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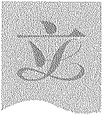

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Hon. Jeffrey Kin-fung Lam GBS, JP

Ms Linda Lai
Deputy Secretary for Commerce & Economic Development
(Commerce and Industry)1
22-23/F, West Wing
Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Dear Ms. Lai

Competition Bill

Follow-up Questions Arising from the 8 November Meeting

At the 8 November meeting, I asked whether the Administration would consider avoiding the use of the term "abuse" in the Second Conduct Rule, as this term has caused a great deal of uncertainty and difficulty in other jurisdictions, in particular the EU.

In your reply, you indicated that the Administration saw no need to avoid using the term "abuse", since it is a well-established concept in other jurisdictions, and has not given rise to problems in practice. (The Administration has also frequently tried to provide re-assurance by saying that EU case law can be relied upon for guidance on what such concepts mean).

I would like to draw your attention to the views of leading competition law experts on this issue.

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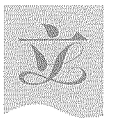

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The first is Professor Richard Whish, whom I understand is well-known to the Administration, and has spoken frequently on competition law in Hong Kong. In the latest edition of his book, he states: "…there remains the question of what is meant by an abuse of a dominant position. No such definition has been provided by the Community Courts".[1]

He goes on to state that the Courts' attempt to define the term "is too indeterminate to provide a coherent definition".[2]

Similarly, two other competition law experts, Robert O'Donoghue and Jorge Padilla (a barrister and economist respectively), comment in their leading textbook that: "…the Community institutions' definition of an abuse under Article 82EC is imprecise, and does not encapsulate a normative concept capable of satisfying the basic requirements of the rule of law and legal certainty".[3] They list five other major problems in the application and enforcement of the abuse provision – one of which is that "the practical application of Article 82EC by the Community institutions and national authorities has been criticized as lacking clarity, consistency, and economic rigour".[4] A copy of the relevant extract from the book is contained in Annex I of this letter.

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[1] *Competition Law* 6ed 2009 at 193.
[2] N 1 above at 194.
[3] *The Law and Economics of Article 82EC* 2006 at 176.
[4] N 3 above at 177-178.

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In the light of the above:

1. **Would the Administration agree that:**
- **the meaning of the term "abuse" under EU competition law is not clear; and**
- **this lack of clarity has given rise to difficulties in practice?**

If the answer is "no" to either of the above questions, please explain why.

2. **If the answer to either of the above questions is "yes", would the Administration agree that it would be worth considering alternative draft wording in the Bill which more precisely describes the conduct which the Second Conduct Rule is intended to target, such as the wording highlighted in Annex II of this letter. If the answer is no, please explain why.**

Exclusions on Grounds of Overall Economic Efficiency

As the Bills Committee has started scrutinizing the provisions on 'Exclusions and Exemptions', I would like to raise an important question about this part of the Bill regarding 'efficiency exclusion'.

In the Administration's paper of November 2010, introducing the Competition Bill to the Bills Committee, the Administration stated:

> "The underlying principle of the exclusion mechanism is that certain agreement or conduct that yields efficiency gains which outweigh any anti-competitive harm ......should be exempted from the law".[5]

[5] Overview of the Main Components of the Competition Bill CB(1)320/10-11(02) at paragraph 20.

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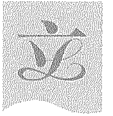

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This statement was made in the context of the First and Second Conduct Rules. Yet, while the Merger Rule gives effect to this policy statement ("The merger rule does not apply to a merger if the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition in Hong Kong"[6]) neither the First nor Second Conduct Rules contain this provision.

The First Conduct Rule is subject to an exclusion in Schedule 1 paragraph 1, the heading of which refers to "Agreements enhancing overall efficiency", but the body of that paragraph does not say that the First Conduct Rule does not apply if the efficiency gains outweigh any anti-competitive harm: it is phrased in entirely different terms from the efficiency exclusion under the Merger Rule. Indeed, the word "efficiency" is not even mentioned in the body of the paragraph. And the efficiency exclusion is completely missing from the Second Conduct Rule.

In the light of the above and in order to give effect to the Government's stated policy intention, would the Administration consider:

1. replacing the wording in Schedule 1 paragraph 1 by the wording of the efficiency exclusion in the Merger Rule (at Schedule 7, paragraph 8(1))?; and

2. inserting the same exclusion in respect of the Second Conduct Rule?

If the answer is no to either or both of these questions, please give a detailed explanation of the reasons.

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[6] Schedule 7 paragraph 8(1).

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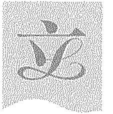

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The Bills Committee Chairman, copied on this letter, has encouraged Members to give the Administration prior notice where possible of any questions, so that the Administration could consider their answers prior to the meeting, thereby expediting proceedings at the meetings. I therefore provide the above questions with the hope that we would receive your detailed replies after the Administration has time to carefully consider them, especially the questions related to 'abuse', an important topic which will certainly be revisited at the Bills Committee in due course. Regarding those questions about 'efficiency exclusion', since Members have already started discussing 'Exclusions and Exemptions', I would be grateful if you would assist the Bills Committee's discussion by sharing verbal replies on 22 November, with written answers to follow.

Thank you very much.

Yours sincerely,

Jeffrey Lam

c.c. Mr Andrew Leung, Chairman, Bills Committee on Competition Bill

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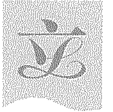

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ANNEX I

Extract from O'Donoghue and Padilla *The Law and Economics of Article 82EC* 2006 at 176-178

(footnotes omitted, emphasis in text added)

"Uncertainty surrounding the definition of exclusionary conduct.

There is currently a great deal of debate among practitioners and antitrust commentators as to what the definition of an exclusionary abuse is or should be. This debate has been prompted by a series of difficulties. First, **distinguishing legitimate competition and exclusionary conduct is inherently difficult, since they are very similar in appearance**. For example, low prices are the essence of competition but they can sometimes be too low and exclusionary. Put differently, both legitimate competition and exclusionary conduct harm rivals, but, in the former case, such "harm" is an essential part of a properly-functioning competitive process. Second, the ways in which a firm can exclude competitors are myriad: a single, overarching definition of exclusionary conduct therefore might risk being either under-inclusive or over-inclusive.

A third problem is that the **Community institutions' definition of an abuse under Article 82 EC is imprecise, and does not encapsulate a normative concept capable of satisfying the basic requirements of the rule of law and legal certainty**. 'Normal competition," as per *Hoffmann-La Roche,* is a vague phrase, since it begs the question of what is "normal." Conduct carried out by a dominant undertaking that is also routinely carried out by non-dominant firms should be presumed "normal" and efficiency-enhancing. And, yet, the Commission has rejected the notion that a common practice within an industry would necessarily constitute "normal competition."

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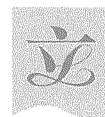

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"Competition on the merits," and "genuine undistorted competition" are similarly vague. These terms have been defined as competition on the basis of "price, quality and functionality" of the product. But this is unclear and does not provide sufficient limiting principles. For example, all predatory pricing and loyalty discounts are competition based on "price," but they are not always allowed. Tying is competition by adding functionality, but is not always allowed. Finally, the term "special responsibility" fares no better. The Court of First Instance has recently clarified that the term "special responsibility means only that a dominant undertaking may be prohibited from conduct which is legitimate where it is carried out by non-dominant undertakings." In other words, it simply encapsulates a general, obvious statement that conduct carried out by firm that are not dominant may be abusive when carried out by a dominant firm rather that constituting a normative definition in itself.

A fourth problem is that a practice may be regarded as not constituting "normal competition," "competition on the merits," and "genuine undistorted competition" in one situation, but not in others. A good example is unconditional price reductions. The rules established under the *AKZO* line of case law state that, first, prices below average variable cost are presumed abusive, and, second, that prices above average variable cost but below average total cost may be regarded as abusive when they are part of a plan to eliminate a rival firm. From this, one might reasonably assume that an unconditional price cut above average total cost is not abusive. And yet, in *Compagnie Maritime Belge,* the Community Courts found that such prices could, in exceptional cases, constitute an abuse. They indicated that the *AKZO* case law was not exhaustive, i.e., that unconditional price cuts could be unlawful in other circumstances. In other words, the terms "normal competition,' 'competition on the merits,' and 'genuine undistorted competition' are not merely vague, but also conclusory. That is, they are defined according to what the Community institutions or national authorities happen to conclude is an abuse in each case. This is highly unsatisfactory.

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Fifth, **the practical application of Article 82 EC by the Community institutions and national authorities has been criticized as lacking clarity, consistency, and economic rigour.** Among the reasons suggested for this are as follows: (1) the Commission has underestimated the risk of causing harm through inadequately considered statements and actions, in particular about pricing abuses; (2) the only general statements about the application of Article 82 EC have been made by the Commission in specialized contexts, notably the telecommunications industry, (3) the Community Courts analyzing antitrust cases in detail only in appeals from the Commission has led to judicial statements very closely tied to the facts of particular cases, rather than general principles; and (4) there are few cases – European companies are less litigious than US companies, and may be less willing to sue dominant enterprises.

Finally, economists have, until recently, largely ignored the assessment of unilateral practices, focusing instead on mergers and other forms of agreements. This has been particularly true in Europe. Moreover, much of the limited economic work on unilateral practices is theoretical rather than empirical."

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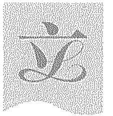

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ANNEX II

Division 2—Unilateral Conduct Substantially Lessening Competition

Subdivision 1—Second Conduct Rule

21. Prohibition of anti-competitive unilateral conduct

(1) Where an undertaking has a dominant position* in a market:

(a) If, after carrying out such investigation as it considers appropriate, the Commission considers it appropriate to do so, it may apply to the Tribunal for on order prohibiting conduct of that undertaking which it has reasonable cause to believe is having the effect or likely effect of substantially lessening* competition in Hong Kong;

(b) If the Tribunal is satisfied, on application by the Commission under subsection (a), that **the effect or likely effect of the conduct is to substantially lessen competition in Hong Kong by foreclosing* competition* where there is no other economic rationale for this conduct**, the Tribunal may make an order that the undertaking engaging in the conduct shall not continue to give effect to the conduct or any part of the conduct as from the date of the Tribunal's determination or, where considered appropriate, some future date;

(c) The Tribunal may, on application by the Commission or any party to an order made under subsection (b), rescind or vary such order where the Tribunal is satisfied that it is appropriate to do so because circumstances have changed;

(d) An undertaking must not continue to give effect to conduct in breach of an order made by the Tribunal under subsection (b) or any variation to such order under subsection (c);

(e) The Tribunal shall not have the power to make an order under subsection (b) or (c) with retrospective effect, but retains the power to make interim orders in relation to such conduct pursuant to section 91.

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(2) **Subsection (1) does not apply where the substantial lessening of competition arises only from the superior competitive performance of the relevant undertaking.**

(3) The prohibition imposed by subsection (1)(d) is referred to in this Ordinance as the "second conduct rule".

* Definitions:

"dominant position" means an ability to conduct business in a way which is over the medium to long term to a large degree unconstrained by the actions or reactions of competitors and/or customers.

"foreclosing" means pushing competitors out of a market or blocking entry in the medium to long term.

"competition" means workable (as opposed to perfect) competition and is a process of rivalry or potential for rivalry whereby undertakings seek to discover new and more efficient ways of offering goods and services.

"substantially lessen competition" means lessen the degree or intensity of competition in a relevant market to such and extent that most consumers as a result of such lessening are, or are likely to be, adversely affected.

"workable" means reasonable in the circumstances of the particular industry under consideration.

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