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Legislative Council

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Background brief on
Telecommunications (Amendment) Bill 2002

Purpose

This paper gives a summary of major issues considered by members of the Panel on Information Technology and Broadcasting when being briefed on major proposals in the Telecommunications (Amendment) Bill 2002 at the meeting on 13 May 2002.

Major proposals in the Bill

2. The Bill seeks to provide a comprehensive and clear legal framework for regulating mergers and acquisitions in the telecommunications industry. According to the Administration, its intention is to adopt a light-handed approach to ensure minimal compliance burden and provide fair and effective competition in the telecommunications market.

3. Having regard to concerns raised by the industry during the consultation exercise, the Administration has proposed to adopt an *ex post* regulatory approach whereby the Telecommunications Authority (TA) will only intervene and conduct a regulatory review after the merger/acquisition has taken place. TA will only step in if there is potential adverse effect on competition in the telecommunications market. Alternatively, a carrier licensee may also seek TA's prior consent to a proposed merger/acquisition on a voluntary basis. TA is also required to formulate a set of criteria on the matters he will consider in determining whether a change or proposed change in ownership has, or is likely to have, an anti-competitive effect and issue guidelines in this respect.

Consultation

4. The public and the industry were consulted on the Administration's preliminary proposal from April to June 2001. A total of 17 submissions have been received and posted on the Website of the Office of the Telecommunications Authority on the Internet for public perusal.

Members' views

5. The major issues considered by members at the meeting on 13 May 2002 are as follows:

(a) Power to impose sanctions

A member has questioned the effectiveness of the Bill which is not backed up by the power to impose sanctions like issuing Injunction/Administrative Orders as in the case of overseas countries such as Australia which also adopts an *ex post* regime.

(b) TA's powers

Some members consider that the regulation of mergers and acquisitions should preferably be entrusted to an independent body, instead of TA. Concerns have been expressed about checks and balances on TA's powers.

The Administration has highlighted its policy of adopting a sector-specific approach to deal with competition matters, as well as TA's role as the industry regulator. Members also note that any party aggrieved by TA's decisions may appeal to the Telecommunications (Competition provisions) Appeal Board set up under section 32M of the Telecommunications Ordinance.

(c) Guidelines to be issued by TA

Some members remain concerned about the guidelines to be issued by TA as they are not subsidiary legislation and are therefore not subject to scrutiny by the Legislative Council.

The Administration considers it more appropriate to set out operational arrangements which may necessitate frequent changes by way of guidelines rather than by legislation. Moreover, TA is also required under the Bill to carry out consultation before issuing the guidelines.

6. The relevant extract of the minutes of the Panel meeting held on 13 May 2002 is at the **Appendix**.

Legislative Council Secretariat
24 June 2002

Appendix

Extract minutes of the Information Technology and Broadcasting Panel meeting on 13 May 2002

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(LegCo Brief Ref. ITBB(CR) 7/13/14(02)Pt.3 and LC Paper No. CB(1)1664/01-02(01))

4. With the aid of power-point presentation, the Deputy Secretary for Information Technology and Broadcasting (DS/ITB) briefed members on the policy objectives of the Bill , the concerns of the industry and how they were addressed, the light-handed approach to ensure minimal compliance burden and overseas practice in regulating mergers and acquisitions. The Director-General of Telecommunications (DG/Tel) explained the Administration's proposal in detail, which was an *ex post* (i.e. conducting regulatory review after such a change) regulatory regime with a channel to seek prior consent of the Telecommunications Authority (TA) on a voluntary basis. Members noted that the Bill had been gazetted on 3 May 2002.

Ex post regulation

5. Mr Howard YOUNG remarked that Members of the Liberal Party had all along supported the Government's current policy in taking sector-specific measures to promote competition. While appreciating that the adoption of an *ex post* approach might encourage investment in a positive way, he enquired about measures to allay the uncertainties arising from an *ex post* approach.

6. In this connection, DS/ITB pointed out that the *ex post* approach had been proposed with a view to addressing the concerns of the industry. For those investors and licensees who might, on their own initiative or on the advice of merchant banks, accountants or lawyers, want to seek certainty, they could seek the TA's consent on a voluntary basis before proceeding with the proposed merger and acquisition activities. DS/ITB and DG/Tel confirmed that where the TA had given such consent, it would be legally binding, unless there were changes to the information which the carrier licensee provided at the time of seeking prior consent.

7. To enhance certainty, DG/Tel advised that under the proposed framework for regulation of merger and acquisition activities, TA would publish guidelines to provide clear and practical guidance to licensees on the factors to be considered by TA in assessing whether a change in ownership or control had, or was likely to have, an anti-competitive effect. The guidelines would provide useful assistance to the carrier licensees and relevant parties in making informed decisions in undergoing mergers and acquisitions in the telecommunications market. On the other hand, if the change in ownership or control raised competition concerns after completion of the merger and

acquisition activities, TA would invite representations from the carrier licensee concerned and other relevant parties, consider the representations, conduct investigation to assess the impact on competition and then direct the licensee to take action to eliminate anti-competitive effect.

8. As regards the *ex post* regulatory approach, Mr YEUNG Yiu-chung was concerned about the timing in conducting the regulatory review. Specifically, he cautioned that conducting a review shortly after the merger and acquisition activities would unlikely gauge the effect, if any, on competition. On the other hand, a review to be conducted years after such a change would create uncertainties and unfairness to the carrier licensees concerned.

9. In response, DG/Tel advised that *ex post* regulatory action, if necessary, might be initiated by TA or in response to complaints. To avoid uncertainty, TA would stipulate in the guidelines the time frame within which any *ex post* regulatory action deemed necessary must be taken.

10. Ms Emily LAU supported a universal approach, instead of industry- specific regulation of merger and acquisition activities. In reply to her enquiry about the 17 submissions received during the consultation on the preliminary proposal from April to June 2001, DS/ITB clarified that there were some submissions advising that any merger and acquisition regulation should be *ex post* in nature. DS/ITB advised that all submissions received had been posted in OFTA's website for perusal.

11. As many telecommunications operators were listed companies, Mr CHAN Kwok-keung was concerned that *ex post* regulation might lead to fluctuations in the prices of their shares if TA subsequently did not give consent to the merger or acquisition. DS/ITB responded that if the merger and acquisition activities in question were likely to cause fluctuation in share prices of the company concerned, the licensee could seek the prior consent from the TA on a voluntary basis in order that greater certainty could be secured.

Regulatory Powers of TA

12. Noting from the Administration's information that Hong Kong was one of the places where the regulator did not have the power to issue Injunction/Administrative Orders, Ms Emily LAU questioned the effectiveness of the Bill which was not backed up by the power to impose sanctions. In response, DS/ITB explained that as it was proposed to adopt an *ex post* regulatory regime where intervention only took place after the completion of a merger and acquisition activity, the Administration did not think it necessary to have the power to issue Injunction/Administrative Orders to stop the activity before its completion. This question could be further discussed by the Bills Committee. Ms Emily LAU nevertheless pointed out that according to the Administration's information, Australia, which also adopted an *ex post* regime, had the said power.

13. As TA would be the future regulator over merger and acquisition activities, Ms Emily LAU asked whether consideration could be given to entrusting this regulatory

function to an independent body instead. Mr Eric LI considered that there might be a need to regulate merger and acquisition by way of legislation. However, he expressed grave concern about over concentration of power in TA in regulating the industry, enforcing legislation, conducting investigation and prosecution, and making determinations. Besides, TA also had vast powers in formulating guidelines for reference/compliance by the industry.

14. On the role of TA in regulating merger and acquisition activities, DS/ITB advised that as there was no competition authority as such under the current sector-specific competition policy, TA was the industry regulator and hence, the appropriate body to deal with regulation of acquisitions and mergers in the telecommunications market. She pointed out that an independent appeal avenue was in place. If any party was aggrieved by TA's direction or decision, he could lodge an appeal with the Telecommunications (Competition Provisions) Appeal Board set up under section 32M of the Telecommunications Ordinance. Apart from the chairman and vice-chairman who must be qualified High Court judge, there were six other independent members comprising professionals such as economists and accountants. As such , the Administration considered that there were checks and balances on TA's exercise of regulatory powers.

15. On whether Hong Kong was the only place to adopt a sector-specific competition policy, DG-Tel advised that in the case of the United Kingdom, for example, although a universal competition law was in place, competition issues relating to the telecommunications sector were dealt with by the industry regulator in the first instance.

The guidelines

16. Mr MA Fung-kwok expressed concern about the guidelines to be issued by TA since they would provide the basis on how TA would assess the potential effect of the merger and acquisition activities on market competition. For example, if a licensee already holding 15% of the company's shares acquired an additional significant proportion of the market shares as a non-voting beneficial shareholder, he enquired whether such act would raise competition concerns. To balance the residual power of TA in issuing the guidelines, Mr Eric LI considered that important issues and requirements contained in the guidelines should be incorporated into legislation. He was of the view that appeals against TA's decision should not lie with the Secretary for Information Technology and Broadcasting who normally would rely on TA's professional advice when making relevant decisions. Mr Kenneth TING also enquired about the arrangements in case the industry disagreed with the guidelines.

17. In response, DG-Tel pointed out that the guidelines set out the factors the TA would take into account in analyzing the effects on competition of a particular merger or acquisition activity in the telecommunications market. They would also specify clearly the circumstances regarding changes to ownership or control of shares in a carrier licensee which may raise competition concerns. Hence, the guidelines provided practical guidance and had to be followed by both the TA and the industry on certain

issues. He stressed that under the Telecommunications Ordinance, TA had to consult the industry before introducing changes to the guidelines. Nevertheless, he advised that there was no provision for "appeals" against the guidelines issued by TA under the existing Telecommunications Ordinance. However, if the Appeal Board ruled against a decision which TA had made in accordance with the guidelines, then, TA might need to consider whether the guideline should be suitably revised.

18. In response, DS/ITB advised that the use of guidelines was to cater for rapid changes in the telecommunications market. Incorporating certain parts of the guidelines into legislation might necessitate frequent legislative amendments which would be time consuming and might not serve the immediate needs of the industry. The requirement for TA to consult the industry before making changes to the guidelines was already a safeguard on TA's power. As regards the proposed content of the guidelines, she referred members to the draft guidelines attached to the consultation paper on regulation of mergers and acquisitions in the telecommunications issued in April 2001.

19. Mr Howard YOUNG noted that Hong Kong, Australia and the United States used "substantially lessen competition" as the criterion for competition test while the United Kingdom used the indicator of "maintaining and promoting competition". Citing an example in which a carrier licensee, which already had a market share of 85%, took up another 5 % market share through merger and acquisition activities, Mr YOUNG pointed out that while the merger/acquisition *per se* did not involve substantial lessening competition, the licensees was in fact taking up a very high market share. He therefore called for suitable measures to quantify the judgements on competition test.

20. In response, DG/Tel confirmed that details on quantifying the extent of lessening competition would be set out in the guidelines. He referred members to the flow chart on systematic process for assessing prevention or substantial restriction of competition attached to the consultation paper on regulation of mergers and acquisitions in the telecommunications market issued in April 2001. Before conducting competition analysis, it was crucial to first define the market. Depending on the type of market, the factors used in assessing market share would range from the number of subscribers, the volume of usage and other factors. The level of competition in a market was then determined by, inter alia, market share and market concentration. In line with overseas practice, the TA would generally only start to assess mergers if the merged entity would supply:

- 40% or more of the market; or

- at least 15% of the market and the concentration ratio of the four (or fewer) largest companies in the market was 75% or more.

In addition, other structural features of the market such as barriers to entry, availability of substitutes and vertical integration would be taken into consideration by TA in determining whether the merger and acquisition activities would bring about anti-competitive effect.

(*Post-meeting note*: The consultation paper (with the Annex containing the draft guidelines) was re-circulated to members on 24 May 2002 vide LC Paper No. CB(1)1824/01-02.)

21. Members noted that the Bill would receive First Reading on 15 May 2002 and would be considered by the House Committee on 17 May 2002. To conclude, the Chairman considered that a Bills Committee should be formed to study the Bill in detail. Members agreed.

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