Hastings International and Comparative Law Review

Volume 17
Number 4 *Summer 1994*

Article 7

1-1-1994

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I. Introduction

Privatization in the telecommunications sector is a growing international phenomenon. Unlike the United States, telephone service in the vast majority of countries has long been provided exclusively by government-owned and operated entities under monopolistic market structures.[1] In some cases a state-owned company has been the service provider; in others a division of the government has operated the network and has provided service itself.

In recent years, countries all over the globe have privatized, are privatizing, or are considering privatizing their telecommunications services providers. For example, the U.K., Argentina, Mexico, Chile, Venezuela, Australia, Hong Kong, Indonesia, and New Zealand have sold interests in their national telephone companies to private investors. Germany, Denmark, Italy, the Netherlands, and India have also announced plans to privatize.[2] Hungary is just completing the sale of a thirty percent interest in its national phone company to a consortium led by Ameritech and Germany's Deutsche Telekom. Singapore

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1. *See* U.S. Dept. of Commerce, National Telecommunications Administration, Comprehensive Examination of U.S. Regulation of International Telecommunications Services, 58 Fed. Reg. 4848 (1993).

2. *Private Phones in Europe*, FIN. TIMES, Nov. 10, 1993, at 15; *see* Stefan Wagstyl, *Indian Telecoms Network to Make $500m Offering*, FIN. TIMES, Nov. 5, 1993, at 24.

floated shares of Singapore Telecom in November 1993.[3] France, Portugal, and Turkey also appear to be planning for some form of telecommunications privatization.[4] In addition, several countries, including Hungary, Greece, Mexico, Venezuela, the U.K., and a number of countries of the Commonwealth of Independent States have privatized their mobile telecommunications sector by licensing private parties to provide cellular or other mobile services.

This article examines the motivations behind the privatization trend and the means and special concerns of telecommunications privatization.

II. Motivations Behind Privatization

There are as many reasons for privatization as there are countries that privatize. The primary economic theory set forth for privatization is that private enterprise — and competition, which is often introduced as part of the privatization process — better uses public resources and is more efficient than government management.[5] Enhancing productivity and efficiency is vital to a country's economic development.

A modern telecommunications infrastructure is also essential to economic development. Indeed, governmental ownership of telecom facilities throughout much of the world has traditionally been viewed as essential to national security. As a vital part of a country's infrastructure, telecommunications facilities serve both public and private needs. Adequate telecommunications capabilities are necessary to attract international and domestic investment. Businesses must be located where telecommunications infrastructure will support their existing and planned operations. Investment goes hand in hand with the existence, or development, of an environment that is conducive to achieving a return on that investment.

The successful modernization of infrastructure requires an influx of capital and the development of trained management and technical

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3. Teo Poh Keng, *Singapore Telecom Defies Sell-Off Fears, Jumbo Privatization off to Orderly Start*, THE NIKKEI WKLY, Nov. 8, 1993, at 23.

4. Peter Wise & Andrew Adonis, *Portugal Prepares Telecoms Sell-off*, FIN. TIMES, Nov. 24, 1993, at 7; *Private Phones in Europe*, *supra* note 2, at 15; *Turkey Telecommunications: Growing Fiber Optic Market*, MIDDLE EAST EXECUTIVE REP., Sept. 1993, at 19.

5. Efficiency in this sense refers to both "static efficiency," or cost-effective operation, and "dynamic efficiency," or innovation and new investment. Mary M. Shirley, *The What, Why, and How of Privatization: A World Bank Perspective*, 60 FORDHAM L. REV. S23, S25-27 (May 1992) [hereinafter *The What, Why, and How of Privatization*].

personnel. In some countries these are in short supply. Privatization of state assets is a way of attracting the capital and personnel necessary to develop the infrastructure. In the telecommunications context, privatization often involves investment by experienced network operators, as in the case of the sale of a thirty percent stake in the Hungarian telephone company to the Ameritech-Deutsche Telekom consortium. Total investment — financial, technological, and managerial — by experienced operators is a way to bring an antiquated network up to date.

Privatization is also a means to operate, maintain, and upgrade the network over time without requiring government funds, which are typically in short supply. In telecommunications, the avoidance of operating and capital funding requirements can be a very powerful motivator since the costs of building the interactive, multimedia networks of the future will reach into the trillions of dollars in the developed countries alone. In the absence of new capital, these expansion programs must be paid for locally, which drains precious resources out of frequently strained economies.

Privatization can also be an effective means of generating much needed funds to reduce deficits or to fund other projects.[6] In Greece, for example, two cellular licenses were awarded to private consortiums in 1992 for a combined US$320 million. Not only will cellular services be provided competitively to the public in accordance with a government specified roll-out schedule and service quality standards, but the government has also obtained funds for other uses. The sale of a forty percent interest in Compañia Anonima Nacional Telefonos de Venezuela (CANTV), the Venezuelan national telephone company, produced US$1.9 billion for the government.

There are defensive motivations to privatization as well. That is, forces beyond any single government's control are unleashing change which cannot be resisted. Technology permits multinational corpora-

6. *Compare The What, Why, and How of Privatization, supra* note 5, at S27 ("If priced properly, the sale of a public enterprise will only generate income in an amount equal to the discounted net present value of any future income the enterprise would have generated for the government plus the scrap value of the enterprise.") This does not account for the fact that a more efficient enterprise offering more and better services could, even at lower rates, do better and generate more revenues than the enterprise would have as a government-run behemoth. This potential increase in revenues should be considered in pricing the public enterprise for sale. Such sale could therefore generate more income for the government than that which the government would have received from operating the enterprise. In addition, the government may need the immediate influx of funds from a sale.

tions or other entities to create networks that take valuable business away from local public service providers. Also, regional political organizations may adopt policies that cause liberalizations in market structure whether the national government is ready or not.

China's Ministry of Posts and Telecommunications (MPT), for instance, serves as the country's long distance carrier as well as its primary telecommunications policy-setting body and regulatory agency. It is also the liaison between the Chinese central bureaucracy and the thirty semi-autonomous provincial carriers. The thirty provincial carriers rely in varying degrees upon the MPT for investment funds and are proportionately more or less autonomous.[7] It is easy to see how a provincial carrier might adopt liberalization policies faster than the MPT in order to better meet local needs. If several provincial carriers initiate liberalization activities, the MPT may be driven to action, even if only to restore a degree of uniformity nationwide. In addition, other ministries and some large industrial organizations operate private communications networks. It is reported that these Ministries may be interested in interconnecting their networks in the future to compete with the MPT's network.[8]

Most privatizations are driven by a combination of these motivations. Each government privatizes differently because the priority of its objectives determines not only the success of the privatization and the conditions under which it takes place, but also the shape of the sector thereafter. For example, if the state wishes to obtain large proceeds for its current budgets, it may be inclined to grant the privatized company certain valuable rights extending into the future. However, the public's interest in competitive provision of services and products frequently conflicts with these special rights. Privatization thus requires a state to prioritize, often for the first time, among important but inconsistent values. Consider, for example, the flip side of the defensive privatization coin — where the political climate or public opinion does not favor privatization but the government wants to go ahead for other reasons. In this case, "selling" the privatization and its potential benefits to the public will be an important concern of the

7. Bill Bien, *Chinese Telecommunications*, U.S. Dept. of Commerce, Office of Telecommunications (draft dated November 1, 1993).

8. *Id.* The ministries operating their own networks include the Ministry of Railways, the Ministry of Petroleum, the Ministry of Coal, the Ministry of Water and Power, the Bank of China, the New China News Agency, and the People's Liberation Army.

government.[9] The need to win short term public support may prevent the government from pushing for other goals, even those of long term public benefit.

Before beginning the privatization process, the government must determine its goals in order to pursue the path most likely to achieve those goals. Argentina began its telecom privatization, for example, in an economic downturn with increasing foreign debt. The sale of the telephone company generated significant and much needed revenues for the government, and at the same time updated the antiquated telephone network. On the other hand, even though British Telecom's network was already modernized, privatization enhanced the company's competitiveness both within the U.K. and globally. Only after determining its goals, can the government formulate a specific privatization plan.

In the best case, privatization can achieve all of the above goals of the government. However, it takes time, commitment, and effort to achieve those goals, and in the short term, some or all of the government's objectives will likely remain unmet. In Argentina, for example, the privatized telephone companies[10] still have service problems and rates have gone up rather than down.[11] In fact, service in Argentina can still be as troublesome as it is in nearby Brazil, whose telephone company is state-run.[12]

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9. The privatization process of telecommunications service providers is almost always conducted amid intense public scrutiny and comment. *See* Hilary Barnes, *Danish Sell-off Confronts Two Obstacles*, FIN. TIMES, Nov. 4, 1993, at 29; *Telecommunications and Power May Set Privatization Trend*, E. ASIAN EXECUTIVE REP., Aug. 15, 1993, at 24 (discussing Thai experience in telecom and power areas). The much talked about privatization of Deutsche Telekom, for example, stalemated for years as the Social Democrats raised opposition to the plan. *See, e.g.*, Ariane Genillard, *Cross-Party Talks Clear Way for Sale of Deutsche Telekom*, FIN. TIMES, Nov. 6-7, 1993, at 24. *See also German Government, Opposition Agree on Telekom Privatization*, REUTER BUS. REP., Nov. 5, 1993; Ariane Genillard, *Deutsche Telekom Hangs on for Sell-off Call*, FIN. TIMES, Oct. 26, 1993, at 27. We in the United States may not fully appreciate the extent of the debate over these issues in other nations given that our own telecommunications services have always been provided by private companies.

10. The national telephone company, ENTEL, was divided into two entities, Telefonica of Argentina and Telecom of Argentina. One serves the northern portion of the country; the other serves the south.

11. Douglas Feiden, *Overseas Operators; Telephone Privatization Plans Could Boost Service, Costs*, CRAIN'S N.Y. BUS., July 19-25, 1993, at 21.

12. *Id.*

III. The Privatization Process in the Telecommunications Context

Privatization is more than simply the transfer of asset ownership from the government to the private sector; it is a way to de-politicize business enterprises. One common denominator of all successful privatizations is the removal of the commercial, financial, and strategic decisions of the business away from political considerations.

Normally, a modest change from a government ministry to a government-owned corporation will not be sufficient to break the control of the political system. Private ownership, either in whole or in part, has proven to be the most reliable catalyst to move firms to the necessary level of efficiency. Indeed, privatization frequently means not only the introduction of private capital into the company itself, but also the introduction of private competitors into the market in which the product or service is provided.

The discipline of at least some private ownership is essential to de-politicization because private capital usually insists on the definition and adoption of a stable legal framework for the allocation of rights and responsibilities between the company and the government. Only by creating an independent framework for parties which is entirely separate from the state, with rights enforceable under the law, can the culture of the enterprise, as well as the relationship between the firm and the state, be altered in a fundamental way.

The telecommunications sector presents a unique context for privatization. The industry involves ownership, maintenance, and operation of an extensive physical infrastructure, including customer premises equipment (CPE); public transmission facilities (terrestrial fiber optic, cable, microwave, and satellite); provision of services to end-users; and the development, integration, and implementation of technological advances to improve capabilities and services.

Telecommunications privatization can also mean granting licenses to private parties for the provision of value-added, cellular, paging, or other telecommunications services not provided by government-owned services.

A. *Regulatory Issues*

In reviewing successful telecommunications privatizations, several structural patterns emerge. There can be a tension between the desire to rid the business enterprise of the distortions created by political control and the state's unwillingness to abandon its ability to affect the conduct of the company. A balance lies in identifying in advance the influence the state wishes to exert so that it is predictable and reasonable. Telecommunications regulatory frameworks are typically enacted to ensure that the privatized company will meet the government's stated expectations.

For a privatization to be successful, the government must attract the right buyer. Where a strategic stake is being offered in a competitive bid, this is especially important because the buyer will be expected to commit not only funds but technical and managerial expertise as well. The ultimate success of the privatization will depend strongly on the buyer's intentions, commitment, relationship with the government, experience, understanding of local culture, circumstances, needs, and technological and managerial capabilities.

Potential purchasers will demand a transparent legal and regulatory framework for the privatized sector and the privatization process — including the process for making the investment, the day-to-day operations of the company, and, ultimately, the removal of profits. Otherwise, interested buyers will not have the confidence to invest the time, effort, and funds necessary for the successful operation of the privatized company. The buyer's investment is, after all, motivated by business reality. The transaction must make economic sense.

As a result, the state's on-going regulation of the telecommunications companies should be separated from any on-going ownership or proprietary interest in the company. Such independent regulation is preferred by buyers and provides stability to the market. For example, the Australian Telecommunications Authority (AUSTEL) existed prior to the privatization of AUSSAT, the state owned satellite company, and the introduction of its competitor, Optus (a consortium comprised of BellSouth, Cable & Wireless, and domestic Australian investors). Regulations adopted in the privatization process turned AUSTEL from a weak agency into a potentially strong one, with authority over rates, interconnection, and other matters. The British and Greek governments established new agencies, Oftel and the National Telecommunications Commission respectively, as the regulatory bodies for their telecommunications service providers. The telecommunications sector law ensures that the agency is independent from undue political pressure.

Telecommunications legislation and regulation should clearly set forth the company's rights and obligations with respect to the types of services to be offered, the degree of market competition, rate regulation, service quality standards, capital investment, network modernization, interconnection, nondiscriminatory and anticompetitive conduct, license and concession fees, national security and emergency procedures, and public payphone installation and operation. The government's rights and obligations with respect to the amendment or termination of licenses and the inspection of the company's operations or facilities should also be specified so that both sides have a clear understanding of their relationship. Hearing procedures that give service providers the opportunity to present evidence supporting their position and to be fairly heard prior to license termination or amendment offer the potential buyers additional assurance. These issues may be addressed in sector law, sector regulations, or the license or concession granted to the privatized company or new service provider.

All laws and regulations should be drafted with an eye toward conformance with international telecommunications and other applicable standards and with the understanding that amendments may be necessary in the future to ensure continued conformance. European Community (EC) directives applicable to telecommunications are particularly important if the country is or may become a member of the EC. These considerations ensure that the network will be integrated with the global telecommunications infrastructure and will be able to meet the needs of the public in the future.

B. Structuring Ownership and Control

The government's desire to maintain influence in the telecommunications sector may also extend to wanting an element of direct control over the privatized telephone company. This can be achieved through retention of majority equity ownership or voting control in the company or through ownership of a special share which gives the government certain rights, such as the British "Golden Share" or the New Zealand "Kiwi Share." For example, the British Golden Share entitles the government to participate in shareholder meetings, although it cannot vote; to nominate a certain number of directors; and to approve any changes to certain provisions of the Articles of Association, including restrictions on shareholding and citizenship requirements for the Board of Directors. The Golden Share approach gives the government influence over major issues but, from most buyers' perspectives, does not unduly restrict the company's independence.

However, not all governments retain an interest in the privatized company. The Argentine government, for instance, did not retain any equity interest or special shares. In such cases the government relies on its regulatory powers to ensure that the company fulfills its role.

The government may also want to ensure that revenues are invested back into the network and not unreasonably extracted by private investors. Thus, restrictions on dividend policies may be imposed.

In structuring elements of influence, the government must not forget the essential purpose of privatization. If the government seeks to retain too much control, its efforts to privatize will be undermined from the outset. The buyer of a strategic stake will require a significant element of control over the enterprise in order to justify the investment it is making. In Venezuela, this tension between the government's hesitation to remove all influence and the buyer's need for control was alleviated by forming two classes of stock. The Class A shares represent the forty percent held by the strategic investors. The Class B shares represent the forty-nine percent retained by the government. The Class A shareholders are entitled to elect four directors and the president of the company while the Class B shareholders can only elect two directors.

In order to make the privatization more politically palatable, the government may also require that a certain percentage of stock in the telephone company be set aside for company employees. For example, ten percent of the stock of the Argentine telephone companies was reserved for employee stock ownership plans. Both British Telecom and its competitor, Mercury Communications, have employee stock ownership plans. Eleven percent of the equity of Venezuela's CANTC was placed in trust for its employees. An employee stock ownership plan holds 4.4 percent of the equity of Mexico's Telmex, and Telmex also purchased another 1.4 percent for resale to certain employees.

Other ownership restrictions may also be imposed. Mexico, for example, requires that majority ownership of Telmex remain in Mexican control. The U.K. prohibits any one entity from holding more than a fifteen percent interest in British Telecom. New Zealand prohibits any one entity from holding more than a ten percent interest in New Zealand Telecom without the prior approval of the Board of Directors and the government (via its holding of the Kiwi Share).

Where the government chooses to retain an equity interest, it will typically sell between twenty and forty-nine percent of the company to private parties through an open bidding or a public offering. Sometimes, in a two step transaction, the government will first sell a certain stake in the company through a competitive bid, and then make a public offering of either a separate interest in the company or a portion of the interest sold to the winner of the competitive bid.

In Argentina, for instance, sixty percent of each company was sold to the highest bidder; thirty percent was subsequently sold through local public offerings; and ten percent was reserved for employees. In New Zealand, the government announced that it would either sell a forty-nine percent stake in the telephone company to a bidder and then conduct a public offering of the rest, or it would sell the entire company to the bidder but then require the bidder to sell approximately half of the equity to the public. The winning bidder, Bell Atlantic and Ameritech, purchased the entire company and then conducted the required public offering. An advantage of the two step process is that a stake held by a strategic investor can build confidence in the company and raise the value of the company for the public offering.

C. Special Concerns of State-Run Economies

Countries with state-managed economies that have not previously had open capital markets, convertible currency, or other free market features, may have a particularly difficult time privatizing. Governments privatizing in transition from a centrally-planned economy to a market-based economy face special problems. Among the most significant of these is the lack of market and legal structures from which to proceed. This manifests itself initially in the practical issues of establishing the ownership and valuation of telecommunications plants and facilities. Sometimes special privatization laws need to be passed to enable the government to sell state assets, license private service providers, clarify ownership of assets, and ensure an orderly process of privatization.

Assuming that the government is legally authorized to proceed, one of the first tasks to be undertaken in order to sell the stock of a state-owned telephone company to private parties is to determine the assets of the company. Such a determination is particularly difficult because general state ownership of all factors of production have blurred the lines of asset ownership between different state-owned entities. Also, regardless of whether the sale is conducted through open bidding, one-on-one negotiations, or public offerings, the market value of these assets and the company's operations must be established. In some instances, governments accustomed to a centrally-planned economy have found it difficult to adjust to the concept of "market value" as opposed to either what it paid for the assets originally, some calculation of the "inherent" worth of the assets, or asset replacement value.[13]

State-owned economies often have little or no experience in fashioning an independent legal system conducting the privatization transactions, or regulating the new private sector. The legal, financial, public relations, and marketing advisors that play a crucial role in the success of any privatization are especially important to guide state-run economies through the privatization process. Such advisors must understand the individual needs of the local community and their client, whether it is the government or the bidder. Experienced advisors should bring to their assignments an awareness of the many methods of accomplishing the various functions associated with privatization. Since such privatizations are political processes, advisors must bring a political sensitivity to their work as well.

IV. Conclusion

The wisdom of private ownership is now generally accepted. In addition, essentially all the major telecommunications companies in the world are diversifying in a more or less similar fashion. While each is acting out its own strategic vision, these firms are riding the inexorable wave of technology around the globe. They bring with them the latest digital multimedia networks and wireless services. To carry out their strategies successfully, these firms require relatively open markets.

The high level of complexity in telecommunications privatizations and the increasing competition for investors' funds and expertise mean that privatizations cannot be conducted in a vacuum. Governments, buyers, and their respective advisors have to rely on the store of experience gained from previous privatizations while continuing to fashion creative responses to each country's particular circumstances.

The government's commitment to a successful privatization is critical. After all, it is the government that will structure the regulatory and economic environment within which the privatization will take place and within which the company will operate. It is the government that runs the privatization process, including establishing the valuation of the company and preparing the company for privatization

13. *See The What, Why, and How of Privatization, supra* note 5, at S29-30 (noting the valuation problems of an African shipyard with government-appraised assets of $6.2 million and prior-year profits of $3600).

by making it attractive to investors through the reduction of debt and the streamlining of personnel and other costs.[14]

When a privatization is successful, the beneficiaries are the consumers around the world who receive the better services and lower prices brought by global competition.

14. *See The What, Why, and How of Privatization*, *supra* note 5, at S28-31.