Bills Committee on Telecommunications (Amendment) Bill 2002

Summary of deputations' views on key proposals in the M&A Guidelines and Administration's response

Issue	Organization/ Individual	Concerns/Views	Administration's Response
1. General comments	Hutchison, SmarTone	• The draft Guidelines should be released in its complete form before the Bill is passed. • The Guidelines should form part of the legislation and subject to scrutiny by Legislative Council.	**Guidelines** • Our proposal (i.e. setting out the test "substantially lessening competition" in the legislation, and supplementing the details in the Guidelines) is in line with overseas practices. Guidelines provide business with practical guidance on the approach the regulatory authority will take in assessing M&A. Such an approach is adopted in Australia, UK, EU, Singapore, USA and Canada. In all these jurisdictions, the M&A guidelines are administrative guidelines issued by the competition authorities. None of them is in the form of subsidiary legislation.
	PCCW	• There must be consultation on the proposed M&A Guidelines before the Bill is passed. • The final form of the draft M&A Guidelines should be made available for consideration.	

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			• The Bill lays down the legislative framework for regulation of M&As. Guidelines serve the function of indicating how TA will administer the law within the statutory boundary. Hence, the draft Guidelines can only be finalized for consultation after passage of the Bill. Upon enactment of the Bill, TA is obliged under the Bill to carry out consultation before publishing the Guidelines under the new section 6D(2)(aa).
		• The proposed Guidelines based on the Explanatory Note might have an "anti-merger" effect.	• TA's Guidelines should not have an "anti-merger effect". As we explained before, M&As are normal business activities and most of them do not raise competition concerns. Our Bill and TA's Guidelines only seek to regulate M&A which substantially lessen competition.
	SmarTone, Telstra	• The Explanatory Note lacks sufficient details to form a basis for consultation.	• Please see response in item (2).

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	Sunday	• The proposed Guidelines support the objectives which the legislation aims to achieve. However, there are no specific practical provisions as to how the Bill will actually be implemented.	• We have already issued the Explanatory Note in December 2002 to explain the key elements of the proposed Guidelines. It covers:- (a) the scope of application of the Bill; (b) the analytical framework for determining whether a M&A has, or is likely to have, the effect of substantially lessening of competition, including how a market is defined, and the factors which TA shall take into account in assessing a M&A (e.g. market share, barriers to entry); and (c) the time frames for investigation and processing of an application for TA's prior consent.
	Professor XU Yan	• The draft Guidelines must be clear and explicit, in particular under an *ex post* regulatory regime.	
	The Law Society of Hong Kong	• Practical examples of the Guidelines in application would be very helpful. (e.g. EC and UK competition guidelines) • Detailed comments have been given on the drafting and the detailed provisions of the proposed Guidelines.	• The Explanatory Note has therefore contained all the key elements for implementing the Bill, which will be set out in further details in the draft Guidelines for consultation. We will take on board the suggestion to provide practical examples in application, and consider the various views submitted in the deputations in preparing the draft Guidelines for consultation. We will ensure that the draft Guidelines are clear and explicit.

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	Professor John URE	• While supporting in principle the Bill to widen the oversight powers of TA with regard to M&As, it is a more sensible approach to regulate anti-competitive practices rather than prohibit M&As given that forecasts on the long-term effects of M&As are full of uncertainty due to the rapidly changing technologies and market situation. • It should be noted that in some other jurisdictions, instead of limiting M&A policy and regulation to narrow criteria of 'substantial lessening of competition', wider criteria are adopted in assessing M&A activities such as the effects of M&As on universal service obligation or the environmental	**Necessity for Regulation of M&A** • Regulation of M&A is a necessary and important aspect of implementing our pro-competition regulatory regime. As we explained before, the existing competition safeguards in sections 7K to 7N of the Telecommunications Ordinance regulate conducts of the licensees only. They are however not able to prevent M&As which will create a market structure that is likely to lead to substantially less competition. This is important to markets where there are high barriers to entry like spectrum constraint and high sunk costs. **Competition Test** • The objective of the Bill is to promote effective competition in the market. Hence, the criterion of "substantially lessening of competition" is proposed. This test is widely adopted in advanced competition or anti-trust jurisdictions:- (a) In the USA, section 7 of the Clayton Act enables control of mergers the effect of which "may be substantially to lessen competition";

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		effects. • Detailed analysis have been given on the key tests of "dominance" or "substantial lessening of competition".	(b) The Canadian and Australian systems are both based on the concept of "substantially lessening competition"; and (c) The UK Enterprise Bill which came into effect in 2002 also adopts "substantially lessening competition" as the competition test for assessing mergers.
2. Matters proposed to be covered in the M&A Guidelines	Hutchison SmarTone Telstra	• A very general and simplistic outline only and lacks tailored sector-specific analysis. • The Explanatory Note merely lists the factors without detailed explanation of the test. • The Guidelines must clearly define a procedure for industry participants to approach TA to obtain prior consent for their proposed transactions.	**Matters covered in Guidelines** • The Explanatory Note aims to give an explanation of the key elements of the proposed Guidelines. The TA will issue the draft Guidelines for consultation after enactment of the Bill. We will take on board the suggestion to specify in the draft Guidelines the procedures for application for prior consent as well as other procedures. We will review and revise the draft Guidelines to include more details as appropriate, and to take into account the comments from the deputations. • We appreciate the industry's request in general for greater certainty. In the light of the request, we will consider whether there is room for improvement in the

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	TUG	• The Guidelines should give due regard to the continuity and level of services caused as a result of the M&A.	legislative framework in the Bill.
	PCCW	• Major issues such as time-frames for review, the key factors that the reviewing body should take into consideration, definition of "substantial lessening of competition" etc. should all be specified in the Bill, not in the Guidelines.	
	Hutchison	• The effect of technological changes and interconnection regime on the assessment of M&A, and the difference in treatment between horizontal, vertical and conglomerate mergers are not covered.	• The effect of technological changes and vertical mergers has already been included as one of the factors which TA shall take into account in assessing a M&A (please see item (3) below). The Explanatory Note also refers to the difference between horizontal and vertical mergers. Interconnection is, however, a separate regulatory issue under section 36A of the Telecommunications Ordinance.

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	Professor John URE	• The Bill/Guidelines may need to cover scenarios where Hong Kong companies will become actively engaged in M&As in Mainland China.	**M&As in Mainland China** • M&A in the Mainland China will be outside the jurisdiction of the Telecommunications Ordinance unless the M&A affects ownership or control of carrier licensees in Hong Kong.
3. Factors for consideration in assessing the effect of an M&A on competition	PCCW	• A horizontal merger may result in the removal of a vigorous/effective competitor which may not necessarily result in lessening of competition. • Whether it is appropriate to assess "high barriers to entry" even if other competitive factors such as extensive competition between market participants is present. • Concerned that pro-competitive vertical mergers may not be approved under the proposed Guidelines.	• <u>All</u> factors for consideration will be taken into account as appropriate by TA in assessing a M&A. They include market share and concentration, barriers to entry, countervailing power, the power to substantially increases prices or profit margins, the dynamic characteristics of the telecom market, the extent to which effective competition remains after the M&A, the nature and extent of vertical integration and the level of import competition etc.. • As Members may note, barriers to entry is just one of the relevant factors. For instance, the TA may allow a M&A in a telecommunications market in the case where a vigorous/effective competitor is removed, if the entry barrier into the market is low as other vigorous/effective competitors may emerge if prices are raised.

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	SmarTone, Sunday	• No clear explanation on the important factor of "substantially lessening competition".	Conversely, in a market with "high entry barrier", a M&A may be allowed if effective competition would remain after the M&A.
	PCCW	• The Explanatory Note places insufficient weight on the benefits of M&As in terms of efficiency gains and other public benefits.	**Efficiency and Other Factors** • The Explanatory Note has already included "efficiencies" as a factor to be considered in assessing M&As:- (a) Mergers can generate efficiencies by permitting a better utilization of existing assets and the realization of economies of scale and scope which would not have been available to either firm without the merger. To the extent that any efficiencies created by a merger are passed on in the form of lower prices or otherwise in the form of more aggressive competitive conduct, the merger may increase competition rather than lessen it; (b) It must be demonstrated that the efficiencies will be achieved by the merger and would be unlikely to have been achieved without the merger (for example, internal re-organisation) or by another means having comparable anti-competitive effects
	Consumer Council	• Factors such as efficiencies (or economies of scale) resulting from horizontal merger must be closely examined. For example, whether efficiencies will result in improvements for consumer welfare due to enhanced competition, whether claimed efficiencies can be specified and verified, and the extent of efficiencies that will satisfy TA's required standards. • The Bill should confer power	

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		upon TA to impose conditions on M&As requiring the merged parties to take actions if the expected efficiencies do not occur after merging.	(for example, a joint venture arrangement); and (c) More fundamentally, a merger effectively reduces the number of competitors in a market by one and there is a presumption that it will lessen competition (though not necessarily "substantially" lessen competition). For this reason, efficiencies are only likely to make a difference in merger analysis when the likely adverse effects on competition, absent the translated efficiencies, are not great. Efficiencies alone would almost never justify a merger where it would result in an oligopoly or monopoly.
	Professor John URE	• The efficiency argument should be treated with caution because greater efficiency resulting from M&As may not have direct benefits for consumers. The efficient operation of the market requires exit as well as entry.	• In general, we welcome the views expressed by Members and the industry on the key factors which will be taken into consideration in assessing the effect of a M&A on competition as outlined in the Explanatory Note. We will take into consideration these views in preparing the draft Guidelines for consultation after enactment of the Bill.
	The Law Society of Hong Kong	• The possible effect of a transitory change in ownership or control over a carrier licensee on consumers may need to be taken into account.	

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		• The description of the application of the SSNIP test is basically correct. • Consumer information, efficiencies/customer benefit should be included as factors to be considered on competition analysis.	
4. Definition of change of control and safe harbour provisions	Hutchison PCCW SmarTone	• Transfer of shares of less than 50% and changes in directors should not constitute change of control. • The threshold for transfer of shares should be much closer to 50%. • The terms "director" and "principal officer" are not defined in the Bill. It is questionable as to how a change of director or principal officer	**Definition of Control** • In M&A regulation, the key issue is whether the M&A may substantially lessen competition. The change of control that may fall under regulation does not involve such a high threshold of 50% as some operators have suggested. To summarise some examples in overseas jurisdictions:- (a) The USA, Australia, Singapore empower the authority to review <u>any</u> change in shareholding which has anti-competitive effect. No percentage change of shareholding is set out in the law nor in the guidelines.

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		will constitute change of control.	(b) In UK, the Enterprise Act 2002 empowers OFT to look into M&As where two enterprises are brought under common ownership or common control. In the draft guidelines published by OFT on "Merger: Substantive Assessment" in 2002, it is indicated that OFT may examine any case where there is a shareholding of 15% or more in order to see whether the holder might be able materially to influence the company's policy.
	Telstra	• TA should be principally concerned only with changes that confer effective control as in most other jurisdictions. • The Guidelines should contain robust and appropriate safe harbour provisions directed at both the change in control threshold and the level of permitted market concentration.	• We propose in the Explanatory Note that TA will not normally consider it necessary to investigate a M&A that would lead to a person exercising beneficial ownership or voting control of less than 15% of the voting shares in a carrier licensee. This is because in general, holding the beneficial ownership or voting control of less than 15% of the voting shares in a carrier licensee would not confer sufficient influence over the affairs of a carrier licensee so as to significantly affect competition in the market. We believe that our proposal is appropriate.
	The Law Society of Hong Kong	• The Bill should only apply to genuine change in control. • The Guidelines should provide unambiguous non-discretionary safe harbour provisions relating to changes in ownership or voting control.	• Moreover, any change, whether it is change in control or change in principal officers (see below), must be

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			considered in context. If a change involves a new investor which is not an existing player in the relevant market in HK, or if a change involves a person who is not currently a principal officer of a licensee in the relevant market in HK, such a change, in all likelihood, will not affect competition. When a change is not so simple, our proposal provides for a voluntary channel for the carrier licensee concerned to seek prior consent from the TA. **Principal Officers** • The "principal officer" (e.g. Managing Director, Chairman of Board and Chief Executive Officer, or equivalent) and "director" may play a decisive role in the conduct of business of a corporation. Any change of principal officer or director may have a significant effect on the change of control. It is crucial to note 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".

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5. Market share test	Hutchison	• Too much emphasis is placed on market shares and concentration when considering market power. Other factors such as potential market entry and countervailing buying power are not taken into consideration.	**Other Factors** • As explained above in item (3), TA will consider all the relevant factors for consideration in assessing the competition effect of a M&A. Market share is only one of the factors to be considered. The other factors, including barriers to entry and countervailing power, have been set out in the Explanatory Note.
	PCCW	• Suggests a market share threshold of 40%, with small market share addition of 5-10% also to be exempt from review.	**Market Share Test of 40%** • We consider that the single threshold of 40% is not appropriate. In the Explanatory Note, we have included two thresholds for the post-merger combined market share of the parties to a merger. If the combined market share is below 15%, the TA is unlikely to intervene. If the combined market share is above 40%, the TA is likely to make a detailed investigation. 40% is the level at which a company is generally regarded as dominant.
	Telstra	• The proposed threshold of 40% or more of the market share of the merged entity for TA to make a detailed investigation is too low.	• Our proposal is similar to those adopted in Australia and Canada. In Australia, the thresholds of 15% and 40% are also adopted. In Canada, the thresholds are even

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			lower - 10% for a market with four-firm concentration exceeding 65%, and 35% for market for lesser concentration.
	The Law Society of Hong Kong	• Suggest to add "generally" in the equivalent paragraph in the Guidelines to read that "Higher market shares and concentration levels as a result of a merger are *generally* necessary but not sufficient conditions for the exercise of market power", as it is conceivable that a company may have the ability to exercise market power without necessarily having high market share.	• We will take on board the suggested textual amendment by the Law Society in preparing the draft Guidelines.

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6. Market definition	The Law Society of Hong Kong	• The use of the phrase "other geographical areas" is confusing, given the second limb of market definition is the relevant geographic market. The phrase may be replaced by "different locations". • Once the market is defined, market share information becomes relevant.	• Comments on market definition are noted and will be taken into account in the finalization of the draft Guidelines for consultation. Convergence will definitely be one of the factors to be taken into consideration in the market definition analysis.
	Professor John URE	• Market definitions can become more complex, especially as convergence takes place, for example between broadband service provided by fixed line, wireless and cable service operators.	

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7. Time frames for TA to review M&As	Hutchison	• Statutory, instead of administrative, time limits should be provided. • The proposed 4 months (for completed transactions) and 1 month plus 4 months (for proposed transactions) should be considerably shortened.	• As we set out in the Explanatory Note, our proposed time frames are comparable to those adopted in overseas jurisdictions : - (a) In UK (*ex post* regime), the Enterprise Act 2002 sets out that the OFT has to investigate a M&A and decide whether to refer it to the Competition Commission within 4 months. The Competition Commission has a further 24 weeks (i.e. 5-6 months) to carry out its investigation. (b) In EU (*ex ante* regime) the European Commission is obliged to finish investigation within 5 months (1 month for initial investigation, and four months for detailed investigation) from date of notification of the M&A.
	SmarTone	• Proposed time-frames too long. TA should make a decision on whether to investigate within 2 weeks after the M&A transaction is completed.	
	PCCW	• The timelines in the Explanatory Note are too long. The maximum time limits for both initiating and completing M&A investigation should be stated in the Bill.	• We appreciate the industry's request for shorter time frames. We agree that time frames cannot be long, but have to be reasonable. In particular, TA is statutorily obliged to give sufficient time to enable the carrier licensee concerned to make representations before arriving at a decision. We consider that the proposed time frames are appropriate.

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	The Law Society of Hong Kong Professor John URE	• Various time limits for within which TA must take a decision on an M&A should be reduced as investigations in Hong Kong market should take less time than similar investigations in other jurisdictions. • Investigations on completed M&As will not really need 3 months for completion if sufficient resources are devoted for them.	
8. Back-stop date (whereby TA cannot investigate into an M&A beyond a certain period of time)	Hutchison	• A statutory, instead of administrative, back-stop date should be provided. • The proposed period of 3 months after the completion of a M&A transaction should be shortened to no more than 2 weeks	• Our proposal of a "back-stop date" of 3 months is reasonable. It is shorter than the backstop dates adopted in other jurisdictions with an *ex post* regime. In UK and Australia, the back-stop dates are 4 months and 3 years respectively.

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	PCCW	• A statutory back-stop date should be provided.	
9. Costs and expenses which TA may recover under proposed section 7P (11)	Hutchison	• There should be a limit on such costs and expenses which may be recovered by TA.	• As we explained to Members, OFTA operates as a Trading Fund under the Trading Funds Ordinance and is required to cover the cost of services from the relevant revenue. This arrangement is similar to that already put into practice for determinations on interconnection terms under section 36A of the Telecommunications Ordinance. Like those for determinations on interconnections, the fees for applications for prior consent under the Bill will depend on the actual costs and expenses incurred in processing the particular application. It is therefore not appropriate to set a cap on the fees to be levied. • OFTA envisages that, based on its experience in the levy of charges for interconnection cases, the level of charges for merger and acquisition cases would be around HK$55,000 per case for minor cases; and around HK$110,000 per case for major cases. Such level of charges will be comparable to those levied by competition authorities overseas for similar work.

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			Examples are given below :- (a) Australia: Australian $15,000 or HK$60,000 per case; (b) Canada: Canadian $26,750 or HK$133,750 per case; and (c) UK: Pound Sterling 5,000 – 15,000 or HK$60,000 – $180,000 depending on the value of the gross assets acquired.
10. Procedural safeguards and transparency	Hutchison TUG	• TA has no obligation to keep the merging parties informed of the case against them, or to provide written reasons where he blocks a merger. • Users' views should be gauged by public hearings or by inviting users to submit views for pending cases.	• Under section 7P(2) of the Bill, TA is obliged to give a reasonable opportunity to the carrier licensee concerned before he forms an opinion under the Bill. Under section 6A(3)(b) of the Telecommunications Ordinance, he is further required to set out his decision with reasons in writing.

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	PCCW Professor John URE	• The procedures for handling representations on M&As (e.g. by way of written submissions, public hearing etc) are not spelt out in the proposed Guidelines. • The procedures involved should be conducted in the most "light handed" way, for example, by the use of "state-of-play" informal briefings between OFTA and the companies involved to speed up the process.	• We will specify the procedures for handling representations in the draft Guidelines for consultation after enactment of the Bill. We would aim to ensure that the procedures are transparent, practical and will fulfill the due process requirement.
11. Checks and balance on TA's power	Hutchison, PCCW, SmarTone PCCW	• A specialised board or panel is a more appropriate and accountable regulatory structure than a single-person regulator to review M&A cases. • It will be more desirable for the Telecommunications (Competition Provisions) Appeal	• As we set out in the paper entitled "Further information on regulation of mergers and acquisitions in Telecommunication industry by the Telecommunications Authority" at the 6 November 2002 meeting [CB(1)499/02-03(01)], we consider that the TA is the appropriate body to regulate M&A activities of the telecommunications industry:- (a) TA is already doing so for the fair competition

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		Board, instead of TA, to review M&As.	provisions and the existing licence conditions on M&A regulation. In the overseas jurisdictions, the enforcement of fair competition provisions and M&A regulation is invariably undertaken by the same competition authorities.
	Professor XU Yan	• In the absence of a general competition law, TA is the right party to regulate M&A activities in the telecommunications sector.	(b) The key is to have sufficient checks and balances to ensure fair enforcement of the provisions. We consider that our proposed safeguards, which are the same with those for the fair competition provisions, are adequate : -
	Professor John URE	• An independent commission comprising representatives of commercial and consumer interests, industry specialists and professionals will be more appropriate in making decisions, which are subject to appeal, in relation to M&A activities in the telecommunications sector.	– the TA is supported by OFTA, which is equipped with expertise in all relevant fields including accounting, legal, economic and telecommunications. In particular, a Competition Affairs Branch has been established to better support the TA in enforcing the fair competition provisions, and the M&A regulation upon enactment of the Bill; – The TA must afford a reasonable opportunity for the relevant person to make representations. He must set out his decisions with reasons in writing under section 6A(3)(b) of the

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			Ordinance. Such reasons will form the basis for appeal or judicial review; and – TA's decisions are subject to appeal to the Telecommunications (Competition Provisions) Appeal Board (in addition to judicial review). The Appeal Board is allowed to review the merits of the appeal case and is empowered to uphold, vary or quash the TA's decisions.

Organizations/individuals	Detailed submission at
Hutchison Global Communications Limited, Hutchison Telecommunications (HK) Limited and Hutchison 3G HK Limited (Hutchison)	-LC Paper No. CB(1)963/02-03(01)
PCCW Limited (PCCW)	-LC Paper No. CB(1)963/02-03(02)
SmarTone Mobile Communications (SmarTone)	-LC Paper No. CB(1)963/02-03(03)
Telstra International (Telstra)	-LC Paper No. CB(1)963/02-03(04)
Consumer Council	-LC Paper No. CB(1)963/02-03(05)
Professor XU Yan	-LC Paper No. CB(1)963/02-03(06)
Professor John URE	-LC Paper No. CB(1)984/02-03(01)
Sunday	-LC Paper No. CB(1)1014/02-03(01)
Hong Kong Telecommunications Users Group (TUG)	-LC Paper No. CB(1)963/02-03(07)
The Law Society of Hong Kong	-LC Paper No. CB(1)963/02-03(08)

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