SmarTone's Submission to the Legislative Council

on the

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

A Sector-Specific Regulation which is unjustified

1. The Bill aims to introduce a sector-specific mergers and acquisitions ("**M&A**") regulation to the telecommunications industry. ITBB's justification for this, as provided in the Legislative Council ("**LegCo**") Brief, is basically that *"because of the structural feature of the telecommunications industry including high concentration levels, high barriers to entry through high sunk costs, scarcity of radio spectrum and high levels of vertical integration, a sector-specific M&A regulatory regime is necessary to prevent over-concentration of market power in a few operators and undesirable cross-ownership"*[1]. We strongly disagree that the above is sufficient to justify the sector-specific M&A regulation because the Administration has failed to take into account the competitive environment of the telecommunications industry.

2. The telecommunications industry in Hong Kong is one of the most competitive in the world. Except for the local fixed line market where a dominant operator exists, all other telecommunications markets are highly competitive. Hong Kong has one of the highest mobile penetration rates in the world. The fierce competition in the mobile market has provided substantial benefits to consumers not only from the extremely competitive pricing but also from the quality services and network coverage provided by the mobile operators. Competition in the IDD and Internet access markets is also fierce in which consumers have benefited from the significant reduction in costs for using these telecommunications services. Thus competition has proven to work effectively in the telecommunications markets and it is evident that previous M&A transactions have not adversely affected competition[2].

3. In such a highly competitive sector it is expected that the level of regulation should be progressively reduced so that decisions are made according to market force instead of government intervention. However, the current proposal of Information Technology and Broadcasting Bureau ("**ITBB**") is apparently at the opposite end of this principle. A direct adverse effect is that telecommunications market would be subject to more stringent control than other sectors and M&A activities would be distorted by unnecessary government intervention. This would ultimately discourage investment in the telecommunications sector.

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[1] ITBB, Legislative Council Brief (File Ref: ITBB CR 7/13/14(02) Pt.3), paragraph 11, 3 May 2002

[2] For example, previous acquisitions such as CSL acquired PacLink and SmarTone acquired P Plus have not produced any adverse effect on the competition level of the mobile industry.

Details of the TA's Guideline is silent in the Bill

4. From the face of it, it seems that the current proposal has shifted from the original ex ante approval regime to an ex post regime which is said to minimise the burden of compliance placed on operators. This may be attributable to the strong opposition from the industry in response to the consultation conducted in April 2001. However, it is not possible to assess the actual effect of the Bill without also examining the guideline, which aims to set out the analytical framework of the Telecommunications Authority ("**TA**") in his decision of whether a particular M&A transaction has, or is likely to have the effect of substantially lessening competition in a telecommunications market.

5. We would like to draw the LegCo members' attention to the vast numbers of comments presented to the 2001 consultation paper, which pointed out that the draft guideline presented to the industry at that time was neither sufficient nor complete to enable the operators to predict the outcome of the regulator's consideration of a proposed M&A transaction. Further, any M&A transaction will be subject to a subjective test based on the "opinion of the TA". This subjective rather than objective test would substantially increase the uncertainty of the proposal. In view of the large uncertainties inherent in the outcome of the TA's decision and the broad TA's power to completely wipe out the deal, it is unlikely that any operator would take the risk of not getting the prior consent from the TA and therefore there is a large tendency that operators would seek the TA's approval before any actual M&A transaction. This would effectively make the proposed regulation an ex ante rather than an ex post regime.

6. The competitive analysis of M&A is widely recognised by many jurisdictions as a highly complex matter which requires in-depth economics and anti-trust analysis. We are therefore of grave concern that the details of the guideline would be solely determined by the TA, which may not have the professional knowledge in this particular area. Although ITBB specified that it will carry out a consultation with the industry before issuing the said guideline, it is our worry that the consultation exercise would not be an effective channel for the operators to pursue their views. It is evident from the fact that although the majority views received by ITBB in the 2001 consultation were not in support of the regulation, ITBB has insisted to introduce the Bill. Thus we respectfully request that not only the Bill but also the guideline should be carefully considered by LegCo members who has much greater power than the operators to effect amendment to the document.

Other specific comments on the Bill

7. In sub-section (12) of the proposed Section 7P of the Bill, it is regarded that there is a change in the control of an operator if a person becomes the beneficial owner or voting controller of more than 15% of the voting shares in the operators. Notwithstanding that there is no justification provided as to why the threshold is set at 15%, we wish to highlight for the members' consideration that there were a number of submissions to the 2001 consultation which considered the threshold of 15% as too low to infer that there would be a change in control of the operator. It is very unlikely that an acquisition of 15% shares would represent a change in the control of a company. Further, the Bill considers that there is a change in the control of a licensee if a person becomes a director or principal officer of the licensee. This broad statement which basically covers any movement in the senior management of a licensee would only add to the uncertainties of the regulation and give the TA wide discretionary power.

8. Subsection (1) of Section 7P stipulates that the TA may direct the licensee to take such action as appropriate to eliminate the anti-competitive effect should he form an opinion that a completed M&A transaction has, or is likely to have, the effect of substantially lessening competition. The action may include the procuring of modifications to the control of and the ownership of shares in the licensees. Our concern in this section is that it has not specified any time limit upon which the TA will make the direction. It is highly undesirable and disturbing if the TA could subsequently revoke any completed M&A transaction after an unduly long period. This would significantly increase the business risk inherent in the M&A transaction. It is therefore necessary to specify a reasonable time limit such that if the TA does not issue the direction within the time limit, the completed M&A transaction should be deemed to be having no anti-competitive effect and should not be subject to any direction issued under Section 7P. In light of the swift decision making process required in most M&A transactions, our view is that the time limit should be set as two weeks from the completion date of the M&A transaction. In any event if the merged entity subsequently engages in any anti-competitive practices or abuse of dominant power, the TA is already empowered under Sections 7K and 7L to effectively deal with any such practices.

9. Sub-sections (5) and (6) of Section 7P state that a carrier licensee may apply to the TA for consent to a proposed M&A transaction and the TA will form a decision on the application. We have concerns in these sections because, first of all, there is no timescales specifying the timeframe that the TA should reply to the applicant. It is imperative that any proposed M&A transaction would not be subject to any undue delay in the regulatory approval procedure. An approval procedure without time limit would be a major obstacle to any potential M&A transactions. Thus a reasonable timeframe should be included should the Bill be enacted. There are some international experiences that we may share with the LegCo members. The European Commission's standard practice is to express its decision on any M&A application within 1 month. Should the Commission consider longer period is required, in any event the maximum review period is 4 months from the application date.

Singapore has also adopted the same time limits as the European Commission in its proposed M&A regulatory framework.

10. The second problem inherent in sub-sections (5) and (6) is that there is no specification about the approval procedure of which the applicants should follow when they seek to obtain the TA's consent of any M&A transaction. This again adds to the uncertainties of the regulation and causes delay to the approval process.

11. Last but not the least, in subsection (11) of Section 7P, it specifies that any costs or expenses incurred by the TA in making its decision or processing an application is recoverable from the licensee concerned. This is a vague provision which undoubtedly increases the uncertainties inherent in the regime and the licensee's financial exposure. Given that OFTA is already in a strong financial position[3], there is no need to recover the cost from the operators. In any event, should the cost be recoverable from the licensee, it is strongly suggested that it should be in a form of fixed amount application fee. A reference can be made to the proposed regime in Singapore in which an application processing fee of S$10,000 (about HK$43,000) will be levied per M&A application.

Conclusion

12. Due to the large investment and the high risk inherent in such investment in the telecommunications sector as well as the competitiveness of the telecommunications market, M&A activities in the market are expected to increase. The government policy of issuing unlimited licences, or issuing the maximum number of licence (in the case that licence number has to be limited by factors such as the availability of spectrum) has implied that the appropriate market structure and number of players in the telecommunications market should be decided by market force instead of the government regulation. The proposed M&A regulation would impose unnecessary regulation to the telecommunications market which would hinder the development of the market and ultimately affect the public interest.

[3] OFTA has accumulated HK$778 million in capital and reserves by the year ended 2001 (OFTA Trading Fund Report 2000 – 2001, page 69)