PCCW LIMITED ("PCCW")
SUBMISSION TO
THE LEGISLATIVE COUNCIL
ON THE
TELECOMMUNICATIONS (AMENDMENT) BILL 2002
("THE BILL")

Introduction

The Bill, if enacted, would be first legislation of its kind in Hong Kong. It would be the first time that mergers and acquisitions – which the ITBB Brief recognises "are part of normal business activities and are economically beneficial to society" – have been subject to regulatory control on the basis of their effect on competition. Given Hong Kong's clear policy preference for free trade and light-handed regulation, the need (or otherwise) for such proposed regulation, aimed as it is at a sector which is not unique in its structure and has been particularly badly hit by the economic downturn, should be very carefully considered. The case for such regulation would have to be compelling before such regulation was introduced. As demonstrated below, no such compelling case exists.

Moreover, although the telecommunications sector is the target of the Bill, the repercussions on other sectors should not be underestimated. First, the Bill, if adopted, might form a blueprint for similar M&A regulation in other industries in Hong Kong. Secondly, while the ITBB Brief emphasises that the proposal "will only apply to carrier licensees", it fails to highlight the fact that, as from the end of this year, the moratorium on the issue of carrier licences will be abolished and it will be open to any business (subject to compliance with minimal prudential criteria) to apply for a carrier licence, even although telecommunications may be a peripheral part of their activities. The Bills Committee should not therefore assume that only the current fixed and mobile carriers will be affected.

PCCW strongly opposes the introduction of sector-specific M&A regulation in telecommunications, and therefore recommends that the Bill should be rejected. The reasons are set out in detail in PCCW's response to OFTA's Consultation Paper of 17 April 2001, a copy of which for convenience is attached in the Annex to this letter. The main reasons are highlighted in Part 1 below.

Even if the Bills Committee chooses not to follow our recommendation, and believes that sector-specific merger regulation in telecommunications is appropriate, the Bill in its current form is manifestly defective and unduly intrusive. The reasons are explained in Part 2.

Part 1 – Why Sector-specific Merger Regulation in Hong Kong is Inappropriate

There is No Need for Sector-specific M&A Regulation in Telecommunications

1. The TA has frequently stated that his policy is "light-handed regulation", i.e. regulating only where there is a need. This is consistent with the overall Hong Kong approach to regulation. No need for a regulation on mergers and acquisitions in the telecommunications sector has been shown.

   No abuses have occurred to warrant the imposition of burdensome M&A regulation. On the contrary, in his Consultation Paper of 17 April 2001, the TA reviewed the existing constraints in operators' licences regarding transfers of shares, assets, control and licences and concluded that, because of these measures, "it has been the practice of licensees to seek the consent of the TA prior to any significant change of ownership of control, whether or not

involving an acquisition or merger". This is a strong argument against the need for M&A regulation.

Moreover, there is no evidence that the telecommunications sector is unique. Sectors other than telecommunications in Hong Kong have survived and operate efficiently without M&A regulation. No proposal to introduce M&A regulation in those sectors has been put forward, and there is no logical reason to treat telecommunications differently.

It is not a sufficient justification to say that certain competition rules already apply in the Hong Kong telecommunications sector. As noted below, sectoral regulators in other jurisdictions have power (like the TA) to enforce rules against anti-competitive practices, but have no merger control powers.

Such Regulation would place Excessive Power in the Hands of the TA

2. Effectively, if the Bill is enacted, the TA would be prosecutor, judge and jury as to whether an M&A transaction should proceed. This contrasts with other jurisdictions such as the U.S., U.K. and Australia where there is a separation of functions. In the U.S. the Department of Justice ("DoJ") or the Federal Trade Commission ("FTC") have primary jurisdiction over M&A cases, not the Federal Communications Commission ("FTC"). The DoJ and FTC ultimately have to prosecute their case against the transaction in the courts, and a similar system is adopted in Australia. In the U.K., three authorities are involved in reviewing the transaction before it can be prohibited: the Office of Fair Trading, the Competition Commission and the Secretary of State for Trade and Industry.

   The right of appeal against TA decisions to the Telecommunications (Competition Provisions) Appeal Board ("the Board") does not provide a sufficient check on the TA's powers, since it would (at best) cause delay to the completion of many mergers and acquisitions and (at worst) cause them to be abandoned. The Board (like the TA-see below) has insufficient resources to conduct a proper assessment of the likely economic effects of a particular M&A transaction within a commercially-realistic timeframe.

   An alternative approach which could provide a more effective check on the TA's power would be to follow the U.S/Australian model referred to above. In other words, placing the burden on the TA to prove its case against a particular M&A before the Board, and letting the Board decide. This would mean enabling the Board to obtain the specialist legal and economic analysis which is required. In addition, there would need to be clear agreement on all sides that the Board has the necessary powers, such as the power to take interim measures pending its final decision.

   Moreover, the TA's power is increased by the way in which the Bill has been drafted:

   – the range of transactions which are subject to potential investigation goes far beyond those which might give rise to competition concerns. This

point was made forcibly by PCCW and other operators in response to the TA's consultation on the M&A proposal last year. It is disappointing that, in spite of these submissions, the TA still seems intent on extending his power over as wide a range of transactions as possible.

– the TA has a wide discretion in deciding what "substantial lessening of competition" means; and

– no time limits are placed on the TA's investigation and decision - making processes.

Each of these points is explained further in Part 2.

The TA does not have sufficient resources

3. It is notable that in jurisdictions which choose to regulate M&A on competition grounds, M&A decisions are taken by a public body (such as an agency or department) with the considerable sector-wide competition expertise and resources which are necessary for a proper legal and economic assessment of the anticipated competitive effects of mergers and acquisitions within commercially-realistic timeframes. They are not taken by individual sectoral regulators with insufficient expertise and resources to conduct such assessments.

   For example, in the US, the DoJ and FTC have primary jurisdiction over M&A cases (not the FCC) and have the necessary specialised legal and economic staff to evaluate the difficult issues presented by M&A cases. Likewise, in the UK, while the telecommunications regulator OFTEL has power to enforce rules against anti-competitive agreements and abuses of dominant positions, it has no power to regulate M&A: only the general competition authorities acting under general competition law have this power. By contrast, OFTA does not have the expertise to conduct the required detailed and comprehensive legal and economic analysis required and has indicated that it will not be adding specialised staff to do so.

   The dangers of a sector-specific approach to M&A in Hong Kong are therefore that either defective decisions will be made (the TA having too little expertise or erring on the side of caution in prohibiting the transaction in the case of doubt), or that the assessment will take so long that the economic benefits to be gained from the transaction – even if it is ultimately approved - will be lost. It is notable (and perhaps not coincidental) that no time limit is placed on the TA within which he must make a decision - this is completely unacceptable as explained further below.

   For these reasons, and the other reasons set out in our response to OFTA's Consultation Paper, we would strongly recommend that the Bills Committee reject the Bill.

Part 2 – <u>Why the Bill in its current form is manifestly defective and unduly intrusive</u>

In case the Bills Committee decides, in spite of our above recommendation, that the introduction of sector-specific M&A regulation in telecommunications is justified, we have a number of significant comments regarding the Bill as currently drafted. These comments follow the order of the relevant clauses of the Bill, and are not ranked in order of importance: they are all important. Many of these comments were made by PCCW and other operators last year in response to the TA's consultation, and it is disappointing that none of them have been reflected in the Bill as currently drafted:

<u>Clause 2</u>

1. The TA intends to produce guidelines on the matters to be taken into account in deciding whether a particular M&A transaction would substantially lessen competition. PCCW submits at point 2 below that guidelines are insufficient to deal with this issue and that the concept of "substantially lessening competition" needs to be defined in the Bill itself. However, if guidelines are to be used, the TA should be required to provide a copy of his draft guidelines to the Bills Committee, and to publish the draft guidelines for public consultation, before the Bills Committee makes any decision to adopt the Bill.

   OFTA produced a set of draft guidelines which accompanied its Consultation Paper of 17 April 2002. These were the subject of extensive criticisms by the industry, and it is unclear whether those criticisms have been accepted by OFTA and reflected in an updated draft. It is essential in these circumstances that the Bills Committee and the public see the draft of any guidelines before making any decision to adopt the Bill, so that it can make a decision with a full picture as to how the TA intends to apply the regulation. It is also essential (for the same reason) that other interested parties (such as telecommunications operators) are consulted on a revised draft of the guidelines before the Bill is adopted.

<u>Clause 3</u>

2. The test of "substantially lessening competition" gives the TA a huge amount of discretion in determining what M&A transactions are prohibited. Provision needs to be made in the Bill as to what this concept actually means. For example, is a gain of 5% in market share as a result of the transaction a substantial effect on competition, or would it have to be 15 or 25%? It is not sufficient to deal with this matter in the TA's guidelines, since this would simply be the TA's interpretation: it would give the Board no assistance, in the event of an appeal, in knowing what the legislator actually meant by this concept. The TA or ITBB should consult on how the concept should be defined.

3. No time limit is specified within which the TA must take a decision in respect of a completed merger/acquisition. This could lead to a prolonged period of uncertainty, during which the parties to a completed deal would not know if

the TA was going to object to the deal, and if so what remedies he would seek to impose. A maximum period after the deal is completed should be specified, and provision made that unless a decision prohibiting the deal is made during that period, the deal will be deemed to have been approved. The TA or ITBB should consult on what that period should be.

4. Paragraphs 1(b) and 1(c) of the proposed new section 7 should be deleted. A change of control is what distinguishes M&A from other commercial transactions, and that is the only test which is relevant. Paragraph 1(b), which refers to any change in the beneficial ownership of the voting shares of a carrier licensee, is far too wide and could result in a large range of innocuous corporate transactions being subject to the TA's scrutiny. Paragraph 1(c) is unnecessary since paragraph 1(a) already covers any change of control.

   Similarly, the definition of change of control in the proposed section 7P(12) is far too broad. Becoming a director or principal officer, the beneficial owner of 15% or more voting shares, or the voting controller of more than 15% of the voting shares, would not in themselves (contrary to the implication of this section) give a person the power "to ensure that the affairs of the licensee are conducted in accordance of the wishes of that person". Since it appears intended that this is the real test, paragraph 12(d) is a sufficient definition of control and paragraphs (a), (b) and (c) should be deleted in the interests of clarity and avoiding over-regulation. In consequence of the deletion of proposed section 7P(1) (c) recommended above, proposed section 7P (13) should be deleted.

   There is no exclusion in the Bill for internal corporate restructurings within the same group of companies where the control of a company within the group is not shared with or transferred to 3rd parties outside the group. Such transactions should not be the subject of M&A regulation and should be expressly excluded.

5. The TA should not have power to investigate any change of control: a "safe harbour" needs to be provided to exclude changes of control which are de minimis. As currently drafted, the Bill would apply to any change of control, irrespective of the turnover of the parties, the assets to be acquired, or the market share of the parties concerned. This is out of line with other jurisdictions which have merger control, and which contain a jurisdiction threshold based on turnover, assets acquired, or market share. The TA or ITBB should consult on what the appropriate threshold should be.

6. There is no provision for the TA to accept an undertaking by the operator(s) to take action to eliminate the perceived anti-competitive effects of the deal as an alternative to being subject to a formal direction. Statutory provision is commonly made for such undertakings in other jurisdictions, and undertakings are preferable to formal directions in the interests of light-handed regulation. Provision for undertakings in lieu of directions should therefore be made in the Bill.

7. There is no time limit within which the TA must make a decision on an application for consent to the deal under the proposed section 7P(6). As speed is of the essence in these transactions, it is important that a statutory time limit is included, and that the period is as short as possible while allowing a full review of the competitive impact (if any) of the deal. The TA or ITBB should consult on what the appropriate period should be.

8. The proposed section 7P(11) – dealing with recovery by the TA of costs and expenses – is not acceptable. As the TA will be adding no staff, cost recovery is not warranted. If costs were to be recovered, it is unsatisfactory to give the TA power to recover costs and expenses without specifying what level of costs and expenses are likely to be involved. We would recommend that if any costs and expenses are to be recovered, this should be through a specific maximum fee which is laid down by statute. The TA or ITBB should consult on what the appropriate level of fee should be.

9. Generally, the Bill does not address a number of important issues. These include the following:

   - whether joint ventures would fall within the Bill, or be subject only to the possible application of section 7K/GC15 of the FTNS licence.

   - whether non-compete covenants (which are an integral part of many M&A agreements) would be dealt with under the Bill or only under section 7K/GC15 of the FTNS licence.

   We trust that such important matters would be addressed in the TA's Guidelines.

PCCW Limited
3 September 2002

Annex

“REGULATION OF MERGERS AND ACQUISITIONS IN THE TELECOMMUNICATIONS MARKET”

RESPONSE BY PACIFIC CENTURY CYBERWORKS LIMITED (“PCCW”) TO OFTA’S CONSULTATION PAPER DATED 17 APRIL 2001 (“THE PAPER’)

Introduction

OFTA has proposed in the Paper the introduction of a regulation which would require a wide range of share transfer transactions in telecommunications companies to be subject to the TA’s prior approval (“the Proposal”). The legislation would apply initially to changes in the ownership or control of fixed and mobile carrier licensees, but OFTA suggests that it might in future be extended to other telecommunications operators such as internet service providers.

This would be the first legislation of its kind in Hong Kong. It is quite possible that it would, if adopted, form a model other for similar legislation applying to other industries, or indeed a general regulation applying to all industries. As such, the Proposal has implications extending beyond the telecommunications industry, and merits very serious scrutiny.

PCCW strongly opposes the Proposal, for the reasons set out in this Paper. In summary, the reasons are as follows:

1. The Paper does not attempt to justify the need for a merger control regulation applying purely to the telecommunications industry, and such a regulation would in any event be impracticable and inappropriate:

   (a) No justification. The Paper states that the aim of the Proposal is to prevent the level of competition in telecommunications markets being “significantly diminished by mergers and acquisitions”. However, it points to no merger or acquisition which has had that effect, or which the existing regime has been unable to addresss. It contains no reasoning as to why new legislation is necessary to achieve that aim, and indeed contains comments which argue against the need for such legislation. In the absence of a clear and demonstrated need, the Proposal can only be seen as unnecessary and inconsistent with the Government’s stated preference for light-handed regulation.

   (b) Impracticable. Merger control regulation is extremely complex and should be administered by a government department or commission with specific competition responsibility and expertise, as in other jurisdictions, not a sectoral regulator.

   (c) Inappropriate. If merger control legislation is to be adopted in Hong Kong, it should apply to all sectors and should not be limited to telecommunications.

2. <u>Assuming a merger control regulation was required, the model proposed by OFTA is fundamentally flawed</u>

   (a) The Proposal contains measures and controls which extend far beyond what would be necessary to achieve the Government's stated aim, and raises questions as to whether there are other aims behind the Proposal. The Proposal is therefore excessive, disproportionate, and contrary to the Government's stated policy of light-handed regulation.

   (b) The tests for granting approval are unduly burdensome, too vague, and (depending on how they are interpreted) could be set at too low a level.

   (c) The Paper contains no reference to issues which are fundamental to any proper consideration of merger control legislation, and the consultation is therefore deficient.

   (d) The proposed mechanism for notifying the TA of relevant changes in share ownership or control is unworkable in practice.

1. A merger control regulation applying purely to the telecommunications industry is unnecessary, impracticable and inappropriate:

   (a) No Reasoning as to why the Proposal is necessary

   OFTA has stated on numerous occasions that it has a policy of minimum intervention in commercial affairs, in other words "light-handed" regulation. When the Government opposed the introduction of a general competition law in November 1997, it said in its response to the Consumer Council Paper:

   "We are committed to the promotion of free trade and competition. We also subscribe to the economic philosophy of minimum government intervention in market forces. This is the best formula for enhancing economic efficiency, which is the ultimate, shared objective of our competition and trade policies."

   The Paper itself repeats this policy statement, in the Guidelines attached to it:

   " At the outset, it should be stressed that the TA starts from a presumption of minimal regulatory intervention in what are essentially market-driven transactions".

   According to this test, the case for a new regulation would have to be convincingly proved before such a step could be justified. However, the Paper contains no reasoning as to why a new regulation is necessary, and indeed contains certain comments which actually argue against the need for a new regulation.

   (i) The Paper states that the aim of the Proposal is to prevent the level of competition in telecommunications markets being "significantly diminished by mergers and acquisitions". However, it points to no merger or acquisition which has had that effect, or which the existing regime has been unable to address. On the contrary, experience shows that the TA has indeed taken a role in approving the few significant acquisitions which have taken place in the Hong Kong telecommunication sector in recent years, including PCCW's acquisition of Cable & Wireless HKT in August 2000.

   (ii) After reviewing the existing constraints on telecommunications licensees regarding transfers of shares, control, assets and licences, the Paper concludes in paragraph 11:

   "Because of the above measures which may be used to deal with mergers and acquisitions, it has been the practice of licensees to seek the consent of the TA prior to any significant change of ownership or control, whether or not involving an acquisition or merger."

   This statement constitutes a strong argument that the Proposal is unnecessary, particularly coming as it does from an authority which has an explicitly non-interventionist policy.

(iii) The Press Release which accompanied the publication of the Paper contains the following statement:

"Up to now, the control of mergers and acquisitions in the telecommunications market is mainly through licence conditions. We intend to bring such regulation to a firmer footing through subsidiary legislation".

However, there is nothing in the Paper to explain why regulation is preferable to licence conditions. On the contrary licence conditions would appear to allow more flexibility.

(iv) OFTA comments in paragraph 8 of the Paper that *"until a regulation under section 37 of the Telecommunications Ordinance is enacted, there is no comprehensive requirement for the TA's consent to be obtained"* for such changes. However:

- there is no comment, far less assessment, on whether the lack of such a comprehensive requirement (if correct) has proved or may prove a problem in the telecommunications sector. On the contrary, there is nothing to suggest that mergers and acquisitions are, or are likely to be, more prevalent in the telecommunications sector or elsewhere, or that certain mergers and acquisitions have produced or may produce problems in terms of competition which cannot be resolved under the existing regime.

- Even if additional steps were considered necessary, the same non-interventionist, light-handed policy would address any necessary regulatory changes through the licences, where the existing restrictions are contained, rather than through new legislation. But as noted above, there is no reasoning in the Paper as to why legislation rather than licence changes are appropriate.

(v) For any new legislation in Hong Kong, and especially legislation as interventionist and unprecedented as that contained in the Proposal, one would expect a proper costs/benefits assessment in the Proposal. This is particularly the case given the stated policy of the Hong Kong SAR government in general, and OFTA in particular, of minimum intervention in commercial affairs, i.e. light-handed regulation. However, no such assessment is contained in the Proposal.

(b) <u>The Proposal would place too much responsibility on, and discretion in, the TA. If any merger control regime is introduced it should be administered by a specialist government department or agency, not a sectoral regulator.</u>

The assessment of the competition effects of a merger or acquisition is a complex and resource- intensive task. It involves predicting the effects on competition of future market structure. Moreover, this analysis usually has to be conducted within a very compressed timeframe, so that commercial transactions are not unduly delayed, and

that the benefits of those mergers and acquisitions which raise no significant competition concerns can be realised.

In view of these complexities, other jurisdictions place responsibility for administering merger control in the hands of government departments or agencies with specialist responsibility for competition issues (including merger control), rather than sectoral regulators. So in the US, it is the Department of Justice which has this responsibility, not the Federal Communications Commission. In the UK, it is the Office of Fair Trading and the Competition Commission, not OFTEL. In Australia, it is the Australian Competition and Consumer Commission, not the Australian Communications Authority. And in the European Union it is Directorate General IV of the European Commission (Competition), not Directorate General XIII (which regulates the telecommunications sector at an EU level). Sectoral regulators give input to the work of competition authorities, but do not administer the merger control rules.

Giving the TA this responsibility would therefore be inconsistent with overseas practice, and would place too much responsibility and discretion in the TA. It is not sufficient that the TA's decisions be subject to appeal to the Telecommunications (Competition Provisions) Appeal Board, as suggested in the Proposal. Any appeal is likely to lead to uncertainty and delay in completing transactions. Quality decisions based on proper analysis must be taken at the outset. In the absence of sufficient support and resources to conduct the thorough analysis required, the regime would inevitably result in over – cautious regulation, i.e. to transactions being blocked in the event of doubt as to their anti-competitive effects. This would in turn have a chilling effect on merger and acquisition activity.

(c) <u>If Merger Control Regulation is to be adopted in Hong Kong , it should be apply generally and not to a specific sector</u>

Many companies are part of corporate groups which have diverse interests spanning a range of industries. Telecommunications operators are no exception. Assessing the effects on competition of a proposed merger or acquisition therefore should, and in other jurisdictions with merger control rules does, involve looking at its impact in all markets which may be affected. The effect of the Proposal, however, would be to restrict any assessment of the competitive effects of the transaction purely to the telecommunications sector. The TA would therefore be placed in the invidious and illogical position of publicly approving the transaction in question if it had no impact on the telecommunications sector, even though it may have serious effects on competition in other markets.

The TA does have power under the existing rules to take action against anti-competitive practices. However, an anti-competitive practice normally affects only one market. The position is entirely different with a merger or acquisition.

In other jurisdictions with merger control regulation (such as the EU, UK, US, Australia and New Zealand) merger control regulation is of general application and not restricted to a specific sector. As noted above, it is administered by national competition authorities, not by sectoral regulators. If merger control regulation is necessary in Hong Kong, it should be of general application, and administered by a general competition authority. It should not be the exclusive preserve of a sectoral regulator in one industry. Similarly, if overconcentration is a concern in telecommunications, then it should also be a concern in other industries in Hong Kong, especially those which, even at this time, are just as if not more concentrated than the telecommunications industry.

2. Assuming a merger control regulation was required, the model proposed by OFTA is fundamentally flawed

(a) The Proposal is grossly excessive and disproportionate in relation to its stated aim.

The Proposal purports to be aimed at controlling anti-competitive effects of mergers and acquisitions. In reality it goes well beyond this. At most, the Proposal should be aimed only at transfers of control which have a substantial anti-competitive effect. However:

(vi) The Proposal would require the TA's approval not just for mergers and acquisitions, but also to a wide range of other transactions involving the transfer of shares.

Mergers and acquisitions have as a common feature a change in control; two (or more) businesses which were previously independent becoming a single economic entity and therefore subject to single or common control.

However, disturbingly, the Proposal would require prior approval not just for changes of control. Prior approval would also be required for any share transfer transaction which resulted in any single shareholder owning or controlling a certain percentage of the share capital of the company (15%, 35% or 50%) even if no change of control was involved. Moreover, the Proposal would not necessarily stop there: OFTA seeks views on whether prior approval should also be required at 25%, and proposes an obligation to notify the TA at 10%. Remarkably, the Proposal in its present form would even apply to internal corporate reorganisations: this is presumably unintentional but would need to be clarified.

These requirements go far beyond what is necessary in a merger control regulation. Other jurisdictions with merger control regulations use the concepts of control or decisive influence as the test for the definition of a merger or acquisition for that purpose (although in some cases there may be a presumption of control when a majority shareholding is obtained). This inevitably raises the raises the question of whether the level of market competition is the only aim behind the proposal.

Moreover, controlling share transfer transactions in this way would have a chilling effect on investment in Hong Kong, and is inconsistent with Hong Kong's reputation as a free economy. The fall in share values in the technology and telecommunications sectors is well-known, and the Proposal could well make even more difficult for companies to raise funds on the capital markets. There are exceptions in the Proposal for share transactions made purely for investment purposes, but it is by no means clear that these exemptions would be wide enough to avoid the adverse effects mentioned above.

(ii) There is no consultation in the Paper on whether a pre-notification requirement is actually needed. In certain jurisdictions with merger control rules such as the UK, Australia and New Zealand, the relevant authority has power to intervene against mergers and acquisitions which reduce competition to an unacceptable level, but there is no requirement on the parties to seek the government's prior approval to the transaction. What this means in practice is that the onus is on the parties to assess whether the proposed transaction may be subject to objection on competition grounds, and if so, whether it is desirable to seek prior comfort or clearance from the relevant authority, rather than take the risk of being required to undo the transaction or divest assets subsequently. Compulsory prenotification involves a substantial additional cost on the parties to the proposed transaction. Again, for a government authority with an expressly non-interventionist, light-handed policy, one would expect it to consult on whether such a voluntary notification system is preferable to a pre-notification requirement, rather than to assume that pre-notification is the only or the preferred option.

(iii) Change in control should not be sufficient to trigger any prenotification requirement or to open the transaction to regulatory scrutiny, since this would catch a wide range of commercial transactions which are innocuous from a competition point of view. An additional threshold should be required for these purposes. This is the case in other jurisdictions with merger control regulation. For example, in the UK (where no prenotification is required) the competition authority has no power to examine a merger or acquisition unless either a certain market share would be achieved or increased by the merger, or the assets of the "target" company exceed a certain level. Taiwan uses a market share test. The US uses a "size of party" or "size of transaction" test. The EU, Netherlands, and Switzerland use a turnover test. The Proposal itself gives, as one of the two thresholds at which the TA "will generally only start to assess mergers" whether the merged entity would supply 40 per cent or more of the market. (As noted above, the UK also uses a market share test). That could therefore be used as the relevant threshold. (The other threshold suggested by the TA, which involves a concentration ratio, is set at too low a level and could still catch transactions which are innocuous from a competition point of view).

(b) <u>The test for granting approval gives too much discretion to the TA, and is out of line with tests used in other jurisdictions</u>

In any merger control regime, it is important that the test for granting approval or prohibiting the transaction (as well as for seeking approval, where there is a pre-notification requirement) is not set at too low a level, and is as transparent as possible, so that the parties can predict the regulatory risks with some degree of certainty. This is particularly important in regimes where no compulsory pre-notification requirement is imposed and the parties have to make their own assessment, but is also important where pre-notification is required. (As noted above the Paper does not, but should, solicit views on whether any pre-notification requirement is necessary).

The Paper (at paragraph 22) states:

"The <u>main</u> (emphasis added) *consideration of the TA in deciding whether a transaction will prevent or substantially restrict competition, or create or enhance a dominant position in a telecommunications market."*

This statement raises a number of points:

- the statement implies (by the use of the word "main") that the effects on competition would be the only criterion which would be used in assessing whether the transaction would be approved. This is disturbing. The effects on competition should be the only criterion, and that this should be clearly stated. However, if other criteria would be used, in the interests of transparency and maximising legal certainty, these criteria should be stated explicitly and comprehensively, with a clear statement of how they could be used and weighted.

- it appears that there is in fact not one test, but four separate tests: "prevent" competition, "substantially restrict" competition, "create" a dominant position, and "enhance" a dominant position. It appears that if any of these tests were satisfied the transaction would be blocked. It is unnecessary and unduly burdensome to have four tests. Morever, the tests themselves are vague, and depending on how they are interpreted, could be set at too low a level and result in the unnecessary blocking of a wide range of transactions which do not have a significant impact on competition in the relevant market. Further consideration needs to be given to what the appropriate standard should be. As regards creation of a dominant position, competition rules (including those under the Telecommunication Ordinance) do not generally prohibit the acquisition of a dominant position in itself. This test is therefore certainly inappropriate.

- turning to the Guidelines themselves, it is surprising that they do not offer any guidance on what the tests mean and how they will be applied. In fact, the only reference to a possible test for approval is the reference at the foot of the flowchart, which only refers only to two of the four tests mentioned in the Paper:

"prevention" or "substantial restriction" of competition. There is therefore an inconsistency between the Proposal and the Guidelines.

The Proposal states that one of its purposes is *"to have a transparent* (emphasis added) *and efficient regulatory regime governing M&A activities."* The Proposal is far from transparent in so far as the test for approval is concerned.

(c) The Paper contains no reference to issues which are fundamental to any proper consideration of merger control legislation, and the consultation is therefore deficient.

The Paper is silent on a number of fundamental issues. For example:

Timescales. It is clearly imperative that decisions on mergers and acquisitions are made as expeditiously as possible, so that these transactions are not unduly delayed. No timescale is proposed in the Paper. In fact, as noted above, PCCW doubts whether the TA would have the resources to make proper merger control decisions within a commercially acceptable timeframe, which would inevitably result in over-cautious regulation.

Undertakings. The Paper suggests that relevant transactions would either be approved or disapproved. There is no reference to conditional approvals, i.e. approvals which would be given on the proviso that the parties undertake to divest of certain assets to eliminate the competition concerns. Such undertakings are a common feature of merger control rules in other jurisdictions.

(d) The Proposed Mechanism for Notifying the TA is unworkable in practice

If there is to be a pre-notification requirement, it is vital that the pre-notification is made at the earliest practicable time, if undue delay in the completion of commercial transactions is to be avoided. The obligation should therefore be placed on the party or parties which are proposing to acquire control, not on the company which is potentially subject to the change in control, as suggested in the Proposal. That company may be unaware of the Proposal at the outset. This is particularly the case if there is a change of control at a level higher than that of the company's immediate shareholders.

Conclusions

In summary, PCCW believes that OFTA has not demonstrated any need for the Proposal, and that in any event a merger regulation applying purely to the telecommunications sector is inappropriate and impracticable. Even if a merger regulation applying purely to telecommunications was necessary, appropriate and practicable, the model suggested by OFTA is fundamentally flawed, in particular since it is grossly excessive and intrusive in relation to its purported aim. The Proposal should be withdrawn, and any future proposal for

merger control should be of general application to all industrial sectors, administered by a competition authority, and discussed in the context of whether general competition legislation should be introduced in Hong Kong. Critically, the overall weakness of the Paper can only emphasise that OFTA and the TA should not be given such broad responsibility and discretion.

PCCW

12 June 2001