Competition Bill: the Proposed Conduct Rules

Comments on the Issues raised at the Bills Committee Meeting on 7 June 2011

At the last Bills Committee Meeting on 7 June, a number of fundamental concerns were raised about the scope and nature of the proposed Conduct Rules. In fact, these concerns echo those which the Chamber has previously raised with the Bills Committee and the Administration, and to which we have proposed solutions which we believe will effectively address them. We thought it might assist Members if we re-iterate those solutions prior to the next meeting on 21 June, for ease of reference.

1. Can the Conduct Rules or Guidelines be more Specific in identifying the Conduct which will be prohibited?

This concern has been consistently voiced by the Bills Committee members at a number of meetings, including most recently at the meeting of 7 June by the Honorable Members Dr. Leung Ka-Lau, Miriam Lau, Chan Kin-Por and Albert Ho. Members are rightly concerned that businesses should know in advance what conduct is prohibited, so that they can avoid breaching it inadvertently. These are also concerns which have also been expressed on numerous occasions by this Chamber. The Administration's response has also been consistent, namely that clarity will be provided by guidelines which will be issued by the future Commission, and that the Conduct Rules have to be framed generally so as not to "tie the hands" of the future Commission and Tribunal.

With respect to the Administration, this response is self-contradictory. The Conduct Rules and guidelines cannot be specific and clear as to which conduct is prohibited, while at the same time giving the Commission and Tribunal maximum flexibility in the future to target any conduct which they believe has a sufficiently negative effect on competition. The purpose of rules and guidelines is precisely to limit administrative discretion, so as to give those subject to them sufficient legal certainty to be able to conduct their business. If, on the other hand, maximum flexibility is to be allowed, both the rules and the guidelines have to be worded in broad, non-specific terms. This is amply demonstrated by the document

produced by the Administration for the meeting of 7 June entitled Guidelines on the First Conduct Rule (the "Guidelines Document")[1]. As Members have pointed out, the Guidelines Document is mostly non-committal as to what conduct is prohibited, essentially taking the position that many types of conduct may or may not infringe the Conduct Rules, depending on their future economic effects. However, businesses are not in a position to predict in advance what the future effects of their conduct will be (except in the most obvious or extreme cases) or *what level* of effects deemed to be "anti-competitive" will trigger an infringement.

In any event, the Tribunal will be bound to follow the words of the Ordinance, not Guidelines, so the legal drafting in the Ordinance (both the conduct rules, and guidelines if it is decided they should be incorporated in a schedule to the Ordinance) must be clear as to what is and is not prohibited.

The Chamber has proposed two relatively straightforward drafting changes to the Bill in particular which would address this problem of lack of clarity:

(a) the examples in the First Conduct Rule (Clause 6(2)) should be drafted in more specific terms and be limited to conduct which is most commonly regarded as being anti-competitive, namely price-fixing, market-sharing and bid-rigging: so-called "hardcore" conduct. (Agreements to limit output with a view to maintaining or raising prices could also be specified, although the reference to price-fixing could be drafted in such a way as to cover such conduct). The mark-up of the Bill which the Chamber provided to the Committee with its initial submission in November 2010 contained proposed drafting amendments which would achieve this.

(b) All other types of conduct ("non-hardcore" conduct) should not be prohibited <u>in the Bill itself</u> on the basis of their future economic effects, since these cannot be predicted with sufficient certainty. Instead, at most, such conduct should only be prohibited <u>if and when the Tribunal finds</u>, on application by the Commission, that

[1] CB(1)2336/10-11(01).

such conduct substantially lessens competition and does not have any countervailing economic benefits. If the Tribunal makes such a finding, it could issue a cease and desist order to prohibit such conduct, (unless the party or parties had voluntarily ceased the conduct before then) and illegality and sanctions would only arise if the order was breached. The Chamber believes that this a much fairer and proportionate way of addressing conduct on the basis of its economic effects. It has pointed out that Hong Kong would not be alone in adopting this approach to "non-hardcore" conduct: Canada adopts a similar approach.

2. Will bid-rigging be automatically prohibited, irrespective of whether it involves SMEs, or its effects on competition?

The Hon. Regina Ip raised the question of whether "bid-rigging", of the kind at issue in the Tai Po market case, would be prohibited under the Bill, even if it was only SMEs which were involved. The Administration's response was "very likely". In other words, it would not be prohibited *automatically*. But the circumstances in which it would be prohibited remain unclear. However, the Administration subsequently appeared to state a few moments later in the discussion that the examples in Clause 6(2) were indeed automatically prohibited, regardless of effects on competition.

The Guidelines Document is not clear on this matter either, and in fact is also self-contradictory. It states that there are no automatic breaches of the First Conduct Rule, and lists bid-rigging as an example of conduct which **"may breach the First Conduct Rule, depending on the circumstances"**.[2] This is consistent with the policy statement in the Government's May 2008 Consultation Document that there should be no *per se* infringements (i.e. automatic infringements, regardless of effects on competition). However, in the same document, a few paragraphs later, it directly contradicts this by stating that bid-rigging arrangements **"will, by their very nature, be regarded as restricting competition appreciably"**.[3]

[2] Paragraph 4.2.
[3] Paragraph 4.10.

This confusion raises serious questions as to whether the Administration itself fully understands the nature of the Bill it is asking Members to adopt and should be of concern to SMEs. If it is not possible to get clarity from the Administration on this simple question, then one must ask how SMEs, such as those involved in the Tai Po case, could possibly predict for themselves in such cases what they could and could not legitimately do under the proposed competition law.

Members may wish to ask the Administration to confirm whether its May 2008 proposal that there be no *per se* prohibitions still stands, and if so whether any amendments should be made to the Bill to put this matter beyond doubt. Members should bear in mind that a *per se* prohibition could have serious ramifications, making normal and healthy conduct illegal without any consideration of its positive effects on competition and exposing SMEs to higher risks of breach.

3. Is there a difference between "prevent, restrict or distort" (as used in the Conduct Rules) and "substantially restricting" (as used in the Telecommunications and Broadcasting Ordinances), or "substantially lessening" (as used in the Merger Rule) If so, what is it? Why have different tests been used?

These issues were raised at the last meeting by Mr Timothy Tso, Legco's Assistant Legal Adviser, and the Hon. Ronny Tong SC. With respect, the Administration did not give a satisfactory response to these questions at the meeting on 7 June, and they have been asked to address this subject again at the next meeting on 21 June.

The Administration said that the concept of "preventing, restricting or distorting competition" (PRDC) had been used in the Conduct Rules, because it was a concept drawn from EU competition law, which had a "richer" body of case law interpreting it. However, this response omitted to mention the following major points:

- The EU case law interpreting the PRDC concept is extremely unclear. As one leading commentator has remarked:

  "While it is easy to say what the Courts have not done, it is less easy to provide an explanation of how they have interpreted the notion of a restriction on competition, because the case law is very opaque, and recent cases often restate bland pronouncements from earlier cases without adding any substance to them".[4]

- What is clear is that the EU courts have interpreted a restriction of competition as being a restriction on a business's commercial freedom in the market,[5] which arguably virtually every commercial contract contains, not a substantial lessening of the intensity of competition in the market, a completely different and less intrusive concept. It is therefore incorrect for the Administration to state that they are "not inconsistent" with each other. Clearly, a court would be entitled to take the view that if the PRDC concept and the SLC concept are used in the same statute, they must have been intended to mean different things.

- Notwithstanding the EU courts' case law, the EU Commission's enforcement practice is to tackle only those cases where a substantial lessening of market competition was involved,[6] in line with its "more economic" approach to competition law, and the laws of countries such as Canada, Australia and New Zealand (where a rich and substantial body of case law does exist). Since the EU Commission is the decision-maker under EU competition law, it is able through its enforcement practice to restrict the application of the PRDC wording in EU law to "substantial lessening of competition" in practice. However, the

[4] G. Monti *EC Competition Law* Cambridge University Press, 2007 at 31.
[5] For a discussion of the EU approach see Monti, n4 above pp 22-29.

[6] See for example *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*, European Commission OJ C11 2001 p 1 paragraphs 27-28.

situation is completely different in Hong Kong, where it is the Tribunal which will make decisions based on the express wording in the Ordinance. If the law uses a term taken from EU competition law, the Tribunal may feel bound to follow the precedents of the EU courts, not the enforcement practice of the Commission - indeed the Administration has indicated that this is the policy intention. The result may therefore well be the "importation" of case law into Hong Kong which is not only unclear, but is also over-intrusive, antiquated, out-of-step with international best practice and, indeed, not even followed in practice by the EU Commission.

- The Administration has not explained the reason for its significant shift from "substantially lessening competition" (as initially proposed in its May 2008 Consultation Paper) to "preventing, restricting or distorting competition" (the test used in the Bill).

The SLC concept should be substituted for the PRDC concept in the Conduct Rules, in line with the Merger Rule, the Government's original proposal, and international best practice.

4. <u>Should Mergers be excluded from the Conduct Rules?</u>

Mr. Timothy Tso, Legco's Assistant Legal Adviser, raised the question of whether mergers would be covered by Clause 6(1) of the Bill (the First Conduct Rule), and if so, whether the Government should consider explicitly excluding such agreements from the application of Clause 6(1).

The Administration conceded at the meeting that mergers could be covered by the First Conduct Rule, if they were formed by an agreement between undertakings and had the object or effect of "preventing restricting or distorting competition". (The Administration might have added that they could be caught by the Second Conduct too, which was the case

under the equivalent provision in EU competition law when the EU failed to clarify this issue in the early stages of EU competition law development).

In other words, the Bill as currently drafted does not meet the Government's stated policy objective. The Government has consistently stated publicly that only mergers involving carrier licensees under the Telecommunications Ordinance would be covered by the competition law in the first instance, in line with the recommendations of the Competition Policy Review Committee in 2006.[7] We now have a situation where mergers could be attacked under the conduct rules, it could take years to resolve any such disputes and there is no clearance mechanism for parties wanting certainty and no intention to staff the Commission to handle the likely influx of merger related cases this will give rise to.

To bring the Bill into line with the Government's policy, a short and simple insertion should be made in the First and Second Conduct Rules to exclude mergers from their scope, as in Singapore and Jersey. Simple amendments also need to be made to Schedule 7 to bring it into line with that policy, since currently Schedule 7 would catch a merger affecting <u>any</u> sector, as long as one of the parties happened to have an affiliated company which was a carrier licensee. Draft amendments to this effect were provided to the Bills Committee along with the Chamber's submission in November 2010.

5. <u>Should "competition", "substantial lessening of competition" etc. be defined?</u>

Dr. Leung Ka-Lau pointed out that certain key concepts such as "competition" were not defined and raised the issue of whether they should be.

The Government's response was that these concepts were not defined in the competition laws of other jurisdictions, and that by seeking to insert definitions, this might undermine the Hong Kong court's ability to rely on precedents in other jurisdictions.

[7] See for example CB(1)372/08-09(03) at paragraph 10.

Various jurisdictions do define key terms in their competition laws and policy issues can affect approach in any event, e.g. EU unification policy which has a significant impact on the EU's approach to competition law. The Chamber believes that, rather than seeking to rely on foreign case law, which may or may not be drawn from jurisdictions with similar policy considerations to those of Hong Kong, it is much more satisfactory, in the interests of clarity of both law and Hong Kong's competition/economic policy, to define these concepts in the Bill itself. This is because there is no certainty as to whether, and if so to what extent, the Hong Kong courts will be guided by foreign precedents (and if so, which ones), and as noted above EU case law (at least) is unclear. There is also the risk (as noted above) that the result will be the importation of an over-intrusive regime which is out-of-step with international best practice.

It is not a complex task to define these terms, and the Chamber provided suggested definitions with its mark-up of the Bill in November 2010.

6. <u>Should vertical agreements be excluded from the Bill?</u>

Whether vertical agreements are included or excluded will significantly affect the scope of the legislation, and the resources required to administer it, given the substantial number of such agreements in any market economy. The current general consensus internationally is that vertical agreements are not potentially problematic, unless they involve companies which are dominant. It is therefore appropriate to exclude vertical agreements from the scope of the First Conduct Rule (as in Singapore). Where dominance is involved, vertical agreements would be caught by the Second Conduct Rule anyway, if they had requisite adverse effect on competition.

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Submitted by The Hong Kong General Chamber of Commerce
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