CB(1)2548/01-02(01)

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JOINT SUBMISSION TO
LEGISLATIVE COUNCIL
BILLS COMMITTEE

ON

PROPOSED REGULATION OF
MERGERS AND ACQUISITIONS IN
THE TELECOMMUNICATIONS MARKET

UNDER

TELECOMMUNICATIONS (AMENDMENT) BILL 2002

14 SEPTEMBER 2002

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EXECUTIVE SUMMARY

In response to the Legislative Council Brief issued on 3 May 2002 by the Information Technology and Broadcasting Bureau ("ITBB") on the proposed amendments under the Telecommunications (Amendment) Bill 2002 (the "Bill"), Hutchison Global Communications, New World Telephone and Wharf New T&T make the following submission:

1. We endorse the Government's policy to promote fair and effective competition in the telecommunications industry and agree with the use of sector-specific regulation to promote competition.

2. Indeed, the telecommunications legislation and licences already contain prohibitions against anti-competitive conduct and abuses, providing the telecommunications industry with more safeguards than any other sector of the Hong Kong economy.

3. We do not agree, however, with the proposal to expand sector-specific regulation to include merger and acquisition control. The proposed sector-specific merger and acquisition control regime:

   - treats one sector of the economy differently from the others;

   - singles out carrier licensees without justification;

   - fails to recognise properly the benefits of mergers and acquisitions;

   - creates problems of inconsistency by not taking into account other rules which may be relevant to merger and acquisition activities such as Hong Kong's Stock Exchange Listing Rules and Takeover Code;

   - fails to recognise that mergers and acquisitions are often not just related to one sector, for example where parties are engaged in a variety of businesses; and

- fails to take into account the technological convergence of information-related sectors of the economy.

4. We are not aware of any other economy which regulates telecommunication mergers and acquisitions without regulating mergers and acquisitions across the economy. International opinion, including from the OECD, is that industry specific regulators do not have the specialist skills and expertise to deal with the complex legal and economic issues which arise in merger and acquisition control. The few examples where merger and acquisition control has been given to sector-specific regulators are generally acknowledged to have been problematic, if not failures.

5. The Government has concluded on a number of occasions that Hong Kong does not need a general competition law regulating mergers and acquisitions: "*Hong Kong is a small and externally-oriented economy which is already highly competitive.*"[1] We do not see any justification to single out the telecommunications industry, and carrier licensees in particular, for special treatment.

6. The Legislative Council Brief (at paragraph 11) concludes that structural features of the telecommunications sector require the sector-specific regulation of mergers and acquisitions. We take issue with ITBB's characterisation of the telecommunications industry:

   - the Hong Kong telecommunications sector is one of the most open markets in the world, with many operators, relatively low barriers to entry, efficiently allocated spectrum and mandatory access rules;

   - these facts do not support ITBB's conclusion that the structural features of the telecommunications sector warrant special treatment through merger and acquisition control. Any perceived structural problems are already addressed in both the existing regulatory framework (such as the facilities access regime)

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[1] May 1998 Statement on Competition Policy.

and the extensive powers the Telecommunications Authority ("TA") has to regulate anti-competitive conduct.

7. The proposed Bill introduces uncertainty and acts as a potential impediment to investment in Hong Kong. Given the current economic climate, both locally and globally, we believe that the proposed Bill runs contrary to the Government's competition policy to enhance economic efficiency and free flow of trade, and runs contrary to consumer welfare. The Brief itself concludes that it is "*Government's policy not to have an over-arching competition law or competition authority in Hong Kong*."

8. We are concerned with the lack of checks and balances. The effect of the proposed Bill is to delegate to the TA, being an administrative authority, important functions which should properly be exercised by the legislature or the judiciary:

   - the basic tenets of the proposed merger and acquisition control regime have yet to be worked out, and are left to the TA to determine through guidelines. In the future, the TA will be able to change the fundamental character of the merger and acquisition control regime by changing the guidelines without having to consult the Legislative Council. The TA will be performing the role of the Legislative Council; and

   - the TA is being vested with broad powers to issue directions to enforce its own decisions. Other competition regulators (for example in the US and Australia) which decide that a merger or acquisition is anti-competitive cannot act unilaterally and must prove their case before a judge to obtain orders blocking the merger or acquisition. The TA will be performing the role of the courts. A right of appeal is no safeguard, as it shifts the burden of proof onto carrier licensees.

9. The Government argues that it has adequately addressed industry concerns by shifting from a pre-approval (*ex ante*) regime to post transaction disallowance (*ex post*). However in doing so it has failed to address the substantive issues which will

arise whether the regime is *ex ante* or *ex post*, resulting in a significant amount of uncertainty. These defects include:

- any merger or acquisition, regardless of size, will be subject to TA review. The Bill lacks thresholds (eg. turnover, asset and/or market share tests) which must first be satisfied prior to the TA having the power to review;

- the proposed competition test – substantial lessening of competition - against which a merger or acquisition is to be assessed is inconsistent with the existing dominance test set out in the Telecommunications Ordinance and the relevant TA's statements;

- at the pre-approval stage, there is no statutory timetable within which the TA must assess a proposed merger or acquisition;

- post-transaction, there is no back-stop date after which the TA is no longer able to unwind or modify a merger or acquisition. Accordingly, any merger or acquisition can be subsequently unwound, regardless of when it was first implemented; and

- OFTA would be granted the very wide power to review any transaction involving a "change in the ownership or control over a licensee". The definition of "change of control" is inconsistent with the Hong Kong Code on Takeovers and Mergers, and ignores the factual reality. Changes in a single director of the company or changes in shareholding as low as 15% are defined as a change of control and therefore subject to review, and potential modification and prohibition by the TA.

We request that the Legislative Council reject sector-specific merger and acquisition regulation in the telecommunications industry and reconsider the proposed approach set out in the Bill.

1. INTRODUCTION

1.1 In this Submission, we provide our views on the regulation of mergers and acquisitions in the telecommunications industry proposed under the Telecommunications (Amendment) Bill 2002 (the "Bill") which was introduced to the Legislative Council on 15 May 2002. We also make reference to the Legislative Council Brief dated 3 May 2002 issued by the Information Technology and Broadcasting Bureau ("ITBB") on the Bill (the "Brief"). For convenience, we use the expression 'merger' as a reference to both merger and acquisition, and we use 'merger control' as a reference to the control of both mergers and acquisitions.

1.2 The original proposal on the regulation of mergers in the telecommunications industry, as set out in the consultation paper dated 17 April 2001 issued by the TA (the "Consultation Paper"), was to establish a rigorous *ex ante* or pre-notification and approval regulatory regime. A total of 17 submissions were made in response to the Consultation Paper. The majority of the submissions voiced strong opposition to the merger regulation proposed in the Consultation Paper, not only on the basis of its *ex ante* approach but also on other fundamental issues such as the appropriateness of sector specific merger controls and the extent of the unchecked power granted to OFTA.

1.3 Although the Brief asserts that the proposed *ex post* regime is a major concession in response to criticisms from the industry following the Consultation Paper, we believe that the Bill fails to address the following fundamental issues:

- whether regulation is necessary at all, particularly in light of existing powers (see section 2);
- whether an industry specific regulator should have merger control responsibilities, and the criticisms which have been made worldwide of industry specific regulators having a merger clearance role, including criticisms by the OECD and recently the FCC Chairman and the US Congress (see section 3);

- the criticisms of the flaws in the original *ex ante* regime which have not been addressed and merely been transposed to the current *ex post* format (see sections 4.1 to 4.13 and sections 5.1 to 5.18); and

- the growing level of criticism of the merger regimes on which the Bill is based, such as the current inquiry into Australia's general competition laws (see sections 4.14 to 4.19).

2. INADEQUATE RATIONALE FOR THE INTRODUCTION OF THE BILL

The absence of clearly identified policy goals

2.1 Consistent with international best practices in the area of regulatory reform, good regulation should "*serve clearly identified policy goals, and [be] effective in achieving those goals*".[2]

2.2 We are of the view that there are no clearly identified policy goals to justify the proposal. The Brief notes that "*it is the existing policy of the Government to promote fair and effective competition in the telecommunications market. Consumers benefit from this policy and it is important that we safeguard the level of competition in the market*".

2.3 The Brief acknowledges that: "*many of the mergers and acquisitions do not raise regulatory concerns. Indeed, mergers and acquisitions are part of normal business activities and are economically beneficial to the society*".

2.4 ITBB contends (see the Brief at paragraph 11) that structural features of the telecommunications industry in Hong Kong require sector specific merger control to prevent over-concentration of market power in a few operators and undesirable cross-ownership. We take issue that the listed features are a proper characterisation of the structure of the telecommunications sector.

2.5 ITBB claims high concentration levels. But Hong Kong is a highly open marketplace. Hong Kong has more competitors than markets of much larger size. Hong Kong has 10 fixed network operators, 6 mobile operators, 6 mobile virtual network operators

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[2] *The OECD Report on Regulatory Reform Synthesis* (1997), p. 28.

(MVNOs), 24 EFTNS operators and a much larger number of value added service providers and resellers (213 external service licensees, and 321 value-added and PNETS licensees). The legislative mandate for MVNOs and the further liberalisation of the FTNS sector offer the prospect of even more operators.

2.6 ITBB claims high barriers to entry through high sunk costs. But Hong Kong has one of the most extensive access regimes in the world designed to overcome barriers to entry. The industry's facilities access regime in general (in particular the extent of unbundling in the incumbent's fixed network) and more recently the MVNO regime address this to a significant degree by requiring existing operators to provide new entrants with economically efficient access to infrastructure. While there is room for improvement in the administration of the current access regime, OFTA's efforts would be better spent on addressing these issues than embarking on the new complex area of merger regulation.

2.7 ITBB claims scarcity of radio spectrum. Spectrum is not relevant to a number of the carrier licensees singled out by this proposal and so the government's premise is weak. The Government has allocated spectrum to six 2G mobile operators and four 3G mobile operators, which is already a large number of operators given the size of Hong Kong. There is also a licence requirement for 3G operators to share a third of their spectrum with MVNOs.

2.8 ITBB claims high levels of vertical integration. But existing regulation and market trends again ensure that there is adequate vertical segmentation. Numerous PNETS operators supply retail services in competition with carriers over carrier networks. Regulated access rules ensure that MVNOs can connect their own switched and value added platforms to carrier networks. Independent retailers, especially in the mobile sector, undertake many of the retail sales functions of carriers. Competition policy and economic theory recognise that, in the absence of market power, vertical-integration is not anti-competitive. Vertical-integration can be beneficial to competition in the case of new entrants because it allows them to meet customers' demand for integrated products and services and also to realise important vertical efficiencies, lowering their costs of service. OFTA has adequate powers to address those circumstances in which vertical integration gives rise to competition concerns.

2.9 Accordingly, we reject ITBB's conclusion that the structural features of the telecommunications sector warrant special treatment through merger control. The existing regulatory framework and the extensive powers the TA has to regulate the conduct of licensees already address any issues, which arise out of the structural features of the telecommunications sector. In addition, those features exist to varying degrees in other sectors, and ITBB has not explained why telecommunications should be singled out.

2.10 Furthermore, the factors which ITBB identifies as creating greater risks of anti-competitive mergers in telecommunications are also counterbalanced by the rapid technological and service developments characteristic of the telecommunications industry. Rapid technological change has the potential to reshape existing markets and create markets over very short timeframes, making any long term dominance of a single carrier less likely.

2.11 The convergence of all the innovative and dynamic "information-based industries" means that singling out 'carrier licensees' as the target of specific regulation is inappropriate and a potentially distortionary policy choice.

2.12 A number of mergers and acquisitions have occurred in telecommunications market over the last several years as a natural function of the market. These transactions have had no subsequent adverse effects on the level of competition in Hong Kong. Even recently, OFTA justified its declarations of REACH and PCCW as non-dominant in relation to certain international services on the basis of fundamental shifts in the industry, principally overcapacity, which OFTA said made it difficult for any operator to exercise market power.

2.13 As a result, this combination of track record and the nature of the sector suggest that the risks of anti-competitive mergers may well be lower than in some other sectors. If there was a case in the early days of liberalisation of the telecommunications industry that mergers may have had an anti-competitive effect, the market has moved on.

The absence of any legislative deficiency

2.14 The Brief notes that the primary legislative deficiency which the Bill seeks to address is that "*under current licence conditions, the TA only has the power to regulate if the*

transfer of licence, or under some licences, transfer of shares in the licensee, is involved". It asserts that the need to provide the TA with new powers under the Bill arises since many mergers and acquisitions do not involve such a transfer when the change in ownership occurs at holding company level.

2.15 The proposed powers to regulate market structure are unnecessary when the *Telecommunications Ordinance* makes provision for the regulation of market conduct. If merged parties (including as a result of the merger) are in a dominant position in a telecommunications market, the TA may consider whether the provisions under sections 7G, 7K, 7L and 7N of the *Telecommunications Ordinance* should apply to them to prohibit anti-competitive conduct in which they are engaged. Similarly, in relation to non-dominant licensees, the TA may consider whether the anti-competitive practices provision under section 7K of the *Telecommunications Ordinance* should be applied.

2.16 These powers to regulate conduct and to address perceived barriers in the telecommunication sector are already far more extensive than in other sectors of the Hong Kong economy. Without the proposed addition of merger powers, the TA is already better placed to address any anti-competitive effects of merger than is the case in any other sector of the Hong Kong economy. Additional regulatory measures are simply not needed. If the proposed merger control regime were introduced, telecommunications would have a double layer of competition regulation while other sectors of the Hong Kong economy have none at all.

The risks of adopting international merger regimes from other jurisdictions

2.17 The Government has already recognised that Hong Kong is a small open economy where merger rules are not needed. If Hong Kong adopts the merger control as proposed in the Bill, it will be adopting merger or anti-trust laws which were developed originally for large economies with big domestic markets, such as the US and the EU.

2.18 In the current inquiry into Australia's merger rules, the Business Council of Australia recognises the danger of over-regulating a small economy and states that:

> "*The size of the Australian economy creates an acute dilemma for the regulation of competition policy. Robust domestic competition is an important contributor to*

the productivity and efficiency gains that deliver benefits for domestic consumers and businesses alike. It also underpins our international competitiveness. However, over-vigorous controls may deny firms in small, fragmented economies the economies of scale and scope needed to successfully compete and grow in global markets."[3]

2.19 The Canadian merger rules also look beyond the competitive effects of a merger to consider whether, given that Canadian companies have to compete in the larger US market nearby, the efficiencies from the merger which allow the merged entity to be a more effective competitor, outweigh the competition effects.

2.20 Hong Kong is in a similar position and any merger control rules should be appropriate to its size. This may require factors other than rigid economic analysis, which is required by the Bill, to determine if a merger is beneficial or harmful, such as public interest factors or whether the efficiency gains of the merger outweigh its effects in lessening competition. All this requires careful thought and consultation across the entire economy, rather than rushing forward with a Bill targeted at one sector.

The current state of the telecommunications Industry

2.21 We have already noted that Hong Kong's telecommunications industry is more highly regulated than almost any other sector of the Hong Kong economy. Adding a further level of regulation, especially of such uncertain operation, is poorly timed. Globally, the telecommunications industry is facing uncertain times. The industry has faced rapidly falling values and increasing debt and numerous companies have failed. Michael Powell, Chairman of the Federal Communications Commission, has stated that the industry problems are:

- Inefficient industry structures characterised by excess capacity;
- Lack of investor confidence;
- Capital markets closing to new investment; and

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[3] Business Council of Australia Submission to the Review of the Trade Practices Act 9 July 2002 p. 71

- Companies that have pulled back from spending in this capital-intensive industry.[4]

2.22 Powell recognised the role that regulatory policy can play in ensuring brighter long-term prospects for the telecommunications sector. He pressed the need for regulatory reform to create incentives for effective and sustainable competition and to provide a regulatory framework that promotes competition, investment and innovation. He encouraged an approach in which regulators facilitate industry rationalisation to ensure its long-term health and, in other speeches, he has called for the FCC's merger role to be removed and the merger approval process to be simplified.

2.23 The delays, risks and uncertainties of a regulatory process are a major consideration of any investor, especially in an industry that already has large commercial risks and requires substantial capital investment. Capital markets already are taking an extremely cautious approach to the telecommunications industry. The Government's decision to regulate only telecommunications mergers, therefore, creates a distortionary effect. This may disadvantage telecommunications operators in the competition for capital, at a time when the telecommunications industry could do without such a disadvantage. When deciding whether to invest in telecommunications or pursue other opportunities in other sectors of the economy, investors inevitably will take into account that mergers in those other sectors can be completed without the risk of being blocked or subsequently unwound by a regulator.

3. SECTOR SPECIFIC REGULATION

International precedent

3.1 International precedent and opinion is strongly against using an industry-specific regulator to perform the function of regulating mergers and acquisitions.

3.2 The OECD Committee on Competition Law and Policy reported in 1999 on the relationship between regulators and competition authorities.[5] The Committee preferred

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[4] Statement of Michael K Powell, Chairman, Federal Communications Commission, on "Financial Turmoil in the Telecommunications Marketplace: Maintaining the Operations of Essential Communication" Before the Committee on Commerce, Science and Transportation, United States Senate 30 July 2002

general regulators to sector specific regulators for a number of reasons.[6] It pointed to the fact that a general regulator would be less self-interested in the outcomes of its decisions. Since a general regulator does not have a direct role in the ongoing regulation of the industry and is more removed from the industry participants, it can take a more neutral perspective. Additionally, merger review involves complex legal and economic issues. As the OECD identifies, a regulator with an economy-wide perspective and responsibility for a larger pool of mergers is better able to better develop its skills in merger analysis than an industry specific regulator that deals with the occasional merger in its industry.

3.3 Where the regulator has a wide range of powers that may be exercised in other contexts (for example, the setting of spectrum fees, regulation of interconnection and conduct in the retail sector), the regulator also has the ability both to extract concessions from and to affect licensees involved in a merger review in other contexts. OFTA would not only approve mergers, but would have ongoing powers over interconnection, pricing, spectrum charges and other regulatory matters crucial to the day to day operation of telecommunications operators. Even if the merging operators had strong advice that there were good grounds to oppose the regulator's rejection of a merger or the imposition of onerous conditions, there may be a reluctance to do so because of concerns about the effect which a confrontation with the regulator may have on the regulator's treatment of the operator on other matters. For this reason, there is an inherent risk in empowering a single regulator with merger as well as other industry specific regulatory functions.

3.4 There are only a few examples overseas of industry specific mergers and acquisition regulation, and most of them have been heavily criticised. In the US, the role of reviewing mergers and acquisitions in the telecommunications sector is undertaken by both the FCC and the Department of Justice. However, the duplication of responsibilities has attracted intense criticism. In particular, the Chairman of the FCC, Michael Powell, has stated that he favours an end to the FCC's mergers and acquisitions role, stating:

> "*we should constantly ask ourselves whether some other agency has roughly equivalent or even superior expertise and authority to address any given factor, either in reviewing the merger at issue or in some other context ... Simply put, we*

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5 Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy "Relationship Between Regulators and Competition Authorities" DAFFE/CLP(99)8

6 see p. 33

cannot command respect as an "expert agency" if our pronouncements turn on subjects in which we are not expert or which do not rely on our unique capabilities".[7]

3.5 Industry-specific merger regulation proved to be disastrous in the US aviation industry. Prior to 1989, the Civil Aeronautics Board, and then the Department of Transportation, had authority over mergers and acquisitions in the United States airline industry. The industry specific regulator approved two mergers which the general competition regulator, the Department of Justice, advised against approving. In 1988 the General Accounting Office[8] reported that one of the approved mergers had resulted in a fare increase, and that the choice of airlines on certain routes decreased. Following the regulatory failure, the Department of Transport's responsibilities for merger control were passed to the Department of Justice. As the Department of Transport has limited experience in mergers, it was recognised that it misjudged the complex legal and economic issues, which the Department of Justice was able to answer correctly due to its wider experience from many mergers across all sectors of the US economy.

3.6 The United Kingdom has a range of industry-specific regulatory bodies, including OFTEL regulating telecommunications[9], OFWAT regulating the privatised water and sewerage industry and OFGEM regulating gas and electricity markets. Each of these regulators has powers to control anti-competitive conduct in their industry sectors, which are similar to OFTA's powers under the licenses and sections 7G, 7K, 7L and 7N of the Telecommunications Ordinance. None of them exercises sector specific merger powers.

3.7 When the UK Government enacted its new Competition Act, it was considered inappropriate that the industry specific regulators should be given any formal role in merger clearance, other than the right to be consulted by the Office of Fair Trading and the Competition Commission about mergers in their sector. The UK Government also has recently announced that the only UK example of industry-specific merger rules, mergers

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7 http://www.fcc.gov/Speeches/Powell/Statements/stmkp823.html

8 United States General Accounting Office, "Airline Competition: Fare and Service Changes at St Louis Since the TWA-Ozark Merger" Briefing Report to the Honorable John C. Danforth, Committee on Commerce, Science, and Transportation, US Senate, September 1998

9 OFTA and the broadcasting regulator are to be merged into a single regulator called OFCOM.

and acquisitions involving newspapers, will be integrated into the normal merger control regime administered by the general competition regulator, the Competition Commission[10].

3.8 Accordingly, the overwhelming weight of world experience is that power to regulate mergers should not be given to a sector specific regulator.

4. INAPPROPRIATE GRANT OF POWERS AND DISCRETIONS

4.1 In its Consultation Paper, the TA had proposed an *ex ante* regime, under which carrier licensees would be required to notify the TA and obtain prior approval for certain classes of transactions. Under the Bill, however, the TA purports to adopt an *ex post* regime, whereby the TA would have the power to take action against transactions after they close if the TA is of the opinion that the transaction has or is likely to have the effect of substantially lessening competition in a telecommunications market. As the consequences of regulatory action are large, most concerned parties will seek OFTA approval even where there is only a small risk that a transaction would be determined to be anti-competitive. As the TA's powers and discretions under the Bill are so broad and the operation of the Bill is so uncertain, licensees will feel even more compelled to obtain the TA's prior approval to minimise the risk of unpredictable ex post outcomes.

4.2 Most of the submissions on the original proposal for an *ex ante* process criticised the broad powers conferred on OFTA and the lack of safeguards. The Government's proposal for an *ex post* regime with a voluntary pre-merger clearance process does not address these fundamental concerns.

Introduction of guidelines

4.3 Clause 2 of the Bill requires the TA to issue guidelines on matters which must be taken into account before forming an opinion that a transaction has the effect of substantially lessening competition. The TA must also consult the industry before issuing the guidelines.

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10 Communications Bill, Reform of the Newspaper Merger Regime, 3 July 2002, Memorandum, Department of Trade and Industry.

4.4 We consider that it is difficult for the Legislative Council to properly assess the proposed framework without having comprehensive, clear and objective guidelines. The industry and prospective investors will have to refer to the guidelines to make informed decisions as to whether pre-approval should be sought from the regulator (if based on their own assessment the transaction is likely to have the effect of substantially lessening competition in a telecommunications market) or if the transaction can be completed without seeking pre-approval (if they decide it is unlikely to do so). Without properly developed guidelines, how can the Legislative Council determine whether the framework fits the purpose for which it is intended?

4.5 The Consultation Paper annexed a set of Draft Guidelines setting out the basis on which the TA would consider proposals for mergers and acquisitions in a telecommunications market. These Draft Guidelines set out an analytical framework in very general terms only and did not adequately deal with the complexity of the task involved in the analysis of the effects on competition or a transaction. If the final version of the Guidelines remains unclear, vague and incomplete, the TA will have a wider discretion in its interpretation and construction of the provisions of the Bill. This increases the risks associated with regulatory intervention, including uncertainties and inconsistencies in the application of the law and the cost to business of compliance.

4.6 Additionally the Draft Guidelines appear to be closely based on the *Merger Guidelines of the Australian Competition and Consumer Commission* (June 1999), in that they place considerable emphasis on market share and concentration ratios. This approach has attracted a high level of criticism in recent years by economists as well as legal practitioners. In short, the approach assumes that all transactions that breach the concentration thresholds are anti-competitive because they increase the likelihood of collusion.[11] It shifts the onus to the merger parties to prove that there is no substantial lessening of competition, rather than to the competition authority to establish the contravention. This means that too little weight is given to the pro-competitive effects of a merger.[12] Instead, it has been suggested that "*the criteria for assessing mergers should direct the regulators or the courts to allow those mergers that promote economic*

[11] See Australian Competition and Consumer Commission, *Merger Guidelines* June 1999 at paras 5.156-5.157.

[12] Tim Bednall, "Section 50: whither the law?", *Australian & New Zealand Trade Practices Law Bulletin*, vol 18 no 45-52.

efficiency and to disallow those mergers that promote monopoly power".[13] This is the approach, for example, taken in Canada.

4.7 In the Bill, the determination of whether a transaction has an anti-competitive effect ultimately remains a matter which would be decided based on the subjective opinion and discretion of the TA. Any subjective opinion or discretionary decision by a regulator, particularly in circumstances where the regulator lacks significant expertise and experience in merger clearance processes, carries a high risk that it will be wrong, inconsistent with previous decisions and uncertain in its application.

Power to direct the licensee to take action

4.8 Under section 7P(1) of the Bill, the TA has the power to "direct the licensee to take such action specified in the notice as the Authority considers necessary to eliminate any such anti-competitive effect". The action may include, without limitation, the procuring of modifications to the control exercised over the licensee or the beneficial ownership or voting control of any of the voting shares (section 7P(3)) or the divestiture of assets.

4.9 This power is much broader than the powers which many general competition authorities have in major overseas jurisdictions. In the US, Australia and New Zealand, the relevant statutes impose prohibitions on mergers and acquisitions which have the requisite anti-competitive effect. The statutes then empower the competition or enforcement authority to prosecute companies whom they allege have contravened the relevant prohibition. The authority can apply to the court for remedies when a finding is made that the company has contravened the prohibition, including injunctive relief, penalties, restitution and other orders. However, the decision to impose the appropriate remedy is made by the court, an independent third-party adjudicator.

4.10 The separation of power between the judiciary and the executive is a key protection of the rights of citizens and the rule of law. The exercise of power to enforce administrative decisions is commonly seen as the exercise of judicial power. Coercive powers to require businesses and assets to be divested or mergers to be unwound, with potentially serious impacts on property rights of companies (and citizens who hold shares in those

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13 Philip Williams and Graeme Woodbridge, "Antitrust Merger Policy: Lessons from the Australian Experience", from a conference organised by the National Bureau of Economics Research in the US.

companies), are seen as powers which are only appropriately exercised by an independent judiciary. As such, a decision by an administrative body to issue a direction (for example, to cease and desist from completing a transaction) would seem to be an exercise of judicial power and therefore inconsistent with the constitutional framework of separation of powers.

4.11 Where merger authorities do have powers to issue their own orders stopping mergers, there are usually a range of statutory safeguards to ensure that the competition agency acts in a "semi-judicial" manner, including to conduct formal hearings, allow legal argument and give reasons. For example, in the US, the Federal Trade Commission (**FTC**) has the power under section 5(b) of its own Act and section 11 of the *Clayton Act* to issue orders to cease and desist from violations. However, the FTC's power may only be exercised following a lengthy administrative process - a hearing of which 30 days' notice must be given, a reasoned decision, and a period of at least 60 days thereafter before violation of the FTC's order attracts sanctions. If the FTC's order is not complied with, the FTC must apply to a court for orders imposing penalties or other relief. If a concerned party appeal against FTC's order, the order does not take effect until the appeal has been finalised.[14]

4.12 Similarly, section 74A of the New Zealand *Commerce Act* gives the Commerce Commission power to make a "cease and desist" order when it is necessary to act urgently. However, the Act provides an opportunity for the alleged contravener to have access to information held by the Commission, a hearing at which there is a right to be represented by counsel and to call and cross-examine witnesses. The order must clearly set out the facts and reasons based on which it has been issued.

4.13 The proposed power of the TA to direct a licensee to take action necessary to eliminate the anti-competitive effect of conduct is only subject to minimal checks and balances, which are an insufficient counterweight to the wide-ranging scope of the power. The TA is only required to give a reasonable opportunity to the licensee to make representations and to consider those representations before issuing a direction. There is no other provision for any process whereby the licensee may interrogate the basis for the TA's

[14] The FTC's preferred path has been to seek court injunctions, since it acquired the power to do so in 1973: Federal Trade Commission, *A Brief Overview of the Federal Trade Commission's Investigative and Law Enforcement Authority* at http://www.ftc.gov/ogc.brfovrvw.htm.

decision. Similarly, there is no requirement that the TA provides reasons for its decision. Appeal rights are also limited since they do not automatically have the effect of suspending the operation of TA's direction during the course of the appeal. [15]

Inconsistency with international developments

4.14 The Bill fails to address the growing level of criticism of the overseas merger regimes on which the proposal is based, particularly Australia's *ex post* regime, which has come under strong attack in the Federal Government's current review of the *Trade Practices Act*.[16]

4.15 Australia's merger clearance procedure resembles the proposal set out in the Bill, in that it is an *ex post* regime under which the Australian Competition and Consumer Commission (**ACCC**) has the power to take action against transactions after they close and parties have the option of applying for clearance from the ACCC, either on an informal basis or under a statutory authorisation process. In practice, the vast majority of mergers are cleared on an informal basis under which the ACCC's informal powers are - like the TA's proposed formal powers - relatively unfettered by legislative checks and balances.

4.16 The wider business community has strongly criticised the difficulties that the ACCC's merger clearance procedure has created. In Telstra's submission to the Government's current review, it claims that many aspects of the procedure are not satisfactory, including:[17]

- the lack of transparency, in that the ACCC has a very high level of administrative discretion that it can use to influence transactions and extract concessions;

- the inconsistency, particularly in the application of the ACCC's guidelines, which leads to a high degree of uncertainty for business;

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[15] Telecommunications Ordinance, section 32N.

[16] See the terms of reference of the review at http://tpareview.treasury.gov.au/content/termsofref.asp. The review committee is due to report on its findings in November 2002.

[17] At http://tpareview.treasury.gov.au/submissions.asp. See pp. 93-94 of Telstra's submission.

- incomplete information, in that there is no guarantee that the ACCC's decision will be based on complete information;

- insufficient reasoning, in that there is no requirement for the ACCC to publish the reasons for its decisions;

- excessive power to extract concessions;

- compliance risks, which shift to industry participants where there is a voluntary *ex post* regime; and

- overall uncertainty for parties engaged in a transaction as to whether approval will be granted for a transaction.

4.17 As such, many parties are calling for reforms to increase the levels of accountability by the ACCC in its exercise of its merger review procedures, with the Business Council of Australia stating:[18]

> "*..problems are compounded by an opaque administrative process. If a firm disagrees with an ACCC (pre-merger) decision not to clear a proposed merger, its only option is to go ahead with the merger in the knowledge that the ACCC will almost certainly take court action. There is no other means of having the decision reviewed. This means that, as a practical matter, merger decisions are rarely challenged, even where the proponent has strong advice that the merger would not breach the Act. The end result is inefficient commercial processes and unsatisfactory outcomes for the Australian economy*".[19]

4.18 The ACCC process is an informal process, and many submissions to the Australian review have advocated a statutory process. However, merely setting out a bare process for pre-merger clearance in the legislation, as is the case with the Bill, does not address the lack of transparency and overuse problems identified with the informal Australian process. More fundamental and extensive safeguards are needed in the legislation to ensure the pre-merger process is credible and certain, such as requirements for the

[18] See the submissions by the Business Council of Australia and the Law Council of Australia at ibid.

publication of reasons and constraints on the type of undertakings or conditions which are sought.

4.19 Accordingly, OFTA and ITBB are out of step with international developments by seeking to implement a merger review procedure which is largely modelled on and shares many of the difficulties of the international regimes.

5. DEFECTS IN THE BILL

Mergers of minor importance?

5.1 In countries with merger control rules, sensible thresholds are used to provide comfort and certainty to parties to mergers of minor significance that the merger is below the level of regulation. A well-considered regime should allow parties to a merger of no consequential importance to proceed without any concern with merger regulation. In Canada, to trigger an obligation to notify under the Competition Act both party-size and transaction-size thresholds must be crossed. In France there are both worldwide and French turnover thresholds. In Ireland there are alternative asset and turnover tests. In the United States there are size-of-parties and size-of-transaction tests. In Taiwan there are market share and turnover thresholds.

5.2 The Bill does not appear to have considered these. Under the Bill, any merger, regardless of size, is potentially subject to review. This is the type of regulatory uncertainty which is an impediment to investment and has a stifling effect on competition.

Competition Standard

5.3 A competition standard is the test which is applied in various circumstances to determine whether the relevant controls available to a regulator need to be used. In merger control, the standard is used to check the relationship between a proposed merger proposal and the state of the market to determine whether regulatory action should be taken.

5.4 The Bill says that the competition standard for merger control would be whether it "substantially lessens competition". (This standard is adopted from the Australian merger

[19] Business Council of Australia Submission to the Review of the Trade Practices Act 9 July 2002 p. 71

and acquisition laws). However, there is already another competition standard in the carrier licences and the Telecommunications Ordinance. That test is used to determine whether a carrier should be subject to the highest level of regulatory controls. That standard asks whether the carrier is in a “dominant position” or has “dominance”. A “Dominance” test is generally regarded as requiring a higher concentration of market power than a “substantial lessening of competition” test.

5.5 By suggesting a lower test, the Bill would make it easier for the TA to pass the test to regulate mergers than the Ordinance does for the TA to pass the test to regulate ongoing conduct. It is illogical and inappropriate that the test for regulatory intervention in a merger or acquisition should be easier to pass than the threshold needed to implement the highest levels of conduct regulation. Merger control is usually regarded as a much more serious and intrusive form of regulation than ongoing conduct regulation. A regulator should have to satisfy itself of a high test before intervening. A merger may not raise competition concerns serious enough to justify blocking the merger, but there could be competition concerns to be addressed afterwards through ongoing regulation. That can justify having a lower test for ongoing conduct regulation than for mergers. But the test for mergers should not be lower than for ongoing conduct regulation. We are not aware of any economy which advocates such a distorted approach.

5.6 As a result of the different standards, OFTA would have the power to intervene in a merger or require divestiture even in circumstances where the merged entity would not have enough market power to warrant ongoing price or tariffing regulation by OFTA. Faced with any concern about whether there would be a basis for ongoing regulatory constraints, OFTA would have an incentive to intervene at the merger stage ‘just in case’ it cannot do so later. OFTA would be able to bypass the higher dominance threshold for ongoing regulation by using the power to impose conditions on a merger which did not create a dominant entity. This anomaly would also provide an opportunity, and perhaps an incentive, for OFTA to develop ‘personalised’ regulation going outside the scope of its post-merger powers.

Lack of appropriate time limitations on the exercise of merger clearance powers

5.7 We are also concerned that the TA’s powers are not subject to appropriate limits on the time within which they may be exercised.

5.8 Under section 7P(1), there is no time limit within which the TA must make a decision to oppose a transaction.

5.9 Further, although under sections 7P(5) and (6), a licensee can seek pre-approval for a transaction on a voluntary basis from the TA, the sections do not specify a time by which the TA must consider and complete its review of the application for pre-approval of any merger and acquisition and form an opinion as to whether the pre-approval is to be granted.

5.10 Mergers and acquisitions, particularly in the current adverse economic climate, are usually subject to tight timelines over which the parties have no control, such as threatened insolvency or US Chapter 11 proceedings. A delay by the TA in granting approval may be tantamount to a denial of approval as the transaction may collapse commercially before the TA finalises his decision. The absence of appropriate time limits applicable to the TA's exercise of its powers further increases the uncertainty of the proposed regulatory framework and the disincentive it poses to investment.

5.11 Most overseas merger control regimes specify timeframes

5.12 The consequences of a merger being challenged post closure are great, including the stock market effects (if the merged entity or a parent of one of the parties is listed) and the impact on employees and customers if the merger has to be reversed. To minimise the potential for disruptive effect, there must be a short and fixed timeframe in which the regulator can take action after a merger. There is none in the Bill.

Change of Control

5.13 Under Section 7P(1) of the Bill, the TA's power to review a transaction is triggered by a change in:

(a) the control exercised over a carrier licence;

(b) the beneficial ownership of any of the voting shares in a carrier licensee; or

(c) the voting control of any of the voting shares in a licensee.

5.14 The term "change of control" is defined very widely in section 7P(12) of the Bill to include a change of director or principal officer of the licensee or if a person becomes the beneficial owner or voting controller of 15% or more of the voting shares in the licensee. This definition is not credible.

5.15 We fail to see how a change of director or principal officer alone can constitute a change of control or have any impact on competition in a market. Indeed, in most cases a change of director or principal officer will occur in the ordinary course of managing the business of the licensee, when there is no change of control or ownership.

5.16 There is also no proper basis for providing that a change of beneficial ownership or voting control of 15% of shares amounts to a change of control of a licensee. This is inconsistent with the concept of control under the Hong Kong Codes on Takeovers and Mergers, which provides that a change of control occurs where there is an acquisition of a legal or beneficial interest or an ability to control 30% or more of the voting shares of a company. This is also inconsistent with comparable provisions in the competition laws of other jurisdictions. For example, under Australia's *Trade Practices Act*, a "controlling interest" is defined in essence as a corporation which is a subsidiary of the acquirer, where the acquirer is in a position to control the composition of the subsidiary's board of directors; to cast more than 50% of the maximum number of votes that can be cast at a general meeting of the subsidiary; or to hold more than 50 % of the issued share capital of the subsidiary. In the European Union, there is no specific shareholding test to determine control. Instead, control is based on the ability to exercise decisive influence, a more sophisticated analysis which needs to be determined on a case by case basis.

5.17 The effect of the proposed definition is that the TA has very wide ranging powers to intervene in many transactions involving a licensee or even where there is a change in the management of a licensee. This can give rise to enormous uncertainty. It certainly creates a heavy compliance burden for licensees.

Costs and expenses of TA's procedures

Under section 7P(11), the licensee making an application for pre-approval of a transaction must bear the costs and expenses incurred by the TA in granting the pre-approval. The section, however, does not limit the classes of costs or expenses that may be incurred by the TA in making a decision or make any provision for steps that could be taken where the licensee disputes the amount incurred by the TA. The costs that parties incur in obtaining pre-approval for a complex merger are often very high (such as the costs of external economic and legal experts). It is unreasonable for the Bill to grant unfettered rights to the TA to incur costs and yet look to recoup them from the relevant licensees.