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SmarTone Mobile Communications Limited

Submission to Bills Committee

On the Telecommunications (Amendment) Bill 2002 ("the Bill")

On

The Key Proposals in the M&A Guidelines

February 2003

1. Introduction

SmarTone appreciates the invitation from the Bills Committee to comment on the key proposals in the M&A Guidelines, as detailed in the "Explanatory Note on the Guidelines on the Competition Analysis of Mergers and Acquisitions in Telecommunications Markets" (the **"Explanatory Note**") prepared by the Government. We are pleased to submit our views as follows.

2. Checks and balances on the power conferred on the TA by the Bill

Before commenting on the Explanatory Note, we would like to reiterate our views on one of the important issues of the Bill for the Bills Committee's consideration.

Currently, as provided in the Bill, the decision of whether a particular M&A transaction is substantially lessening competition is ultimately decided in the opinion of the TA. This is a subjective test based on the opinion of a single person. It is, however, worth noting that in most other jurisdictions with merger control, such decision is usually made by a committee or a board consisted of a number of members. For example, in Canada, the decision is made by the Competition Tribunal consisting not more than 12 members. In United States, such decision is made by the Federal Communications Commission (FCC) consisted of 5 commissioners. In United Kingdom, such decision is made by the Competition Commission consisted of one full-time member (the Chairman) and a number of part-time members appointed by the Secretary of State and drawn from industry, commerce and academic life. Since the decision on any M&A would have significant impact on the business of the involved parties, we consider that having a specialised committee to make the decision instead of by the opinion of the TA solely would provide more checks and balances on the TA's power.

We note that the Government has emphasized that there are sufficient checks and balances in the Bill, namely, judicial review and appeal to the Telecommunications (Competition Provisions) Appeal Board. However, these are costly options that would place substantial financial burden on the aggrieved party. More importantly, the onus of proof in the process of judicial review and appeal is on the aggrieved party. The aggrieved party would need to establish a valid ground for appeal or judicial review, otherwise the action will be struck out by the Appeal Board or the court.

As mentioned in our last submission, we consider that the onus of proof should be on the TA, who forms the opinion that a particular transaction would substantially lessen competition. If the TA, in his opinion, considers that a transaction would substantially restrict competition, he should substantiate his decision before the court so as to obtain an injunction order to stop the transaction. This is the current practice adopted in Australia, which is also an ex-post regime.

The Government's response to our proposal is that it is not justified in a streamlined approach because this will add to the cost and complexity of the system and there is no specialised court which can process cases and deal with economic issues expeditiously.

We cannot agree with the Government's response. The Government should have already accepted that judiciary professional is appropriate to review TA's decision in relation to competition issue because the chairman and deputy chairman of the Telecommunications (Competition Provisions) Appeal Board are persons qualified for appointment as a High Court Judge. Also, as mentioned in our last submission, the experience in Australia demonstrates that the court is capable of being the decision-making body in determining whether a transaction is substantially lessening competition and being the checks and balances on the power of the competition authorities. As regards the Government's concern of increasing cost and complexity of the system, there are always trade-offs between

administrative convenience and control of administrative power. It is our view that the need of sufficient and effective checks and balances on the TA's power outweighs the concern of cost and complexity in the current case.

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3. The M&A Guidelines

As a general comment, we note that the Explanatory Note only sets out the TA's preliminary views on the key matters that should be addressed in the M&A Guidelines. It is unclear as to how comprehensive and definitive it is as compared to the draft M&A Guidelines pursuant to the statutory consultation purpose. The Explanatory Note is, at most, just a skeleton or a framework of the proposed M&A Guidelines.

We would like to reiterate our view that whilst the stated policy objectives of the Bill are to provide a transparent and efficient regulatory regime and to assist the industry in making informed decisions concerning merger and acquisition activities, we are unable to appreciate that since the crux of the proposed regulation, the M&A Guidelines, is not yet available. Unless the M&A Guidelines set out a clear, practical and objective assessment process, the industry and investors will not be able to make informed decisions on M&A transaction. This will increase rather than decrease regulatory uncertainties and will unduly restrain M&A activities in the industry.

We submit that the full draft M&A Guidelines should be released for review by the Bills Committee and the industry before the Bills Committee makes any decision on the Bill. Until a complete draft of the M&A Guidelines is made available, we would like to reserve most of our comments on the Guidelines at the moment.

4. Lack of definition and explanation

We note that some of the key words used in the Explanatory Note are lack of definition and explanation. For instance, there is no definition on the term "vigorous and effective competitor". Although it is regarded as an important factor in the competition analysis (paragraph 36 of Annex A of the Explanatory Note), there is no detail about what are the characteristics of a "vigorous and effective competitor" and what are the classification criteria. Merely listing the factor without detailed explanation of the test is insufficient.

Another example is that there is no clear explanation on the fundamental terminology of "substantially lessening competition". It appears that the only hint is given in paragraph 22 of Annex A of the Explanatory Note, which states that "*the TA will interpret a substantial lessening of competition in terms of the creation or enhancement of market power*". Does it mean that a mere creation or enhancement of market power is sufficient? Or would it be a concern only when the M&A transaction would result in a creation or enhancement of a **significant** market power, which is more consistent with the test of substantiality? There is also no explanation on what is regarded as "substantially", which is quite subjective and of uncertain nature.

It appears that the Explanatory Note is not detailed enough for the Bills Committee and the industry to understand the proposed decision process and to anticipate the outcome of the TA's analysis.

5. The legislation should include the M&A Guidelines

It is our view that the M&A Guidelines should form part of the legislation so that the formation and any subsequent change of the M&A Guidelines will be subject

to the formal scrutiny power of the Legislative Council. The Bill provides that the TA can issue and subsequently amend the M&A Guidelines so long as the consultation requirement under the proposed section 6D is satisfied. We consider that it is problematic. Given the M&A Guidelines are the crux of the regulation and any change to the M&A Guidelines may substantially vary the spirit and substance of the M&A assessment criteria upon which the Bill was enacted, it is our view that the M&A Guidelines should be subject to the formal scrutiny power of the Legislative Council.

We consider that there are two possible ways to address the issue. Firstly, as mentioned in our previous submission, the M&A Guidelines could be stipulated in a form of subsidiary legislation. This will ensure that the formation and any change of the M&A Guidelines will be subject to the scrutiny of the Legislative Council. Although the Government has commented that such arrangement would restrain its flexibility in amending the M&A Guidelines, it is our view that administrative convenience should not be the only consideration; the need for controlling delegated powered conferred on the TA is also an important consideration that should not be ignored.

Another suggestion is that the factors that the TA shall take into account when forming his opinion under the proposed section 7P should be stipulated in the primary legislation. Such practice is currently adopted in sections 7K and 7L of the Telecommunications Ordinance, in which the matters that the TA shall take into account in considering whether a conduct is anti-competitive and whether a licensee is dominant are expressly provided. It is also the current practice in Australia and Canada whereby the matters taken into account by the merger control authorities are stipulated in the primary legislation. The relevant provisions of the legislation in Australia and Canada are attached in **Appendix I** for reference.

6. Scope of Application: definition of change in control

In Section A of Annex A of the Explanatory Note, it sets out the scope of application of the M&A Guidelines. We would like to comment on this as there were many comments submitted to the Bills Committee expressing concerns on this area as the current drafting of the Bill would allow the TA to intervene into any change of a carrier licensee not resulting in a change in control.

6.1 Change of director or principal officer

Change in control is broadly defined in the Bill to include a change of director or principal officer of the licensee. We note that "director or principal officer" is not defined in the Bill, which would create uncertainties and leave the matter subject to TA's interpretation. We also fail to see how a change of director or principal officer alone would constitute to a change in control of a licensee. It is more likely that a change of director or principal officer as a result of a change in the control of the licensee would have an effect on the control of a licensee, in which case the latter is already covered by the Bill. Hence it is our view that the control on "director and principal officer' as currently provided in the Bill is inappropriate and unnecessary.

The Government's response to this is that the TA will not be empowered to intervene in any change of "director" or "principal officer". The TA may intervene only if such a change would "substantially lessen competition".

We consider that the Government's response is unable to ease the concerns because, ironically, the TA's decision framework of what would be regarded as "substantially lessen competition" remains largely uncertain. This demonstrates the importance of having a clear, comprehensive and objective framework for determining what would be regarded as "substantially lessen competition".

Otherwise, the TA would be given great discretionary power to intervene given the uncertainties inherent in the Bill.

6.2 Threshold of 15%

Change in control also covers circumstances in which a person becomes the beneficial owner or voting controller of 15% or more of the voting share in a licensee.

In response to the industry's comments that the threshold of 15% is too low to assume a change in control, the Government has quoted two precedents in existing law to substantiate its proposal:

- Section 13A in the Telecommunications Ordinance on the definition of exercise control of sound broadcast licensees.
- Telecommunications (Method for determining Spectrum Utilization Fees) (Third Generation Mobile Services) Regulation in the definitions for "Participation" and "Indirect Interest" related to "Connected Bidders".

We note that the former is for the control on sound broadcast licensees, which is not directly relevant to the telecommunications industry. It may be appropriate for using a more stringent threshold concerning the control of a sound broadcast licensee, since the sound broadcast programme service, which is free-to-air and accessible by most of the general public, would have significant impact to the society. However, we do not believe that the same threshold should be used for the control of mergers and acquisitions of the telecommunications industry.

As regards the 15% threshold as used in the 3G licensing, we would like to point out that it is for the definition of "connected bidders", but not for "control". We would like to draw the attention of the Bills Committee that, as stated in

Appendix A of the 3G Information Memorandum, the threshold at 50% is used to define "control" in a body corporate[1].

7. Time-frames for investigations

We consider that the proposed time-frames for investigations are too long and far from satisfactory. For a transaction not seeking prior approval from the TA, the maximum time-frame for getting regulatory clearance is as long as 7 months (i.e., TA can start the investigation at the end of the 3-month time limit and then the investigation can take 4 months). The Government has not provided any substantiation why the TA would need 3 months to decide only on the issue of whether investigation is necessary. The time-frame is by no means acceptable to the business world whereby certainty and timing are of great importance. We opine that the TA should make the decision of whether to investigate **within 2 weeks** after the transaction is completed or the fact of the completion is made known to the public.

As for the time-frame for consideration of an application filed for prior approval, the Government has quoted the time limits adopted in UK and the European Union to substantiate its proposal that the TA can take as long as 5 months to complete the investigation. We consider that the analogy drawn by the Government is not appropriate. In other jurisdictions, the M&A regulation is applicable to all sectors of the economy, which consists of a much greater market both in terms of products and geographical area. We believe that the TA should be able to process M&A application in a much efficient and effective manner than other jurisdictions given that the scope of the proposed regulation is confined to the Hong Kong's telecommunications industry only.

[1] Hong Kong Third Generation Mobile Services Licensing – Information Memorandum (Appendix A, Page 73, July 2001)

Appendix I

Country	Factors set out in the legislation for consideration in assessing effects of mergers on competition	Who determine whether a merger has the effect of substantially lessening competition?
Australia	**Trade Practices Act 1974 – Section 50** Without limiting the matters that may be taken into account for the purposes of subsections (1) and (2) in determining whether the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market, the following matters must be taken into account: (a) the actual and potential level of import competition in the market; (b) the height of barriers to entry to the market; (c) the level of concentration in the market; (d) the degree of countervailing power in the market; (e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins; (f) the extent to which substitutes are available in the market or are likely to be available in the market; (g) the dynamic characteristics of the market, including growth, innovation and product differentiation; (h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; (i) the nature and extent of vertical integration in the market.	If the Australian Competition and Consumer Commission (ACCC) considers that a merger is likely to substantially lessen competition, it may seek an interim injunction from the Court to stop the proposed acquisition going ahead, prior to a final hearing. If ACCC is successful at the final hearing, the Court may grant a permanent injunction. The question of whether an acquisition will in fact substantially lessen competition is a matter for the Court, not ACCC.

Appendix I

Canada	**Competition Act (Chapter C34)** **Section 92 (2)** For the purpose of this section, the Tribunal shall not find that a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially solely on the basis of evidence of concentration or market share. **Section 93** In determining, for the purpose of section 92, whether or not a merger or proposed merger prevents or lessens, or is likely to prevent or lessen, competition substantially, the Tribunal may have regard to the following factors: (*a*) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the parties to the merger or proposed merger; (*b*) whether the business, or a part of the business, of a party to the merger or proposed merger has failed or is likely to fail; (*c*) the extent to which acceptable substitutes for products supplied by the parties to the merger or proposed merger are or are likely to be available; (*d*) any barriers to entry into a market, including (i) tariff and non-tariff barriers to international trade,	Assessment of merger is conducted by the Competition Tribunal established under the Competition Tribunal Act. The Competition Tribunal is a specialised court that is independent of Government. The Tribunal is chaired by a judge and includes lay members who bring a business and economic perspective to the proceedings.

	(ii) interprovincial barriers to trade, and (iii) regulatory control over entry, and any effect of the merger or proposed merger on such barriers; (*e*) the extent to which effective competition remains or would remain in a market that is or would be affected by the merger or proposed merger; (*f*) any likelihood that the merger or proposed merger will or would result in the removal of a vigorous and effective competitor; (*g*) the nature and extent of change and innovation in a relevant market; and (*h*) any other factor that is relevant to competition in a market that is or would be affected by the merger or proposed merger. **Section 96** (1) The Tribunal shall not make an order under section 92 if it finds that the merger or proposed merger in respect of which the application is made has brought about or is likely to bring about gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made.	