



## **The Preliminary Report of the Telecommunications Concession Conversion Study\***

**T**his preliminary report presents the results of the first phase of the Telecommunications Concession Conversion Study. The results are derived from:

- The review of two separate reports on the concession conversion study, one undertaken by the Working Group to Investigate Implications of Concession Conversion<sup>1</sup> and the other by a consortium comprised of Dhana Siam Securities Co., Ltd., Baring Brothers Ltd. and Credit Suisse First Boston (Singapore) Ltd.;
- The review of other relevant information and studies as well as opinions obtained from major stakeholders.

The objective of this study is to determine the conceptual framework and procedural methods to be used in determining whether or not to recommend the conversion of the existing telecommunications concessions to the State Enterprises Policy Committee.

The scope of the study is three-fold:

1. To consider whether the conversion of existing concessions is necessary;
2. To recommend a clear framework, mechanism and a specific time frame for the conversion process should conversion be found desirable; and
3. To determine the direct and indirect benefits that could be derived from concession conversion.

The research team analyzed two major dimensions of concession conversion: its principles and its methods.

### **PRINCIPLES**

Principles refer to the conceptual framework to be used during the decision-making process with regards to the question of whether or not it is desirable to convert or not to convert the existing concessions. These principles will also be used to help determine what compensation, if any, should be offered. This framework is to be applied universally to all concessions regardless of the methods to be used.

### **METHODS**

These are the methods to be applied to the process of concession conversion, taking into account differences in the service segment and the particular details of each concession. Different sets of alternatives may be required for different concessions, so as to reflect the different nature of each individual concession and each service offered in the concession. Various methods are used in order to make concession conversion more appropriate, practical and acceptable to both parties in each concession.

Prior to proceeding with the decision on whether or not to convert existing contracts, it is critical to determine appropriate, fair and unambiguous principles that are generally understandable and acceptable by all of the involved parties, i.e., policy makers (the Government), concession providers (state enterprises), concessionaires (private businesses), users of telecommunications services and the general public.

The preliminary report deals with the first dimension of concession conversion—that is, the principles to be applied to all concessions. Conversion methods will be presented in the final report.

### **Background on Telecommunications Concessions and Future Market Liberalization**

Prior to the Sixth National Economic and Social Development Plan, investment in the Thai telecommunications infrastructure sector had lagged behind that of other infrastructure sectors. During the Sixth National Plan, however, economic growth surged to unexpectedly high levels, leading to a severe shortage of telephones and other telecommunications services.

As the public sector could not invest enough in the expansion of telephone services to match the rapidly increasing demand, the Government realized that private sector participation and investment was needed. The law, however, did not, and still does not, allow private enterprises to own the network equipment assets that are meant for public services. It was at this juncture that the Build-Transfer-Operate (BTO) concession was granted to circumvent legal restrictions. The BTO concession allows the state (as concession provider) and private companies (as investors of the network construction and service providers) to jointly share monopoly profits from the provision of telecommunications services. An example of this is the revenue sharing scheme that operates using the monopoly rights of state enterprises, namely the Telephone Organization of Thailand (TOT) and the Communication Authority of Thailand (CAT), the Post and Telegraph Department and the Ministry of Transport and Communications.

It is true that the BTO concession had substantially alleviated service shortages in telecommunications service and facilitated economic expansion at that time. However, the granting of over 30 BTO concessions within the span of a couple of years has led to a tangled telecommunications environment which could substantially hinder the liberalization process. The conditions, rights and restrictions imposed by these BTO concessions are, furthermore, not in line with market liberalization. Thus the continuation of many concessions is bound to deliver less consumer benefits from the future liberalization of markets when compared to the benefits that have been enjoyed by other liberalized markets. It is therefore necessary that the Government provide a clear policy direction on concession conversion.

### **Benefits of Effective Competition Under a Fully Liberalized Telecommunications Environment**

The purpose behind the liberalization of the Thai telecommunications industry is the creation of an open, competitive environment where effective competition is encouraged and practical. It is hoped that an open competitive telecommunication environment will not only enhance the country's competitiveness, but will also bring about a myriad of consumer benefits including:

- Lower prices
- Increased service choice and innovation
- Improved service quality
- Substantial increases in investment and job opportunities to build, upgrade and operate networks and services
- Optimal use of existing networks which will enhance overall telecommunications sector efficiency and facilitate economic growth
- Better quality of life as a result of adequate and quality networks and services at lower costs to connect instantly and cheaply both at the national and international levels.

### **Conceptual Framework and Principles for Concession Conversion**

The conceptual framework to convert or not to convert the BTO concessions has as its primary concern preparing for an effective, open and competitive market once the state monopoly is terminated.

Along these lines, the decision to convert or not to convert the existing BTO concessions should rely on principles that reaffirm the Thai telecommunications liberalization policy and its objective to establish the most conducive environment for effective competition as soon and as completely as possible, as follows.

**Principle 1**     *The market for each telecommunications service shall be free from monopoly power either from any sole operator or a single dominant operator that can easily use its market power against its competitors to the disadvantage of consumers.*

**Principle 2**     *The playing field of each service shall be made level for both old operators and new*

*entrants legally licensed to provide telecommunications services. All players will be subject to the same rules and regulatory restrictions, enjoy similar rights, and contribute equitable share of obligations according to the future Telecom Act. This is to ensure fair competition, where no player is in an advantageous or a disadvantageous position unless such a position is derived from competitive ability.*

**Principle 3** *All operators shall not possess any vested interests in each other, either in the form of share cross-holding or revenue sharing, as this could lead to monopolistic behavior or the unfair determination of service fees. Such cases would diminish effective competition and, hence, benefits to the consumer.*

There is no denying that the change of policy to terminate monopolies and foster competition in the telecommunications industry will definitely affect the existing BTO concessions one way or another. As a result, the decision-making process and the implementation of concession conversion should take into consideration impacts arising from such a policy change. This leads to Principles 4 & 5 below.

**Principle 4** *Each private concessionaire shall not receive future benefits of any kind greater or lesser than those that could be expected from the specified terms and conditions of the concession, and for the entire remaining period of each BTO concession.*

The net compensation (that is, from private concessionaires to the relevant state enterprise in the case of positive impacts on the future earnings of private concessionaires, or from the relevant state enterprise to private concessionaires in the case where the impacts are negative) is to be calculated as follows.

**Principle 5** *Compensation calculations will follow the following guidelines:*

- i) *Private concessionaires will be compensated should their revenue stream decrease as a result of concession conversion. On the contrary, they will compensate the state should their revenue stream increase, as from the termination of revenue sharing for instance. In any event, the amount of compensation to be made shall be calculated to cover the entire duration of each concession.*
- ii) *Should the termination of the state monopoly and the subsequent liberalization of the telecommunications industry result in an **increase** or **decrease** in the revenue stream of private concessionaires, they **will compensate** the state, or **will be compensated** by the state, accordingly. The calculation of the impact on the future revenue stream as a result of liberalization will also take into account the specific details of each individual contract.*
- iii) *Any impact occurring as a result of normal business risk, such as the economic slump, business strategy or market factors, shall not be accounted for by the compensation calculation and offsetting package.*

### **The Case where Concession Conversion is to Occur**

Should the decision be made to convert concessions, the subsequent concession conversions may range from the amendment of certain conditions of the concession to the termination of the entire concession should it be deemed contradictory to the free market philosophy outlined in Principles 1-3. This is to be done in order to create a level playing field where competition between private concession holders and the TOT/CAT can be allowed to occur as soon as telecommunications liberalization takes place. The competitive capability of the Thai telecommunications industry would therefore be increased as a result.

In the case of concession conversion, the transfer of physical asset ownership from the state to private concessionaires is not necessary. However, the state must take immediate action to remove undue restrictions or conditions on rights-of-use that hinder free competition or tilt the playing field. Such undesirable conditions include the following:

- Revenue sharing between the two would-be competitors
- Sharing of business benefits or risks
- Restrictions on the right to expand or to fully utilize networks to maximize returns and minimize costs

- Restrictions to the adjustment of service tariffs

The following principles should apply when concession conversion occurs.

**Principle 6** *Both parties to a contract need to mutually agree on the terms for concession conversion. However, the framework for concession conversion must be defined by Principles 1-5 above.*

**Principle 7** *Immediately following market liberalization, the private concessionaire shall be duly awarded an operating license covering the same type and scope of services as those specified in the BTO concession. The concessionaire will also be compensated for any additional obligations that are incurred over and above those specified in the concession, such as license fee payments for the extent of services specified in the concession and for the remaining period of the concession. However, the concessionaire must bear any obligation related to any additional future rights above and beyond those specified in the concession contract.*

### **The Case where Concession Conversion is not Undertaken**

In case the parties cannot agree on concession conversion, competition can still occur through the entry of new players. However, as past experiences have shown, the growth of new entrants' market share will be rather slow, thus undermining Principle 1 and hindering the effectiveness of the competition so generated.

In addition, the failure to convert BTO concessions, or to convert only some of them, may, under certain conditions, lead to a situation where the TOT and the CAT remain sole operators of such telecommunications services as basic telephone service and mobile phone service, even after market liberalization. Moreover, the TOT and the CAT would also be the sole operators of nearly all telecommunications sectors if they were to merge into one holding company, as outlined in the Telecommunications Master Plan, and still had private concessionaires as business partners. This scenario is thus heavily inclined to the existence of only one operator exercising near absolute market dominance in some or all markets if the future regulatory body is not strong or experienced enough. Even in the United States, a strong and experienced Federal Communications Commission (FCC) is still far from being able to curtail the monopoly power of Regional Bells Operating Companies (RBOCs) and achieving a sufficient level of competition in the local telephone service markets across the U.S.

The following principle should thus be observed if the conversion of some concessions does not take place.

**Principle 8** *The Government shall seek and implement measures to decrease limitations and obstacles to effective competition between the TOT and the CAT in markets when they are already competing either directly or through their private concessionaires.*

The preliminary report also includes an analysis of the recommendations proposed by the report of the Working Group to Investigate Implications of the Concession Conversion and the report by the consortium comprising Dhana Siam Securities Co., Ltd., Baring Brothers Ltd., and Credit Suisse First Boston (Singapore) Ltd., based on the conceptual framework and the set of principles detailed here. The views and opinions of major stakeholders obtained from brainstorming sessions and written documents have also been taken into consideration.

### **The Next Step**

The next step will be to design methods for converting each concession using the conceptual framework and principles established for inclusion in the Final Report to be submitted to the Ministry of Finance and subsequently to the State Enterprise Policy Committee.