

# POLICY NOTE

## IN THE MATTER OF DIRECTIVE FOR ESTABLISHMENT OF INTERNATIONAL CLEARING HOUSE EXCHANGE FOR INTERNATIONAL INCOMING CALLS FOR LONG DISTANCE INTERNATIONAL, FIXED-LINE LOCAL LOOP, WIRELESS LOCAL LOOP AND MOBILE OPERATORS

1. A directive dated 13-08-2012 issued by the Ministry of Information Technology (hereinafter referred to as the '**MOIT**') for establishment of international clearing house exchange for international incoming calls for long distance international, fixed-line local loops, wireless local loops and mobile operators (hereinafter referred to as the '**Directive**') has come to the notice of the Competition Commission of Pakistan (the '**Commission**').
2. By way of background it is pertinent to highlight that LDI Operators earlier vide application dated 09-09-2011, (i) PTCL; (ii) Multinet Pakistan (Private) Limited; (iii) 4B General International (Private) Limited; (iv) Wi-tribe Pakistan Limited; (v) Dancom Pakistan (Private) Limited; (vi) Wise Communication System (Private) Limited; (vii) Worldcall Telecom Limited, (viii) ADG (Private) Limited; (ix) Link Direct International (Private) Limited; (x) Telecard Limited; (xi) Circle Net Communications Pakistan (Private) Limited; (xii) Wateen Telecom Limited; (xiii) Redtone Telecommunications Pakistan (Private) Limited; and (xiv) Telenor LDI Communications (Private) Limited (hereinafter collectively referred to as '**LDI Operators**'), sought exemption under Section 5 of the Competition Act, 2010 (hereinafter referred to as the '**Act**') for their proposed International Clearing House Agreement (hereinafter referred to as the '**ICH Agreement**') entered between PTCL and the LDI Operators.
3. It is hoped that the LDI operators duly apprised MOIT prior to passing of the Directive regarding Commission's stance on the subject issue. However, the Commission was not informed or consulted regarding any such deliberations. The

Commission has already passed an order dated 8 February, 2012. It was involved in this matter from October 2011 to February 2012 and the subject application was withdrawn on the ground that the industry did not reach consensus on the modalities of ICH operators and that the applicant did not consider it '*a live case*'. The Commission made it abundantly clear that the subject matter has serious competition concerns. It was observed that if in future the applicants enter into any such agreement/arrangement, notwithstanding any authorization obtained from any other authority, such agreement/arrangement would require clearance from the Commission before giving effect to such agreement.

4. There are presently 13 LDI operators in addition to PTCL who are licensed to originate and terminate voice traffic in Pakistan. The sector has evolved with the growth of Cellular telephony services and Teledensity has increased up to 72% from a large pre-paid card based business to inexpensive nationwide and international calls from Cellular and Local Loop operator connections. The sector dynamics are such that incoming international voice traffic dominates the outgoing international voice traffic despite the ease of availability for International dialing now available on pre-paid SIM's and on PSTN lines. There is vertical integration for Operators who own their own LDI's or have arrangement through partnerships as voice traffic originates and terminates at the Cellular subscribers (120M) and PSTN subscribers (3.1 M) and WLL subscribers (3.1 M). PTCL was the sole monopoly at time of deregulation and still is the dominant player in international incoming voice traffic with around 50% market share and their once high margin business has suffered most with the strong price competition.
5. While it may be within the domain of MOIT to issue policy directives in relation to the subject industry, it needs to be appreciated that any such policy decision/directive/circulars are in fact subject to the substantive provisions of the statute in force.

6. MOIT through the Directive has expressed its support for the establishment of International Clearing House Exchange arrangement (hereinafter referred to as the '**Proposed ICH Arrangement**') of LDI Operators primarily on the following basis:
- (i). PTA's request for amicable resolution of the matter pertaining to Access Promotion Charges (the 'APC') contribution to be made by the LDI Operators to the Universal Services Fund (the 'USF') under the Access Promotion Contribution Rules, 2004 & Access Promotion Regulations 2005;
  - (ii). to curtail and eliminate the grey traffic;
  - (iii). the existing Deregulation Policy 2003; and
  - (iv). the existing regulatory regime.
7. With respect to the above aspects, the Commission wishes to point out the following:
- (i). As per the Directive, number of cases are pending wherein LDI operators have challenged APC for USF contribution before the courts and huge amount in this regard is payable to PTA. However, in Para 3 (e) of the Directive it is stated that the pre-ICH outstanding liabilities on account of regulatory and GoP dues will continue to be individual responsibility of each LDI operator i.e. '*to be discharged as final settlement through legal process*'. Further it is stated that to show the commitment to return the outstanding dues against concerned LDIs, an Escrow account is to be opened with PTA and *the ICH operator shall deposit 15% of respective LDI operators' revenues obtained through this new arrangement* so that the same can be used to pay the dues in case the decision of the court is against LDI operators. It is thus not clear how the matter stands resolved when the settlement is subject to judicial review i.e. '*final settlement through legal process*' which in any event, the parties are bound to honor.

- (ii). Under post Proposed ICH Arrangement, all incoming traffic in future will terminate on PTCL infrastructure. The inbound traffic is significantly more than outgoing traffic, so will lead to less incentive to use international bandwidth from a PTCL's competitor(s) and the Proposed ICH Arrangement would not only eliminate competition but also further strengthens PTCL's dominant position. Prior to deregulation in this sector bandwidth rates were very high and with competition have come down to competitive levels, both for Voice and Data, which can run the risk of going up once again.
  
- (iii). Presently it is possible to call overseas high volume destinations in US/Canada/UK/Australia for Rs 2 + tax or around 2 cents so termination cost to foreign operator has to be less than that. Similarly termination costs for Pakistan are presently under 8.8 cents. With the ICH agreement the termination rates for Pakistan will be raised by consortium to approved PTA levels which will likely result in foreign operators to increase outgoing termination rates. This potential increase to around 8.8 cents will affect consumers in Pakistan who are likely to pay more for making international calls in future under ICH arrangement and it can also fore close the option for the remaining LDI operators to negotiate. It may be relevant to add that the Deregulation Policy 2003 provides that as the markets for particular services become effectively competitive, PTA shall reduce the regulatory burden on PTCL in respect of such services, while maintaining appropriate anti-competitive safeguard.
  
- (iv). With respect to the second aspect the Proposed ICH Arrangement is supposed to restrict Grey traffic by converging all incoming traffic at PTCL gateway and by putting in better monitoring facility. However under the ICH agreement the termination rate for Pakistan is expected to go up to 8.8 cents from currently lower rates. This may provide further incentive for Grey market players to increase their traffic. Also, in future if an arbitrage

opportunity exists the players operating in the Grey traffic will likely exploit that, thus ICH move is unlikely to curb the Grey traffic and may kindle its further growth.

- (v). Reverting now to the third aspect, the existing policy which we understand is reference to De-regulation Policy issued on 13 July, 2003 (hereinafter the ‘**Deregulation Policy**’) and must be taken holistically. From competition view point the Deregulation Policy emphasizes *inter-alia*
  - (a). *Increase service choice for customers of telecommunication services at competitive and affordable rates and*  
...  
...
  - (f). *Liberalize the telecommunication sector by encouraging fair competition amongst service providers.*
  - (g). *Maintain an effective and well defined regulatory regime that is consistent with the international best practices*

However, through the Proposed ICH Arrangement it appears that the competition among the LDI Operators is restricted/prevented/diminished as each operator will have a guaranteed quota of incoming international traffic as per their existing market share. In this regard it is pertinent to highlight that the LDI Operators are under a mandatory obligation to stay within the Proposed ICH Arrangement for a period so determined by the Government of Pakistan but such obligation is without prejudice to the rights of LDI Operators under their LDI Licenses (which inherently envisages that they can originate and terminate calls at their infrastructure). Apart from this contradiction, the role of the LDI Operators seemingly would be that of bystander as most of the decision making would depend or be passed on to PTCL.

- (vi). As for the aspect regarding regulatory regime for the telecom operators all relevant laws and applicable rules and regulations which *inter alia* includes the Competition Act must be taken into account. As mentioned in Para (2) above the Commission has already passed an order dated 8 February, 2012 in which the Commission made it abundantly clear that the subject matter has serious competition concerns.
- (vii). The Proposed ICH Arrangement directly violates Section 4 of the Act, and particularly, clause (a) & (b) of subsection 2 of Section 4 which prohibits price fixing and division of market via quotas. Under the Proposed ICH Arrangement the consortium will designate PTCL to undertake negotiations on termination rates with foreign operators, and LDI operators also signing up to a percentage quota, will be guaranteed from the revenue PTCL collects from the incoming international terminations. Thus the consortium as such will fix price for termination rates and also via percentage quota allocated, share in the proceeds from the terminations from foreign operators, a clear violation of the Act. This is a typical example of cartelization. In this environment there is no incentive for a LDI Operators to improve sales, or enhance quality of service (QoS) or for that matter to invest in Network. While LDI operators retain the right to originate international voice traffic to foreign operators the inability to control inbound termination price and volumes effectively leads to a weaker bargaining position, when negotiating with foreign operators. With fixed quotas there will also be less incentive for LDI's to bring in additional voice traffic from overseas operators as any upside will be shared as per quota. The forming of ICH consortium is a cartel which will restrict competition and has to be discouraged.
- (viii). Furthermore, in terms of Para 3(d) of the Directive, the representatives of PTA and MOIT on Board as observers of Proposed ICH Arrangement, in itself curtails the free market commercial decision making of the LDI Operators and perhaps undermines the regulatory powers of PTA.

(ix). We note that in economics and especially in the theory of competition, barriers to entry are obstacles in the path of an undertaking which wants to enter a given market. It is any factor that makes it difficult for a new undertaking to enter a market. The term refers to hindrances that an undertaking may face while trying to enter into a profession or trade. In the instant matter, a substantial advantage will be available to the existing LDI operators due to the Proposed ICH Arrangement. The incumbent LDI operators will be in a position to exploit the said arrangement through a cost advantage over potential new entrants. They may use this advantage to cut prices if and when new players enter the market. Although they will be moving away from short run profit maximization objectives, they will however inflict losses on new undertakings and thus protect their own market position in the long run unless the new entrant also agree to such an arrangement. Once a potential entrant is successfully barred from a market, existing players are free to revert to their prior anticompetitive conduct. This will eventually have a negative impact on the end consumer, who must now face higher prices (due to monopolistic or oligopolistic pricing structures and inefficient and obsolete technology), lower quality products (the effect of less research and development) and ultimately fewer alternatives.

8. Although it has been stated in the Para 3(bi) of the Directive that the appointment of an independent undertaking to monitor the said arrangement and submit MIS reports on a daily basis to PTA or MOIT to prevent “collusive behaviour and to ensure transparency; however, under the given arrangement it seems more likely that such arrangement results in monitoring the consortium members to prevent any deviation from allocated quotas, which in itself is anti-competitive under the Proposed ICH Arrangement. In fact such monitoring tools are typically used by cartels to monitor the observance of the common policy and not otherwise. Monitoring essentially is a regulatory role entrusted to the sector regulator and should be discharged accordingly.

9. **Conclusion**: Under the provisions of the Act, the Commission is mandated *inter alia* to provide for free competition in all spheres of commercial and economic activity to enhance economic efficiency and to protect consumers from anti-competitive behavior. Under the Directive and Proposed ICH Arrangement price fixation and sharing of market (quota allocation) are promoted. Such practices i.e. price fixation and quota allocation are considered *per se* illegal being the most pernicious anticompetitive conducts.

Competition regime is all about applying competition policy & principles of law to make undertakings compete vigorously with each other. This fair business rivalry ensured through the competition rules brings efficiency, increased productivity, creates a wider choice for consumers and helps reduce prices and improve quality. It also plays important role in weeding out inefficient undertakings and relocation of output from less productive to more productive undertakings. It needs to be recognized that the larger benefit of competition is to promote and enhance economic efficiency.

In view of the above highlighted competition concerns and the statutory responsibility of the Commission under the Act to prevent or eliminate anti-competitive behavior and in pursuance to Section 29 of the Act, we recommend withdrawal of the Directive.

Please be advised that any such proposed arrangement/agreement if entered into in terms of Section 4 of the Act is not tenable under law.

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**Islamabad, the 28<sup>th</sup> of August, 2012**