

Appropriate Merger and Acquisition Legislation
in
Hong Kong's Telecommunications sector

**A Submission from SUNDAY to the Legco Bills Committee on the
Telecommunications (Amendment) Bill 2002**

2 October 2002



As a committed and innovative competitor in Hong Kong's mobile telecommunications sector, SUNDAY has a clear interest in proper protections against monopolistic market distortions. It also recognizes the potentially damaging impact on competition or innovation of particular kinds of merger or acquisition. As such, SUNDAY acknowledges and appreciates the perfectly proper concern felt by Ofta to have in place clear and simple legislation that protects against anti-competitive market dominance. It is strongly supportive of the objectives implicit in the proposals and amendments contained in the Telecommunications (Amendment) Bill 2002, now being considered by the Legco Bills Committee. SUNDAY greatly appreciates the efforts of the Legco Bills Committee in support of this aim, and thanks it for the opportunity to present its views.

Current Competitive Environment for Mobile Telecommunications

Globally, the telecommunications sector is a sector facing significant challenges. After massive excessive investment in 3G licences, many of the world's leading telecoms companies have gone bankrupt, or are in the process of painful and protracted restructuring to rebuild the basis for long term growth. Mercifully, Hong Kong's mobile operators were not laid low by crippling 3G auction costs, but they have been painfully hurt by the fallout from operators elsewhere. Poor investor sentiment towards the sector has decimated share prices and sharply lifted the cost of servicing bank debt.

Even though Hong Kong's mobile service providers are in a healthier state than counterparts in many markets worldwide, they are today operating in a difficult operating environment. Fierce price and product price competition has forced operators to be both efficient and highly innovative, but at the same time has

constrained profitability. While share prices remain at severely depressed levels, competitors not only have difficulty in raising investment funds through the equity

financing markets, but live with a constant danger of predatory attack. This provides a powerful reason for Ofta to introduce new and clearer legislation to ensure that merger and acquisition activity does not subvert competition.

Consolidation in the mobile telecommunications industry in the coming years is likely. Indeed, it can be considered essential and desirable if companies are to emerge with the financial strength to provide the sound telecommunications platform needed for Hong Kong businesses going forward. As such, mobile telecommunications service providers are critical not simply as providers of handsets to retail consumers, but as builders of Hong Kong's critical infrastructure. This provides a further reason for ensuring that effective competition is ensured, going forward.

Ensuring a competitive future will not be determined by ensuring a particular number of players are competing in the market, or ensuring that no individual company achieves more than a particular arithmetic market share. Rather, it will be determined by the highest possible levels of transparency over ownership and effective control, and legislation that provides certainty about true beneficial ownership and timely information on share purchases or disposals.

Questions

In light of the above observations, SUNDAY raises a number of questions associated with the Telecommunications (Amendment) Bill as currently drafted:

- The legislation appears to regard services to the retail consumer as the key measure of whether adequate competition exists or not. However, it is just as important to remain keenly focused on suppliers of services to mobile operators, and to the presence or absence of investment that continues to build a progressively more efficient and sophisticated telecommunications infrastructure upon which competitive Hong Kong companies will need to operate;

- The legislation appears to assume that Hong Kong's telecommunications market can be examined as a single and distinct market, in which the ownership of local operators can provide comprehensive information on whether appropriate competition exists. In fact, it is a small city market linked to a number of much larger regional and global markets. A company might account for a large market share in Hong Kong, but be a small operator internationally. By contrast, an operator with a small local presence might exert disproportionate competitive force by virtue of ultimate ownership by a significant global player. The implication of this insight for the proposed Telecommunications (Amendment) Bill 2002 is that legislation based on market share within Hong Kong should not be an exclusive guide in terms of assessing whether effective competition exists or not;
- The current draft Merger and Acquisition legislation takes no account of the damage to competition that arises from vertical integration through the telecoms industry, where an ownership change at a higher point in the vertical chain could damage the competitive environment, but fall outside the remit of the legislation. The proposed Bill appears to provide no mechanism for blocking an anti-competitive development if the source of that development lies "up-stream" in a vertically integrated company, in particular if this is veiled through holding company arrangements or trusts;
- Factors determining whether or not mergers/acquisitions would have a materially damaging impact on the local competitive environment for mobile services fall across several sectors of the economy and are not confined to telecommunications alone. A merger or acquisition outside telecommunications could have a profoundly damaging impact on competition, even though no ownership change had occurred between the mobile telecoms companies themselves;
- The declared purpose of the Bill is to empower the Telecommunications Authority to regulate merger and acquisition activities that could

“substantially lessen competition” in the telecommunications market. However, the phrase “substantially lessening competition” is not been defined in the Bill. Nor has the Bill provided a framework by virtue by which Ofta will regulate mergers and acquisitions activities for the telecommunications sector. For any judgment to be made about the objectives of the Bill, it is essential that the firm and concrete guidelines on how Ofta will implement the Bill are made available for consultation within the industry.

Summary

The proposed Telecommunications (Amendment) Bill 2002 meets a real and urgent need for Hong Kong mobile telecommunications operators. However, full assessment of how the Bill would work, and whether it would achieve intended objectives, will not be possible until concrete and practical guidelines are unveiled that provide insight into how the Bill would be implemented.

In a context where there is likely to be a high level of merger and acquisition activity in the telecommunications sector worldwide in the coming years, and where market consolidation is a real possibility, it will be critical that Ofta is able through this legislation not simply to track in arithmetic fashion the accumulation of shares by outside parties in a telecommunications company, but to trace both ultimate ownership, and a purchaser’s intent.

A pure arithmetic measure, by focusing on size and market share as the key criteria for determining whether effective competition exists or not, will not necessarily capture such ultimate ownership or intent. In Asia, anonymous trusts and holding companies in which the beneficial interest is veiled are frequently used as vehicles to build holdings in companies. Competition in the telecommunications sector could be subverted unless mechanisms exist within the proposed legislation to force disclosure



of any such veiled interests at an early enough stage for any necessary pre-emptive action to be taken. SUNDAY seeks clarification from Ofta on how such qualitative objectives will be achieved within the powers of the proposed Bill.

Otherwise, SUNDAY appreciates the efforts of Ofta to ensure effective regulatory oversight based on clear rules and service standards. It is by focusing on such rules and standards that Ofta will continue to promote high quality services and the competitive development of telecommunications services in Hong Kong.