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The Telecommunications (Amendment) Bill 2002
Presentation by Stuart Chiron, Director of Regulatory Affairs, PCCW Limited at LegCo Bills Committee Meeting, 7 October 2002

1. Introduction

PCCW welcomes this opportunity to present its views on the Bill. Overall, we see this Bill as unnecessary and counter-productive. Unnecessary because the current regulatory regime is sufficient to protect users and competition. Counter-productive because the proposal will increase uncertainty in the market, discourage needed investment and ultimately harm users.

I'd like to start by reviewing the policy and market setting.

1. First, the ITBB Brief accompanying the Bill explicitly recognises that mergers and acquisitions (M&A) "are part of normal business activities and are economically beneficial to society."
2. Second, Hong Kong's clear policy preference (frequently repeated by the TA and others in government) is for open markets and light-handed regulation, i.e. regulation only where there is demonstrated need for government intervention.
3. Third, Competition rules already exist in the telecom sector through license conditions and the Telecom Ordinance.
4. Fourth, the telecommunications sector, at which this Bill is aimed, is not unique in its structure from other sectors where no M&A legislation is in force or has even been proposed.
5. Fifth, the telecoms industry has been badly hit by the economic downturn. This sector needs predictability and certainty.

2. <u>There is No Need for an M&A Bill</u>

- No problems in the telecoms sector have occurred to justify the imposition of M&A regulation. The ITBB Brief points to no market failures or M&A abuses. In fact, in his Consultation Paper of 17 April 2001, the TA himself concluded that "it has been the practice of licensees to seek the consent of the TA prior to any significant change of ownership or control, whether or not involving an acquisition or merger". So according to the TA's own words, the Bill is essentially unnecessary.

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

- It is <u>not</u> a sufficient justification to say that certain competition rules already apply in the Hong Kong telecommunications sector and therefore it is appropriate to add M&A oversight powers. Sector regulators in other jurisdictions have power (like the TA) to enforce rules against anti-competitive practices, but have no merger control powers. In fact, the existence of these general competition rules in the Ordinance and carrier licenses negates any overarching need for M&A oversight.

3. **<u>The Bill is Inconsistent with the Stated ITBB Policy Objectives</u>**.

Let me now turn to the policy objectives listed in the ITBB brief and explain why the current regime already meets these objectives and why the proposed Bill does not.

The first listed policy objective is the protection of user interests and the promotion of fair competition.

The current statutory and license regime is absolutely sufficient for the TA to protect user interests and competition in the telecom sector. If a merger or acquisition creates a carrier with market power, that entity's <u>conduct</u> if anti-competitive can today be fully addressed under its license and the Ordinance. If a merger or acquisition did not create a carrier with market power, I assume that the Government would not be interested in having that arrangement delayed or discouraged, although that is certainly not the result under the Bill.

The second ITBB policy objectives relates to transparency. The current regime is very clear in its structure and execution as to what arrangements need TA prior approval. Further, if carriers want additional comfort they may and do today seek guidance from the TA. It is therefore not correct to suggest that the current regime lacks transparency, increases uncertainty or is inefficient.

The third ITBB policy objective concerns predictability and speed. That is, assisting investors to make informed decisions and to speed up the process for regulatory approval. The current regime is well understood and predictable, and satisfies these criteria.

Unlike the current regime, the proposed Bill will actually achieve the opposite of these objectives. It will replace a regime that is transparent, straight-forward and working with an approach featuring vague guidelines, a standard of review that has no clear meaning, no timeframes and increased subjective power in a regulator with little substantive competition law experience. It will not assist the industry to make informed decisions. It certainly will not speed up the regulatory process and has no checks and balances. The Bill will, at the end of the day, not produce user benefits or protect competition.

4. <u>The Bill is Inconsistent with Global Best Practices</u>

The proposed bill is inconsistent with global best practices in several important aspects. First, from a competition law perspective, the HK market is not unique. The logic of this is that all sectors or no sectors should be subject to competition law provisions. Any sector-by-sector approach is simply not justifiable as a good public policy, economics or law. It is not consistent with global best practices.

Second, the proposed Bill empowers the sector specific regulator with M&A oversight. This is as unique as it is frightening. Competition law presents complex economic and legal issues. For this reason in the US, it is the Department of Justice and the Federal Trade Commission and not the Federal Communications Commission that looks at telecom M&A. In the EU, it is DGIV and not DGXIII; in the UK it is the Office of Fair Trading, the Competition Commission and the Secretary of State for Trade and Industry, and not Oftel. Global best practices indicate that specialised competition agencies and the courts, and not the sector specific regulator are the "judges" in these matters.

Third, the proposed Bill fails to follow global best practices in many critical details. For example, a large number of very minor shareholding changes would be captured by the Bill's extremely broad language. No timelines for any OFTA action are included, the regulator is given substantial subjective power, and the necessary checks and balances are weak. The standard of review, a substantially lessening of competition, is too broad. Not only could it capture any merger of existing operators in the same market, but the word substantially is not defined.

5. <u>The Bill would give the TA Excessive Power</u>

This point, noted above, needs to be emphasised. Effectively, if the Bill is enacted, the TA would be the <u>sole arbiter</u> as to whether an M&A transaction should proceed. This contrasts with other jurisdictions where expert competition agencies and the courts are the arbiters. In the U.S. the Department of Justice or the Federal Trade Commission, the expert competition law agencies, ultimately have to prosecute their case against the transaction in the courts, and a similar system is adopted in Australia. In the U.K., three authorities are involved in reviewing the transaction before it can be prohibited: the Office of Fair Trading, the Competition Commission and the Secretary of State for Trade and Industry.

6. <u>The TA does not have sufficient resources</u>

In other jurisdictions which choose to regulate M&A, decisions are taken by an agency with considerable competition expertise and resources which are necessary for a proper legal and economic assessment of the anticipated competitive effects of mergers and acquisitions. These agencies cover all markets and act within commercially-realistic timeframes. M&A decisions not taken by individual sectoral regulators with insufficient expertise and resources to timely conduct such assessments. OFTA does not have the expertise to conduct the required detailed and comprehensive legal and economic analysis required and has indicated that it will not be adding specialised staff to do so.

The dangers of a sector-specific approach to M&A in Hong Kong are therefore that either: (a) defective decisions will be made (the TA having too little expertise or erring on the side of caution in prohibiting the transaction in the case of doubt), or (b) the assessment will take so long that the economic and consumer benefits to be gained from the transaction – even if it is ultimately approved - will be diminished or even lost if the parties walk away from the transaction.

7. <u>Amendments are necessary</u>

If, for whatever reason, LegCo does not wish to follow the recommendation of PCCW and other operators that the Bill be rejected, appropriate amendments must be made.

a) <u>Guidelines must proceed the Bill</u>

The Bill provides for Guidelines to be subsequently adopted by the TA. If Guidelines are to be used, it is essential that LegCo and the public are fully consulted on these Guidelines before the Bill is adopted. I understand that some LegCo members made this point to the TA at the last meeting on the Bill. The Bills Committee must be able to make its decision with full knowledge as to how the TA intends to apply the legislation. This consultation should cover all aspects of M&A review, including the standard of review. Absent such a consultation, and the establishment of clear guidelines, the market will face greater unpredictability and uncertainty. This would not be a recipe for investment and growth.

b) <u>The test of "substantially lessening competition" is too vague and gives the TA excessive power in determining which M&As to prohibit.</u>

The Bill employs the test of substantially lessening competition to review M&A proposals. This is an extremely subjective test and, in reality, could be used to capture every M&A transaction.

One might certainly ask what the word substantially means. The word substantially is described in OFTA's 1995 Competition Guidelines to mean "big, considerable or significant."

That sounds reasonable. But here is the problem. In OFTA's tariff review process it may reject a tariff if it finds that the proposal will <u>substantially</u> restrict competition. Substantially lessen, substantially restrict. Sounds about the same and you have read the submission from the Consumer Council that the existing substantially restrict test should replace the unknown substantially lessen test in the Bill. So how has OFTA interpreted and used the substantially restrict competition standard in the tariff review process?

OFTA has recently interpreted the word substantially to block a PCCW discount tariff plan that was above cost but would have been particularly attractive to less than ¼ of 1% of all residential users. Substantially may therefore mean less than 1%. Is that your intent?

In addition to indicating that OFTA is micromanaging the market and preventing PCCW from competing, this example may tell you that this sector regulator does not know what the word "substantially" means and that it may not be the appropriate choice to oversee M&A.

c) <u>No time limits are specified within which the TA must take a decision</u>

This could lead to a prolonged period of uncertainty, during which the parties to the M&A deal would not know if the TA was going to object to the deal, and if so what remedies he would seek to impose. An excessive delay would prevent the benefits of the deal from being realised. As in other countries, maximum time limits must be specified, within which the TA must make a decision, in the case of both proposed, and completed, deals. Timelines must therefore be established for both initiating and completing any investigation. Otherwise, the process will be inconsistent with the ITBB Brief objectives.

d) <u>The Bill would apply to non-M&A transactions and to M&A which have no possible effect on competition</u>

- M&A are characterised by a change of ownership and perhaps control. That is what distinguishes M&A from other commercial transactions. Yet the Bill would cover any change in the beneficial ownership or voting control of any single voting share in a carrier licensee. This is clearly far too wide.

- Similarly, the definition of change of control in the proposed section 7P(12) itself is far too broad. Becoming a director or principal officer, the beneficial owner of 15% or more voting shares, or the voting controller of more than 15% of the voting shares, would not (contrary to the implication of this section) give a person the power "to ensure that the affairs of the licensee are conducted in accordance of the wishes of that person".

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

- The TA should not have power to investigate any change of control: a "safe harbour" needs to be provided to exclude changes of control which have no practical effect on competition, for example because of the small market shares of the parties involved. Other jurisdictions which have merger control, have a threshold based on turnover, assets acquired, or market share.

8. The Need to Strengthen the Appeal Board's Powers (Checks and Balances)

As noted earlier, if the Bill is adopted, the TA would be the only sectoral regulator in any major jurisdiction of which we are aware with power to oversee M&A. In these circumstances it is crucial that the Appeal Board has the necessary powers to fully and effectively review the TA's decisions. One necessary power is the power to suspend the TA's decision until the Appeal Board makes a final ruling on the merits of the TA's decision. A TA decision requiring the unwinding of a merger will in effect require the re-creation of the previous corporate structures. This will require shareholdings and assets to be transferred, contracts terminated, stock exchange filings, etc. The legal costs in such an exercise can be very substantial and the impact on employees and customers could be significant. In these circumstances, where a prima facie case has been established against the TA's decision, the Appeal Board should have power to hold it in abeyance while it conducts its comprehensive work. PCCW and OFTA have recently been debating whether the Telecoms Ordinance gives the Appeal Board the power to grant a stay – we suggest that the Bill be amended to grant such a power to put the matter beyond doubt. If you trust the Appeal Board to make a substantive decision, you must also trust the Appeal Board to use its discretion to grant interim relief where appropriate.

Finally, on the subject of the Appeal Board's powers, there seems to be no reason for limiting those powers as the Telecoms Ordinance currently does. There seems to be no reason why the Appeal Board's jurisdiction should not be commensurate with the TA's powers, as is the case of equivalent Appeal Boards in the EU. This would promote a necessary system of checks and balances.

9. <u>Conclusion</u>

It is clear to PCCW that this proposed bill is not necessary, will not meet the objectives laid out in the ITBB brief, does not reflect light handed regulation, will discourage rather than encourage pro-competitive market rationalisation and will inhibit industry investments. As such, this proposed bill will discourage job creation, adversely affect the ability of HK to be a telecom hub, and limit the telecom sector's ability to drive an economic recovery.

In addition, the proposed Bill is inconsistent with global best practices, weak and incomplete, and gives too much subjective power to a regulator with limited expertise in complex competition law matters. No guidelines have been finalised but yet will be drafted by this same regulator. In effect, at the end of the day, the regulator will be judge, jury and prosecutor.

Finally, the ability of the Appeal Board to review the actions of the regulator must be a critical aspect of this legislation. The powers of the Board need to be expanded and must include discretionary relief.