingTel to assert that in other countries such as Australia dominance regulation no longer applies to ITS. The Australian competition regime can still potentially be applied in relation to ITS and there are a number of regulatory safeguards that only apply to Telstra. The situation in the UK and EU is also similar. There are strong competition laws backing up sector specific regulation. We note our view that this is the best regulatory model as industry codes and guidelines by themselves are relatively weak. However, we understand that review of this issue is beyond the scope of the IDA ITS Consultation and that for the moment the IDA must work within the existing Code framework. Nevertheless, in considering whether to wind back Code provisions it should bear in mind that the Singapore regime lacks some of the broader economy wide safeguards found in other jurisdictions.

IDA should reject SingTel Exemption Request outright

Macquarie strongly submits that, based on:

- the high market share claimed by SingTel of 79%, which could in reality be much higher
- the high market concentration, with SingTel having a 67% lead over its next competitor and no other operator with significant market share,
- lack of evidence provided by SingTel countering the compelling presumption from its market share,

IDA should reject the SingTel Exemption Request without the need for further investigation of ITS markets.

In rejecting the SingTel Exemption Request outright, we believe it is critical that care be taken not to give SingTel ammunition to come back with further frivolous exemption requests, for example, simply because its ITS market share has reduced by a few percentage points or because a few more operators enter the market. It should not rush to do a full investigation now and set what may be dangerous precedent. Rather, we submit that, after rejecting the SingTel Exemption Request, IDA should as a second step start a work program to develop guidelines for assessing markets and market power under the Code, which will be appropriate for all telecommunications markets. We therefore

turn now to overseas experience with assessing ITS dominance, which we believe provides a sound basis for developing Singapore's approach to future dominance investigations for ITS and other markets. It is worth highlighting that in the jurisdictions reviewed, the regulators had already developed guidelines for market assessment before attempting to investigate ITS dominance.

OFTEL ANALYSIS OF ITS IN UK

Oftel 2003 Wholesale Review

Oftel is currently examining wholesale ITS competition in its "Review of the Wholesale International Services markets and related remedies" ("Oftel 2003 Wholesale Review").³ This review should be seen in the context of an international services sector that was first liberalised in 1993 and then further opened in 1996 ie, 10 years of service competition and 7 years of facilities competition.

For ease of reference, we summarise below some of the initial conclusions reached, which we believe are significant to future action by IDA:

- Oftel considers that wholesale international services raise such significant competition issues that they deserve special market analysis, in addition to any markets the European Commission has recommended in its recent slate of new legislation.
- Regulation of these services enables competitors to purchase wholesale services from BT and C&W in order to develop their own retail services to further develop competition and deliver benefits to customers.
- Oftel defines the product markets as wholesale international services and the geographic market as the United Kingdom. The product markets are split by route.
- It specifically rejects arguments that the development of refile, transit and similar services result in expansion of the market beyond national boundaries but of course sees these services as relevant in assessing market power and constraints thereon.
- Oftel assesses dominance in the defined markets based on the following:

Firm related criteria:

- Economies of scale (eg. total traffic volumes will have a significant effect on costs, enabling large scale operators to operate at low average cost)
- Vertical integration (eg. combined wholesale and retail operators are in a stronger position due to economies of scope)
- Access to capital markets and financial resources

³ A consultation document issued by the Director General of Telecommunications, 17 March 2003 (consultation to close 30 May 2003).

Customer related criteria:

- Countervailing buying power

Market entry related criteria

- Ease of market entry (eg. negotiation of correspondent relationships, degree of liberalisation in destination country, whether there are alternatives to direct supply)

Quantitative information criteria:

- Market shares
- Excess pricing
- Oftel believes that market power should be assessed in relation to each country route and that an assessment of competition in ITS services across the board is inadequate and incorrect under a proper competition analysis.
- In this regard, it relies on the EU position. The European Commission has found that international retail and wholesale service markets are a particular case where it may be appropriate to treat paired countries or even cities as separate markets.⁴
- Oftel finds that BT and C&W continue to have market power for a significant number of routes.
- Market power is inferred from market share and pricing trends:

“In those [route] markets in which a single provider enjoys a very high market share, the Director considers that this implies market power on the part of that provider. In those markets on which market shares are moderately high, and on which wholesale price levels have been static or increasing in the past two years, the Director has similarly inferred that a position of market power is enjoyed by the relevant provider.” (para 3.42)

- Oftel considers that there are liberalised routes which are not dominated, but this is based on a route specific analysis taking into account a number of factors including whether there are actual alternative suppliers operating, market shares, degree of competition in destination countries etc. It may still presume dominance on potentially competitive routes if BT and C&W retain high market share.
- Dominance is viewed as persisting in the context of 10 years of service competition and 7 years of facilities competition.
- Dominance is viewed as persisting in the context of at least 500 operators offering WHOLESale international services from the UK, leaving aside all of the retail operators,

⁴ Para 61, “Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services”.

resellers and definitely not taking into account businesses such as hotels that are not really part of the telecommunications sector.

- Dominance is viewed as persisting in the context of significant traffic growth (from 3.5B minutes in 1994-95 to 8B in 2001-02) and reductions in service price and revenue. Oftel notes that price reductions are less rapid on non-competitive routes and that price declines and traffic increases can be attributed to the industry's increase in cable capacity rather than just competition.
- Even on routes found to be competitive, Oftel does not plan to remove all competitive safeguards and will continue to impose obligations for example in relation to undue preference or discrimination.
- On dominated routes, the following additional obligations will remain applicable:
 - to provide service on reasonable request
 - to publish the terms of service (RIO)
 - to notify prices significantly in advance (28 days)
 - accounting separation.
- Oftel takes the approach of detailing why it is important to retain each of these ex ante obligations on incumbents.
- Oftel also stresses the residual competition law controls on BT and C&W and the fact that market definition for the purpose of removing certain ex ante safeguards should not prejudice analysis in subsequent analyses under ex post provisions.

Oftel 2003 Retail Review

Oftel is also currently examining retail ITS competition in its current review of fixed narrowband markets ("Oftel 2003 Retail Review").⁵ Again, we summarise below some of the initial conclusions reached, which we believe are significant to future action by the IDA:

- Oftel defines the retail international services market as having national boundaries, with the product markets being split by route.
- Oftel applies a route by route analysis to the retail market. This is because there is no demand side substitutability for calls to different destinations (eg someone wanting to call from the UK to USA will not be satisfied with being offered a call from the UK to Australia). Oftel only groups destinations into a single market where they are proven to be competitive at the wholesale level such that supply side substitutability may exist.

⁵ "Review of Fixed Narrowband Markets", A consultation document issued by the DGT, 17 March 2003 (consultation to close 30 May 2003).

- Oftel excludes mobile calls from the retail market, given that the relatively high price of such calls limits the degree of substitutability with fixed line international services.
- Given the recent redefinition of its market power test to equate to dominance, Oftel will apply European competition law principles as follows:

“... dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50 per cent. The Director General considers it unlikely that an undertaking will be individually dominant if its market share is below 40 per cent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market) provided strong evidence of dominance.” (cited in para 4.5; emphasis added)

- It considers market share analysis based on both revenue and traffic are helpful because revenue shares will capture the effects of any premiums above the competitive price level that operators are able to charge.
- Given limited route by route data, BT’s aggregate market share by traffic in the retail residential market is being used in Oftel’s analysis. This exceeds **46%**.
- Oftel further refers to the fact that market concentration using HHI is high.
- Ultimately, based on the fact that the market share by revenue is a much higher **58%**, Oftel is applying a presumption of dominance.
- While it finds greater competition for business customers, this is in the context of an incumbent market share that has been around the 20% mark for at least 4 years.
- Despite increased competition, Oftel plans to retain many ex ante safeguards and stresses the importance of ex ante regulations.

Previous Oftel Reviews

The Oftel 2003 Wholesale and Retail Reviews build on earlier reviews, with the first completed in March 2000 (“Oftel 2000 Review”)⁶, a further consultation in 2001 (“Oftel 2001 Consultation”)⁷, and then another finding in March 2002 (“Oftel 2002 Review”)⁸. In other words, Oftel has put more than three years work into its competition analysis for the international services sector. We believe that this merits due regard being had to the approach it takes in this area.

It is worth briefly summarising some of the earlier conclusions reached by Oftel as they covered both retail and wholesale international services markets. As in 2003, Oftel assessed market power on a route by route basis.

⁶ We have not detailed the Oftel 2000 Review as later Reviews contain a greater degree of information and analysis.

⁷ “Competition in International Markets”, A consultative document issued by the DGT, 29 November 2001.

⁸ “Competition in International Markets”, A statement issued by the DGT, 26 March 2002.

Oftel 2001 Consultation

- In the Oftel 2001 Consultation, Oftel found that in terms of residential customers, after 8 years of service competition and 5 years of facilities competition, BT was dominant at the retail level with 49.4% market share⁹ (despite a downward market share trend from 71.8% over 2 years and a large number of new operators).
- Comparison of market share calculations eg by revenue and traffic was critical to market power assessment. BT's retail market share by revenue was much higher (over 60%) than its market share by traffic, meaning that it could price higher than competitors. This indicated market power.
- At the wholesale level, Oftel found great variance in market share. It considered that where there is a high market share, market power is likely. Oftel did not expand on the percentages it classified as high or low but had described a 60% plus market share as high.
- The dominant operators themselves argued that above 40% market share should trigger further investigation of dominance, in line with the EU approach mentioned earlier.
- Oftel considered it was only necessary to take the route by route analysis further and look at other factors such as entry barriers where market share figures were not high.
- Taking this approach, Oftel found BT dominant at the wholesale level for many routes despite the fact that there had been facilities competition for 4 years and despite the existence of around 13 to 15 wholesale operators on most routes reviewed.
- Routes were only found competitive where there were low and volatile or decreasing market shares, low market concentration, a number of competitors for the specific route, liberalisation of the far end market and alternative suppliers of direct routes.
- Even where routes were found competitive, they still remained subject to key safeguards such as:
 - a reduced period of advance charge notification
 - prohibitions on undue discrimination
 - supply to any person on reasonable request.

Oftel 2002 Review

- This review was completed after 9 years of ITS service competition and 6 years of facilities competition.

⁹ We have referred to BT's volume market share to allow some comparison with SingTel's published 79% market share. We note that SingTel's market share would likely be even higher if an 'apples to apples' comparison was made as the UK analysis excludes calls from mobiles. SingTel includes calls from mobiles, which no doubt reduces its market share given the somewhat greater degree of mobile (cf fixed) competition in Singapore.

- Oftel rejected dominant operator requests for the markets for retail and wholesale international service to be determined as effectively competitive in their entirety.
- Oftel also rejected the dominant wholesale operator request to only treat routes where its market share was above 40% as needing further investigation. (We note the low threshold suggested even by the dominant operator, which is in stark contrast to SingTel's current market share.)
- Oftel continued to apply a route analysis despite the fact that the routes under consideration involved only a small percentage of overall calls.
- Oftel continued to find that dominance persisted in all retail IDD markets for residential customers, even where there was competition at the wholesale level for a route and also persisted in relation to business customers for routes not subject to effective wholesale competition.
- Oftel's conclusion on dominance took into account BT's high market share which, while falling, remained significantly higher by revenue than by volume. It also took into account BT's ability to maintain a high ROCE (Return on Capital Expenditure).
- Once again, it continued to apply ex ante safeguards to both dominant and competitive services, although reduced in the case of the latter (as per Oftel 2000 Review).

We note that Oftel has generally considered residential and business segments of international service markets separately. This split is largely a legacy of its price control regulation where price cap mechanisms make the same distinction. We consider that the breakdown is unnecessary at this relatively immature stage of competition in Singapore where SingTel is clearly dominant across the board. We also believe that, even in the longer term, such a break down of data may not be possible with the result that market share figures may be tainted. Oftel noted this weakness as it was mostly provided with volume data that did not distinguish residential and business traffic. Therefore its theoretical split of the market was not fully carried through in its analysis. In any event, we have reservations about the correctness or practicality of this split given substitution possibilities and the huge variation in business customer size and strength relative to residential customers. The latter means that market analysis could be overly fragmented such that a pragmatic approach dictates grouping all end users.

OFTA ANALYSIS OF ITS IN HONG KONG

OFTA has been analysing competition in ITS over more than a four year period. Its work began at least as early as 1999, when there was already evidence of significant service competition in retail ITS markets. It has culminated in late 2002 with the roll back of dominance obligations in respect of all retail ITS, given credible evidence that a state of effective competition might exist. Oftel has taken a similar approach in respect of wholesale ITS competition.

The below summarises two of the key OFTA Statements on retail ITS competition. Given OFTA's view that retail competition is largely dependent on wholesale markets, the Statements are also useful in describing its competition analysis at this wholesale level. These Statements illustrate the amount of data and analysis required, and the degree of competition that should exist, before removing dominance obligations.

1999 Statement on Non-China Routes¹⁰

- Oftel defined the market as being for retail external call services (but not including calls from mobiles) with the geographic market being Hong Kong ie national.
- Oftel further split the market between routes which were competitive and non-competitive at the wholesale level.
- It then analysed dominance on a route by route basis.
- Oftel set out guidelines for how market power should be analysed in the first instance:

“... if a firm has a market share persistently above 50% it is likely that it is dominant. Therefore, when looking at the other market conditions, [the TA] needs to satisfy himself that these demonstrate that the market is competitive and/or contestable before he would classify a firm with market share above 50% as non-dominant.” (para 44)

“The 50% market share is simply used as a starting point for the TA to examine the market conditions and is based on the experience of other jurisdictions both in relation to the telecommunications related markets but also when applying general competition law.” (para 44)

- This statement clarified Oftel’s earlier guidelines on competition analysis with the result that dominance can be presumed where market share is above 75%, is likely above 50% and may still exist below 50%, with non-dominance only possible to presume below 25%.
- OFTA carried out a thorough investigation of market share, stressing that it calculated this based on verifiable data, rather than merely estimating it or relying on HKT figures.
- This revealed that for routes competitive at the wholesale level, HKT had approximately 40% of traffic and on other routes its share was **above 55%**.
- As is critical in any competition analysis, OFTA also looked at market concentration and found that on competitive routes the gap between HKT and the second player was only 15% whereas on other routes the gap was 40%.
- Of course, OFTA did not solely rely on market share. It also examined the ease of market entry and existing competition and looked at patterns of price competition. However, rather than carrying out an overall market analysis which might be unduly influenced by a few instances of effective competition, OFTA again split the analysis between routes which were competitive and non-competitive at the wholesale level.
- Given the above 55% share and concentration levels for non-competitive routes, OFTA determined to continue to treat HKT as dominant in these markets and only wound back dominance obligations in respect of competitive routes.

¹⁰ “Application for a Declaration of Non-dominance in the International Call Services Market for Non-China Routes by Cable & Wireless HKT Telephone Limited”, Statement of the Telecommunications Authority, Hong Kong, 4 August 1999.

- Even on the routes where HKT was reclassified as non-dominant, OFTA continued to impose additional competition safeguards for several years until its recent decision to remove dominance obligations from HKT altogether.

2002 Statement on all residual retail ITS routes¹¹

- By the time OFTA decided to remove dominance obligations applicable to ITS, competition in the market was relatively mature.
- As in 1999, it elected to assess dominance using the same market definitions and on a route by route basis.
- OFTA continued to place weight on market share and restated the presumptions applicable to dominance analysis from earlier reviews.
- In terms of market share figures, OFTA found that HKT's collective market share over the residual routes was below 30% and the individual routes where it had more than 50% share were a minority with minimal traffic.
- Analysis of routes indicated the following:
 - In a number of cases, HKT was not even the market leader (48 routes or 40% industry revenues).
 - In other cases, it had below 40% or even 25% share with there being a small gap only to the next largest player.
 - HKT's market share was below 50% over 146 routes concerning over 95% of relevant traffic and revenues. Its market share was over 50% on only 9 Routes concerning 1% traffic.
 - The routes involved contribute approximately 3% of total industry outgoing traffic and consistently less than 10% industry revenues.
 - HKT's collective market share for residual routes was not significantly different from its share over non-dominant routes
- HKT also appeared to be a price follower in many instances.
- HKT also was able to support its non-dominance arguments by reference to the structural separation of HKT and Reach, which effectively created a division between wholesale and retail operators.

¹¹ "Application for a Declaration of Non-dominance in the Retail External Call Services Market for all Routes over which PCCW-HKT Telephone Limited is Still Regarded as Dominant", Statement of the Telecommunications Authority, Hong Kong, 8 October 2002.

- OFTA also went on to assess the barriers to retail competition created by limited wholesale competition and found that Reach's market share was an indication for the availability of alternative wholesale services via transit and refile:
 - Reach's market share was below 50% over 112 of the routes, above 50% over 23 routes and 100% over 4 routes only
 - Refile was available for all but the 4 monopolised routes
 - For 177 routes, refile costs were lower than Reach gateway prices.
- This degree of wholesale competition was key to OFTA's finding of effective retail competition.
- Also relevant was the safeguard regulatory controls at the wholesale level. Wholesale competition was preserved by the requirement for Reach to provide wholesale external call services on relevant routes at the gateway price determined by OFTA and at arms length to all retail external call service providers (as stressed by OFTA at para 55).

In taking a broad approach and removing dominance obligations for all residual routes, a key consideration for OFTA was that the traffic being carried over these unpopular routes was insignificant, especially when weighed against the administrative burden of the dominance obligations. This should not be taken as a precedent for removing dominance obligations for administrative ease across all ITS services, as requested by SingTel.

SUMMARY OF LESSONS FROM UK AND HONG KONG EXPERIENCE

We believe that the following are some of the key lessons from UK and Hong Kong experience for analysis of ITS dominance but also review of other markets:

- It is important for regulators to have guidelines before carrying out competition reviews, which set out the approach to be taken to matters such as market definition and market power analysis.
- Such guidelines will be easier to administer if they contain market share presumptions and also set out other relevant competition criteria.
- In carrying out market analysis, it is appropriate to find there are separate wholesale and retail ITS product markets.
- The geographic dimension of the market is limited to national boundaries, with the existence of regional hubbing and similar services only relevant to constraints on market power.
- Despite this geographic dimension, analysis of dominance is appropriately done on a route by route basis at both wholesale and retail levels. (We comment further on this in Annex A.)

- Route by route analysis is resource intensive and so may not be warranted in the early days of competition but becomes relevant as overall ITS market share thresholds reach a ‘grey’ area eg. below 50%.
- Even where market share on individual routes is less than 50%, further analysis is required of all factors relevant to a finding of dominance (ie well accepted factors such as barriers to entry, access to capital markets etc).
- Competition in ITS is extremely important and a regulator must undertake a rigorous market analysis supported by detailed market data before determining it is safe to remove protections against abuse of dominance.
- A finding of effective competition on a route does not necessarily mean that all competition safeguards should be removed. Each safeguard should be carefully reviewed. (We comment further on this in Annex B.)
- A regulator should not fetter its future right to intervene, although the regulator may wish to provide guidance that it is less likely to find certain behaviour to be anti-competitive.
- Before removing any sector specific protections, a regulator should ensure that there are general competition rules that will provide a backstop.

The overseas experience outlined above is recent. Further, other than the more developed state of competition, the ITS sector is not so significantly different in these countries that a different approach in Singapore is justified. For example, if Oftel found that a below 50% ITS market share supported a finding of dominance, we do not believe that other factors such as entry barriers, market concentration, buyer behaviour etc are so different in Singapore as to render SingTel, with its 79% market share, non-dominant.

On the other hand, we stress that to the extent dominance obligations have been removed in UK and Hong Kong, this does not mean that Singapore is so similar it should follow suit. Dominance obligations have only been removed in these countries after a longer period of competition and at a time where incumbent market shares had reduced to well below 50%. While Singapore may wish to appear as competitive as these jurisdictions by also winding back dominance regulation, it would be imprudent to do so given the relatively immature state of competition.

SUGGESTED APPROACH FOR SINGAPORE

We believe that the overseas experience outlined in this paper supports the IDA responding to the SingTel Exemption Request along the following lines:

- Exemption from dominance obligations should not even be considered while overall ITS market share is high.
- While market share is high, there is no need to go into a more comprehensive competition analysis of other factors relevant to a dominance assessment such as entry barriers.
- Given SingTel’s recently published claim to have 79% ITS market share, IDA should reject outright SingTel’s Exemption Request. (We note that SingTel’s market share is likely to be

even higher based on revenue and if mobile calls were excluded. We also believe it is safe to assume that market share, if split between wholesale and retail, would be similarly high.)

- IDA should have a threshold overall ITS market share figure, such as 50%, triggering the point in time when it will more closely examine dominance exemptions. 50% or less would be a supportable threshold given the approach taken in Hong Kong, UK and EU. Use of a threshold would prevent SingTel from wasting IDA resources with frivolous exemption requests while it still has high market share.
- At the point where SingTel market share reaches the relevant threshold, IDA should introduce a route by route analysis of dominance, split between wholesale and retail markets.
- It should incrementally remove dominance obligations from SingTel route by route based on SingTel providing verifiable data, rather than just competition rhetoric.
- A starting point would be analysis of market share based on both traffic and revenue, as well as market concentration.
- It should then take into account other standard factors relevant to a dominance assessment eg as outlined in the Oftel Reviews. We also refer to criteria in the EU guidelines.¹² We believe a number of these are characteristic of SingTel's operations.

*“- overall size of the undertaking,
- control of infrastructure not easily duplicated,
- technological advantages or superiority
- absence of or low countervailing buying power
- easy or privileged access to capital markets/financial resources,
- products/services diversification (e.g. bundled products or services),
- economies of scale,
- economies of scope,
- vertical integration,
- a highly developed distribution and sales network,
- absence of potential competition,
- barriers to expansion.”*

- The IDA should not automatically remove all dominance obligations where it finds a route competitive. It should recognise that competition safeguards may still be necessary and that its right to intervene in future should not be fettered.
- In absolutely no circumstance should IDA provide exemptions from ex post dominance safeguards such as those in section 7 of the Code.

The above approach is consistent with the Code and we do not believe it needs to be expressly stated in the Code for IDA to adopt it.

¹² Para 78, “Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services”.

In taking the first step of rejecting the SingTel Exemption Request outright, we believe it is critical that care be taken not to give SingTel ammunition to come back with further frivolous exemption requests (for example, simply because its ITS market share has reduced by a few percentage points or because a few more operators enter the market).

We therefore believe that the IDA should set out clear guidance for future proceedings under s 2.6.1 of the Code, either in the reasoning contained in its decision on the IDA ITS Consultation or by issuing guidelines immediately following its decision. We believe the latter would be preferable for the reasons highlighted at the start of this paper. It would ensure that the current proceeding is not delayed beyond Code timelines, and that preparation of the guidelines is not rushed. Use of guidelines will also enable the IDA to make clear how it will act across all telecommunications markets, rather than just ITS.

The experience gained from this proceeding will also highlight whether there is a need for improvements to relevant Code provisions as part of the forthcoming Code review. We believe that the guidelines could usefully be developed at the same time the Code is being reviewed to ensure a comprehensive approach is taken in future.

ANNEX A – ADDITIONAL COMMENTS ON ROUTE BY ROUTE ANALYSIS

Macquarie believes it worthwhile to provide some additional comments on the correctness of a route by route analysis of SingTel ITS dominance, and in particular to address some of the comments made in the SingTel Exemption Request.

SingTel has argued that a route by route analysis would be too complex for the IDA and an ‘inefficient’ approach given how competitive the Singapore market is. We stress that OFTA strongly resisted such self-serving arguments. It did so in the context of a market where the incumbent had only a 30% market share as opposed to SingTel’s 80% monopoly. In its 2002 Statement, OFTA opined:

“While the retail external call services market is becoming less and less segregated across different destinations, especially over the Routes, the TA does not consider the market to be fully synthesized yet. Therefore, he considers a pure collective assessment on the Application to be inappropriate and imprudent. Instead the TA will first conduct a route-by-route analysis, and on top of which he will make further observations on a collective or grouped basis. He will then consider whether collective or grouped observations should contribute to his decision. The TA does not accept insignificant traffic and administrative ease to the rationale for a collective assessment ...” (p 13)

We believe SingTel’s argument should be turned against it as per the approach suggested above. Given SingTel’s very high market share, it is complex and unnecessary at this stage to do a further analysis until such time as the SingTel’s overall market share has reduced and it can produce evidence that it generally, or at least on some routes, carries below 50% of traffic. Then it would be appropriate to carry out a route by route analysis and incrementally remove SingTel ITS from the scope of dominance obligations as its market share reduced.

SingTel’s Exemption Request also states that route by route analysis was only used historically by other regulators in an environment of limited market competition such as when there were fewer cables available etc. However, this ignores the fact that OFTA specifically revisited the appropriateness of route by route analysis in 2002 and Ofel did so in 2003, with both continuing to find it the correct approach even in a competitive market.

SingTel’s further comment that international transit markets have developed to the point that a route analysis is unnecessary is similarly unsupported by any facts. To support this it would be necessary to carry out a similar exercise to OFTA’s research whereby the availability of refile and the costs of such were compared against direct route options. Even then, this does not remove the need for route by route analysis but merely goes to assessment of constraints on market power.

ANNEX B – ADVERSE IMPACT OF EACH EXEMPTION SOUGHT

The IDA ITS Consultation asks commenting parties to specifically address each type of ITS product and each Code provision from which exemption is sought. Macquarie submits that in light of the above conclusion that SingTel remains dominant across all ITS services, comment on specific services and exemptions would be premature and irrelevant. The simple fact is that, given SingTel's continued dominance, all Code safeguards remain just as important in protecting end users and promoting and preserving effective competition as when first introduced. Further it would be incorrect to analyse each SingTel ITS product because the relevant markets for competition analysis are broader than that.

Macquarie therefore does not provide detailed comments on SingTel ITS products or impact of exemptions sought but rather comments below on the importance of current Code safeguards.

S3.3.1 – Duty to provide service on demand to end users

Macquarie views this provision as a loose form of universal service provision obligation for Singaporeans. Unlike many other jurisdictions, there are no other protections provided by the regime for end users who may be 'unattractive' as telecommunications customers. We consider that there is a grave risk that such end users will suffer if SingTel is exempted from section 3.3.1 since competition is not so aggressive in Singapore that customers rejected by SingTel will necessarily be snapped up by other operators. Many of these customers will be low end residential users who are not even part of the target market for the majority of licensees.

S3.3.2 – Duty to provide service at just and reasonable prices, terms and conditions

Macquarie is curious as to why SingTel seeks the ability to offer unjust and unreasonable prices, terms and conditions. Such conduct would ipso facto be damaging to end users and competitors and would therefore not meet the requirements for exemption.

We see this provision as supporting s 3.3.1. There would be no point in having a requirement to ensure all end users get ITS on demand if the IDA did not also oversee the terms of such service provision.

S3.3.3 – Duty to provide service on a non-discriminatory basis

This provision protects against not only end user discrimination, but perhaps more importantly prohibits SingTel from discriminating in favour of a related entity and requires that such entities be supplied pursuant to filed tariffs. It does not prohibit discrimination per se if based on objective reasons.

This provision is necessary to protect competition at the wholesale level. Just because there are other licensees offering IDD services does not limit the harm caused by SingTel leveraging its dominance into other markets via related entities. The prohibition on discrimination ensures that competing retail operators are placed in an equivalent position to SingTel's retail business and so better able to compete. If SingTel were to offer them less favourable terms, they and hence their customers would be disadvantaged.

In the UK, Oftel continued to apply prohibitions on undue discrimination even after routes were found to be competitive. It refused to fetter itself by providing an exemption altogether and only went as far as conceding that discrimination was less likely to be undue in competitive markets.

Macquarie submits that in the first place, SingTel remains dominant across the board such that exemption is inappropriate. We further submit that even as routes become competitive on an incremental basis, IDA should follow the UK approach and retain the right to find undue discrimination should the need arise.

S3.3.4 – Duty to file and supply on tariff

This provision supports the non-discrimination obligations and so is equally important. Without it, IDA will have limited information on SingTel activities. Without tariff filing and obligations to supply on tariff, the IDA will be unable to monitor whether SingTel does offer fair and reasonable terms that are not anti-competitive, unless customers complain. The most vulnerable customers are the least likely to be informed enough to do so.

The lack of SingTel tariff information will also make it more difficult for the IDA to benchmark the competitiveness of Singapore's main operator with other countries.

Again, we note that Oftel continued to require filing of prices, terms and conditions even in relation to service routes found to be competitive. In Australia, Telstra is still required to file tariffs with the ACCC and price caps are also applied to Telstra basket of services which includes international calls. In Hong Kong, HKT and Reach are still obliged as FTNS to file and get approval for tariffs.

S3.5.5 – Duty to provide unbundled services

Section 3.5.5 ensures that end users are protected from SingTel requiring them to purchase additional services just because they want SingTel's IDD service. This provision is in the end user interest and also protects competition in related markets. Given SingTel's significant market share for IDD, if it were to impose bundled packages on its customers there would be a severe adverse effect on suppliers of services competing with those included in the bundle. Just because end users may be able to go elsewhere for unbundled IDD services does not mean that they will, given consumer apathy and concern over moving away from incumbent services.

In Hong Kong, HKT and Reach as FTNS are required to offer service on an unbundled basis.

S5.8.1 and 5.8.2 – Duty to allow resale and sales agency

Resale is a key contributor to the improving state of competition in Singapore and to remove this obligation on SingTel would definitely damage the market. Other jurisdictions such as Hong Kong and Australia take the approach that an incumbent cannot prohibit resale. Sales agencies are similarly important, being equivalent in function to resellers but simply having a different legal structure.

S5.8.3 – Duty to tariff and offer wholesale services

This provision is vital to wholesale competition and thus in turn retail competition. It is related to the protection against SingTel discriminating in favour of related entities but clearly goes beyond to also catch discrimination in favour of SingTel partners etc.

If IDA exempts SingTel ITS services, SingTel may refuse to offer wholesale services. Even if SingTel continues to offer wholesale services voluntarily, without the s5.8.3 protection there is nothing to stop it from distorting the market in favour of certain parties or against those downstream licensees which it does not support. Macquarie believes it is naive to think that SingTel will feel forced to keep its terms ‘as is’ to meet competition. If so, there would be no need to seek exemption from the obligation to supply wholesale IDD services.

It is not an answer to allege that downstream licensees can simply turn to alternative wholesalers. They may not necessarily be able to find suitable alternatives suppliers providing service across all routes (including monopoly routes). If retail providers are unable to offer an overall retail product on all retail routes, it is likely that there would be a significant impact on the retail ITS market.

Even to the extent other operators do supply wholesale services, their pricing would be benchmarked against SingTel’s. If IDA removes SingTel’s obligation to supply a wholesale product at prices, terms and conditions subject to IDA scrutiny, there is no doubt that SingTel will (assuming it continues to even offer a wholesale product) offer far less competitive terms and other operators will follow suit.

We believe that s5.8.3 is one of the most important provisions subject to the SingTel Exemption Request, given the importance of wholesale competition to the retail level and thus end users. It is critically important that the IDA does not remove wholesale services from the regulatory regime. This is particularly so while SingTel remains dominant in ITS. However, just as OFTA and Ofel retained competition safeguards even after reclassifying ITS routes as competitive, we believe s5.8.3 should continue to apply while there is an overall dominance classification under s2 of the Code.

Section 7

There should be no exemptions from s7 of the Code. These are Singapore’s equivalent to ex post competition law. In Hong Kong and UK, while dominance obligations have largely been removed in respect of ITS, regulators have retained the ability to pursue incumbents under general competition law provisions.

If the section 7 protections are removed, there would be no recourse against SingTel if the IDA subsequently finds abuse of dominance in the supply of ITS. Exemptions should be granted in respect of ex ante provisions only and NEVER against ex post provisions.

Macquarie submits that SingTel’s attempt to get IDA to allow it to predatory price by exempting it from s 7 should be a particular cause for concern. SingTel suggests in its submission that, due to competition, ITS prices will not go up, however, it makes no assurances that they will not go down too far ie by way of predatory pricing or deep discounting. It is clear that SingTel has the wherewithal to sustain below cost pricing for long periods of time and as long as it might take to steal market share from competitors. With exemption from s7, there would be nothing to stop

SingTel from offering calls to select destinations for free or at deep discounts in a manner that adversely affects competition in the IDD market.

In any event, if SingTel believes it is not dominant in ITS so its pricing cannot be predatory, then it should not be concerned with the application of s7 as it will not find itself in breach. The same analysis applies to price squeezes and cross subsidisation.

Finally, exemptions from ss7.2.2.1 and 7.2.2.2 non-price protections should also be refused as they would impact on interconnection obligations, which SingTel has said it is not seeking to deviate from. Once again, if SingTel really is not dominant then its price and non price conduct will not meet the key test in s7.2 of unreasonably restricting competition and it should not be concerned with the application of s7. This is the whole purpose and benefit of ex post regulations. Regulators do not apply them when inappropriate but also do not fetter their right to enforce should the need arise.