

For discussion

**Bills Committee on
Competition Bill**

Guidelines on the Second Conduct Rule

Purpose

This paper sets out the key topics and contents which could be covered in the guidelines on the second conduct rule with a view to facilitating Members' scrutiny of Part 2 of the Competition Bill (the Bill).

Role of regulatory guidelines

2. Under the Bill, it is a statutory requirement for the future Competition Commission (the Commission) to issue guidelines indicating the manner in which the Commission expects to interpret and give effect to the conduct rules. The Bill also requires the Commission to consult any persons the Commission considers appropriate before issuing any such guidelines or amendments to them.

3. As Clause 1 of the Bill allows a phased commencement of different parts of the Ordinance, our plan is to first set up the Commission which will conduct consultation and prepare the guidelines, after the passage of the Bill and before the prohibitions come into force. During this transitional period, stakeholders, particularly the business community, can better understand the new law, put in place compliance and training programmes and make adjustments to their business practice as necessary.

4. The Administration notes Members' request for details on the interpretation and implementation of the proposed conduct rules during the scrutiny of the Bill. In this regard, we have already submitted discussion papers on guidelines on the first conduct rule as well as guidelines on market definition. The document at **Annex** explains the elements of the second conduct rule and provides examples of conduct that could infringe the second conduct rule.

5. It should be noted that the document is prepared on a provisional basis with reference to guidelines developed in other jurisdictions. The actual guidelines can only be prepared after consultation with relevant stakeholders. It therefore remains the Commission's duty, which should not be construed as having been affected by the document in any way, to draw up, consult on and issue its guidelines after the passage of the Bill.

Advice sought

6. Members are invited to note the contents of the paper.

**Commerce and Economic Development Bureau
June 2011**

1 SCOPE OF THE SECOND CONDUCT RULE

- 1.1 Clause 21(1) of the Competition Bill (the Bill) provides that 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. Clause 21(1) prohibits the abuse of a substantial degree of market power but does not prohibit undertakings from having a substantial degree of market power or striving to achieve it through legitimate means. The prohibition imposed by clause 21(1) is referred to as the “second conduct rule”.
- 1.2 Clause 21(2) of the Bill provides an illustrative list of conduct that may constitute such an abuse of market power-
- (a) predatory behaviour towards competitors; or
 - (b) limiting production, markets or technical development to the prejudice of consumers.
- 1.3 In terms of geographical application, clause 23 of the Bill provides that 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.
- 1.4 The second conduct rule does not prohibit any conduct that falls within the general exclusions in Schedule 1 to the Bill or meets all the requirements specified in an order made by the Chief Executive in Council under clause 31 or clause 32 of the Bill.

2 ASSESSMENT OF MARKET POWER

- 2.1 There is a two-step test to assess whether the second conduct rule applies -
- whether an undertaking has a substantial degree of market power in a market; and

- if it does, whether it abuses that market power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong.

2.2 An undertaking does not operate in a vacuum in a market. There is ongoing rivalry between undertakings in terms of price, service, innovation and quality to which each undertaking must react if its products and services are to remain an attractive choice to consumers. As a result, undertakings in a competitive market, whether big or small, are mutually constrained in their pricing, output and related commercial decisions by the activity of other undertakings that compete in, or may compete in, the market.

2.3 Market 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. An undertaking can, in principle, temporarily raise its prices above competitive levels. If an undertaking that faces competition does so, however, it will be unable to do so “profitably” for a sustained period, because customers will switch to other cheaper suppliers, additional suppliers may enter the market, and hence the undertaking will lose sales and become unprofitable. 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. Hence, if the undertaking can remain profitable while charging prices above competition levels, over a non-transitory period, then it can be considered to have market power. An undertaking with market power might also have the ability and incentive to harm the process of competition in other ways, for example by weakening existing competition, raising entry barriers or slowing innovation.

2.4 Market power is not absolute. It is a matter of degree and the degree of market power that the particular undertaking in question possesses will depend on the circumstances of each case. More than one undertaking may have a substantial degree of market power in a relevant market. It is not necessary to show an undertaking is a monopoly or has absolute power in a market in order for it to have a substantial degree of market power. In assessing whether an undertaking has a substantial degree of market power, the extent to which there are constraints on that undertaking’s ability to profitably sustain prices above competitive levels will be considered. Relevant constraints on an ability to exercise market power include -

- **existing competitors:** this refers to competition from undertakings already in the relevant market, to whom buyers might switch if the

undertaking with a substantial degree of market power sustained prices above competitive levels. The market shares of competitors in the relevant market are one measure of the competitive constraints from existing competitors;

- **potential competitors:** this refers to the possibility that undertakings will enter the relevant market and gain market share at the expense of the undertaking with a substantial degree of market power that sustained prices above competitive levels. The strength of potential competition is affected by barriers to entry and the ability of potential competitors to enter the market;

- **other factors:** such as the existence of powerful buyers.

3 EXTENT OF EXISTING COMPETITION: MARKET SHARES

Market Share and Market Power

3.1 In general, an undertaking's market share is an important factor in assessing market power. Market power is more likely to exist if an undertaking has enjoyed a persistently high market share over time. Likewise, market power is less likely to exist if an undertaking has a persistently low market share. Relative market shares can also be important. For example, a high market share might be more indicative of market power when all other competitors have very low market shares.

3.2 The history of the market shares of all undertakings within the market is often more informative than considering market shares at a single point in time, partly because such a snapshot might not reveal the dynamic nature of a market. For example, in a highly competitive market, market shares often will be volatile as undertakings constantly innovate to get ahead of each other. Rapid changes in market shares may indicate that barriers to entry (or expansion) in a market are low and therefore suggest the absence of market power. An undertaking is more likely to have market power if it has a high market share and has either maintained or grown that share over time, and its competitors have relatively weak positions.

3.3 While the consideration of market share over time is important, market share does not on its own determine whether an undertaking has a substantial degree of market power. Other factors may also be considered -

- **low entry barriers:** an undertaking with a persistently high market share may not necessarily have market power where there is a strong

threat of potential competition. If entry into the market is easy, the incumbent might be constrained to act competitively so as to avoid attracting entry over time by potential competitors.

- **bidding markets:** sometimes buyers choose their suppliers through procurement auctions or tenders. In these circumstances, even if there are only a few suppliers, competition might be intense. This is more likely to be the case where tenders are infrequent (so that suppliers are more likely to bid), and where suppliers are not subject to capacity constraints (so that all suppliers are likely to place competitive bids).

- **successful innovation:** in a market where undertakings compete to improve the quality of their products, a persistently high market share might indicate persistently successful innovation and so would not necessarily mean that competition is not effective.

- **responsiveness of customers:** where undertakings have similar market shares, this does not necessarily mean that they have similar degrees of market power. This may be because their customers may differ in their ability or willingness to switch to alternative suppliers.

- **price responsiveness of competitors:** the ability of an undertaking with relatively high market share to increase prices without constraints also depends on the production capacity of its competitors in the market. If all undertakings in the market have limited capacity, the undertaking's competitors might not be in a position to increase output in response to higher prices in the market.

Market Share Threshold

There is no market share threshold in the Bill for defining a substantial degree of market power. This is because, as explained in paragraph 3.3 above, an undertaking's market share cannot on its own determine whether an undertaking has a substantial degree of market power.

In jurisdictions such as the EU, UK and Singapore, the prohibition on abuse of market power is formulated on the basis of the concept of "dominance". A definite percentage of market share is not specified under their competition law for the same reasons set out in paragraph 3.3 above. Based on case law and guidelines issued by the competition authorities in these jurisdictions, different market share percentages in the range of 40% to 60% are adopted as indications that an undertaking may be dominant in a market. For example, the

European Court has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%. Both the EU and Office of Fair Trading of the UK consider it unlikely that an undertaking is dominant if the market share is below 40%. For Singapore, the Competition Commission considers a market share above 60% to be a likely indication of dominance. In all the abovementioned jurisdictions, the competition authorities do not rule out the existence of dominance at a lower market share if other factors suggest strong evidence of dominance.

Measuring Market Shares

3.4 Data on market shares may be collected from a number of sources including:

- information provided by undertakings themselves. Undertakings may be asked for data on their own market shares, and to estimate the shares of their competitors;
- trade associations, customers or suppliers who may be able to provide estimates of market shares; and
- market research reports.

3.5 The appropriate method of calculating market shares depends on the case at hand. The following data may be used to calculate the market share -

- **value of sales:** market share is usually determined by an undertaking's sales to customers in the relevant market. Often value data will be more informative, for example, where goods are differentiated.
- **volume of sales:** market share can sometimes be determined by volume of sales especially when the concerned goods are more homogeneous.
- **production capacity:** sometimes market shares will be measured by an undertaking's capacity to supply the relevant market where capacity is an important feature in an undertaking's ability to compete, such as in a market where undertakings are operating at, or close to, full capacity.

4 EXTENT OF POTENTIAL COMPETITION: ENTRY BARRIERS

4.1 Entry barriers are important in the assessment of potential competition. The lower the entry barriers, the more likely it will be that potential competition will prevent undertakings already within a market from profitably sustaining prices above competitive levels. Even an undertaking with a large market share would unlikely have market power in a market where there are very low entry barriers. An undertaking with a large market share in a market protected by significant entry barriers is likely to have market power.

4.2 Examples of barriers to entry include -

- sunk costs;
- limited access to key inputs and distribution outlets;
- economies of scale;
- exclusionary behaviour by incumbents.

Sunk Costs

4.3 Sunk costs of entry are those costs which must be incurred to compete in a market, but which are not recoverable on exiting the market. Entry will occur only if the expected profit from being in the market exceeds any sunk costs of entry.

4.4 Sunk costs can give an incumbent a strategic advantage over potential entrants. Providing that prices are not below average variable cost, the incumbent would find it profitable to remain in the market, while a potential entrant may not find such prices high enough to justify incurring the sunk costs of entry.

Limited Access to Key Inputs and Distribution Outlets

4.5 Entry barriers may arise where inputs or distribution outlets are scarce, and where an incumbent obtains an advantage over a potential entrant due to privileged access to those inputs or outlets.

4.6 An incumbent might own or have privileged access to an essential facility, which its rival does not. The assessment of whether a particular facility is essential must be on a case-by-case basis. A facility will only be viewed as essential where it can be demonstrated that access to it is indispensable

in order to compete in a related market and where duplication is impossible or extremely difficult owing to physical, geographic, economic or legal constraints.

Economies of Scale

- 4.7 Economies of scale exist where average costs fall as output rises. In the presence of large economies of scale, a potential entrant may need to enter the market on a large scale (in relation to the size of the market) in order to compete effectively. Large scale entry might require relatively large sunk costs and might be more likely to attract an aggressive response from incumbents. These factors may constitute barriers to entry.
- 4.8 Attaining a viable scale of production may take time. For example, a new entrant at the manufacturing level might need to secure many distribution outlets to achieve a viable scale. If, perhaps due to long term contracts, many input suppliers or distributors are locked-in to dealing with the incumbent, the new entrant might not be able to achieve an efficient scale of production over the medium term. This could deter entry.

Exclusionary Behaviour

- 4.9 The term "exclusionary behaviour" refers to anti-competitive behaviour which harms competition, for example, by removing an efficient competitor, limiting competition from existing competitors, or excluding new competitors from entering the market.
- 4.10 An undertaking contemplating entering a market weighs up its expected profit from being in the market with the expected sunk costs of entering. Expected profits from being in the market may depend on how the entrant expects the incumbent to react when it enters the market: the potential entrant might believe that the incumbent would, for example, reduce prices substantially if it entered and so reduce the prospective profits available.
- 4.11 If a new entrant expected an incumbent to respond to entry with predatory prices (i.e. below some relevant measures of cost), this could deter entry. For example, if an incumbent has successfully engaged in predatory behaviour in the past, it may have secured a reputation for its willingness to set predatory prices. Any future potential entrants to this market might then be deterred from entering due to the likelihood of facing an aggressive response.

5 BUYER COUNTERVAILING POWER

5.1 The strength of buyers and the structure of the buyers' side of the market may constrain the market power of a seller. Buyers will have countervailing power if they have a choice between alternative sellers.

5.2 A buyer's bargaining strength might be enhanced if -

- the buyer is well-informed about alternative sources of supply and could readily, at little cost to itself, switch substantial purchases from one seller to another while continuing to meet its needs;
- the buyer could commence production of the item itself, or "sponsor" new entry by another seller relatively quickly, for example, through a long-term contract, without incurring substantial sunk costs (i.e. irretrievable costs);
- the buyer is an important outlet for the seller, that is, the seller would be willing to cede better terms to the buyer in order to retain the opportunity to sell to that buyer; and
- the buyer can intensify competition among sellers through establishing a procurement auction or purchasing through a competitive tender.

6 ABUSE

6.1 Where it is established that an undertaking has a substantial degree of market power in the relevant market, the second part of the test is to assess whether the undertaking abuses that market power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong.

6.2 The concept of abuse can be understood as an objective concept relating to the behaviour of an undertaking with a substantial degree of market power which is such as to influence the structure of a market, and which, through recourse to methods different from those that condition normal competition in products or services, has as its object or effect hindering the maintenance of the degree of competition still existing in the market or the growth of that competition. Whether a particular conduct constitutes an abuse is highly fact-specific. Clause 21(2) lists out broad categories of business behaviour within which examples of abusive conduct are most likely found.

- 6.3 Abusive conduct that has as its object or effect to prevent, restrict or distort competition generally involves conduct which amounts to exclusionary behaviour, because such conduct removes or weakens competition from existing competitors, or establishes or strengthens entry barriers, thereby removing or weakening potential competitors. Examples of such exclusionary conduct are set out in Part 8 below.
- 6.4 It is possible for an undertaking which has a substantial degree of market power to commit an abuse in a different but closely associated market. For example, bundling or tying two products together to exclude competitors in one of the product's relevant markets may constitute an abuse.

The “Objective Justification” Defence

Overseas case law and practices of competition authorities suggest that an undertaking may raise a defence to an accusation of abuse where it can show that it had an “objective justification” for its behaviour.

The concerned undertaking must be able to show that the otherwise abusive conduct is objectively necessary. Such necessity must be based on objective factors that apply in general for all undertakings in the market. On the basis of these factors, the concerned undertaking must be able to show that without the conduct the products concerned cannot or will not be produced or distributed in that market.

For example, a refusal to supply might be justified by the poor creditworthiness of the buyer. However, the concerned undertaking will still be required to show that it has behaved in a proportionate manner in defending its legitimate commercial interest. It should not take more restrictive measures than are necessary to do so.

7 OBJECT OR EFFECT OF PREVENTING, RESTRICTING OR DISTORTING COMPETITION

- 7.1 Clause 21 distinguishes between “object” and “effect” and prohibits an undertaking with a substantial degree of market power from abusing such market power by engaging in conduct with either the object or the effect of preventing, restricting or distorting competition in Hong Kong.

- 7.2 “Object” refers to the objective purpose of the conduct engaged in by the undertaking considered in the economic context in which it is to be applied, and does not mean the subjective intention of the concerned undertaking.
- 7.3 It is necessary to identify the object which was sought to be achieved by the conduct. The assessment of whether particular conduct has the object of restricting competition requires the conduct to be viewed within its economic context and market setting.
- 7.4 If the conduct has more than one object, it will breach the second conduct rule if one of its objects is to prevent, restrict or distort competition (c.f. clause 22(1) of the Bill). It is also possible to infer the object from the conduct in question (c.f. clause 22(2) of the Bill).
- 7.5 Where the conduct has as its object the prevention, restriction or distortion of competition in Hong Kong, it is not necessary for the competition authority to prove that the conduct would have an anti-competitive effect in order to find an infringement of the second conduct rule. Nevertheless, the restriction of competition must be appreciable. If the conduct having an anti-competitive object would likely have only a minimal effect on competition if it were carried out, then the second conduct rule may be held not to apply.
- 7.6 In a situation where the purpose of the conduct in question is unclear, it would be necessary to look at the effect of the conduct in order to reach an opinion as to whether the second conduct rule has been contravened.
- 7.7 In assessing whether the conduct had the effect of preventing, restricting or distorting competition, the competition authority will consider whether there has been an appreciable adverse effect on competition in the relevant market. One way of doing this is by assessing what the market conditions would most likely have been, in the absence of the conduct (i.e. the counter-factual) and comparing these anticipated market conditions with the conditions resulting where the conduct is present (i.e. the factual). The competition authority will assess the effects of specified conduct on a case-by-case basis in the light of available evidence.
- 7.8 By way of example, prohibited effects might include:
- anti-competitive foreclosure of competitors;
 - raising of barriers to entry; and

- withdrawal of products or services from the market or a reduction in the quality of the services offered.

7.9 The effect on competition must be more than minimal. The conduct concerned must have an appreciable adverse effect before the competition authority will be concerned.

7.10 Importantly, it should be noted that the Bill is concerned with protecting the process of competition and not individual competitors. Competition by its own nature is a robust process. Consumers benefit when competitors have strong incentives to win the competitive battle against its competitors. In a highly competitive market, individual competitors inevitably will enter and leave the market over time as they take their chances and as they fail. The Bill instead is concerned with the health of the process of competition.

8 EXAMPLES OF CONDUCT THAT MAY CONSTITUTE AN ABUSE

8.1 This part contains a discussion of various types of conduct that may constitute an abuse of market power. The examples are not exhaustive. There are no automatic breaches of the second conduct rule. The facts and circumstances of each case and all elements of the second conduct rule will need to be considered.

Predatory Behaviour

8.2 An undertaking may engage in predatory behaviour, for example, by setting prices so low that it forces one or more undertakings out of the market. The undertaking may incur losses in the short run, in order to harm competition, so as to be able to charge higher prices in the longer run. While consumers may benefit in the short run from lower prices, in the longer term, consumers will be worse off due to weakened competition which in turn leads to higher prices, reduced quality and less choice.

8.3 In assessing if predation is taking (or has taken) place, the competition authority will usually first consider the question of whether the undertaking with a substantial degree of market power is pricing below the relevant measure of cost. While the cost benchmarks to be used may differ according to the facts of each case, in general, the following benchmarks may be applied in determining predation:

- where price is below the average variable cost (“AVC”) of production for a sustained period of time - predation may be presumed in the absence of objective justification for this pricing strategy.
- where price is above AVC but below average total cost (“ATC”) of production – this pricing strategy may be evidence of predation but other evidence will need to be considered to determine if predation is taking (or has taken) place.
- where price is above ATC - evidence on costs does not indicate predation.

Price is Below AVC

8.4 Pricing below AVC is unlikely to be economically rational, because an undertaking that does so is, on average, making losses on each unit of output it produces. The undertaking could increase its profitability by reducing its output, or by ceasing supply altogether. Thus if an undertaking with a substantial degree of market power sets prices below AVC, it may be presumed that it is doing so for a predatory purpose unless it can prove otherwise.

8.5 However, the competition authority will also consider any evidence that the undertaking’s behaviour may be objectively justified. Some possible legitimate commercial reasons for such conduct may include **loss leading**, where a retailer cuts the price of a single product in order to increase sales of other products, or **short-run promotions**, which involves selling below AVC for a limited period, especially where a new product is introduced to a market.

Price is Above AVC but Below ATC

8.6 Where an undertaking prices above its AVC but below its ATC, it may be an entirely rational commercial behaviour because a contribution is being made to overhead costs even if a full share of average total cost is not recovered. Predation will not be presumed and other evidence may need to be considered. For example, the competition authority will consider if the undertaking’s strategy makes commercial sense only because it intends to harm competition. The behaviour of the undertaking may also provide evidence of its intention to engage in predatory behaviour. For example, if the undertaking with a substantial degree of market power targeted price cuts against a competitor, while maintaining higher prices elsewhere, that might indicate predatory intent.

Tying and Bundling

- 8.7 Tying occurs when the seller makes the sale of one product (the tying product) conditional upon the purchase of another product (the tied product) from the seller. Bundling refers to situations where a package of two or more goods is offered. Cases where only the bundle is available and not the components individually are referred to as pure bundling. Cases where both the bundle and the components are available on the market are referred to as mixed bundling if the bundle is sold at a discount to the sum of the prices of the components.
- 8.8 Tying and bundling are common commercial practices that often have no anti-competitive consequences. Both undertakings with and without market power engage in tying and bundling in order to provide their buyers with better products or offerings in more cost effective ways.
- 8.9 However, an undertaking with a substantial degree of market power in one product market (or more) for a tie or bundle (referred to as the tying market) can harm competition through tying or bundling by foreclosing the market for the other products that are part of the same tie or bundle (referred to as the tied market). For example, by tying, an undertaking with a substantial degree of market power may reduce the number of potential buyers that is available for its competitors in the tied market and can create a barrier for new entrants. This may cause existing competitors to be marginalized or to exit from the tied market. The foreclosure of the tied market may allow the concerned undertaking to achieve larger profits in the tied market.
- 8.10 In assessing tying and bundling practices, the competition authority will consider factors such as whether the concerned undertaking has a substantial degree of market power in the tying market; whether the tying and tied goods are two distinct products and whether the practices are likely to have a market distorting foreclosure effect.

Margin Squeeze

- 8.11 A vertically integrated undertaking may have a substantial degree of market power in the supply of an important input for a downstream market in which it also operates. In such a case, the vertically integrated undertaking could potentially harm competition by reducing the margin between its input price (e.g. wholesale price) available to wholesale customers and the price it sets in the downstream market (e.g. retail price) to retail customers such that an equally efficient downstream competitor is forced to exit the market or is unable to compete effectively because

their profit margins are squeezed. This is known as a “margin squeeze”, and is likely to constitute an abuse of a substantial degree of market power.

- 8.12 In testing for a margin squeeze, the competition authority will ask whether the integrated undertaking’s downstream business would be able to cover its costs and keep itself in the business if it paid the same input price that the integrated undertaking charged its competitors, given its revenues at the time of the alleged margin squeeze.

Refusals to Supply and Essential Facilities

- 8.13 The starting point for the competition authority will always be that an undertaking, whether having a substantial degree of market power or not, should be free to decide whom they will deal with, or will not deal with. Therefore, a refusal to supply, even by an undertaking with a substantial degree of market power, would not normally be an abuse.
- 8.14 In certain circumstances, a refusal to supply by an undertaking with a substantial degree of market power may be considered an abuse if there is evidence of likely substantial harm to competition and if the behaviour cannot be objectively justified. Objective justifications might include the buyer’s poor creditworthiness, or capacity constraints, for example.
- 8.15 An example of a refusal to supply that may constitute an abuse is a refusal to allow a rival to have access to an essential facility. A facility will be viewed as essential only where it can be demonstrated that access to it is indispensable in order to compete in a related market, and where duplication is impossible or extremely difficult owing to physical, geographic, economic or legal constraints. An asset will not be regarded as an essential facility, if other similar facilities compete within the same relevant market (i.e. if there are potential substitutes), or if the facility is not indispensable to the provision of the product in question.
- 8.16 As with refusals to supply in general, a refusal to allow access to an essential facility will constitute an abuse only if there is evidence of likely substantial harm to competition and there is no objective justification for the undertaking’s behaviour. Objective justifications might include constraints in the capacity of the facility; substantial increase in cost resulting from granting access that might jeopardize the economic viability of the facility holder or the undertaking seeking access not being technically able to use the facility in a proper manner.

9 GENERAL EXCLUSIONS AND EXEMPTIONS FROM THE SECOND CONDUCT RULE

General Exclusions

9.1 The second conduct rule does not apply to any of the cases in which they are excluded by or as a result of Schedule 1 to the Bill. The exclusions in Schedule 1 apply to conduct if the conduct meets the requirements of the exclusion, without the need for a formal decision from the Commission applying the exclusion. Undertakings can, therefore, raise the exclusion as a defence to enforcement proceedings brought by the Commission or third parties. This also provides an opportunity for undertakings to self assess their conduct against the statutory exclusions.

9.2 The following types of cases listed in Schedule 1 of the Bill are relevant—

- (a) conduct engaged in for compliance with legal requirements;
- (b) an undertaking entrusted by the Government with the operation of services of general economic interest in so far as the second conduct rule would obstruct the performance, in law or in fact, of the particular tasks assigned to it.

(a) Conduct Engaged in for Compliance with Legal Requirements

9.3 Conduct is excluded from the second conduct rule to the extent that it is engaged in for the purpose of complying with any requirement imposed by or under any written law in Hong Kong.

(b) An Undertaking Entrusted by the Government with the Operation of Services of General Economic Interest in so far as the Second Conduct Rule would Obstruct the Performance, in Law or in Fact, of the Particular Tasks Assigned to It.

9.4 Details of this exclusion are explained in paragraphs 5.18 to 5.25 in the Bills Committee paper on guidelines on the first conduct rule (Paper No. CB(1)2236/10-11(01)).

Exemptions from the Second Conduct Rule

9.5 Unlike exclusions, exemptions require a positive decision to apply the exemption to specified conduct or specified classes of conduct.

Exemption on Public Policy Grounds

- 9.6 Clause 31 of the Bill provides that the Chief Executive in Council may, by order published in the Gazette, exempt specified conduct or a specified class of conduct from the application of the second conduct rule, if he or she is satisfied that there are exceptional and compelling reasons of public policy for doing so.

Exemption to Avoid Conflict with International Obligations

- 9.7 Clause 32 of the Bill provides that the Chief Executive in Council may, by order published in the Gazette, exempt specified conduct or a specified class of conduct from the application of the second conduct rule, if he or she is satisfied that it is appropriate to do so, in order to avoid a conflict between the Ordinance and an international obligation that directly or indirectly relates to Hong Kong.
- 9.8 Clause 33 of the Bill requires every order made under Clauses 31 or 32 to be published in the Gazette and be subject to negative vetting by the Legislative Council.