THE LAW SOCIETY OF HONG KONG 香港律師會

DRAFT HONG KONG TELECOMS M & A GUIDELINES - COMPETITION COMMENTS

We have the following specific comments on the Legislative Council Bills Committee on Telecommunications (Amendment) Bill 2002's explanatory note on the guidelines on the competition analysis of mergers and acquisitions in the telecommunications markets, dated December 2002. Numbers refer to paragraph numbers in the notes on the guidelines.

As a general comment, practical examples of the guidelines in application would be very helpful (see eg EC and UK competition guidelines). Also, there are a number of grammatical errors in the text and hopefully these would not be carried through to the actual guidelines.

1 Note the different thresholds of control: the EU test is that of decisive influence, whereas the UK has a slightly lower threshold of material influence.

2 The effect of a change in ownership or control over a carrier licensee which is transitory (e.g. purchase by a bank, insurance company or stockbroker) might have on consumers may need to be taken into account.

6 & 7 The use of the phrase "other geographical areas" in these paragraphs is a little confusing, given the second limb of market definition is the relevant geographic market. Perhaps words such as "different locations" might be suitable alternatives.

13 The description of the application of the SSNIP test is basically correct i.e. that the competition authority will take the narrowest group of products that satisfies the SSNIP test and then keep expanding the range of products included within the group until it reaches products that no longer satisfy the test.

18 Given the nature of the telecommunications markets, it might be useful to include "consumer information" in the list of structural features.

21 *De minimis* situations are normally taken out of consideration by the application of an "appreciability" test i.e. to see whether the merger or acquisition would have an appreciable effect on competition. Although the position is not entirely clear, it seems to be the general approach of countries that apply the SLC test that "substantial lessening of competition" is a single term with economic meaning and that it should not be split out into its constituent parts i.e. it is not necessary to consider whether there is competition, whether it will be lessened as a result of the

merger and whether that lessening will be substantial. The guidelines may therefore deal separately with "appreciability" and "creation of market power".

22 For the reasons the wording "however, beyond distinguishing the *de minimis* situations" is not necessary. Also, the usual UK and EU language for the situation described in the final sentence of paragraph 22 is that a company is dominant when it can act independently of its competitors. The TA may not necessarily wish to equate dominance with SLC.

29 UK (and EU) competition authorities consider not only the situation with the merger under consideration and absent it, but also the alternatives to the merger e.g. would the target go out of business, would some other party buy the target, etc. The TA may wish to consider such situations also.

30 We suggest that in the equivalent paragraph in the actual guidelines the words currently appearing at the beginning of the second line be changed to read "merger are generally necessary but not sufficient" as it is conceivable that there could be situations in which the company could have the ability to exercise market power without necessarily having high market share.

31 It might be useful to clarify that the 15% and 40% market share figures are not intended to be jurisdictional thresholds, if this is the intention.

34 - The statement that information on market shares and concentration levels is readily available understates the difficulties often involved in defining the market correctly. In many mergers, a great deal of time and argument is taken up in defining the market and it is only once the market has been defined that market share information becomes relevant.

37 See comment on paragraph 30.

39 We suggest that the second sentence of this paragraph if kept in the actual guidelines be changed to read "a vigorous and effective competitor serves to undermine attempts …"

40 The guidelines should ensure conformity of language; use "barriers to entry" rather than "barriers of entry".

53 - 57 Some of the activities described could, if carried out by a dominant market player, amount to abuse of a dominant position. In addition, less tangible first mover advantages e.g. building brand loyalty or locking consumers into a particular type of technology could be included.

69 - 73 The EU does not yet have an efficiencies defence as such; the new merger control regime introduced in the UK by the Enterprise Act 2002 will include a "customer benefits" derogation to a merger that would otherwise be blocked; the Bills Committee may wish to discuss whether it wants to go for a full blown "efficiencies

defence", which is something it would likely wish to include on the face of the legislation, or simply include efficiencies/customer benefits as a factor to be considered by the TA in its overall assessment of the merger. In any event, it is usual for it to need to be shown that the efficiencies cannot be achieved in any less anti-competitive manner and it might be useful for the guidelines to specifically articulate examples of the types of efficiency that could be used. The danger of a fairly wide efficiencies definition is that the point will almost always be raised by firms seeking to prevent a merger being blocked.

75 A distinction should probably be drawn in the second sentence between the assets of the supplier and the supplier itself and the extent to which either or both is able to act as a competitive constraint on the market.

76 The word "apparently" in the third line sits a little oddly given the nature of the guidelines.

74 - 78 A number of jurisdictions include words to the effect that, if a merger is permitted on the failing firm argument basis and that firm is then revived in substantially the same form as it existed pre-merger, such as to give rise to a suspicion that the firm was not in fact failing, they will pursue the case vigorously.

79&80 Perhaps need further consideration of the overlap between the relevant geographic market ("RGM") and the section on import competition. E.g. whether the RGM is defined by reference to the location of the customers, or by call termination location, or by location of the provider and whether, if overseas services provide an adequate substitute for domestically provided services, whether the RGM perhaps extends beyond Hong Kong. Obviously, this will raise issues of territorial jurisdiction.

84 Note the four month time limit for the OFT to reach a reference decision under the Enterprise Act 2002 applies only in circumstances where the transaction has not otherwise been brought to the OFT's attention; where the parties submit a merger notice detailing the proposed acquisition, the OFT will be under a statutory duty to decide whether or not to refer within 30 days and where the parties make an informal submission to the OFT, it has an administrative deadline of 40 days. In the penultimate line of paragraph 84, the word "data" we assume should read "date".

Additional Comments

A. Scope of Application of Section 7P (1)

In the draft Guidelines, the TA refers to the need to regulate the effect on competition of a "merger or acquisition". However, as pointed out in our comments on the Bill itself, section 7P(1) applies to any purchase of shares in a carrier licensee (and not just changes in control). The Guidelines attempt to deal with some of the problems of this over broad scope in paragraphs A2 and A3.

Paragraph A2 states that the TA is "unlikely to be concerned" about transitory changes in ownership or control of a carrier licensee (i.e. trading of shares by investors and brokers etc. with a view to re-selling). It also excludes acquisitions by liquidators and acquisitions by "financial holding companies which do not result in control over the competitive conduct of the carrier licensee".

In paragraph A3, it states the TA will "in general" take the view that the acquisition of 15% or less of the voting shares of a carrier licensee would not significantly affect competition in the market. The percentage should that specified in the Takeover Code from time to time.

In our original submissions on the Bill, we suggested that:

(a) Section 7P (1) should only apply in relation to changes in control; and

(b) Any change in share ownership that does not constitute a change of control should be dealt with by the existing anti-competition provisions in the Telecommunications Ordinance.

This remains our view.

However, if the Bill itself is not to be amended, the effect of this, in our opinion, over extended reach of the Ordinance could be limited by appropriate safe harbour language in the Guidelines. In our view, the provisions in Paragraphs A2 and A3 are not sufficient to provide a safe harbour both in terms of their scope and also the certainty of the protection they bring.

Certainty

The use of words such as "*unlikely to be of concern*" and "*in general*" to preface exceptions should be avoided. We understand that the regulator wishes to retain discretion. It is not sufficient to argue that an interested party could discuss the matter beforehand with the regulator.

The regulator may have the best of intentions to always be consistent and reasonable. However, market forces work much better if there is certainty. The feasibility of a transaction should not depend on the discretion of government officials.

Scope

We would suggest that the following activities should not require TA approval or prior disclosure to the TA :-

(a) Any transfer of beneficial ownership of the voting shares of a carrier licensee (this is consistent with The Hong Kong Stock Exchange's definition of change in control for listed companies) unless the transfer results in a person acquiring an interest of 30% or over which it did not have before the transfer. Given this higher threshold, we feel there is no need to make exemptions for transferring "*transitory*" holdings.

(b) Acquisition by liquidators.

Changes of shareholdings of 30% or more (or the percentage specified in the Takeover Code from time to time), at the holding company level between financial holding companies

should, in our view, trigger a notification requirement. However, if the transfer does in fact not involve the management of the carrier licensee then the Guidelines should indicate that such a transfer would be approved.

B. Time Limits for Approval

Paragraph C of the proposed Guidelines sets out various time limits in which the TA will react. The TA has followed time frames similar to those used in other jurisdictions. However, given that the Hong Kong market is smaller than, for example, USA, Australia and UK, we suggest these time limits be reduced as investigations in the Hong Kong market should take less time than similar investigations in those other jurisdictions. The current proposed time limits are:

(a) the TA must initiate an investigation within 3 months after a transaction is completed or made known to the public - we suggest reducing this to 2 months;

(b) the TA will make a decision on a completed transaction within 4 months after the initiation of an investigation - we think this could be reduced to 3 months; and

(c) where a party has applied for consent in advance, the TA says it will take a month to decide whether or not detailed consideration is necessary, and if the case warrants detailed consideration, a further 4 months to complete the consideration. We believe the 1 month period is satisfactory but suggest reducing the further 4 month period to 3 months.

C. Conclusion

We repeat our initial view that what the telecommunications market requires above all else is certainty. We therefore suggest that only genuine changes in control should be covered by section 7(P). Failing that the Guidelines need unambiguous non-discretionary safe harbour provisions and strict time limits for TA decisions.

The Law Society of Hong Kong
The Management and Technology Committee
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