

Legislative Council Panel on Information, Technology and Broadcasting

Telecommunications Authority Guidelines :

Mergers and Acquisitions in Hong Kong Telecommunications Markets

19 April 2004

The Telecommunications (Amendment) Ordinance 2003

- Mergers and acquisitions are normal business activities which can enhance efficiency, but may also lessen competition to the detriment of consumers and other players

The Telecommunications (Amendment) Ordinance 2003 (Cont'd)

- Telecommunications (Amendment) Ordinance 2003 enacted in July 2003 to
 - protect consumer interests through the promotion of fair and effective competition
 - assist the industry in making informed decisions on merger and acquisition matters through the provision of a clear and transparent regulatory regime
- ⇒ **a pro-consumer and pro-industry Ordinance**

The Telecommunications

(Amendment) Ordinance 2003 (Cont'd)

- Various safeguards built in to provide certainty to the industry
 - Only mergers and acquisitions that may substantially lessen competition may be regulated
 - Only carrier licensees (e.g. fixed operators, mobile operators) are regulated

The Telecommunication (Amendment) Ordinance 2003 (Cont'd)

– Further safeguards

- only when ownership changes cross the three threshold of 15%, 30% and 50%* may it trigger investigation of whether the merger and acquisition may substantially lessen competition. For new players acquiring a carrier licensee, the thresholds are further limited to 30% and 50%* only
- a “benefit to the public” test is included to balance the adverse effect of substantially lessening competition

* or control of the carrier licensee

The Telecommunication (Amendment) Ordinance 2003 (Cont'd)

- Further safeguards (Cont'd)
 - only the carrier licensee concerned and the investors may appeal against the Telecommunications Authority (TA)'s decisions
- ⇒ **the Ordinance already strikes the right balance between protecting consumer interests and providing certainty to the industry**

The Guidelines

- 2 rounds of consultation held
 - 1st draft guidelines taking into account industry comments during the Bills Committee stage of the Ordinance were issued in Aug 2003 for consultation
 - 2nd draft guidelines further taking into account industry comments during the first consultation were issued in Dec 2003 for further consultation

Key Issues in 2nd Consultation (Cont'd)

(1) Safe Harbour

- While there is general industry support for a safe harbour mechanism, there is no consensus as to which measure should be adopted

Key Issues in 2nd Consultation

(Cont'd)

- Possible measures
 - Traditional Herfindahl - Hirschman Index (HHI) (used by USA, UK and EU)
 - an index by summing up the squares of the market shares of all the firms operating in the market. The higher the index, the more concentrated a market is
 - under the index, a merger will be presumed not to substantially lessen competition and hence not be investigated if
 1. The post-merger HHI is less than 1,000; or
 2. The post-merger HHI is less than 1,800 and the change in the HHI is less than 100; or
 3. The change in the HHI is less than 50

Key Issues in 2nd Consultation (Cont'd)

- Possible measures (Cont'd) :
 - Modified HHI (not adopted elsewhere in the world)
 - variations proposed by PCCW in the first consultation exercise
 - traditional HHI but modified to allow many more mergers and acquisitions not to be investigated.
PCCW proposes that a merger and acquisition will not be investigated if :-
 1. The post-merger HHI is less than 1,800; or
 2. The change in HHI is less than 550

Key Issues in 2nd Consultation (Cont'd)

- Possible measures (Cont'd) :
 - Modified HHI (Con't)
 - if adopted, TA will be deprived of a chance to examine the following mergers to see whether they are anti-competitive :-
 - i) all but 4 mergers out of over two dozen possible combinations - including the majority of mergers between the top 4 players
 - ii) any merger between operators in the fixed line markets, save for a merger involving PCCW

Key Issues in 2nd Consultation (Cont'd)

- Possible measures (Cont'd) :
 - Combined market share (CR4) ratio (adopted by Australia, Japan and Canada*)
 - under the measure, a merger and acquisition will be presumed not to substantially lessen competition and hence not be investigated if
 1. The merged entity has less than 15% share of the market; or
 2. The merged entity has less than 40% share of the market and post-merger the 4 largest firms (CR4) will have a combined market share of less than 75%.

*Canada actually uses more stringent safe harbours

Key Issues in 2nd Consultation

(Cont'd)

- Carrier licensees like PCCW, SmarTone, HGC, CSL/Telstra support the use of a modified HHI
- International operator AT&T support the use of traditional HHI. Opposed to using modified HHI
- Consumer Council supports the use of either traditional HHI or combined market share - preference for more straightforward CR4. Opposed to any modifications
- Telecoms Users Group's general comment is to adhere to international best practice which the 2nd Draft Guidelines have achieved

Key Issues in 2nd Consultation

(Cont'd)

- Administration's Response :
 - The “safe harbour” measures are intended to be screening devices to screen out those mergers and acquisitions which are unlikely to substantially lessen competition.
 - If they are set too wide, they will automatically exclude mergers and acquisitions which may substantially lessen competition without the chance for TA to take a look first

Key Issues in 2nd Consultation

(Cont'd)

- If a merger and acquisition falls outside the “safe harbour” it does not mean that it is anti-competitive. It merely provides TA with a chance to take a look at the deal.
- Following a preliminary investigation, the TA may conclude that the merger and acquisition does not substantially competition after investigation.
- The key is that TA should have a proper chance for investigation before so concluding
- The safe harbour is only relevant when the ownership change thresholds in the Ordinance are triggered

Key Issues in 2nd Consultation

(Cont'd)

- In addition to the clear lack of consensus on this issue, adoption of modified HHI as proposed by the carrier licensees is undesirable because
 - (A) Hong Kong will deviate from international best practice, while the industry has always been urging the TA to adopt international best practices in other aspects
 - (B) While these “safe-harbour” measures are used in many different countries, including in some of the largest economies and in some of the smallest, the relevant “safe-harbour” thresholds remain essentially constant and modifications are rare

Key Issues in 2nd Consultation

(Cont'd)

- Adoption of modified HHI as proposed by the carrier licensees is therefore considered undesirable, a view which is in line with the submission of the Consumer Council
- To address industry's concern, we intend to use both the traditional HHI and CR4 concurrently. Therefore a merger or acquisition that meets either threshold will fall within the safe harbour
- The effect of this approach is to increase the coverage of the safe harbour mechanism in the Guidelines, thereby increasing certainty, while at the same time ensuring that Hong Kong applies internationally recognised standards of practice

Key Issues in 2nd Consultation

(Cont'd)

(2) Burden and standard of proof

- Carrier licensees gave further views on various burden and standard of proof issues, such as
 - TA should give reasons to support its decision to reject claims that are unfound
 - the merging party claiming that there is no substantial lessening of competition should not be required to substantiate its claims

Key Issues in 2nd Consultation

(Cont'd)

- Administration's Response :
 - The burden of proving that there is a substantial lessening of competition rests with the TA. It is for the parties claiming that there is no substantial lessening of competition to substantiate their claim. If the TA rejects the claim, he will give reasons.
 - Our proposal is reasonable. To address industry's concerns, we will make textual improvements to put matters beyond doubt.

Conclusion

- We have incorporated the industry's views in the legislative process and 2 rounds of consultation of the guidelines as far as practicable : -
 - adopt both traditional HHI and CR4 as “safe harbour” measures
 - Make some further textual improvements to the Guidelines
 - Other improvements already made in the 2nd consultation paper
 - provide further comfort in including financial transactions in the “safe harbour”
 - add more specific examples for application of the guidelines in Hong Kong's market to provide guidance and certainty to the industry
 - delete the requirement for performance bond for guaranteeing the realization of future public benefits from the merger and acquisition

Conclusion (Cont'd)

- Our proposal accords with international best practice, with a proper balance between providing certainty to the industry and protecting consumer interests.

Way Forward

- Need to bring the Telecommunications (Amendment) Ordinance which has been passed in July 2003 into force as soon as possible, as urged by Consumer Council and the Telecoms Users Group
- We plan to bring the Ordinance into force within this legislative session, which will require : -
 - (i) issuing the finalized guidelines as soon as possible; and
 - (ii) tabling the commencement notice in May 2004