3 September 2002

The Hon Sin Chung-kai
Bills Committee Chairman
Bills Committee

C/-Clerk of the Bills Committee
Legislative Council
Room 509 West Wing
Central Government Offices
Hong Kong

Dear Sir

Telecommunications (Amendment) Bill 2002

As you will be aware Telstra is a significant investor in the Hong Kong telecommunications industry through its investment in its wholly owned subsidiary Hong Kong CSL Limited ("CSL") and its 50% interest in REACH Limited.

CSL has today made a submission to the Bills Committee on the Telecommunications (Amendment) Bill 2002. Telstra supports and agrees with CSL's submissions

Telstra would also appreciate the opportunity to present to the Bills Committee on the Telecommunications (Amendment) Bill 2002.

Yours faithfully

Simon Brookes
General Counsel, International
Telstra Corporation Limited

Hong Kong CSL Limited

Submission to the Legislative Council On the Telecommunications (Amendment) Bill 2002

1 Introduction

1.1 This document outlines Hong Kong CSL Limited's ("**CSL**") submissions on the **Telecommunications (Amendment) Bill 2002** ("**Bill**"). It is structured as follows:

(a) section 2 contains the Executive Summary;

(b) in section 3, we have set out CSL's submission as to why sector specific mergers and acquisition legislation is inappropriate; and

(c) in section 4, we have set out specific comments on the Bill.

2 Executive Summary

2.1 In CSL's view, there is no justification for industry specific regulation of mergers and acquisitions. On the contrary, if there is to be merger and acquisition regulation, it should be universal and applied consistently - it should not be industry specific.

2.2 If the Legislative Council considers it appropriate to introduce industry specific mergers and acquisition legislation then the legislation should ensure the tests to be applied and the procedures to be adopted (including decision making timeframes) are transparent and consistent and that the Telecommunications Authority ("**TA**") is fully accountable. Consistent with this most of the proposed amendments set out below are aimed at ensuring that the Telecommunications Ordinance provides a framework in which the TA is accountable and that the TA exercises its powers in a transparent and consistent manner.

2.3 It is CSL's understanding that Bills Committee has been formed to scrutinize the Bill.

3 Telecommunications Specific M&A Regulation

3.1 CSL considers that the Legislative Council should support a presumption of minimal regulatory intervention. Accordingly, before an industry is subject to any additional regulation, the Legislative Council should insist that there is clear justification for the additional regulation.

3.2 The Hong Kong telecommunications industry is very competitive by world standards. In fact, Hong Kong has one of the highest mobile penetration rates in the world. We therefore fail to see the need to introduce stringent mergers and acquisitions legislation in such a competitive market. Moreover, CSL has

not seen any material demonstrating that there has been any mergers or acquisitions in Hong Kong where the existing regulatory regime has not been able to adequately address any concerns.

3.3 In any event there are very few developed countries that have industry specific merger control but many have general competition laws. For example, 5 of the 6 jurisdictions listed in the presentation made to the Bills Committee on 25 July 2002, ignoring Hong Kong, have general (rather than industry specific) competition law. This indeed is the broader issue that the Legislative Council needs to consider. The OECD and the World Bank in "A Framework for the Design and Implementation of Competition Policy" (1999, World Bank, Washington DC) tend to prefer broader competition laws than sector specific laws. Moreover, Australia's Hilmer Report concluded (at page 85) that there are "*compelling efficiency and equity arguments for ensuring that competitive conduct rules … are applied uniformly and universally throughout the economy*".

3.4 Accordingly and in the absence of any compelling reason for the introduction of industry specific mergers and acquisition regulation, CSL submits that Legislative Council should not impose such legislation on the telecommunications industry.

4 Specific Comments on the Bill

4.1 CSL's specific comments on the Bill are set out below. In making these comments CSL's fundamental proposition is that the tests to be applied and the procedures to be adopted (including decision making timeframes) must be transparent and consistent and ensure that the TA is fully accountable. A significant and valid criticism before the current Dawson Inquiry into Australia's **Trade Practices Act** 1974 is the lack of transparency, consistency and accountability of the Australia Competition and Consumer Commission. Consistent with this, most of the amendments set out below are aimed at ensuring that the Telecommunications Ordinance provides a framework in which the TA is accountable and that the TA exercises its powers in a transparent and consistent manner. For example, we have submitted that the tests should be objective not subjective.

4.2 CSL's specific comments on the Bill are:

(a) the change of control threshold is too low;

(b) the tests in section 7P(1) should be objective;

(c) the guidelines issued by the TA under section 6D should be subject to review by the Legislative Council;

(d) the scope of directions issued by the TA under section 7P(1) should be determined on an objective basis and confined to Hong Kong;

(e) the TA should only be permitted to issue a direction under section 7P(1) if it is in the public benefit to do so;

(f) there should be a time limit specified in clause 7P(1) during which the TA may exercise his power to issue directions after a change of control;

(g) the TA should also be permitted under section 7P(6) to consent to changes in control which are in the public benefit;

(h) the proposed statutory basis for voluntary pre-approval in section 7P(5) and consent given by the TA in section 7P(6) should incorporate clear statutory procedures;

(i) the amendments should not preclude an option for an informal clearance procedure;

(j) there should be a limit on the costs which may be recovered by the TA under section 7P(11) for considering an application under subsection 7P(5);

(k) appeals under section 32L to the Appeal Board should be on their merits and the timeframes for appeal increased;

(l) licence conditions should not deal with the same subject matter as section 7P; and

(m) the test of the effect on competition in section 7K (anti-competitive practices) should be consistent with the test in Section 7P.

4.3 The change of control threshold is too low

In section 7P(1)(a) of the Bill, the TA is empowered to regulate changes in control over carrier licensees, which in the TA's opinion substantially lessen competition.

Section 7P(12) of the Bill sets out the circumstances in which a "change in control" of a carrier licensee is deemed to have occurred. CSL's view is that section 7P(12) is too broad and includes circumstances where a change in control would not be expected to have occurred in practice. For example, section 7P(12) deems a change in control to occur if a person:

(a) becomes a director or principal officer of the licensee (irrespective of the size or the composition of the board);

(b) becomes a beneficial owner or voting controller of more than 15% of the voting shares; or

(c) otherwise acquires the power to "ensure that the affairs of the licensee are conducted in accordance with the wishes of that person".

Moreover, sections 7P(1)(b) and (c) are not limited by section 7P(12). On the contrary, they operate where there is change in the beneficial ownership or voting control over *any* of the voting shares in a carrier licensee. For a listed company, this will probably happen on a daily basis. This is clearly far too wide.

CSL believes that the Securities and Futures Commissions' Code on Takeovers and Mergers provides an appropriate reference point for determining when a change of control occurs. In essence, CSL believes that the threshold should be the acquisition of a legal or beneficial interest or ability to control 30% of the voting rights in a licensee. There should be an appropriate exception for financing arrangement, namely, if the carrier licensee grants a security over its shares there is no deemed change of control.

4.4 The substantial lessening of competition test in section 7P(1) should be objective

Assessment of whether a change in control "substantially lessens competition" requires economic analysis and therefore should be an objective test and not "in the opinion" of the TA. We note objective tests are used elsewhere, for example in Australia.

4.5 The guidelines issued by the TA under section 6D should be subject to review by the Legislative Council

Consistent with the need to ensure that the substantial lessening of competition test is objective, the proposed guidelines under section 6D of the Telecommunications Ordinance should, as part of the public consultation process, be subject to review by the Legislative Council.

4.6 Notice of direction issued by the TA under section 7P(1) should be objective and confined to Hong Kong

The scope of any notice issued by the TA should be to limited to taking such action as is necessary to eliminate anti-competitive effect determined on an objective basis.

Also arguably, if a change in control to a licensee occurs with the effect of substantially lessening competition in a place outside Hong Kong, section 7P may grant the TA authority to issue a notice requiring the licensee to take action to eliminate that anti-competitive effect. The TA's powers should be clearly limited to only issuing notices where there has been a substantial lessening of competition in a telecommunications market in which the TA has licensed the licensee to operate.

4.7 The TA should only be permitted to issue a direction under section 7P(1) if it is in the public benefit to do so

As currently drafted, the amendments give the TA wide powers to issue directions where a change in control results in a substantially lessening of competition. However, a lessening of competition is not necessarily contrary to the public interest. Some examples of the mergers resulting in public benefit are:

Acquisition of a carrier, which offers a unique technology type

Where a carrier which is financially failing is the only carrier which services a particular segment of the market, for example by offering a particular technology type, it is likely to be in the public benefit for another carrier to acquire the failing carrier and continue to offer the service. It may be in the public benefit that such an acquisition proceed notwithstanding its competitive effect. The public will benefit by:

- continuing to have access to the services and to technology upon which they have become reliant;
- possibly receiving improved services as a result of efficiency benefits from the merger;
- the continued employment of the employees of the failing carrier;
- the protection of the position of the creditors of the failing carrier; and
- having retained for them a wider scope of technology choices.

Improving international competitiveness

A carrier which provides services both within Hong Kong and in the region may want to expand internationally and use Hong Kong as a regional base. In order to do so, it might first need to strengthen its Hong Kong operations and then use the expertise of its stronger Hong Kong base to expand internationally. Such a process will benefit Hong Kong by:

- encouraging regional telecommunications companies to base their regional operations in Hong Kong (with the resulting benefits of employment of Hong Kong residents, the provision of commercial office space by Hong Kong companies etc);
- improving services offered to Hong Kong residents (for example, the international expansion may result in better roaming arrangements for mobile subscribers);
- better position Hong Kong as a telecommunications hub;
- deliver revenue to the Hong Kong economy and investors in Hong Kong; and
- enable Hong Kong companies to strengthen their competitiveness against other regional telecommunications companies.

As the Bill is currently drafted, if in the TA's opinion the above scenarios resulted in a substantial lessening of competition, then the TA would be permitted to issue directions notwithstanding the broader public benefit to either the Hong Kong economy or Hong Kong consumers. Accordingly, in order to ensure the TA takes into account the public interest, the TA should only be permitted to issue a direction under the proposed section 7P(1) if not

only is there a substantial lessening of competition but also it is in the public benefit that such a direction is issued.

4.8 There should be a time limit specified in clause 7P(1) during which the TA may exercise his power to issue directions after a change of control.

In order to ensure there is appropriate certainty for industry and financial communities, there should be a limit on a timeframe in which the TA may exercise powers under subsection 7P(1) after a change of control, for example, 60 days.

4.9 The TA should also be permitted under section 7P(6) to consent to changes in control, which are in the public benefit.

As currently drafted, the amendments only empower the TA to consent to a change in control, which (in the TA's opinion) do not substantially lessen competition. However, a lessening of competition is not necessarily contrary to the public interest as noted in 4.7 above. Accordingly, the TA should also be empowered to consent to transactions with a public benefit (even if there is a lessening of competition).

4.10 The proposed statutory basis for voluntary pre-approval in section 7P(5) and consent given by the TA in section 7P(6) should incorporate clear statutory procedures.

The statutory pre-approval formal clearance should be subject to clear statutory procedures setting out strict time frames and criteria for the TA's decision-making process. There should be included a statutory requirement for the TA to publish detailed reasoning for its decision, deleting any confidential information. This will promote transparency and public accountability in the TA's deliberative process.

In most jurisdictions where mandatory or voluntary pre-notification applies, the relevant competition authority generally has a period of time in which to respond to the proposed merger. For example, under the voluntary pre-approval process in New Zealand, the New Zealand Commerce Commission is required to provide a written notice to an applicant either giving or declining to give clearance within 10 working days. After such lapse of time without response, a statutory immunity from prosecution will normally apply. This feature (i.e. 10 days) should be incorporated into the Telecommunications Ordinance.

Further, where clearance has been denied, the applicant should have, in addition to its other options, the right to a merits s review of the TA's decision.

4.11 The amendments should not preclude an option for an informal clearance procedure.

In addition to the formal voluntary pre-approval process we encourage OFTA to make available to applicants an informal clearance procedure that will provide the TA with a degree of flexibility, speed and cost effectiveness.

This will enable a party not wishing to apply for formal approval to nevertheless engage in an informal discussion with the TA. The process governing the informal process should be guided by objective standards.

4.12 There should be a limit on the costs which may be recovered by the TA under section 7P(11) for considering an application under subsection 7P(5)

It is inappropriate for legislation to grant the TA an unfettered right to incur costs and then recover those costs from a licensee. This is particular so in circumstances where carrier licensees are subject to significant licence fees. In order to provide certainty and appropriate controls on the TA, a preferable approach would be for a fixed application fee to be chargeable under section 7P(11).

4.13 Appeals under section 32L to the Appeal Board should be on their merits and the timeframes for appeal increased.

It should be made clear that any appeal to the Appeal Board will be as part of a full merits review (ie a full rehearing de novo) by the Appeals Board (rather than a review of points of law). A right to a merits based review is not only consistent with international practice (see for example section 152DO(3) **Trade Practices Act** 1974 (Commonwealth of Australia) and Article 4 of the Framework Directive of the European Parliament and Council) but also reflective of the fact that potential complex economic evidence may need to be presented and tested.

Also the current proposed requirement that an appeal must be lodged within 14 days is too short and is not reasonable in circumstances where complex arguments may need to be prepared and economic evidence gathered. This timeframe should be increased to 4 weeks.

4.14 Licence Conditions should not deal with the same subject matter as section 7P

Conditions in various licences already issued by the TA contain provisions dealing with changes in control (for example "2G" and "3G" licences). Section 7P should contain an exhaustive statement of the TA's powers in respect of change in control in order to ensure that there is a consistent regulatory approach. Accordingly if the new 7P is enacted then:

(a) any existing licences that contain conditions that deal with the same subject matter as section 7P should be void; and

(b) the TA should not be permitted to indirectly extend that power by including provisions in new licences or varying existing licences.

Accordingly, the Bill needs to be amended to ensure that all licence conditions are consistent with section 7P.

4.15 The test of the effect on competition in section 7K (anti-competitive practices) should be consistent with the test in Section 7P.

The tests under section 7K (anti-competitive practices) and section 7P are not consistent-the proposed section 7P test is "substantially lessening competition" whilst the section 7K test is "substantially restricting

competition". Section 7K should have the same test as the test in section 7P. Inconsistent language is likely to result in ambiguities in its interpretation and confusion among the telecommunications and financial communities. Section 7K should be amended so that it is consistent with section 7P.

5 Conclusion

5.1 In CSL's view there has not sufficient justification for industry specific regulation of mergers and acquisitions-any should be universal and applied consistently-it should not be industry specific. In any event, the contents of the Bill raise a number of significant issues and at the least the amendments described above need to be made to the Bill.