Presentation to the Legislative Council Bills Committee by Telstra

Good afternoon

My name is Stephen Mead. I am here on behalf of Telstra. As members will be aware, Telstra is Australia's largest telecommunications carrier and has significant investments in Hong Kong. It owns 100% of Hong Kong CSL Limited and is the co-joint venturer with PCCW in the international connectivity business called Reach. Reach has its global headquarters here in Hong Kong.

Firstly, I would like to thank you for giving Telstra the opportunity to make a presentation this afternoon. I will keep my comments brief.

There have been a number of significant developments since this committee first considered the Telecommunications Amendment Bill 2002. These include the issue of a report by the World Trade Organisation concerning Hong Kong, an announcement by the Deputy Prime Minister of Singapore regarding competition laws in Singapore and reforms in Europe. My presentation this afternoon will focus on these developments and in particular the threshold issue of whether sector specific competition law in appropriate.

Based upon the material I am about to outline, Telstra recommends that this Committee should:

- firstly, give further consideration to the threshold issue of whether sector specific regulation is appropriate having regard to recent international developments in this area; and

- secondly, delay its consideration of the M&A guidelines until it is provided with a comprehensive draft of the guidelines.

My presentation is split in to four components namely, a summary of our previous submissions, an outline of recent developments, a discussion of the threshold issue of whether sector specific competition law is appropriate and finally some comments on the draft merger and acquisition guidelines.

Previous submissions

We have previously explained to the Bills Committee that we have extensive concerns with the proposed Telecommunications Amendment Bill 2001. Our threshold concern is that we do not see any justification for telecommunications industry specific competition law. In this regard, our concerns are two fold. Firstly, the Hong Kong telecommunications industry is very competitive by world standards. By way of example, it has one of the highest mobile penetration rates in the world. We have not seen any evidence that the current regulatory framework is inadequate. Secondly, we respectively submit to the committee that it is inappropriate to impose sector specific competition law. I will expand on this point further in the second part of my presentation.

If the Legislative Council decides that it is appropriate to introduce industry specific competition law, we submit that the form of that regulation in the proposed Telecommunication Amendment Bill is inappropriate in a range of areas. I do not propose to outline those issues today. However, the general theme running through our previous detailed comments on the proposed bill is the need for transparency, consistency and regulatory accountability.

Recent Developments

There have been a number of recent developments which I would like to outline to the Committee this afternoon. Respectfully, each of these developments warrants further consideration of the threshold issue of whether it is appropriate for the Telecommunications Authority to be vested with the power to regulate the structure of the telecommunications industry.

The first development is the issue by the World Trade Organisation of its publication Trade Policy Review, Hong Kong China. In that review, the WTO commented that:

> *"the existence of different rules for different sectors could lead to a distortion of resource allocation because firms would choose to enter the sectors with clear competition rules, so they could not be coerced by incumbents. Moreover, regulators, (for instance, in telecommunications) have to perform a dual role of traditional regulator and of enforcer of competition policy, which could compromise their impartiality. Different regulators may also interpret competition provisions differently and possibly inconsistently. An independent competition body/agency/authority might well better promote and enforce competition".*

The above concerns are echoed by Professor Ergas in his report which has been provided to this committee. The WTO report alone should be enough to prompt a reconsideration of the threshold issue of whether sector specific competition law is appropriate.

The second development is the announcement by Singapore that it will pass generally applicable unfair competition laws. That is, Singapore will follow the general international approach of enacting general competition laws.

The final development is the reforms announced by Europe's Competition Commissioner. These reforms include new procedures to ensure that there is appropriate review mechanisms for M&A decisions.

These developments are examples of 2 key principles which are being generally applied in competition law throughout the world, namely, that competition laws are to be applied generally across all firms and sectors of the economy and secondly, competition laws should not be vested in one person. The proposed Telecommunications Amendment Bill breaches both of these principles. Accordingly, this Committee should revisit the need for and appropriateness of the proposed Bill.

No need for Sector Specific Competition Law

The third part of my presentation this afternoon focuses on the threshold issue of whether it is appropriate, and consistent with international practice, for the Legislative Council to enact sector specific competition laws for the Hong Kong SAR. We submit the proposed approach is inconsistent with international practice. To support the proportions I am about to make, Telstra commissioned a report from Professor Henry Ergas. Professor Ergas, is a world renowned economics Professor. He has extensive experience in Australia, New Zealand and the European union. A copy of Professor Ergas' report and his CV has already been provided to this committee.

The proposed section 7P will give the Telecommunications Authority the power to regulate the structure of the telecommunications industry. The concept of a Hong Kong regulator having the

power to micromanage the whole structure of an industry goes against Hong Kong's long and successful tradition of market based policies supplemented by cautious intervention. In the telecommunications industry, this cautious intervention exists in the form of conduct based regulation which has successfully regulated the industry to date.

The power to regulate the structure of an industry is a significant power which could have grave consequences if it is inappropriately exercised. If the regulator gets it wrong it is usually impossible for the error to be corrected. For example, in the case of the regulator objecting to a merger, the acquiring entity may invest its funds in another jurisdiction. The regulation of conduct does not have such severe consequences. Accordingly, it is more appropriate to regulate the conduct of industry participants rather than attempting to regulate matters such as how many companies should be permitted to participate in the industry or what are acceptable market shares. Accordingly, we submit that it is more appropriate that resources are allocated to conduct based regulation rather than the proposed structure based regulation.

We consider that there are five key reasons why it is more appropriate to enact general competition laws rather than sector specific laws.

Firstly, it is a waste of money to develop competition regulatory expertise in multiple government agencies.

Secondly, a sector specific regulator has greater tendency to persist with the regulation of an area even where there is no longer a need. This is because a sector specific regulator which voluntarily relinquishes its role in any particular area loses a proportionally larger part of its funding and status.

Thirdly, a single regulator with overall responsibility for mergers and acquisitions in the territory is much more likely to have the requisite experience.

Fourthly, a regulator that makes many decisions in a wide range of industries applying consistent economic theory is more likely to make correct decisions as compared with a regulator which makes a few decisions limited to one industry. This leads to a higher risk premium for capital investment in Hong Kong which in turn endangers Hong Kong's competitiveness in telecommunications.

Fifthly and finally, some firms may find they are subject to competition regulation by more than one regulator under more than one law. This may lead to investment decisions based upon the nature of regulation rather than economic factors. Moreover, merger and acquisition approval may be required from two or more regulators for the same transaction.

The above comments are supported by the paper prepared by Professor Ergas.

Accordingly, we have submitted that there is no justification for the introduction of merger and acquisitions laws for the telecommunications industry. If the Legislative Council enacts mergers and acquisition laws they should apply to all firms, sectors and industry in the Hong Kong SAR.

Merger and Acquisition Guidelines

The final area which I have proposed to address this afternoon is to comment on the Telecommunications Authority's preliminary views on the key matters that should be addressed in the M &A guidelines.

As a general comment, we note that the TA has only set out his preliminary views on key matters. It is not clear how comprehensive and definitive the explanatory note is as compared to the final version of the proposed guidelines. In our view, the explanatory note is merely a framework and, is an insufficient basis for public consultation and review. Accordingly, we reserve most of our comments until a complete draft of the detailed M&A guidelines are made available.

However, this afternoon, I wish to raise two issues which are critical and therefore must be addressed in the M&A guidelines. Those issues are firstly, the M&A Guidelines must contain robust appropriate safe harbour provisions directed at both the change in control thresholds and the level of the permitted market concentration. As is currently drafted, the TA's preliminary views do not contain such definitive provisions which will assist in providing regulatory certainty.

Secondly, the M&A guidelines must clearly define a procedure for industry participants to approach the TA to obtain pre clearance process for proposed transactions.

The above matters will greatly assist in providing greater pre -transaction certainty to industry participants as to the legality of proposed transactions. This will assist in improving compliance, increasing transparency, reducing administrative cost and reducing regulatory risk. Given the preliminary and incomplete nature of the proposed M&A Guidelines, if the Legislative Council proposes to continue considering the Telecommunications Amendment Bill 2002, we urge the Legislative Council to delay its review until a comprehensive draft of the proposed guidelines is made available to this committee.

Finally and importantly, as I outlined at the start of my presentation this afternoon, we submit that there are two key steps this committee should take. The first is to take time and care to consider the inappropriateness of sector specific competition regulation. In this regard, it is important to analyse recent international developments and ask why the Bill is appropriate in light of those developments and why the Legislative Council should enact laws that put Hong Kong at odds with modern international competition regulation. This committee should meet again to consider this important threshold issue.

Secondly, this Committee should delay its consideration of the proposed M&A Guidelines until it is provided with a complete draft of the proposed guidelines that include safe harbours and a pre-clearance procedure.

Thank you for your time this afternoon.