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Dear Timothy,

Competition Bill

I refer to your letter of 26 October 2010 seeking our clarification on various matters relating to the captioned Bill (the Bill). Our responses are set out in the following paragraphs: -

Clause 2

2. The definition of "shadow director" is primarily meant to supplement clause 99 of the Bill which empowers the Competition Tribunal (the Tribunal), on application by the Competition Commission (the Commission), to make a disqualification order against a person in case of contravention of a competition rule. By defining the scope of 'director' to include a 'shadow director', the Bill enables the Tribunal to make disqualification order against a person who is not occupying the position of director or apparently involved in the management of a company, but nevertheless has significant

influence over the directors of the company through his/her directions or instructions. We also note that the definition of "shadow director" adopted in the Bill is broadly the same as that stipulated in the UK Company Directors Disqualification Act 1986, the Securities and Futures Ordinance (Cap. 571) and the Financial Reporting Council Ordinance (Cap. 588).

3. As regards the meaning of "economic activity" for defining "undertaking" under the Bill, we have followed the practices in most major competition jurisdictions to elaborate the term through case laws. Indeed, case laws in Europe have developed some guiding principles to elaborate on "economic activity", which includes offering goods or services in a given market. There is no need for a profit-making motive or economic purpose, whilst the legal status of the entity and the way it is financed (e.g. public authorities or state-owned) are irrelevant. Pursuant to European Union competition law jurisprudence, entities engaging in activities which amount to "tasks in the public interest which form the essential functions of the state" are generally not considered as undertakings. In other words, a function or activity which is an expected or necessary part of the Government - which only the Government can do and where it is "connected by its nature, its aim and the rules to which it is subject with the exercise of powers ... which are typically those of a public authority"- is not an economic activity. While 'economic activity' is the key consideration in assessing whether an entity is an undertaking, each conduct undertaken by that entity has to be considered on its own merits to decide whether such conduct amounts to an 'economic activity'. An entity having the potential or being capable of carrying out economic activity may not 'qualify' them to be an undertaking under the specific circumstances or conduct in which they are engaging.

Clause 5

4. Clause 5(1)(b) of the Bill provides that the Chief Executive in Council (CE in Council) may, by regulation, disapply the

provisions referred to in clause 3(1) to any person, or any person to the extent that the person is engaged in an activity specified in the regulation. The flexibility is considered necessary to cater for unforeseen circumstances under which non-statutory entities not covered by clause 5(1)(a), may warrant exemption. In considering making the regulation to exempt certain persons or specified activities, the CE in Council will consider whether there are exceptional and compelling reasons of public policy for doing so. The regulation will be subject to vetting by the LegCo.

Clauses 6 and 21

5. Under clauses 6(1) and 21(1) of the Bill, the "object" of an agreement or a conduct should be interpreted as the objective meaning and purpose of the agreement/conduct considered in the economic context in which it is to be applied, rather than the subjective intention of the parties when entering into the agreement or engaging in the conduct. We recognize that it can be difficult to discern intent or object, and also to distinguish an anti-competitive object from a legitimate business object. Indeed, it is not unusual for many competition cases that, after all the evidence has been considered, the existence of anti-competitive object is ascertainable only by inference from the conduct of the undertaking or of any other person or from other relevant circumstances. Express provisions (clauses 7(2) and 22(2)) are therefore included in the Bill to cater for these scenarios.

6. As for the absence of the word "substantially" in the proposed first and second conduct rules, we have followed the practices adopted by the European Commission and the United Kingdom (UK)[1] to do away with the word 'substantially' noting that

(1) Article 101(1) of the Treaty on the Functioning of the European Union prohibits "all agreements between undertakings, decisions by association of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market". Section 2(1) of the UK Competition Act 1998 adopts similar language in stipulating the general prohibition on anti-competitive agreements.

a competition law should be meant to catch only conduct which has an "appreciable effect" on competition even if there is no 'substantial' threshold and the abundance of case laws from the UK and EU in this regard. The future Commission could be reminded to make this point clear to the general public in the guidelines to illustrate such interpretation of the conduct rules.

7. On the question of whether to set out in the Bill the factors for determining the degree of market power of an undertaking, we recognize that the assessment of market power is not a straight-forward task and has to be dealt with specifically on a case-by-case basis according to experience in other competition jurisdictions. This complex task involves, above all, the derivation of a market definition on which the market share of the undertaking concerned is compiled. The intention is to cover these steps of assessment in the Commission guidelines so as to allow sufficient flexibility to cater for circumstances varying from case to case. This is also the approach adopted by the UK Competition Act from which we have drawn majority of our reference in drafting the Bill.

8. On the use of "substantial degree of market power (SMP)" instead of "dominance" in the second conduct rule, our research indicates 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 consultation in 2008. Whilst SMP appears to represent a lower market share threshold than dominance, it is worth noting that the two concepts should not be viewed as a mere description of market share. In fact, according to overseas experience, market share is only one of the factors in assessing dominance or SMP. It is often more important to focus on market power and how such ability is used profitably to sustain prices above competitive levels or to restrict output or quality below competitive levels. It is also interesting to note that the UK Office of Fair Trading (OFT) actually

stipulates in its guideline on "Abuse of a dominant position" that "an undertaking will not be dominant unless it has substantial market power" (paragraph 4.11).

Clauses 9 and 24

9. Under clauses 9(2) and 24(2) of the Bill, the Commission is only required to consider an application for a decision if all the conditions under the sub-clauses are fulfilled, including that the Commission is possible to make a decision on the basis of the information provided. These conditions are formulated to balance the need for enhancing legal certainty for an undertaking through a decision on the one hand, and ensuring efficient operation of the Commission on the other. We note from overseas experience that in the early stage of implementation of the competition law, there would be great demand for an opinion or determination by the competition authorities that might significantly drain their resources. To minimize the risk of opening up a floodgate of applications for decisions from undertakings and avoid the possibility of diverting the Commission's resources from its pivotal role in combating anti-competitive conduct, we have provided some conditions in clauses 9(2) and 24(2) which must be satisfied before the Commission is required to consider an application.

10. On the questions of the types of information that are required to be provided by an undertaking to the Commission, we note from overseas experience that these may include the specific questions on which the decision is sought, information and reasoning on all points relevant for the evaluation. The competition authorities may also use other information at its disposal from public sources and may seek supplementary points from the applicant. According to overseas experience, the specific information required is provided not in the law but administrative guidelines or procedural rules possibly because of the varying nature of these information from case to case. We therefore propose to leave the Commission with the flexibility to deal with these matters administratively.

Clauses 11, 26 and 83

11. Clause 34(1)(a) requires the Commission to maintain a register of all decisions made in respect of applications made under clauses 9 or 24 (i.e. decisions made under clauses 11 or 26). Clause 34(3) further requires the Commission to make the register open to public inspection. Persons with sufficient interest in these decisions would therefore be in a position to know of the decisions even if they are not applicant in respect of the case. Those who have sufficient interest in such decisions may apply to the Tribunal for a review of the determination within 30 days after the day on which the determination was made under clause 83(2).

Clause 33, 39 and 117

12. We noted the omission. We will rectify this through Committee Stage Amendment when we resume second reading debate of the Bill.

Clause 79

13. In other major competition jurisdictions, leniency regime or prosecutorial discretion by the enforcement authorities is often provided administratively rather than through legislation. Indeed, under the UK regime details of their leniency programmes, for example, information to be provided to secure immunity from prosecution, applicants' rights for non-disclosure of their identities or leniency information, are stipulated in the regulatory guidelines. Recognising that leniency programme is increasingly regarded as an effective tool in detecting and prosecuting collusive behaviour in recent years and in order to provide greater certainty for leniency arrangement under the Bill, we have included an express provision (i.e. clause 79) to empower the Commission to enter into leniency agreements with a person in exchange for that person's co-operation in an investigation or in proceedings under the Bill. The

Commission must not, while a leniency agreement is in force, bring or continue proceedings for a pecuniary penalty in breach of that leniency agreement. As such, applicants will either be given total immunity from pecuniary penalty in a leniency agreement or will not be accepted by the Commission in a leniency agreement at all. Our policy intention is to keep the leniency arrangement as simple as possible particularly during the infancy stage of the Commission.

Part 6

14. As the introduction of a cross-sector competition law would be a new step for Hong Kong, we consider it not appropriate to provide for criminal sanctions including jail sentences for anti-competitive conduct from the outset. This approach is supported by the community as reflected in the responses we received in our public consultation exercise. We also note that in many overseas jurisdictions, the criminalisation of competition law has been an evolutionary process, i.e. the laws were originally civil in nature and subsequently criminal offences were introduced at a later stage.

Clause 143

15. Clause 143(3) provides that the Tribunal is to conduct its proceedings with as much informality as is consistent with attaining justice. The Judiciary has no objection to this provision. The policy objective is to enable the Tribunal to conduct proceedings with as little formality and technicality and with as much expedition, as the requirements of the Bill and justice permit, in order to address community concerns on procedural complexity and litigation cost possibly involved under the proposed judicial enforcement model. Clause 156 empowers the Chief Judge, after consulting the President of the Tribunal, to make rules regulating and prescribing, amongst others the practice and procedure to be followed in the Tribunal in all matters with respect to which the Tribunal has jurisdiction. This is

the same approach adopted by the Lands Tribunal, Labour Tribunal and the Small Claims Tribunal.

Part 11 and Schedule 6

16. The proposed concurrent jurisdiction mechanism is intended to retain the specialist knowledge of the Telecommunications Authority (TA) and the Broadcasting Authority (BA) in competition regulation and for them to initially share some of the Commission's workload to promote efficiency. Taking into account the concern of some respondents to the 2008 public consultation that having more than one regulator enforcing the same law could lead to confusion and inconsistency, we have made it a statutory requirement for the Commission, the TA and the BA to prepare and sign a Memorandum of Understanding (MOU) in order to ensure co-ordination and clarity in the exercise of the concurrent jurisdiction. Clause 160 of the Bill further safeguards against any arbitrary transfer of a single competition matter between competition regulators, by stipulating that such transfer can be carried out only when a prior agreement among the regulators concerned is in place. Noting that the MOU is largely concerned about the allocation of duties and coordination of regulatory role among the three competition regulators which appear to have no substantial implications to the general public, we consider it appropriate to leave full flexibility in their hands in respect of the preparation of MOU after enactment of the Bill.

Schedule 1

17. Section 3 of Schedule 1 provides that neither the first conduct rule nor the second conduct rule applies to an undertaking entrusted by the Government with the operation of services of general economic interest (SGEI) in so far as the conduct rule would obstruct the performance, in law or in fact, of the particular tasks assigned to it. According to competition guidelines and case laws developed in overseas jurisdictions, the act of "entrustment" of the

Government or public authorities could be by way of legislative measure or regulation, or through an act of a public authority in such capacity. These may include the grant of a concession or licence governed by public law. In respect of SGEI, the European Commission has stated that these are services that the authorities consider should be provided in all cases, whether or not there is incentive for the private sector to do so. Moreover, such services must be widely available and not restricted to a class, or classes, of customers.

18. Undertaking seeking to benefit from exclusions in section 3 of Schedule 1 must be able to demonstrate that it has been entrusted with the SGEI by the Government. The undertaking may apply to the Commission for a decision on whether or not the agreement in question is excluded from the application of the first or second conduct rule by or as a result of Schedule 1 in accordance with the procedures and conditions set out in clauses 9 or 24 of the Bill. As elaborated in paragraph 11 above, any decisions made by the Commission in respect of applications under clauses 9 or 24 will be published for public information in a register to be maintained by the Commission.

Schedule 7

19. In the two public consultation exercises conducted in 2006 and 2008, respondents' views on merger regulation were diverse. We have also kept in mind the view of the Competition Policy Review Committee (CPRC) in June 2006 that the focus of competition law should be on prohibiting conduct, rather than targeting market structure through the regulation of monopolies and mergers, and that mergers may be an efficient way to achieve economies of scale in a small economy like Hong Kong.

20. Therefore, we consider it pragmatic and sensible not to regulate merger activities under the Competition Bill, except for carrier licenses granted by the Telecommunications Authority (TA)

which is already subject to such regulation (c.f. section 7P of the Telecommunications Ordinance (Cap. 106)). We have, however, taken the opportunities to modernize merger control under the Bill in the light of recent developments in the merger rule of other competition jurisdictions. We have also adjusted the provisions to cater for possible extension to a cross-sector regulation. As experience and expertise about the competition law regime build up, we would be in a better position to review the effectiveness of the law and assess whether cross-sector merger provisions are suitable and needed in Hong Kong.

Yours sincerely,

(Wendy Chung)
for Secretary for Commerce and Economic Development

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