HSBC

Ref:

The Hon Andrew Leung Kwan-yuan, GBS, JP
Chairman of the Bills Committee on the Competition Bill

21 November 2011

c/o Clerk to Bills Committee
Bills Committee on Competition Bill
Legislative Council
Legislative Council Complex
1 Legislative Council Road
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Honourable Chairman and Members,

**Comments on the Government's proposed amendments to the Competition Bill**

The Hongkong and Shanghai Banking Corporation Limited would like to thank the Bills Committee for this opportunity to submit comments regarding the Government's proposed amendments to the Competition Bill (LC Paper No. CB(1)91111-12(01)).

HSBC welcomes the Government's efforts to bring legal certainty through its recent proposals for amendments. In particular the Administration's introduction in the Bill of thresholds below which certain types of conduct would not be subject to the law is to be commended. The express exclusion of merger activity also brings clarity to a question which raised significant uncertainty.

We note however that the Administration's proposals fail to address a number of important matters of concern to HSBC and others. As actors in a regulated industry, financial institutions like HSBC face demands and compliance requirements issued by sectoral regulators. The new law would add complexity to Hong Kong's regulatory environment, and it is unfortunate that the Bill does not better address the relationship between competition and financial services regulators. The law should also be clearer in relation to what is expected from companies that face competing or conflicting obligations under general competition law and the requirements set out by sectoral regulators. These and many other technical concerns, as well as concrete proposals on how to amend the Bill to bring it more in line with international best practices, were outlined in HSBC's previous submission (LC Paper No. CB(1)1042/10-11(01)).

It is not HSBC's purpose to repeat these concerns and concrete proposals for change in the present letter. We wish to react to the Government's position on what conduct is sufficiently material to fall within the scope of the law, in particular in the context of the Administration's latest proposals.

## 1 HSBC's proposal

HSBC's proposal is twofold.

***Dominance.*** First, the Bill should adopt clear terminology when setting out the market power test: "dominance" should be the test, and not "substantial degree of market power".

***Market share threshold.*** Second, the Bill should set out a clear market share benchmark to measure dominance, for example in its Schedule 1.

Our proposed amendments are set out in the Annex. The reasons for HSBC's proposals are set out below.

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## 2 The use of "substantial degree of market power" in the Bill creates uncertainty for businesses

Under Section 21(1) of the Competition Bill, "an undertaking that has a substantial degree of market power in a market must not abuse that power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong".

It is particularly important that the text of the Bill itself brings clarity on what is of "minor significance" and on what constitutes "market power" that is significant enough to warrant scrutiny, given the uncertainties arising from the hesitant and conflicting statements from the Administration on these matters during the legislative process.

Commenting on the use of the substantial degree of market power test in the Bill, Government officials have stated that the concept is interchangeable with that of dominance and that there was no substantial difference between the two concepts. The Secretary for Commerce and Economic Development noted that "[o]verseas jurisprudence suggests that there is no material or practical difference between substantial market power and dominance"[1]. The Administration again recently confirmed this view in its response to the Legislative Council Secretariat: "On the use of "substantial degree of market power (SMP)" instead of "dominance" in the second conduct rule, our research indicated that there is probably little difference between the two standards. For instance, the European Commission used the two concepts interchangeably in their written submissions during the public consultations in 2008."[2]

At the same time, the Administration - in the same paper - admits that "SMP appears to represent a lower market share threshold than dominance". Government representatives even went further during a Bills Committee meeting held last July, during which they stated that the substantial degree of market power test was more adequate in the context of Hong Kong's small economy than the dominance test. According to the minutes of the meeting, "[t]he Administration responded that due consideration had been given to the local context when drafting the Bill. To reflect that Hong Kong was a small-scale economy, the Bill proposed "substantial degree of market power" rather than EU's "market dominance" as a threshold to assess whether an undertaking possessed significant market power under the second conduct rule."[3]

The Government paper containing draft *Guidelines on the Second Conduct Rule* also contributed to the uncertainty. The Guidelines state that "[m]arket power arises where an undertaking does not face sufficiently strong competitive pressure and can be thought of as the ability to profitably sustain prices above competitive levels or to restrict output or quality below competitive levels. [...] The ability to make decisions on pricing and quality without regard to the reactions of customers and other suppliers is the essence of market power". This discussion of the test for market power in the Guidelines is very much consistent with the definition of the dominance test.[4] However, this definition directly contradicts the meaning of "substantial degree of market power" as defined in Australia's competition legislation, one of the very few laws that use this test. According to Section 46(3c) of the *Competition and Consumer Act 2010*, "a body corporate may have a substantial degree of power in a market even though: (a) the body corporate does not substantially control the market; or (b) the body corporate does not have absolute freedom from constraint by the conduct of: (i) competitors, or potential competitors, of the body corporate

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1 Speech by the Under Secretary for Commerce and Economic Development, Mr Gregory So, at the 5th Annual Conference of the Asian Competition Forum, 7 December 2009.

2 Administration's response to the Assistant Legal Adviser's letter dated 26 October 2010 (LC Paper No. CB(1)1034/10-11(05)).

3 Bills Committee on Competition Bill, minutes of eighteenth meeting held on Tuesday, 5 July 2011 (LC Paper No. CB(1)44/11-12).

4 In the *United Brands* and *Hoffmann-La Roche* cases, the Court of Justice of the European Union defined dominance as "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers". See Judgment of 13 February 1979 in Case 85/76, *Hoffmann-La Roche & Co. AG v Commission of the European Communities*, and judgment of 14 February 1978 in Case 27/76, *United Brands v Commission of the European Communities*.

in that market; or (ii) persons to whom or from whom the body corporate supplies or acquires goods or services in that market".[5]

Further, the Guidelines acknowledge that "an undertaking's market share is an important factor in assessing market power".[6] However they not only fail to provide any market share threshold that may be indicative of a substantial degree of market power, but they only contain references to precedents from jurisdictions that rely on the dominance test and not on the substantial degree of market power test.

The meaning of the words "substantial degree of market power" in the Bill is thus very uncertain. This is very unfortunate given the importance of Section 21 of the Bill for many businesses: in foreign jurisdictions, there are forms of market conduct that are perfectly legitimate and encouraged when involving parties without dominance but which may sometimes be abusive when involving parties with dominance. Without prejudging on the views of the future Competition Commission or the Competition Tribunal on what may constitute an abuse, it is important from a practical perspective that businesses in Hong Kong know what is the threshold above which common commercial practices such as rebates or bundled sales must be monitored by their compliance departments.

The above strengthens HSBC's views already expressed in its previous submission that the more widely accepted "dominance" test should be used in Section 21 of the Bill. More generally, the uncertainty over the scope of the second conduct rule will induce firms to refrain from business practices which are lawful and competitively neutral (if not pro-competitive). It is thus important that the Bill clearly stipulates what substantial market power is, and what is a conduct of minor importance under the second conduct rule.

## 3 "Dominance" is the appropriate legal test and terminology

Most established competition law regimes refer to the dominance test in their legislation. The test is used in the rest of China. Laws in Canada, the EU, the UK, France, Germany, Malaysia, the Netherlands, Singapore and many more countries all use "dominance". Most jurisdictions with small territories also use the same test, as shown in the table below.

| Relevant jurisdiction | Legal test |
|---|---|
| **Belgium** | Dominance |
| **Israel** | Dominance |
| **Jamaica** | Dominance |
| **Jersey** | Dominance |
| **Luxembourg** | Dominance |
| **Malta** | Dominance |
| **Netherlands** | Dominance |
| **Singapore** | Dominance |
| **Switzerland** | Dominance |
| **Taiwan** | Dominance |

5 Section 46(3C) of the Competition and Consumer Act 2010.

6 Draft *Guidelines on the Second Conduct Rule* submitted by the Commerce and Economic Development Bureau to the Bills Committee on the Competition Bill on 30 June 2011 (LC Paper No. CB(1)2618/10-11(01)).

The adoption of a dominance test would allow a future Competition Commission in Hong Kong to have regard to clear guidance in well-established European case law as well as precedents adopted in most other jurisdictions, including Singapore. HSBC is also aware that clear guidelines on the abuse of dominance have been adopted by several competition authorities.[7] The opportunity to rely on clear foreign precedents when interpreting the Competition Ordinance would be lost if another test than dominance were to be used.

Finally, the dominance test is more suited for multinational companies active in several jurisdictions and for smaller players who may only be active within the Pearl River Delta region. For both types of companies, a different market power test would markedly increase the complexity and cost for firms in complying with both Hong Kong's competition law regime and other regimes - considering that other jurisdictions (including mainland China) mostly apply a dominance threshold.

## 4 A 50 per cent market share threshold is appropriate for Hong Kong

Irrespective of the legal terminology used, HSBC believes that adopting a low market share threshold would not be a sound economic policy for a small territory where entry barriers are low. Further, a low threshold would increase the compliance burden for many firms operating in Hong Kong and would make the region comparatively less attractive to foreign investment.

### 4.1 Size does not matter, according to a report published by the International Competition Network

The International Competition Network is an international body devoted exclusively to competition law enforcement and its members represent national and multinational competition authorities: its members comprise 104 competition agencies from 92 jurisdictions. It regularly conducts surveys and issues best practice recommendations.

During the conference on competition law in small economies organised by the International Competition Network in 2009, competition authorities were asked whether a specific regime should apply to the conduct of dominant undertakings in a small economy. The majority of competition authorities that participated in the survey agreed that "the analytical framework underlying the assessment of abuse of a dominant position is not altered by the economy's relative size."[8]

The basic objectives of competition policy are similar for large and small economies. In both, the aim of the prohibition of the abuse of market power is to set standards for the conduct of firms with a position of such economic strength that they have a degree of immunity from the normal disciplining effects of a competitive market. In other terms, only players with significant influence over the market are subject to the prohibition of the abuse of market power. What matters is the size of the undertakings on the market, not the size of the market itself.

### 4.2 A smaller economy should concentrate on market efficiency

If size were to matter - contrary to the views expressed by a majority of competition authorities within the International Competition Network - the small size of an economy should only favour the implementation of a competition policy focused on economic efficiency. For example, on that issue, the Jersey Competition Regulatory Authority's *Guidelines on Abuse of a Dominant Position* state that "[c]onduct that stems from the superior efficiency of an undertaking is not an abuse - the

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7 For instance, the *Guidance on the EU Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, the State Administration for Industry and Commerce's *Regulation on the Prohibition on Abuse of Dominant Market Position*, the National Development and Reform Commission's *Regulation on Monopolistic Pricing Practices* and the Competition Commission of Singapore's *Guidelines on the Section 47 Prohibition*.

8 *Competition law in small economies*, Special project for the 8th annual conference of the International Competition Network, prepared by the Swiss Competition Commission and the Israel Antitrust Authority, June 2009.

purpose of competition policy is to encourage, not penalise, efficiency".[9] The reason, essentially, is that a small economy cannot afford the deviations from efficiency that a large economy could absorb. In particular, small economies should avoid the "undeviating pursuit of wealth dispersion and small size of firms at the expense of efficiency" because doing so will preserve inefficient firms and inefficient operation of the market.[10]

### 4.3 Most small economies use high market share thresholds

An analysis of the legal test and the market share threshold used in other small economies shows that many small jurisdictions have adopted the dominance test. Further, a vast majority of them use a market share threshold of between 40 and 60 per cent as an indicator of the existence of dominance, as shown in the table below:

| Relevant jurisdiction | Legal test | Indicative threshold |
|---|---|---|
| **Belgium** | Dominance | 40% |
| **Israel** | Dominance | 50% |
| **Jamaica** | Dominance | 50% |
| **Jersey** | Dominance | 50% |
| **Luxembourg** | Dominance | 40% |
| **Malta** | Dominance | 40% |
| **Netherlands** | Dominance | 40% |
| **Singapore** | Dominance | 60% |
| **Switzerland** | Dominance | 40% |
| **Taiwan** | Dominance | 50% |

Hong Kong itself already uses high market share thresholds to measure market power in the telecommunications and broadcasting sectors. HSBC notes that both the Telecommunications and Broadcasting Authorities use the dominance threshold, and that the indicative market share thresholds are set at a relatively high level. In the broadcasting sector, "a licensee is unlikely to be individually dominant in a defined television programme service market, in the absence of factors suggesting otherwise, if its market share is below 40 per cent. There will be, however, a presumption of dominance, in the absence of evidence to the contrary, if a licensee has a market share persistently above 50 per cent."[11]

In the telecommunications sector, while the new *Guidelines to Assist Licensees to Comply with the Competition Provisions under the Telecommunications Ordinance*[12] do not provide any indication of market shares for the purpose of assessing market power, HSBC notes that under the previous

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9 Competition (Jersey) Law 2005, *Guidelines, Abuse of a dominant position.*

10 JOSEPH FARRELL and CARL SHAPIRO, *Horizontal mergers: an equilibrium analysis*, in *American Economic Review* (1990), vol. 80, 107 - 26.

11 *Guidelines to the application of the competition provisions of the Broadcasting Ordinance*, Broadcasting Authority, 11 May 2007, paragraph 55.

12 *Guidelines to Assist Licensees to Comply with the Competition Provisions under the Telecommunications Ordinance*, Office of Telecommunications Authority, 30 December 2010.

guidelines, a licensee with a greater than 75 per cent market share will be presumed to be dominant.[13]

## 5 Conclusion

As a result of the above, HSBC cannot see any legitimate reason for adopting a "substantial degree of market power" test rather than "dominance". Further, there are no grounds supporting the adoption of a specific rule to deal with abuses of market power in Hong Kong on account of the territory's size or the size of the local economy. There is no support for the Administration's argument that the small scale of the economy necessitates the adoption of a low threshold when defining substantial market power or dominance. Even if one were to follow the Government in considering that size matters, one would acknowledge that many small market economies have chosen dominance as the legal test to measure substantial market power, and that the reference market share thresholds are between 40 and 60 per cent.

However, HSBC agrees with the Administration's view that the Competition Bill, like any piece of economic regulation, should be tailored to the needs of Hong Kong. The defining characteristic of our jurisdiction is however not its size, but the openness of the economy: it consistently ranks very high as an attractive place to start new businesses, where entry barriers are low and regulatory hindrances minimal. More than in many other jurisdictions, an undertaking with a high market share in Hong Kong will be subject to the threat of competitive entry, and this explains why HSBC recommends the adoption of a dominance test with a market share threshold sets at no less than 50 per cent. This could be achieved by way of amending Section 21(1) of the Bill and the proposed new Section 6 as outlined in the Annex.

If the Government and the Legislative Council were of the view that certain economic sectors suffer from a lack of competition due to the existence of barriers to entry, HSBC would contend that in its experience this is an uncommon occurrence in Hong Kong. A cross-sector competition law should not be designed with the exceptional circumstances of particular markets in mind. It should establish sound rules that apply equally to all sectors of the economy. If the particularities of specific markets raise concern, these should be dealt with by specific regulations and not in a legislation of general application.

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We hope the Bills Committee will find these comments helpful. Should you wish to discuss any of the points raised we would be happy to accommodate the Committee.

Yours faithfully,

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Annex

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[13] *Guidelines to Assist the Interpretation and Application of the Competition Provisions of the FTNS Licence*, Office of Telecommunications Authority, June 1995.

## ANNEX

HSBC's proposal is to bring the treatment of restrictive practices and unilateral conduct under the future Competition Ordinance in line with international best practices.

In particular, conduct should only be subject to the conduct rules if it its object or effect is to substantially prevent, restrict or distort competition in Hong Kong. Whether a conduct is capable of having this substantial or appreciable effect is a function of the market share of the undertaking involved, and the Bill should therefore, in line with international practice, contain a clear market share threshold below which conduct cannot have this effect.

HSBC has already included specific drafting suggestions in its previous submission. The suggestions below include HSBC's previous proposals concerning the materiality threshold and the dominance test, and include new proposals concerning Sections 5 and 6 which the Administration now proposes to include in Schedule 1 to the Bill.

| **Name** | |
|---|---|
| Current text | Proposed amendment |
| A BILL<br><br>To<br><br>Prohibit conduct that prevents, restricts or distorts competition in Hong Kong; [...] | A BILL<br><br>To<br><br>Prohibit conduct that **substantially** prevents, restricts or distorts competition in Hong Kong; [...] |

| **Section 6(1) of the Bill** | |
|---|---|
| Current text | Proposed amendment |
| (1) An undertaking must not (a) make or give effect to an agreement; (b) engage in a concerted practice; or (c) as a member of an association of undertakings, make or give effect to a decision of the association, if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong. | (1) An undertaking must not (a) make or give effect to an agreement; (b) engage in a concerted practice; or (c) as a member of an association of undertakings, make or give effect to a decision of the association, if the object or effect of the agreement, concerted practice or decision is to **substantially** prevent, restrict or distort competition in Hong Kong. |

| Section 7 of the Bill | |
|---|---|
| Current text | Proposed amendment |
| (1) If an agreement, concerted practice or decision has more than one object, it has the object of preventing, restricting or distorting competition under this Ordinance if one of its objects is to prevent, restrict or distort competition. | (1) If an agreement, concerted practice or decision has more than one object, it has the object of **substantially** preventing, restricting or distorting competition under this Ordinance if one of its objects is to **substantially** prevent, restrict or distort competition. |
| (2) An undertaking may be taken to have made or given effect to an agreement or decision or to have engaged in a concerted practice that has as its object the prevention, restriction or distortion of competition even if that object can be ascertained only by inference. | (2) An undertaking may be taken to have made or given effect to an agreement or decision or to have engaged in a concerted practice that has as its object the **substantial** prevention, restriction or distortion of competition even if that object can be ascertained only by inference. |

| Section 8 of the Bill | |
|---|---|
| Current text | Proposed amendment |
| The first conduct rule applies to an agreement, concerted practice or decision that has the object or effect of preventing, restricting or distorting competition in Hong Kong even if (a) the agreement or decision is made or given effect to outside Hong Kong; (b) the concerted practice is engaged in outside Hong Kong; (c) any party to the agreement or concerted practice is outside Hong Kong; or (d) any undertaking or association of undertakings giving effect to a decision is outside Hong Kong. | The first conduct rule applies to an agreement, concerted practice or decision that has the object or effect of **substantially** preventing, restricting or distorting competition in Hong Kong even if (a) the agreement or decision is made or given effect to outside Hong Kong; (b) the concerted practice is engaged in outside Hong Kong; (c) any party to the agreement or concerted practice is outside Hong Kong; or (d) any undertaking or association of undertakings giving effect to a decision is outside Hong Kong. |

| Section 21(1) of the Bill | |
|---|---|
| Current text | Proposed amendment |
| Division 2 - Abuse of Market Power | Division 2 - Abuse of ~~Market Power~~ **Dominant Position**<br><br>21. Abuse of ~~Market Power~~ **Dominant** |

| 21. Abuse of Market power | **Position** |
|---|---|
| (1) an undertaking that has a substantial degree of market power in a market must not abuse that power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong. | (1) an undertaking that has a ~~substantial degree of market power~~ **dominant position** in a market must not abuse that ~~power~~ **position** by engaging in conduct that has as its object or effect the **substantial** prevention, restriction or distortion of competition in Hong Kong. |

| **Section 22 of the Bill** | |
|---|---|
| Current text | Proposed amendment |
| 1) If conduct has more than one object, it has the object of preventing, restricting or distorting competition under this Ordinance if one of its objects is to prevent, restrict or distort competition.<br><br>(2) An undertaking may be taken to have engaged in conduct that has as its object the prevention, restriction or distortion of competition even if that object can be ascertained only by inference. | 1) If conduct has more than one object, it has the object of **substantially** preventing, restricting or distorting competition under this Ordinance if one of its objects is to **substantially** prevent, restrict or distort competition.<br><br>(2) An undertaking may be taken to have engaged in conduct that has as its object the **substantial** prevention, restriction, or distortion of competition even if that object can be ascertained only by inference. |

| **Section 23 of the Bill** | |
|---|---|
| Current text | Proposed amendment |
| The second conduct rule applies to conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong even if (a) the undertaking engaging in the conduct is outside Hong Kong; or (b) the conduct is engaged in outside Hong Kong. | The second conduct rule applies to conduct that has as its object or effect the **substantial** prevention, restriction or distortion of competition in Hong Kong even if (a) the undertaking engaging in the conduct is outside Hong Kong; or (b) the conduct is engaged in outside Hong Kong. |

| **Schedule 1, Section 5(1), of the Bill** | |
|---|---|
| Administration's Proposal | Proposed amendment |
| 5. Agreements of minor significance | 5. Agreements of minor significance |

| | |
|---|---|
| (1) The first conduct rule does not apply to –<br><br>(a) an agreement between undertakings in any calendar year if the combined turnover of the undertakings in the year preceding that calendar year does not exceed $100,000,000;<br><br>(b) a concerted practice engaged in by undertakings in any calendar year if the combined turnover of the undertakings in the year preceding that calendar year does not exceed $100,000,000; or<br><br>(c) a decision of an association of undertakings in any calendar year if the turnover of the association in the year preceding that calendar year does not exceed $100,000,000. | (1) The first conduct rule does not apply to –<br><br>(a) an agreement between undertakings in any calendar year if the combined turnover of the undertakings in the year preceding that calendar year does not exceed $100,000,000 **or if the combined market share of the undertakings on the relevant market(s) at the relevant time does not exceed 20 per cent**;<br><br>(b) a concerted practice engaged in by undertakings in any calendar year if the combined turnover of the undertakings in the year preceding that calendar year does not exceed $100,000,000 **or if the combined market share of the undertakings on the relevant market(s) at the relevant time does not exceed 20 per cent**; or<br><br>(c) a decision of an association of undertakings in any calendar year if the turnover of the association in the year preceding that calendar year does not exceed $100,000,000 **or if the market share of the association on the relevant market(s) at the relevant time does not exceed 20 per cent**. |

| **Schedule 1, Section 6(1), of the Bill** | |
|---|---|
| Administration's Proposal | Proposed amendment |
| 6. Conduct of minor significance<br><br>(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 for the year preceding the calendar year in which the conduct is engaged in. | 6. Conduct of minor significance<br><br>(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 for the year preceding the calendar year in which the conduct is engaged in **or the market share of which at the relevant time does not exceed 50 per cent on the relevant market**. |