香港地產建設商會
THE REAL ESTATE DEVELOPERS ASSOCIATION OF HONG KONG
香港中環德輔道中十九號環球大廈1403室
Room 1403, World-Wide House, 19 Des Voeux Road Central, Hong Kong.
Tel: 2826 0111 Fax: 2845 2521

28 November 2011

Clerk to the Bills Committee on Competition Bill
Legislative Council Complex
1 Legislative Council Road
Central

Attention: Ms. Sarah Yuen

Dear Ms. Yuen,

Comments on the Government's Proposed Amendments to the Competition Bill

The Real Estate Developers Association of Hong Kong (REDA) would like to thank the Bills Committee for this opportunity to submit written submissions regarding the Government's proposed amendments to the Competition Bill (reference CB(1)91/11-12(01)).

While REDA welcomes most of the Government's latest proposals, we note that some of the major concerns raised by the community have not been addressed yet.

In particular:

- The proposed exclusion regime for statutory bodies. It represents a departure from international practice and creates substantial legal uncertainty. REDA stands by its previous proposals in this regard.

- There remains significant uncertainty concerning the assessment of market power under the Bill. This could be remedied by inserting a market share threshold in the law.

1 The proposed exclusion regime for statutory bodies is inconsistent with international practice and creates substantial legal uncertainty

The exclusion regime for statutory bodies contained in the current Bill is inappropriate. Such a regime is at odds with the Government's stated policy to promote free trade, enhance efficiency and safeguard consumers' interests. The proposed regime is likely to compromise Hong Kong's position as a leading free economy.

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REDA has already explained why the proposed exclusion regime should not be adopted in Hong Kong in its previous submission to the Bills Committee made on 29 November 2010:[1]

- the proposed regime is rigid and inadequate, resulting in considerable commercial activity falling permanently outside the scope of the future Competition Ordinance;

- the proposed regime will affect the level-playing field in the property markets, as bodies such as the Hong Kong Housing Authority will benefit from a blanket exclusion; and

- the regime is not necessary to preserve the efficient provision of public services. Government entities that are not engaged in economic activities are already excluded from the law because they are not "undertakings", and Government entities engaged in economic activities will not be subject to the law if that would frustrate the performance of public services with which they are entrusted.

The proposed regime has not been the subject of extensive debate to date in the Bills Committee, and the Government has failed to address the concerns expressed by REDA and many others.

Departure from international practice

To REDA's knowledge, the proposed exclusion regime for all statutory bodies constitutes a departure from international practice: most competition law regimes including those in the EU, the UK and China apply to all undertakings irrespective of whether they are privately owned or owned by public authorities. Adopting a different design would lead to potentially severe market distortions by statutory bodies which engage in commercial activities.

Significant departure from existing policy

The proposed exclusion regime also proves to be a significant regression from the Government's existing competition policy which does not provide for differential treatment of statutory bodies. The Government's *Statement of Competition Policy* expressly invites compliance by all government entities and emphasises that "government entities should ensure that all statutory bodies under their charge pay heed to the Statement as well".[2] The same policy is stated in the

1 REDA's previous submission is available at http://www.legco.gov.hk/yr09-10/english/bc/bc12/papers/bc121129cb1-622-8-e.pdf (reference CB(1)622/10-11(08)).

2 Competition Advisory Group, *Government of the Hong Kong Special Administrative Region's Statement on Competition Policy*, May 1998.

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Competition Advisory Group's *Guidelines to maintain a competitive environment and define and tackle anti-competitive practices*.[3]

Significant legal uncertainties

The current wording used in clauses 3 and 5 of the Bill leads to significant legal uncertainty.

On the one hand, it is unclear whether private parties dealing with excluded statutory bodies will also benefit from the same exclusion. Also, undertakings that are controlled by statutory bodies but that are separately incorporated will apparently not benefit from the exclusion, rendering the regime opaque and unnecessarily complex.

On the other hand, the cumulative conditions for the Chief Executive in Council to decide to subject specified statutory bodies to the full extent of the Competition Ordinance are unclear and their application is uncertain. For example, the wording used in condition (b) ("the economic activity of the statutory body is affecting the economic efficiency of a specific market") is unfortunate, as any decision by the Chief Executive in Council to apply competition law to a statutory body will be an indication that the statutory body in question already "affects" the economic efficiency of a market in a way that may deserve examination under the conduct rules. Likewise, condition (a) ("the statutory body is engaging in an economic activity in direct competition with another undertaking") constitutes another example of how ill-conceived the whole regime is: as a consequence of this condition, the Chief Executive in Council will not be in a position to propose applying the law to statutory bodies that occupy a monopoly position on the market. Unless the legislative intent is not to apply the Competition Ordinance to *any* undertaking that has a monopoly, this condition, like the other mentioned, defies logic.

The proposed regime is inappropriate for Hong Kong. The relevant provisions of the Bill should be amended as recommended by REDA in its submission of 29 November 2010.

2 The assessment of substantial market power under the second conduct should be clarified

The second conduct rule, set forth in clause 21 of the Bill, prohibits an undertaking that has a "substantial degree of market power" from abusing that

[3] Competition Advisory Group, *Guidelines to maintain a competitive environment and define and tackle anti-competitive practices*, September 2003.

power by engaging in conduct that prevents, restricts or distorts competition in Hong Kong.

REDA has already explained in its previous submissions that it favours the adoption of a "dominance" threshold rather than a "substantial degree of market power" threshold. We refer to point 2 of our submission of 29 November 2010 and to point 6 of our submission of 9 August 2011.[4]

Among its many advantages, the adoption of a "dominance" threshold would allow the Competition Commission and the Competition Tribunal to refer to the numerous foreign precedents when interpreting the Competition Ordinance. This would bring more legal certainty to companies operating in Hong Kong, as they would know they could rely to some extent on foreign precedent when assessing whether they fall within the scope of the second conduct rule. The Administration's reluctance to adopt the "dominance" test thus deprives the Hong Kong community from legal certainty.

Irrespective of the language used in the Competition Bill, matters are made worse by the Administration's own uncertainties about the meaning of its proposed "significant degree of market power" test. On the one hand, the Administration contends that there is no material or practical difference between the two concepts[5] but on the other hand it admits that the substantial degree of market power threshold "appears to represent a lower market share threshold than dominance".[6] Further, while it acknowledges that "an undertaking's market share is an important factor in assessing market power",[7] the Government fails to provide any guidance on the market share levels above which significant market power will be found, and it only refers to precedents from jurisdictions that rely on the dominance test in its draft *Guidelines on the Second Conduct Rule*.

This is extremely confusing. Clarity is required on what a "substantial degree of market power" means, and this clarity must be written in the law.

2.1 What is substantial market power

As leading economists and law professors acknowledge, every firm enjoys some degree of market power, and it is only those firms that enjoy significant market

4 REDA's 9 August 2011 submission is available at http://legco.gov.hk/yr09-10/english/bc/bc12/papers/bc12cb1-2869-1-e.pdf (reference CB(1)2869/10-11(01)).

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

6 Administration's response to the letter dated 26 October 2010 of the Assistant Legal Adviser to the Bills Committee on the Competition Bill (reference CB(1)1034/10-11(05).

7 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 (reference CB(1)2618/10-11(01)) at ¶3.1.

power that should be constrained by the prohibition set out in clause 21.[8] As the Government itself admits, substantial market power only arises in those circumstances where an undertaking is free from competitive constraints and can profitably apply prices above competitive levels for a sustainable period of time.[9]

These are exceptional circumstances, and this explains the exceptional nature of the prohibition set out in clause 21 of the Bill. Indeed, clause 21 prohibits conduct that is otherwise completely legitimate under competition law: "two for the price of one" promotions, tying and bundling, selling at a loss, pricing below cost, etc. All of these practices are not only permitted under competition law but they are actively encouraged. The goal of competition law is to encourage firms to compete with one another as customers benefit from this competition: most business practices involve harm to competitors since that is the nature of the competitive process.[10] As many competition authorities and courts have acknowledged, the primary purpose of the prohibition of the abuse of substantial market power is to protect the competitive process, not competitors.[11] Clause 21 is therefore a derogation to the general principle, and the exceptional prohibition it sets forth only applies to the extraordinary circumstance where an otherwise normal, legitimate and encouraged conduct would adversely affect customers, i.e. where a competitor in the exceptional position of substantial market power does not compete on the merits but engages in practices that will allow it profitably to apply prices above the competitive level for a sustainable period of time.

It is therefore very important that the legislator sets an appropriate threshold above which this exceptional rule will apply. Below the appropriate threshold, the effect of the rule will be to discourage competition, thereby impairing the very competitive process that the law seeks to protect.

2.2 The right market share threshold

A low market share threshold will increase the administrative burden for many Hong Kong businesses

As mentioned above, clause 21 sets out extraordinary prohibitions constraining a business with substantial market power to engage in conduct that is perfectly legitimate when engaged into by firms that do not enjoy the same degree of market power. It is important to recognise that this is a very significant burden. The lower the threshold, the larger the number of firms having to bear this burden.

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8 BISHOP, SIMON and WALKER, MIKE, *The Economics of EC Competition Law*, London, Sweet & Maxwell, 2002, at page 184; WHISH, RICHARD, *Competition Law,* London, Butterworths, 2003, at page 179.

9 Draft *Guidelines on the Second Conduct Rule* at ¶2.3.

10 BISHOP, SIMON and WALKER, MIKE, at page 187.

11 See, among many others, advocate General Jacobs, opinion delivered on 28 May 1998 in case C-7/97, *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG et al.*

A low market share threshold would be detrimental to Hong Kong's economy and consumers

The small nature or geographic footprint of an economy should only favor the implementation of a competition policy focused on economic efficiency. For example, on that issue the Jersey *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 purpose of competition policy is to encourage, not penalise, efficiency".[12] 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.[13]

Many other similar economies set a threshold above 50 per cent

A majority of competition authorities in countries with small economies which responded to a recent study led by the International Competition Network reported that the analytical framework underlying the assessment of abuse of market power is not altered by the economy's relative size.[14] All of the countries qualified as "small economies" by the International Competition Network use the dominance threshold to assess the existence of substantial market power. Further, a significant number of them set a market share threshold at 50 per cent or above: jurisdictions with small territories such as Israel, Jamaica, Jersey, Singapore and Taiwan all set the threshold at 50 or 60 per cent.

2.3 Setting the right threshold in the law

In view of the uncertainty referred to above, the threshold should be set in the law. This could be done by inserting a market share threshold in clause 21 itself.

Alternatively, as REDA notes that the Government's latest proposals include two new general exclusions from the conduct rules at clauses 5 and 6 of Schedule 1, REDA would propose to set the threshold in the new clause 6. REDA would propose, in line with international practice, that the new clause 6 of Schedule 1 also refers to a market share threshold under which no undertaking can be found to hold a significant degree of market power (or dominance if clause 21 is amended as suggested by REDA in its previous submissions).

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12 Competition (Jersey) Law 2005 Guidelines, abuse of a dominant position.

13 *Horizontal mergers: an equilibrium analysis*, Joseph Farrell and Carl Shapiro, in *American Economic Review* (1990), vol. 80, 107 - 26.

14 International Competition Network, Special Project for the 8th Annual conference, *Competition law in Small Economies*, prepared by the Swiss Competition Commission and the Israel Antitrust Authority, 2009.

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Irrespective of where the threshold would be inserted in the Bill, consistent with the objective of applying the extraordinary prohibition contained in clause 21 only to those exceptional situations of substantive market power, REDA would suggest to set the market share threshold at 50 per cent.

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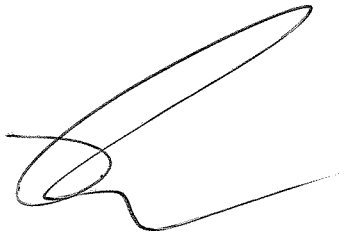
We hope the Bills Committee will find the above comments helpful. Should you wish to discuss any of the points raised, we would be happy to accommodate the Committee.

Yours sincerely



Louis Loong
Secretary General

c.c. Secretary for Commerce and Economic Development