

**For discussion
on 10 April 2012**

Bills Committee on Competition Bill

Responses to outstanding issues from previous meetings

Purpose

This paper sets out the Administration's responses to questions raised by Members at the previous meetings concerning the threshold for the second conduct rule and the thresholds for agreements / conduct of lesser significance.

Market Power Threshold for the Second Conduct Rule

2. As explained in our response to the Bills Committee at the meeting on 2 April 2012 (LC Paper No. CB(1)1450/11-12(02)), we consider a lower threshold of "substantial degree of market power" more suitable for Hong Kong than the "dominance" threshold, which requires a market share persistently over 50%. Given that Hong Kong is a small and geographically concentrated economy, it is not unusual for a small number of firms, each constituting a significant but short of 50% market share, to have control over certain markets in Hong Kong (i.e. oligopolistic market). Adopting a threshold as high as "dominance" would affect the effectiveness of the Bill in addressing public concerns over anti-competitive conduct of some oligopolies in Hong Kong.

3. Some Members and depositions have suggested that if the threshold of "substantial degree of market power" is to be adopted, the Administration should consider spelling out a minimum market share percentage below which an undertaking would unlikely possess a substantial degree of market power. They have also suggested that, in order to provide more certainty, such minimum market share percentage should be prescribed in law.

4. Insofar as the market share percentage threshold is concerned, it was proposed in our public consultation document "Detailed Proposals for a Competition Law – A Public Consultation Paper" issued in May 2008 that the market share percentage threshold for "substantial market power" should be about 40%. As regards the suggestion of specifying a "minimum" market share threshold, we note that jurisdictions adopting "dominance" as their market

power test consider that undertakings with market share percentages less than 35% to 40% would unlikely be dominant¹, which means a margin of 10% to 15% between the threshold for presumed dominance and the “minimum” market share threshold. Taking account of the international practices, and the fact that we have adopted a lower threshold of “a substantial degree of market power” than the “dominance” test for the second conduct rule, we propose adopting a “minimum” market threshold of 25%, although a substantial degree of market power could still be established if other relevant factors provided strong evidence of such market power.

5. We do not propose specifying the minimum market share threshold in the Competition Bill (the Bill) since it would limit the flexibility of the Competition Commission (Commission) to enforce the second conduct rule amidst changing market circumstances and different market structures of different sectors. The international best practice is to set out the market share thresholds and other factors of assessing market power in non-statutory regulatory guidelines. However, noting Members’ and deputations’ concern, as an alternative, we propose setting out this minimum market share threshold of 25% in the Secretary for Commerce and Economic Development’s concluding speech for resumption of the second reading debate.

Thresholds for Agreements/ Conduct of Lesser Significance

(i) Threshold for the Second Conduct Rule

6. Among the proposed adjustments to the Bill announced in October 2011, we proposed that conduct of an undertaking the turnover of which did not exceed HKD 11 million would be excluded from the application of the second conduct rule. There have been suggestions that the proposed threshold of HKD 11 million is too low. Some deputations have suggested that the turnover threshold for the second conduct rule should be on par with the listing requirements for listing on the Main Board of the Hong Kong Exchange (i.e. HKD 500 million)². There have also been suggestions that different thresholds

¹ The Canadian Competition Bureau considers that a market share of less than 35% will normally not give rise to concerns of market power or dominance. If a firm has a 35% or higher market share, the Competition Bureau will normally continue its investigation. The UK’s Office of Fair Trading considers it unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40%, although dominance could be established below that figure if other relevant factors provided strong evidence of dominance. The EU considers that dominance is not likely if the undertaking’s market share is below 40% in the relevant market. However, there may be specific cases below that threshold where competitors are not in a position to constrain effectively the conduct of a dominant undertaking.

² According to the Hong Kong Exchanges and Clearing Limited, a new applicant for listing equity securities on the Main Board of the Exchange must have a trading record of not less than three financial years and meet one of the profit, market cap/revenue or market cap/revenue/cashflow tests. In terms of revenue, the applicant is required to have a revenue of at least HKD 500 million for the most recent audited financial year.

should be adopted for different sectors taking account of their different market circumstances. Some have suggested excluding “micro companies” from the calculation of the turnover threshold since these companies would very unlikely possess any market power, and their inclusion in the calculation of the average turnover of small and medium enterprises (SMEs) would distort the resultant threshold.

7. First, we do not consider the proposal of adopting the listing requirements as the threshold acceptable since it would have the effect of excluding the vast majority of, or even all, undertakings in a market and severely affect the overall effectiveness of the Bill. On the suggestion of sectoral thresholds, the process of defining all sectors of businesses in Hong Kong in the law and determining the appropriate threshold for each of them would be arbitrary, time consuming and controversial. It would cause more confusion than provide certainty to the business sector.

8. The original proposal of HKD 11 million was drawn up with reference to the average annual business turnover of a SME³. It is intended to provide more certainty to smaller companies which are unlikely to have any market power in a market. While an undertaking with an annual turnover above HKD 11 million is not excluded from the application of the second conduct rule, it does not automatically mean that it possesses a substantial degree of market power, which is a question of fact depending on the circumstances of each case.

9. Taking account of Members’ and deputations’ concerns and the fact that a turnover above HKD 11 million does not presume a substantial degree of market power, we have revisited the turnover threshold. We remain of the view that any adjustment to the threshold must be justified based on objective criteria and must not undermine the overall effectiveness of the competition law in tackling abuse of market power. With these considerations in mind and taking account of the latest statistics from the Census & Statistics Department, we propose increasing the turnover threshold for conduct of lesser significance under the second conduct rule to HKD 40 million on the following grounds -

- (a) the figure represents the average turnover of SMEs exclusive of those with five or less employees during the period from 2006 to 2010. Companies with five or less employees have been excluded to take on board Members’ and deputations’ suggestion that very small companies should be excluded from the turnover calculation;

³ According to the statistics of the Census & Statistics Department, the average annual business turnover of SMEs between 2005 and 2009 is about HKD 11 million.

- (b) undertakings with turnover below HKD 40 million would unlikely have a substantial degree of market power anyway, unless the concerned market is very small or narrowly defined. Assuming a 40% market share as an indication of a substantial degree of market power (see paragraph 4 above), a market would have to be as small as HKD 100 million in terms of total business receipt of all players in the market so that an undertaking with a turnover of HKD 40 million (and assuming all turnover of the undertaking is derived from the same market) would have a substantial degree of market power in that market; and
- (c) with the proposed threshold of HKD 40 million, nearly 95% of all SMEs would be excluded from the application of the second conduct rule (vis-à-vis some 86% under the original proposed threshold of HKD 11 million). This should give more certainty to SMEs.

The proposed amendments in mark-up version to the latest version of section 6 of Schedule 1 to the Bill are at **Annex A**.

(ii) Threshold for the First Conduct Rule

10. As one of the proposed adjustments to the Bill announced in October 2011, we proposed that all agreements between undertakings with a combined turnover not exceeding HKD 100 million in the preceding financial year would be excluded from the application of the first conduct rule, except those agreements involving serious anti-competitive activities, namely price-fixing, bid-rigging, market allocation and output control. Some Members and deputations have suggested that the threshold should be further increased and reference could be made to the threshold adopted in the UK⁴.

11. In devising the current proposed threshold of HKD 100 million, we have made reference to the turnover of an average-sized SME and consider that an agreement between undertakings the combined turnover of which does not exceed HKD 100 million should not have a significant impact on competition in Hong Kong. The exclusion, however, does not apply to agreements involving the four types of serious anti-competitive activities (i.e. price-fixing, bid-rigging, market allocation and output control). All agreements involving serious

⁴ The UK Competition Act 1998 and Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulation provide a “small agreement” regime under which a party to a “small agreement” is immune from financial penalty. A “small agreement” is defined as an agreement between undertakings the combined turnover of which does not exceed GBP 20 million (approximately HKD 242 million).

anti-competitive activities are not excluded regardless of the combined turnover of the undertakings involved. Noting Members' and deputations' concern and suggestion and the fact that no agreement involving serious anti-competitive activities would be excluded, we accept the proposal to adjust the threshold to HKD 200 million which is close to the "small agreement" threshold of GBP 20 million adopted in the UK's Competition Act. The proposed amendments in mark-up version to the latest version of section 5 of Schedule 1 to the Bill are at **Annex B**.

Advice sought

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

**Commerce and Economic Development Bureau
April 2012**

Annex A

6. **Conduct of lesser significance**

(1) The second conduct rule does not apply to conduct engaged in by an undertaking the turnover of which does not exceed ~~\$11,000,000~~ \$40,000,000 for the turnover period.

(2) Subject to subsection (3), the turnover period of an undertaking is –

- (a) if the undertaking has a financial year, the financial year of the undertaking that ends in the preceding calendar year;
or
- (b) if the undertaking does not have a financial year, the preceding calendar year.

(3) The turnover period of an undertaking is the period specified as such for the purpose of this subsection in the regulations made under section 162A(2) if –

- (a) for an undertaking that has a financial year –
 - (i) the undertaking does not have a financial year that ends in the preceding calendar year; or
 - (ii) the financial year of the undertaking that ends in the preceding calendar year is less than 12 months;
or
- (b) for an undertaking that does not have a financial year –
 - (i) the undertaking is not engaged in economic activity in the preceding calendar year; or
 - (ii) the period in which the undertaking is engaged in economic activity in the preceding calendar year is less than 12 months.

(4) In this section –

“preceding calendar year” (對上公曆年) means the calendar year preceding the calendar year in which the conduct mentioned in subsection (1) is engaged in;

“turnover” (營業額) means the total gross revenues of an undertaking whether obtained in Hong Kong or outside Hong Kong.

Annex B

5. **Agreements of lesser significance**

- (1) The first conduct rule does not apply to –
 - (a) an agreement between undertakings in any calendar year if the combined turnover of the undertakings for the turnover period does not exceed ~~\$100,000,000~~ \$200,000,000;
 - (b) a concerted practice engaged in by undertakings in any calendar year if the combined turnover of the undertakings for the turnover period does not exceed ~~\$100,000,000~~ \$200,000,000; or
 - (c) a decision of an association of undertakings in any calendar year if the turnover of the association for the turnover period does not exceed ~~\$100,000,000~~ \$200,000,000.

(2) Subsection (1) does not apply to an agreement, a concerted practice, or a decision of an association of undertakings, that involves serious anti-competitive conduct.

(3) Subject to subsection (4), the turnover period of an undertaking is –

- (a) if the undertaking has a financial year, the financial year of the undertaking that ends in the preceding calendar year; or
- (b) if the undertaking does not have a financial year, the preceding calendar year.

(4) The turnover period of an undertaking is the period specified as such for the purpose of this subsection in the regulations made under section 162A(2) if –

- (a) for an undertaking that has a financial year –

- (i) the undertaking does not have a financial year that ends in the preceding calendar year; or
- (ii) the financial year of the undertaking that ends in the preceding calendar year is less than 12 months;
or
- (b) for an undertaking that does not have a financial year –
 - (i) the undertaking is not engaged in economic activity in the preceding calendar year; or
 - (ii) the period in which the undertaking is engaged in economic activity in the preceding calendar year is less than 12 months.\

(5) In this section –

“preceding calendar year” (對上公曆年) means the calendar year preceding the calendar year mentioned in subsection (1)(a), (b) or (c);

“turnover” (營業額) –

- (a) in relation to an undertaking that is not an association of undertakings, means the total gross revenues of the undertaking whether obtained in Hong Kong or outside Hong Kong; and
- (b) in relation to an association of undertakings, means the total gross revenues of all the members of the association whether obtained in Hong Kong or outside Hong Kong.