HKT

Consultation Paper
on
Application for Prior Consent
under Section 7P of the
Telecommunications Ordinance (“TO”)
in respect of the
Proposed Acquisition of CSL New World Mobility Limited
by
HKT Limited

Submission of HKT Limited

4 February 2014

HKT Limited and Hong Kong Telecommunications (HKT) Limited (hereinafter "HKT") are pleased to submit comments regarding the proposed acquisition by HKT Limited of CSL New World Mobility Limited, the holding company of CSL Limited ("CSL"). Both HKT and CSL are carrier licensees. HKT would note that it has, on behalf of RBB Economics, submitted an assessment of the proposed acquisition. HKT supports RBB's analysis and conclusions.

I. Background

The proposed transaction ("Transaction") will result in the acquisition of CSL New World Mobility Limited by HKT Limited. CSL's primary assets include without limitation its network, licenses and spectrum, intellectual property rights, customer contracts, shop leases, and goodwill as well as certain affiliated (non-licensed) entities. This acquisition would represent the 'return' of CSL to the HKT group, the situation that existed before the sale of CSL to Telstra in two tranches, in 2001 (60%) and 2002 (40%). [1]

The total mobile market share of HKT post acquisition of CSL by subscribers will be about 31% and by revenues will be about 29%. Market shares by subscribers, revenues and spectrum for all the market participants are found in the Consultation Paper.

The Commercial Objective. The primary commercial objective and the rationale of the Transaction is to enable HKT to compete more efficiently in the Hong Kong

[1] An important characteristic of an open and dynamic market is the ability of investors to fulfil exit strategies. It would not be efficient or desirable to make market exits unduly difficult.

market by reducing its cost base and achieving economies of scale in the mobile sector. The provision of services at a lower marginal cost would enhance HKT's ability to serve its customers across all its brands, (ie 1O1O, One2Free, NWM and PCCW Mobile), and increase investment and innovation to the benefit of HKT's consumers and the Hong Kong economy.

The Market. The mobile market in Hong Kong is dynamic and hyper-competitive. There are currently five facility based licensees vigorously competing. A sixth licensee, 21 ViaNet, has obtained spectrum and is preparing to enter. Multiple MVNOs and resellers also exist. The highly competitive nature of the market will not change post Transaction: The competitive process will remain strong, consumers will continue to have choice, the market will remain very contestable and there will be no creation of a dominant position.

The Hong Kong mobile market is widely recognized as one of the most open and competitive markets in the world. It is one of the least concentrated markets with competition re-enforced by requirements as to interconnection, number porting and resale. The financial strength of the market participants, the lack of customer loyalty, high advertising spends, multiple well known brands, entrenched price competition, and the high level of investment/innovation all act to maintain the high levels of facility based and resale competition.

No Substantial Lessening of Competition. The Transaction will not have, or be likely to have, the effect of substantially lessening competition in a telecommunications market.[2] The relevant product market is the supply of mobile services. The relevant geographic market is Hong Kong. Post Transaction, HKT will not have the ability to price above competitive levels and will remain constrained by its competitors and customers. The merged entity will not be able to act in the market without regard to competitors or customers.

As a 'merger', the proposed Transaction would represent a situation where 6 existing network licensed operators would decrease to 5 (ie, a **'6 to 5'** merger with 21 ViaNet

[2] This is the statutory test under Section 7P of the Ordinance.

considered). Without 21 ViaNet being considered, it is a **'5 to 4'** merger.[3] Such a '6 to 5' (or even '5 to 4') merger is very much consistent with global and Hong Kong precedents as presented in the Consultation Paper (both as to resulting market shares and number of remaining operators). HKT is not aware of any ' 6 to 5' or '5 to 4' merger proposal in the mobile market such as is presented here as ever being rejected.

The facts and nature of the proposed Transaction, coupled with the highly competitive nature of the mobile market, assessed in the context of the Hong Kong and global precedents[4] and the CA's stated approach to the application of the Section 7P regime as set out in the Merger Guidelines, lead HKT to conclude that the Transaction does not give rise to any significant competition or market structure issues and that the CA's approval under Section 7P is warranted.[5]

<u>Consumer Benefits</u>. Both HKT and CSL customers will benefit from the proposed Transaction. Post Transaction, HKT will be a more efficient competitor as it will combine the HKT and CSL networks and customer bases in order to achieve economies of scale.[6] Significant opex savings will be derived, for example, from having fewer cell site and shop rentals. Capex swings will be derived (over time) from a unified network. This will in turn allow HKT to invest more in innovation, enhanced services, network up-grades and service quality to the benefit of customers of HKT.

In particular, as a result of this Transaction, 'HKT' customers will gain access to CSL's below 1GHz spectrum which will allow better indoor coverage and increase service quality. HKT's customers will also obtain access to CSL's LTE network and international roaming arrangements. At the same time, 'CSL' customers will gain access to HKT's extensive WiFi network as well as innovative apps. Both 'HKT' and

[3] Since merger reviews are forward looking exercises, and this is indeed noted in the CA's Merger Guidelines, it is most appropriate to view the proposed Transaction as a **'6 to 5'** merger.

[4] HKT notes that it mistakenly presented the 2010 Sunrise/Orange '3 to 2' proposed merger as approved in its table of global precedents. That proposed merger was actually not allowed as it would have reduced the number of MNOs to two with the only other remaining competitor holding a 60% market share in terms of subscriptions.

[5] While HKT believes that no significant competition concerns arise at the retail or wholesale level, HKT (as the acquiring entity/licensee) has offered certain commitments as described in the Consultation Paper.

[6] Any network rationalization effort would reduce the total number of base stations. However, the remaining number of base stations in the 'merged' network would be significantly larger than now exists in either the CSL or HKT networks. This would result in improved coverage and service quality.

'CSL' customers will benefit from an increased number of base stations, increased investment in innovation and network up-grades, enhanced service quality, and the faster introduction of new services. Overall, service continuity and service quality will be ensured (and actually enhanced) for the HKT expanded customer base. The transition for HKT and CSL customers should be seamless, with no network 'switch offs' or negative events, and certainly HKT has a clear incentive to satisfy all of its customers (including all their contract rights and expectations). To the extent that HKT becomes a more efficient and vigorous competitor, other competitors will need to improve their game (ie, invest and innovate more), which will benefit even non-HKT customers.

II. The Questions Raised

In this section, HKT, addresses the specified questions raised in the Consultation Paper:

(a) possible unilateral effects;
(b) possible coordinated effects;
(c) possible effects in non-mobile markets due to HKT's status as an FNO;
(d) HKT's proposed commitments; and
(e) potential public benefits.

Unilateral effects. The issue of unilateral effects looks at whether the merged entity will acquire market power and will have the ability to act without significant competitive constraint from competitors (both existing and potential) and consumers. The most common characteristic of such market power is the ability to increase prices significantly over a substantial period of time.[7]

It should be clear that the merged HKT/CSL entity will not acquire market power (ie, it will not be able to act without constraint). First, the Hong Kong mobile market is one of the most competitive and least concentrated markets in the world. Competition

[7] HKT endorses the detailed analysis presented by RBB Economics on this and the other questions presented by the CA.

is fierce. The intensity of this competition and lack of concentration will remain post-merger. Second, HKT's competitors are extremely well-resourced and deep pocketed entities (eg. Hutchison, China Mobile, SmarTone and even some of the MVNOs). Third, structurally it is clear that competition is firmly embedded as evidenced by clear interconnection and dispute resolution regimes, high advertising spends, limited customer loyalty, high investment/innovation trends, substantial price competition, the high level of customer migration between MNOs (which occurs primarily outside of the number porting regime but also by number porting), etc. Fourth, this is a merger between smallest and third largest MNOs. It is not a merger between the largest MNOs. Fifth, there is a trend away from the MNOs and towards content providers and handset manufacturers in terms of any market power. Finally, there is substantial supply side and demand side substitutability. Overall, the merged entity would operate in a very competitive market and remain constrained by its competitors and customers.

Market shares can give a rough indication of potential market power and possible unilateral effects. In this regard the merged entity would have a market share by revenue of about 29% and a market share by subscribers of about 31%. These market share levels have not raised concerns previously in Hong Kong (eg, PacLink/CSL in 1997 (40%) and CSL/NWM in 2006 (33%) or globally (please see Sections 9 and 10 of the Consultation Paper). Indeed, a post-merger market share of less than 40% generally is not seen to raise market power issues.[8] In addition, the concentration ratios are the lowest or among the lowest both pre and post Transaction (eg, HHI and CR3) as shown by RBB in its assessment.[9]

The number of remaining operators (ie, 5 with 21 ViaNet or 4 without 21 ViaNet) post Transaction also does not raise competition concerns based on Hong Kong and global precedents (please see Sections 9 and 10 of the Consultation Paper as well as the RBB assessment).

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8 In Section 9 of the Consultation Paper, Market Concentration, it is also noted that HKT's post Transaction spectrum holdings would be 31.7%. HKT would note China Mobile's recent sale of 8MHz of spectrum to HKTVN. However, that spectrum remains available to the market and does not change our analysis or conclusions.

9 Please see Table 3 of the RBB assessment which presents country specific information as to the number of MNOs, HHI, largest market share, CR2 and CR3.

Coordinated effects. The Hong Kong mobile market is extremely competitive. There is no real possibility that coordinated conduct would occur (eg, coordinated price increases not reflecting costs) as a result of the Transaction. There is no clear evidence to suggest that coordinated conduct has occurred in the market or would likely occur post Transaction, or can be linked to the Transaction in any way.[10]

Other markets. HKT is also an FNO and the Consultation Paper asks if this raises any competition concerns (eg, market power as to interconnection or backhaul services). Importantly, CSL is not an FNO and does not act in any fixed market. CSL does not, for example, provide backhaul or WiFi services to other MNOs. Indeed, like the other MNOs, it is a buyer of such services. In short, the proposed Transaction does not result in any accretion of market power to HKT in any fixed market.

As to interconnection services, as outlined in Section 12.6 of the Consultation Paper, interconnection arrangements are in general well settled, not controversial and governed by commercial arrangements. Indeed, such arrangements have never been regulated (MNO to MNO) or have been deregulated (FNO to FNO, FNO to/from MNO and international calls). In these circumstances, it is clear that the proposed Transaction will not result in any accretion of market power to HKT and does not raise competition concerns as to the provision of interconnection services.

As to backhaul services, on the supply side there is absolutely no change: there are and will continue to be multiple providers including HKT, Hutchison, Wharf, New World, HKBN and Traxcom. HKT estimates that Hutchison is the largest backhaul provider in the market. On the demand side, the number of sites requiring backhaul continues to increase. This is being driven by a dramatic increase in penetration rates, data consumption, the expansion of LTE, the growth of connected devices (eg M2M), etc which all has to be supported by backhaul. In addition, smaller cell sites (eg, femtocells and ‘small cells’) are becoming an important technology trend, all requiring backhaul. Even if the total number of existing HKT and CSL cell sites

[10] Please see Whish, Competition Law, Sixth Edition, at p. 808 in regard to the three conditions which must be met for coordinated conduct to be successful. The conditions are: (a) the ability for several firms to coordinate their behaviour in order to exercise market power collectively; the ability of the coordinating entities to punish those firms that refuse to coordinate or that break ranks (ie, to make their market participation more costly); and (c) the ability of the coordinating firms to be free of competitive constraints from other market players or consumers. None of these conditions would appear to be present in the proposed Transaction.

decreases as the result of an efficiency/rationalization exercise, the overall growth trend for the market should continue. Overall, the backhaul market is competitive and has multiple supply side options due to the robust network buildouts of the FNOs which are continuing. Indeed, the competition to supply such links should actually increase as network rollouts continue. In short, the supply side is characterized by numerous alternative providers who compete via tenders and multiple round negotiations which will continue, demand is growing, and the competitive process is working well. The Transaction does not give rise to foreclosure concerns or inhibit competition.

As to CSL's specific backhaul situation, these are subject to long term contracts (generally 3-5 years), have early termination penalties as well as minimum requirements, and have several years yet to run. HKT is not a significant supplier of CSL's backhaul links. Even if such links are ultimately provided by HKT, which would only occur if HKT is a more efficient supplier and over time, it would merely represent a 'loss' to one supplier as the result of the competitive process, and would not present a competition concern. The Transaction does not change the multiple supply side options for backhaul services, the continuing growth in demand for backhaul services, the competitive nature of the market, or the competitive process. [11]

As to the backhaul links between mobile switching centers, HKT is a minor supplier. Traxcom and HKBN are understood to be the major suppliers of this backhaul service. HKT would note that it has offered a commitment to continue to provide wholesale services such as interconnection, backhaul, MVNO/resale, etc. [12]

As to WiFi services, the analysis above as to backhaul generally applies. However, supply side substitutability for the provision of WiFi services is unlimited since these services require less investment and can be provided by <u>any entity</u> under a class licence. Thus, suppliers range from FNOs to businesses, universities and the Government. The largest supplier of WiFi services is HKBN which provides WiFi services to SmarTone, Hutchison and CSL. HKT provides WiFi services to its mobile

[11] Excluding self provided links (ie links provided by an FNO to a related MNO), we estimate that Hutchison remains the primary supplier of backhaul and HKT remains in second place, with Wharf a close third.

[12] The proposed commitment, described below, ensures that the wholesale market remains vibrant. There will be no foreclosure in any market, and no adverse vertical effects.

arm and to China Mobile. Even if CSL's WiFi links are ultimately provided by HKT, which would only occur if HKT is a more efficient supplier, it would not change the multiple supply side options available and would only represent a 'loss' to one supplier (who is also the largest supplier) as a result of the competitive process. It would not change the broad supply side options or present a competition concern. On the demand side, the demand for WiFi is increasing and this trend will not abate. CSL is not a provider of WiFi services and this will not change post Transaction. Overall, there are multiple providers (or possible providers) on the supply side and demand is growing. The proposed Transaction would therefore have no effect on the competitive supply of WiFi services, foreclose entry or inhibit competition.

HKT's proposed commitments. HKT does not believe that the Transaction raises any significant competition concerns. Nevertheless, specific commitments have been offered to address possible competition concerns that may arise. The commitments also address possible consumer concerns even though such concerns are outside of a Section 7P competition analysis. These HKT commitments are: to continue the provision of CSL and HKT wholesale services; to fulfill all of CSL's license and customer contract obligations; and for HKT and CSL not acquiring more than 2 x 15 MHz of 3G capacity upon expiry of the existing assignments in 2016 and not participating in the 2014 3G spectrum auction.

The third commitment noted above may be of particular interest to the CA as it raises the 'consumer' issue of whether HKT can smoothly implement this commitment. Although not a competition issue, and HKT does have more than 2.5 years to address the issue, HKT does further discuss this issue below.

As HKT noted in its Application, not acquiring more than 2 x 15 MHz of 3G capacity in 2016 will be costly and painful, but manageable. HKT will have to be pro-active in the market in regard to mitigation efforts (eg, 4G migration). However, HKT would note (without necessarily agreeing with all of) the comments and conclusions of the CA and the CA's consultant Network Strategies in the recently concluded 3G consultation that the 3G incumbent operators have sufficient 3G capacity, more than enough 4G capacity and can take measures between now and late 2016 to mitigate any technical or service quality issues. As stated by Network Strategies in its 3G report:

> "For the entire Hong Kong territory-wide mobile network as well as the 3G territory-wide network, the DCO [design capacity overage] results show that there is sufficient network design capacity to accommodate all demand. This is due to the fact that there is significantly more capacity than demand on the 4G networks at present." (p. iv).
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> "The operators with excess capacity can share their spectrum with other operators who do not have enough spectrum to support all their demand. Thus, spectrum sharing can eventually result in more efficient overall use of spectrum." (p.39).
>
> "The spectrum in the operators' existing allocations may be refarmed by upgrading technology that utilises the spectrum bands. For example, operators are currently reducing the amount of spectrum deployed for 2G services as demand for these services declines, with the shift to 3G and 4G services. Operators then re-use those cleared bands for the provision of 3G and 4G services." (p.39).
>
> "[t]here is significantly more capacity then demand on the 4G networks. Therefore if operators implemented strategies to accelerate migration of 3G customers to 4G the impact on the 3G hotspot network…could be reduced."(p.40).
>
> "The 4G network capacity, in particular, overwhelms any deficit in design capacity that is present on the 3G hotspot networks (explained in more detail below) as there is significantly more capacity than demand on the 4G networks at present." (p.71).

The CA also stated that 3G and 4G capacity exceeded demand, that there was ample capacity on the 4G networks to meet demand, and that operators with smaller spectrum holdings could discuss with other spectrum assignees MVNO arrangements to meet their requirements. In short, the CA concluded that sufficient capacity existed, MNOs in ‘short supply’ could negotiate MVNO arrangements and MNOs could take mitigation measures. (See the Statement of Communications Authority and the Secretary for Commerce and Economic Development at page 13 and Annex pages 8, 16 - 20). Of course, to the extent that China Mobile acquires 3G capacity in the up-coming 3G auction (and that is a most likely result), it will need to use less of HKT’s 3G capacity. Thus, HKT believes that it has the time, incentives and ability to implement/manage this 2016 transition.

<u>Public benefits</u>. The proposed transaction will yield substantial public benefits. The derived consumer benefits are summarized at page 3 above. These include direct benefits for HKT and CSL customers, and indirect benefits for the customers of other MNOs as those MNOs are forced by competitive pressures to lift their games. In addition, there will be a downward pressure on retail prices as HKT is able to compete from a lower overall cost base, increases investment, becomes more innovative, introduces new services, and improves service quality. Benefits to the economy may include users becoming more efficient as their costs are lower than they would otherwise be or new/better services are introduced. A more efficient telecommunications sector will help maintain Hong Kong as a telecommunications hub, create jobs and help stimulate the economy. Environmental benefits will also occur as HKT utilizes few base stations.

III. <u>Other issues</u>.

HKT notes that the proposed Transaction has been the subject of several news articles and commentary. This is not unexpected, and most items have addressed issues relevant to the proceeding. Some have not. The latter group of items is addressed below:

a. Myth: 'The Li family will have too much market power'. Truth: This matter was addressed in great detail when PCCW acquired HKT in the year 2000. At that time HKT/CSL and Hutchison were fierce competitors. HKT as a member of the PCCW group and Hutchison have competed head to head since then in multiple telecommunications markets for almost 15 years. PCCW offered in 2000 to put in place regulatory safeguards including specific compliance committees which monitor the relationship between HKT and Hutchison under both the Telecommunications Ordinance and the Broadcasting Ordinance. All directors sitting on these committees are non-executive directors, and the majority of directors and the chairs of these committees, are independent non-executive directors. These regulatory safeguards have worked well and continue to be in place. HKT's acquisition of CSL simply returns matters to their 2000 situation (ie, to the status quo ante). Therefore, no new arrangements need to be put in place concerning the separate, and competitive, Li family interests.

b. Myth: 'The market will be less competitive since 5 facility based operators will now become 4'. Truth: If this superficial analysis was accepted, then no merger in any market would ever be accepted since by definition a merger results in one less competitor. On the legal and economic level, the test is a substantial lessening of competition. It is not a simple head count of players. More importantly, merger activity most often creates a stronger market player, one that is more efficient and able to compete more vigorously with other market participants. Scale and scope improvements directly benefit the customers of the merged entity and indirectly benefit all consumers as competition encourages investment and innovation. The competitive process is strengthened by such mergers. It is for this reason the vast majority of mergers are both pro-competitive and pro-consumer. The establishment of a more efficient and effective competitor will be the result of this Transaction where the proposal is for the smallest MNO to acquire the third largest MNO.

c. Myth: 'The merger will result in a substantial number of job losses'. Truth: This is not a competition issue. Nevertheless, this concern is without merit and is inaccurate as the number of HKT's employees has been and will continue to grow. HKT's senior management have given assurances on this point, noting the growth of

HKT (and its number of employees) across all of its lines of business, the need for technically skilled professionals, a significant number of vacancies, and welcoming CSL employees.

d. Myth: 'Hong Kong is no longer Asia's world city as another foreign company exits.' Truth: Telstra made a business decision based on its view of the future mobile market and the HKT offer. HKT would note that Telstra will continue to operate in Hong Kong via its other existing telecommunications activities: its Reach joint venture and other international telecommunications traffic businesses. Telstra is not exiting Hong Kong.[13]

e. Myth: 'There is no competition law and no law barring anti-competitive behaviour.' Truth: The Telecommunications Ordinance contains provisions relating to both mergers (7P) and anticompetitive behaviour (7K).

IV. Conclusion

- **The mobile market in Hong Kong is dynamic and hyper-competitive, and will remain so…the proposed Transaction will not create unilateral effects**
  - China Mobile, Hutchison and SmarTone are deep-pocketed, experienced and entrenched competitors
  - HKT/CSL will become a more efficient and effective competitor
  - MVNOs and resellers will continue their market activities
  - The resulting market shares and concentration levels do not raise concerns
  - The MNOs have sufficient spectrum to compete, to innovate and to invest

- **The TO, CA's policies and market environment ensure a competitive market**
  - well established interconnection, porting and dispute resolution regimes
  - full array of wholesale/resale services will continue to exist

[13] To support the expansion of its activities and capabilities in Hong Kong, Telstra's wholly owned subsidiaries Telstra International Limited and Telstra International HK Limited continue to provide services under their jointly held UCL No. 26. In addition, on 20 January 2014 Telstra announced that it had committed to a major upgrade of its undersea cable systems by Infinera including the RNAL system, a key system serving Hong Kong which spans 9,000 kilometres to connect it to Taiwan, Japan and South Korea.

- well informed consumers, limited customer loyalty, high customer movement/churn
- high advertising spends
- an investment and innovation driven market

- **Robust economic analysis supports the Transaction**
- **Significant pro-competitive effects and public benefits will result from the proposed merger**
- **The proposed commitments are pro-competitive and pro-consumer**
- **Hong Kong and global precedents support the Transaction**
- **Environmental benefits will occur as well**

HKT respectfully requests that its Application filed under Section 7P be approved.

Submitted by HKT
4 February 2014