THE LAW SOCIETY OF HONG KONG

Submission to Bills Committee on the Telecommunications (Amendments) Bill 2002 (“the Bill”)

Regulation of Mergers and Acquisitions in the Telecommunications Sector

1. **Scope of the proposed Bill**

The Bill applies to carrier licences, which include local fixed telecommunications network services operators, TV broadcasters who own or operate transmission facilities, external fixed telecommunications network services operators, mobile operators and satellite operators. It does not apply to non-carrier licences.

If the legislator assumes that a merger regime should be limited to the telecommunications sector, it should be aware that, in order to be effective, such a regime should not be limited to parts of that sector. New developments in information technology have led to an ever-increasing overlap between the industry sectors of telecommunications and information technology. This "convergence" led the European Commission to reconsider its policy framework for telecommunications and to extend its applicability to electronic communications as a whole. A merger regime that does not follow this approach risks being sidestepped by market developments. The market for backbone providers in the Internet market could serve as an example of how competition problems can arise due to a merger in this industry (see case IV/M.1069 - WorldCom/MCI, paras. 88-124). Too narrow an application of a merger regime also makes it unreliable for business since questions of limitation of application are not easily determined in practice.

In point 5 of the Legislative Council Paper for the House Committee Meeting on 17 May 2002, it is stated that the extension of the regime to non-carrier licences may be considered if there is concern about possible over-concentration of market power in the provision of public telecommunication services as a result of concentration activities involving non-carrier licences. A merger regulatory framework is a preventative tool rather than one based on reaction to market situations, therefore it should be considered whether the application should be extended at a time when such over-concentration can still be prevented without too much interference in the market rather than at a time when such intervention has to be strong due to pressing anti-competitive developments.

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2. Voluntary notification and ex-post system

An unduly restrictive merger regime restricts rather than favours competition. Mergers are not anti-competitive per se. They are anti-competitive only if they change the market situation in a way which seriously lessens competition in the market. In an assessment of whether such lessening of competition is serious, it should be considered that every merger which involves overlapping markets lessens competition due to the obvious elimination of a market player. However, the advantages of the merger to the consumer may still outweigh the negative results. It therefore should be right to recommend that the test of lessening competition includes consideration of pro-competitive, countervailing factors. These factors should include efficiencies (or economies of scale) as a result of the merger. Such factors may therefore have a direct effect on productivity gains and hence, price, which the Legislative Council brief does not presently address. Efficiencies are relevant under US federal antitrust law, but not currently EC merger control. However, the European Commission now takes the view that efficiencies should be relevant to merger review.

The ex-post model under the proposed Bill is apparently based upon the UK merger control regime. It is not the system employed in the US and the EU, in which transactions above a certain size must be notified by a stipulated deadline. In the US the transaction must be suspended until cleared, which is a form of pre-notification, whereas in the EU a transaction above a certain size must be notified within seven business days of agreement being reached as well as being suspended pending approval. The UK regime is subject to the criticism that too many transactions bypass scrutiny and is reliant upon complaints by third parties for effective monitoring of the market. In the absence of complaints, the UK authorities have no means of determining whether transactions may be anti-competitive unless they go into the market for information on their own initiative. Required pre-notification shifts the burden of providing significant preliminary information from the authorities to the parties.

An ex-post system may create insecurity for business. If the Telecommunications Authority is entitled to research any concentration for an unlimited period of time, businesses will be insecure as to whether their transactions will stand or not. Companies may react to this insecurity in two ways. They may either notify all transactions to the authority in the way which is foreseen in the proposal and thus force the authority to act, which in turn may lead to an overburdening on the authority or they may, on the other hand, refrain from notifying transactions and try to cope with the inherent insecurity in doing mergers. However, according to the experience in the UK and the EU, such insecurity often leads to a fall in merger activity, which is neither good for business nor for competition.

We recommend that these shortcomings be addressed as follows:

All large-scale transactions above a certain size should be subject to mandatory pre-notification. This notification should be comprehensive and place the burden of supplying significant information directly on the parties. All other transactions, which are below the set threshold, should either be subject to the proposed voluntary ex-post regime or, preferably, subject to safe harbour treatment and not subject to attack at all. In a voluntary notification regime, if this is

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the ultimate route adopted, the authorities should be given a time limit to submit transactions to review.

3. Types of transaction affected

The Bill currently would apply the regulation not only to changes in control, but also *any* changes in ownership, provided that they have, or are likely to have, the effect of substantially lessening competition. This would bring even acquisitions of nominal share purchases or accretions, not resulting in a change in control, within the purview of the proposed merger control. This is the US approach, but not the EU model, which depends upon a change in control. It is difficult to judge which approach would be more appropriate for Hong Kong. Such judgment would depend on a number of objective and subjective factors. Perhaps one means of addressing this issue from an economic perspective is to see how, for example, the EU deals with such non-control-creating acquisitions.

In the EU, acquisitions of ownership not effecting a change in control of the target are reviewable not under the EC Merger Regulation, but rather Article 81 of the EC Treaty, in the event that the shareholding is obtained in a competitor. In other words, in such cases of passive investment, the test is not one of whether a merger has taken place, with the usual test that applies to concentrations of market power, but whether the share acquisition is a means for two legally separate competitors to coordinate their market activities, for example, with regard to pricing. Since the Telecommunications Ordinance contains certain provisions which are equivalent to Article 81 and the competitive assessment includes not only factors relating to market power and dominance but also to coordination of competitive behaviour by the parties, the US approach proposed in the Bill would seem to be excessive or not inappropriate for dealing with such scenarios.

The Management and Technology Committee
The Law Society of Hong Kong
5 October 2002

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