Opinion of 29 April 2004

TELECOMMUNICATIONS AUTHORITY GUIDELINES

MERGERS AND ACQUISITIONS IN HONG KONG TELECOMMUNICATIONS MARKETS

1. Introduction

I have been asked by OFTA to provide an independent opinion on the *Mergers and Acquisitions Guidelines* (hereafter 'the Guidelines') that will be issued under section 6D of the Telecommunications Ordinance of 2000 (as amended) for the purpose of providing guidance on the application in practice of the new section 7P, which will shortly enter into force in the Hong Kong Special Administrative Region. I have been asked in particular to comment on three questions: first, whether the Guidelines are appropriate to enable the Government to achieve the policy objective behind section 7P of the Ordinance, as explained in paragraph 1.6 of the Guidelines, that is to say '*forestalling a market structure not conducive to competition*'; secondly, whether the Guidelines provide a framework within which it will be possible to administer the new system introduced by section 7P; and finally whether the Guidelines accord with international best practice, in particular in relation to (a) the safe harbour rules; (b) efficiencies/the failing firm defence; and (c) countervailing benefits. I shall deal with each of these questions below, following a few general introductory comments.

2. General comments

(a) *The adoption and review of guidelines*

It is a noticeable feature of systems of merger control in recent years that competition authorities have published guidelines that supplement the basic framework of rules established in the primary legislation. Obvious recent examples of this are to be found in EU law, where the European Commission has published a number of Notices and Guidelines, in particular the recent *Guidelines on the Assessment of Horizontal Mergers* (OJ [2004] C 31/5); and in UK law, where both the Office of Fair Trading (*Mergers: Procedural Guidance* and *Mergers: Substantive Assessment Guidance*) and the Competition Commission (*Merger References: Competition Commission*

Guidelines) have published guidance on aspects of the new merger control regime introduced by the Enterprise Act 2002. Such guidelines may deal both with matters of procedure: for example how cases will be handled, whether confidential advice will be available and whether pre-notification is mandatory; and with substance: for example the grounds on which a merger might be prohibited or have to be modified, and how any efficiency considerations will be factored into the analysis. Such guidelines must strike the correct balance between providing practical advice to the business, investment and legal communities as to what might be expected of a system of merger control on the one hand and avoiding too much hypothesis and speculation, which can lead to a loss of clarity, on the other hand. It is impossible to address every possible issue of 'what might happen' in advance; it is inevitable that there will be something of a learning process for all stakeholders as a new system of merger control is introduced, and it is important therefore to review from time to time any guidelines that have been written in the light of relevant experience of the legislation in practice. The commitment of the TA, in paragraph 1.3 of the Guidelines, to review them from time to time is to be welcomed in this respect.

(b) *Merger review principles*

Most mergers do not give rise to competition concerns, and a system of merger control involves an interference in the operation of the market for corporate control. In my opinion, interventions to prohibit or require the modification of mergers ought, as a general proposition, only to be possible where there is a real possibility of a substantial lessening of competition in the market. I consider that it is helpful that the Guidelines explicitly recognise that most merger and acquisition activity does not raise competition concerns (paragraph 1.5), and that intervention will occur only where there is a potential adverse effect on competition (paragraph 1.6). It is important that the business and investment communities should understand that control will be taken over mergers only where there is the prospect of serious harm to the competitive process which, as already noted, was the original concern of the Hong Kong Government (see paragraph 1 above).

3. <u>Are the Guidelines appropriate to enable the Government to achieve its policy objective?</u>

The Guidelines appear to me to be consistent with the Government's stated policy: to prevent the emergence of market structures not conducive to competition. The Guidelines reflect the approach to merger control taken in many other jurisdictions, explaining, for example, how markets are to be defined, the problems of 'non-coordinated (unilateral) effects' and 'coordinated effects' that might result from mergers, and the significance of barriers to entry and of buyer power. As already stated, I doubt that it would be fruitful to speculate too much on all the factual situations that future mergers might produce: rather I consider that the Guidelines should concentrate on the main principles that OFTA will apply to merger investigations. In this respect the Guidelines are consistent with those to be found in other jurisdictions.

4. Do the Guidelines provide a framework within which it will be possible to administer the new system introduced by section 7P?

I believe that the Guidelines do provide an appropriate framework for the investigation of mergers. Section 6 is clearly of importance in relation to the procedural aspects of the new law, and provides useful guidance on matters such as confidential guidance, the pre-notification of mergers and '*ex post*' investigations. It may be the case that further procedural issues will come to light after the system enters into effect, and I would suggest that this experience should be incorporated into revised guidance on a regular basis.

5. Do the Guidelines accord with international best practice in relation to (a) the safe harbour rules (b) the efficiency/failing firm defences and (c) countervailing benefits?

(a) *The safe harbour rules*

Paragraphs 2.6-2.13 propose two 'safe harbours', on the basis of the CR4 Ratio test (paragraphs 2.8 and 2.9) and the Herfindhal-Hirschman Index (the 'HHI') (paragraphs 2.10 and 2.13). I am asked whether the Guidelines accord with international best practice. I will consider how these safe harbours compare with the position in US, EU, UK and Australian law.

- **The CR4 test**

The CR4 standards proposed in paragraphs 2.8 and 2.9 of the Guidelines accord with paragraphs 5.87-5.103 of the Australian Competition and Consumer Commission's *Merger Guidelines*. The CR4 standard suggested in the Guidelines is not used to provide a safe harbour in the US, EU or UK.

- **The HHI test**

The HHI standards proposed in paragraphs 2.10-2.13 of the Guidelines accord with paragraph 1.51 of the US *Horizontal Merger Guidelines*, with paragraph 4.3 of the UK Office of Fair Trading's *Mergers: Substantive Assessment Guidance* and with paragraph 3.10 of the UK Competition Commission's *Merger References: Competition Commission Guidelines*. The Australian Competition and Consumer Commission's *Merger Guidelines* do not make use of the HHI. Paragraph 20 of the European Commission's *Guidelines on Horizontal Mergers* has higher thresholds for 'moderately concentrated' and 'concentrated' markets, but does *not* provide a safe harbour at those levels in a number of specified circumstances – for example where a merger involves a potential entrant or a recent entrant with a small market share, or where one or more merging parties are important innovators in ways not reflected in market shares. In so far as the OFTA Guidelines are intended to provide a simple screening device to provide certain mergers with a safe harbour, it seems to me that the US, UK and Australian approach is likely to be more easily applicable than the more complicated approach of the European Commission.

(b) *Efficiencies and the failing firm defence*

The Guidelines set out OFTA's position in relation to 'efficiencies' and 'failing firms' at paragraphs 4.75-4.85 and 4.86-4.89 respectively. I see no significant difference between the treatment of these issues in the Guidelines and the position in the other jurisdictions referred to above.

(c) *Countervailing benefits*

Section 7P(1)(b) of the Ordinance provides that the TA may not issue a direction in relation to a merger if satisfied that a change 'has, or is likely to have, a benefit to the public and that the benefit outweighs any detriment to the public …'. Section 5 of the Guidelines provides some guidance as to how the TA will apply this provision in practice. I cannot comment on this provision by reference to international best practice, since this 'public benefit' test seems to me to be specific to Hong Kong law. UK law allows for 'relevant customer benefits' to be taken into account in merger appraisal, and also provides for intervention by the Secretary of State in the case of 'certain pubic interest cases', but these are very specific provisions of UK law. US and EU law do not contain provisions of this kind at all, although EC law recognises that a Member State might wish to intervene against a merger in pursuit of its 'legitimate interests', which may include the plurality of the media, public security and prudential supervision. South African law provides for the consideration of certain 'substantial public interest grounds', of which the relevant statute gives examples. However I consider that provisions such as this are nation-specific, and that therefore it is not really possible to distil any general principles of 'international best practice'. My own view, however, is that, wherever possible, merger control should be applied purely with competition policy and the maintenance of competitive market structures in mind, and that a real danger exists of undermining the effectiveness of the law if other considerations are allowed to influence decision-making. In that sense I consider that the interpretation given to the 'public benefit' test in section 5 of the Guidelines to be a sensible approach.

6. Conclusion

I appreciate that merger control is a new phenomenon in Hong Kong, and that there is therefore anxiety as to how the new provisions will be applied in practice. In my view the principles and procedures set out in the OFTA Guidelines provide a sound basis for the application of the new legislation, and are consistent with the merger control policy of other jurisdictions, including the US, EU, UK and Australia.

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