SmarTone Mobile Communications Limited

Submission to the Bills Committee

On

Telecommunications (Amendment) Bill 2002

26 September 2002

1. Executive Summary

1.1 SmarTone Mobile Communications Limited ("**SmarTone**") is in support of the Government's policy of promoting fair and effective competition. However, SmarTone, for the reasons set out in this submission, questions the need of introducing the Telecommunications (Amendment) Bill 2002 (the "**Bill**") to regulate mergers and acquisitions ("**M&A**") activities in the telecommunications industry and has grave concerns about the excessive power given to the Telecommunications Authority (the "**TA**") by the Bill.

1.2 SmarTone considers that the Government has failed to take into consideration the already highly competitive environment of the Hong Kong's telecommunications industry, especially the mobile market. SmarTone questions why the telecommunications industry is singled out given that it is even more competitive than some other sectors of the economy.

1.3 The TA already has extensive statutory power under the competition provisions in the Telecommunications Ordinance (Cap. 106) to prohibit any anti-competitive practice possibly arising from M&A activities.

1.4 The Bill proposes additional M&A regulation to only one sector of the economy whilst M&A issues are common to other sectors. This will disadvantage the telecommunications industry in competing with other sectors for scarce capital, especially in the current bearish economic environment. The piecemeal M&A regulation will distort the function of the capital market, undermine the economics of the telecommunications industry where scale is important and discourage investment in the telecommunications industry. SmarTone considers that, should HK introduce M&A control, it should be carried out by a general competition authority overlooking economy-wide M&A activities.

1.5 SmarTone is of the view that the proposed M&A regulatory regime lacks transparency and would give wide discretionary and excessive power to the TA on M&A matters with minimal check and balance.

1.6 In the absence of the draft guideline which should set out the details of the TA's M&A evaluation criteria, the Bill is in a substantially incomplete and non-transparent form. The power of the TA to issue guideline after the enactment of the Bill, with the minimum requirement of conducting consultation with the affected parties, would give too much power to the TA as an administrative body. SmarTone therefore requests that the guideline should be released as soon as possible and should be subject to the review by the Legislative Council.

1.7 The test that whether a particular M&A transaction has or likely to have the effect of substantially lessening competition is ultimately determined in the TA's opinion. The use of subjective rather than objective test will inevitably create regulatory uncertainties and hinder normal business activities.

1.8 The Bill, if passed, will give the TA the power to issue guideline on the M&A assessment criteria, the power to enforce the law and the power to determine whether an M&A transaction has or is likely to have the effect of substantially lessening competition. SmarTone is of grave concern of this unfettered powers of the TA, which is inconsistent with the rule of separation of powers.

1.9 It is questionable whether the proposed M&A regime is, in practice, an ex ante or ex post regime given the great regulatory uncertainties inherent in the regime and the wide discretionary power of the TA. It is also doubtful whether the upcoming guideline would be specific and objective enough for operators to make their own assessment.

1.10 SmarTone also has comments on some other defects of the Bill, such as the problem of too wide the definition of change of control, the lack of timeframe for the TA's decisions or directions and the lack of transparency in the M&A approval procedure.

2. Introduction

2.1 SmarTone appreciates the opportunity to submit its views on the Bill to the Bills Committee of the Legislative Council (the "**LegCo**"). The Bill, which aims to introduce a sector-specific M&A control to the telecommunications industry, will have substantial impact on the development of the industry and therefore warrants careful consideration by the LegCo.

2.2 The original proposal of the Bill was set out in the consultation paper issued by the Office of the Telecommunications Authority ('**OFTA**") of 17 April 2001 (the "**Consultation Paper**"). Majority of the submissions in response to the Consultation Paper opposed the proposal. The oppositions primarily centred on the sector-specific M&A regulation, the ex ante approval regime, the wide discretionary power of the TA and the generality of the draft guideline.

2.3 Despite such oppositions, the Government nevertheless introduced the Bill to the LegCo for First Reading in May 2002. SmarTone submitted its initial views on the Bill to the LegCo House Committee on 15 May 2002 and urged for the Bill to be reviewed by the Bills Committee.

2.4 SmarTone is pleased to further submit its views to the LegCo Bills Committee in the following sections:

- Section 3 – Is sector-specific M&A regulation necessary?
- Section 4 – A sector-specific M&A control would unfairly discriminate the telecommunications industry
- Section 5 – The Bill would give wide discretionary and excessive power to the TA
- Section 6 – Comments on other defects of the Bill
- Section 7 – Conclusion

3. Is Sector-Specific M&A Regulation Necessary?

3.1 Is government M&A regulation necessary in a highly competitive market?

3.1.1 It is widely recognised that the telecommunications market in Hong Kong, especially the mobile market, is very competitive by world standard. Market rationalization and efficiency gain through M&A in a competitive market are normal commercial activities that should not be unduly restrained. The Government has acknowledged on several occasions that M&A are economically beneficial and perform an important role in the efficient performance of markets and industry rationalization. In such a highly competitive market, it is expected that the level of regulation should be progressively reduced so that market activities are driven by free market force instead of being constrained by government regulation.

3.1.2 SmarTone does not believe that the various structural features of the telecommunications industry as quoted by the Government in the LegCo Brief are sufficient to justify the Government's proposal. For instance, there are regulatory measures in place to ensure low barrier to entry. The Open Network Access policy, which requires 3G network operators to open up 30% network capacity to non-affiliated MVNOs, enables MVNOs to enter the market at a much lower set up cost than the 3G network operators. Similarly, new fixed telecommunications network services ("**FTNS**") operators can have access to the unbundled local loop of the incumbent FTNS operator under the type II interconnection regime, which facilitates the services and network rollout of the new FTNS operators.

3.1.3 SmarTone therefore questions the rationale for introducing additional M&A regulation to the telecommunications industry, bearing in mind that telecommunications industry is even more competitive than some other sectors in the economy.

3.2 The TA already has extensive statutory power to prohibit any anti-competitive conduct possibly arising from M&A activities

3.2.1 Given that the primary concerns of the Government are the anti-competitive effects on the market as a result of M&A, SmarTone submits that the existing competition provisions in the Telecommunications Ordinance (Cap.106) (the "**Ordinance**") should be sufficient to address the Government's concerns.

3.2.2 The Telecommunications (Amendment) Bill 2000 enacted last year introduced various competition provisions in the Ordinance. Section 7K of the Ordinance contains the general prohibition on all telecommunications licensees engaging in anti-competitive conduct, namely ***"conduct which, in the opinion of the Authority, has the purpose or effect of preventing or substantially restricting competition in a telecommunications market."*** On the other hand, if a merged entity is regarded as holding a dominant position in a market, Section 7L of the Ordinance would apply so that the merged entity is subject to additional and more stringent regulatory control to prohibit it from abusing its dominant power. As regards the enforcement of the above provisions, the TA is empowered by Section 36C of the Ordinance to impose substantial financial penalty for any breach of the competition provisions.

3.2.3 SmarTone therefore questions the need of introducing additional M&A regulation to the telecommunications industry, given that the industry is already subject to the above sector-specific competition provisions.

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4. A sector-specific M&A control would unfairly discriminate the telecommunications industry

4.1 It is well recognised that M&A are normal business activities across other sectors of the economy. A sector-specific M&A regulation applied only to the telecommunications

industry will put the industry in a disadvantageous position in attracting local and overseas investors and competing with other sectors of the economy for scarce capital.

4.2 In the current bearish economic situation and the negative sentiment towards investing in the telecommunications industry both locally and worldwide, any additional M&A regulation specific to the Hong Kong's telecommunications industry would have a detrimental effect to the industry. Since investment in telecommunications is predicated on economies of scale and is highly capital intensive, any additional constraints and regulatory uncertainty as a result of the proposed M&A regulation would discourage incentive to invest in the Hong Kong's telecommunications industry. This is contrary to the policy objective of promoting Hong Kong as the pre-eminent communications hub in the region.

4.3 SmarTone therefore considers that, if M&A regulation is introduced in Hong Kong, it should be carried out by a general competition authority instead of the sector-specific regulator. This will ensure that M&A regulation is consistent across different sectors in the economy which minimises the distortion to the capital market. This is also in line with practices in other jurisdictions with merger control whereby merger regulation exists across the board and on a non-sector-specific basis (e.g., European Union, UK, US, Australia and New Zealand).

4.4 Also, in view of the complexities and specialities involved in evaluating M&A activities, it is common in other developed jurisdictions that the M&A regulator is a competition authority specialising in competition analysis and is independent from the sector-specific regulator. For example, in UK, it is the Office of Fair Trading and the Competition Commission, not OFTEL, to regulate M&A issues. In Australia, it is the Australian Competition and Consumer Commission instead of the Australian Communications Authority to review M&A transaction.

5. The Bill, if passed, would give wide discretionary and excessive power to the TA

5.1 The Bill is deficient in its present form without a clear guideline on the M&A assessment criteria

5.1.1 The TA is required to specify clear guideline which sets out the assessment criteria for determining whether a M&A transaction has or is likely to have an anti-competitive effect. However, the guideline is currently not available for review by the Bills Committee. As stated in the Bill, the TA only needs to carry out consultation with the affected parties before the formulation of such guideline.

5.1.2 SmarTone considers that the guideline is an essential and integral part of the proposed legislation. In the absence of a clear and completed guideline, it is impossible for the Bills Committee to assess the full effect of the Bill. To achieve the Government's stated policy objective of providing a transparent and efficient M&A regulatory regime, the guideline must be clear and specific enough to enable operators to make their own assessment of any potential M&A transaction. The determination of whether the proposed M&A regulation is actually an ex-post or ex-ante regime would very much depend on the details of the guideline.

5.1.3 SmarTone would like to bring to the attention of the Bills Committee that the draft guideline accompanied with the Consultation Paper released last year received many comments that it was incomplete and superficial. It was generally considered by many respondents that the draft guideline failed to recognise the complexity of merger analysis and was too general to provide sufficient and clear guidance to the industry. The competitive analysis of M&A is widely recognised by many jurisdictions as a highly complex matter which requires in-depth economics and anti-trust analysis. The draft guideline, if adopted by the Government, will place too much discretionary power to the TA over M&A activities. Regulatory uncertainties will make the regime an ex ante rather

than ex post one in practice, which will cause delays and unnecessary constraints to M&A in the industry.

5.1.4 SmarTone therefore considers that the draft guideline should be released as soon as possible and the Bills Committee should carefully examine and review the document.

5.1.5 SmarTone notes that the TA is empowered by the Bill to change the guideline without getting the approval from LegCo. Hence it is possible that the original proposition upon which the Bill was approved is amended subsequently. This gives too much power to the TA, as an administrative body, in revising the M&A regulatory regime. Such power should be exercised by the LegCo instead of the TA.

5.2 The test in Section 7P (1) should be objective rather than subjective

5.2.1 The decision on whether or not a particular M&A transaction has or is likely to have the effect of substantially lessening competition is ultimately decided in the TA's opinion. Other jurisdictions which have implemented M&A regulation commonly use objective tests in evaluating M&A transaction, which is based on pure economic and competition analysis. The use of subjective test rather than objective test creates the problem of regulatory uncertainties and gives wide discretionary power to the TA. In view of the lack of transparency in the TA's decision making process and the broad power of the TA to overrule any completed M&A transaction, it is unlikely that any licensee would take the risk of not getting the prior consent from the TA. Regulatory uncertainties will effectively make the proposed regulation an ex ante rather than an ex post regime in practice.

5.3 The TA has unfettered power under Section 7P (1) to direct licensees to revoke M&A transaction

5.3.1 Under Section 7P of the Bill, the TA may direct the licensee involved in a M&A transaction to take such action as the TA considers necessary to eliminate any anti-

competitive effect. The scope and extent of the TA's direction is solely based on the TA's subjective views. Since the TA may totally revoke the transaction, this is a very serious consequence to the parties involved. Notwithstanding this, the TA's direction against any completed M&A transaction is immediately enforceable. SmarTone considers that such an extensive power should not be exercised solely based on the TA's opinion and should be subject to more stringent check and balance mechanism.

5.3.2 The practice in Australia may be a good example for Bills Committee's consideration. The Australian Competition and Consumer Commission ("**ACCC**") is responsible for regulating economy-wide M&A transaction in Australia. When ACCC considers that a M&A is likely to substantially lessen competition, it may seek an injunction from the court to stop the proposed M&A from going ahead. ACCC will need to demonstrate to the court why it considers that the proposed M&A will substantially lessen competition. The question of whether the proposed M&A will in fact substantially lessen competition or not is a matter for the court.

5.3.3 Contrary to the international practice, the Bill currently proposes a framework in which the TA has the powers to make the law (i.e., by issuing guideline without the approval of LegCo), to enforce the law and to determine whether a licensee is in breach of the law. SmarTone is of grave concern of this unfettered powers of the TA, which is inconsistent with the rule of law of separation of powers.

5.4 The appeal mechanism is not an effective forum for an aggrieved party to seek remedy resulting from TA's direction.

5.4.1 The Bills allows any carrier licensee aggrieved by a direction of the TA issued under section 7(P) to appeal to the Telecommunications (Competition Provisions) Appeal Board. However, it is envisaged that few decisions will go to the Appeal Board because M&A transaction is normally required to be concluded within a very short period of time.

The lead-time required for the appeal procedure would effectively eliminate any initiative to appeal.

5.4.2 Furthermore, the appeal mechanism will shift the burden of proof to the merging entities to prove that they are aggrieved by the TA's decision. Also, since an appeal is not capable of suspending the operation of the appeal subject matter, the effectiveness of the appeal mechanism is questionable.

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6. SmarTone's specific comments on the Bill

6.1 Definition of Change of Control

6.1.1 In sub-section (12) of the proposed Section 7P of the Bill, it is regarded that there is a change in the control of an operator if a person becomes the beneficial owner or voting controller of more than 15% of the voting shares in the operators. Notwithstanding that there is no justification provided as to why the threshold is set at 15%, we wish to highlight that there were a number of submissions to the 2001 Consultation Paper which considered the threshold of 15% as too low to infer a change in control of the operator. It is very unlikely that an acquisition of 15% shares would represent a change in the control of a company. The threshold is much lower than the normal level of control of 50% under company law and is also lower than the 30% trigger threshold for public offers under the Hong Kong Securities and Futures Commissions' Code on Takeovers and Mergers.

6.1.2 Further, the Bill considers that there is a change in the control of a licensee if a person becomes a director or principal officer of the licensee. This broad statement which basically covers any change in the senior management of a licensee would only add to the uncertainties of the regulation and give the TA wide discretionary power to intervene in the normal business of the licensee.

6.1.3 The Bill gives power to the TA to intervene any M&A transaction of carrier licence regardless of the size of the transaction. SmarTone wishes to point out that it is quite common in overseas jurisdiction with merger control that the triggering point for seeking M&A approval is based on certain specific thresholds with regard to the size or significance of the transactions. For example, the European Commission uses the merged entity's world-wide turnover as the threshold to determine whether approval is required.

6.2 There should be a time limit for the TA to issue direction for any completed M&A transaction

6.2.1 Subsection (1) of Section 7P stipulates that the TA may direct the licensee to take such action as appropriate to eliminate the anti-competitive effect, should he form an opinion that a completed M&A transaction has, or is likely to have, the effect of substantially lessening competition. The action may include the procuring of modifications to the control of and the ownership of shares in the licensees.

6.2.2 There is no time limit specified upon which the TA is required to make the direction. The impact is serious if the TA could revoke any completed M&A transaction any time after the completion of the transaction. This would significantly increase the business risk and regulatory uncertainty inherent in M&A transaction. It is therefore necessary to specify a reasonable time limit such that if the TA does not issue the direction within the time limit, any completed M&A transaction should be deemed to be having no anti-competitive effect and should not be subject to any direction issued under Section 7P afterward. In light of the swift decision making process required in most M&A transactions, our view is that the time limit should be set as two weeks from the completion date of the M&A transaction. We would like to stress that, if in any event the merged entity subsequently engages in any anti-competitive practices or abuse of dominant power, the TA is already empowered under Sections 7K and 7L to effectively deal with any such practices.

6.3 There should be a clear and reasonable timeframe for the TA to approval or disapprove M&A application

6.3.1 Sub-sections (5) and (6) of Section 7P state that a carrier licensee may apply to the TA for consent to a proposed M&A transaction and the TA will form a decision on the application. We have concerns that there is no timeframe within which the TA should reply to the applicant. It is imperative that any proposed M&A transaction should not be subject to any undue delay in the regulatory approval procedure. An approval procedure without a reasonable and specific timeframe would cause great uncertainty to any potential M&A transaction. It is a common practice that a reasonable timeframe is specified in any M&A approval regime. For instance, the European Commission specifies a clear timeframe for M&A approval. The standard lead-time is 1 month. In the event that more time is required, the maximum lead-time is 4 months. Singapore also specified a clear timeframe in its proposed M&A regulatory framework.

6.4 There should be clear procedure on M&A application

6.4.1 Another problem inherent in sub-sections (5) and (6) is that there is no specification about the approval procedure upon which the applicants should follow when they seek to obtain the TA's consent of any M&A transaction. This reinforces our position that the proposed regime, in its current form, lacks transparency and creates regulatory uncertainties.

6.5 The M&A application fee should be nil or at least be a fixed fee

6.5.1 In subsection (11) of Section 7P, it specifies that any costs or expenses incurred by the TA in making its decision or processing an application is recoverable from the licensee concerned. This effectively grants the TA an unfettered right to charge the M&A application parties. This will increase the uncertainties inherent in the regime and the

licensee's financial exposure. Given the strong financial position of OFTA (according to OFTA Trading Fund Report 200-2001, OFTA has accumulated HK$778 million in capital and reserves by the year ended 2001), SmarTone is of the view that there is no need to recover the cost from the licensees. In any event, should the cost be recoverable from the licensees, it is suggested that it should be in a form of fixed amount application fee. A reference can be made to the proposed regime in Singapore whereby an application processing fee of S$10,000 (about HK$43,000) will be levied per M&A application.

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7. Conclusion

7.1 SmarTone questions the need of introducing the proposed sector-specific M&A regulation, especially the telecommunications industry is highly competitive and already subject to extensive competition provisions. Such a sector-specific M&A control would create a non-level playing field between the telecommunications sector and other sectors in the capital market.

7.2 SmarTone has grave concerns about the wide discretionary and excessive power of the TA under the Bill. The regulatory framework as proposed by the Bill lacks transparency since the evaluation framework which should be set out in a guideline is not yet available and the ultimate decision of whether a particular M&A transaction has the effect of substantially lessening competition is in the TA's subjective opinion. The great regulatory uncertainties inherent in the proposed M&A regime would substantially hinder normal business activities in the industry. SmarTone is of the view that there should be sufficient check and balance on the TA's power, and the guideline must be subject to the review by LegCo and be finalised before the enactment of the Bill.