CATHAY PACIFIC

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30th November, 2010

Mr. Andrew Leung Kwan-yuen
Member
Legislative Council
2/F Shui Hong Industry Building
547-549 Castle Peak Road
Kwai Chung, N.T., Hong Kong

Dear Andrew ,

Cathay Pacific's view on the Competition Bill

As you are aware, the HKSAR Government is in the process of formulating a Competition Law. The Legislative Council has formed a Bills Committee to scrutinise the Bill.

While Cathay Pacific has consistently supported the concept of a competition law in Hong Kong, we are also of the view that the Bill should take into account the commercial and operational environment of Hong Kong, as well as drawing reference from international best practices.

Many of the these concerns, such as the meaning of "substantial degree of market power", the exemption of statutory bodies, and compliance with international obligations would have a potential impact on the way corporations conduct their business in Hong Kong.

The Bill as it is currently drafted lacks essential details which would be articulated only after the formation of a Competition Commission. We believe it is of vital importance to ensure a thorough process is put in place for the deliberations of the guidelines to allay fear of insufficient clarity which could open the floodgate of unnecessary legal challenges.

We have put together our concerns in the form of a position paper. We think you as a stakeholder might find it relevant as the public debate deepens on this issue so vital to the business community and the economy as a whole.

We would be most grateful for any feedback you might have. Please feel free to email me at quince_chong@cathaypacific.com or call me on 2747 8556.

Yours sincerely,

Quince Chong
Director Corporate Affairs

CATHAY PACIFIC

Cathay Pacific Airways Position Paper on Competition Law

Basic Position

Cathay Pacific has consistently supported the concept of a competition law in Hong Kong. As early as 2007, our former Chief Executive stated "Cathay Pacific Airways is supportive of the Government's initiative of introducing a competition law in Hong Kong. . . . . The formulation of a Competition Law is a notable milestone for Hong Kong and its structure and method of introduction are of the highest importance. It stands to benefit Hong Kong's economy and world standing when drafted to address the characteristics of Hong Kong's economy but, equally, the drafting must be at pains to avoid placing unnecessary burdens on the economy which is itself the lifeblood of Hong Kong's success." Our position remains unchanged.

The current Bill lacks sufficient clarity and detail to allow Cathay Pacific to provide its complete views. Many of the essential details are not addressed in the Bill, but instead we expect are likely to appear in guidelines to be issued by a yet-to-be named Competition Commission. We trust that the guidelines, which we would expect are likely to form much of the substantive regulation and enforcement policy of the Competition Commission, will be drafted with substantial input from all Hong Kong stakeholders. It is for this reason that Cathay Pacific reserves its final views of the Competition Bill until such time as the requisite guidelines are published for comment.

Specific Comments

Notwithstanding our reservations, Cathay Pacific has the following observations and recommendations:

1. In the Second Conduct Rule, which relates to the conduct of single firms, the Bill applies the more restrictive "substantial degree of market power" standard rather than the more mainstream "abuse of dominant position" test. We are concerned that neither "market" nor "substantial market power" are defined, meaning that the prohibition is at best vague and once again will have to rely on yet unpublished guidelines. Assuming that the Competition Commission adopts definitions of these terms consistent with other mainstream competition regimes, Cathay Pacific points out that this more restrictive standard of "substantial degree of market power" will be particularly intrusive and burdensome. Cathay Pacific also has concern that this more restrictive definition may force businesses to compete unduly and undermine the efficiencies that would naturally tend to arise in places such as Hong Kong, where narrow geography and the relatively small population can unusually produce small localised markets.

2. For our business, which is aviation, international air services agreements as well as international aviation law and convention limit market participation to "designated carriers," many aviation routes may unwittingly fall within the more restrictive test, subjecting certain carriers to unwarranted increased and inefficient regulatory scrutiny. We also note that with respect to the aviation industry, the notion of narrow geographic markets is inconsistent with the desire of the HKSARG to position Hong Kong "as a leading centre of international and regional aviation." [1] By the Civil Aviation Department's own mission statement, Hong Kong competes with other airports throughout the region and the world. Hong Kong cannot compete as an international aviation hub if Hong Kong's home carrier cannot compete on a level playing field with other flag carriers.

3. Cathay Pacific is concerned that the investigative threshold of "reasonable cause to suspect a contravention" is ambiguous at best and provides an unnecessarily low standard at worst. As Cathay Pacific has learned, the burden of investigation, in terms of legal fees, lost productivity and distraction from our core business, can be more punitive than the sanctions imposed. Moreover, in instances in which Cathay Pacific's conduct has been vindicated, that has often been little consolation given the burden of the underlying investigation that has been endured. Cathay Pacific trusts that the subsequent guidelines will provide safeguards to protect enterprises from unnecessary or otherwise unfounded investigations.

4. While Cathay Pacific is grateful that the drafters considered our position regarding compliance with international obligations and in particular expressly included air services agreements, we note that this exemption is permissive and not mandatory. More specifically, the Bill states that the Chief Executive in Council *may* exempt a specified agreement or class of agreement "in order to avoid a conflict between this Ordinance and an international obligation that directly or indirectly relates to Hong Kong." Cathay Pacific believes this exemption should be automatic and not permissive. Moreover, we believe that an "international obligation that directly or indirectly relates to Hong Kong" is insufficiently defined. In particular, Cathay Pacific flies to 60 destinations in 30 countries, and as such is subject to laws, regulations and requirements around the world. While Cathay Pacific firmly believes that these foreign laws indirectly relate to Hong Kong as they may apply to routes between these countries and Hong Kong, the Bill is unclear as to the reach of this permissive exemption. Cathay Pacific is all too familiar with the perils of attempting to comply with conflicting legal requirements and administrative regimes.

5. Cathay Pacific has previously acknowledged the legitimacy of "follow-on" actions arising from confirmed infringement cases; however, we are concerned that the Bill's allowance of private "stand-alone" actions –without an initial Commission determination of an infringement is unwarranted and is a substantial departure from similarly situated jurisdictions. If stand-alone actions are permitted, the Commission runs the risk of

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[1] See, e.g., Hong Kong Civil Aviation Department Mission, Visions and Values, *available at* http://www.cad.gov.hk/english/vision.html

turning competition law into a litigation plaything. While that may benefit the legal services industry, it does nothing to promote consumer welfare and indeed would result in increased costs to Cathay Pacific and other companies, costs that would be ultimately borne by consumers.

6. The Bill, by default, exempts all "statutory bodies" from the competition rules. While the Chief Executive in Council, at his discretion, *may* bring a statutory body within the competition rules if it is engaged in "economic activity," again this is permissive and not mandatory. Moreover, we note that the term "economic activity" is not defined, leaving uncertainty as to which statutory bodies are subject to the Chief Executive's discretion. This default exemption, which is contrary to the practice of most other competition regimes, stands to place Cathay Pacific at a competitive disadvantage, as one of our Company's key suppliers is the Hong Kong Airport Authority ("HKAA"), a statutory body under Hong Kong's Airport Authority ordinance. The HKAA is entrusted to "provide, operate . . . , develop and maintain, at and in the vicinity of Chep Lak Kok, an airport for civil aviation." As the only provider of airport services in Hong Kong, which of course is Cathay Pacific's hub, the Company cannot enjoy the protections and rights that many of its competitors realise at their own hubs. Indeed, there are over 500 statutory bodies in Hong Kong, many of which engage in "economic activity" assuming the definition of this term means involvements in the provision of goods or commercial services. This default exemption runs the risk of creating a two-tiered economy in Hong Kong: one that enjoys statutory status as well as exemptions from the Bill; the other that must compete with these protected entities without such immunities or protections.

7. Indeed, the Bill applies to all "undertakings," (which are not "statutory bodies") defined as "any entity . . . engaged in economic activity." Again this key term "economic activity," which is the lynchpin of application of the Bill, is not defined.

8. Although the May 2008 Consultation Paper gave the impression that vertical agreements, or those agreements between suppliers and vendors (rather than between competitors) would not be a focus of the Bill, this issue has been left unaddressed in the First Conduct Rule. Cathay Pacific believes that, consistent with the spirit and intent of the Consultation Paper, vertical agreements should not fall within the purview of Bill. Vertical agreements promote intra-brand competition and otherwise protect the integrity and distribution of our services. Moreover, even in jurisdictions that extend application of their respective competition laws to vertical agreements, such jurisdictions generally curtail such application. For those jurisdictions that do not, the resulting enforcement regime does more to protect competitors rather than competition, which is not consistent with the "international best practice" that the May 2008 Consultation Paper laudably sought to achieve.

Conclusion

Cathay Pacific commends the drafters on their efforts, and appreciates the care and diligence that went into the process. However, we believe with additional attention to these points, as well as concurrent publication of the applicable guidelines, the consultative process will be more meaningful and the result would be a much clearer competition law that would better promote consumer welfare and ensure the continued efficiency and vitality of the Hong Kong economy.

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