The Legislative Council
Bills Committee on Telecommunications (Amendment) Bill 2002

Administration's Response to
Committee Stage Amendments Proposed by Hon Sin Chung-kai

Introduction

At the Bills Committee meeting on 9 June 2003, the Hon Sin Chung-kai proposed a set of Committee Stage Amendments (referred to as "Member's CSAs" in this paper). Subsequent to the meeting, Hon Sin revised the Member's CSAs which were tabled at the Bills Committee meeting on 13 June 2003. The Administration has reservation on the Member's CSAs as some of them do not meet the policy objectives of the Bill while others are not entirely workable. Our detailed responses are set out below.

2. The Administration however appreciates the concerns of the industry as reflected in the Member's CSAs. After due consideration, we propose to introduce further CSAs to address these concerns without compromising the policy objectives and principles, while at the same time workable. They are set out in another paper to the Bills Committee entitled "Additional Committee Stage Amendments Proposed by the Administration".

Change in Control

3. Member's CSAs seek to limit the applicability of the Bill only to situations involving change in control exercised over a carrier licensee. They aim to, *inter alia*, raise the threshold in the definition of a change in "control" from 15% to 30%, and delete a change in "beneficial ownership" or "voting control" of a voting share in a carrier licensee (i.e. deleting the proposed sections 7P(1)(b) and (c) and 7P(5)(b) and (c) of the Bill).

4. We do not agree to raising the general threshold which may trigger the regulatory mechanism of the Bill from 15% to 30% (30% should only be the threshold for special cases involving new market entrants with minimal stake in any of the other carrier licensees). 15% is already the highest threshold adopted by overseas countries we are aware of as the level that may confer material influence on the operation of a company. 30% is far higher than the international norm. Most jurisdictions do not prescribe a threshold in their laws. In other words, the authorities concerned may start a detailed investigation process when they consider that competition may be substantially lessened. In these jurisdictions, the practical guidance for investigation is set out in administrative guidelines, most of which put the threshold at 15% or less. Singapore is revising its code and a 12% threshold for instigating investigation is being proposed. In the Bill, we adopt a much less stringent mechanism : not only is the threshold written into the legislation, it is also proposed at a level higher than that set by regulatory authorities overseas.

5. The 15% threshold does not necessarily and automatically invoke investigation of Mergers and Acquisitions (M&As). Most M&As are straightforward and will not need to go through this process. The test is “substantially lessening competition”. Details will be set out in administrative guidelines, for which the Telecommunications Authority (TA) is obliged to consult the industry under the Bill. The Legislative Council (LegCo) will also be consulted during this process. Government has undertaken not to bring the substantive provisions of the Bill into operation without the guidelines. Thus LegCo will retain control over the commencement of the Bill if it is not satisfied with the guidelines.

6. The threshold for regulating M&As should not be compared to the threshold for making general offers set out in the Codes on Takeovers and Mergers and Share Repurchases issued by the Securities and Futures Commission. The threshold for making general offers, currently set at 30%, is for the protection of minority shareholders. According to the consultation document issued by the Securities and Futures Commission for the lowering of the threshold for “general offers” from 35% to 30%, the consideration of the threshold is that a shareholder with 30%

shareholding acquires "effective control" of the company. Minority shareholders should be given an opportunity to dispose of their shares if "effective control" of the company has been changed.

7. However, in M&A regulation, competition concern may arise well before a shareholder acquires "effective control" of a company. The thresholds adopted by competition authorities are normally one that would enable the shareholders to exercise material influence over the affairs of the company which would naturally be below the level for "effective control". Since the threshold for regulating M&As is completely different from that for "general offers" for protecting minority shareholders, these thresholds are pitched at different levels in overseas jurisdictions. The table attached at Annex is a comparison of the level of these two thresholds.

8. In respect of the suggestion to delete a change in "beneficial ownership" or "voting control" of a voting share in a carrier licensee (i.e. deleting the proposed sections 7P(1)(b) and (c) and 7P(5)(b) and (c) in the Bill), we must point out that the proposed sections 7P(1)(a), (b) and (c) and 7P(5)(a), (b) and (c) under our Bill are necessary to enable the Government to look into M&As where:-

- sections 7P(1)(a) and 7P(5)(a) - a person acquires "control" over a carrier licensee (e.g. when an acquirer increase his shareholdings from 0% to 16%)

- sections 7P(1)(b) and (c) and 7P(5)(b) and (c) - a person already in "control" of a carrier licensee further increases his shareholdings thereby increasing substantially the extent of his influence over the affairs of the licensee (e.g. when an acquirer increases his shareholdings from 16% to 29%)

9. Hence, the proposed sections 7P(1)(a), (b) and (c) and 7P(5)(a), (b) and (c) together empower the Government to look into M&As where a person first acquires control, and subsequently increases his shareholdings.

10. We note that Member's CSAs seek to include in the definition of "control" the situations when:-

(i) another licensee in the same telecommunications market becomes the beneficial owner or voting controller of more than 15% of the voting shares in a carrier licensee (proposed section 7P(12)(f) and (g)); and

(ii) a person becomes the beneficial owner or voting controller of the largest single group of voting shares in a carrier licensee (proposed section 7P(12)(d) and (e)).

We understand that these CSAs attempt to remedy some of the loopholes created by raising the threshold from 15% to 30% and deleting the proposed sections 7P(1)(b) and (c) and 7P(5)(b) and (c).

11. In our view, these remedial provisions fail to meet the policy objective of the Bill and leave open unacceptable loopholes. The addition of the definition set out in paragraph 10(i) on the one hand clearly recognises that the 15% threshold is in fact an appropriate level in the regulation of M&As. On the other hand, by limiting the acquisition to be made by a "licensee" only, it creates loopholes for the licensee to circumvent the provision by carrying the acquisition through its holding/affiliated company. Indeed, the fundamental issue to be addressed in the Bill is to empower the Government to regulate M&As at holding company level, as M&As nowadays will not normally occur at licensee level. In addition, that the threshold is lowered from 30% to 15% only in respect of acquisition of another licensee in the *same* telecommunications market can hardly work in legislation. For one thing, it is difficult to define what exactly "the same telecommunications market" is. Indeed, whether licensees belong to the same telecommunications market is affected by convergence of market and technologies. This itself would require a detailed study which may not give rise to definitive answers.

12. The addition of the definition set out in paragraph 10(ii) on its own is innocuous, but it will still not be able to catch acquisitions of more than 15% but less than 30% shareholdings if the acquisition does not

make the person the single largest shareholder. In general, the deletion of items (b) and (c) from section 7P(1) and section 7P(5) will lead to a defect in the regulation in that the regulator is not empowered to examine the effect on competition arising from the influence or control exercisable by a group of persons acting in concert albeit individually each person's beneficial ownership or voting control does not exceed the thresholds in the proposed section 7P(12). We have worked out additional CSAs that may address the industry concern without compromising the policy objective of the Bill (see details in our paper entitled "Additional Committee Stage Amendments Proposed by the Administration").

Power of the Telecommunications Authority

13. Under the Government's proposal in the Bill, the TA will regulate M&As which have, or are likely to have, the effect of substantially lessening competition. His decisions/opinions/directions are subject to appeal to the Telecommunications (Competition Provisions) Appeal Board (the Appeal Board), which is already handling appeals on competition safeguards under sections 7K-7N of the Telecommunications Ordinance (the Ordinance).

14. Member's CSAs aim to drastically change the institutional framework. TA is to grant approvals to M&As only, and there is no appeal channel for these cases. He must refer those M&As which may substantially lessen competition to the Appeal board for decision-making, subject to more investigations. There is also no appeal channel when the Appeal Board approves an M&A; the only appeal opportunity is to the Court of Appeal if the Appeal Board rejects an M&A. Member's CSAs also seek to impose impossible statutory timelines on the TA and the Appeal Board in performing their functions. In particular, if TA and the appeal Board do not form an opinion within the statutory time lines the M&As will be given consent by default.

15. We are obliged to set out in full the reasons for our objection to these Member's CSAs.

16. First, many of TA's actions are guided by administrative guidelines, for which the TA is obliged by law to consult the industry and

those affected or concerned. This procedure applies in the case of M&A activities. Second, TA's determinations and decisions are transparent as he publishes them with the relevant analysis and considerations for general information, once made. Third, for competition related matters, the Ordinance provides for an independent Appeal Board to review TA's decisions. A person who has the requisite legal qualifications to sit on the High Court chairs the Appeal Board. Fourth, TA's actions and decisions are open to judicial review.

17. The proposed regulatory mechanism in the Bill is based on this existing structure of the Ordinance. To use the Appeal Board, as proposed by industry, to review and approve administrative guidelines for handling M&A cases, and to investigate cases that the TA has doubts, is hardly acceptable.

18. First, it changes and distorts the nature of the Appeal Board fundamentally to that of an investigation committee of first instance with executive functions. The TA is relegated to a consenting agent. Second, the arrangement undermines the integrity of the structure of the Ordinance (TA and Appeal Board with judicial review as remedy). The actual modus operandi and the relationship between the TA and the Appeal Board in the Ordinance will be confused. Third, practically, the Appeal Board as it is constituted and resourced at present will not be able to perform the role of an investigation committee on its own of M&A activities (which will be tantamount to the otherwise full function of the Office of the Telecommunications Authority (OFTA) in this area). The additional resources requirement is real. Fourth, an avenue of appeal under the Ordinance is negated because of the distorted role of the Appeal Board.

19. We would also like to point out that the drastically reduced statutory time limits proposed in the CSAs are impossible. None of the overseas appellant courts or competition authorities is required to work within the timeframes proposed by the CSAs. For example, it is unworkable for the TA to complete investigation and decide within 4 weeks to either approve the M&A or refer it to the Appeal Board for further investigation and decision. The TA cannot take such a decision without consulting the parties likely to be affected in the industry.

Moreover, many relevant timelines are stipulated in guidelines, rather than in legislation. To impose by law impossible timelines that compromises the work of the TA and the Appeal Board and the consultation function in the regulatory process will create a floodgate for judicial reviews. We believe these are important matters of principle at stake.

Recovery of costs and expenses

20. Under the Government's proposal, TA is empowered to recover the costs or expenses incurred by TA fully from the licensee or the proposed acquirer for processing an application for prior consent. This arrangement is similar to that already put into practice in respect of determinations on interconnections under section 36A of the Ordinance. Member's CSAs aim to cap the amount of costs or expenses that may be levied to HK$100,000.

21. OFTA would recover the cost in processing an application for prior consent by the carrier licensee and proposed acquirer. It will not recover the cost in the case of a post-M&A investigation or informal consultation prior to the M&A. We believe that it is a matter of principle that the carrier licensee or a proposed acquirer should be required to pay for the cost of OFTA's service. Otherwise, OFTA, as a trading fund, would need to recover its costs from other sources. Our alternative proposed CSAs which aim to address the industry and Member's concern without compromising our principle are set out in the paper entitled "Additional Committee Stage Amendments Proposed by the Administration".

Obligation to provide reasons for decisions

22. Member's CSAs introduce a new provision to mandate TA and Appeal Board to notify the licensee/proposed acquirer of their decisions with a statement of reasons. This amendment is unnecessary. Under section 6A(3)(b)(i) of the Ordinance, the TA is required to give reasons in writing when he exercises power under the Ordinance. Under section 32O(5) of the Ordinance, every decision of the Appeal Board after

hearing an appeal shall be in writing and contain a statement of the reasons for its decision.

Commerce, Industry and Technology Bureau
18 June 2003

Annex

Comparison between
Thresholds Adopted by Competition Authorities in Examining Mergers and Acquisitions and
Those for Mandatory "General Offers" in Takeover Codes in Overseas Jurisdictions

Jurisdiction	Threshold for "General Offers" in Takeover Code	Thresholds for Examining Mergers and Acquisitions by Competition Authorities
Hong Kong	- 30% (Rule 26, The Codes on Takeovers and Mergers and Share Repurchases, February 2002)	- More than 15% (Proposed in Telecommunications (Amendment) Bill 2002)
United Kingdom	- 30% (Rule 9, City Code on Takeovers and Mergers)	- No threshold provided for in Enterprise Act 2002 in what constitutes "ceasing to be distinct enterprises" (section 26) - In the guidelines, the Office of Fair Trading (OFT) may examine shareholding of 15% or more in order to see whether the holder might be able materially to influence the company's policy. "Occasionally, a holding of less than 15% could attract scrutiny where other factors indicating the ability to exercise influence over policy are present." (para. 2.9, "Mergers: Substantive Assessment Guidance" issued by OFT in May 2003)
Australia	- 20% (section 606 and 611, Corporations Act 2001)	- The Trade Practices Act 1974 (section 50) prohibits any acquisition of shares which would have the effect of substantially lessening competition. - In the guidelines published by the competition authority (ACCC), it is stated that "[T]here is no threshold shareholding for the purpose of s.50" (para. 3.19, Merger Guidelines issued by ACCC in June 1999)

Jurisdiction	Threshold for "General Offers" in Takeover Code	Thresholds for Examining Mergers and Acquisitions by Competition Authorities
Singapore	- 30% (Rule 14, Singapore Code on Takeovers and Mergers)	- No minimum threshold in existing Competition Code (any change in ownership, shareholding or management of the licensee is subject to approval) (para. 9.2.2 of Telecom "Competition Code") - In May 2003, the telecom regulator (IDA) proposes to amend the Competition Code to provide for the following thresholds: - less than 5% - no notification or approval required - 5% to less than 12% - notification to IDA required - 12% or more - IDA prior approval required
Canada	Information not available	- In the Competition Act (section 91), the definition of "merger" covers the acquisition of "significant interest" in a corporation. - In the Merger Enforcement Guidelines published by the Competition Bureau, it is stated in Part 1 that "[i]n the Bureau's experience, direct or indirect ownership of less than 10 percent of the voting shares of a corporation has generally been found not to constitute ownership of a "significant interest" in the corporation"