

Submission in Response to OFCA Public Consultation Paper:

**APPLICATION FOR PRIOR CONSENT UNDER SECTION 7P OF THE
TELECOMMUNICATIONS ORDINANCE IN RESPECT OF THE PROPOSED
ACQUISITION OF CSL NEW WORLD MOBILITY LIMITED BY HKT LIMITED**

4 February 2014

EXECUTIVE SUMMARY

Certari Consulting Limited is pleased to provide this submission in response to the OFCA Public Consultation Paper "Application for Prior Consent under Section 7P of the Telecommunications Ordinance in respect of the Proposed Acquisition of CSL New World Mobility Limited by HKT Limited" issued on 11 January 2012 ("**Consultation Paper**").

In preparing this submission, we make reference to the Consultation Paper and to the Public Version of the "Application to the Communications Authority Under Section 7P of the Telecommunications Ordinance Regarding the Acquisition of all the shares in CSL New World Mobility Limited by HKT Limited" dated 4 October 2013 ("**HKT Application**"), published as Annex A to the Consultation Paper.

The purpose of this submission is to comment on the proper application of section 7P in the context of applications for consent of the kind made by HKT Limited in the present proceeding.

Specifically, we submit that:

- While competition agencies have hitherto relied on subscriber porting statistics as indicative of the extent of competition between operators, this metric is less reliable today, as it excludes mobile data subscribers who do not port their numbers when they change provider but merely terminate their contract and open a new contract with their new provider. In a sophisticated market such as Hong Kong, mobile data subscribers may well make up the majority of customers switching between networks.
- The Communications Authority's Merger Guidelines rightly emphasize: "*By its nature, an assessment of whether a merger substantially lessens competition is concerned with the likely effect of the merger on competition in the future.*"
- The "with-and-without" test required by the Merger Guidelines requires consideration of the most likely *future* market structure *without* the proposed transaction taking place, which often will differ from the *status quo* market structure.
- "Without" the transaction proposed by HKT Limited taking place, a merger between a different pair of MNOs (other than HKT and CSL) would be likely to happen in future.
- A future "without" market in which *a different pair of MNOs has merged*, other than HKT and CSL, may well be less competitive than a future market "with" the proposed transaction (e.g. if consolidation occurs by the merger of other MNOs who have a larger combined market share).
- By considering the market "before and after" the proposed transaction, rather than "with-and-without" it, the HKT Application adopts a conservative analysis – that is, an analysis that is not as favourable to HKT as could legitimately be argued for. HKT is perhaps discounting the likelihood of consolidation in the market from 'abundant caution'.
- Even on HKT's conservative "before and after" analysis, there do not appear to be grounds for the Authority to decline consent, on the basis of the information presented in the HKT Application.
- The entry of 21 ViaNet to the market is likely in both the "with" and "without" scenarios, so the new MNO should be counted in both cases.

(We rely on the information disclosed in the Public Version of the HKT Application in making this submission.)

PORTING STATISTICS

In the past, the Authority has (like many other telecommunications regulators) had regard to subscriber porting statistics as an important indicator of the degree of competition between operators. The greater the number of ports, considered in relation to the number of subscribers overall, the more intense the rivalry between those operators.

Customers who subscribe for mobile voice services normally attach value to continuity in their use of a particular number. It is more convenient for the customer (and for others) if the customer can continue to use the same number after changing service providers. The substantial majority of voice service subscribers, therefore, will change providers by requesting the “porting” of their existing number to the new operator. Porting statistics, therefore, are a reasonably reliable indicator of the movement of voice subscribers between operators.

Customers who subscribe for mobile data services (e.g. by means of a 3G “dongle”) use a SIM card with subscriber number to access those services but, because they do not share that number with others they wish to be able to contact them, suffer no inconvenience if that number changes when they change service providers. The substantial majority of data services subscribers, therefore, will change providers by entering into a new contract with a new provider, who supplies a SIM card with a new number and without porting of the customer’s previous data SIM number. Porting statistics, therefore, are not reliable as an indicator of the movement of data services subscribers between operators.

Since porting statistics do not reflect the movement of data services subscribers between MNOs, and since mobile data services are an important part of MNOs’ businesses, porting statistics no longer accurately reflect the extent of competition between MNOs. It is now necessary for regulators to qualify the significance they attach to porting data. It will also be necessary for regulators to develop new measures or indicators of inter-operator competition for use in future.

RELEVANT TEST UNDER SECTION 7P

Section 7P of the *Telecommunications Ordinance* applies to transactions which involve change in the beneficial ownership or voting control of shares in a telecommunications licensee, beyond specified thresholds.

The relevant subsections of s. 7P of the Hong Kong *Telecommunications Ordinance* provide:

- (6) *Where there is a proposed change in relation to a carrier licensee, the licensee or any interested person may apply in writing to the Authority for consent to the proposed change.*
- (7) *Where the Authority, on receiving an application made under subsection (6)—*
 - (a) *forms an opinion that the proposed change would not have, or be likely to have, the effect of substantially lessening competition in a telecommunications market, the Authority shall decide to give consent,...*

The *Telecommunications Authority Guidelines: Mergers and Acquisitions in Hong Kong Telecommunications* (“**Merger Guidelines**”) observe that: “the TA will interpret a substantial lessening of competition in terms of the creation or enhancement of market power.” It is submitted that this interpretation is correct.

Relevantly, the Merger Guidelines also explain, very briefly, that the Authority will apply what it refers to as the “with-and-without test.” This test is stated in only two paragraphs:

By its nature, an assessment of whether a merger substantially lessens competition is concerned with the likely effect of the merger on competition in the future.

To assess whether competition has been substantially lessened by a merger, the TA will employ a “with-and-without” test. That is, the level of competition that exists and would be

*likely to exist in a market without the merger will be assessed and compared with the likely level of competition were the merger to proceed.*¹

That the relevant test is future-oriented, or forward-looking warrants greater emphasis. The assessment of the effects of a merger “by its nature” is concerned with the likely effect on competition “in the future”.

The correct application of this test requires a comparison of:

- The likely *future* state of competition in the relevant market *with* the proposed merger; and
- the likely *future* state of competition in the relevant market *without* the proposed merger.

The Merger Guidelines do not require, we submit, comparison of the likely future state of competition in the relevant market with the *current* state of competition. The current state of competition in the market should be treated as relevant to the extent that it provides a basis for postulating the likely future state, both with and without the proposed merger proceeding.

The “with-and-without” approach has been accurately described by competition agencies in other jurisdictions where the same test applies.

In the United Kingdom, for example, the *Merger Assessment Guidelines* state:

*[The Competition Commission] has to make an overall judgement on whether or not an SLC has occurred or is likely to occur. To help make this judgement on the likely future situation in the absence of the merger, the CC may examine several possible scenarios, one of which may be the continuation of the pre-merger situation; but ultimately only the most likely scenario will be selected as the counterfactual.*²

In New Zealand, the Commerce Commission’s recently revised *Mergers and Acquisitions Guidelines* state:

*To assess whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual); with the likely state of competition if it does not (the scenario without the merger, often referred to as the counterfactual); and determine whether competition would be substantially lessened comparing those scenarios.*³

In its *Merger Guidelines*, the Australian Competition and Consumer Commission explains that the *status quo* prior to the proposed merger will often provide the counterfactual, but that this will not always be appropriate:

*However, in some cases taking the state of competition prevailing at the time of the merger as the benchmark for analysis could risk attributing a change in the level of competition to a merger, when the real cause is some other development that is unrelated to the merger and likely to occur regardless of the merger.*⁴

¹ Communications Authority *Telecommunications Authority Guidelines: Mergers and Acquisitions in Hong Kong Telecommunications* (May 2004) paras 4.26 – 4.27.

² Competition Commission and Office of Fair Trading *Merger Assessment Guidelines* (OFT1254, Sept. 2010) para 4.3.6.

³ New Zealand Commerce Commission *Mergers and Acquisitions Guidelines* (July 2013) para 2.29.

⁴ Australian Competition and Consumer Commission *Merger Guidelines* (November 2008) para 3.17.

The HKT Application compares the future market structure “with” completion of the proposed merger (4 MNOs, or 5 counting 21 ViaNet) against the *current* market structure “without” the proposed merger (5 MNOs, or 6 counting 21 ViaNet). We consider that this approach is a conservative one, in that it is not as favourable to HKT as could legitimately be argued for.

EVALUATION OF PROPOSED ACQUISITION UNDER SECTION 7P

The HKT Application characterizes the effect of the proposed transaction as follows:

As a ‘merger’, the proposed transaction would represent a situation where 6 existing operators would decrease to 4 (i.e. a ‘5 to 4’ merger). With 21 ViaNet considered, it is a ‘6 to 5’ merger.⁵

The entry of 21 ViaNet to the market as an additional MNO appears imminent, albeit as a comparatively small MNO in terms of subscribers, revenue or spectrum, during the foreseeable period. We consider it is necessary to have regard to the participation of 21 ViaNet in both the likely future market with the merger and the likely future market without the merger. Thus, the proposed transaction involves a 6 MNO to 5 MNO change (rather than “5 to 4”), before the likelihood of future consolidation in the MNO sector is factored into the analysis.

We submit that it would be appropriate, and consistent with the Authority’s Merger Guidelines, to assess the effects of the proposed transaction having regard to both: (a) the imminent entry of 21 ViaNet; and (b) the likelihood that without the proposed merger one or more *other* mergers would occur among the MNOs.

Due to fragmentation of the industry and the intensity of competition, consolidation in the MNO sector has in recent years been the subject of frequent comment. The likelihood of consolidation is not contradicted by the entry of 21 ViaNet, which perhaps intends to target a particular niche in the market and probably will have a different cost structure to the established major players.

The HKT Application refers to the prospect of future consolidation:

The Hong Kong mobile telephony market is one of the least concentrated mobile markets and is currently rather fragmented. Substantial efficiencies could be realized by industry consolidation, thereby reducing the costs of supplying mobile services to the benefit of consumers.

As OFCA will be aware, there has been considerable comment over the years regarding a need for industry consolidation of mobile network operators in Hong Kong. Market consolidation seems to be desirable as the current number of mobile network operators is unsustainable in the long-run given the size of the Hong Kong economy and population, and the level of infrastructure investment needed to provide current (and future) bandwidth hungry services/applications such as 4G and 4G follow on services/applications.

The likelihood of MNO consolidation in Hong Kong could legitimately be taken into account in considering the likely future state of competition in the market *without* the proposed merger.

We submit that the assessment as to whether the proposed change would be likely to have the effect of substantially lessening competition in the relevant market ought to involve a comparison of:

- (a) the likely future state of competition in the relevant market (including 21 ViaNet) *with* the proposed merger, which involves consolidation between HKT and CSL; and

⁵ HKT Application, Executive Summary, p 4.

- (b) the likely *future* state of competition in the relevant market (including 21 ViaNet) *without* the proposed merger, which involves not continuation of the *status quo* but rather consolidation between a pair of MNOs other than HKT and CSL (e.g: (i) CSL and an MNO other than HKT; (ii) HKT and an MNO other than CSL; or (iii) MNOs other than both CSL and HKT).

The difference between continuation of the *status quo*, and a future market that involves consolidation between a different pair of MNOs is likely to be profound.

For example, the HKT Application indicates that HKT is the smallest MNO and CSL is the third largest MNO. If the proposed transaction does not occur, the likely future market structure could involve consolidation between (hypothetically) the third largest and second largest MNOs; or the largest and the third largest; or the largest and the second largest.

The difference is important: when assessing whether the proposed change would be likely to substantially lessen competition, the relevant comparison is not between the future market with the proposed transaction and the *status quo* market, it is in accordance with the “with-and-without” analysis, between the future market with the proposed transaction and the future market without it – which might well involve *an entirely different merger taking place*.

A duly forward-looking “with-and-without” analysis of the effects of the proposed transaction on competition in the future should take into account the likelihood of future consolidation between a different pair of Hong Kong MNOs, if the proposed HKT transaction does not in fact occur.

In the present context (depending on the evaluated likelihood of industry consolidation if HKT’s proposed transaction does not proceed) the relevant comparison might well not be 6 MNOs (*status quo*) versus 5 MNOs (after HKT-CSL merger), but rather 5 MNOs (after HKT-CSL merger) versus 5 MNOs (after consolidation between a different MNO pair).

In summary, we submit that if the proposed transaction does not proceed, then the likely future state of the market might well involve a consolidation between a pair of operators *other than* HKT and CSL. HKT’s proposed transaction leads in all or virtually all foreseeable cases to *a better outcome for the competitive process* and consumers than would a different merger.

Since the HKT Application considers the effect on competition of the proposed merger of HKT and CSL, relative to the *status quo* market, and not relative to a future market in which *different* MNOs consolidate, we submit that the HKT Application adopts a conservative analysis. That is, HKT presents an analysis that is not as favourable to HKT as could legitimately be argued for. HKT is perhaps discounting the likelihood of consolidation in the market from ‘abundant caution’.

If there is likely to be no future consolidation in the mobile sector, then the *status quo* would be the correct counterfactual (as assumed in the HKT Application). On the basis of the data presented in the public version of the HKT Application, it appears that the proposed transaction would not exceed the Authority’s ‘safe harbour’ thresholds⁶ and should be granted consent by the Authority.

CONCLUSION

In the words of the TA’s *Merger Guidelines*, assessment of the effects of a merger “by its nature” is concerned with the likely effect on competition “in the future”.

A duly forward-looking analysis of the effects of the proposed transaction on competition in the future should take into account the likelihood of future market consolidation between a different pair of Hong Kong MNOs, if the proposed transaction does not in fact occur.

⁶ See, HKT Application, p 45.

Since the HKT Application considers the effect on competition of the proposed merger of HKT and CSL, relative to the *status quo* market, and not relative to a future market in which a *different* pair of MNOs consolidates, we submit that the HKT Application adopts a conservative analysis.

Under either approach, the proposed merger should be regarded as not raising competition concerns, given the well-known intensity and robustness of competition in Hong Kong's mobile services market.

Confidentiality is not asserted in relation to the content of this submission.

Submitted for Certari Consulting Limited

by Dr. Andrew Simpson
www.CertariConsulting.com
4 February 2014