For information on 4 August 2006

Joint Meeting of the Legislative Council Panel on Information Technology and Broadcasting and Panel on Financial Affairs

Issues Relating to Change in Shareholding of PCCW Limited

Purpose

This paper briefs Members on issues in relation to any change in shareholding of PCCW limited (PCCW) from the perspective of telecommunications and broadcasting regulation.

Background

2. According to the announcement by PCCW on 10 July 2006, it had been informed by Pacific Century Regional Developments Limited (PCRD), a Singapore-listed company, that PCRD has entered into a conditional sale and purchase agreement with Mr Francis Leung and Fiorlatte Limited, pursuant to which PCRD has agreed to sell and Fiorlatte Limited has agreed to purchase up to 1,526,773,301 shares, representing approximately 22.66% of the issued share capital of PCCW, for an amount of $9,160,639,806 (i.e. $6 per share). The proposed sale is subject to payments made over 18 months.

3. The subsidiaries of PCCW that are carrier licensees under the Telecommunications Ordinance (TO)(Cap.106) or television programme service licensees under the Broadcasting Ordinance (BO) (Cap. 562) are listed at **Annex A**.

A

Regulatory Issues

Telecommunications

4. Under section 7P of the TO, where there is a “change” in

relation to a carrier licensee, the Telecommunications Authority (TA) may conduct an investigation and 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.

5. According to section 7P(16) of the TO, there is a change in relation to a carrier licensee if –

(a) a person becomes the beneficial owner or voting controller of more than 15% of the voting shares in the licensee. However, if that person is not, or does not concurrently become, the beneficial owner or voting controller of more than 5% of the voting shares in any other carrier licensee, then the former transaction is not considered a "change" under section 7P of the TO;

(b) a person becomes the beneficial owner or voting controller of more than 30% of the voting shares in the licensee; or

(c) a person becomes the beneficial owner or voting controller of more than 50% of the voting shares in the licensee, or acquires the power to ensure that the affairs of the licensee are conducted in accordance with the wishes of that person.

6. The person causing the change, or the concerned licensee, may seek the TA's prior consent under section 7P of the TO on the proposed change. If prior consent had not been sought, the TA may commence *ex post* investigation. This power can be activated within 2 weeks after the TA knows or ought reasonably to have known that the "change" has occurred, for example, a beneficial interest in the shares has passed to the new owner. Section 7P of the TO gives the TA the power to direct the carrier licensee concerned to take such action as specified by the TA to eliminate or avoid the effect of substantially lessening competition, if such effect is identified. The matters that the TA may take into account in forming any such opinion according to Schedule 2 to
B the TO are listed at **Annex B**. They are further elaborated upon by guidelines issued by the TA under section 6D of the TO.

7. From the telecommunications regulatory perspective, the TA is monitoring the progress of the acquisition by Fiorlatte Limited of the 22.66% shareholding in PCCW held by PCRD with a focus on whether an existing telecommunications carrier licensee will –

(a) become a party with beneficial ownership in, or voting control over, the voting shares in; or

(b) acquire the power to control the affairs of

the carrier licensees that are subsidiaries of PCCW.

8. Should any or both of the above situations occur, and the threshold for a "change" in relation to a carrier licensee as defined in section 7P of the TO be reached, the TA may exercise his power under the same section to investigate whether or not this "change" is likely to have a substantial lessening of competition effect in a telecommunications market. During his investigation, the TA is statutorily required to consult all carrier licensees and interested persons on the possible effects of the transaction. A public report will be published setting out the TA's assessment and decision.

9. If the acquirer of the shares in PCCW seeks the TA's prior consent under section 7P of the TO in order to avoid any potential regulatory intervention after the event, the TA is also statutorily required to instigate a full investigation and public consultation process concerning the competition effects of transaction before deciding whether or not to grant such consent, with or without conditions. A report on the TA's competition assessment will also be made public.

Broadcasting

10. PCCW Media Limited (PCCW Media), a domestic pay television programme service licensee, and Starbucks (HK) Limited (Starbucks), a non-domestic television programme service licensee, are wholly-owned subsidiaries of PCCW. Under the respective licence conditions, the licensees shall comply at all material times with the statements and representations made in the Licensee's Proposals, including but not limited to the legal and beneficial interests in the voting control and shares in the Licensees, unless otherwise waived by the Broadcasting Authority (BA). In other words, the burden of compliance rests with the licensees. If there is any change to the corporate and shareholding structure included in its Licensee's Proposal, the licensee shall apply for the requisite waiver.

11. Since it is likely that the proposed change in the shareholding of PCCW will lead to changes in the legal and beneficial interests in the

voting control and shares and the corporate and shareholding structure of the two television programme service licensees, the BA has reminded them in writing of the relevant licence conditions.

12. From time to time, the BA processes applications of this nature by licensees. When considering whether a waiver should be granted, the main factors that the BA will take into account include:

(a) whether the licensee concerned remains a company incorporated in Hong Kong under the Companies Ordinance (Cap. 32) (sections 8(1) and 8(2) of the BO);

(b) whether persons exercising control of the licensee remain fit and proper as required under section 21 of the BO. Under section 21(4) of the BO, factors that should be taken into account in determining whether a person is fit and proper include the person's business record, criminal record in respect of offences involving bribery, false accounting, corruption or dishonesty; and

(c) whether the licensee still satisfies the "ordinarily resident in Hong Kong"[1] requirement under the BO. In the case of a domestic pay television programme service licensee, the majority of directors and principal officers actively participating in the management of the licensee company shall be ordinarily resident in Hong Kong for a continuous period of not less than seven years (section 8(4)(a)(ii) of the BO). In the case of a non-domestic television programme service licensee, not less than one director or principal officer of the company must satisfy the requirement of being ordinarily resident in Hong Kong for a continuous period of not less than seven years (section 8(4)(b) of the BO).

13. In addition, a domestic pay television programme service

[1] Briefly, "ordinarily resident in Hong Kong' means residence in Hong Kong for not less than 180 days in any calendar year, or residence in Hong Kong for not less than 300 days in any two consecutive calendar years. In relation to a company, it means the majority of the directors are ordinarily resident in Hong Kong continuously for not less than seven years, and the control and management of the company is bona fide exercised in Hong Kong.

licensee is subject to the disqualified person[2] restrictions under the BO. If the change in shareholding of PCCW will result in a disqualified person exercising control of PCCW Media, prior approval from the Chief Executive in Council on public interest grounds is required. Pursuant to section 3(3) of Schedule 1 to the Ordinance, in considering the public interest for granting the approval, the Chief Executive in Council shall take account of, but not limited to, the following matters -

(a) the effect on competition in the relevant service market;

(b) the extent to which viewers will be offered more diversified television programme choices;

(c) the impact on the development of the broadcasting industry; and

(d) the overall benefits to the economy.

Effectiveness of existing regulatory regime

14. Since the commencement of section 7P of the TO in 2004, there have been a number of transactions relating to carrier licensees subjected to scrutiny under this section. The legislative framework has provided clarity for licensees and their investors in carrying out their transactions.

15. In addition to section 7P of the TO, which focuses on changes in the beneficial ownership and control of voting shares in a telecommunications carrier licensee, or the power to control the affairs of the licensee, the TA has the power under sections 7K and 7L of the TO to investigate the competition effects of agreements and arrangements, and unilateral market conduct, involving telecommunications licensees. This is a further component of the competition law regime under the TO that applies in the telecommunications sector giving the TA the power to penalise and direct licensees to desist from behaviour that adversely affects competition to the detriment of consumers.

16. The Government conducted a Television Policy Review in

[2] Broadcasting licensees, newspapers (including magazines), and advertising agencies, and persons exercising control of them or their associates are disqualified persons under the BO who shall not exercise control of a domestic free television programme service licensee or a domestic pay television programme service licensee unless the Chief Executive in Council is satisfied that public interest so requires and approves otherwise.

1998 to update the television regulatory regime and introduce further liberalisation measures to fulfil the policy objectives of encouraging investment and innovation in the broadcasting market, ensuring fair competition in broadcasting[3], enhancing programme choice for the audience, and maintaining Hong Kong's status as a broadcasting hub in the region. We widely consulted the public and the industry on the recommendations of the review before implementing the existing regulatory regime by enacting the BO in July 2000. The existing regime works well in serving the policy objectives.

Communications and Technology Branch
Commerce, Industry and Technology Bureau
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[3] Under the BO, licensees shall not engage in conduct which, in the opinion of the BA, has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market (section 13) and that a licensee in a dominant position in a television programme service market shall not abuse its position (section 14). The BA may investigate and impose sanctions on any contravention of the competition provisions.

Annex A

Subsidiaries of PCCW Limited that are carrier licensees under the Telecommunications Ordinance or television programme service licensees under the Broadcasting Ordinance

Company	Equity held by PCCW Limited	Type of services operated
PCCW-HKT Telephone Limited	100%	Local and external network and services
PCCW Global (HK) Limited	100%	Satellite-based external network and services
Reach Network Hong Kong Limited	50%	External network and services
SUNDAY 3G (Hong Kong) Limited	79.35%	3G mobile network and services
Mandarin Communications Limited	79.35%	2G mobile network and services
PCCW Media Limited	100%	Domestic pay television programme service
Starbucks (HK) Limited	100%	Non-domestic television programme service

Annex B

Matters to be Taken into Account
by the Telecommunications Authority In Forming Any Opinion
under Section 7P(1) of the Telecommunications Ordinance

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 persons 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.