

**TELECOMS INFOTECHNOLOGY FORUM**

**MERGERS & ACQUISITIONS:  
A TELECOMS POLICY FOR HONG KONG?**

February 24, 2003

Bloomberg Auditorium

**SUMMARY PAPER**

## Telecoms InfoTechnology Forum

### Mergers & Acquisitions: a telecoms policy for Hong Kong?

The ‘years of the locust’ for telecommunications and IT spending and investment is the best way to describe the period 2001-2002, brought about through over-investment on a grand scale. Factors responsible included over-optimistic forecasts by networks of short-term growth in especially Internet traffic, and under-estimations of the total cost of ownership and over-estimations of performance and returns on investments on IT by corporate customers. The result: a big industry shakeout, but also sooner or later a cyclical return to growth. This forum will examine both these aspects.

On the structural front, divestments, write-downs, closures, bankruptcies and Chapter 11 filings. This would seem fertile ground for takeovers, buyouts and M&As in general, but these have slowed down from the giddy heights of the dot.com boom years. Nevertheless the industry expects consolidation in markets where margins are negative or wafer thin and as the emphasis of financial markets return to... returns. Corporate spending on IT is surrounded by uncertainty as to which technologies and which service providers will survive the fallout. Recovery isn’t just about total spending, but also about which technology directions to take, and many companies are wary about committing at this stage.

Under these conditions, industry consolidation is widely anticipated, so what should M&A policy look like? Everywhere it is coming under review. The FCC in the USA seems to be swinging behind the Regional Bell Operating Companies (RBOCs) by denigrating services competition based upon local loop unbundling as a poor substitute for full-blown facilities competition – the final nail in the coffin for the surviving CLECs (Competitive Local Exchange Carriers)? Part of the Bush Administration’s greater tolerance of dominant companies? In Europe competition and M&A policies, which are not sector specific, have been under attack and review in the EU for the past year suggesting the European Commission may retreat from what its critics argue is a policy of over-zealous close scrutiny.

In Hong Kong the Government is proposing its own Amendment Bill to strengthen the hand of OFTA in reviewing M&As for possible “substantial lessening of competition” effects. There is concern within the industry that this will result in undue delays and complications in what is essentially a commercial process, and some argue that what is now needed is a general competition policy, not sector specific legislation. On the other hand, consumer and user groups are concerned that consolidation will see prices go up and customer choice go down. TIF will look at the issues in more detail prior to Legco’s Bills Committee due on 27 February.

**Venue:** Bloomberg Auditorium, 27/F Cheung Kong Centre  
2 Queen’s Road Central, Central

**Time and Date:** 2 – 5.30pm Monday 24 February, 2003

#### **2 – 3.00pm – Session One**

- **Guest Speaker:** Ewan Sutherland, Executive Director, INTUG – signs of market recover, or signs of market consolidation: a user perspective (20-30 minutes)
- Dr Robert Crandall, Brookings Institution – the state of competition in the U.S. market

#### **3:00 – 3:30 pm – Coffee Break**

**3.30 – 5.30pm - Session Two:**

- **Keynote:** Edward Whitehorn, Assistant Director (Competition Affairs) OFTA - M&A legislation in Hong Kong (20-30 minutes)

**A Panel Discussion:** Tony Cheung, President, Fixed Network and VAS Group, ITAHK; Simon Chan, Chairman of HKTUG; Victor Hung Tin-yau, Chief Trade Practices Officer, Consumer Council; Michael Reede, Partner, Paul, Weiss, Rifkind, Wharton and Garrison; Ewan Sutherland, Executive Director, INTUG; Agnes Miu, Director of Legal & Regulatory, Hutchison Global Communications

List of Participants	
Alcatel China Ltd	Ambrose Lo
Alcatel China Ltd	Paul Christensen
Allen & Overy	Anna Gamvros
Allen & Overy	Noel Murphy
Arculli and Associates	Bernardine Lai
Arculli and Associates	Dr Andrew Simpson
Artesyn Technologies Asia Pacific Ltd	Dr W K Lo
Asia First Technology	David Werner
Brookings Institution	Robert Crandall
CM Consult	Terry O'Neill
CITB	Gracie Foo
CITB	Linda So
Consulate General of Canada	Brian Wong
Consulate General of Japan	Hiroyuki Hishinuma
Consumer Council	Victor Hung
Credit Suisse First Boston (HK) Ltd	Christopher Fang
Denton Wilde Sapte	Eddie T K To
DLA	Peter Tse
Dow Jones Newswires	Nisha Gopalan
Goldman Sachs Asia	Radek Barnert
HKTUG	Simon Chan
Hong Kong Baptist University	Yan Mei Ning
Hong Kong Land Infrastructure Ltd	Martin Lodge
HSBC	Geoff Lee
Hutchison Global Communications Limited	Agnes Miu
Hutchison Global Communications Limited	Andrew Kwok
Hutchison Global Communications Limited	Lam Siu Keung
Hutchison Global Communications Limited	Mary Cheah
Hutchison Global Communications Limited	Thomas Yau
Hutchison Telecom	Conrad Chan

Hutchison Whampoa Limited	Lorelei Fleming
Infocast	Chui Yee Kwok
Interactive Telecom Limited	Joseph Chan
INTUG	Ewan Sutherland
ITAHK	Tony Cheung
Legislative Council (Panel on Information Technology & Broadcasting)	Hon SIN Chung Kai
McKinsey	Gordon Orr
McKinsey	Jon Garcia
New World Telecommunications Limited	Dumas Chow
OFTA	Edward Whitehorn
Oriental Daily News	Ivan Ho
Ove Arup & Partners HK Limited	Jonathan Lamm
Paul, Weiss, Rifkind, Wharton & Garrison	Michael Reede
PCCW Ltd.	Eva Chan
PCCW Ltd.	Stuart Chiron
PCCW Ltd.	WH Tang
Peoples Telephone Co Ltd	James Kong
PricewaterhouseCoopers	Andy Wong
PricewaterhouseCoopers	Gloria Ho
PricewaterhouseCoopers	Ian Sanders
PricewaterhouseCoopers	Katy Spooner
PricewaterhouseCoopers	Nigel Mukherjee
REACH	Julia So
REACH	Shirley Woo
Reliance Service Limited	Raymond Ng
Resources Connection	Thomas Chu
Simmons & Simmons	Jodie Coutts
Simmons & Simmons	Kate Ollenrenshaw
Sing Pao Newspaper Company Limited	Shek Wing Lok
Sing Tao Daily	Chan Kwok Kin
State Publications Limited	Edward Leung
SUNDAY Communications Ltd	Cheung Wai Lok

Telecom Asia	Robert Clark
Telecom Research - Asia-Pacific	Graham Mead
The Hong Kong Polytechnic University	Dr Mark Williams
The Hong Kong Polytechnic University	Dr Stephen Luk
The Standard	Georgina Lee
The Sun	Alton Chi-yeung Yam
TraxComm Ltd	Nelson Tsang
TraxComm Ltd	Wong Wai Lun, Bernard
United States Consulate General	Mark Womble
Vision Century Corporation Ltd.	Philip Zhai
Wharf T&T Limited	Agnes Tan
White & Case	Chung Ying Woo
Winstar Communications HK Ltd	Loren Smith
	Gary Lam

# Telecoms InfoTechnology Forum

## Mergers & Acquisitions: a telecoms policy for Hong Kong?

24 February 2003

(Venue: Bloomberg Auditorium)

### Executive Summary

1. TIF debated the new powers to be given to OFTA over mergers and acquisitions. Back in July 2002 TIF debated the future of IP networking and it turned out to be 'one of the liveliest TIF's and yet almost complete consensus!' This TIF was equally lively, but with much less consensus. Nevertheless it was productive. The Bills Committee of Lego met three days later, on 27t February, and many of the points made below were subsequently raised there. At the time of writing the Bills process is continuing, and this Summary is therefore also designed to assist legislators.

#### European Union

2. **Session one** was addressed by **Ewan Sutherland, the Executive Director of the International Telecommunications Users' Group (INTUG)** and by the eminent telecommunications economist **Dr Robert Crandall of the Brookings Institute in Washington D.C.** Ewan began by surveying a panoply of issues facing the industry and users globally. These include broadband pricing and mobile international roaming charges (see also para 4 below) which is an example of the 'joint dominance' problem the M&A legislation in Hong Kong is designed to address. He notes that M&A activity in Hong Kong may well involve changes of ownership that involve international firms. He then turns to the sullied experience of **telecoms mergers and acquisitions in Europe** and the pernicious role of financial markets. His mobile operator in Belgium was 'bought and sold three times in a matter of months at dramatically different volumes. One day I was worth 600 euros, another day I was worth 1,400 euros. I'm still trying to work out how anybody thought they are going to extract that from me in the way of volume.' Once the prices crumbled the telecoms industry turned to the regulators to bail them out, and of course Europe is also home to many vendors who provide employment and R&D euros, so the process becomes very political. Ewan also makes the point that evidence suggests that most M&A activity does *not* produced the claimed for increases in efficiency through cost savings and business synergies. 'Mario Monti who is a professor of economics, as well as being the European Commissioner for competition, noted that more CEOs regret discretely and privately that their deals have been authorised, rather than they had not been authorised.' (Also see the TIF Briefing Paper [http://www.trp.hku.hk/tif/papers/2003/feb/briefing\\_030224.pdf](http://www.trp.hku.hk/tif/papers/2003/feb/briefing_030224.pdf)).

## USA

3. **Dr Robert Crandall (Brookings Institute)** was a visiting guest who generously agreed to speak *impromptu* on the recent decision of the FCC to abolish local loop unbundling for broadband in the USA and, in opposition to the FCC Chairman, to push back to individual states the decision on PSTN unbundling. Unbundling had in practice degenerated in the USA to the wholesale leasing of the ‘uni-platforms’ of the Regional Bell incumbents by their long distance competitors, such as AT&T and MCI, wherein all network elements were unbundled and thus none were unbundled. The entrants to the local loop simply bought the entire package. This resulted in Dr Robert Crandall’s opinion in a lack of investment in innovation and new services ‘because they don’t own their own networks, they are not going to develop any new services. They show no interest in it. Secondly, nobody in the United States seems to be gravitating from the uni-loop to facilities.’
4. Dr Crandall also notes that unlike Hong Kong the distance of the local loop in the US presents a major cost barrier. **Dr John Ure, director of the Telecoms Research Project, HKU and TIF**, notes that may be a reason why unbundling of the local loop and the building of competing customer access networks has been relatively more successful in Hong Kong than in most other places. Recent data showing the declining market share of PCCW is indicative of this, although it took longer than some people anticipated. **Dr Crandall** also notes the problem of high mobile termination charges do not exist in the USA because the mobile sector operates a Calling Party Pays (CCP) system with a ‘reciprocal compensation for local carriers of which wireless carriers are a subset.’ (See para 2 above.)
5. **Dr Crandall** goes on to address the **M&A situation in the USA**. Under general competition law ‘you’ve got to provide an economic analysis that shows a merger may tend to lessen competition or to create a monopoly in any line of commerce, which is taken to mean an economic market. It is very difficult to prosecute those mergers through the antitrust division because the courts simply will not ratify any attempt to attack those mergers.’ However telecoms is different because mergers have to be approved at either the individual state level by the regulatory commissions or by the FCC at the federal level ‘under a public interest standard, which means any darn thing the FCC wants to do because the law [1996 Telecom Act – ed.] is written so vaguely that the courts will not overturn the commission on doing these things. As a result it becomes a political feeding ground.’ So ‘there’s a strong intellectual argument for changing that law.’

## M&A in Hong Kong

6. **Session Two** was devoted to the M&A debate and was led by **Edward Whitehorn, Assistant Director (Competition Affairs) OFTA**. He explains the new law will only apply to carrier licencees and extends the existing powers of OFTA only in cases where the market structure changes as a result of share transfers arising from M&A activity. There are three types of changes which will bring the powers into effect: (a) a change in control exercised over a carrier licencee; (b) a change in the beneficial ownership of any of the voting shares in a carrier licencee; and (c) a change in voting control of any of the voting shares in a carrier licencee. A change of control is deemed to have occurred if one of four events takes place:

(i) a person becomes a director or principal officer of the carrier licensee; (ii) a person becomes the beneficial owner of more than 15 per cent of voting shares in a carrier licensee; (iii) a person becomes a voting controller of more than 15 per cent of voting shares in a carrier licensee; and (iv) a person acquires the power to conduct the affairs of a carrier licensee. All of these indicate a change in control. In all these cases the test will be whether the M&A significantly lessens competition in the relevant market.

7. The principle embodied by the law is *ex post* regulation and any investigation by OFTA must be completed within 4 months. OFTA will invite informal *ex ante* approaches to receive confidential advice, however this advice will not prejudice OFTA's legal rights to initiate an investigation *ex post*. Interested parties can also request prior consent from OFTA that will trigger an *ex ante* public investigation to be completed within one month after which either approval will be given or a second more intensive stage of investigation will begin to be completed within 4 months. OFTA decisions can be challenged at the Appeals Board. One participant was concerned that the *ex ante* and the *ex post* decisions could end up with access to different information using different tests and assessments, to which Edward responded by pointing out that prior consent would require a public approval process, unlike the request for confidential advice.
8. **Victor Hung Tin-Yau, Chief Trade Practices Officer, Consumer Council and Simon Chan, Chairman of HKTUG** both supported the principles of the proposed law. **Victor Hung Tin-Yau** argues that sector specific regulation is not contradictory to the ideal of general competition law that still does not exist in Hong Kong because the lessons and experience of sector specific regulators can feed into a future competition commission. **Simon Chan** supports this view arguing that telecommunications requires specialist regulation by people with expertise and training. **Ewan Sutherland** also stresses the need for the special expertise of economists, accountants and lawyers to be brought into the picture to improve the quality of judgement and avoid special interest group lobbying.
9. **Tony Cheung, President, Fixed Network and VAS Group, ITAHK, Agnes Miu, Director of Legal & Regulatory, Hutchison Global Crossing and Michael Reede, Partner, Paul, Weiss, Rifkind, Wharton and Garrison** expressed strong opposition to, or reservations about the proposed new law. **Tong Cheung** argued that existing conditions in the Ordinance and the carrier licences were already sufficient to protect against anti competitive behaviour and 'therefore, there's no need for any other sector-specific regulation in the M&A.' In response to Victor, Simon and Ewan, Tony argues that OFTA 'may not have the specialist skills in dealing with the complex legal and economic issues arising from telecommunications M&As.' But his main point is the unjustified asymmetric treatment of this industry and the uncertainty it generates for potential M&A activity and for any new investment that may seek to enter the industry in this way. He suggests that 4 months *ex post* threatens to be a major deterrent to such investment and the Internet & Telecoms Association of Hong Kong that represents most of the operators is concerned at the lack of checks and balances in the new law.

10. **Agnes Miu** reinforces this argument by pointing out that in overseas jurisdictions a separate authority employing specialist professionals makes decisions, not the regulator, and that where M&A provisions exist they are dealt with by a competition commission, not a telecoms regulator. But her main objection is that the proposed law introduces new powers at a time when the industry is facing a serious economic challenge. 'It is not like an extension or clarification of existing rules and that's also the basis of our objection. And at this juncture I think introducing something new already on a very hot-headed industry is very badly timed.' Several participants supported the view that investment could be negatively effected by M&A legislation that singled out telecoms, a point that was picked up in a WTO report on Hong Kong in December 2002. In response Agnes stressed that opposition to this asymmetric treatment is 'a matter of principle.'
11. **Michael Reede** questions the consistency of the Bill as it covers some share transfer transactions but not others, for example in the mobile sector. He cites the case of CSL's takeover of Pacific Link. OFTA dealt with the issue quite rapidly but under the Bill it would trigger a process that could become much more detailed and lengthy which could easily scupper an investment. He is uneasy with the wide powers of discretion the Bill gives to OFTA and he reiterates the point Agnes makes citing Australia where the judgement lies not with those involved in day-to-day regulation of the industry. He also reminds us that Hong Kong is a city market, not an EU or USA.
12. **Edward Whitehorn** responds to Michael that the Pacific Link M&A was captured by the licence conditions and OFTA wants 'a more consistent regime so that we don't only have some mergers subject to control and others not.' He also defends the maximum period of 4 months investigation as a trade-off between timeliness and the quality of the decision which may have to stand up before the Appeal Board, but **Michael Reede** points out the maximum may easily end up as a minimum. **John Ure** suggests that OFTA could borrow from the EU's use of informal 'state of play' meetings to speed the process. He also agrees that the use of sophisticated economic tests could become unmanageable, although given Michael's point that Hong Kong is just a city market this should simplify the process. He adds that in Hong Kong's case it may turn out that the vertical effects of M&A outweigh in importance the horizontal effects, an atypical situation. **A participant** makes the additional point that sector specific M&A law may run into problems when the mergers cut across converging industries, for example telecoms and broadcasting.
13. **One participant** makes the point that the 'jurisdictional trigger mixes up the tests, the substantive test. And I would ask why the jurisdiction is drafted as widely as it is so that there is no level of materiality for any transaction regardless of size or value... secondly, the response that we always hear back from OFTA is that, well, we will only take action where there is a substantial lessening of competition. And again, I would say that that is a substantive test against which to evaluate a merger, not one against which to trigger a review.' In response **Edward Whitehorn** accepts 'there is a very widely drawn jurisdiction in the bill, and we are considering in OFTA whether

we should introduce some kind of thresholds ourselves to provide guidance to the industry.’ And he assured participants that ‘A single change of one principal officer in a carrier licensee is hardly ever going to produce any competitive problems. But the bill is drafted in that way, so we will have to find a way to make it work.’ **Michael Reede** understands why the regulator would want legislation to cover all eventualities, but ‘we don’t have any hard figures other than the very low percentage thresholds for the equity transfers.’ [The thresholds appear in the Guidelines and not in the Bill itself – ed.]

14. **Ewan Sutherland** suggests the ‘normal response of operators is not 3G but 3D; deny, delay, degrade. Nobody would possibly want that, or it will be very difficult to implement, and when it does happen you make it not work very well.’ The simple economic truth is that merger controls improve the economy. He adds that the ideal policy is to do away with licences unless scarce resources are involved, but without licences we need an alternative policy instrument to regulate M&A activity. **Tony Cheung** found this view not relevant to Hong Kong today where licences do exist and are sufficient. He also argues the case that mergers can bring efficiencies to the industry, but **John Ure** points to the Briefing Paper that cites non-conclusive evidence that seriously questions the efficiency gains from most mergers. **Another participant** questioned the industry why a merger that could give a company, say 45 per cent of the market would ‘be a benefit to the industry and to the consumers.’ **Michael Reede** responds that the issue is really about the transparency of the process, about thresholds for example, and about potential lengthy delays in the process.
15. Finally a **participant** asks how many operators constitute a competitive market? For **Ewan Sutherland** the real question is about freedom to enter and exit the market, not how many exist at any one time. For **Victor Hung Tin-Yau** the danger of lower numbers was the emergence of collective dominance. **Tony Cheung** suggests that six mobile operators is too many in Hong Kong. **Agnes Miu** distinguishes between the short-term benefits of price competition to consumers and longer-term benefits to consumers of an industry that was profitable. **Michael Reede** draws attention to the provisions for MVNOs in Hong Kong’s 3G market. For **Simon Chan** it’s more a question of user choice and quality of service. **Edward Whitehorn** stresses the need to examine a wide range of market factors, for example, market shares. **John Ure** closed the session by pointing out that uniform prices will be exhibited in both collusive and perfectly competitive markets and only by comparing rates of return with other competitive industries could these two types of markets be easily distinguished.
16. **Conclusion:** half the panel supported M&A legislation, even if they preferred to see a general competition policy put in place, and the other half opposed the legislation as asymmetric but would also oppose general competition law as being unsuitable for Hong Kong’s small, open and liberal economy. **Tony Cheung** summed up his position when he said ‘the comments that I’ve heard this afternoon further convinces me that it is absolutely necessary to have this panel review, because I find it very uncertain, very risky.’ Perhaps the closest TIF came to a consensus on anything was

general agreement that the provisions of the Bill required close scrutiny and there are grounds for improvement and/or clarification in the guidelines to make it as light handed as possible.

**Monday, 24th February, 2003  
(2.15 pm) Telecoms Infotech Forum,**

**"Mergers & Acquisitions: A Telecoms Policy for Hong Kong?"  
at the Bloomberg Auditorium, Hong Kong**

**JOHN URE:** Welcome to the meeting of the Telecoms InfoTechnology Forum. For those who don't know me, my name is John Ure. I direct the Telecoms Research Project at the University of Hong Kong. We've got good news and bad news. The bad news is that Bill Rojas has come down with a stomach bug over the weekend, so Bill won't be able to join us today. The good news is that Dr. Robert Crandall, who is a very eminent economist from the Brookings Institute in Washington, and a specialist in telecommunications economist, is in town will be attending TIF. And I've invited him to make a contribution during this first session. The first session will be led off by Ewan Sutherland, who is the Executive Director of the International Telecommunications Users Group. Ewan is based in Brussels. And will give an overview of what he sees to be the state of the industry. I've also asked Ewan, in anticipation of the theme of the second session, to talk a little bit also about mergers, acquisitions policy in Europe. Ewan will also join the panel in the second session. So he will have two bites of the cherry on that one. And then when Dr Robert Crandall comes, I'll ask him to talk a little bit about policy issues in the United States. In particular, some of you may have noted that the FCC has split right down the middle. The chairman of the FCC William Powell, the son of Colin Powell, came out with very clear statements that he thought unbundling of the local loop should be scrapped as a policy. The FCC Commission split and voted against that proposal, and proposed, instead, that each state should be allowed to determine its own policy. So I'm hoping Bob Crandall will make a comment or two on that, among other issues. Before I introduce Ewan, Simon, would you like to, on behalf of the Hong Kong Telecom Users Group, officially give a welcome to Ewan.

**MR SIMON CHAN:** I'm Simon Chan, the current Chairman of the Hong Kong Telecom User Group. I'd just like to say a few words about Ewan before he starts. Some of you may have heard about INTUG, but most of you may not have heard about it. INTUG is the counterpart of Hong Kong TUG because as the telecom user group, we have a worldwide network of user groups and associations around the world who are all members of INTUG. So globally we are driving towards the liberalisation and work of the industry to make it a more better place for the telecom market. I knew Ewan several years ago. In Hong Kong we have opened up the telecom in markets almost every sector, so we are actually a bit fortunate. In Europe where Ewan came from, he has a long -- yes, he can talk a very long history about how difficult it is in European markets. Every jurisdiction has difficulties in opening up from, you know, from unbundling of the local loops to roaming and whatever. So Ewan is teaching at a University in England and recently he joined INTUG as Executive Director in 1999. He has frequently come to Hong Kong and he can talk hours about Europe and all this telecommunications work. We will give him only about 20 minutes to talk about what John just mentioned. Please welcome Ewan.

**MR EWAN SUTHERLAND:** Good afternoon, ladies and gentlemen. Let me try not to waste too much of my 20 minutes. INTUG, as Simon said, tries to bring together international aspects of telecoms. So what we are doing is picking up national associations, whether that's Hong Kong TUG here. I've just come from Johannesburg where I was with the Communication Users Association there. Next week I will be with our Australian user group. So an important part of what we're doing is picking up specific national experiences and identifying how we address those. So that there are a number of countries who I point to Hong Kong when they say mobile number portability is a very difficult problem. We can happily say it was solved here some considerable time ago. Here's an example of a solution, here is how it can be done. How can you customise that for your situation. Obviously there are many instances where Hong Kong is a bad example on the grounds that it is not immediately comparable with South Africa in any obvious way. It is not immediately comparable with the United States of America or other places. So what we are trying to do is find those examples, so issues come up. The other part of the story comes from multinational corporations. And we then take those issues to global bodies, international bodies. Such as the International Telecommunications Union, to the World Trade Organisation, to the Organisation for Economic Cooperation and Development -- and I'll come back to that in a moment -- and to APEC TEL. So the last week of March some of our members will be in Kuala Lumpur for the meeting of the Telecom Working Group of APEC. And that's an opportunity for us to say to countries there what's going well, what's going badly, what you can bring to that. Part of, in fact, what we will be doing in that is addressing issues of the countries who are falling behind in broadband. So it is an opportunity to do that. And CITELE is merely the American equivalent that's for North and South America. And as was said, I'm based in Brussels. So I spend a significant part of my time working with the European Commission and with the European Parliament and the other European institutions and telecoms. So we try to take the positive experiences. So what we are looking for is -- it is an old story, real and effective competition, genuine choice for users, lower prices, higher quality, all at the same time, thank you very much. And more innovation and everything moving forward and market structures which achieve that. And by way of example, what I'm being asked to do next week is try to explain to Australia why it has so far managed to sink to number 20 in the global table for broadband and why it shows every sign of sinking to number 25 and number 30 and number 40. Not least because the incumbent operator has decided its target is one million -- what it likes to call broadband lines of about 512 K. That's compared to Japan's which has added more than a million lines in the last six months and at nine or twelve megabytes per second. And it is trying to see why is the market structure and the regulatory structure in Japan delivering that, whereas, in Australia clearly it is not. So it is taking those experiences and trying to achieve those objectives and working collaboratively with international bodies, governments and regulators. The priority -- number one priority says mobile networks. Mobile networks have presented some of the most difficult abuses for users. In fixed mobile call termination, in international mobile roaming charges. So when my mobile phone rings here in Hong Kong, I am very hesitant to answer it, because I'm going to be charged something like two Euros a minute for incoming calls. Looking at regulatory best practice and how we can share that, look for liberalisation, specific problems and issues, such as leased lines. Why are they quite as expensive as they are. And picking up issues such as

IP Telephony. A very nice example of IP Telephony has come in the last few days from Japan where the incumbent operator has just responded to the offer of Yahoo BB. Yahoo BB offers voice telephony from its Broadband network onto the Japanese network at two cents a minute. NTT has just responded with the same price offer. What's interesting is that in order to keep life simple, Yahoo BB has the same price for calls to the United States of America from Japan, two cents a minute. Now when you reduce the whole world to two cents a minute, it changes somewhat the nature of the game. And the problem is that you have got a bunch of operators who resist that. And so having just come from South Africa where, basically, IP Telephony is seen as something to be outlawed and illegal and to be deposed of, it is a very different attitude. So the other issues on that are how do we close the digital divide. What can we do about universal access on some specific numbering issues. That's very much what we've said are priorities. I mean, a crucial part sitting here in Hong Kong it is very hard not to appreciate the importance of global markets and continental scale markets. Big users. The brand names you see on the buildings looking out from here. And I have to say as somebody who doesn't like heights, I'm sort of a safe distance from the window here, but if I'm prepared to, you know, somebody holds tightly to me and I go closer and start to read the names, those are companies who need global networks. And they are looking for global services or, at the very least, continental services. If you go to business school at the moment, what did they tell you is the optimum? The optimum is five suppliers. I do not mean by that five market players. I mean, that you have picked five suppliers from the global market to provide your services. The reality today is that you have multiple fixed operators. That you cannot go to any one operator who can supply those services, because there are innumerable operators. The core volume proposition in mobile telephony is roaming for businesses. And the catch with that is that they make a lot of money by not supplying you with a global service when they could do and significantly save your costs and make business more efficient. Just how do we achieve that? A big part of the problem has been the failure of the operators in building a global business model. What they've done is build a series of failures. They tried joint ventures. So there may be people in the room who were customers of Uni-Source or Concert. I have interesting things in the office which have brand names of companies which no longer exist. I was at a conference recently and criticised somebody for using an antique. It was the PTC 1997 bag which had MCI on it. These were names which came to us which we were told they were to be the solution, they were to be the way forward, and the joint ventures failed. The operators then tried building into markets. They tried to create new constructions. British Telecom came to Asia and tried things. Deutsch Telecom, France Telecom tried things in specific markets. But these very quickly turned out not to work. We then went through a series of serial acquisitions. And I think the crucial part to the serial acquisition story was that the financial markets paid for all of this. The financial markets made it great fun to go out and buy customers, by buying up companies. I found myself as a customer of a mobile operator in Belgium bought and sold three times in a matter of months at dramatically different volumes. One day I was worth 600 Euros, another day I was worth 1400 Euros. I'm still trying to work out how anybody thought they are going to extract that from me in the way of volume. It was a financial engineering exercise which they had created. And that when the financial market peaked, the financial market looked very much like Mount Fuji; that very nice slope up, a lot of smoke and fire at the top, and

then this rather unpleasant slope down on the other side. And the problem is that as the share prices come down, nobody wants the shares. And we have already seen Deutch Telecom write off 20 billion dollars worth of acquisitions. So we had the wonderful spectacle a few years from the press of spokesman from Deutch Telecom telling us that they had paid so much money for Voice Stream in the United States of America, because the US was an emerging market. Mobile in the United States would be driven up to Western European levels and this investment would be showing wonderful volume. And instead of which it has been, in effect, written off, it no longer exists as an investment. The operators tried start ups in other countries. Now it seems they would like to consolidate. Now the idea is competition really was a bad idea and we want to pull away from that. Fashion, it seems, changed in management. And I think it was Barbara Shapiro wrote a nice book entitled, Fad Suffering in the Boardroom. The emphasis being that sometimes fads come into boardrooms and it goes. A good question is why would you consolidate? Is consolidation something intrinsic in the market, is it something which we would reasonably expect. And the truth is that much of it comes back to the core competence of the operators. Theoretically business school analysts would tell you that a competence of an operator would be in satisfying customers and their telecommunications needs. The reality is that in many cases what an operator is good at is manipulating the regulatory and the licensing process. The theory was we would have a phased stage of liberalisation. And what happens is we never quite get there. It is like that curve which never quite reaches the horizontal axis. Our ability is to delay, to put off, to say, for example, there's been big arguments in Europe that you wouldn't want to regulate fixed to mobile call termination. You wouldn't want to regulate international mobile roaming. Why was this? Because it represented 25 percent of the income of the mobile operators for call termination and 15 percent for roaming. And if you cut down on those, they would see their share price and their credit ratings fall. They would respond to that by cutting their investments and they would hit the manufacturers. So the mobile operators were going around, and in some cases getting their principle shareholders - in this case, France Telecom, largely still owned by the French government, Deutch Telecom, by the German government - going in and saying, You don't want to regulate this. This is a terrible thing. It will do bad things to the industry. It will destroy economic volume. It will undermine the operators and it will damage the manufacturers. It will cut research and development. It will destroy Europe. So it was very much a political set of arguments at that level. It was not helped by the fact that the European Commission are responsible. As a Finnish National, Nokia represents about a quarter of the Finnish economy. And he [the Commissioner -ed.] has political aspirations in his home country one day. The idea of going back, having done significant economic damage to Nokia is clearly not something which he would wish. The problem then is that if your core competence is, well basically you are a law firm, which does telecoms on the side, it turns out that your pattern of foreign acquisitions now looks unprofitable and appears unfocused and you face too much competition. And in many cases any competition is too much. So I come from South Africa where SBC has an investment. The problem there is very simply, why are SBC, why are Telecom Malaysia in that market, what is the logic of being there? And the answer is very little. When you look at the annual report of SBC or Telecom Malaysia, you see coloured dots on the map with no apparent pattern or purpose. So instead the operators want to retract, to subcontract in marginal markets and

get other people to do that. Because these are real problems, these are commodity services. These are the capacity to ship bits, either over cable or over the air, at relatively low prices. These are not differentiated services, so it is not something to worry about. The financial market clearly is substantially guilty of the problems. They flooded the money in. People always complain about the auctions. Remember the auctions in Germany, the auctions in the United Kingdom. The two largest auctions were conducted in the financial markets and the share prices held up during those auctions. So although the UK operators agreed eventually to pay 22 billion, that was done with the full and informed consent of the financial markets. The financial market proved that at any point they could have said, stop, that this is a very silly thing to do. Now we've reached the other position where they found nothing. And an obvious question is did they know what they were doing then, do they know what they are doing now, and who is it? That somewhere along the line thinking they are regulating the financial markets. We are having to pick up the pieces in telecoms as users. An obvious question is telecoms a different -- really an important aspect, fixed networks are still, in most markets, dominated by incumbent operators. So we have to look very carefully at any consolidation there. Any mergers, any acquisitions are clearly going to be influenced by the dominance of particular operators. And that's taken many years to break. Mobile networks have very severe barriers to enter it. And you therefore are dealing with what is basically an oligopoly, in most cases. So your hard core oligopolies and duopolies. It is very hard to route these things out on an international basis with these cross borders. And so far nobody has actually yet gone to a competition authority and said please, could we have leniency? We will admit that this is an oligopoly, we will admit we are running a cartel like yourself. Another crucial economic argument says innovation is something which you should be looking at. The problem is that there is not much R&D spending in the sector. Much more of that is in the suppliers than in the operators. So that probably isn't something that differentiates telecoms. As John said, we are going to look at mergers. And I will quickly flick through some pages. You've got paper copies there available. A crucial question for Hong Kong may be that the core parts of the merger may be approved somewhere else and it may be what in terms of the merger are relatively peripheral parts of the view here. Is the constant authority the telecoms regulate the competition authority or some government minister somewhere. The US solves that problem by having pretty much everybody involved and we all get a safe. We have important intergovernmental collaboration on this looking at best practice. I spent part of the week before last at the OECD Competition Committee, which was addressing some of these issues. The competition will come up eventually in WTO. There are some things which are peculiar to high tech mergers which is the importance of R&D, human -- much more than physical capital and innovation. How do you deal with problems? One example is we've been doing a lot of work with INTUG on the roaming. International mobile roaming has a dominance case, joint dominance. And here your problems are rapid changes in technology, short product cycles, pricing information which changes all the time, arguments about network effects, compatibility and standards. The question you then have is, do you need for high tech some sort of special procedure, some different remedy. The theory in the Hong Kong context, that's been handled purely for telecoms. But there's a broader -- those issues are going to be the same in other parts of the economy. You have to start defining markets. If you want a really good challenge, I think

two of the hardest distinctions which the European Commission had to make in its recent decision on market definitions was, what was the definition for mobile data. Is mobile data SMS which is carried in the signalling channel? SMS may be contestable with voice. Where does hot spot data fit with the rest, where does fixed data. What is that pattern between which is a very, very hard market to define. The European Commission, for example, simply ducked one of the hardest problems. And that was is voice call origination the same market. Is there one or are there two; one for mobile and one for fixed. The European Commission administratively separated them and said they are different. However, the truth is that, in many cases, those are contestable. And there is recent comment from the US Department of Justice that views that contestability as significant. And therefore, it was saying it would look up mergers in that light. Once you say that to the market, that changes quite significantly the type of mergers. And in the US context that might hint at the possibility of the 8 Baby Bells cases getting yet bigger still. We've seen one example in AOL Time Warner which one part for telecoms, which is relevant, is instant messaging. And there was an obligation there either to standardise or to interconnect. And the result in a very heavily concentrated market. It has been that you still can't interconnect, you still can't interwork because clearly it is a benefit to AOL and its ICQ subsidiary. So we have a problem here with a behavioural remedy which doesn't seem to be working. Let me skip through that and pick that one. This is a US consumer group saying that the avalanche of American telecom was threatening to undermine the developments of broad-based competition. Now that's the argument which was dealt with last week by FCC. The constant question of how much consolidation is good and when does it become bad. And we've seen massive consolidation in the US with Bell Atlantic/Nynex and GTE. MCI Worldcom ultimately reaching its nemesis in the accounting scandals related to that SBC being a problem. And you've seen recent decisions in cable television. So these are constant issues coming up in different markets, under different regulatory regimes. The European Commission has addressed based on what is called the Merger Regulation, which dates from 1962 from the original version. Recently being reviewed, it is going to be reviewed again. Other people want the end of mergers. Seen as politically very, very sensitive. One example which was very beneficial to users, which was this one, which is Atlas. Atlas was a merger of the data businesses of the French incumbent operator and the German incumbent operator. And what was the result, the result was approval, but only after the national markets had been deregulated. So the competition authority was able to impose as a remedy further opening of the market, so it moved liberalisation forward. Telia and Telenor was going to be a merger. One lesson here, don't get governments too closely involved in mergers. What happens was the Swedish minister was recorded in television, didn't know the microphone was on, referring to Norway as being the last Marxist state in Europe. At that point negotiations between the two governments mysteriously broke down. And Telia, the Swedish operator, instead married the Finnish operator, Sonera. But it was a very easy marriage to approve because all the work had been done in the previous case. Vodafone and Mannesmann -- I will return to in just a second. The program of cooperation between Europe and the US to try to harmonise the regulation of mergers. But there would be two major disputes involving General Electric, Honeywell, Worldcom and Sprint. So there are disagreements on how this is done. Joint dominance is very important in the European Union. It comes out of the original treaty. It is used as the basis for the case I'm involved

in on international mobile roaming, which is now driving down the prices of roaming or will do later this year. Those of you who like legal cases, can read 72 pages on the United Kingdom long distance and short distance holiday market in the Airtours case. And fascinatingly, one of the ways they distinguished the two markets was that the two operators could use different brochures. So if you go into the tour operator and you ask for a brochure with Hong Kong holidays in it, you get the long distance brochure, and otherwise, you get the short distance for holidays still in Europe. Very interesting way they have to draw that distinction. The Vodafone case -- the Vodafone built up its operation in mobile by a series of acquisitions. Vodafone originally created the Pro 2 UK national champion. And gradually built up acquiring companies in this whole series of countries. The acquisitions were paid for not with money but with shares. Everybody was happy to take Vodafone paper. There then was a very unpleasant, a very bitter battle with Germany over management. Arguably the first contested to take over Germany. And that saw in the settlement the divestiture of the engineering activities. They were spun off. There was then an undertaking to provide -- the argument was that Vodafone would be the only operator in a position to provide continental scale mobile services. And so it made an undertaking that it would provide third-party access to any pan-European services. Its solution to that has been very simple; not to provide any pan-European services. And to continue to offer home network plus rest of Europe roaming. When anybody inquired, it proceeded to offer several thousand tariffs. Some of which would not be available until the month after the customer used them on the grounds that these were volume-dependent tariffs. In effect what they did was offer something which was unusable to any of the competitors. Now the good news is that that expires in a few days time. I think it is on the 14th of April. So that will go and maybe at that point we will see Vodafone offering something. So Vodafone has got back into the mergers and acquisitions game. The qualification on that is that the roaming market has been analysed by the same competition policies in Europe, and seems to be basically a cartel. And those of you who like complicated documents, there is a 32-page working document from the European Commission which requires a Ph.D in law and a Ph.D in economics, and some passing knowledge of the technicalities of telecoms in order to be able to read it. So these are the sorts of very practical issues which have come up. The catch, of course, is recently we have seen very few mergers in telecoms because of less money. Clearly there are special cases. The France Telecom, the Deutsch Telecom special defence is they have got so much debt that if anything happens to them the banking system and the economy goes down. They have 65 and 70 billion Euros worth of debt. Respectably, that's the sort of thing normally acquired by an African military dictatorship over a quarter of a century, and having got rid of a string of dictators. So the problem becomes do you recognise a fairly firm defence. That is well established in traditional industries. Hard in telecoms. Do you recognise efficiency gains. Again, very hard to recognise that volume in telecoms. More important, it is arguably more important to get innovation than lower prices. I mean representing telecoms users, I would expect both. We know the cost drivers in the industry are pulling things down. We know how that should be. But there's an argument which says you shouldn't look at the prices but the ability to innovate. You should look at the attributes of the software. Now, very quickly you realise that this takes you to the case involving Microsoft and its dominance on that sector of the industry. There are arguments which the telecoms and high tech, in general, is different. Your being commissioned

process, as whether innovation having superior welfare defence, should be the focal point of competition policy instead of price competition. So you have in some way to balance those, whether technological developments are increasing in pace. One of the arguments, which an interesting example from Germany. The German telecoms regulator was asked, would it open five gigahertz band for Wireless One? And it looked at this and the argument was maybe this would effect the roll out of 3G. And it said eventually, a wonderfully clever ruling, which said no, these are complimentary services, they do not compete. This left the German mobile operators in the position they could hardly turn up and say, well, actually they do compete. Because the first thing the stock market would have done is said, Oh, they compete, right. Bring the share price down. So they were caught in that respect. But this question of technological innovations happening in another related market, as those markets become bigger, clearly it takes us away from traditional telecoms regulations to be much narrower and much more focused. Mario Monti who is a professor of economics, as well as being the European Commissioner for competition, noted that more CEOs regret discretely and privately that their deals have been authorised, rather than they had not been authorised. So there are occasions when, in a sense, he, as the competition authority, is saving them from the error of their ways when they see what might have happened. And that's clearly part of the problem. A new problem which has come to us, which is bankruptcy. And the problems of bankrupt operators and what happens with that; what do you do with the assets? One or two people have been arguing the risk of cyclical bankruptcies that telecoms become like the airline business? Where one passenger goes into bankruptcy and lowers the cost so much that the only way I can compete with them is to go into bankruptcy myself. Let me finish on a very simple example. There's an argument about spectrum trading. The mobile operators turn up and say, Well, he's got the spectrums, he's got volume, we should be allowed to trade in it. And on the face of it that has a certain plausibility. The problem I have with that is that there are some very peculiar aspects of this. That spectrum is spectrum in very particular ranges. It is spectrum agreed globally as being the spectrum for a particular service. Now, in theory, if somebody can make a business in making electronic garage door openers, the garage door opener that click. And one wishes to come along and buy up the Vodafone spectrum then, I suppose, they should possibly be allowed to do that. What it seems is that what the operators would like to do is reduce the numbers of players in the market. And clearly if you have, for argument sake, five operators in a mobile market, and the fifth one is out, it is going to be very difficult to have that operator sell the spectrum to one of the existing four players. That's not going to be easy. That happened interestingly recently in a rather peculiar case in South Korea which was approved. Now, what the mobile operators have done is realise that the regulator is not going to stand for number five selling its spectrum to number two. So what they have thought up is a very clever idea, that they will divide the spectrum evenly into four parts. The sort of King Lear approach. You divide the kingdom up into equal parts, give it to the children and retreat quietly from the scene. The catch is that then means nobody can enter the market. There is no remaining spectrum. What they have done is reduced the number of market players without the possibility of subsequent market entry. The only way you will be able to enter is if you can afford to buy one of the existing operators and, of course, nobody has the money to buy an existing operator. And so we end up in the same sort of way that people in steel industries used to buy up the plants of their

competitors and scrap it. It is very much on that line of thinking. And that seems to be thinking behind the mobile operators in spectrum trading. I will throw in a very quick observation which comes out of the OECD, which was a question asked by the South African chairman of the Competition Appeals Tribunal, which is, I've read all the stories about the Asian tigers, nobody ever mentions competition authorities. Why is that? Does this mean you can grow your economy enormously without any competition authority. And my response to that is the second part of that which says, Well, maybe it wasn't responsible for the growth but might possibly have been responsible for things going wrong. The absence of one. So quick conclusions. We see massive distortions of financial markets which have hit telecommunications very badly. We saw people who had zero cost of capital coming into the game and then disappearing from the game, changing things, setting the regulatory framework which turned out to be wrong. We have seen consolidation becoming a fashion, the new idea. My concern is that I don't think it is likely to be any more successful than the previous strategies of the operators. Many of whom, as I say, are law firms with networks attached. Competition policy is a national means to control excessive consolidation. Presents difficult problems when that company is fundamentally based in another country. And where a merger approval may be made in your market and how you deal with that. That is particularly true in smaller markets. Merger approval is very complex. It becomes a political and a regulatory game. Very clear, the emphasis people are having in trying to influence that. It is very hard to assess the arguments of the abilities and the willingness of market players validity when we have seen so many defensively by those operators to keep the prices up and to resist innovation. Thank you very much.

**INTUG**

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**Consolidation and competition in telecommunications**


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**INTUG contents**

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- what is INTUG?
- continental and global strategies
- high-tech mergers policy
- spectrum trading
- bankruptcy
- conclusions



**INTUG what is INTUG?**

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- members
  - national associations
  - corporations
  - individuals
- activities
  - ITU and WTO
  - OECD
  - APEC TEL, CITELE and EU



**INTUG our aims**

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- real and effective competition
- genuine choice for users
- lower prices
- higher quality
- more innovative services
- constructive co-operation with
  - international bodies
  - governments
  - regulators



**INTUG our priorities**

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- open access to global mobile networks
- regulatory best practice
- liberalization
- leased lines
- IP telephony
- digital divide
- universal access
- numbering



**INTUG global and continental markets**

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- multi-national corporations want:
  - global services
  - continental services
- instead of the business school ideal of picking only five global suppliers we have:
  - multiple fixed operators
  - innumerable mobile operators
- a few global service providers



## INTUG no global business model

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- operators have failed to create even one model for trans-national business
- joint ventures
- building new entrants in foreign markets
- serial acquisitions
- creating start-ups in other countries
- now it is consolidation

fashions seem to change!

## INTUG why consolidation?

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- core competence is manipulation of the regulatory process which is generally national
- foreign acquisitions now:
  - look unprofitable
  - appear unfocused
  - face too much (any) competition
- instead operators can sub-contract in other markets for commodity services (i.e. they failed to differentiate themselves)



## INTUG financial markets

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- flooded telecommunications with money, they sanctioned:
  - acquisitions
  - infrastructure investments
  - 3G auctions
- now will fund absolutely nothing
- did they know what they were doing?
- who was regulating them?



## INTUG is telecoms different?

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- fixed networks are still dominated by incumbent operators
- mobile networks have severe entry barriers
- hard core duopolies and oligopolies:
  - hard to root out on international basis
  - nobody has applied for leniency (so far)
- innovation:
  - R&D spending
  - but more a factor in suppliers than operators



## INTUG merger approval

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- who has powers to consider a case?
  - legal presence
  - conflicting decisions
- competent authority:
  - telecoms regulator
  - competition authority
  - government minister



## INTUG inter-governmental collaboration

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- OECD
  - Competition Committee
  - collaboration with APEC
- APEC
- WTO negotiations
  - the round after Doha
- International Competition Network (ICN)



## INTUG high-tech merger issues

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- importance of R&D
- human more than physical capital
- importance of innovation:
  - rapid change
  - short product cycles
- network effects
- compatibility and standards

A special procedure?  
Different remedies?



## INTUG markets

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- need to define market(s) to determine the effect(s) of a merger
- forward looking
- market shares
- innovation drives technological changes

It is challenging to define a mobile data market, as distinct from mobile voice, SMS, hot-spot data and fixed data.



## INTUG AOL-Time Warner

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- instant messaging
- obligation either
  - standardise
  - all interconnection
- market is very heavily concentrated
- still does not properly:
  - interconnect
  - interwork



## INTUG FCC Commissioners Capps

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The Nineties brought new rules permitting increased consolidation in the broadcasting industry, on the premise that broadcasters needed more flexibility in order to compete effectively. These rules paved the way for tremendous consolidation in the industry – going far beyond, I think, what anyone expected at the time. These changes created efficiencies that allowed some media companies to operate more profitably and on a scale unimaginable just a few years ago. They may even have kept some companies in business, allowing stations to remain on the air when they otherwise might have gone dark. But they also raise profound questions of public policy. How far should such combinations be allowed to go? What is their impact on localism, diversity and the availability of choices to consumers? Does consolidation always, generally or only occasionally serve the interests of the citizenry? How do we judge these things?



## INTUG Consumers Union (USA)

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Consumers Union is concerned that an avalanche of mergers in the telecommunications and cable industries is threatening to undermine the development of broad-based competition for local telephone, long distance, television and high-speed broadband Internet services. The Clinton Administration -- including its antitrust and regulatory enforcers - and the Congress appear frozen in place as today's mergers are justified on the basis of yesterday's mergers, and then used to justify even further consolidation in the future. This merger-mania is already so out of hand that the most popular services most consumers want and need may be available from only one or two players in the market.

Statement before Committee of US Senate 8 November 1999.



## INTUG USA

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- complex regulatory arrangements: Department of Justice, FTC and FCC
- “Baby” Bells cases:
  - Bell Atlantic/Nynex
  - Bell Atlantic/GTE
  - MCI Worldcom
  - SBC Corp (SouthWestern Bell and PacTel)
- recent decisions on cable tv and satellite



## INTUG European Commission

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- Merger Regulation based on Articles 81 and 82 of the Treaty, recent reviews
- Atlas, later Global One (FTel and DTAG)
- Telia and Telenor (then with Sonera)
- Vodafone and Mannesmann
- programme of cooperation with USA different legal approach and disagreements over:
  - GE and Honeywell
  - Worldcom and Sprint



## INTUG joint dominance

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24 February 2003  
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- in Article 82 of the Treaty:  
“Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States.”
- used in the international mobile roaming case
- clarified by ECJ in *Airtours versus European Commission*



## INTUG Vodafone

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- long chain of approvals of its acquisitions
- acquisitions paid for with the high and rising value of its shares (not yet written off)
- bitter battle over Mannesmann
  - divestment of engineering activities
  - made an undertaking to provide third parties with any wholesale pan-European services
  - never been used and expires in a few weeks
- roaming market is seen as a cartel



## INTUG special defences

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- failing firm
- efficiency gains
- more important to get innovation than lower prices:
  - so don't look at ability to control prices, but ability to innovate (attributes)
  - but very hard to assess incentives to innovate or withhold innovation
  - takes you into the US *versus* Microsoft case



## INTUG European Commission

TIF, Hong Kong  
24 February 2003  
www.INTUG.net

- ... Two question could be distinguished:
- Whether innovation, having superior welfare effects, should be the focal point of competition policy instead of price competition, and
  - Whether technological developments are increasing in pace, in general or at least in certain sectors, and if so whether this should lead to changes in current competition policy practice.



## INTUG Prof. Mario Monti

TIF, Hong Kong  
24 February 2003  
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I know more CEOs regretting discreetly that their deals have been authorised than regret that their deals have not been authorised

*Financial Times* 27 January 2003



## INTUG bankruptcy

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- a relatively new problem
- KPN Qwest
- Worldcom
- Global Crossing
- risk of cyclical bankruptcies like the airline business



## INTUG spectrum trading

TIF, Hong Kong 24 February 2003  
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- extreme barriers to entry:
  - mobile telephony
  - Wireless Local Loop
- operators want to reduce the number of market players
- will not be allowed to sell to one of the existing players
- instead they are trying to divide it up amongst all players to block subsequent market entry



## INTUG Asian tiger question

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- no mention of competition authorities in accounts of Asian economic growth
- did competition policy play a role in growth?
- did it play a role in its downfall?



## INTUG conclusions

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- distortions in financial markets hit telecommunication very badly
- consolidation is likely to be as bad as other “strategies” devised by the operators
- competition policy is a *national* means to control excessive consolidation
- merger approval is complex in telecommunications, often played as politico-regulatory game
- it is very hard to assess arguments about abilities and willingness of market players to innovate



## INTUG thank you

TIF, Hong Kong 24 February 2003  
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**DR JOHN URE:** Thank you very much, Ewan. What I will propose now is to ask Bob Crandall to give us a talk. Then to have Q&A before we have the coffee break and then move on to the specific discussion of M&A. Bob, as a way of introduction, to those of you who did not hear me right at the very beginning. The good news and the bad news today. The bad news first was that Bill Rojas is down with a stomach bug and can't be here to make his presentation. The good news, unplanned, was that Dr. Robert Crandall from the Brookings Institute is visiting Hong Kong. Dr Crandall is an eminent economist and well-known specialist in telecommunications economics. So we are very delighted to have Bob here today. And Bob is going to talk a little bit about the American scene and raise some of the issues about the FCC decision on local loop competition, and M&A policy in Hong Kong. Bob.

**DR ROBERT CRANDALL:** Thank you very much for having me. I did not expect to get up and give a formal presentation. Indeed, I have all sorts of formal presentations with me but none of them would be on point for what we will talk about here. Which is, first of all, the development of the local competition in the United States, the implications of last week's ruling on issues like unbundling the local loop. I also want to talk a bit about the continuation of regulation in a liberalised market. And, particularly, over the control of pricing. And I think, if I have any time left at all, which I probably won't, to talk a little bit about M&A activity, which is very different in the United States than, obviously, here or even than in Europe. Let me begin with the local competition decision. You actually started local competition a little bit earlier than we did in the United States. In a formal sense, you with the 1995 policy, we started with the 1996 Act. Although we had had local competition for special access for business customers reaching their long distance carriers in large metropolitan areas and in urban business districts prior to 1996. But with the 1996 Act we launched into an exercise and regulated competition. That is, we started regulating at the wholesale level through requiring resale at discounted prices and access to unbundling at terms to be decided by the Federal Communications Commission, subject to a standard that those elements should be unbundled. Which are necessary to prevent the impairment of competition or the impairment of the ability of a competitor to compete. Essentially, without formally saying it, it sounds like an essential facility sort of argument; that is, where something is an essential facility, where it would be difficult for the competitor to build in the short run or even the long run, then that should be provided to the entrant by the incumbent at regulated prices. The regulated prices were very vaguely described in the Act and, in fact, it involved a lot of controversy, and a lot of political maneuvering over the last seven years. At every stage of this process, given our constitutional system, the rules have been appealed to the courts and the courts have been quite ruthless, as they have been over many decades actually. With the Federal Communications Commission sending their rules back, telling them that they have, in fact, erred and had not considered sufficiently what alternatives were available to entrants in mandating such widespread unbundling. The idea, of course, is to require only that unbundling, which is necessary to allow competitors to enter, and perhaps, not even to require it as a permanent matter, although that's not specified in the Act. There's a lot of discussion of that, particularly in the Netherlands and Europe, where they actually talked about a phase-out within five years. In Canada, where they also had an initial ruling in 1997, which would be subject to further review, in which they decided

that the urban local loop was not an essential facility and therefore it did not have to be unbundled. Now, all this is important because, particularly, now with the telecommunications sector very much depressed with investment spending way down in every country, including the United States, one wants to encourage facilities based competition, investment in new facilities and new services. One of the problems that has gripped the competitive world of telecommunications is that there essentially has been very little growth in revenues. In the United States the wireline carriers have not grown in the seven years of deregulation in terms of revenues. And the reason for that is that there hasn't been enough growth of new services to offset the effect of lower rates on revenues when, for traditional services, the price elasticities of demand are less than one. And as prices fall, revenues fall. So it is very important to get the investment and to get the development of new services in order to have a growing competitive telecommunications sector. We did not get competition in airlines from a declining revenue base. In fact, what has happened in the United States is that telecommunications share of the gross domestic product in nominal dollar terms has fallen over the last 18, 19 years. Whereas, airlines have grown over the last 25 years. Airlines are still below telecommunications but not a lot of, surprisingly enough. And that's because in airlines as the prices came down, the price elasticity and demand was high enough that there was growth and, of course, there was exogenous growth in travel as people became wealthier. That is not happening right now in telecommunications. Now, when one looks at the United States and looks at Canada and even Europe and compares it with Hong Kong, one is struck by the differences in the cost conditions due to population density. You started requiring the unbundling of the local loop in 1995 and now, therefore, you are eight years into this exercise and yet there is apparently discussion to continue it. One would wonder, why in a market where the population density is so high and, therefore, the economies of density are much less important; that is, the entering carrier who only gets two, three, four, five percent of the market, can obtain cost conditions that are just about as low as the incumbent. And, in fact, with newer technology, may have lower cost in some cases. In the United States where we have much lower population density, it is very difficult for anyone to enter markets. You know, suburban markets outside of Washington, D.C. where the number of lines per square mile may only be 100, 150, 200 lines. The United States to this day we have such long loop lengths that we only have DSL service offered by incumbents to maybe 60, 65 percent of the population potentially able to get DSL service, because of very long loop lengths which, in turn, reflects very low population density. We just simply have a much different market. You have a much easier market in which to encourage investment in facilities-based competition. And so, therefore, it seems to me if you wish to promote competition, as well as investment, as well as a development of new services, you want to think about phasing out unbundling, and particularly in the most dense parts of Hong Kong. And all but the very, very least dense parts of Hong Kong, which would probably be not very different from central business districts of Canada, where Canada decided not to unbundle the local loop. The other thing about the telecom experience, at least with respect to the United States, is it is the first time that we've attempted to introduce competition through legislation while continuing regulation. Typically what we have done in the case of trucking, air cargo, airlines, is to phase out regulation when we introduce competition or maybe to drop regulation almost immediately when we introduce competition. In the case of telecommunications, we all

have these very detailed wholesale regulatory schemes of unbundling the local loop in the United States of mandating resale. But also of constraining the incumbent in its ability to respond to price reductions initiated by entrance. It is interesting to compare the United States and Canada in this regard. Because in the United States we broke up the Bell system in 1984 but did not deregulate AT&T until 1985. That meant that AT&T could not reduce its prices to meet the competition without constraint, without regulatory constraint, until 1985. This was done not to make sure the prices were low, but to make sure the prices weren't cut to disadvantage the entrance of Worldcom, MCI, Sprint and the others. Once we phased out the regulation of AT&T and began to allow them to respond, prices began to fall much more rapidly. And, of course, with a competition of wireless, for wireline now in the United States, long distance prices in the United States have fallen at a phenomenal rate, such that revenues from the long distance carriers are falling at single and double-digit rates each year. In Canada, when they introduced competition for the first time in long distance in 1992, '93, they allowed the incumbents to respond. And Canada got the same reduction in long-distance rates which benefited consumers from these price reductions in the five years that it took us 15 to 20 years to get. Because they did not attempt to protect the competitors by keeping the incumbents rates artificially high. It is important to let the incumbent cut his prices in response to the entrance and not to maintain an artificial umbrella above it. Now, sometimes people think that it is a good idea not to allow price discrimination. But, in fact, price discrimination is exactly how competition breaks out. If you are forced to charge everybody the same price through a price reduction, you are much less likely to make such a price reduction than you would if you were allowed to selectively cut your prices in response to your competitor. And that's typically the way competition breaks out in any market. Whether we are talking about telecommunications, steel, automobiles or whatever. Now, the United States last week made one very important decision and one very muddled decision in the local arena. One, they decided that, for the most part, the requirements of unbundling and line sharing for broadband competition would be eliminated. And that was a fairly decisive decision. On the other side, they decided that unbundling as they call it, the unbundled network platform, would be essentially punted to the states. Remember, we have a federal system of regulation in which the Federal Communications Commission, at least under the '96 law, is supposed to set certain of the standards for the states to follow but the states implement the pricing policies, the unbundling policies for the local carriers for their local servers. So the states have jurisdiction over intrastate services; that is, local and intrastate long distance services. The FCC, the chairman of the FCC was quite aggressively promoting a change in the policy. Because under the policy as it had evolved sort of gradually, not just through FCC decisions, but through deals struck through mergers, through deals struck at the states, as part of allowing the Bell companies into long distance services, had required virtually everything to be unbundled, indeed everything to be unbundled in the form of what's called the uni-platform. Which means nothing is unbundled. Essentially the entrant gets the entire service from the incumbent at discounts that range up to 50 and 60 percent off the retail prices. And this has been taken up with alacrity by AT&T and MCI, Worldcom, who have about half of the so-called uni-platform lines in the United States. And the entire unbundling regime has turned towards this so-called uni-platform, which is little more than resale. While the local loop unbundling by itself has not grown very much at all. And I suspect when we

see the next numbers, it will actually be in decline. And the reason for this is that in the United States no carrier has been able to make much of a success out of taking the unbundled local loop and developing local services in concert with other services and selling them to businesses or residential customers. Those that have tried a very large number of them in bankruptcy, have been acquired just short of bankruptcy. Some have reorganised and still operating, a few are barely operating. Allegiance telecom is one. Focal Life, I'm not sure if it's been in bankruptcy yet, it may still be out of bankruptcy and it may still be operating. But they have very little capitalised market value left and are not doing very well at all. So essentially what we have moved toward is an arbitrage model where we will give entrants access to the entire service of the incumbent at 50, 60 percent off and let him try to compete that way. But since anybody can play in that game, as long as he's called a certified telecommunications carrier, those margins are going to be a bit down very quickly and it is not going to be a very profitable business after a while. As soon as the arbitrage opportunities are taken away that is not a very satisfactory business. And because they don't own their own networks, they are not going to develop any new services. They show no interest in it. Secondly, nobody in the United States seems to be gravitating from the uni-loop to facilities. If you see the unbundling as a transition, allowing competitors entry first with a toe-hold so that they can build out their networks later, that simply is not happening with unbundled loops. Switch over to Europe and you'll see exactly the same thing. Except that in Europe nobody thinks that the use of the unbundled loop makes any sense for narrow band voice competition. For the most part, they are basically resellers in the narrow band area. And the entire argument among regulators, if you've heard any of them here in Hong Kong come to speak to you from the European Union, you will hear them tell you that this makes sense only to prod the incumbents into rolling out the services and it is largely a broadband exercise. Well, after two years of doing it for the entire EU and five years of doing it in Germany, the total number of unbundled loops in Europe effective the end of last year, the end of 2003, it was a little over 400,000 broadband loops unbundled out of 195 million loops or something like that, in the entire country. It hasn't made much progress there. In the United States broadband unbundling is even less potent. It only has about 250,000 in the middle of last year. And the only company that's doing it, Covad, it is in substantial financial difficulty, is going through bankruptcy reorganisation. So what we have here is an attempt to force competition through unbundling which is not working and which may not be necessary -- about five more minutes, okay -- and which probably is not necessary in a market as dense as Hong Kong, where facilities can be built in competition within the incumbent. We also, I think, have experience that suggests we ought to allow, if we are going to have competition, we ought to allow price flexibility as much as possible. Then if we don't do it, what we could do is create an umbrella for the entrance. Finally, let me point out on this score, that one of the problems with going down the unbundled loop road, particularly in the United States and probably elsewhere, is that once companies are formed to use it and start failing, there's pressure on the regulators to reduce the rate of the wholesale rates. And in the United States, state after state after state has reduced the wholesale rates on the loop and on the whole unbundled platform. I think this is simply a delaying tactic. It obviously eats into the cash flows of the incumbents. And the incumbents are now cutting back substantially on their capital expenditure program. Let me finally conclude by saying a little bit about mergers and acquisitions.

The mergers and acquisitions that you put on the board or put on your slide up here in the United States largely dealt with mergers in companies in adjacent markets. Because there was no direct competitive effect. And because, under United States law, you've got to provide an economic analysis that shows a merger may tend to lessen competition or to create a monopoly in any line of commerce, which is taken to mean an economic market. It is very difficult to prosecute those mergers through the antitrust division or the Federal Trade Commission. In the case of telecom, it is the antitrust division because the courts simply will not ratify any attempt to attack those mergers. To attack them on the grounds that Bell Atlantic might have assaulted Nynex's markets and vice versa, a potential competition theory is very difficult to get through the United States courts. These hypothetical arguments that they might compete, you know, that Deutsche Telecom might compete with France Telecom and vice versa, or that Nynex might compete with Bell Atlantic when they have other problems are not going to hold much sway in court. However, in the United States we have an M&A policy which requires for telecom firms, that they be approved at the state level, by the state regulatory commissions if their license is involved there, by the antitrust authorities, the US Department of Justice under the Clayton Act, and then under the Federal Communications Act at the Federal Communications Commission under a public interest standard, which means any darn thing the FCC wants to do because the law is written so vaguely that the courts will not overturn the commission on doing these things. As a result, it becomes a political feeding ground. If we were having a meeting today at the FCC over a major merger which, of course, are not taking place now because of the equity markets, all of you people in this room would represent a different interest group; the Native Americans for Arizona, the Baptist Church of Alabama, and they would all be getting their oars in to get a little bit of the rents from the merger. And it would only be in the public interest if all of these interests were satisfied. Needless to say, that takes away the incentive to merge and takes away a lot of the economic efficiencies if, in fact, these people could do this. And there's a strong intellectual argument for changing that law. Whether the congress will ever do it because, after all, the congress is beholden to many of the same interest groups. As the FCC is in those merger proceedings, is an interesting question. But that, I think, is one of the more important issues in the United States. Our mergers and acquisition policy as administered by the antitrust division and interpreted by the courts, makes most economists feel pretty good; that is, they don't go overboard one way or the other, they seem to follow rather sound economic logic. Let me just stop there.

**DR JOHN URE:** Anybody who's been to the World Bank web site will have seen a book review I did of a World Bank publication last year on telecommunications regulation. And there is a little anecdote in there that I mentioned that I was at a meeting in Washington several years ago reporting on the fact that, in my estimation, the price elasticity of demand for international telephone calls was considerably less than one. In fact, it was minus 0.3. A figure which, incidentally, rather mysteriously appeared in a subsequent OFTA document and it was used in the calculation of the compensation of Hong Kong Telecom International passing on its license. And I quote an eminent economist who at that meeting who said, "My God, don't tell the international telecom companies that, otherwise they'll never agree to liberalise." Now, I'm not saying who the eminent economist was, but Bob Crandall was in the room. I think Bob has obviously

raised a number of issues and so has Ewan. I think we do have, perhaps, a few moments to take any burning questions. Perhaps less on the M&A, because we are going to discuss that in the second session. But Bob's comments on local loop unbundling might have provoked one or two people to think, and Ewan's comment on mobiles. So is there anybody in the room who would like to take this opportunity to make a point or ask Bob or Ewan any questions on their contribution? Oh, yes, there's a question.

**A PARTICIPANT:** Thank you. Local unbundling is usually considered as a fixed network issue, and at one time I have thought about whether they should extend it to the mobile network. For example, I wish to ask a question about an economic query, how would that threaten a mobile communication development in terms of extending their local loop unbundling to network sharing or open up the network of a dominant player?

**DR JOHN URE:** Is that a question about mobile virtual network operators or are you saying that it doesn't go far enough?

**A PARTICIPANT:** In a mobile virtual network the operator hasn't got a right to use just any frequency spectrum and, hence, radio stations. But in terms of mobile operators, you could have 13 mobile operators in dominant positions. And in certain countries, where the mobile network is being opened up, there usually are dominant players. Should mobile networks be opened up to allow the new entrance to operate, like domestic roaming.

**DR JOHN URE:** Ewan, is that something you'd like to comment on, given your research in this area?

**MR EWAN SUTHERLAND:** The logic of local loop unbundling is that there is one network, which, as Bob said, is basically seen as an essential facility which you then open up to other players, but nobody is going to come and build another network of that sort. And the argument he's making is that in Hong Kong the potential network is so dense, as it is in Korea, that you could build another network. Now in mobile, the constraint is the number of networks in the market. And in most countries there are a significant number, and you know, an entity is a small integer. There are typically two, three, four, five, six chunks of spectrum assigned to 2G. My impression at the moment is that should you, especially with the benefit of the financial resources held in the buildings around us [a reference to the bank buildings – ed.] ... there are licenses on the table covering several-hundred million people in OECD economies. Apart from anything else, the idea of even suggesting carrier pre-selection to mobile network operators is one which I would be reluctant to do if they were in the same room, because they'd resist that so viciously.

**A PARTICIPANT:** Also there are technical issues that make unbundling at the wireless level not so easy.

**MR EWAN SUTHERLAND:** There's an argument which says you never needed to assign licenses for 3G, you could have had a single operator provide the network and run it effectively as sort of a state loop company, that would have gone. But we are in a

position where at the moment that you might have that argument I think with 2G, which is a reasonably successful business, where there is a significant barrier to enter, where they do behave as an oligopoly. But, you know, unkind as I have been known to be to the mobile operators, who are operating an oligopoly cartel, there are plenty of things we can do before we get to the point of unbundling. The argument, as Bob said, the local loop unbundling is because there is no other way to build the network, and that's not true in mobile. But I mean one answer in mobile is to kick the military out and some of the spectrum –

**A PARTICIPANT:** Right. The essential –

**MR EWAN SUTHERLAND:** Or you could go further, you could allow the military to sell the spectrum and then you pay for a new carrier.

**DR ROBERT CRANDALL:** The essential facility is owned by the government and there is no reason why there couldn't be more spectrum in that case, but I wouldn't even characterise the United States wireless sector as an oligopoly, it is in a highly competitive market. And I would think that those of you who think that calling party pays makes a lot of sense, have to realise that all this problem with mobile termination derives from that. We don't have that problem at all in the United States for two reasons, we don't have calling party pays. And we have reciprocal compensation for local carriers of which wireless are a subset. So Vodafone and some of the international players think the United States carriers are crazy; that is, they compete. We have an extremely competitive wireless sector which is taking away enormous amounts of traffic from the wireline sector. I mean the wireless sector is also taking away lines from the wireline sector in Europe. But I don't think there's any need to worry about the degree of competition. Nobody suggests that because we only have seven car assemblers in the United States, Toyota, Nissan, Mazda, Mitsubishi, General Motors, Ford and Daimler-Chrysler. That's a real problem here. And I don't think there's a real problem in wireless. And, by the way, given wireless-wireline contestability, there may not be much of a problem in wireline either. The real problem is getting going on investment and new services and new ideas.

**DR JOHN URE:** Any other questions? One time, Bob, I thought you were going to come close to say the local loop is a natural monopoly.

**DR ROBERT CRANDALL:** I think it is an open question. The local loop could be a natural monopoly. At the bottom of the Colorado River canyons where it is not contestable by wireless or whether there can't be very many wireless carriers. In certain geographical regions it could be. And you have to define both types of markets you are talking about. Are you talking about narrow band and broadband, and what the potential substitutes are. You cannot use the brochures from the travel agency as evidence. You need a little more evidence on cross-price elasticities of demand, I think, than that. That is, to what extent would a shift to wireless or shift to another mode discipline any price increase by a wireline carrier. That's the critical issue in determining whether anybody has market power and therefore whether you even need to worry about an essential facility.

**MR EWAN SUTHERLAND:** I think the crucial issue is increasingly as we're looking at broadband, the problem -- there's no question that in many parts of the world there is a significant contestability between mobile voice-call origination and fixed call origination. That's a very narrow band. The problem comes, how do you get the broadband services out there. And that's a particular problem in Asia, where you have got hundreds of millions of subscribers who have a mobile phone, but who do not have a fixed phone to fall back on. That's a group of people that it is a problem for.

**A PARTICIPANT:** I have the impression that in the recent years the sentiment of regulation or competition has changed. I don't know whether it has led to the stock prices or telecom. It gives me the impression that the regulators are more -- are trying to be more lenient to be in quotation, more lenient to the telecom service providers. How true is this statement?

**DR ROBERT CRANDALL:** Well, I can speak mostly from US experience. I mean, I do have conversations with regulators in Europe, and occasionally even here in Hong Kong, but I think I speak more from the US experience. Any time you liberalise a market, particularly one that is as technologically dynamic as this one, nobody knows where it is going, and therefore, there are lots of failures. When we liberalised airlines, there were hundreds of new carriers that formed over a period of years and failed. And to this day there are still a number of holdovers from that period that are probably going to fail. United States airlines are in bankruptcy. Nobody can predict where this is going. The regulators had to do something. They prescribed a series of rules that they thought would promote competition. Not surprisingly, not all of them worked. Not many of them worked. We got ten, twelve percent of the lines in the United States in entrant's hands, because too many of those entrants are in bankruptcy now. And as a result with the downturn, the politicians are turning on the regulators, blaming the regulators for the problem with the telecom sector. It wasn't the regulators who caused the stock market bubble, it wasn't the regulators who caused the dot com bubble. But now they are under pressure from the politicians, because the politicians don't want to admit in the United States they wrote a bad law, or that they weren't specific enough in the law and gave too much discretion to the regulators. So there is a tendency to pick on the regulators. In terms of the intellectual side of things, I don't see such a shift. But among the politicians, I think there is no doubt about it. I testified before the congress a couple weeks ago and both Republicans and Democrats were assailing the FCC from making all the wrong choices. Had you asked them two years ago, they would not have made those judgments. But today with the stock market in so much trouble and the carriers in trouble, it is easy for the politicians to turn on some of them.

**A PARTICIPANT:** That's no different than in Hong Kong, runs as bad a government policy -- before they fail --

**MR EWAN SUTHERLAND:** We had the incumbent operator in New Zealand produce the professor of economics from somewhere the southeastern US recently, to argue that the entire destruction of the telecom sector was caused by the Federal Communications

Committee. You know, it wasn't quite good as -- there was nothing at all in the balanced way. It was simply said that the FCC is responsible. Now, if you look across Europe, it is very hard to know who is responsible, in particular, for debts of both telecom and France Telecom. But you have to say somebody, somewhere is responsible for, in one case, 65 billion Euros worth of debt; in the other case, 70 billion Euros worth of debt. But the political reality of that is that you end up with so much debt that they could bring down banks and financial systems. Put that to governments! They necessarily go to the regulator and say please be generous, please be kind. You don't want to do anything which is going to damage that. And having spent so much time and effort liberalising markets, it is very disappointing to find ourselves in the position that there are no new entrants because nobody has any money to put into them. And in a sense we have to wait for the business models to become a little more realistic, a little bit more sensible. And the financial markets to decide that, perhaps, they will once again trust people in telecoms.

**DR ROBERT CRANDALL:** And I think, nevertheless, I might want to point out that I do believe that extremely liberal entry conditions through unbundled network elements and resale arrangements, probably induced some capital investment that was unwise. All you have to do is compare Canada with the United States. Across the border in Canada there wasn't nearly as much entry by small firms with these business plans hoping to get a few customers and then go public and then get out of the way well after the stock market collapsed on them. So I think the regulations were somewhat to blame. All I want you to wish to suggest is, that the regulators couldn't have known very well, they made one judgment and I think it turned out that some of those judgments were wrong. And we ought to learn from those. We got to learn that, in fact, it does not look like a serious business case can be made out of reliance upon unbundled local loops in competing a dynamically progressive telecommunications market, where you have to develop new services in which to survive. And it particularly does not look like it's going to work in the United States, and it doesn't look like it necessarily will in Hong Kong.

**MR EWAN SUTHERLAND:** I think the other twist to that is the unbundling process has become extremely political, extremely regulated. And it is interesting that the one outstanding success of local loop unbundling is in Japan where there have been new economists brought in to argue that there's a price squeeze, new lawyers brought to contest the case. Nearly 6 million customers all have high speed, very high capacity broadband. And the success, the conclusion we may reach from that, is that however it was done in -- and I'm not sure I completely understand that it was done, it may be so unique as it be inapplicable even as close as Hong Kong, let alone in the US and certainly not in Europe.

**DR ROBERT CRANDALL:** Wait a minute. I want to ask if would he buy Yahoo stock today? Japan has grown very rapidly. The Yahoo broadband has grown very rapidly using unbundled local loop, but they are losing money hand-over-fist selling off their other assets to pay for it. Maybe it will work, maybe it won't, but are you making a prediction it is going to work?

**MR EWAN SUTHERLAND:** I'm not making a prediction. In fact, I've got a meeting scheduled for Thursday morning with Nazu San, who is a former OECD economist with - who was making similar comments and being wrongly assailed by his Japanese government for saying anything negative. So ask me that question this time next week and I'll be happy to answer it once I've seen the Japanese government and the OECD and the operator.

**DR JOHN URE:** Given the time, I think we have to bring this session to a close so that we can have 20 minutes for coffee. Can I thank both Ewan and Bob for giving some really good insights. Thank you very much.

(A short break 3:30 to 3:50 pm)

**DR JOHN URE:** Ladies and gentlemen, we'll start the second session. Our first speaker is going to be Edward Whitehorn, who is the Assistant Director for Competition Affairs at OFTA. Then we are going to invite a panel of people to give different views on the proposed bill for mergers and acquisitions, and their views on the role of regulation in this area. And I might join at one end of that panel. Terry O'Neill, Chairman on CM Consult, has agreed to act as the MC for the panel discussion. So let's begin by inviting Edward to come up and give a review of the proposals and the reasons for them. Edward.

**MR EDWARD WHITEHORN:** Good afternoon, ladies and gentlemen. What I intend to do over the next 20 minutes or so, is to talk about the proposed bill, which is currently before the Legislative Council, a bill to introduce merger control to Hong Kong. But the first thing I want to say is that merger control in Hong Kong is not new. There have been provisions in the licenses of the operators for a long time, which regulate, to some extent, the merger and acquisition activity within the telecom sector. So the bill is not entirely new. It will amend the powers which the TA has to control merger and acquisition activity. And the policy objective is to make it a clearer and more comprehensive framework. So, to some extent, it is a tidying up of the law. Although it does inevitably extend the powers as well, by making it a more comprehensive and coherent merger control regime. Before the bill actually comes into force, the TA will issue a guideline, after consultation with the industry, which will set out the factors that he intends to take into account when assessing a merger acquisition under the new law. I don't propose to say very much more about this guideline this afternoon. Not least because a paper has been prepared for the Legco Bills Committee outlining the approach which the TA will take, and that paper, as you probably all know, is available on the Legco web site. So moving on, in fact, I should have had that slide on while I was speaking, so I'll have to go straight on to the next one. Got it. Right, the draft law. The first and, perhaps, most important feature of the new law is that it is an ex post system. That means that the control powers take effect after the event. Once the merger has taken place, the TA will then have the power to intervene if, and only if, he considers the merger to have an adverse effect on competition. This contrasts with a so-called ex-ante regime, where the parties to a merger are required to obtain approval before they finalise a merger. Examples of ex-ante regimes are the European Union and the United States of America. In those regimes one needs to pre-notify the merger and obtain consent before

proceeding. That is not the way the Hong Kong law has been designed. It is intended to be a light-handed approach to merger control. And the burden on industry will be minimised because only those mergers which are potentially problematical will need to be examined or, indeed, even submitted to OFTA. So there's no requirement to notify or to seek prior approval, and the parties can go ahead with the merger. Although, of course, they do so at their own risk. And I will say something in a few minutes about the procedure to get around the problem of taking this risk. The law will apply only to carrier licensees; that is, a subset of the licensees who are currently covered by the telecommunications ordinance. So this is a narrower group than all licensees in the industry. Now, to just outline the jurisdiction which TA will have, and this part is a little bit complicated, I'm afraid. But there is essentially a provision that gives the TA the power to intervene when there is a change. And there are three changes, three types of changes, which will bring the powers then into effect. The first is a change in control exercise over a carrier licensee. And the second is a change in the beneficial ownership of any of the voting shares in carrier licensee. And thirdly, the change in voting control of any of the voting shares in a carrier licensee. Any of these three changes would trigger the powers to which the TA has. So essentially what this is, is a change of control where a new owner or a new controller comes into existence, then prima facie, they need to obtain or they need to satisfy the TA that the merger is not anti-competitive. And change of control is then defined in the legislation. And again, this is slightly technical, but the change of control is deemed to occur if one of these four events takes place. The first is if a person becomes a director or principal officer of the licensee. And I should say immediately that it is highly unlikely that this would have an adverse effect on competition. The second is where the person becomes the beneficial owner of more than 15 percent of the voting shares in the licensee. And 15 percent has been chosen as a threshold to indicate a change or potential change in control of a carrier licensee. Thirdly, a person becomes a voting controller of more than 15 percent of voting shares. And finally, the person acquires the power to conduct the affairs of the licensee. All indicating a change in control. Then if the TA is to examine a merger or acquisition, the test, the substantial test which will be used, is whether the change has or is likely to have the effect of substantially less in competition in a telecommunications market. So a merger or acquisition is only liable to regulatory action if it satisfies this test. It is essentially an economic test. One has to carry out an economic analysis in order to decide whether there is substantial competition. It is the same test that is used in United States of America, in Canada, and in Australia. And contrasts with the test used in the European Union, where it is strengthening of a dominant position is a substantial test. Then if the TA decides that there is a substantial lessening of competition brought about by this particular merger, it then has the power to take action. But I should say at the outset, that this action only happens after the parties involved in the transaction have had an opportunity to make representations to the TA, and those representations have been taken into account. There is a specific clause in the bill which mandates the TA to obtain representations and to take them into account before coming to a decision. But once he has taken a decision that a merger or acquisition would have the effect of substantially lessening competition, he can direct the licensee to take such action as is necessary. Typically this would probably involve some form of divestments, possibly a part of the business acquired. And, in an extreme case, it could mean that the merger has already happened, it will have to be

unwound. However, I mentioned earlier on the risks that the parties would run if they were to complete a merger without obtaining any prior view from the TA about its possible anti-competitive effects. And in order to give the parties more certainty, there is a procedure in the bill which allows for an application for prior consent. So before the merger is actually completed, the parties can come to the TA and ask him for a view. It is entirely voluntarily and it is entirely up to the parties whether they seek that view or not. And when receiving one of those applications, the TA will carry out the usual analysis, the usual economic analysis of the merger. And he will then either give consent to the proposed merger, or refuse consent, or impose conditions if it is to go ahead. That decision is then binding on the TA. So that if the merger then does proceed, there's nothing more that the TA can do about it once the merger is actually consummated. And there's also provision in the bill for the TA to charge fees for that service. The time-frames for investigation are not specified in the bill. Again, they are going to be specified in the guidelines which we issue before the bill comes into effect. And the proposed guidelines are actually set out in the paper on the LegCo web site. Very briefly, for an ex post investigation, the time line is going to be three months for the TA to start an investigation. So three months after the merger has happened or three months after it comes into public domain, if it is not public knowledge when it happens, the TA will be able to start the investigation. And he will then have four months to complete that inquiry and make a decision on whether to intervene or not. When there is an application for prior consent, there will be a two-stage investigation. A preliminary inquiry, which will last one month, to decide whether there is any serious issue which needs to be looked at in more detail. If there is no serious issue apparent at that first stage, then the party will obtain their consent and can go ahead with the merger. However, if there were doubts about the anticompetiton effect of the merger, then the TA will open a detailed investigation, which will last no more than four months and then come to a final decision on whether to consent or not to the application. Once the decision has been made, there's a provision for appeals to the appeal board. This is, more or less, the same procedure as applies at the moment for decisions taken in relation to anti-competitive conduct. The appeal board, as you probably know, consist of a legally qualified chairman and two lay members. There is also a legally qualified deputy chairman. And the lay members are drawn from a panel and include economists, academics and consumer affairs experts. Finally, then, where do we go from here? The administration is currently considering issues which have been raised in the Bills Committee and by the industry. And, in fact, the next meeting of the Bills Committee will be later this week when the industry will be making representations about the paper outlined in the guidelines. It is envisaged that the bill will come into force later this year and will probably be fully in force within about nine months or so. Thank you.

## Telecoms InfoTechnology Forum

24 February 2003

### M & A Legislation in Hong Kong

#### Edward Whitehorn

Assistant Director (Competition Affairs)  
Office of the Telecommunications Authority

1

## Introduction

- Bill currently before LegCo
- Policy objective to provide clear and comprehensive framework to assist investors to make informed decisions
- TA to issue guidelines, after consultation, to give practical guidance to the industry

2

## Draft Law

- *Ex post* regulation
- "light-handed" approach
- no requirement to notify, or seek prior approval
- law will apply only to carrier licensees

3

## Jurisdiction

The TA will have power to intervene when there is a change in :

- (a) control exercised over a carrier licensee
- (b) the beneficial ownership of any of the voting shares in a carrier licensee
- (c) the voting control of any of the voting shares in a carrier licensee

4

## Change of Control

This occurs if:

- (a) a person becomes a director or principal officer of the licensee
- (b) a person becomes the beneficial owner of more than 15% of the voting shares in the licensee
- (c) a person becomes a voting controller of more than 15% of the voting shares in the licensee
- (d) a person acquires the power to conduct the affairs of the licensee

5

## Test

The TA will be able to intervene only when the change has, or is likely to have, the effect of

**substantially lessening competition**

in a telecommunications market

6

## Action

The TA will be able to direct a licensee to take such action as is necessary to eliminate any anti-competitive effects of the merger

7

## Application for Prior Consent

- Parties can ask the TA to consider a proposed merge
- TA can give consent, refuse consent or impose conditions
- Decision is binding on the TA
- Provision for TA to charge fees

8

## Time-frames for Investigations

- To be specified in the guidelines
- Ex post investigation
  - to be initiated within 3 months
  - to be completed within 4 months
- Application for prior consent
  - preliminary investigation to be completed within 1 month
  - detailed investigation (if necessary) within a further 4 months

9

## Appeals

- Decisions of the TA subject to appeal to the Telecommunications (Competition Provisions) Appeal Board
- Appeal Board consists of legally qualified chair person and two lay members

10

## Way Forward

The Administration is currently considering issues raised by the LegCo Bills Committee and the industry.

11

**DR JOHN URE:** Terry, if you would like to come up. If the panel members would also like to take their seats and I'll join you. And, Terry, we'll take the panel in order of the program.

**MR TERRY O'NEILL:** Good afternoon, ladies and gentlemen. First of all, thanks very much for all the speakers this afternoon and to some of the panelists who have not yet had their chance to speak. There is some very interesting comments put out by some of the panelists so far. I have a question to put to the panelists themselves, but I'm more than willing to open the floor if anyone would like to start with any questions themselves.

**MR TERRY O'NEILL:** Yes, if Ewan and working down across the panel, if you would like to just say a few words about M&A and thoughts on M&A policy.

**MR EWAN SUTHERLAND:** I feel a bit guilty taking the microphone first since I've already said quite a lot about of mergers and acquisitions. At this stage I'm going to pass up. I think I've said enough which should be controversial.

**MR VICTOR HUNG TIN-YAU:** I'm Victor Hung from Consumer Council. The council welcome the bill. Basically we feel that M&A legislation on the telecom service is a way to open up additional safeguard to promote competition in the industry, so this is our general statement.

**MR SIMON CHAN:** This is Simon from the Hong Kong Telecom User Group. Our group represented business users view. We also, in general, welcome the bill because the user group has been advocating the liberalisation of the Telecom sector more than ten years ago, so and the Hong Kong TUG is also pro competition. And so for this M&A -- well, actually for the whole telecommunications bill, we are seeing that we would like to have a more balanced view of the power of the TA in this competition issue. As regarded to -- one question is that there's some misunderstanding that the competition will only benefit the user in general, but I think this is not correct. Because since the deliberalisation in 1995, all sectors of the industry no matter is a user, the business -- the operators have all benefits from the liberalisation process. So we believe that competition should be the safeguard for the users and also for the industry. As regarded to whether we need to sector-specific regulation in the M&A activities, we also think that the telecom is a specialised industry. Where we need expertise and special training and the knowledge in this sector. So whether this is going to be the TA or some form of special committee, we think that we need some more specialisation in this area. Particularly, OFTA can have the expertise to regulate in this area. In the long-term, maybe the general competition law made may be required but that's too far away. Two other comments on the specific issues in the guidelines. One is that the users consultation process. There is a provision for proper hearing if the TA decided that they require some opinion from the industry group. So I think this is a good way and we also would like to be involved in the process. Lastly, is the continuity and level of services after the merger and acquisition. This is stating the obvious, because when an M&A occur, normally the services will be transferred from one to the other, or integrated with another operator. But we would like to see that as

probably one of the most important area in the condition for the M&A activities. So this are the views from the HKTUG. Thank you.

**MR TERRY O'NEILL:** Thank you, Simon.

**MR TONY CHEUNG:** My name is Tony Cheung. I'm representing the Internet and Telecom Association of Hong Kong. As you know, the ITAHK, the Internet and Telecom Association of Hong Kong, comprises around 150 members, basically representing the telecommunications industry in Hong Kong. We're the largest body having members coming from all the major carriers in Hong Kong. And some of the equipment vendors and some other value-added service providers, so we do have a good representation in this paper. Basically, the members are very supportive for the government in promoting a level playing field for the industry players, and in promoting effective competition in Hong Kong. But as regards to this M&A bill, we have staged a strong objection, opposition to this, for the various reasons. First of all, we believe that the telecom legislation, the licenses, has already certain provisions against any anti-competitive conduct and abuses and, therefore, there's no need for any other sector-specific regulation in this M&A.

And we certainly would not agree that this M&A bill would be targeting on the telecommunications industry alone. As we see the government is unable to justify why this telecommunications industry is being singled out as a target for this M&A. Why has the telecommunications industry sector been treated differently from the others. And it also fails to recognise properly the benefits of the M&A to the industry. And, obviously, it creates problems of inconsistencies by not taking into account of the fact that there are some other rules in Hong Kong; for example, the Hong Kong Stock Exchange, a listing rules then take over -- which has a different set of rulings regarding the M&A. And also it fails to recognise that the M&A are often not just related to one single sector. It often is related to other sectors as well. We also think that the regulator, the OFTA, they may not have the specialist skills in dealing with the complex legal and economic issues arising from the telecommunications M&As and, therefore, they may not be in the best position to make a judgment on how an M&A should be approved or not. This is some evidence by the fact that there's been some examples previously in the states. The industry regulator on the airlines had given their approval or disapproval on certain M&As within the airline industry. And later on it was found that they were not doing a good job at all, because they lacked the expertise and knowledge in that particular industry. So that would remind us about not having the expertise, it may not be beneficial to the economy as a whole. And the government had also said that Hong Kong is a small and extremely oriented economy. Which by itself is already very highly competitive and, hence, if we looked at some of the other examples in Hong Kong, we had takeovers and mergers happened in the last ten years. Like in the case of Pacific Link being taken over by the then Hong Kong Telecom. The recent merger or joint venture between Telstra and PCCW and reached somewhere of the assets of level 3. And we never find any major problems out of these takeovers or mergers. And, therefore, I don't see any major threats for this M&A activities in Hong Kong. Especially, we already have a rather comprehensive set of regulation under the Telecoms Ordinance and also we are being

banned by the licenses conditions that we have. And moving on, we believe the bill may introduce uncertainties to the M&A activities in Hong Kong because of the ex post arrangement. I think most of the members of the association, if there should be any mergers or acquisition, would choose to obtain prior approval of OFTA, because there is always a risk of being disproved of all these kinds of activities. The cost to the members would be very high if they are going to spend an amount of money to acquire or to merge with another company that would involve a lot of cost, not just in the legal cost but there would be a lot of other associated costs as well. So the risk of being disproved is very high, and therefore, it would generate a lot of uncertainties. And, on the other hand, the time taken for this approval is too long, I mean in the timetable, in the time-frame of telecommunications, three months, the four months is too long to get a transaction done on the M&As. And therefore, we feel that it really introduces uncertainties to the association's members. And lastly, we think that there is a general concern among the members that there is insufficient checks and balances. Because the TA would be vested with almost a supreme authority by, first of all, they own the guidelines. It is very easy for them to change the guidelines. In fact, they are playing the role of the judiciary, as well as the executive, and being the administrator. And there's a high risk of focusing or getting the two powers together without the necessary checks and balances, and therefore, it may pose another uncertainty or risk of danger to the M&A activities in Hong Kong. And therefore, to sum up, the members of the association, I think, I will say the majority of the members holding a different view than some of the governments suggest. And we feel that this bill should be abolished rather than to have it going through the legal process.

**MR TERRY O'NEILL:** Thank you, Tony. Agnes.

**MS AGNES MIU:** I basically agree with what Tony has said. In fact, Tony in his capacity as a representative of NT&T previously had discussion with us on a joint submission. And NT&T, New World, and ourselves made a joint submission to OFTA September last year. And we made basically the same point as Tony has just said. And I won't repeat myself on those. But if I can just add to that. I just want to make clear that I don't quite agree with something Edward just said about currently there is a lot already about M&A in existing regulatory regime. I think there is definitely provisions about change of control in 3G companies. But as far as other licensees are concerned, there is only expressed provision which deals with the transfer of the license from one company to another. But there is nothing that actually deals with change of control in the licensees themselves. So this is all new to us. It is not like an extension or a clarification of existing rules and that's also the basis of our objection. And at this juncture I think introducing something new already on a very hot-headed industry is very badly timed. Of course, everyone is well aware of how badly structured the telecom industry is. Companies are failing, that people are in Chapter 11. They ultimately are the suppliers that we also rely on for services and products. And their going into Chapter 11 also has an adverse impact on us in Hong Kong. And we are also aware of Henry Tang having proposed a study of the restructure of Telecom Authority and Broadcasting Authority, which I think he did indicate a study would be expected to complete within a year. If we are talking about restructuring the Telecom Authority and the Broadcasting Authority which, I think,

members of the LegCo have been asking since three years ago in view of the convergence of technologies, why are we doing this now, just with a single person from TA having to take on this huge job of mergers and acquisition positions. And we are more adverse to this introduction of the bill when this is then in the context of an absence of general competition law in Hong Kong. There are actually no major economies in the world that does this. So why do we think we have the model for success in Hong Kong? I think the Bills Committee members did ask after to conduct a study of other jurisdictions who have M&A controls. And none of them are seen to have sector specific just addressed to telecom itself. And none of them have the decision process and investigation process, and the power to make -- to require licensees to do anything or vested in one single person. They either have a board of a number of people of multidisciplines, and they also have maybe independent decisions made by a separate authority following investigation by the regulatory authority. So the investigation and the decisions are not made by the same body. But here now we are proposing a model where everything is done under a single person. Now, what if this single person goes wrong. I am not saying that he would definitely be wrong, but there is a good danger of a single person being wrong. Even EU having all these decisions made by a board can go wrong. And they have a history of M&A control for ten years already. And we are now talking about introducing this and then entrusting this very important job to one single person. I won't actually labor on a lot of the disadvantages of sector-specific measures. There is ample study done on it in the OECD paper in 1999. Information about this paper is easily available on the web site. It is also included in our previous submission made in September last year. There is also included, as I understand, in Telstra's recent submission. I think it just gone in last Saturday. They've included a paper from a very eminent Australian economist, Henry Ergas. Who spelled out numerous defects of sector-specific measures. That paper will also be available on the web site shortly. But as a submission from the members of the public, all the details will go public so you can have easy access to that. If I can just mention a few sector-specific regulators are less likely to build up the required expertise over time. There is, of course, a higher danger of mistakes, and there is also wastage of cost. And you have maybe a company being subject to different regulations at the same time. Different sets of regulations under different regulatory authorities. All these anomalies are questions that we have to deal with if we are introducing these sector-specific measures for Hong Kong. I may as well just pass the mike for now. I may have more to Add, but I'll leave that for later.

**MR TERRY O'NEILL:** Thanks, Agnes.

**MR MICHAEL REEDE:** I'm part of the group of the lawyers that John thought would actually think the bill was a great idea. Actually, I'm very cautious about the bill. I'm very cautious for many of the reasons that Agnes mentioned. That viewed from a high level, there are some issues that are hard to contest. But the application of the bill would be the key issue, and the application of the bill using principles drawn from other markets that geographically and dynamically are quite different to the Hong Kong market. And, I think, therefore, particularly this point at this juncture in the development of Hong Kong's telecommunications markets, that it could be potentially a very chilling effect on much due to naturalisation in sectors such as mobile in Hong Kong. In some respects it might

improve the situation, since Agnes mentioned there are quite different regimes that apply. There are some mobile licensees that actually have shareholding transfer controls. Licenses control asset and license transfers, but other transactions are exempted. So I would like to know, for example, whether OFTA plans to regulate other forms of transactional controls using the same regime. I was also fortunate to be involved in what's probably the best example of M&A transaction in Hong Kong back in '96 with the CSL Pacific Link acquisition. And I think the TIF paper -- and one issue I actually disagree with from the TIF paper prepared for today, is we haven't got any evidence of what happens in the market. In that particular transaction, produced a market with a 45 percent market share mobile sector of CSL. Now, that would trigger a very detailed review under the current proposal. And viewed from other markets it would also warrant potentially a very detailed review. Now, in that particular case, the transaction probably would not have gone ahead with the detailed review. At that time afterwards it did have controls of that particular transaction at that time. And it took a very fast-track review and made the right decision. And with the benefit of hindsight we can see how that particular merger quickly competed away any profit margins in market share in the mobile sector now. And all the predictions we made in the submissions at that time for wide measure, should have proceeded, actually proved to be for more conservative from the acquiring party's perspective than the market actually dictated. I'm saying that that's a very good example of empirical evidence in this market for how quickly the dynamics of the market can unwind on any particular market share concentration is achieved from a particular merger. I think also in this market, a particular market share concentration figures used as indicative guides can be quite wrong. It's a city market. If you went to the EU, or you went to the Department of Justice or the FCC in the states and said, give me a merger control regime for New York or London or Paris. They would give you a very different answer to their general national policy which is applied across the wider economies. So just drawing slightly from those jurisdictions, I think, can be quite difficult and might produce the wrong output for Hong Kong. And I think overall why I'm most concerned about the bill is the width of the discretion involved. And don't forget, I think, while we have the test, a test adopted in other markets, the test does apply in the opinion of the TA. That's not a feature you find on the markets. It is, to some extent, a subjective test. The discretion is wider than in other markets. And that worries me, you haven't got the back up of a court system, a general antitrust, that regime with a precedent of both economically and legally to be able to apply the degree of vigour that is required in those decisions. So particularly given the conservative approach of many telecommunications regulators to issues in the sector, when they take on the role of being a competition M&A regulator, they will tend to apply very conservative decisions and the timing for that at this juncture is quite wrong. If you turn to other markets that we've gone upon for the consultation paper, including Australia, for example, the same individuals judging within a regulator a particular merger are not the individuals closely involved in the day-to-day telecommunications sectoral specific competition. They are a different group, with different economic skills. And their function is removed from the acts of regulating the day-to-day terrifying and the connection decisions in the marketplace. So it is very hard when you have a very highly empowered single individual like you do in Hong Kong. Rather than a particular commission with a wide variety of the views deeply entrenched historically and currently in sectoral regulations to stand back and look at it from a very

dispassionate economic perspective, adopting a hands-on approach to stay out of the market and let the market rationalise. And there is certainly very clear drivers for consolidation in this market, in both the mobile and the fixed sector. Particularly, the mobile sector, it would be a shame if that doesn't have any, and the cost structures remain high and the losses remain a function of that particular sector.

**MR TERRY O'NEILL:** Thanks Michael. Edward.

**MR EDWARD WHITEHORN:** I just want to add a brief word about time lines. It is obviously that everybody wants to have their decision as quickly as possible. But I think it is important to remember that is a trade off between the quality of the decision making and the time allowed to the regulator to make that decision. And I would suggest an international best practice, shows that to do a detailed M&A inquiry in less than four months is probably not possible. Not if one wants to obtain a detailed, thorough decision which can stand up to appeal in the courts. So there is this trade off although, from the point of view of the parties who are wanting a merger, four months may seem like a long time. If you think about what has to be done during that period, it is not actually unreasonable to any view.

**DR JOHN URE:** Thank you very much, Edward. I've been--as an economist, I have been very jealous of lawyers for a long time in Hong Kong, so this is an opportunity to get some work as an economist. That was my initial attraction to this. In the paper that we've done as a background, there's a checklist, certainly not an exhausted one, of some of the questions which I think need to be asked with respect to whether one is generally in favour or generally opposed to the proposals. Which I've divided between procedural issues and substantive issues. I won't go through all those in detail but just draw your attention to them. Essentially under the procedural issues, I think the issue is just how light handed, how flexible the procedures would be in practice. Taking a leaf out of the European approach, for example, the recent proposals from the European Commission are very actually detailed, the opportunity for companies that are involved to have state of play meetings, informal state of play meetings, so that issues can be resolved before the process becomes too formalised and too bogged down. On the area of the substantive issues, I think, there's a range of questions there. Edward's just made the point that maybe four months is cutting it a bit fine. Well, I have two reactions to that. One is that if that's the case, that does show that this could -- there is a danger that this could become highly bureaucratic or highly lucrative for economists process. But it also raises the question in my mind actually, how far is that likely to be a problem in reality in Hong Kong, given the scale of the Hong Kong market. I mean, for example, the geographical issue is of a totally different level, say, from the United States or Europe. So I really wonder how much detailed analysis would be required on the geographical side, probably not so much. On the product side, more difficult as Agnes pointed out, in the area of convergence, obviously that does raise some difficulties. But those difficulties will be there anyway. Now, I think there's a case to answer, which has been raised; namely, okay, there is a provision in the licensees in the existing ordinance, so why go beyond that. Whatever Michael's view on the PacLink, it was effectively done in a very short period of time. It was a sensible decision, I think. It was seen by the industry at that time

to be a sensible decision, and I would say it was a sensible decision in retrospect. But in answering that, the point I would like to stress to put into the debate, is that up until now it has been a regulatory issue, because we have an industry specific regulation. This is a step towards competition policy. And the stress there is on the word policy. And it does seem to be that the proposals raise a series of very interesting questions for Hong Kong, and for the legislators. What kind of policy do you want to see evolving in Hong Kong? Now, I can well understand within the telecoms industry, people saying well, why should we be the whipping boy, why should we be the single exception at this stage. I think a lot of people, certainly not all, a lot of people in this room, would actually agree with the sentiment but would like to take it, therefore, to a higher stage and say that there is room for competition policy in Hong Kong. I'm sure that's something the Consumer Council would agree with. And how far is this debate going to generate that debate. And it really - it does seem to me a wider policy issue. Because, for example, when one is using criteria to judge the effects of a merger or an acquisition, how far are the criteria that they used, this is a substantive issue here, how far -- they could be very narrowly focused on substitutability and price competition, or how far are they going to be broader based, taking into concern more community issues. It could be environmental issues, it could be universal services issues in the case of telecom issues. That is a policy level of decision. Therefore, what comes up in my mind is ultimately the regulators, perhaps, are not the best body to handle M&A issues. Although, in the immediate future, I don't see much option -- much alternative in the case of Hong Kong. But it is a LegCo challenge to raise that issue as an option -- as an alternative, where does competition policy go in Hong Kong. There is one other issue that that raises, also. In the paper that we did for this meeting, there's a quote from the Office of Fair Trading in the UK. And it is quite an interesting quote, which is why I wanted to put it in the paper. Which says that the commission members in the UK are independently appointed or at least are independent of government. That is to say, they, just like the Bank of England is independent in determining interest policy. It is no longer the minister or the secretary of state who can determine that. So in the case of mergers, acquisitions and the Commission for Fair Trading, those areas are independent of government with one or two areas of exception. Now, the theoretical basis or intellectual basis for that came out of whole decades of debate, about whether the government is the referee overseeing fair play on the playing field, or whether the government is itself a special interest or can become a special interest, or, for example, can be captured by lobbyists. And for sure there's a lot of lobby in Hong Kong. So that then raises an interesting question about whether it should just be the TA, or whether we should start thinking about an independent commission. So what I'm -- to sum up those points, what I'm suggesting here is that in principle I am in favour of mergers, acquisition policy. I think there is a case to answer about how far within the telecommunications industry existing regulation is sufficient, and I'd like Edward -- give him a chance to come back on that one. But I also believe that this really needs to be taken up by legislators as a policy issue, not a purely regulatory issue. And it should be seen as a stepping stone to that wider debate about competition policy in Hong Kong. Just a couple of other points, I think, in terms of the types of M&A that we are talking about. The horizontal mergers, acquisitions issues, I think, are well spelt out in the paper of OFTA. And the questions that I've raised in the paper are really questions of trigger points; are there too many, are they too high are they too low. And what tests should be

used to carry those out. I'm very doubtful about many of the substantive tests that are, as it were a textbook test, it would be very difficult to do in practice. But the issue of vertical mergers or vertical market power, is something which, I think, in the case of Hong Kong may be more significant potentially than some of the debaters have mentioned. Again, the existing regulation without the structural separations and the accounting separations. But I also think that we have to think more about, and I'm thinking now about the points that Robert Crandall made earlier, thinking about less regulation on the retail side, but revisiting the wholesale markets in terms ensuring that there is vigorous competition that would be safeguarded in the event of mergers and acquisitions in the vertical market. I say that again, because we know we live in a town, a city, that is dominated by very few conglomerates. That's a point that shouldn't be missed.

**MR TERRY O'NEILL:** Thanks, John. I could summarise those speeches if you would like, but I'll open the floor now. Is there any burning questions?

**A PARTICIPANT:** What's the (inaudible) why now, what made the-- you know, of all the things we can do, this is what we need to do now?

**MR EDWARD WHITEHORN:** Okay. What John and Agnes said is quite right. I mean, I don't want to give the impression that there are no new powers being taken in this bill. It is certainly the case that there is at the moment only a patchwork of powers available to the TA through conditions in the licenses of the licensees. But the purpose in the bill is to rationalise that, to put in place a more comprehensive and a more consistent regime, so that we don't only have some mergers subject to control and others not. The merger which took place a couple of years ago, which some of the panel have spoken about, clearly was caught by the existing license conditions and allowed the TA to examine the transaction and give his view on whether it should go ahead or not. And there may well be other merger transactions taking place right now over which there is no regulatory control. And I think the purpose of the bill is to say well, let's have all or nothing. Let's regulate all the mergers in a consistent way, so that we have a comprehensive regime which is well-known to the industry and will, therefore, give them more certainty as opposed to the patchwork which we have at the moment.

**A PARTICIPANT:** What's the trigger, the driver? What is the rationale for leaving a situation where we control some mergers and not others participate in all licenses -- all of those who have licensees have a degree of certainty, even though the methodology of assessments is not clear, we know what we are getting when we have in our license. What is now being said is we have the existing license and we have this over general policy, as the panelists have said, going to add, in my opinion, further uncertainty to the whole process.

**MR EWAN SUTHERLAND:** I would say there is less uncertainty so far as it now applies to everyone. And there will be one set of rules if you like, one procedure, one set of guidelines to make it clear how the TA intends to analyse these transactions.

**MR MICHAEL REEDE:** What will happen to the existing transfer as the transfer controls and licenses? Will that be removed? Is there a single system who will interpret those?

**MR EWAN SUTHERLAND:** I think I can say that the new bill, when it is enacted, will take precedence. We will use that first of all, I guess -- and I'm only really speaking off the cuff -- that as we renew the licenses, we would not renew those conditions which would become obsolete because of the existence of the bill. The bill would be the primary instrument for controlling merger and acquisition activity.

**MR TERRY O'NEILL:** Okay. There is a gentleman on my left, who has been burning to ask a question for the last five minutes.

**A PARTICIPANT:** My question is one about principle, really. I take on board very much what the industry has been saying about issues of principle. And the potentially very distorting effect of introducing merger regulation in telecoms. Only in December the World Trade Organisation published a report on the trade policy review aspects of Hong Kong's competition. Part of it was in connection with competition regulation and the unevenness that which can lead to decisions being distorted as a result of uneven competition policy with only two sectors that's specifically regulated. So I wonder what the panel has got to say about that as a policy matter. Whether the current situation in Hong Kong will distort investment decisions and, therefore, proceeding at this point with a new merger and acquisition point in this sector only, is not a good idea. And the real issue is whether or not we should have a general competition law covering all sectors equally.

**MS AGNES MIU:** If I can just fill in a bit on the background information. I, myself, have asked this question many times to Legco members, and also in a casual discussion to Consumer Council. They have been advocating a general competition law for a few years and electorate members even offered to show us debate papers they had on the subject. And because the government has actually expressly denounced general competition over Hong Kong. And that's why in our campaign to set aside this sector's specific measures, we ask the same question again. Well, if there is a policy issue of a general competition, well, why don't you start the debate all over and deal with that rather than just making us telecoms suffer. Because I think you are quite right about the distortionary effect. I think we will just be discriminated against our fight for capital. Shareholders if they -- or investors, if they have a choice, they would go to a less regulated industry than a fully regulated industry, like what we have now in telecom. And some electorate members answer to me is that well, if we have M&A or telecoms specific measure for one industry, at least that's one step forward to a general competition law, let's do that in the hope that we will eventually have general competition law. It is a bit unfortunate since Sin Chung Kai is not here. I would like to urge him to rethink this whole thing because of all the dangers of starting the sector specific measures. And you are not ending up anywhere in your fight for general competition law. If we have to deal with that debate on general competition law, let's do it now, before you do the telecom specific measures for us.

**MR TERRY O'NEILL:** Mr Cheung.

**MR TONY CHEUNG:** It is just that the industry doesn't envisage a lot of M&A activities in the near future. We all know that the business environment had changed quite a bit since 12 or 18 months ago and, therefore, there is no such urge to have the law passed and that would give us more time to consider putting this in the general competition law, rather than having it rushed through. I mean, the timing is favourable to having a review on this.

**MR TERRY O'NEILL:** Thank you. I think Ewan wants to comment on that specific question.

**MR EWAN SUTHERLAND:** I am very accustomed to listening to operators' special pleading. The normal response of operators is not 3G, but 3D; deny, delay, degrade. Nobody would possibly want that, or it will be very difficult to implement, and when it does happen you make it not work very well. The problem here is very simple. Nobody with any very great understanding of economics would deny the competition policy serves a very useful purpose. Merger controls improve the economy. There's plenty of work from OECD and other places which say that, so nobody is denying that proper controls over mergers will be a good thing. If somebody is telling me that you will discourage investment by controlling mergers, it is telling me implicitly that somebody thinks that by acquiring some other operator, they can improve their return on their capital which suggests that they are going to extract monopoly rents somewhere in the Hong Kong market. Now, that suggests that the net economic welfare of Hong Kong is going to be significantly disadvantaged by having that sort of merger. So the answer is that clearly a general law competition law is a good thing. It is something which Hong Kong should have. But that by introducing into one sector, the distortion it has is to make that part of the economy better and more efficient than the other parts of the economy and it will, therefore, show that it worked better. And the other parts of the economy will gradually acquire that. Now, how quickly that happens is very hard to say. But it is very hard to believe that allowing this sort of legislation which Edward has described, is going to do any substantial economic harm to any of the operators in the sector.

**MR VICTOR HUNG TIN-YAU:** Okay. Probably we, as a staff of the Consumer Council, we have to say something about it. Consumer Council basically, no doubt, we have advocated to have a comprehensive competition law or competition commission in Hong Kong, which is to overlook the competition process in every market. However, this sector specific regulation shouldn't have any incompatibilities with a general competition law because there will always be the need for communication and a division of work. We have the need to draw upon the expertise of the industry itself, and also from the experience of specialists. If there is a competition commission, a general competition commission in Hong Kong, they will probably gain more knowledge in dealing with the general competition issue. Joining these two groups together, if there exists a general competition authority, it won't be incomparable as measured before, it won't be the same as having sector specific regulation on its own.

**MR EWAN SUTHERLAND:** Can I just add a separate point which is that global best practice is to do away with licenses. Unless you absolutely have to have a license for something, you should not be licensing. You should not be licensing anybody who does not require a scarce resource. There is a very elegant study done by the European telecommunications office, which proved that nobody in this room is eligible to have a telecoms license in Italy. Because none of you have certificates to prove that you are not members of the mafia. Well, if -- and all these absurdities and the questions then came, Well, what do you actually need for a license? Why do you need a license? And one part, you just don't need them, unless somebody needs numbers or spectrum or something very specific. So that then imposes on you the problem that you cannot then regulate through licensed conditions. So the other side to that is to say why do we need licenses for internet service providers or for particular categories of operators. There is no obvious or immediate reason. Therefore, you move to more generic regulations.

**MR TERRY O'NEILL:** Sorry, Ewan, just to clarify. The implication being that licenses are not required because the market will chose how many operators should actually -- okay, ... please, Tony.

**MR TONY CHEUNG:** We've already got licenses. If there were no licenses at all, I think today we need to assign a bill very badly. The license conditions GC, 7K, 7L, 7N, and 7G, I'll stipulate that we cannot have any abuse of dominance in the market, and we have to watch our back because the OFTA is watching us. Because we know that if there is anything we are doing wrong, of lessening any competition, then suddenly we'll get the kind of penalty as stipulated. So, therefore, with the provisions in the license today, there is absolutely no need for a double regulation separately on the M&A. I mean, I want to reiterate this point from the association.

**MR TERRY O'NEILL:** Thank you, Tony. John.

**DR JOHN URE:** Just two points, firstly following Ewan. Most of the evidence, such as it is, is that there's very few, if any, efficiencies that have come out of most of the mergers or acquisitions that have taken place. Most of the research suggests actually that the advantage of a merger or acquisition is to close down entry to markets rather than to increase efficiency. And that's just on the basis of the work that's been done. It is not conclusive, but it is something that should be brought to mind. And I guess the same question is, I mean, I think we should recognise that regulation in Hong Kong has been incredibly successful, although everybody bellyaches about it from time to time. There are very few markets in the world, if any, where even the local loop opening has been as successful as it has been in Hong Kong. I think we shouldn't underestimate that. People were complaining that oh, it should have far more and it should be faster and so on. But if you compare Hong Kong with most of the markets, Hong Kong is actually doing rather well. Last time I threw a question back to Edward a case to answer. Now, I'll throw a question back to the industry. And that is what is it, you really fear about the M&A if, in fact, most of the regulations that exist already hem you in, in terms of what you can and

can't do, What is the single most greatest fear you have from introducing this kind of more comprehensive –

**MS AGNES MIU:** It is not a question of fear. I think we started off by making it very clear. And that gentleman from that PolyTech also agreed it is a matter of principle. I think we are against measures, taken specifically against our industry. If you think all these competition safeguards are good for Hong Kong, why don't you do it across the board. There were a few reasons given by OFTA for introducing it to the telecoms specific sectors. Specifically, there being high concentration levels, scarcity of resources, vertical integration in the industry, plus high entry costs and barrier, et cetera. But these are not features are not unique to telecom. I can name more than ten industries that have all these features too, and it's sort of discriminated. As I said already, it discriminates us against our search for capital, our fight or capital, and it also leaves all this anomalies about leaving one company possibly subject to different sets of regulation in connection with one transaction.

**MR TERRY O'NEILL:** Tony.

**MR TONY CHEUNG:** I'm with the industry. Well, we certainly don't want to see a tighter view jacket on ourselves. Because that was certainly a factor in any of our M&A decisions. We would like to encourage more M&As, if possible, with the benefits, the kinds of scale ultimately that would benefit to the consumers, rather than hurting their interests. And, of course, I'm talking about under the conditions that we have to behave, rather than just creating oligopolies, upgrading monopolies, to consumer interests. Therefore, I think it is important that we have to strike a balance here of not discouraging any M&A activities which would definitely bring the benefits, not just to the consumers, but to the economy as well.

**MR TERRY O'NEILL:** Sorry, Agnes.

**MS AGNES MIU:** If I can just add to answering your question. The existing regulations and the ordinance deals a lot with regulation of anti-competitive conduct. I think it's a whole different subject in terms of what OFTA is trying to do now by regulating the market structure. I think you are probably more familiar with all the increasing writings from the economist about how government try to regulate market structure tends to end up in errors rather than in success. I think the past history have proved that the best regulator probably is the market itself. Particularly in matters like mergers and acquisitions. It is all very well for human being to say, well, I think based on best probabilities, this is the number of licenses that the market requires. But given the very unique nature of Hong Kong, being very small, and despite the fact that our regulators have actually studied and decided on the number of licenses say, for example, the mobile industry, I would say that we have far too many. And if the market actually drives for consolidation, why should we put something in the process to prohibit it or to slow it down. There was also a pre-eminent economist by the name from MIT. Jerry Houseman, yes. I think he has also put in the paper to join this lively discussion since last year. Quoting the cost of -- or the process of regulatory decisions on M&A matters on the

economy and development of technology. In some countries and with the time frame we are talking about, you can delay a merger and acquisition for more than half a year and if parties decide to take it to appeal it is another year. And he has actually quantified the loss on the economy by specific numbers with live examples from the states. Again, I cannot recite those figures from my mind. But I think that this is a very worthwhile study to turn to.

**MR TERRY O'NEILL:** Thank you, Agnes. Can I just turn the questions over to the floor.

**A PARTICIPANT:** Just a question, then the comment. Question first to Edward Whitehorn, on behalf of we nonlawyers in the audience. Can you give us an example of an M&A scenario which is not caught by the current existing regulations? Second, just a comment on what to Agnes and Tony Cheung have been saying. Which is that I think I admire, I agree with the internal consistency of the logic of what you say. It is anomalous for the telecom services in Hong Kong to be uniquely caught by competition policy. But we've had a telecoms competition policy in some sense as we have heard in the OFTA licensing conditions and regulations over the last eight or nine years. But as Agnes has said, the government is still after that fact and the fact that it has performed reasonably adequately or without any disasters and the government has seen no reason to change its mind in opposing an economy wide competition policy. So it is very hard to see that we are going to get a competition, a full competition policy in the near future. And there has been -- we have found it is very hard to change this government's mind on it until it has made its mind up.

**MR TERRY O'NEILL:** Edward.

**MR EDWARD WHITEHORN:** It is a difficult question because it requires knowledge of all the license conditions which would apply if there was a merger. But I think I can give you an example where the current license conditions would not apply. And that is where we have let us say, a carrier licensee A, owned by conglomerate B. Now, conglomerate B sold its interest in that carrier licensee to conglomerate C. And I think I'm right in saying that would not be caught by the current license conditions. Because carrier A remains the licensee, its license is not surrendered or transferred. It is merely the ownership of the carrier licensee which has changed.

**MR TERRY O'NEILL:** Could I just add a supplementary question to Edward, actually, and some of the panelists may chose to comment. In terms of the test of substantially lessening competition, is there any way that OFTA proposes to quantify or otherwise define that?

**MR EDWARD WHITEHORN:** I think the simple answer is no. It is not intended to be a purely quantitative test. One cannot say well, competition is being lessened by five percent, therefore, we have an objection, or competition must be lessened by 70 percent before we get worried. It is simply not possible to do that kind of an analysis. We will use a quantitative test wherever we can. To start at a very simple level, we would certainly

look at market shares. We would look at barriers to entry and maybe the cross elasticities of demand. These kinds of things which can be quantified. But it depends very much on the data which is available in the particular transaction one is considering. But at the end of the day a substantial lessening of competition is not a purely quantitative test, it has other elements as well. So the answer is no, it's not simply mathematical, although we do try using hard data as much as we can.

**MR TERRY O'NEILL:** There's a gentleman waiting very patiently on my right.

**A PARTICIPANT:** I'm not going to dwell on whether there should be a competition law in Hong Kong, but rather I'm focusing on whether the proposed bill is workable. I'm going to focus on three issues. Firstly is about a proposed bill. At the moment it is limited to carrier licensees. The carrier licensees, as you may know, that limit it to the facility operators. The experience in Europe, in general, competition should not be limited to certain category of companies. And competition laws should be proactive rather than a drastic measure; that is, where if there is a problem of either licensees in breach of competition coalitions, you legislate to control them. That is not the way to do it. And the second issue is about whether to control, change of control new licensees. Under the current proposed bill it must be, if there's any control in the licensee or some other factors, which Edward mentioned, in this way they would create, from my view, a lot of uncertainties in the market. And another way to handle that is, firstly, if you have a control, a change in control that will be subject to the proposed bill. What happened, there's no control, how do you regulate the conduct of those licensees. A way to handle that might be what there has been carried out in the UK, that is, you have the competition and the equivalent of the competition had in Hong Kong is provided in the Telecom Ordinance. There are a number of provisions there that can regulate those licensees where you can do. And finally I'm getting to explain a scenario where, because of the convergence, which in telecom broadcasting in the media, how the proposed bill might have problems in regulating their telecom centre. If you have an operator providing content on media service image, you must make sure you have a number of parties involved in this type of activities. If the telecom operator and the infrastructure provider as well as the media owner or the content provider, under the proposed bill or under their current telecom law, it is going to regulate the telecom operator and another step of regulations will regulate the broadcasting operator. But in that case there might not be a broadcasting operating law. And, finally, the current law or even the proposed law is not going to deal with anti-competitive conduct by their infrastructure operator. So I'm more focusing on how the new law might deal with the problem. And I can see this are some of the problems that should be addressed.

**MR TERRY O'NEILL:** Sir, can I just clarify the question, then, Peter, your three concerns. The scope applies to fixed carriers only. There's an issue around convergence as currently discussed in the industry, and the third is how anti-competitive measures will be covered under the new M&A law; is that correct? Okay. Michael.

**MR MICHAEL REEDE:** I think it is correct that in some respects we're trying to rationalise a system that we have as to transfers, the regulator, shared transfers that are

not in the system provides a single solution. However, the problem with sectoral competition or particularly in areas M&A regulation, is that many anti-competitive conduct issues cross-sectoral and cross-market, and telecoms to broadcasting is a good example because they are adjacent sectors. So it is all very well to say you can take one step forward and try it in a particular sector. However, it is just a fact that competition law is not sealed sector by sector. And then, in fact, most issues people now -- particularly in telecommunications are cross-sectoral, a combination of advantages in a particular information technology licensing advantages. Broadcasting content, for example, if I'm a powerful content provider and I enter this market and I wish to acquire a delivery system, I'm treated differently if I'm a carrier seeking to acquire another carrier. So it underlines the issue that you simply cannot regulate by sectoral basis efficiently. You can get some of the problems, you solve some of the transactional approaches that are in existence. But you simply cannot solve many of these issues which pertain to activities crossing sectors and crossing markets.

**MR VICTOR HUNG TIN-YAU:** I would just like to comment. When the government introduced a broadcasting bill in 2000, the council had already advocated that there should be single authority, which is handling this convergent industry, which is composed of infotechnology, telecom, and broadcasting. I'm happy to know that the government now considered this is the right way to move forward. So I think that, however, given that, this may be several years down the road to reorganise the regulator authority, then still we had the bill, in particular, M&A, for the regulator to acquire knowledge and also building capacity on to how to handle this issue. I think that's why that the council is still supporting the bill before us.

**MR TERRY O'NEILL:** Simon.

**MR SIMON CHAN:** I'd like to respond to this issue about carrier license. Because in Hong Kong we have been very successful of liberalising the services of the market. There is virtually almost no condition, already very few condition. You can just apply for HK\$750 and you can apply for a license. So the control is only on the resource constrained services, like fixed network, spectrum for mobile users. So you are talking about a handful or 10 or 20 of the affected operators. You are not talking about hundreds. So we are of the opinion that for various services we don't need to regulate. For the resources we do need to regulate because there is a contentions for resources. And I think that's the basis with the existing M&A bill we could regulate this market better. I think the effect for the operators, I've heard from Tony that the majority of the members have objection. But I don't understand because there's only some of them would be affected under this bill, but the majority of them may not.

**MR TERRY O'NEILL:** There was a third question around the entry of competitive measures. Edward, do you have any views or comments on that?

**MR EDWARD WHITEHORN:** Just to say that the provisions in the ordinance which regulate anti-competitive behaviour will remain. They are not changed in any way by this bill. The bill will only concern the changes to the structure of the market. So a structural

change will come under the new provisions, but anti-competitive conduct by one or more licensees, will continue to be subject to the existing provisions in section 7K, L and N of the ordinance.

**A PARTICIPANT:** I'm interested to hear the panel's opinion on what strikes me as a possible logical inconsistency in the structure of this bill. We've talked about it being ex post regulation and yet it's already been acknowledged by the operators that in nine times out of ten, the majority of the occasions it is likely the licensee will approach the regulator in advance for a ruling, the so-called application for prior consent. Now, the problem with that, or at least the problem that strikes me, is that operators, licensees approaching the regulator will bring private information. The regulator will assess that private information, those submissions based upon subjective and objective criteria. However, if -- and make a decision -- however, if he was to wait until after it had become public information that a merger and acquisition had occurred, then you would have not only the submissions from the operators, you would have submissions from users, the trade representatives, whatever. And therefore, there is the potential for, all other things being equal, a decision prior to the announcement of a merger, an application for prior consent to come out with a different decision so that which would incur, if indeed, the test and the assessment was being made after that merger had been publicly announced. And I just wonder whether there is, indeed, a fundamental flaw in the way it is structured to allow that two-sided test with possibly different outcomes.

**MR EDWARD WHITEHORN:** I must apologise for not making it clear in my presentation, that in an application for prior consent, the investigation would be public. So the parties would have to put the proposed transaction into the public domain if they wanted a formal decision for prior consent. But having said that, we would also operate a confidential advice service. In other words, parties would be free to approach us to discuss a proposed transaction. We would give them a view, but clearly that would only be based on the information which they, themselves, brought to us and that view would not bind the TA. So if you want a binding opinion from the TA, it is obvious that it must be public. Because we would need to take into account information which would not be available from the parties themselves. We would need the views of competitors, for example, to assist us in coming to a decision. So the application for prior consent is only after you have made the transaction public.

**MR MICHAEL REEDE:** I must comment that that underlines one of the key aspects of the change, which is, if you compare it to, for example, the CSL takeover of Pacific Link. In that scenario it was a private ruling, it was done within three weeks, and it was done with a full submission and assessment by the TA. I'm full of praise for that particular ruling. That transaction from the site, I think, would not have happened if there had been a four-month process and it was unleashed to the game theory of the market and proposing operators trying to unhinge the transaction. So once we introduced the process into this particular scheme, it will lead to a very active lobbying environment. And you will have a situation rather, like Bob Crandall outlined early on, not quite the complexity in degree of the US market, but you will have all the operators opposing the merger or looking to try and position for a merger themselves with the same carrier, will enter the

fray and there will be lots of lobbying taking place trying to influence the TA's decision. Information in the marketplace, its affecting the share prices, it does give the transaction time to actually -- although that may be a good thing. People believe that most of these transactions don't produce the synergies that they predict. However, I do think that that particular transaction of now six years ago was handled, I think, in a very appropriate way for Hong Kong, I think, now purely because this system is in place, purely because there is a four-month time limit placed at the outer edge of the assessment, it will take at least four months to get it done. It is not quite as crazy to get in the US market, where you can wait anywhere from 12 to 18 months, sometimes the conflict approvals from various government agencies. But it will introduce a very significant delay to the process. And I think that, in and of itself, will cause many of these rationalisation transactions not to occur.

**MR TERRY O'NEILL:** Ewan.

**MR EWAN SUTHERLAND:** I have some difficulty in matching the comments that have been made with the realities. I think back over the creation of Vodafone, of Orange, of a number of other networks. There have been no problems in buying and selling other operators. This simply has not been an issue. I can anticipate the problem in Hong Kong, where the first two or three occasions when OFTA is asked to make a ruling, there is no precedent. So there is an initial period where you simply have no idea how the edges of the judgment will be taken. But there's plenty of precedent from other parts of the world. You know perfectly well if you own one mobile operator and trying to buy another one, is going to be very poorly received. That's not one you want to try, but in other cases it will clearly be obvious. You may find yourself in that gray area where you don't know how OFTA may interpret it, but you might be able to see what the European Commission would interpret the best way, the US authorities will interpret it another way. And that's a period where we're going to have to live with the problem. Other than that, I simply don't recognise the problem. Mergers and acquisitions go on all over the world with varying degrees of repetitive. Just as an example, I was somewhat taken aback a few years ago to discovery that on the Christmas Eve issue of the European Union's Official Journal, there was notification of the Worldcom/Sprint merger. And the lawyers had apparently gone to some trouble to file papers on the correct day the Europe Commission was obliged to publish the notification inviting comments on this merger, which had ten days, ten calendar days to submit comments, which published over the millennium new year and Christmas Eve, meant that not very many people were reading these journals on Christmas day to check for this. So there are ways to get through that. But once you have some precedence, it is clear how you deal with these problems. And you sign a non-disclosure agreement. I've done that myself. It is not a problem, you get used to it. And you go back to the basic principle which says, a good economy, a WTO practice, ITU practice, ABD practice said you have an independent regulator. And you have broad competition law powers and it's an advantage to be there before other people.

**MR TERRY O'NEILL:** Okay. Move on to the next question. The lady on my right.

**A PARTICIPANT:** I just want to pick up on a comment you made earlier about the proper concern of the bill, and that it was only concerned with changes in the structure of the market. And I would agree with you that that is the proper concern of merger control. However, I think that as drafted in the bill that is not what is the concern of the bill. The jurisdictional trigger mixes up the tests, the substantive test. And I would ask why the jurisdiction is drafted as widely as it is so that there is no level of materiality for any transaction regardless of size or value, is subject to review. And, secondly, the definition of change, which would include a change even in the acquisition of one additional share or a change of directorship. And again, if we go back to what the proper concern of merger control is, to be changes in the structure of the market, why is the jurisdictional trigger drafted so widely but without any consideration with materiality. And, secondly, the response that we always hear back from OFTA is that, Well, we will only take action where there is a substantial lessening of competition. And again, I would say that that is a substantive test against which to evaluate a merger, not one against which to trigger a review.

**MR EDWARD WHITEHORN:** I accept that there is a very widely drawn jurisdiction in the bill and we are considering in OFTA whether we should introduce some kind of thresholds ourselves to provide guidance to the industry. And also for our own practical purposes, because clearly, we do not want to look at each and every single transaction which falls within these very wide criteria. A single change of one principal officer in a carrier licensee is hardly ever going to produce any competition problems. But the bill is drafted in that way, so we will have to find a way to make it work. But I quite take the point that it is very wide and it will probably be helpful to have some kind of thresholds which would indicate, at least, the level at which we would begin to have some concern and look into the transaction with more detail.

**A PARTICIPANT:** Just one comment on that. In order to have certainty in the marketplace, should that not be in the statute those guidelines?

**MR EDWARD WHITEHORN:** I think there are arguments either way. The guidelines are clearly under the TA's control, so if LegCo decides not to narrow the criteria, then it is the guidelines we will use to do so.

**MR MICHAEL REEDE:** Some history to this. In 1995 there was actually a proposal introduced on the first occasion to try to control this FCC licensed shares transfers. This was triggered by any single share transfer. And it was pointed out very quickly that any unmarket share transfer would have triggered that hard line with the regulations. And that regulation died a very quick death. We then had a bit of time until the first installment of this particular environment, which there was a hard line set at various percentage levels with no discretionary competition law test applied to those. So we've come a long way. I think deep down there is a desire to have an open field to regulate anything that might occur just in case. And I can see why, as a regulator, you would want that, because who knows when that structure will be produced to try and work around the system. On the other hand, the discretionary gulf is enormous. And so we have in a current set of guidelines, principles have been announced. Generally it will take you much further to

understand exactly those issues. And we don't have any hard figures other than a very low percentage thresholds for the equity transfers. So we are a long way, even in those principles of having any sense of the scope of these particular processes.

**MR TERRY O'NEILL:** Tony.

**MR TONY CHEUNG:** Well, the comments that I've heard this afternoon further convinces me that it is absolutely necessary to have this panel review, because I find it very uncertain, very risky. I heard the comments from everyone that we may have to look at what EU has been doing. And I mean, this is Hong Kong, and we have to rely on our law or ordinance in this place. I can't just do the guess work, trying to expect what will happen, trying to anticipate what the OFTA would say, yes or no, to our M&A proposals. And with all these uncertainties, it can only add to the danger of having these M&As. So, I therefore, would urge that the government would withdraw the bill and, you know, consider a general completion of that law -- competition law.

**MR TERRY O'NEILL:** Any further comments from the panel? Any questions from the floor?

**A PARTICIPANT:** Earlier you raised the issue that previous mergers had been waved through quite quickly in Hong Kong and that was somehow to the advantage of the industry ending up with the concentration of market share with something around 45 percent. I'm interested to understand why that is somehow thought to be a benefit to the industry and to the consumers. And that by introducing something more of a regulatory structure, would somehow diminish the perceived benefits or potentially stop their benefits from coming through. It is just not quite clear why the introduction of a very transparent set of arrangements to govern mergers and acquisitions, somehow diminish the so-called advantages of the merger.

**MR TERRY O'NEILL:** Is that question directed to Michael initially, is it?

**A PARTICIPANT:** Michael's original point, yes.

**MR TERRY O'NEILL:** Would you care to reply to this, Michael?

**MR MICHAEL REEDE:** Sure. I think it's been that the whole issue here is the balance between market failure at one end of the decision and the regulatory failure at the other. And certainly having a single regime with the degree of transparency is attractive. I think, the very first point I made at introduction, is the key from the application. And certainly, I think, we need better clarity as to time periods that are not, for example, always going to be four months. That is a presumption, I think, is going to start to become a presumption. I certainly think that we need some more guidance in the principles of the scope of the mergers that will acquire real interest that should be towards the higher end of the market. I'm not really contesting that it's wrong to obviously have a degree of transparency. I think I'm actually saying there has got to be a high degree of transparency. If you are going to have such a system, it should be a fast-track process in the four months. And the

degree of transparency in the guidelines should be greater, and it should lean towards the more liberal end of the spectrum of this particular market.

**MR TERRY O'NEILL:** Victor.

**MR VICTOR HUNG TIN-YAU:** The general comment is that, I think, for a market that is highly concentrated, I think I see no natural market mechanism or channel this benefits to the ultimate user or the consumer or the supplier. I don't see what is the logic behind, because when you think about it in a very simple scenario, suppose that the Hong Kong MTR and the KCR are merged together as a single entity, privatise it, and then how will it benefit to the Hong Kong users, transporters. I don't see it, unless you have strongly regulated price control. Now, price control is very difficult to justify, even that the market has been concentrated. I don't think that that will be more interventionist to a market if you let allow the market to a single operator and that will -- imposing the price control. Now, obviously, you look at the telecom audience, we have the price control on the Telecom. But the TA is not using it because they've said there's no dominant position there. But in given that, if we let the market evolve in this stage, having imposed price control, and that would be more interventionist.

**MR TERRY O'NEILL:** Any comments from the panel? Any further questions from the floor?

**A PARTICIPANT:** This is a very quick question in two parts. The first part is, would the panel agree with the general proposition that a market with four mobile network operators is substantially less competitive than a market with six mobile operators? And if the answer to that question is yes, what are the implications for the government's decision to license four rather than six 3G mobile network operators?

**MR TERRY O'NEILL:** I can allow each of the panelists 23.5 seconds to answer this question, and I'll start with Mr Sutherland, to my left.

**MR EWAN SUTHERLAND:** I wait until I see some 3G services. The question of how many operators you have in the market is not, I think, relevant. The crucial thing in mobile is to know that somebody can exit the market if they want out and somebody else can come in. And the problem is the barriers to entry in the market. Now, that may be solved in 3G by alternatives technology and that may take away the problems, because there may not be barriers to enter into the technologies. So you can have -- a classic example is Sweden, three operators, no competition, zero competition between those three operators there. They carried on a triopoly for a decade. The number may not matter. It is the ability to get in and the barriers to get in.

**MR TERRY O'NEILL:** Victor.

**MR VICTOR HUNG TIN-YAU:** I think as the number increase -- as the number of lines increased, they are more likely to have collective dominance, the number they have in the market. Now, you asked me to draw a threshold, whether it is four or five or six, I

think this depends on different markets, okay. Unless there is other given factors we can consider is, however, some of the expert in European Commission has laid out number three or four. The number of operators in the markets, at least, will be substantially a greater opportunity for collective dominance.

**MR TERRY O'NEILL:** Simon.

**MR SIMON CHAN:** I think that the more important thing is about the critical factor is whether we have got the choices and level of service. If you look at the case where all six operator join hands to increase the fee, that is not a matter of four or six, it is the same. So I think, that's why I think in the carrier license, that's why we need to regulate the carrier license, because they have the access to restricted resources. And if they have disconnective dominance or one or two or whatever, how many numbers, collectively dominate market, then the user will have less choice and that's what we do not like to see.

**MR TERRY O'NEILL:** Tony.

**MR TONY CHEUNG:** Let me give a quick reply on your hypothetical question. The reduction in the number of players, that would give an impression of less competition, but it wouldn't be the case. For example, if the number of mobile operators were to be reduced to five or four, because Hong Kong is a very small market and the number of players already is too many at the moment. I can't give a definite number of three or two is exceptional or not. But I think the way to look at it is, if there should be any consolidation in the industry, it may give benefits to the new merged operator to bring down the costs and to compete effectively with the bigger ones. I guess there is the benefit of this M&A, rather than we just focus on the negative side of it. And, of course, there is always the OFTA, the regulator, to look at the interest of the economy and the consumers, and so is the Consumer Council. And, therefore, I think ultimately it is the benefit of the M&A that we should be focusing, rather than just on the number itself.

**MR TERRY O'NEILL:** Thank you. Agnes.

**MS AGNES MIU:** I sort of touched on this in passing in on one of my earlier comments. I don't actually quite believe a regulator telling the market how many licensees they should have. I think, as far as the 2G mobile market is concerned, there are now six licensees and they have now applied for consolidation for a long while. They are struggling on a very thin margin, very low profitability. There is a distinction between long-term and short-term benefits for consumers. The number of licensees made the price for such a stifling competition, that in the short-term consumer may have the benefit of low prices, but in the end low prices will actually have backfired on the operators. There would be very little money to file back into the development of technology. And ultimately the backfire would go on to consumers as well. I believe that the market should determine how many licenses it should have. And, in fact, on this -- it may be known to some people here, that previous attempted mergers of 2G operators have been sort of discouraged by OFTA on the basis that any consolidation that reduce -- any mergers and acquisitions that reduce the number of licensees in the market, is to be

discouraged and to be disapproved. And I think that is not a very good principle to go by. And I hope that in the new M&A regime this whole idea would be abandoned.

**MR TERRY O'NEILL:** Thank you. Michael.

**MR MICHAEL REEDE:** My answer is simply if you have four licensees with an MVNO strategy overlayed across that regime, it gets very competitive. So you have four network players, you have a regime to enforce the service level of competition. And certainly in the 2G sector, there are far too many aspects that the networks duplicated. Most of them are consultants, including they have done studies of benefits to be achieved through consolidating sites. At the moment massive dead weight loss in the industry. And site costs flowing actually to most of the landlords in Hong Kong through the duplication. And it is actually quite unimportant to consumers, although it does raise cost levels. So there are those networks, intelligent parts of the networks that actually add certain features. And there is retail price competition. And there are very large parts of the network which could be common, and it could be joint ventured or owned by one or two or three or four players and still sponsor a much lower cost structure within the sector and with a high degree of retail competition, price competition and quality control competition.

**MR TERRY O'NEILL:** Thank you, Michael. Edward.

**MR EDWARD WHITEHORN:** I do not think that the number of players in the market is the sole determinate of the level of competition. One does need to take into account other factors, such as the market share, which each of the operators has. And also things like barriers to entry, which Ewan mentioned. So I think one needs to take a much wider view of the market before drawing any conclusions about the level of competition.

**MR TERRY O'NEILL:** Thank you. John, I'll ask you to come up and make closing comments. My thanks to all the panel members and the questions asked. Thank you.

**DR JOHN URE:** I'll do my quick answer to that question and then draw the session to a close. If you had a market of three players and they all charged exactly the same prices, from the callers point of view, you wouldn't actually know whether that was collusion or perfect competition. This is the same result. What would give you a clue is if you looked at the rate of return and found it excessive in terms of other competitive industries. If you go from three down to one, which is where we started from with telecoms, that's exactly what happened here. You had schemes of control that looked at rates of return and so on. So at one end of the spectrum you have a highly competitive market, the other end of the spectrum you have to have somebody looking at rates of return and regulating prices and whatever. So the question of six or four, there is, even in theory, there is no simple answer to that, except that if you are going from six to four or eight to three or whatever, you actually do need to start looking at things like rates of return. Just simple information to determine whether there is prima facie, a case of collective dominance, gouging, or whatever. So, are the current regulations sufficient to cover that or, indeed, do we need the mergers and acquisitions to cover aspects which aren't covered at the moment? I, as

an academic, I would certainly, again in abstract say, well, what is the harm of having the legislation to give the empowerment. The question is always, how is it used, how is it used in practice. All I would say in conclusion, Victor must be extremely happy because we've had two members of the industry here saying that they will support a competition policy in Hong Kong. And I think you should sign them up to your campaign immediately. Let me draw the session to a close. Firstly, by thanking all our panelists, and Terry, for chairing the session. Thank you all very much for your contributions. Obviously, the next stage of this debate is the LegCo panel meeting, I think it is on the 27th. And there are some pretty hard issues here which go beyond telecoms as we've seen. So thank you for coming. Just a brief word about the future, we'll be putting together a program of TIF events and basically the theme of that program will be, okay, we've got the infrastructure, it's a superb infrastructure, it is continually being rolled out in different ways and using different technologies. The question now, perhaps, is not the building of the infrastructure, it is how does Hong Kong use its infrastructure. What are the services being provided, what's the efficiency and productivity that is coming out of the development of broadband, what does that do for Hong Kong's advantage. So we are going to be proposing a conference which will be looking at broadband, but in the enterprise and then the customer sector. And then the idea at the moment is then to follow it up by looking at different sectors, strategically important sectors of the economy. For example, logistics, the development of e-commerce, revisit that. Digital entertainment, broadcasting, there are various areas, tourism sector. With specific forums around those issues. We only keep this going through sponsorship, I should add. So anybody who would be interested in being sponsors of any of those events, please see me immediately! Quickly!! And, finally, thank you also Bloomberg for the, again, the splendid facilities.

**MS AGNES MIU:** I just want to clarify one thing. I think both Tony and I, are not saying that we must have general competition law in Hong Kong. All we are saying is if you think there are benefits for competition policy, then let's do the debate and the study, and then apply it across the economy generally, and don't just pick on us, telecom.

**DR JOHN URE:** Agnes, it was said tongue in cheek, believe me. On that note of clarification, thank you very much.

(Proceedings concluded at 5:45 pm)