Legislative Council Bills Committee on Telecommunications (Amendment) Bill 2002

Administration's Further Proposed Committee Stage Amendments and Other Improvements

Introduction

At the meeting on 30 April 2003, the industry and the Consumer Council gave the third round of deputations to the Bills Committee. We note that there is general support for the Administration's proposed CSAs and other improvements, and that there are requests for further improvements. Having carefully considered these views, we propose to introduce further committee stage amendments (CSAs) and other improvements to address the concerns raised.

Further Improvements

Change in control

2. Some industry members suggest that a change in principal officer or director of a carrier licensee may not constitute a change in control in the licensee concerned, and hence should be deleted from the definition of "change in control". They opine that the Bill should only regulate mergers and acquisitions (M&As) which constitute a genuine change in control amounting to 50% change in ownership.

3. We have duly considered the views. While the principal officer or a director can have material influence in the conduct of business of a carrier licensee, we appreciate the concern on the possible regulatory burden posed by this to the industry. On balance, we consider it acceptable to accede to industry's request to delete a change in principal officer and director from the definition of "change in control". We will propose CSAs to the proposed section 7P(12) of the Bill.

4. We believe that our improved proposal, which has further taken into account views of the industry, strikes the proper balance between ensuring that anti-competitive M&As will be regulated under the Bill and addressing the concerns of the industry. We do not consider that raising the threshold to 50%, as some industry members suggest, is appropriate. In M&A regulation, the key issue is whether the M&A may substantially lessen competition. In overseas jurisdictions, the change of control in the context of M&A regulation does not cover only change of "majority control" recognized by company law, but also the ability of "material influence" over the affairs of a licensee which could substantially lessen competition. Therefore the high threshold of 50% in the context of "majority control" over the licensee in the context of company law is not relevant to the M&A regulation. In USA, Australia and Singapore, the legislation empowers the authorities to review *any* change in shareholding which has anti-competitive effect. In UK, the threshold set out in the draft guidelines issued by the authority is 15% or more to implement the definition of "control" (which includes the concept of "material influence") in the legislation.

5. We would also like to clarify industry's mis-conception of the threshold used for the licensing of third generation mobile services (3G) in 2001. For the 3G licensing exercise:-

(a) any entity holding 50% or more shareholding of a potential 3G bidder can only submit one bid; and

(b) any entity holding less than 50% but 15% or more shareholding of a potential 3G bidder may submit more than one bid, which are called "connected bids". However, only one of the connected bids would be successful in obtaining a 3G licence through another bidding process.

In order words, to ensure effective competition, no entity is entitled to hold 15% or more shareholdings in more than one of the four 3G licensees. The threshold in the 3G licensing exercise is therefore 15%, not 50% as some of the industry members quote.

Procedure and speed of review of M&As

6. The industry acknowledges the importance of the work of Office of the Telecommunications Authority and the Telecommunications (Competition Provisions) Appeal Board (Appeal Board) in the review of M&As. In particular, the Appeal Board is found to be an effective appeal channel given its wide powers to uphold, vary or quash the decisions of the Telecommunications Authority. The industry deputations raise some alternatives on the role the Appeal Board may play. Some advocate an asymmetric arrangement whereby the Telecommunications Authority (TA) should be empowered to approve certain M&A cases (e.g. "easy" M&As, M&As which TA will approve) but required to refer some M&A cases (e.g. "difficult" M&As, M&As which TA intends to object) to the Appeal Board for decision (i.e. the first alternative). On the other hand, some prefer a single process where all M&A cases are decided by the Appeal Board, with no appeal channel (or limited appeal in the form of judicial review to the court) (i.e. the second alternative).

7. Under our present system, the TA makes decisions on competition provisions (i.e. sections 7K-7N of the Telecommunications Ordinance), which are subject to appeal to the Appeal Board with wide powers to uphold, vary or quash TA's decisions. This appeal mechanism works well, as the industry deputations testify, and to extend it to review the merits of TA's decisions on M&As would be appropriate. The carrier licensees and the acquirer who are aggrieved by TA's decisions should be allowed to appeal to the Appeal Board. While there may be alternatives that could be developed based on the Administration's proposal, Members may note that there is no industry consensus on the option to be adopted, nor is there any undisputed model which we could draw from overseas experience in regulating M&As[Note]. Indeed, we note that the two alternatives proposed by industry have their own pitfalls:-

(a) For the first alternative, there would be no objective basis for determining which cases should be referred to the Appeal Board and which not. In particular, there is no clear rule to classify what are the "difficult" and "easy" M&A cases for different

---

Note Please see Bills Committee paper "Further Information on Regulation of Mergers and Acquisitions in Telecommunications Industry by the Telecommunications Authority" issued in December 2002.

treatment. This would not be workable legally, and would create uncertainty to the parties involved in the M&As.

(b) For the second alternative, no appeal based on merits of a case can be made once a decision is made. The integrity of our system would be in doubt without sufficient checks and balances. Indeed, there is no empirical evidence in overseas jurisdictions in favour of combining regulatory decisions with the appeal process. Each jurisdiction develops their own mechanism [Note]. The EU, USA and Singapore all allow for an appeal process.

8. We fully agree with the industry that time is of essence to M&As. In order to address this concern, we have critically reconsidered the time limits for the TA to review M&A, and we propose to shorten them as follows :-

(a) <u>investigation into a completed M&A</u> – to shorten the backstop date (during which the TA is empowered to initiate an investigation) from 3 months to 1 month. A further CSA to the proposed section 7P(1A) of the Bill on the backstop date is proposed to this effect. In addition, we will shorten the time limits for TA to conduct investigation, which will be specified in TA's guidelines, from 4 months to 3 months; and

(b) <u>processing an application for prior consent</u> – to shorten the time limit for TA to conduct a detailed analysis from 4 months to 3 months. Hence, the TA would be obliged to decide within a month whether detailed analysis is warranted, and if so, an additional 3 months to conduct the analysis.

The timelines represent the *maximum* time needed for the TA to make a quality decision on M&A matters, and comply with the due process requirement including giving sufficient time for the relevant parties to make representations. The actual time taken to review individual M&A may be shorter, depending on the nature and complexity of the case.

Factors for consideration in assessing a M&A

9. As we have set out in the Explanatory Note on the Guidelines on the Competition Analysis of M&A issued to the Bills Committee in December 2002, "the extent to which substitutes are available in the telecommunications market" is considered in defining the relevant market and therefore has already been taken into account. Nevertheless, we agree with some industry deputations to explicitly include this factor as a factor to be considered in the competition analysis in the proposed Schedule 2 to the Bill.

The guidelines by the TA

10. Some industry deputations suggest that TA's guidelines on M&A matters to be issued under the proposed section 6D(2) of the Bill should be reviewed by the Legislative Council before commencing operation. As we explained before:-

(a) Guidelines provide business with practical guidance on the approach the regulatory authority will take in assessing M&As. None of them is in the form of subsidiary legislation in Australia, UK, EU, Singapore, USA and Canada;

(b) We have already proposed to introduce CSAs such that the Government will commence the Bill only after the guidelines are ready after consultation (see paragraph 18 of the paper "Administration's Proposed Committee Stage Amendments and other Improvement" issued in March 2003); and

(c) The TA is statutorily obliged to conduct consultation and issue guidelines after enactment of the Bill. The consultation will be a transparent process whereby the industry and public may give their views. To give Members more assurance, we will notify the Legislative Council Panel on Information Technology and Broadcasting of the consultation of the guidelines. If Panel Members are interested, the Administration can be invited to brief them on the guidelines.

Conclusion

11. We will introduce further CSAs on the following :

(a) to delete a change in principal officer and director from the definition of "change in control" in the proposed section 7P(12);

(b) to shorten the backstop date for TA to conduct investigation from 3 months to 1 months under the proposed section 7P(1A); and

(c) to add in a factor in the list of factors for consideration in assessing a M&A as suggested by the industry in the proposed Schedule 2.

A copy of the further CSAs to be made, in revision mode to extracts of the Bill, is attached at Annex.

12. We have duly considered views expressed in three rounds of deputations and taken on board improvements as appropriate. We consider that our further improved proposal strikes the right balance between stipulating a light-handed and transparent regulatory regime to facilitate business decisions on M&As, and providing a level playing field in the telecommunications market that benefit consumers as well as competing operators. As the Bill was introduced in May 2002, it is of uttermost importance that the Bill be enacted as soon as practicable to eliminate the grey areas of the existing regulatory framework.

Commerce, Industry and Technology Bureau
May 2003

Annex

Administration's Further Proposed Committee Stage Amendments to the Telecommunications (Amendment) Bill 2002 (as market in revision mode to extract of the Telecommunications (Amendment) Bill 2002)

(1A) An investigation under subsection (1)(d) may only be begun within 1month after the change occurs or within 1 month after the Authority knows, or ought reasonably to have known of, the change, as the case may be.

(12) For the purposes of subsections (1)(a) and (5)(a), there is a change in the control exercised over a carrier licensee if –

~~(a) a person becomes a director or principal officer of the licensee;~~

(b) a person becomes the beneficial owner of more than 15% of the voting shares in the licensee;

(c) a person becomes a voting controller of more than 15% of the voting shares in the licensee; or

(d) a person otherwise acquires the power, by virtue of any powers conferred by the memorandum or articles of association or other instrument regulating the licensee or any other corporation, to ensure that the affairs of the licensee are conducted in accordance with the wishes of that person.

9. Schedule 2 added

The following is added –

"SCHEDULE 2 [s. 6D(2)]

MATTERS TO BE TAKEN INTO ACCOUNT BY AUTHORITY

1. The height of barriers to entry to a telecommunications market.

2. The level of market concentration in a telecommunications market.

3. The degree of countervailing power in a telecommunications market.

4. The likelihood that the change would result in the carrier licensee or interested person being able to significantly and substantially increase prices or profit margins.

5. The dynamic characteristics of a telecommunications market, including growth, innovation and product differentiation.

6. The likelihood that the change would result in the removal from a telecommunications market of a vigorous and effective competitor.

7. The extent to which effective competition remains or would remain in a telecommunications market after the change.

8. The nature and extent of vertical integration in a telecommunications market.

9. The actual and potential level of import competition in a telecommunications market.

10. The extent to which substitutes are available in a telecommunications market.".