The Telecommunications (Amendment) Bill 2002:

"Administration's Proposed Committee Stage Amendments and Other Improvements"

1. Introduction

PCCW welcomes this opportunity to present its views on the Administration's Proposed Committee Stage Amendments and Other Improvements ("**CSAs**"). Despite some positive features of the CSAs, PCCW wishes to again emphasise that the Telecommunications (Amendment) Bill 2002 ("**Bill**") is unnecessary and will have a significant adverse affect on the Hong Kong telecommunications sector for the following key reasons:

- the imposition of M&A regulation on the telecommunications sector alone is unjustified as there have been no problems identified which would require such regulation;

- the Bill is likely to deter much needed investment and activity in the telecommunications sector;

- an established regime already exists which is effective in protecting user interests and competition in the telecom sector;

- the Bill inadequately addresses critical issues such as the standard of review, timeframes, burdens of proof, safe-harbours etc;

- The double de novo review structure of the Bill would discourage M&A transactions as the review process ignores the fragile and highly time sensitive nature of the M&A process; and

- the Bill and the proposed OFTA Guidelines would very likely prohibit all mergers except the most innocuous ones.

Assuming, however, that the Bill is inevitable (although we do not understand why an inadequate bill is inevitable) and despite the generally positive nature of the CSAs, PCCW reiterates the need for further significant changes to the Bill. This submission responds to the proposed CSAs and sets out the key changes which are still necessary.

2. The Need for Primary M&A Review by the Competition Board

While PCCW generally supports improved checks and balances, PCCW reiterates the need for an expert competition agency, namely the Telecommunications (Competition Provisions) Appeal Board ("**Competition Board**") to be the first and only arbiter of any M&A approval scheme. This proposal has found a level of support in the industry and the non-carrier participants attending the LegCo 27 February Bills Committee meeting.

As has previously been submitted by PCCW, the Competition Board has greater expertise than OFTA in competition matters. Its membership and focus make it a superior candidate to oversee merger and acquisition activity. This is based on five considerations:

1. Global best practice indicates that specialised competition agencies and the courts, not sector specific regulators, should be the "judges" in these matters. As described in further detail below, the Competition Board is a specialised entity and has demonstrated greater competition law expertise than OFTA.

2. Global trends in M&A regulation indicate a strong preference for a board making a decision rather than a single person (especially where that single person is not a competition law expert).

3. Consistent with the principles of checks and balances, it is preferable to separate the decision making power for general communications policy implementation from M&A review.

4. Because time is of the essence, it is preferable to have one comprehensive review rather than two hurried and perhaps incomplete reviews. De novo review of M&A by the Competition Board, while essential for maintaining appropriate checks and balances, will clearly be more effective and efficient if it occurs at first instance.

5. OFTA can still have a significant role in the M&A process by having a pre-clearance role and by actively participating in proceedings before the Competition Board. (In comparison, it is not clear how the Competition Board could participate in proceedings before the TA).

Based on our direct experiences with OFTA over the last two years in relation to tariff reviews and other proceedings which employ a competition law analysis, our view is that OFTA does not have the necessary level of competition law expertise to be given primary jurisdiction over M&A issues. At the same time, the Competition Board has demonstrated its ability in this area.

In March 2003, PCCW took a case related to a tariff rejection by OFTA to appeal before the Competition Board. PCCW was highly impressed with the Competition Board's grasp of the relevant competition issues. By comparison, during the hearing, OFTA abandoned or substantially modified each of the arguments it had made in support of its written rejection of the tariff.

The Competition Board has not yet given its judgement on the case, but it has shown a significant level of expertise and understanding of the issues raised. While one case may not be a referendum on OFTA's competition law expertise, it provides compelling evidence. To ignore such evidence would put a critical local industry sector at risk. Accordingly, the only realistic course of action would be to either task the Competition Board with M&A review jurisdiction or to have no legislation at all – either option would be preferable to tasking OFTA with M&A review jurisdiction as the Bill proposes.

3. The Need for Oversight by a Single Entity

Oversight by a single entity is required as time is of the essence in M&A transactions. Given the fragility and time-sensitivity of M&A transactions, the proposed double de novo review process would be counter-productive. Therefore, PCCW once again recommends that any M&A review be done by the Competition Board in a process that includes input from OFTA. As noted above, this proposal has received significant support from the industry and other parties who have made submissions to LegCo regarding the Bill. In particular, PCCW notes that the Consumer Council agrees with the industry that a clear need exists in the M&A review process for "simplicity and expediency" and that:

> *"this is a constant theme that occurs in the formation of competition policy in other competition law jurisdictions… [T]he streamlining of the decision making process implied in the suggested role for the Board, which is in any event the final*

decision making body, would on its face meet the need for simplicity and expediency."

The Consumer Council also agrees with the industry that:

"excessive delays occasioned by regulatory processes may well stifle efficient mergers and acquisitions."

The Consumer Council then notes that the Board has no staff, and that a limited OFTA role (i.e. to make a prima facie decision per the substantially lessen competition standard and then to refer the matter to the Competition Board for a final decision) would still be necessary. PCCW welcomes the Consumer Council proposal as a step in the right direction as it recognises the fundamental criterion of speed as articulated by the industry. However, PCCW is not convinced that the Consumer Council's proposal will actually meet this criterion. First, if the TA's role as the initial reviewer is not relatively short, then the problem of speed and two de novo reviews will not be successfully addressed. Second, if the time period for the TA's review is too short, the actual utility of this proposal by the Council will be quite limited.

It is because of the above that PCCW proposes a single review in which the TA would be an active participant but within the time line that other interested parties could also participate before the Competition Board. That is, there would be a single review and a single review period. The ex-post process would not have the "pre-step" suggested by the Council in which the TA undertakes a prima facie review and then refers cases to the Competition Board for a final decision. The lack of a staff at the Competition Board is not a major concern as input from OFTA, proponents, opponents and any other party (including the Consumer Council or the public) would fill this role as it does before other tribunals and courts.

In short, instead of two short proceedings (i.e. one before OFTA and one before the Competition Board) where time lines are very condensed, evidence may not be fully developed and decisions may be problematic, PCCW would suggest a single but more comprehensive proceeding before the Competition Board in which OFTA and all other interested parties would participate. This approach utilises OFTA's staff, maximises the time available for a comprehensive review by the Competition Board and meets the speed criterion. In this process, OFTA's role remains central and the TA could still be tasked with providing pre-clearances.

PCCW also notes that its recommendation is in line with recent international developments. For example, in Australia, a recent review of the competition provisions of the Trade Practices Act (which regulate Australian M&A) has recommended changes to the Australian merger authorisation process in recognition of the fragility and time-sensitivity of M&A transactions. Currently, applications for authorisations of mergers resulting in net public benefit must be made to the regulator (the Australian Competition and Consumer Commission (**ACCC**)), with ACCC decisions being appealable to the Australian Competition Tribunal (**Tribunal**). The Dawson review noted that since its introduction in 1995, only 5 authorisations of mergers have been sought from the ACCC, and concluded that the slow and uncertain double review process was commercially non-viable, particularly for M&A involving publicly listed companies. It has therefore been proposed to by-pass the ACCC's involvement in the authorisation process and to have authorisation applications be made direct to the Tribunal. As the Dawson Report noted:

> *"Direct application to the Tribunal would greatly reduce the time taken in considering an application for authorisation. It would also meet the perception of some parties that the ACCC is not able to look afresh at authorisation applications based upon public benefit because of its previous consideration of the effect, or likely effect, of the proposed merger on competition…*

The time taken by the authorisation process would be reduced because direct application would eliminate the current requirement that the ACCC first consider the proposal for up to 45 days and the attendant risk that the matter still could not proceed because of a review initiated by a third party. Under the proposed arrangement, authorisation would become a one step process…

The Committee's proposal has significant implications for the Tribunal. A procedure would need to be devised which would enable interested third parties to present their views. The ACCC should appear to assist the Tribunal. In this capacity it would have the responsibility of using its resources to prepare and place before the Tribunal the material necessary for it to evaluate the application and make the decision. In this way, the quasi-judicial role of the Tribunal would be preserved…"[1]

4. The Bill must only apply to true "M&A" transactions

Despite the CSAs, the Bill would continue to cover any change in the beneficial ownership or voting control of any single voting share in a carrier licensee. As stated previously, M&A regulations should focus on change in control and not change in ownership.

PCCW also reiterates the need to establish 'safe harbours' to exclude changes of control which have no practical effect on competition from the scope of the Bill using certain thresholds. PCCW proposes that a 'safe harbour' threshold be set such that

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[1] Review of the Competition Provisions of the Trade Practices Act ("**Dawson Report**"), January 2003 at page 65

transactions involving less than 40% market share or 5-10% market share increases be excluded from the scope of the Bill.

5. The Bill must set out an objective test of "substantially lessening competition"

PCCW supports the factors for consideration introduced by paragraph 8 of the CSAs, but would propose the inclusion of an additional factor of the "net public benefit" that would arise due to the transaction in question. Such an approach is similar to the merger authorisation process used in Australia.

Despite the introduction of various factors for consideration by paragraph 8 of the CSAs, the Bill still lacks a sufficiently objective test of "substantially lessening competition". While some other jurisdictions have subjective tests, they have substantial experience and court precedent in applying such a test. Competition authorities in Hong Kong have no such experience or precedent.

The approach taken by the Explanatory Note would characterise virtually all mergers as likely to substantially lessen competition. Therefore, a more objective test in-line with LegCo's intent needs to be defined in the legislation.

As stated previously, PCCW proposes a test based on the following principles:

- First, a "change of control" must have occurred, meaning that a different entity is truly in a position to control the material decisions of the corporation.

- Secondly, that change in control must be one that will "substantially lessen competition", which should be defined objectively, narrowly and clearly. PCCW would suggest a definition along the lines of OFTA's 1995 Competition Guidelines which take substantial to mean to mean "big, considerable or significant."

Without such a test, many economically efficient and competitively neutral mergers and acquisitions will be prevented in the Hong Kong telecommunications market. PCCW will provide further details of its proposed test in a future submission.

6. The Bill must set out time limits for completion of M&A Reviews

Although PCCW supports the notion of a backstop date as introduced by paragraph 5 of the CSAs, we believe that the period before the backstop date should reduced to no more than one month. Given that the Bill applies to just one sector of the economy there is no reason why it should take longer than this to decide whether to investigate. Reducing the backstop date will also lead to increased commercial certainty in the M&A process.

In addition, we continue to believe that there should be a maximum time limit for completing an investigation in line with other jurisdictions. This is necessary to ensure certainty and encourage M&A activity and is in line with the approaches adopted in other jurisdictions such as the US, EU, UK, Singapore and Canada. There is no reason why M&A reviews in Hong Kong should not be subject to the same restrictions. As stated previously, PCCW does not believe that the timeframes specified in the guidelines provide sufficient certainty and believes that any such timeframe should form part of the Bill itself.

7. Guidelines should be drafted by Competition Board and completed prior to the enactment of the Bill

PCCW believes that LegCo should not pass the Bill until it has reviewed and is satisfied with the completed Guidelines. In addition, we continue to suggest that the Guidelines be written by the Competition Board due to its greater experience in this area.

PCCW notes the actual proposed amendment to clause 1 does not appear to achieve the purpose outlined in paragraph 18(a) of the CSAs. Assuming that LegCo enacts the Bill prior to completion of the Guidelines, PCCW therefore proposes the following form of clause 1(3):

> *"Sections 3, 4, 5, 6 and 7 shall come into operation on the date that the guidelines issued by the Appeal Board in relation to the operation of Section 7P of the Telecommunications Ordinance (Cap. 106) in accordance with Section 6D of the Telecommunications Ordinance (Cap. 106) are approved by the Legislative Council."*

8. Application for Prior Consent

PCCW supports the introduction of applications for prior consent by the acquirer.

9. Enhancing Checks and Balances

Whilst PCCW supports the proposals made in paragraph 11 of the CSAs, as noted elsewhere, PCCW believes that any M&A review should be done by the Competition Board alone and that any dual review process will be essentially counter productive.

10. Consultation Requirement

While PCCW supports this amendment, it reiterates its previous statements that the Bill requires appropriate provisions for the protection of confidentiality. Where a licensee or acquirer feels that there is need for confidentiality, there should be a procedure where they can apply to have specific information treated as confidential and limited embargoes placed on certain information.

11. Minor CSAs

PCCW agrees with the minor CSAs proposed in paragraph 18.

12. Conclusion

Whilst PCCW generally supports the changes made by the CSAs, it notes that significant flaws in the Bill remain and recommends that, if LegCo decides to proceed with the Bill, it be deferred until these flaws can be rectified. In particular, PCCW wishes to stress the need for the first and final arbiter of M&A review to be the Competition Board and the need for an objective test of whether a transaction substantially lessens competition to be incorporated in the Bill itself.

We note that OFTA has recently submitted a short paper to the Bills Committee on the overseas case law interpreting the "substantially lessens competition" standard. PCCW will be responding to this submission as soon as practical.