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By Fax
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15 November 2006

Miss Polly Yeung
Clerk to Panel
Information Technology and Broadcasting Panel
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Miss Yeung,

Panel on Information Technology and Broadcasting
Special meeting to be held on 23 November 2006

I refer to your letters ref. CB1/PL/ITB on 25 October 2006 and 15 November 2006 to Mr Joseph Wong.

We have earlier provided an information paper (your reference LC Paper No. CB(1)2076/05-06(01)) setting out the issues under the telecommunications and broadcasting regulatory frameworks. In response to your six questions, I am pleased to provide our response below that supplements our views in the information paper above.

Question (a): *What are the legislative requirements and regulatory framework for monitoring shareholding changes in telecommunications/broadcasting companies in Hong Kong to ensure fair market competition and protection of consumers' interests?*

Response: The Telecommunications Ordinance (Cap. 106) has provisions which specifically oversee mergers and acquisitions involving telecommunications carrier licensees. Section 7P of the Telecommunications Ordinance (TO) empowers the Telecommunications Authority (TA) to rule against a merger or acquisition where, in the absence of countervailing public benefit, the transaction has or is likely to have the effect of substantially lessening competition in a telecommunications market. Section 7P(16) of the TO contains the threshold for situations where a share transaction constitutes a "change in relation to a carrier licensee".

The parties involved in the share transaction do not have to get the TA's consent beforehand, but there is a procedure whereby they can apply to the TA for prior consent to the proposed share transaction. In the absence of a prior consent granted by the Authority, the TA may initiate an investigation within two weeks after he knows or ought reasonably to have known that a "change in relation to a carrier licensee" has occurred.

If the TA concludes that the change has, or is likely to have, the effect of substantially lessening competition in a telecommunications market, and there are no countervailing public benefits, the subject carrier licensee can be directed to take action, including procuring modifications to the transaction itself, to eliminate or avoid the adverse competition effects.

On the broadcasting side, two wholly-owned subsidiaries of PCCW Limited are television programme service licensees under the Broadcasting Ordinance (BO)(Cap. 562). PCCW Media Limited (PCCW Media) holds a domestic pay television programme service licence while Starbucks (HK) Limited (Starbucks) holds a non-domestic television programme service licence.

PCCW Media and Starbucks are required under their respective licences to comply at all times with the statements and representations submitted in their licence applications (known as "Licensee's Proposal"), 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).

The proposed change in the shareholding of PCCW Limited will lead to changes in the corporate and shareholding structures of the two television programme service licensees as represented in their Licensees' Proposals. The onus of compliance rests with the licensees. PCCW Media and Starbucks have submitted their applications for waiver under their respective licences to the BA. The BA approved the applications on 28 October 2006, with the clear provisos that the waivers shall not take effect before the completion of the transfer of all the interests and title in the shareholding in PCCW Limited, and that the waivers shall cease to have effect or be effective upon any change in shareholding and control in relation to the buyer of the shareholding in PCCW Limited, the two licensees themselves and the relevant controllers and shareholders as submitted in their applications.

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

(i) 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);

(ii) 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

(iii) whether the licensee still satisfies the "ordinarily resident in Hong Kong"[1] requirement under the BO (resident requirement). In the case of a domestic pay television programme service licensee, the resident requirement means that the majority of directors and principal officers actively participating in the management of the licensee company shall be for the time being ordinarily resident in Hong Kong and have been so resident 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 resident requirement (section 8(4)(b) of the BO).

In addition, a domestic pay television programme service licensee is subject to the disqualified person (DP)[2] restrictions under the BO to safeguard against the risks of media concentration and editorial uniformity. If the

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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.

2 Broadcasting licensees (except that a non-domestic TV licensee is not a disqualified person in relation to a domestic pay TV licence), newspapers (including magazines), and advertising agencies, and persons exercising control of them and the associates of the above 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.

change in the shareholding of PCCW Limited will result in a DP exercising control[3] of PCCW Media, the licensee is required to apply for prior approval from the Chief Executive in Council (CE in C). The CE in C may approve the application on public interest grounds. Pursuant to section 3(3) of Schedule 1 to the BO, in considering the public interest for granting the approval, the CE in C shall take account of, but not limited to, the following matters –

(i) the effect on competition in the relevant service market;
(ii) the extent to which viewers will be offered more diversified television programme choices;
(iii) the impact on the development of the broadcasting industry; and
(iv) the overall benefits to the economy.

Question (b): *What are the service licences currently held by PCCW? Whether the change in shareholding in PCCW resulting from the proposed sale had the effect of substantially lessening competition in the telecommunications market under section 7P of the Telecommunications Ordinance (TO) (Cap. 106)?*

Response: PCCW Limited together with its related companies currently hold a number of licences, including carrier and non-carrier licences, under the TO. These licences are listed in the Annex.

The regulatory arrangement under section 7P of the TO is *ex post* in nature. Unless the carrier licensee or an

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3 Under section 1(6) of Schedule 1 to the BO, a person exercises control of a corporation if-
(a) he is a director or principal officer of the corporation;
(b) he is the beneficial owner of more than 15% of the voting shares in the corporation;
(c) he is a voting controller of more than 15% of the voting shares in the corporation; or
(d) he otherwise has the power, by virtue of any powers conferred by the memorandum or articles of association or other instrument regulating that corporation or any other corporation, to ensure that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person.

interested person seeks the prior consent of the TA under section 7P(6) of the TO, or until the proposed change in relation to the carrier licensee occurs, the TA cannot legally come to a view, as to whether the change has the effect of substantially lessening competition. Any opinion on the substance of the transaction, expressed by the TA in advance of a formal investigation, could prejudice both the investigation and any subsequent opinion on the competition merits.

Question (c): *It is understood that TO provides for an ex post regulatory regime under which the parties concerned are not obliged to seek TA's prior consent before proceeding with a proposed merger or acquisition. However, the parties concerned may seek TA's prior consent on a voluntary basis. What advice/information, if any, has been provided by TA to the parties concerned?*

Response: Up to now, no party has approached the TA seeking prior consent to the proposed change in shareholding in PCCW Limited. The TA has however liaised with PCCW Limited and Fiorlatte Limited about the progress of the deal. The TA currently has no information about the transaction which is not also in the public domain.

Question (d): *Whether the Administration and the regulators see any inadequacies, as reflected in the proposed sale of shares in PCCW in question, in the existing legislative and regulatory framework, and a need for reviewing the existing monitoring mechanism to improve its effectiveness? Whether and how specific follow-up actions would be taken and what are the factors to be taken into consideration in deciding on the follow-up action, if any, to be taken.*

Response: Section 7P of the TO only came into force in 2004. Since then, the TA has published some five reports on acquisition transactions affecting carrier licensees. From the experience to date, the TA is not aware of any inadequacy in the existing regulatory framework on mergers and acquisitions in the telecommunications industry.

Concerning the broadcasting regulatory regime, the Government conducted a Television Policy Review in 1998 to update the television regulatory regime and introduce further liberalisation measures to fulfill the policy objectives of encouraging investment and innovation in the broadcasting market, ensuring fair competition in broadcasting [4], 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.

Question (e): *According to the Administration, there is no statutory restriction on the acquisition of shares of local telecommunications companies by foreign companies. In the present case, the proposed sale of 22.66% shareholding in PCCW to Fiorlatte Limited has evolved from the initial plan for divestment of PCCW's core telecommunications and media related assets to potential foreign buyers (Australian investment bank Macquarie Group and US firm TPG-Newbridge). However, the proposed acquisition of assets has subsequently been discontinued. Concerns have been raised that the discontinuation of the proposed acquisition was allegedly due to political pressure. What are the Administration's comments on such concerns?*

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[4] 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.

Response: There is no foreign ownership restriction over telecommunications licensees under the TO. Investors irrespective of their nationalities are welcomed to invest in the telecommunications infrastructure in Hong Kong. However it is entirely a commercial decision on the part of the investor whether to invest. It would not be appropriate for the Administration to comment on the business decisions of individual company or market speculations.

Question (f): *Apart from the proposed sale of PCCW's shareholding in question, whether the proposed acquisition of a local Chinese newspaper by Mr Richard LI, who is still a major shareholder of PCCW, would breach the restriction on cross-media ownership under the BO?*

Response: According to media reports, Mr Richard Li has acquired 50% interest in a local newspaper through an off-shore company owned by an off-shore discretionary trust (the acquisition). Mr Richard Li is the settler of the discretionary trust.

Cross-media ownership restrictions on broadcasting licensees are embodied in the DP provisions under the BO. Please refer to the last paragraph of our response under question (a) above on the relevant statutory provisions.

The onus of complying with the statutory provisions in relation to DPs rests with the licensee. PCCW Media is required to apply for prior approval of the CE in C if there is or is going to be any disqualified person issues arising as a result of or connecting to the acquisition. So far, no application has been received.

Mr Francis Leung announced on 12 November the agreements between Fiorlatte Limited and Telefónica Internacional S.A.U., Li Ka Shing Foundation and Li Ka Shing (Canada) Foundation for the three parties to acquire the shares of PCCW Limited.

The TA will as soon as possible contact the relevant parties to ascertain whether there will be a change, in beneficial ownership or voting control or in relation to power to influence the affairs of a carrier licensee, as defined in section 7P of the TO as a result of the acquisition. Under section 7P, the TA may, within 14 days after the change has occurred, commence an investigation into the effect of the change on competition in the market. If the TA after the investigation forms the opinion that the change has the effect of substantially lessening competition in a telecommunications market, it may direct the licensee to take action to eliminate or avoid such effect.

According to the fixed carrier licence held by PCCW-HKT Telephone Limited, it has to operate, maintain and provide a good, efficient and continuous service in a manner satisfactory to the TA. In addition, all licensees are required to comply with sections 7K, 7L and 7N of the TO which prohibit anti-competitive agreements and conduct. The Office of the Telecommunications Authority will ensure that the carrier licensees within the PCCW group will continue to provide satisfactory services in compliance with their licence conditions and that competition in the telecommunications market will be safeguarded.

The BA will remain vigilant to ensure that the conditions in the domestic pay television and non-domestic television programme service licences held by the two subsidiary companies under PCCW Limited and the DP provisions under the BO are duly complied with.

In particular, if the acquisition by various parties of the shareholding in PCCW Limited announced by Mr Francis Leung would lead to further changes in the corporate and shareholding structures of the respective licensees as submitted by them, the two licensees are required to submit updated information to apply for suitable waivers from the BA.

The BA has reminded PCCW Media that PCCW Media and each of the relevant controllers and shareholders should comply with the disqualified persons provisions in the BO.

Yours sincerely,

(LI Yeuk-yue, Tony)
for Secretary for Commerce, Industry and Technology

Encl

c.c. Director-General of Telecommunications
(Attn.: Mr Bernard Hill)
Commissioner for Television and Entertainment Licensing
(Attn.: Mr P L Po)

Annex

List of Telecommunications Licences held by the PCCW Group or its related companies

	Name of Licensee	Type of Licence
1.	PCCW-HKT Telephone Limited	Fixed Carrier Licence
2.	PCCW Global (HK) Limited	Satellite-based Fixed Telecommunication Network Services Licence
3.	PCCW IMS Limited	Public Non-exclusive Telecommunications Service (PNETS) Licence (for Internet Services)
4.	PCCW Media Limited	PNETS Licence (for International Value-added Network Services)
5.	PCCW-HKT Network Services Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
6.	PCCW Powerbase Data Center Svc (HK) Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
7.	PCCW Global Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
8.	PCCW Solutions Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
9.	PCCW-HKT Business Services Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
10.	PCCW-HKT Network Services Limited	PNETS Licence (for Virtual Private Network Services)
11.	PCCW Global Limited	PNETS Licence (for External Telecommunications Services)
12.	PCCW-HKT Network Services Limited	PNETS Licence (for External Telecommunications Services)

	Name of Licensee	Type of Licence
13.	PCCW IMS Ltd.	PNETS Licence (for External Telecommunications Services)
14.	PCCW-HKT Telephone Limited	Public Radiocommunications Services Licence (for services other than land mobile services)
15.	Reach Networks Hong Kong Limited, Reach Cable Networks Limited and Reach Global Services Limited	Cable-based Fixed Telecommunication Network Services Licence
16.	Reach Global Services Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
17.	Reach Cable Networks Limited	PNETS Licence (for International Value-added Network Services & Internet Services)
18.	Reach Global Services Limited	PNETS Licence (for External Telecommunications Services)
19.	Reach Networks Hong Kong Ltd.	Mobile Carrier (Restricted) Licence
20.	Mandarin Communications Limited	Mobile Carrier (2G) Licence
21.	SUNDAY 3G (Hong Kong) Limited	Mobile Carrier (3G) Licence
22.	Mandarin Communications Limited	PNETS Licence (for Internet Services)
23.	Mandarin Communications Limited	PNETS Licence (for External Telecommunications Services)