Telecoms InfoTechnology Forum

Mergers & Acquisitions: a telecoms policy for Hong Kong?

24 February 2003
(Venue: Bloomberg Auditorium)

Executive Summary

1. TIF debated the new powers to be given to OFTA over mergers and acquisitions. Back in July 2002 TIF debated the future of IP networking and it turned out to be 'one of the liveliest TIF's and yet almost complete consensus!' This TIF was equally lively, but with much less consensus. Nevertheless it was productive. The Bills Committee of Lego met three days later, on 27t February, and many of the points made below were subsequently raised there. At the time of writing the Bills process is continuing, and this Summary is therefore also designed to assist legislators.

European Union

2. **Session one** was addressed by **Ewan Sutherland, the Executive Director of the International Telecommunications Users' Group (INTUG)** and by the eminent telecommunications economist **Dr Robert Crandall of the Brookings Institute in Washington D.C**. Ewan began by surveying a panoply of issues facing the industry and users globally. These include broadband pricing and mobile international roaming charges (see also para 4 below) which is an example of the 'joint dominance' problem the M&A legislation in Hong Kong is designed to address. He notes that M&A activity in Hong Kong may well involve changes of ownership that involve international firms. He then turns to the sullied experience of **telecoms mergers and acquisitions in Europe** and the pernicious role of financial markets. His mobile operator in Belgium was 'bought and sold three times in a matter of months at dramatically different volumes. One day I was worth 600 euros, another day I was worth 1,400 euros. I'm still trying to work out how anybody thought they are going to extract that from me in the way of volume.' Once the prices crumbled the telecoms industry turned to the regulators to bail them out, and of course Europe is also home to many vendors who provide employment and R&D euros, so the process becomes very political. Ewan also makes the point that evidence suggests that most M&A activity does *not* produced the claimed for increases in efficiency through cost savings and business synergies. 'Mario Monti who is a professor of economics, as well as being the European Commissioner for competition, noted that more CEOs regret discretely and privately that their deals have been authorised, rather than they had not been authorised.' (Also see the TIF Briefing Paper http://www.trp.hku.hk/tif/papers/2003/feb/briefing_030224.pdf).

USA

3. **Dr Robert Crandall (Brookings Institute**) was a visiting guest who generously agreed to speak *impromptu* on the recent decision of the FCC to abolish local loop

unbundling for broadband in the USA and, in opposition to the FCC Chairman, to push back to individual states the decision on PSTN unbundling. Unbundling had in practice degenerated in the USA to the wholesale leasing of the 'uni-platforms' of the Regional Bell incumbents by their long distance competitors, such as AT&T and MCI, wherein all network elements were unbundled and thus none were unbundled. The entrants to the local loop simply bought the entire package. This resulted in Dr Robert Crandall's opinion in a lack of investment in innovation and new services 'because they don't own their own networks, they are not going to develop any new services. They show no interest in it. Secondly, nobody in the United States seems to be gravitating from the uni-loop to facilities.'

4. Dr Crandall also notes that unlike Hong Kong the distance of the local loop in the US presents a major cost barrier. **Dr John Ure**, **director of the Telecoms Research Project, HKU and TIF**, notes that may be a reason why unbundling of the local loop and the building of competing customer access networks has been relatively more successful in Hong Kong than in most other places. Recent data showing the declining market share of PCCW is indicative of this, although it took longer than some people anticipated. **Dr Crandall** also notes the problem of high mobile termination charges do not exist in the USA because the mobile sector operates a Calling Party Pays (CCP) system with a 'reciprocal compensation for local carriers of which wireless carriers are a subset.' (See para 2 above.)

5. **Dr Crandall** goes on to address the **M&A situation in the USA**. Under general competition law 'you've got to provide an economic analysis that shows a merger may tend to lessen competition or to create a monopoly in any line of commerce, which is taken to mean an economic market. It is very difficult to prosecute those mergers through the antitrust division because the courts simply will not ratify any attempt to attack those mergers.' However telecoms is different because mergers have to be approved at either the individual state level by the regulatory commissions or by the FCC at the federal level 'under a public interest standard, which means any darn thing the FCC wants to do because the law [1996 Telecom Act – ed.] is written so vaguely that the courts will not overturn the commission on doing these things. As a result it becomes a political feeding ground.' So 'there's a strong intellectual argument for changing that law.'

M&A in Hong Kong

6. **Session Two** was devoted to the M&A debate and was led by **Edward Whitehorn, Assistant Director (Competition Affairs) OFTA**. He explains the new law will only apply to carrier licencees and extends the existing powers of OFTA only in cases where the market structure changes as a result of share transfers arising from M&A activity. There are three types of changes which will bring the powers into effect: (a) a change in control exercised over a carrier licencee; (b) a change in the beneficial ownership of any of the voting shares in a carrier licencee; and (c) a change in voting control of any of the voting chares in a carrier licencee. A change of control is deemed to have occurred if one of four events takes place: (i) a person becomes a director or principal officer of the carrier licencee; (ii) a person becomes the beneficial owner of more than 15 per cent of voting shares in a carrier licencee; (iii) a person becomes a voting controller of more than 15 per cent of voting shares in a carrier

licencee; and (iv) a person acquires the power to conduct the affairs of a carrier licencee. All of these indicate a change in control. In all these cases the test will be whether the M&A significantly lessens competition in the relevant market.

7. The principle embodied by the law is *ex post* regulation and any investigation by OFTA must be completed with 4 months. OFTA will invite informal *ex ante* approaches to receive confidential advice, however this advice will not prejudice OFTA's legal rights to initiate an investigation *ex post*. Interested parties can also request prior consent from OFTA that will trigger an *ex ante* public investigation to be completed within one month after which either approval will be given or a second more intensive stage of investigation will begin to be completed within 4 months. OFTA decisions can be challenged at the Appeals Board. One participant was concerned that the *ex ante* and the *ex post* decisions could end up with access to different information using different tests and assessments, to which Edward responded by pointing out that prior consent would require a public approval process, unlike the request for confidential advice.

8. **Victor Hung Tin-Yau, Chief Trade Practices Officer, Consumer Council and Simon Chan, Chairman of HKTUG** both supported the principles of the proposed law. **Victor Hung Tin-Yau** argues that sector specific regulation is not contradictory to the ideal of general competition law that still does not exist in Hong Kong because the lessons and experience of sector specific regulators can feed into a future competition commission. **Simon Chan** supports this view arguing that telecommunications requires specialist regulation by people with expertise and training. **Ewan Sutherland** also stresses the need for the special expertise of economists, accountants and lawyers to be brought into the picture to improve the quality of judgement and avoid special interest group lobbying.

9. **Tony Cheung, President, Fixed Network and VAS Group, ITAHK, Agnes Miu, Director of Legal & Regulatory, Hutchison Global Crossing and Michael Reede, Partner, Paul, Weiss, Rifkind, Wharton and Garrison** expressed strong opposition to, or reservations about the proposed new law. **Tong Cheung** argued that existing conditions in the Ordinance and the carrier licences were already sufficient to protect against anti competitive behaviour and 'therefore, there's no need for any other sector-specific regulation in the M&A.' In response to Victor, Simon and Ewan, Tony argues that OFTA 'may not have the specialist skills in dealing with the complex legal and economic issues arising from telecommunications M&As.' But his main point is the unjustified asymmetric treatment of this industry and the uncertainty it generates for potential M&A activity and for any new investment that may seek to enter the industry in this way. He suggests that 4 months *ex post* threatens to be a major deterrent to such investment and the Internet & Telecoms Association of Hong Kong that represents most of the operators is concerned at the lack of checks and balances in the new law.

10. **Agnes Miu** reinforces this argument by pointing out that in overseas jurisdictions a separate authority employing specialist professionals makes decisions, not the regulator, and that where M&A provisions exist they are dealt with by a competition commission, not a telecoms regulator. But her main objection is that the proposed law introduces

new powers at a time when the industry is facing a serious economic challenge. 'It is not like an extension or clarification of existing rules and that's also the basis of our objection. And at this juncture I think introducing something new already on a very hot-headed industry is very badly timed.' Several participants supported the view that investment could be negatively effected by M&A legislation that singled out telecoms, a point that was picked up in a WTO report on Hong Kong in December 2002. In response Agnes stressed that opposition to this asymmetric treatment is 'a matter of principle.'

11. **Michael Reede** questions the consistency of the Bill as it covers some share transfer transactions but not others, for example in the mobile sector. He cites the case of CSL's takeover of Pacific Link. OFTA dealt with the issue quite rapidly but under the Bill it would trigger a process that could become much more detailed and lengthy which could easily scupper an investment. He is uneasy with the wide powers of discretion the Bill gives to OFTA and he reiterates the point Agnes makes citing Australia where the judgement lies not with those involved in day-to-day regulation of the industry. He also reminds us that Hong Kong is a city market, not an EU or USA.

12. **Edward Whitehorn** responds to Michael that the Pacific Link M&A was captured by the licence conditions and OFTA wants 'a more consistent regime so that we don't only have some mergers subject to control and others not.' He also defends the maximum period of 4 months investigation as a trade-off between timeliness and the quality of the decision which may have to stand up before the Appeal Board, but **Michael Reede** points out the maximum may easily end up as a minimum. **John Ure** suggests that OFTA could borrow from the EU's use of informal 'state of play' meetings to speed the process. He also agrees that the use of sophisticated economic tests could become unmanageable, although given Michael's point that Hong Kong is just a city market this should simplify the process. He adds that in Hong Kong's case it may turn out that the vertical effects of M&A outweigh in importance the horizontal effects, an atypical situation. **A participant** makes the additional point that sector specific M&A law may run into problems when the mergers cut across converging industries, for example telecoms and broadcasting.

13. **One participant** makes the point that the 'jurisdictional trigger mixes up the tests, the substantive test. And I would ask why the jurisdiction is drafted as widely as it is so that there is no level of materiality for any transaction regardless of size or value… secondly, the response that we always hear back from OFTA is that, well, we will only take action where there is a substantial lessening of competition. And again, I would say that that is a substantive test against which to evaluate a merger, not one against which to trigger a review.' In response **Edward Whitehorn** accepts 'there is a very widely drawn jurisdiction in the bill, and we are considering in OFTA whether we should introduce some kind of thresholds ourselves to provide guidance to the industry.' And he assured participants that 'A single change of one principal officer in a carrier licencee is hardly ever going to produce any competitive problems. But the bill is drafted in that way, so we will have to find a way to make it work.' **Michael Reede** understands why the regulator would want legislation to cover all eventualities,

but ‘we don’t have any hard figures other than the very low percentage thresholds for the equity transfers.’ [The thresholds appear in the Guidelines and not in the Bill itself – ed.]

14. **Ewan Sutherland** suggests the ‘normal response of operators is not 3G but 3D; deny, delay, degrade. Nobody would possibly want that, or it will be very difficult to implement, and when it does happen you make it not work very well.’ The simple economic truth is that merger controls improve the economy. He adds that the ideal policy is to do away with licences unless scarce resources are involved, but without licences we need an alternative policy instrument to regulate M&A activity. **Tony Cheung** found this view not relevant to Hong Kong today where licences do exist and are sufficient. He also argues the case that mergers can bring efficiencies to the industry, but **John Ure** points to the Briefing Paper that cites non-conclusive evidence that seriously questions the efficiency gains from most mergers. **Another participant** questioned the industry why a merger that could give a company, say 45 per cent of the market would ‘be a benefit to the industry and to the consumers.’ **Michael Reede** responds that the issue is really about the transparency of the process, about thresholds for example, and about potential lengthy delays in the process.

15. Finally **a participant** asks how many operators constitute a competitive market? For **Ewan Sutherland** the real question is about freedom to enter and exit the market, not how many exist at any one time. For **Victor Hung Tin-Yau** the danger of lower numbers was the emergence of collective dominance. **Tony Cheung** suggests that six mobile operators is too many in Hong Kong. **Agnes Miu** distinguishes between the short-term benefits of price competition to consumers and longer-term benefits to consumers of an industry that was profitable**. Michael Reede** draws attention to the provisions for MVNOs in Hong Kong’s 3G market. For **Simon Chan** it’s more a question of user choice and quality of service. **Edward Whitehorn** stresses the need to examine a wide range of market factors, for example, market shares. **John Ure** closed the session by pointing out that uniform prices will be exhibited in both collusive and perfectly competitive markets and only by comparing rates of return with other competitive industries could these two types of markets be easily distinguished.

16. **Conclusion:** half the panel supported M&A legislation, even if they preferred to see a general competition policy put in place, and the other half opposed the legislation as asymmetric but would also oppose general competition law as being unsuitable for Hong Kong’s small, open and liberal economy. **Tony Cheung** summed up his position when he said ‘the comments that I’ve heard this afternoon further convinces me that it is absolutely necessary to have this panel review, because I find it very uncertain, very risky.’ Perhaps the closest TIF came to a consensus on anything was general agreement that the provisions of the Bill required close scrutiny and there are grounds for improvement and/or clarification in the guidelines to make it as light handed as possible.