CB(1) 141/03-04(03)

Thank you Mr Chairman. I am pleased to present the views of PCCW on these draft merger guidelines for the telecommunciations markets.

Merger Guidelines, as developed in other markets, including the EU and US, are designed for one primary purpose. That purpose is to provide all the stakeholders in a possible merger with as high a level of predictability as possible. That means that government officials, licensees, investors, bankers, lawyers and members of the public should be able to analyze a proposed merger against the guidelines and to forecast with a high level of certainty, in most cases, whether a proposed merger will be approved or rejected. In fact, well written merger guidelines provide valuable guidance so that potential merger partners can design their proposal to avoid competition problems so that the merger will be approved.

The draft guidelines are a good first step in providing predictability to the market stakeholders. Concepts and language have been drawn from the US, EU and Australia. However, as pointed out by commentors ranging from operators to the Law Society, substantial improvements can and should be made. Almost all of these improvements relate to increasing the level of predictability and decreasing the subjectiveness of the process.

You may recall, Mr Chairman, how the industry worked with your committee and the Government to improve the draft legislation earlier this year. Now is the time to work together again to similarly improve the draft guidelines.

The areas in the draft guidelines where predictability and clarity need to be increased include the following:

- First, the draft guidelines do not create any safe harbors. A safe harbor is hinted at if the merged entity has a market share below 15%. But firm safe harbors need to be clearly established in terms of market share, turnover and asset levels. These exist in the EU and US merger guidelines and should be created here.

- Second, under the draft guidelines, a merger that would remove a vigorous and effective competitor from the market will likely be rejected. How do we identify who is vigorous? Who is competitive? Aren't all the market players vigorous and competitive? Why is there an assumption that the new firm would be less vigorous and less effective? The merged entity may indeed be even more vigorous and effective. This part of the draft guidelines needs to be specifically and narrowly defined, or omitted.

- Third, the draft guidelines attempt to establish an easier path to conclude a merger with a firm that is failing. This has merit and is used in other markets. However, this easier path may be an illusion. As it is presented in the draft guidelines, the easier path only operates if the failing firm's network assets would exit the market. But in industries, such as telecom network assets are often sunk. They do not exit the market even if a firm fails. Therefore, a proposed merger with a failing firm would likely not find an easier path. The failing firm test therefore needs to be modified.

- Fourth, the draft guidelines should include many more examples and use off-shore case law. Well-specified guidance illustrated with examples and case law would promote predictability and provide the necessary confidence to make the important investment decisions required in this industry.

- Fifth, the draft guidelines do not recognise the largely beneficial nature of mergers. Instead there is a general anti-merger bias. Why? The vast majority of mergers are beneficial to users in terms of greater efficiency and more vigorous competition. These benefits need to be recognised.

- Sixth, the draft guidelines need to clearly place the burden of proof on the regulator. There maybe cases where the merger proponents need to make a prima facie case but once that is made the overall burden of proof should remain with the TA. This needs to be clarified.

- Seventh, the draft guidelines include the possibility of performance bonds and specific license conditions to ensure that certain public benefit or efficiency estimates are met. But such good faith promises about performance cannot fairly be guaranteed in a dynamic market. The use of performance bonds and license conditions is not found in other major market merger guidelines, such as in the US or EU, and will only act to discourage merger activity and investment. They should not be included.

The US and new EU merger guidelines contain a mathematical formula – called the Herfendahl-Hirschman Index – which greatly assists market

stakeholders predict whether a proposed merger will be approved. In fact, this Index may be seen as the most helpful part of the US and EU guidelines in terms of predictability. The Index measures market concentration. This Index is absent from the draft guidelines.

PCCW does recognize that such a formula would have to be modified to take into account that Hong Kong is a much smaller economy than the US or EU. But this can be done. In fact, the TA has kindly supplied PCCW with some non-confidential market data and we will be making some indexing proposals soon.

To PCCW, the absence of a mathematical index is perhaps the greatest weakness of the draft guidelines. This absence substantially lessens the predictability of the guidelines and directly increases the subjectivity of the guidelines. This is an unfortunate result but one that can be corrected. A modified index needs to be developed and incorporated into the guidelines.

Finally, I would point out one oddity relating to the index and the draft guidelines. On the one hand, the index is omitted from the draft merger guidelines even though it substantially enhances predictability and is included in the US and EU merger guidelines. On the other hand, in the consultation on whether PCCW is dominant in the business line market, the TA states, and I quote "….In other major jurisdictions, the Herfendahl-Hirschman Index (HHI) is generally accepted as the standard measure for market concentration, particularly in accessing merger and acquisition activity…." End quote. The TA then asks whether this index "or any other generally accepted measure" should be used.

PCCW is not aware of any major market that would use a market concentration index for a dominance evaluation but yet reject its use for its primary purpose of a merger analysis. PCCW would also note that the TA characterizes the Herfendahl-Hirschman Index as a generally accepted measure. Yet, the TA rejects its use in the merger guidelines. Why? This needs to be explained. The TA simply cannot have it both ways.

In sum, the draft guidelines are a good first step but substantial improvements are necessary. Due to the scope of these needed improvements, all of which are consistent with enhancing predictability and with global best practices, PCCW sees the need for, and strongly supports, a second consultation.

Thank you.