THE LAW SOCIETY OF HONG KONG 香港律師會

SECOND CONSULTATION PAPER ON DRAFT MERGER AND ACQUISITION GUIDELINES FOR HONG KONG TELECOMMUNICATIONS MARKETS

COMMENTS BY THE LAW SOCIETY'S MANAGEMENT AND TECHNOLOGY COMMITTEE

We start with a general comment namely that the third draft of the Merger and Acquisition Guidelines is a better drafted and more well-balanced document.

Our specific comments are set out below:

Paragraph 1.17 - will the TA seek third party comments if an approach is made to it on a confidential basis? Presumably not, but it would be helpful if this were clear.

Paragraph 1.19 - a 14 day period for appeal is not very long at all for the parties to assemble their arguments and evidence. An extension even to 14 working days might be preferable, or a longer period if possible. In the UK for example, third parties can appeal if they are sufficiently affected by a decision, but this does not appear to be the case in Hong Kong. Moreover, it appears that judicial review is a separate ground of appeal; if this is the case, what are the other grounds of appeal?

Paragraph 1.23 - it may be useful to widen the application of the provisions to both subsequent **and/or separate** conduct of licensees.

Paragraph 1.26 - it is not clear who decides whether restraints are ancillary to the merger agreement or not. Is the onus on the parties to make their own decision, or on the TA to give an opinion?

Paragraph 2.4 - at point 3, we suggest an amendment to read "counterveiling **buyer** power", to make this point clearer.

Boxed text "safe harbours" - the HHI is not used as a jurisdictional threshold in the UK, but merely as one of a number of tools used in the competition analysis. The jurisdictional thresholds are based on target's turnover and share of supply, along with some element of control being present. We therefore believe that the second bullet point is misleading.

In response to the final TA bullet point, HHI is not itself a suitable screening mechanism because it is not always either reliable or clear. It should be used simply as one of a number of tools for the Authority to employ in carrying out competition analysis. This comment is equally applicable to the **boxed text under paragraph 2.12** "*alternative proposal on HHI thresholds submitted by PCCW*".

Paragraph 4.13 - a new EC Merger regulation comes into force on 1 May 2004 and the HK guidelines should be updated to be in line with that development.

Paragraph 4.26 - "sales value" is generally a better measure of market share and power than "sales volume", because it is more closely related to prices and costs. However, where both are available, they can both be used.

Paragraph 4.34 - we suggest the inclusion of a fourth bullet point "**a recent and/or maverick entrant".**

Paragraph 4.38 et seq - we suggest this section on **structural barriers to entry** be split into sections for ease of use i.e.:

paragraph 4.40 et seq should be headed "**sunk costs**";

paragraph 4.43 et seq headed "**economies of scale and scope**";

paragraph 4.44 "**excess capacity**";

paragraph 4.45 "**network effects**";

paragraph 4.47 "**reputational barriers**";

paragraph 4.48 "**essential facility**"; and

paragraph 4.50 "**regulatory barriers**".

Boxed text under paragraph 4.74 "efficiencies" - the TA needs to remain robust in its position on efficiencies. The parties claiming efficiencies should have the onus of proving them and the TA needs to be satisfied that efficiencies will arise within a reasonable time frame e.g. one to two years. See also **paragraph 4.80**, where text could be included to make it clear that the efficiencies must occur within a reasonable time frame.

Boxed text under paragraph 4.85 "failing firm defence" - we agree with the third industry bullet point i.e. that the TA must prove the SLC point. However, the onus is on the parties to prove that the firm is actually failing before the SLC test comes into play. Similarly, **paragraph 4.87** could be amended to make it clear that it is for the parties to satisfy the TA that those listed factors will arise.

Paragraph 6.6 - we suggest adding a clarification here that there is no obligation on the TA to provide informal advice if it is not able to do so, for example, if it would need third party input to properly form a view, but is not able to obtain that input because the deal remains confidential.

Boxed text under 6.14 "remedies" - we disagree with the first bullet point of the TA response. The guidance on remedies is still insufficient and it would be entirely possible and indeed beneficial for the TA to identify the remedies that may be applied in merger cases. See e.g. Schedule 8 to the UK Enterprise Act 2002, which sets out the provisions that may be contained in enforcement orders in merger cases. As a general principle of law, a company must know the sanctions that can be imposed on it before entering into proceedings. In particular, as the "directions" may only be given to the licensee, it would be interesting to see what directions would be given in respect of, for example, change in control through transfer of shares by shareholders of the licensee which is beyond the licensee's control and which the licensee may not have any way to remedy.

Paragraph 6.24 - the TA proposes that fees relating directly to the costs incurred by the TA in considering a case, subject to a cap of $200,000, will be imposed on parties. This does not seem a desirable arrangement. In particular, companies may dispute the level of fees imposed if they consider there have been delays in dealing with their application by the TA, which may lead to litigation; the fee level may turn out to be disproportionately high in comparison to the value of a transaction; companies will not know the regulatory financial implications of entering into a deal until it is too late for them to decide not to. More importantly, the proposal not to charge a fee in respect of completed mergers is likely to lead to a reduction in the number of parties pre-notifying deals, with the knock-on effect that more complicated remedies will often be needed to try to unscramble completed transactions.

We therefore suggest adopting a fixed fee system, perhaps with graduated fees depending on the value of the transaction, or the turnover of the target, that is applicable to all cases whether anticipated or completed. Such a system would have the added benefit of allowing the parties to accurately calculate merger fees at the outset of the deal, rather than having them as an unknown quantity.

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