For discussion
on 15 February 2011

Bills Committee on
Competition Bill

Responses to Follow-up Questions
Arising From the Meeting on 25 January 2011

Purpose

This paper responds to questions raised by Members at the meeting on 25 January 2011.

Granting exemption to small and medium enterprises (SMEs)

2. The objective of the Competition Bill (the Bill) is to combat anti-competitive conduct in all sectors to enhance economic efficiency and the free flow of trade in order that businesses, regardless of their size, can compete among themselves in a fair and healthy manner. SMEs generally lack market power. On an individual basis, their actions would unlikely have the effect of appreciably preventing, restricting or distorting competition. Hence, regulation of SME conduct is not normally pursued as a priority by competition authorities. This situation is reflected by case laws and regulatory guidelines available in other major competition jurisdictions which suggest that a competition law should only be meant to catch conduct which has an "appreciable adverse effect" on competition.

3. However, when many SMEs engage collectively in an anti-competitive behaviour, their combined market share could be significant enough to cause a significant adverse effect on competition to the detriment of other competing firms and consumers. Moreover, when SMEs are involved in "hard-core" anti-competitive conduct, such as price-fixing, output restriction or market allocation, such types of "hard-core" conduct almost always have an adverse effect on competition and rarely have any redeeming economic benefit, and should therefore be prohibited by law regardless of the size of the firms concerned.

4. Against the above, we consider it not appropriate to exempt SMEs from the Bill. However, to ensure that SMEs will not be unnecessarily targeted by the Bill, we will introduce a "de minimis" arrangement which will be set out in the regulatory guidelines (i.e. except for "hard-core" behaviour, the Competition Commission (the Commission) will not pursue an agreement where the aggregate market share of the undertakings involved do not exceed a certain threshold). The Commission will be required by law to consult the public before issuing the regulatory guidelines. As these guidelines will be drawn up during the transitional period between the enactment of the new law and the coming into force of the conduct rules, this approach would provide sufficient flexibility for the Commission to devise a "de minimis" framework that best fits Hong Kong's actual needs. At the same time, through the process of consultation, the business sector, especially SMEs, will be able to obtain a clear understanding of the "de minimis" arrangement and adjust their business operation to adhere to the requirements of the law.

Treatment of technological innovation under the first conduct rule

5. Clause 6(2) of the Bill is meant to provide a non-exhaustive list of agreements, concerted practices and decisions that would particularly likely infringe the first conduct rule. In so far as clause 6(2)(b) is concerned, an agreement between competitors to limit output or control production will limit the volume or type of particular goods or services available on the market and thereby restrict competition. Similarly, an agreement to limit technical development or investment between competitors will reduce competitive pressure. Such agreements are different in nature from engagement in technological innovation and the award of patent or other intellectual property rights (IPRs). Indeed, IPRs and competition law are complementary rather than conflicting with each other, as they share the same fundamental goals of promoting economic efficiency and innovation. IPRs do this through the provision of incentives for innovation and its dissemination and commercialisation, by establishing enforceable property rights for the creators of new and improved products and processes. Competition law does so by preserving competition in the markets, thereby spurring firms to be more efficient and innovative. In general, while an undertaking's possession of an IPR implies exclusivity in the provision of a particular product/service, its exercise of its property rights is not per se an anti-competitive behavior as it is still subject to the competition from

other undertakings with substitute products/services. Other undertakings are free to invent competing products/services and to develop their own brands. Therefore, consumers will not be deprived of choices in the market and there should not be any competition concerns stemming from the award of IPRs.

6. Moreover, the Bill follows international best practices and provides that the first conduct rule will not apply to any agreement that carries or would be likely to carry greater economic benefit than the potential anti-competitive harm. The undertakings concerned can self-assess their IPR-related agreements on such grounds or apply to the Commission for a decision as to whether their agreements are excluded from the first conduct rule.

Role and power of the Commission

7. During the public consultation in 2008, some respondents were concerned about concentration of too much power in one organisation under the then proposed civil administration model, whereby the Commission would have powers to adjudicate on infringements and impose remedies in addition to its investigative role. The judicial enforcement model is proposed in part to address such concern.

8. Under the proposed institutional arrangements, the Commission will only investigate competition-related complaints, bring public enforcement action before the Competition Tribunal (Tribunal), and retain the discretionary power for reaching settlements and facilitating mediation for a contravention of a conduct rule of lesser scale and severity. The adjudicative power is vested with the Tribunal, a superior court of record established within the Judiciary, which is empowered to adjudicate and impose appropriate remedies. Certain determinations made by the Commission will be subject to review by the Tribunal.

9. The Bill also provides for safeguards in relation to the Commission's investigative power. For instance, the Commission must have reasonable cause to suspect that a contravention of any of the competition rules has taken place, is taking place or is about to take place before exercising its investigative powers. The power to enter and search premises as well as power to seize and retain evidence and property could only be exercised upon obtaining a warrant issued by a judge of the Court of First Instance.

10. Moreover, the Commission will be subject to regulation under the Prevention of Bribery Ordinance (Cap. 201), the Ombudsman Ordinance (Cap. 397) and value-for-money audit by the Director of Audit. It also has to keep proper accounts and submit its annual estimates to the Chief Executive. An Annual Report and audited accounts are to be tabled at the Legislative Council after the end of each financial year. To ensure transparency and good governance over the Commission's work, the Bill also contains provisions on the conduct of meetings, scope of delegation and powers to make house rules of the Commission, including those concerning conflict of interest.

Examples of anti-competitive conduct

11. The question of whether a particular conduct is anti-competitive is a question of fact in each case and could only be determined after investigation into the relevant facts and evidence by the future Commission and the subsequent enforcement proceedings before the Tribunal. To facilitate Members' understanding of the types of behaviour which would likely be prohibited by the competition law, we have selected the following alleged/adjudicated cases in Hong Kong and overseas to illustrate some of these anti-competitive conduct. Cases (a) to (c) involve agreements, concerted practices or decisions among numerous competitors in a market to prevent, restrict or distort competition, i.e. a breach of the first conduct rule. The last example involves an abuse of market power whereby a company with a large market share adopted predatory behaviour towards its competitor, i.e. a breach of the second conduct rule.

(a) Increase in charges by laundry shops

12. On 5 November 2004, the Laundry Association of Hong Kong Limited (the Association) placed an advertisement in various local newspapers calling on laundry shops to raise their charges by 10%. The Association stated that the increase was necessary as the high oil prices had significantly increased their costs of operation relating to the use of industrial diesel and automotive diesel, as well as plastic hangers and bags. The advertisement had aroused concern about anti-competitive practices by the Association.

13. Price adjustment in response to increase in costs could be a normal business practice. Nevertheless, by calling on members to increase charges by a uniform rate (i.e. 10%), the Association had

engaged in practice which smacked of behaviour that distorted normal operation of the market, pursuant to the Guidelines issued by the Competition Policy Advisory Group (COMPAG) in September 2003. As directed by COMPAG, the COMAPG Secretariat wrote to the Association in December 2004 explaining to it the situation and urging it to refrain from engaging in any anti-competitive practices in future. The COMPAG Secretariat had also provided a copy of the Guidelines to the Association for reference.

(b) Joint increase in fees for driving lessons

14. On 8 April 2005, eleven private driving instructors' (PDI) associations called for a joint increase in fees for driving lessons. After investigation, the then Environment, Transport and Works Bureau (ETWB) and the Transport Department (TD) concluded that this action represented a prima facie case of anti-competitive conduct, even though there had been no discernible impact on the general level of private driving lesson fees, and the PDI associations had not taken any action to compel their members to implement a joint increase in driving lesson fees.

15. Subsequently, TD explained the Government's competition policy to the PDI associations and advised them as to action that may constitute anti-competitive conduct. To avoid any recurrence of similar incidents, TD continued to monitor the situation and remind the trade about the importance of fair competition during regular liaison meetings with the trade. TD also circulated, on a regular basis, Government's guidelines on competition policy to the PDI associations.

(c) Exchange of information on future fees by schools – Decision of the UK Office of Fair Trading (OFT) **(CA98/05/2006)**

16. The OFT found that, during the period from March 2001 to June 2003, 50 fee-paying independent schools (the Participant schools) exchanged on a regular and systematic basis highly confidential information regarding each other's pricing intentions for the coming academic year that was not made available to parents of pupils at Participant schools or published more generally. The information exchange was organised by the bursar of Sevenoaks School, to whom the Participant schools submitted details of their current fee levels, proposed fee increases (expressed as a percentage) and the resulting intended fee

levels. The Sevenoaks bursar subsequently circulated this information amongst the Participant schools in tabular form. This process of information exchange and the resulting tables of information were referred to as the Sevenoaks Survey or Survey.

17. The OFT considered that the information exchange constituted an obvious restriction of competition whereby the Participant schools knowingly substituted practical co–operation for the risks of competition. Further, this arrangement was implicit in the way that the Sevenoaks Survey operated, and the fact that it was intended that the information exchanged should be reasonably reliable, that there was at least a "gentleman's agreement" amongst the Participant schools that the fee increase figures submitted to the Survey would accurately reflect actual future fee levels. The OFT therefore found that the Participant schools infringed the prohibition (the Chapter I prohibition) imposed by section 2(1) of the Competition Act 1998 by participating in an agreement and/or concerted practice having as its object the prevention, restriction or distortion of competition in the relevant markets for the provision of educational services.

(d) Predatory pricing by AKZO Chemie BV - Judgment of the European Court of Justice (ECJ) **([1991] ECR I-3359)**

18. AKZO, a large Dutch multinational firm, and ECS (Engineering and Chemical Supplies Ltd.), a small United Kingdom (UK) firm, both manufactured organic peroxides. AKZO had a 50% market share in the market for organic peroxide. AKZO and ECS competed in the market for benzoyl peroxide, which is the most important organic peroxide and can be used as a bleaching agent in the production of flour and as an initiator of the polymer production process in the production of plastics. ECS originally only operated in the flour market, but later moved into the plastics market and solicited some of AKZO's customers. AKZO threatened to take punitive action against ECS in the flour market unless the latter withdrew from the plastics market. ECS refused and AKZO began selective price cutting against certain of ECS's customers in the flour market. From the end of 1980 for about four years, AKZO took the following three courses of action –

(i) selling benzoyl peroxide to ECS's customers in the flour segment at below cost and substantially below the prevailing market price. Meanwhile, AKZO charged its own loyal customers about 60% more than the targeted customers of ECS;

(ii) selling the targeted customers flour milling complements at below AKZO's average cost; and

(iii) selling the targeted customers vitamin mixes, which it had bought specifically to resell to these customers, at below its own purchase prices.

19. The issue for the ECJ was whether AKZO's price cutting constituted predatory pricing and violated Article 82 of the EC Treaty, as found by the European Commission (EC). The ECJ held that a 50% market share created a presumption of dominance, and also pointed to AKZO's superior marketing organization and technical knowledge regarding safety and toxicology to support its conclusion. Having ascertained AKZO's dominant position, the ECJ affirmed that AKZO had committed an abuse under Article 82 "*through recourse to methods which, different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition*".

Advice sought

20. Members are invited to note the contents of the paper.

Commerce and Economic Development Bureau
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