THE LAW SOCIETY OF HONG KONG 香港律師會

Submissions of The Law Society on the draft Guidelines on the First Conduct Rule (CR1), the Second Conduct Rule (CR2) and Market Definition

General observations

1. The Law Society welcomes this indication from the Administration as to how it sees the very general prohibitions in CR1 and CR2 being applied, including as to how the issue of market definition might be approached by the Competition Commission ("Commission").

2. The Law Society also welcomes the opportunity to make submissions on the draft Guidelines. However, the Law Society has been hampered in the ability to make fuller submissions on this important issue because of the very tight deadline that has been set down. These submissions, by necessity of time, only address various of the relevant issues, at a high level of generality. The Law Society would hope that a longer period would be given in any consultation by the Commission in the future.

3. Detailed and comprehensive guidelines are obviously an essential component of an effective and fair competition law. However, the Law Society has concerns that these draft Guidelines are being advanced at this stage in the Bills process, in an apparent attempt to resolve concerns that are being expressed about the legal drafting in the Bill.

4. The draft Guidelines will not be binding on the future Commission. While they therefore serve a useful purpose in demonstrating how the Administration would say guidelines should be drafted in the future, they do not give any certainty as to what approach the future Commission will, in fact, take.

5. Under Clause 35 of the current text of the Bill, the Commission which is to be set up after the passage of the Bill will be specifically charged with the duty of issuing guidelines. Clause 131 of the Bill provides that the Commission will not be "a servant or agent of the Government". The Bill, as currently drafted, thus envisages that the Commission will act independently of the Government in carrying out its duties. We support the position that the Commission should act as a statutory regulator which is independent of the Government in performing its functions and duties under the proposed legislation. We think that this will be essential for the Commission to have credibility with the business community and internationally.

6. According to Clause 35 (1) of the Bill, it is the Commission that must issue guidelines-

"(a) indicating the manner in which it [the Commission] expects to interpret and give effect to the conduct rules;

(c) indicating how it [the Commission] expects to exercise its power to make a decision or grant exemptions."

7. Furthermore, Clause 35(2) empowers the Commission to amend from time to time the guidelines that it issues.

8. While it may be helpful for Members of the Bills Committee to have some indication or idea of what such guidelines might possibly contain in order to decide upon the final provisions of the legislation, we think that the draft Guidelines provided by the Government to the Bills Committee should be considered only as an indication and should in no way pre-empt the drafting of the guidelines that will be issued by the Commission once the Commission has been set up under the new legislation. Also, we do not think that the drafting of these guidelines should in any manner become any part of the legislative process itself, for example, to be annexed to the legislation. We think that this would be a mistaken approach and could lead to undue inflexibility in the application of the law. We believe that as currently envisaged by the Bill, the guidelines should remain a communications tool within the legislative framework to be used by the Commission to explain its objectives and its policy priorities and to give guidance to the business community and its advisers on an ongoing basis. Under the Bill (Clause 35(2)) as currently drafted, the Commission will have the power to amend the guidelines from time to time to take account of evolutions in the business environment and economic thinking. We think that this built-in flexibility and pragmatism will be an essential ingredient for a successful general competition law that would make a positive contribution to the Hong Kong economy.

9. This said, concerns have been raised in the Bills Committee process as to the scope of CR1 and CR2. Examples include whether CR1 will apply to vertical agreements, whether CR1 and CR2 are drafted with sufficient particularity to give the necessary legal certainty required under Hong Kong's constitution, the extent to which SMEs and statutory bodies will be subject to CR1 and CR2 and the adequacy of various definitions and key terms used in CR1 and CR2 (e.g. use of "PRDC" v "SLC", use of "substantial degree of market power" v "dominance", the definition of "competition" and "undertaking"). We note the Law Society's submission of 23 November 2010, addressing many of these issues, and the subsequent, more detailed submission of 1 February 2011. There has also, of course, been considerable discussion in the Bills Committee on Competition Law as to how market definition would be approached as this obviously has a significant impact on both the scope and the manner in which CR1 and CR2 might be applied in practice.

10. In view of the above, the Law Society would respectfully submit that the focus at this stage should be on ensuring the legal drafting in the Bill (1) properly reflects

the policy goal underlying the introduction of this competition law and (2) to the best extent possible, drawing on lessons and learning from other jurisdictions, clearly articulates who the law will apply to and what will and will not be prohibited.

11. With that introduction, we turn to more specific comment on the draft Guidelines.

CR1

12. **Undertaking:** The draft guidelines seek to clarify what is meant by "undertaking". While appreciating that the guidelines to ultimately be prepared by the Commission will need to address and spell out numerous issues around the concept of "undertaking", the current Bill could benefit from a fuller definition of the term in the legal drafting. The Law Society appreciates that this concept has been clarified in overseas case law and would encourage the Administration to draw on that case law to incorporate a definition in the Bill, per the Law Society's previous submissions on the Bill.

13. **Vertical agreements**: The Law Society agrees with the observation in the Guidelines as to the fact that, generally, vertical agreements should be viewed as legitimate and normal aspects of the competitive process. This is in keeping with international best practices. The Guidelines note (para 2.5, text box) that the two circumstances in which vertical agreements might give rise to concerns are (i) where a supplier has a substantial degree of market power or (ii) the agreement is, in effect, an arrangement by means of which direct competitors limit competition between them. As to (i), use of market power to reduce competition can be addressed under CR2. As to (ii), any arrangement between competitors, even if by way of a vertical arrangement, can be addressed under a clearly defined prohibition against cartel conduct. These strike the Law Society as better ways of addressing the identified concerns than the current, broad, *prima facie* prohibition that might be applied to all vertical agreements under CR1. There is no apparent reason why this important aspect of the proposed scope of the law should be left to the Commission, and as these Guidelines will not bind the Commission as to approach, we would submit that it would be appropriate, and desirable, to consider a carve-out in the Bill for vertical agreements. This would be consistent with both the Singapore law and the UK law before the UK (for reasons related to the EU's unification principles rather than any competition law reason) followed the EU block exemption system. We note, in any event, that far more detailed guidance would be required if the general prohibition approach were to be retained – see, for example, the OFT's 2004 Guidelines on vertical agreements (**Appendix 1**).

14. **Concerted practices**: Paragraph 2.8 of the Guidelines does not make it clear how businesses might assess the overall economic context in which conduct has taken place. It is not apparent what is meant by "normal conditions of the market" and the term "collusion" (which has connotations of illegality) is introduced, while it does not appear in CR1. The paragraph thereby appears to confuse "concerted practice" (i.e. the concept of undertakings acting in concert) with the potential effect or conditions in the market in which the practice might have occurred. The paragraph is not easy to follow and may confuse, rather than provide meaningful

guidance to the community as to what is and is not a "concerted practice" within the context of clause 6(1) of the Bill.

15. **Decisions by Associations**: there is very little meaningful guidance provided by the Guidelines in this area, which it must be acknowledged is complex and one which has generated considerable voices of concern in the debate over the Bill to date. While the Law Society would not suggest one way or the other whether it is necessarily an appropriate form of guidance for Hong Kong, the Law Society would note the OFT's 2004 Guidelines on Trade Associations, Professions and Self-regulated Industries (**Appendix 2**). Those guidelines run to some 28 pages, and suggest that far more detailed guidelines will be required to assist Hong Kong's many trade associations, professional bodies and self-regulated industries in understanding the potential impact of this law on them.

16. **Appreciable Impact**: The Law Society has noted the debate on the appropriateness of using the EU terminology in this aspect of the conduct rules. There has, in this context, been considerable discussion as to whether the Bill needs to include language to make it clear it is only where there is or could be an appreciable adverse effect on competition that the law will potentially bite. The Guidelines suggest that it is an appreciable adverse effect on competition that is the target of the law (para 3.12, text box), but this is not clear from the drafting of CR1 (or CR2). The Guidelines refer to case law in other jurisdictions which it is being suggested might guide the Commission in this area. However, it is notable that other jurisdictions such as Canada, Australia and New Zealand do not use the "prevent, restrict or distort" language proposed in the Bill. The Law Society also understands from what was said by the speakers at the recent international conference on competition law held in Hong Kong that the law in this area in the EU is not entirely clear, although the EU has sought to remedy the confusion by way of recent guidelines. Accordingly, the Law Society would suggest consideration be given to the use of "substantially lessen competition" in the Bill, which is a test that is supported by a considerable body of case law in jurisdictions such as Australia and which is very clear that what is of concern is an appreciable adverse effect on competition. This would also be consistent with the language used in the Merger Rule in the Bill. Consistency in terminology as between the conduct rules and the merger rule will be essential. If different terminology is used, the Tribunal will naturally conclude that different thresholds were being contemplated by the legislature.

17. **Examples of anticompetitive conduct**: The Law Society is concerned that this long list of conduct identified in section 4 of the Guidelines does not give an indication as to which of this conduct is more likely to be of concern to competition law enforcement. It is clear from commentary in other jurisdictions that it is hard core cartel conduct, bid-rigging, market sharing and exclusionary boycotts that would normally be the focus of the concerted conduct prohibition. This needs to be brought out both in any guidelines and in the drafting of CR1. The conduct listed at clause 6(2) could, in the Law Society's submission, be made clearer in this regard and we believe any guidelines would need to be much clearer on this issue than are the current draft Guideline, if businesses and consumers are to properly understand the potential application of this rule. Paragraphs 4.3 to 4.13 of the Guidelines are (as they address hard core conduct)

at the heart of CR1 ad so should be the focus - they could be made much clearer as to what comprises anticompetitive price-fixing, bid-rigging or market sharing. The Guidelines suggest that joint purchasing/selling, information sharing and standardisation agreements are usually pro-competitive, but then do not give much practical guidance on the circumstances in which such conduct might be of concern. It appears that the level of detail needs to be substantially improved if the guidelines are to provide meaningful guidance as to what is and is not prohibited, particularly given the fact that this is a new law for Hong Kong such that it can be expected the public will need a full explanation as to how it will operate.

18. **General exclusions**: There is no apparent guidance as to the application of the exclusion for agreements made for compliance with legal requirements. We would assume that some guidance is necessary. There is also very little guidance as to how the services of a general economic interest exclusion might be applied in the Hong Kong setting. This is a concept that it appears has been taken from the EU, which has quite a different history in relation to such services and the overlay of state aid cases running through its competition law enforcement. Any meaningful guidance for Hong Kong would need to make some attempt to reconcile this EU provision with the actual circumstances of the Hong Kong market.

19. **Exemptions**: There is no guidance provided as to how the exemptions on public policy grounds and to avoid conflict with international obligations would be applied. The Law Society would expect that such guidance will be necessary.

CR2

20. **Use of "substantial degree of market power"**: it is not clear why the Bill adopts this threshold rather than "dominance". As the Guidelines note (p 4, text box), the dominance threshold is used in EU, UK and Singapore. For reasons given in previous submissions, the Law Society considers "dominance" to be the appropriate threshold for Hong Kong.

21. **Exploitative conduct**: The Guidelines address exclusionary conduct at paras 4.9 to 4.11. This begs the position on exploitative conduct. For reasons detailed in previous submissions, the Law Society considers that it should be made clear that CR2 is limited to exclusionary conduct.

22. **Section 7Q**: The Guidelines do not acknowledge the considerable jurisdictional and other intractable conflicts likely to be created as between CR2 and the proposed section 7Q to be inserted into the competition provisions of the Telecommunications Ordinance. We refer to the Law Society's earlier submissions on this and respectfully submit that serious consideration be given to striking out section 7Q.

23. **Appreciable adverse effect**: We would repeat the submission made above in relation to CR1, in relation to CR2.

24. **General exclusions**: We would repeat mutatis mutandis in relation to CR2 the submission made above in relation to CR1.

25. **Exemptions**: We would repeat mutatis mutandis in relation to CR2 the submission made above in relation to CR1.

Market definition

26. For the reasons made above, we do not think it useful at this stage to make detailed drafting comments on the guidelines. We think that these guidelines provide a reasonable explanation of the usual conceptual framework of "market definition" which is used in making competition analyses in different jurisdictions around the world. However, we would like to make to a few points of substance which we believe have specific relevance to Hong Kong.

27. As a general observation, the guidelines on Market definition themselves state, their application is not merely a mechanical process. This requires the exercise of considerable skill and expertise. The guidelines provide a conceptual framework which includes various tools that can be used to arrive at the definition of the appropriate relevant market. The approach may not be the exactly same in every case.

28. For example, the approach in cases involving allegedly anti-competitive conduct and the approach adopted in merger cases is frequently different, because of the differences in the nature of the evidence which is usually available and the kind of assessment which is required. Conduct cases involve either a review of the objectives or intentions of the parties as usually established by contemporaneous documents and /or the assessment of the actual effects of **past** conduct on the relevant market. Frequently, because one is looking at past events, there is often more objective evidence from past events or documents on what the relevant market is or what the parties or party believed it to be. However, there is then a complex, and often quite subjective, exercise that needs to be engaged in, trying to determine what the market would have looked like but for the conduct being complained of (the hypothetical counter-factual market test). In merger cases, on the other hand, the regulator has to assess the likely effects of a change in the **future** structure of the market (a merger of two previously independent entities) as proposed by the parties; and this may be a dynamic market which is evolving or changing. This is a more focused academic process in which the regulator has to look into the future and assess likely developments. Therefore, a more "rigorous' analytical approach is used to define the relevant market correctly. It is usually in this context that the hypothetical monopolist test (or so-called SSNIP test) is employed in conjunction with other econometric tests.

29. We understand that at least some members of the Competition Commission will have a degree of expertise and experience in competition matters. We think that this will be an indispensable element in ensuring the successful implementation of the Competition Bill when it passes into law.

Products/Services

30. In the explanation of the product market, we think that it should be made clearer that "products" includes not only goods, but also "services" as well. There are many service industries in Hong Kong.

Luxury Goods and Relevant Product Markets

31. As an example of a relevant issue in market definition, the luxury goods industry is significant in Hong Kong, and we think that it would be worth explaining more fully that there can be circumstances where the price differential between products which perform the same basic function (and are therefore for many purposes substitutable) are so great that the different products in different price categories may be considered to constitute different product markets. This will often be the case of luxury or prestige products which are widely sold in Hong Kong. A few examples will illustrate this point:

    - writing instruments: the common ballpoint pen sold by office supply shops compared with prestige ball point pens sold by luxury brands, such as Montblanc, Cartier , ST Dupont etc;

    - clothing: the standard items sold in street markets or mass retail chains compared with those items designed by international couturiers and sold by the major fashion houses;

    - shoes: those produced by the famous international brands of Lobb, Church and Gucci compared with shoes imported from Vietnam and India and sold via large retail chains.

Geographic Markets

32. As a result of the very small size of the territory of Hong Kong S.A.R. and its particular geographical location, many Hong Kong businesses compete in geographic markets which are much larger than Hong Kong, some may cover SE Asia, Asia-Pacific or be even global. The liberalization of world trade through the WTO Agreements and the increasing use of the internet have contributed to the process of globalization of markets. This means that when the Commission would consider whether the effect of a particular agreement would be to "restrict or distort competition in Hong Kong", it may have to take into account the likely reactions of competitors around the world or in the Asia-Pacific region. Paragraph 4.7 of the guidelines talks about "imports" into Hong Kong, but in our view this presentation of the geographic market is much too limited. In many markets, the reactions of competitors around the world are almost instantaneous. Many products are traded over the internet and in some service markets, customers can compare prices from service providers located over very broad geographies----much broader than the territory of Hong Kong. We think that this explanation of geographic market for Hong Kong cases needs to be expanded.

Consultations on draft Guidelines

33. We hope to have the opportunity of being consulted by the Commission on the draft guidelines after the passage of the Bill.

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12 July 2011
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