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Report of the Bills Committee on Telecommunications (Amendment) Bill 2002

Purpose

This paper reports on the deliberations of the Bills Committee on Telecommunications (Amendment) Bill 2002 (the Bill).

Background

2. At present, acquisition and merger (M&A) activities in the telecommunications market are regulated by the Telecommunications Authority (TA) through licence conditions. However, under the current licensing regime, TA only has the power to regulate M & A cases which involve the transfer of licence, or the transfer of shares of the licensee company. On the other hand, M&As nowadays often do not involve such transfer but may take place at the level of the holding company. In order to prevent over-concentration of market power in a few operators through M&As and undesirable cross-ownership which may adversely affect competition, the Administration has considered it necessary to provide a regulatory framework to deal with M&As in the telecommunications sector.

3. The TA issued its preliminary proposals on regulating M&A activities in the telecommunications market for consultation with the public and the industry during the period April to June 2001. Having considered the views received, the Administration has set out its regulatory proposals in the Bill.

The Bill

4. The principal object of the Bill is to provide a clear and comprehensive regulatory framework on M&A activities in the telecommunications market with a view to promoting fair and effective

competition. The Bill seeks to amend the Telecommunications Ordinance (Cap.106) ("TO") to provide for the following :

(a) To confer on TA the power to regulate any change or proposed change in the ownership or control over a carrier licensee which, in TA's opinion, has, or is likely to have, an effect of substantially lessening competition in a telecommunications market;

(b) to introduce a number of procedural safeguards to ensure the fair exercise of the proposed statutory powers by TA; and

(c) to require TA to issue guidelines on the matters that he must take into account before he forms an opinion on the competition effect of an M&A and to carry out consultation before such guidelines are issued.

The Bills Committee

5. Members agreed at the House Committee meeting on 17 May 2002 to form a Bills Committee to study the Bill. Hon SIN Chung-kai was elected Chairman of the Bills Committee and the membership list of the Committee is at **Appendix I**. The Bills Committee has held a total of 12 meetings to examine the Bill. The organizations/individuals which/who have submitted views to the Bills Committee are listed in **Appendix II**.

Deliberations of the Bills Committee

6. Apart from deliberating on the policy aspects and proposed provisions of the Bill, the Bills Committee has also examined the key matters which will be included in the "Guidelines on the Competition Analysis of Mergers and Acquisitions in Telecommunications Markets" (M&A Guidelines) to be issued by TA after enactment of the Bill and which are not subsidiary legislation.

7. The Bills Committee is fully aware that the Bill has raised important regulatory issues which are of great concern to the telecommunications industry and other interested parties. It has conducted three rounds of consultation with deputations, mostly existing telecommunications operators and carrier licensees, to receive their views on the Bill and the M&A Guidelines.

8. The Bills Committee has noted that the Bill has the support in principle of the Consumer Council and some academics for the purpose of safeguarding competition in the telecommunications market. On the other hand,

most of the carrier licensees which have submitted views to the Bills Committee disagree with the introduction of legislation to regulate competition matters in the telecommunications industry. In the course of deliberation, the Administration has taken on board some of the suggestions and concerns raised by members and deputations and proposed a number of amendments to the Bill. Notwithstanding, the Bills Committee notes that many of the carrier licensees maintain their objection to a number of regulatory proposals in the Bill, notably whether TA should act as the regulator for M&As, the scope of the powers conferred on TA, the availability of checks and balances on such powers and the way in which the Administration has proposed to formulate guidelines to implement the statutory provisions.

<u>Introduction of the Bill</u>

9. According to the Administration, the main purpose of introducing the Bill is to promote fair and effective competition in the telecommunications market and to protect consumers' interests, at the same time provide a clear framework for regulating M&As in the telecommunications market to enable investors to make informed business decisions.

10. Some members of the Bills Committee support the objective of the Bill to regulate M&As in the telecommunications market which are anti-competitive. Nevertheless, they urge that a reasonable balance must be struck between regulatory action on the one hand and minimum intervention into normal business activities on the other. Some members, however, are of the view that the Administration should not have introduced the Bill at this point of time because the telecommunications industry is now fragmented and therefore needs consolidation rather than competition. They consider that the Bill will increase the regulatory burden on the local telecommunications industry and is not conducive to its development. There is a view that any legislative proposal to regulate the telecommunications market should be anti-monopoly instead of pro-competition.

11. The Administration has advised that the telecommunications market is developing from monopoly to a fully competitive one. It is necessary to put in place measures to promote competition in the interest of consumers and the healthy development of the industry. The Administration recognizes that M&As are normal activities and very often, are beneficial to the society and has assured members that TA will only intervene where such activities raise regulatory concern. The Administration has submitted to the Bills Committee that instead of imposing a regulatory burden, the Bill, if enacted, will in fact provide a clear regulatory framework which will facilitate the industry in making informed business decisions on M&As.

Sector-specific legislation to deal with M&As

12. The fundamental question of whether the Government should introduce a general competition law, instead of sector-specific legislation, has been raised by some members of the Bills Committee and deputations.

13. Most of the carrier licensees have stressed that sector-specific regulation of M&As is out of line with international practice and will only deter the much needed investment to the telecommunications industry which is operating in a very challenging environment. They maintain the view that if the Government considers it necessary to introduce legislation on competition, such legislation should apply to all sectors of the economy and should not be targeted at the telecommunications industry only. They query the need for the Bill as the telecommunications industry is already subject to extensive regulation and Hong Kong's telecommunications sector is one of the most open and competitive markets in the world. On the other hand, SUNDAY, a mobile service operator, has expressed support for the objective and the proposed amendments of the Bill.

14. Some members of the Bills Committee and the Consumer Council opine that a universal competition law should be enacted. However, given the Government's stance against this option, they are prepared to support the Bill with a view to safeguarding competition in the telecommunications industry. Members are aware that in its recent review on Hong Kong's trade policy, the World Trade Organization has expressed concern about the sector-specific approach currently adopted to deal with competition. While appreciating that this subject is outside the scope of the Bill, those members who are in favour of a general competition law consider that the Administration should re-visit the subject in the light of the latest international developments, such as Singapore's recent announcement of its intention to enact a competition law in two to three years' time.

15. As to why the telecommunications industry is the subject of regulation, the Administration has explained that the telecommunications sector is characterized by structural features which are not generally conducive to competition. These include high concentration levels, high barriers to entry because of high sunk costs and/or spectrum constraints, little potential for competition from outside Hong Kong and high levels of vertical integration. It is therefore necessary to take specific measures to prevent over-concentration of market power in a few operators so as to safeguard fair competition and consumers' interest.

16. Some members and deputations have also queried why the proposed provisions on M&As will only apply to carrier licensees but not other service providers in the telecommunications sector. In response, the Administration has advised that there is currently no market factor such as high barrier to entry, high concentration level and scarcity of spectrum which may

cause concern about possible over-concentration of market power for non-carrier services such as Internet service providers holding Public Non-Exclusive Telecommunications Service licences.

17. Concern has also been raised that the Bill may not be able to deal with the anti-competitive effect arising from M&As outside the telecommunications sector, as well as the possible effect on competition of an increasing overlap between the telecommunications and IT sectors as a result of "convergence". In this regard, the Bills Committee notes that because of the scope of application of TO, the Bill will only be applicable to competition issues in the telecommunications sector. Nevertheless, the Administration has confirmed that any M&A which may substantially lessen competition in a telecommunications market, including an M&A involving vertical integration, will be covered in the Bill.

Ex post regulatory regime

The regulatory approach

18. The Bill proposes an *ex post* regime under which the parties concerned are not obliged to seek TA's prior consent before proceeding with an M&A, as opposed to an *ex ante* regime where the prior consent of the regulator is required. TA will conduct the regulatory review after an M&A is completed. If TA is of the opinion that the change in ownership or control over a carrier licensee has, or is likely to have, the effect of substantially lessening competition in a telecommunications market, the carrier licensee may be directed to take such action as TA considers necessary to eliminate any such anti-competitive effect.

19. The Administration has informed the Bills Committee that the *ex post* regulatory regime has been proposed in response to concerns expressed by the industry during the consultation in April 2001 that a mandatory requirement to obtain TA's prior consent (as in the case of an *ex ante* regime) would place a heavy compliance burden on licensees. Members also note that the regulatory approach adopted in overseas jurisdictions varies. Some countries such as Canada, the European Community, Singapore and the United States adopt an *ex ante* regulatory regime, while others like Australia and the United Kingdom adopt an *ex post* one.

20. The Bill also provides for an alternative option whereby a carrier licensee may seek the prior consent of TA on a voluntary basis before proceeding with an M&A. This will enable the licensee to obtain certainty rather than risk being sanctioned subsequently if the M&A is found to have anti-competitive effect. In exchanging views with the Bills Committee, the Administration's attention has been drawn to the possibility that besides the carrier licensee concerned, the acquirer of the carrier licensee may also wish to apply for prior consent from TA for a proposed M&A, especially in situations

like hostile takeovers. After consideration, the Administration agrees to introduce a Committee Stage Amendment (CSA) to proposed section 7P(5) of the Bill to also allow an acquirer to apply for TA's prior consent.

21. The Bills Committee notes the suggestion of the Law Society of Hong Kong that to avoid uncertainty arising from an *ex post* regime, consideration may be given to requiring large scale transactions above a certain size to be subject to mandatory pre-notification. The Consumer Council has also suggested that TA should be given interim injunctive powers to prevent the continuation of an M&A which is found to have raised regulatory concerns. In response, the Administration has highlighted the need for minimal intervention in consideration that the vast majority of M&A activities pose no threat to competition and are part of normal business activities beneficial to the economy. The Bill will not therefore mandate pre-notification or propose to confer injunctive powers on TA.

22. The Bills Committee has also examined whether a mechanism should be in place to enable TA to be notified of M&As taking place in the telecommunications market. The Administration has pointed out that this approach would be an onerous requirement which will even exceed the statutory disclosure requirement for shareholding changes under the Companies Ordinance (Cap. 32). It will also not be consistent with the light-handed approach which the Administration intends to adopt. The Admnistration has further advised that in practice, it is very unlikely that TA or the public will not be aware of an M&A which may have a significant effect on market competition, since it is likely to be a sizable transaction causing much public attention. Nevertheless, to address members' concern, the Administration has proposed to explain the working arangements in the M&A Guidelines so as to encourage the parties to notify TA of an M&A as soon as it is completed, if the parties have not sought prior consent of TA under proposed section 7P(5) of the Bill. The Guidelines will also encourage parties to discuss any transactions in advance with TA so as to address any regulatory concern at an early stage.

"Back-stop date" and "safe harbour" provisions

23. Most of the carrier licensees which have presented views to the Bills Committee point out that in practice, the *ex post* approach may not necessarily reduce the compliance burden on the industry because TA's powers to review M&A activities are so broad that licensees will feel compelled to seek prior consent to avoid subsequent sanction. Members appreciate the deputations' objection to the absence of a statutory time limit beyond which TA can no longer investigate into a completed M&A. The absence of a "back-stop date" will create uncertainty over completed M&As as they might be liable to being unwound or modified by TA if he subsequently considers that the activity has anti-competitive effect.

24. The Bills Committee notes that it was the Administration's intention to include in the M&A Guidelines a "back-stop date" of three months beyond which TA is not empowered to initiate an investigation into the competition effect of a completed M&A. Most of the deputations however urge that the back-stop date should be specified in law instead of in the Guidelines which have no legislative effect. They also disagree with the proposed period of three months as they see no reason why TA should take so long to decide whether investigation is needed as the Bill will only apply to one sector of the economy. They urge for a shorter back-stop date which will increase commercial certainty in the M&A process.

25. Members acknowledge the industry's concern and agree in principle that the industry should be given greater certainty in a speedy manner. Having critically examined the concerns expressed, the Administration has agreed to shorten the back-stop date from three months to one month and to specify the back-stop date in the Bill as well as in the Guidelines. It will introduce the necessary CSA to add a section 7P(1A) to the Bill. In this regard, the Bills Committee has noted the deputations's suggestion that the period should be reduced to two weeks. The Administration however considers the back-stop date of one month reasonable and advises that it is already shorter than those adopted in other *ex post* regimes, such as four months in the United Kingdom and three years in Australia.

26. The Bills Committee also notes that most of the carrier licensees also deplore the absence of any "safe harbour" provisions in the Bill to explicitly exclude M&A transactions which have no practical effect on market competition. They are concerned that as currently drafted, the Bill will empower TA to investigate into any change of control, irrespective of the value of the transaction or the market share of the parties concerned. In this regard, the Administration has confirmed that "safe harbour" provisions will be included in the M&A Guidelines on which the industry will be consulted. The Bills Committee notes that according to the Administration's preliminary proposal, TA will unlikely be concerned about changes in ownership which are purely transitory such as acquisition by banks with a view to re-selling. As regards market share, TA is unlikely to intervene if the market share of the merged entity is below 15%. TA is likely to make a detailed investigation if the combined market share is above 40%. M&As involving a market share between 15% to 40% will be considered by TA on a case by case basis.

<u>Regulatory powers conferred on TA</u>

The role and composition of the regulator

27. TA, as the industry regulator, will be empowered under the Bill to investigate into M&A activities in the telecommunications sector where such activities raise regulatory concerns, and to direct the licensee concerned to take necessary actions to eliminate the anti-competitive effect of the M&A. Before

making a decision on the competition effect of an M&A (whether it is a completed transaction or an application for prior consent to a proposed M&A), TA is required to give a reasonable opportunity to the carrier licensee concerned to make representations, and to set out his decisions with reasons in writing under existing section 6A(3)(b) of TO.

28. Most of the carrier licensees are of the view that the Bill has conferred very wide powers on TA who will assume the functions of the regulator, prosecutor and judge on M&A activities in the telecommunications sector. They consider this arrangement inappropriate and express grave concern about the lack of checks and balances on how TA will enforce the relevant provisions on M&A, as well as cast doubt on whether TA possesses the necessary expertise to deal with competition matters. The Consumer Council, on the other hand, considers it acceptable for TA, underpinned by the Office of the Telecommunications Authority (OFTA), to regulate M&A matters in the absence of a general competition authority in Hong Kong.

29. A major concern shared by the carrier licensees is that decisions on M&A activities in the telecommunications industry should be vested with a board/panel of members, instead of with a single person. Referring to overseas jurisidctions such as Canada, the United States, Australia, the European Union, Singapore and the United Kingdom where, irrespective of whether an *ex post* or *ex ante* regime is in place, M&A decisions are made by a panel, the deputations urge that TA should not be the sole authority to decide on M&A cases. They have raised some alternatives on the role the existing Telecommunications (Competition Provisions) Appeal Board (the Appeal Board) may play. Some consider that TA can be empowered to approve straightforward cases which do not raise regulatory concerns; but for more complicated cases, they should be referred to the Appeal Board. Some deputations prefer a single process whereby all M&A cases are decided by the Appeal Board. The Bills Committee notes that in their latest submission, the carrier licensees have suggested that TA should only be empowered to make investigation and approve M&As. Where TA believes that an M&A has, or is likely to have, an effect of substantially lessening competition in a telecommunications market, he should refer the case to the Appeal Board for further investigation and decision.

30. Some members of the Bills Committee observe that there is a difference between enforcement of competition provisions under TO and the regulation of M&As. The former is about the regulation of licensees' conduct while the latter is about regulating investment and investors' entry into and exit from a market. TA's regulatory action into M&As may amount to a regulation of the structure of the market which far exceeds the jurisdiction of a industry-specific regulator. Members of the Bills Committee appreciate the deputations' concern that a separate panel/board should be appointed to deal with M&A matters in the telecommunications sector while TA continues to enforce other provisions in TO.

31. While agreeing that the regulatory structure and TA's role in the longer run can be further examined, the Administration does not consider it appropriate on this occasion to draw a distinction between the regulation of M&A activities from the other regulatory functions performed by TA under TO, and to appoint a special board to deal with the former. It has nevertheless assured members that TA is supported by OFTA, which is equipped with expertise in all relevant fields including accounting, legal, economics and telecommunications. In particular, a Competition Affairs Branch has been set up in OFTA to provide support to TA in enforcing competition provisions including those relating to M&As.

Transparency in TA's decision-making process

32. The Bills Committee considers that transparency in TA's decision-making process is of paramount importance in ensuring fair enforcement of the M&A provisions. However, members note that the Bill does not impose any requirement on TA to disclose his findings on investigation into M&A cases, whether completed or proposed. Despite the ongoing practice that TA usually publishes his decisions/statements on OFTA's website, members remain concerned about the absence of any statutory obligation on TA. In this respect, the Administration has agreed to introduce CSAs to the Bill to require TA to publish his opinions, decisions and directions issued in such manner as he considers appropriate. Members note that the timeframe for publishing such opinions, decisions and directions will be specified in the M&A Guidelines.

33. Under proposed sections 7P(2) and 7P(7) of the Bill, TA is required to give the carrier licensee concerned a reasonable opportunity to make representations and to consider such representations before forming an opinion on the competition effect of the M&A in question. Some members have pointed out that as an M&A in the telecommunications sector may have profound implications on other carrier licensees and may be of concern to other interested parties and the public, the opportunity to make representations should not be confined to the carrier licensee concerned only. In response to these concerns, the Administration has agreed to introduce the necessary CSAs to expand the scope of persons who may make representations to include all carrier licensees in the telecommunications market, as well as the acquirer of the carrier licensee concerned.

Appeal mechanism

34. A decision made or direction issued by TA under the Bill is subject to appeal to the Appeal Board set up under section 32M(1) of TO. On appeal, the Appeal Board is empowered to uphold, vary or quash TA's decisions or directions. Members note that TA's decisions and directions are also subject to judicial review.

35. Members have highlighted the importance of an effective appeal mechanism as a necessary check and balance on TA's powers. Consequent to expanding the scope of persons who can make representations to TA, the Administration will also introduce CSAs to include the acquirer of the relevant carrier licensee into the scope of persons who may make an appeal to the Appeal Board, and to widen the scope of appeal subject matters to include all TA's decisions, opinions and directions after investigation. Regarding the industry's concern about whether a completed M&A has to be unwound or modified if an appeal against TA's decision has been lodged with the Appeal Board, the Administration has confirmed that TA's published opinions, directions or decisions will be suspended in operation once an apeal has been filed with the Appeal Board. The necessary CSAs will be introduced to this effect.

<u>Factors for consideration in assessing M&As</u>

Change in control over a carrier licensee

36. The changes in ownership and control regulated by proposed section 7P(1) of the Bill include changes in the control exercised over a carrier licensee, as well as changes in the beneficial ownership or voting control of the voting shares in a carrier licensee.

37. Under proposed section 7P(12)(a), there is a change in the control exercised over a carrier licensee if a person becomes a director or principal officer of the licensee. Most of the deputations have queried how a mere change in the director or principal officer should be regarded as a change in control over the carrier licensee. They hold the view that the Bill should only apply to genuine and effective changes in control. The Bills Committee has requested that a definition of "director" and "principal officer" should be provided for the sake of clarity. Having considered the concerns and the possible regulatory burden on the industry, the Administration will remove a change in director or principal officer from the scope of "a change in the control exercised over a carrier licensee" and will move CSAs to proposed section 7P(12) of the Bill accordingly.

38. The Administration considers that in general, holding the beneficial ownership or voting control of less than 15% of the voting shares in a carrier licensee will not confer sufficient influence over the affairs of a carrier licensee as to significantly affect competition in the market. Therefore, pursuant to proposed section 7P(12)(b) and (c) of the Bill, TA will not normally investigate into an M&A which makes a person become the beneficial owner or voting controller of not more than 15% of the voting shares in a carrier licensee. The industry takes the view that the threshold of 15% in the change of voting shares is too low and will catch a lot of competition-neutral mergers such as the introduction of strategic partners or investors which cannot exercise control

over the licensee. They consider the 15% threshold all the more inappropriate since proposed section 7P(12)(d) has already provided an effective control test. They request that the threshold for triggering action by TA should be set at 40% to 50%, broadly in line with the threshold adopted for defining control in a body corporate in connection with the licensing of 3G mobile services. Some carrier licensees have suggested that reference should be made to merger rules such as the Code on Takeovers and Mergers issued by the Securities and Futures Commission.

39. The Administration has submitted to the Bills Committee that setting the threshold at 15% is appropriate, having regard to the need to ensure that anti-competitive M&As are regulated. It has also referred to overseas practice whereby in the United States, Australia and Singapore, the regulator may review any change in shareholding which has anti-competitive effect. On the threshold adopted in the licensing exercise for 3G mobile services, the Administration has clarified that no entity is entitled to hold 15% or more shareholdings in more than one of the four 3G licensees. Notwithstanding this explanation, the Bills Committee notes that the industry maintains its objection to the 15% threshold.

The test of "substantially lessening competition" in a telecommunications market

40. Under proposed section 7P of the Bill, TA will take regulatory action if an M&A, whether completed or proposed, has, or is likely to have, the effect of substantially lessening competition in a telecommunications market.

41. In examining this criterion, query has been raised by deputations and some members of the Bills Committee that the competition test of "substantially lessening competition" is inconsistent with the existing competition test adopted under sections 7K to 7N of TO in dealing with anti-competitive practices and abuse of market position. In response, the Administration advises that the competition test for assessing M&As should be distinguished from that used for assessing anti-competitive behaviour e.g. cartel and abuse of dominant position. The proposed test of "substantially lessening competition" is modelled on comparable legislation in Australia, the United States and the United Kingdom. The Administration considers it appropriate to adopt the competition test commonly used in overseas jurisdictions to facilitate reference to international practices and jurisprudence.

42. The factors which TA must take into account in determining whether a completed or proposed M&A has, or is likely to have, the effect of substantially lessening competition in a telecommunications market are of important concern to deputations and the Bills Committee. The Bills Committee has considered the following factors proposed by the Administration for assessing the competition effect of an M&A :

(a) the height of barriers to entry to the telecommunications market;

(b) the level of market concentration in the telecommunications market;

(c) the degree of countervailing power in the telecommunications market;

(d) the likelihood that the M&A will result in the acquirer or the carrier licensee being able to significantly and substantially increase prices or profit margins;

(e) the dynamic characteristics of the telecommunications market, including growth, innovation and product differentiation;

(f) the likelihood that the M&A will result in the removal from the market of a vigorous and effective competitor;

(g) the extent to which effective competition remains or would remain in the telecommunications market after the M&A;

(h) the nature and extent of vertical integration in the telecommunications market;

(i) the actual and potential level of import competition in the telecommunications market; and

(j) the extent to which substitutes are available in a telecommunications market.

43. It was the Administration's original proposal to include the list of factors and related details in the M&A Guidelines. While the deputations have not expressed any objection to requiring TA to consider these factors when assessing the competition effect of an M&A, they have urged that these factors should be stipulated in the legislation instead.

44. Having considered the deputations' concerns, the Administration has agreed to add a Schedule to the Bill listing the above factors. Nevertheless, it has stressed that the list is not exhaustive and TA will not be prevented from considering any new and relevant factors in future. Regarding concerns about how the factors will be applied and quantified, the Administration has advised that these will be specified in the M&A Guidelines and the industry will be consulted accordingly.

45. A number of deputations have submitted to the Bills Committee that apart from assessing the competition effect of an M&A, TA should also take into account other relevant benefits such as public interest and economy of scale or efficiencies achieved as a result of the M&A. The Consumer Council and an academic nevertheless caution that the benefit of efficiencies must be carefully assessed as it may not necessarily lead to enhanced consumer welfare.

46. In response, the Administration has confirmed that apart from the factors listed in the Bill, other pro-competitive factors such as efficiencies will be carefully studied in TA's competition analysis. The benefits arising from, for example, the rescue of a failing carrier through an acquisition, are pro-competitive factors which TA will take into account in his competition analysis. The Administration does not consider it necessary to add a public interest consideration as the scope of this concept is too wide.

The M&A Guidelines

47. The Bills Committee has examined the key aspects of the M&A Guidelines, including the nature of the Guidelines, the relationship between the M&A Guidelines and the Bill, as well as the key proposals which will be included in the Guidelines.

Nature of the Guidelines

48. The Bills Committee notes that after enactment of the Bill and before processing any M&A cases, TA is required to formulate a set of criteria on the matters he will consider in determining whether a change or proposed change in ownership or control has, or is likely to have, the effect of "substantially lessening competition in a telecommunications market", and to issue guidelines in this respect. These guidelines are not subsidiary legislation. Before issuing the guidelines, TA must conduct such consultation as required under TO.

49. The Bills Committee attaches great importance to the M&A Guidelines as they will set out the factors which TA will take into consideration when assessing the competition effect of an M&A in the telecommunications market. The Bills Committee has conducted a special round of consultation on key proposals contained in the M&A Guidelines.

50. Most of the deputations urge that the M&A Guidelines should be in the form of subsidiary legislation subject to scrutiny by the Legislative Council. As such, there will be legislative oversight on how TA will enforce the M&A provisions in the Bill. In order that the legislature will have a greater monitoring role, the Bills Committee has asked the Administration to consider the feasibility of making the Guidelines subsidiary legislation. In this connection, the Administration has advised that the M&A Guidelines serve to provide practical guidance to the industry on the approach TA will take when

assessing M&As. Because of the technical and detailed nature of the Guidelines and the need to cope with market conditions which may change from time to time, the Administration has considered that it is not appropriate to make the M&A Guidelines subsidiary legislation. According to the Administration, no other overseas jurisdictions have provided similar guidelines in the form of subsidiary legislation. It has also advised that where certain provisions in the M&A Guidelines are unreasonable or flawed, the Appeal Board is entitled not to take such provisions into account when considering an appeal against TA's decisions.

51. The Bills Committee has urged the Administration to make available the draft M&A Guidelines for consideration as the future operation of the Bill will largely depend on the guidelines. In this connection, the Administration has provided an Explanatory Note on the M&A Guidelines with an Annex setting out TA's preliminary views on the key matters that should be addressed in the M&A Guidelines. The information is not the draft guidelines per se providing practical details, but provides the analytical framework and a list of key matters which will be covered in the future M&A Guidelines. Members in general consider that the paper lacks sufficient details and cannot serve as useful reference on how TA will exercise his powers. They also note the deputations' query that the Explanatory Note is too vague and lacks objective quantifiable yardsticks for the industry's guidance.

52. In response, the Administration stresses that the draft Guidelines can only be finalized for consultation after passage of the Bill. Upon enactment of the Bill, TA will be required under proposed section 6D(2A) to carry out consultation before issuing the M&A Guidelines under proposed section 6D(2)(aa). The Administration has assured members that the consultation will be a transparent process whereby the industry and the public may give their views.

Commencement procedure

53. Given the critical importance of the M&A Guidelines for the guidance of the industry, members of the Bills Committee are keen to ensure that the M &A Guidelines must be in place before the substantive provisions in the Bill regulating M&As commence operation. Otherwise, the industry will be placed in a disadvantaged position as they will have no knowledge of how any completed or proposed M&As will be assessed by TA.

54. To allay concerns about the M&A Guidelines, the Administration has agreed to introduce CSAs to amend clause 1 of the Bill to commence, upon gazettal of the Bill, only those sections empowering TA to conduct consultation on and issue guidelines. The other sections relating to the regulation of M&As (i.e. clauses 3,4,5,6 and 7 of the Bill) will only come into operation on a day to be appointed by the Secretary for Commerce, Industry and Technology when or after the M&A Guidelines have been issued. The Administration has

also undertaken to notify the Panel on Information Technology and Broadcasting of the consultation and to brief the Panel on the draft Guidelines after consultation and before they are issued.

55. The Bills Committee notes that the relevant Commencement Notice is subsidiary legislation subject to negative vetting by the Legislative Council. As such, the Bills Committee has agreed that if necessary, Members may form a subcommittee to pursue with the Administration and deputations issues relating to the M&A Guidelines with a view to ensuring that relevant concerns are duly considered before the substantive provisions in the Bill relating to the regulation of M&As are allowed to come into operation. In this regard, the Bills Committee notes that it is the Administration's intention to bring these substantive provisions into operation before the end of this year.

Public views on M&As

56. Noting that the M&A Guidelines will set out the procedures for TA to gauge public views on the competition effect of M&As, some members have suggested that public hearings should be conducted for this purpose. The Administration however considers that this option may not be appropriate because some information on M&A matters is confidential and not suitable for public disclosure. The Administration has also informed members that apart from the Federal Communications Commission in the United States, it is not aware of any overseas regulators holding public hearings for such purposes.

Informal advice by TA on M&As

57. For proposed M&As for which the parties concerned would like to seek TA's prior consent on a voluntary basis, the Bill has provided a formal channel for seeking such consent. The Bills Committee has noted the industry's view that it will be useful if an arrangement is in place for TA to provide its advice and comments on a proposed M&A on an informal basis. Having considered the need for informal advice and overseas practice, the Administration has agreed to specify in TA's draft Guidelines procedures for an informal channel for parties concerned to seek TA's prior advice on a confidential and non-committal basis. The Bills Committee notes that any advice given under the informal channel will not be binding on TA, nor prejudice TA's duties and powers under the Bill.

Timelines for TA's regulatory action

58. On the various timeframes to be specified in the M&A Guidelines for TA's investigation, the Bills Committee has taken on board the industry's concern about the need for early decisions. After deliberation, the Administration has agreed to shorten the time limit for TA to conduct investigation into a completed M&A from four months to three months. For cases in which TA's prior consent is sought, the time limit for TA to conduct a

detailed analysis will be reduced from four months to three months. Although the shortened timelines still fall short of what the industry requests, the Administration has assured members that the proposed timelines represent the maximum duration. Depending on the nature and complexity of the case, the actual time taken may be shorter. It has also informed members that the proposed timeframes are broadly comparable to those adopted in overseas jurisdictions.

59. Referring to proposed section 7P(11A), members are concerned about the need to specify a timeframe within which TA has to publish his opinions, directions and decisions made in respect of completed M&A cases or applications for prior consent. In response, the Administration has advised that in practice, there may be a short time gap of a few days between the date when TA forms/issues/makes an opinion/direction/decision and the date of their publication if it is necessary to consult the parties concerned about whether certain commercially sensitive data should be published. The Administration will set out in the M&A Guidelines the arrangements for the publication of TA's opinions, directions and decisions.

Definition of "market"

60. As TA will assess the competition effect of an M&A in "a telecommunications market", members consider it important to provide a clear definition of the relevant market against which TA's assessment will be made. The Bills Committee has also noted some deputations' view that the definition should take into account convergence between broadband service provided by fixed line, wireless and cable service operators. The Administration has said that it will take into consideration comments received when finalizing the draft Guidelines for consultation and has confirmed that convergence will be taken into consideration in the market definition analysis.

Recovery of costs incurred by TA

61. Under the Bill, TA is entitled to recover from the carrier licensee concerned the costs or expenses incurred in processing an application for prior consent to a proposed M&A. The Bills Committee notes the industry's grave reservation about the appropriateness for TA to charge fees and their strong request that a fixed fee or a cap should be imposed. Members have also enquired about the financial implications on OFTA arising from enforcement of the Bill, if enacted.

62. The Administration has explained that OFTA operates as a Trading Fund and is required to be funded by the income derived from the services it provides. It has estimated that, based on its experience in the levy of charges for interconnection cases, the level of charges for a minor M&A case and a major case would be around HK$55,000 and HK$110,000 respectively, which are comparable to those levied by overseas competition

authorities in processing M&A requests. The Administration has advised that the fees for processing applications for prior consent will be set in a transparent manner based on a cost-recovery principle. However, since the actual level of fees charged will depend on the actual costs and expenses incurred for the case in question, it will not be appropriate to set a cap on the fees to be levied. The Bills Committee also notes that for the time being, OFTA will make use of the existing resources in its Competition Affairs Branch to take up the work arising from enactment of the Bill.

Committee Stage Amendments

63. The full set of CSAs to be moved by the Administration is at **Appendix III**. Most of the CSAs have been proposed in response to concerns raised by members and deputations. The Bills Committee will not move any CSA in its name.

Recommendation

64. Members of the Bills Committee have no objection to the Administration's proposal to resume the Second Reading debate on the Bill on 18 June 2003.

Advice sought

65. Members are invited to note the recommendation of the Bills Committee in paragraph 64 above.

Council Business Division 1
Legislative Council Secretariat
5 June 2003

Appendix I

Bills Committee on
Telecommunications (Amendment) Bill 2002

Membership list

Chairman	Hon SIN Chung-kai
Members	Dr Hon David CHU Yu-lin, JP
	Hon Eric LI Ka-cheung, JP
	Hon Fred LI Wah-ming, JP
	Hon CHAN Kwok-keung
	Hon Howard YOUNG, JP
	Hon YEUNG Yiu-chung, BBS
	Hon Emily LAU Wai-hing, JP
	Hon Abraham SHEK Lai-him, JP
	Hon Albert CHAN Wai-yip
	Hon MA Fung-kwok, JP
	(Total : 11 Members)
Clerk	Miss Polly YEUNG
Legal Adviser	Miss Connie FUNG
Date	12 July 2002

Appendix II

Organizations/individuals which/who have submitted views to the Bills Committee on Telecommunications (Amendment) Bill 2002

Telecommunications operators

1. Hong Kong CSL Limited
2. Hutchison Global Communications Limited
3. Hutchison Telephone Company Limited
4. Hutchison 3G HK Limited
5. New World Telecommunications Limited
6. PCCW Limited
7. Smartone Mobile Communications Limited
8. SUNDAY
9. Telstra Corporation Limited

Others

10. Consumer Council
11. Hong Kong Telecommunications Users Group
12. The Law Society of Hong Kong
13. Professor John URE of the University of Hong Kong
14. Professor XU Yan of the Hong Kong University of Science and Technology
15. Mr YEUNG Wai-sing, Eastern District Council Member

Appendix III

TELECOMMUNICATIONS (AMENDMENT) BILL 2002

COMMITTEE STAGE

Amendments to be moved by the Secretary for Commerce, Industry and Technology

Clause	Amendment Proposed
1	By deleting subclause (2) and substituting – "(2) Subject to subsection (3), this Ordinance shall come into operation on the day on which it is published in the Gazette. (3) Sections 3, 4, 5, 6 and 7 shall come into operation on a day to be appointed by the Secretary for Commerce, Industry and Technology by notice published in the Gazette.".
New	By adding – "**1A. Interpretation** Section 2(1) of the Telecommunications Ordinance (Cap. 106) is amended, in the definition of "carrier licence", by repealing "the Schedule" and substituting "Schedule 1".".
2	By deleting everything before paragraph (b) and substituting – "**2. Guidelines**

Section 6D is amended –

(a) in subsection (2) –

(i) in paragraph (a), by repealing everything after "方式" and substituting "(包括發牌準則以及他擬考慮的其他有關事宜)的指引；";

(ii) by adding –

"(aa) subject to subsection (2A), specifying the matters, including but not limited to those listed in Schedule 2, that he shall take into account before forming any opinion under section 7P(1) or (6)(a) or (b);";

(iii) in paragraph (b) –

(A) by adding "關於" before "第14(6)(a)條";

(B) by repealing

everything after "問題" and substituting "的指引，但該指引的發出須受第(3)款的規限。";

(iv) by repealing "就以下事項發出指引" and substituting "發出";".

New By adding –

"**2A. Issue of licences**

Section 7(4) is amended by repealing "the Schedule" and substituting "Schedule 1".".

3 In the proposed section 7P –

(a) by deleting subsection (1) and substituting –

"(1) Where, after the commencement of this section, there is a change in –

(a) the control exercised over a carrier licensee;

(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 carrier licensee,

the Authority may -

(d) subject to subsection (1A), conduct such investigation as the Authority considers necessary to enable him to form an opinion as to whether or not the change has, or is likely to have, the effect of substantially lessening competition in a telecommunications market; and

(e) (where the Authority, after conducting such investigation, forms an opinion that the change has, or is likely to have, the effect of substantially lessening competition in a telecommunications market) by notice in writing served on the licensee, direct the licensee to take such action specified in the notice as the Authority considers necessary to eliminate or avoid any such anti-competitive effect.

(1A) An investigation under subsection (1)(d) may only be commenced within 1 month after the change occurs or within 1 month after the Authority knows, or ought reasonably to have known of, the change, as the case may be.";

(b) by deleting subsection (2) and substituting –

"(2) The Authority shall, before forming any opinion or issuing any direction under subsection (1) –

(a) give all carrier licensees and any interested person a reasonable opportunity to make representations to the Authority; and

(b) consider the representations, if any, made under paragraph (a).";

(c) in subsection (3), by deleting "(1)" and substituting "(1)(e)";

(d) in subsection (4), by deleting "(1)" and substituting "(1)(e)";

(e) in subsection (5), by adding "or any interested person" after "the licensee";

(f) in subsection (6) –

(i) in paragraph (a) –

(A) by deleting "is of the opinion" and substituting "forms an opinion";

(B) by adding "作出的" after "建議";

(ii) in paragraph (b) –

(A) by deleting "is of the opinion" and substituting "forms an opinion";

(B) by deleting subparagraph (ii) and substituting –

"(ii) give consent subject to the direction that the carrier licensee concerned takes the action that the Authority considers necessary to eliminate or avoid any such anti-competitive effect.";

(C) by adding "作出的" after "建議";

(g) by deleting subsection (7) and substituting –

"(7) The Authority shall, before forming any opinion, making any decision or issuing any direction under subsection (6) –

(a) give all carrier licensees and any interested person a reasonable opportunity to make representations to the Authority; and

(b) consider the representations, if any, made under paragraph (a).";

(h) by deleting subsection (8) and substituting –

"(8) The Authority shall, by notice in writing served on the carrier licensee referred to in subsection (5) and (where an interested person makes an application under that subsection) the interested person, inform the licensee and (if applicable) the person of –

(a) the decision made under subsection (6)(a) or (b)(i) or (ii);

(b) where a decision is made under subsection (6)(b)(ii), the action that the Authority directs the licensee to take.";

(i) in subsection (10), by deleting "in respect of the change under subsection (1)" and substituting "under subsection (1)(e) in respect of the change";

(j) in subsection (11), by deleting "the carrier licensee concerned" and substituting "the carrier licensee, or the interested person, who makes the application under subsection (5)";

(k) by adding –

"(11A) The Authority shall publish –

(a) where he forms any opinion or issues any direction under subsection (1), the opinion or direction; or

(b) where he forms any opinion, makes any decision or issues any direction under subsection (6), the opinion, decision or direction,

in such manner as he considers appropriate.";

(l) by deleting subsection (12)(a);

(m) in subsection (13), by adding –

""interested person" (有利害關係的人)means –

(a) in relation to a change referred to in subsection (1), a person who –

(i) does any of the acts referred to in subsection (12)(b), (c) or (d) in relation to the carrier licensee concerned;

(ii) becomes the beneficial owner of the voting shares concerned; or

(iii) becomes the voting controller of the voting shares concerned;

(b) in relation to a proposed change referred to in subsection (5), a person who proposes to –

(i) do any of the acts referred to in subsection (12)(b), (c) or (d) in relation to the carrier licensee concerned;

(ii) become the beneficial owner of the voting shares concerned; or

(iii) become the voting controller of the voting shares concerned;".

5 (a) In paragraph (a), by deleting "or (1A)" and substituting ", (1A), (1B) or (1C)".

(b) In paragraph (b), in the proposed definition of "appeal subject matter", by deleting paragraph (b) and substituting –

"(b) in relation to an appeal under section 32N(1A), (1B) or (1C), means an opinion, direction or decision of the Authority published under section 7P(11A);".

6 By deleting the clause and substituting –

"**6. Appeals to Appeal Board**

Section 32N is amended –

(a) by adding –

"(1A) Any carrier licensee aggrieved by an opinion, direction or decision of the Authority published under section 7P(11A) may appeal to the Appeal Board against the opinion, direction or decision (and whether or not the opinion, direction or decision was formed, issued or made in respect of the licensee).

(1B) Any person who –

(a) is, in relation to

a change referred to in section 7P(1), an interested person within the meaning of paragraph (a) of the definition of "interested person" in section 7P(13); and

(b) is aggrieved by an opinion or direction of the Authority published under section 7P(11A)(a) in respect of the change,

may appeal to the Appeal Board against the opinion or direction.

(1C) Any person who –

(a) is, in relation to a proposed change referred to in section 7P(5), an interested person within the meaning of paragraph (b) of the definition of "interested person" in section 7P(13); and

(b) is aggrieved by an opinion, decision or direction of the Authority published under section 7P(11A)(b) in respect of the proposed change,

may appeal to the Appeal Board against the opinion, decision or direction.";

(b) in subsection (3), by adding "subsection (1A), (1B) or (1C) or" before "section 36C".".

7 By deleting everything after "substituting" and substituting "", or before the opinion, direction or decision referred to in section 32N(1A), (1B) or (1C) was formed, issued or

made, as the case may be.".".

New By adding –

"**8. Licences which are not carrier licences within the meaning of section 2**

The Schedule is renumbered as Schedule 1.

9. Schedule 2 added

The following is added –

"SCHEDULE 2 [s. 6D(2)]

MATTERS TO BE TAKEN INTO ACCOUNT BY AUTHORITY

1. The height of barriers to entry to a telecommunications market.

2. The level of market concentration in a telecommunications market.

3. The degree of countervailing power in a telecommunications market.

4. The likelihood that the change would result in the carrier licensee or interested person being able to significantly and substantially increase prices or profit margins.

5. The dynamic characteristics of a

telecommunications market, including growth, innovation and product differentiation.

6. The likelihood that the change would result in the removal from a telecommunications market of a vigorous and effective competitor.

7. The extent to which effective competition remains or would remain in a telecommunications market after the change.

8. The nature and extent of vertical integration in a telecommunications market.

9. The actual and potential level of import competition in a telecommunications market.

10. The extent to which substitutes are available in a telecommunications market.".".