

# **GUIDELINES TO THE APPLICATION OF THE COMPETITION PROVISIONS OF THE BROADCASTING ORDINANCE**

## **INTRODUCTION**

1. The Communications Authority (CA) is responsible for the regulation of all television programme services in Hong Kong. The legislative framework set out in the Broadcasting Ordinance (the Ordinance) contains express provisions to ensure fair and effective competition in the television programme service market.

2. The Ordinance empowers the CA to enforce the provisions prohibiting the abuse of a dominant position and the use of anti-competitive conduct. In order for the CA to carry out its duty effectively, there must be transparent and accountable processes and procedures, which allow all interested parties to understand how – and in what circumstances – the CA will enforce its statutory duties in respect of competition. This document is designed to assist that process.

3. Nothing in these guidelines can override any legislation, licence condition or direction currently in force. They are intended to set out the general principles that the CA expects to apply when exercising powers under the competition provisions. However, they do not form part of the Ordinance and do not affect its legal scope. The CA would normally expect to follow the guidelines and to give reasons if it departed from it. The CA, however, cannot legally fetter its discretion in advance and therefore it retains the ability to depart from the guidelines where the circumstances warrant it.

4. These guidelines focus on issues such as market definition, the assessment of market power, the assessment of conduct in the television programme service market, etc. However, they do not attempt to assess any individual broadcaster's actual position in the Hong Kong market. The position of individual broadcasters in the market will only be assessed on a case-by-case basis as the need arises.

5. These guidelines are divided into two main sections: -

Part A is an overview of the competition provisions; and

Part B sets out the analytical framework the CA will use when enforcing competition provisions.

There is a separate set of guidelines, i.e. Competition Investigation Procedures, setting out the procedures that will be followed by the CA in dealing with complaint cases concerning competition.

## **A. OVERVIEW OF COMPETITION PROVISIONS**

### **Main Prohibitions**

6. The Ordinance contains (sections 13 and 14) two main prohibitions:
- (a) a prohibition of anti-competitive conduct which has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market; and
  - (b) a prohibition on the abuse of a dominant position which has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market.

7. For both prohibitions, the test that the CA is required to apply when assessing potential liability in the Ordinance is whether the licensee's conduct has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market.

***Purpose or effect***

8. The conduct of licensees will breach the competition provisions if it has either the purpose or the effect of preventing, distorting or substantially restricting competition.

9. In ascertaining the purpose of the conduct in question, the CA would consider the objective meaning and purpose of the conduct in its economic context. In the absence of direct and overwhelming evidence to the contrary, the CA may, on the basis of evidence available, infer a proscribed purpose or draw an inference from conduct and other circumstances.

10. In evaluating whether the conduct has, or is likely to have, an anti-competitive effect, the CA would look at the state of competition in the market and compare that to the nature and extent of competition which would exist in the relevant television programme service market or markets but for the conduct in question. The CA would assess the conduct by examining it in its market and economic context.

***Preventing, distorting or substantially restricting competition***

11. The CA recognises that all business conducts of licensee have implications on the level of competition within a television programme service market. Only the business conduct that prevents, distorts or substantially restricts competition will be prohibited by the Ordinance.

12. The CA considers that the “preventing”, “distorting” and “substantially restricting” of competition in the context of the Ordinance have their respective and ordinary meanings.

***Television programme service market***

13. Taking into account (i) the definition of “television programme service” in section 2 of the Ordinance; (ii) the “services” which are licensable under the Ordinance; and (iii) the scope of the anti-competitive conduct regime in the Ordinance, the CA considers that a television programme service market refers to a downstream market or markets for the provision of television programme service to the general public or a smaller segment of the public. The CA considers, therefore, that the focus of its regulation should be on the conduct of

licensee in a downstream market.

14. In addition, the CA also considers that licensee's conduct in other upstream or related markets (that is, markets which might not fall within the definition of a television programme service market) where the conduct results in the prevention, distortion or substantial restriction of competition in a television programme service market may breach the competition provisions since the restriction of competition occurs in a television programme service market.

### **Anti-competitive Conduct**

15. The prohibition covers conduct such as agreements between licensees that have the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market in Hong Kong. Examples of such conduct that may be caught by the prohibition are discussed as part of the Stage 3 analysis. The list is not exhaustive and is for illustration purposes only. The important issue is whether the conduct in question has the purpose or effect of preventing, distorting or substantially restricting competition.

### ***Relevant Terms Used***

16. “**Agreement**” has a wide meaning and covers agreements whether legally enforceable or not, written or oral; it includes so-called gentlemen's agreements. There does not have to be a physical meeting of the parties for an agreement to be reached: An exchange of letters or telephone calls may suffice if a consensus is arrived at as to the action each party will, or will not, take.

17. “**Indirect agreements**”. An indirect agreement may exist where there is informal co-operation without any formal agreement or decision.

### **Abuse of a Dominant Position**

18. The provision relates to licensees which are in a dominant position in a television programme service market. The Ordinance only prohibits any conduct of the licensee which amounts to the abuse of a dominant position, not the holding of the position per se. Conduct by a dominant licensee that has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market is deemed to be an abuse. As such, the provision prohibits conduct where the following two conditions are met:

- (a) the licensee is dominant in the relevant television programme service market;  
and
- (b) the licensee is abusing that dominant position.

### **Exemptions**

19. The Ordinance provides (section 13(5)) for exemption from the prohibition against the anti-competitive conduct, namely:

- (a) any restriction imposed on the inclusion in a television programme service of a

television programme wholly or substantially produced by the licensee of the service; or

(b) any prescribed restriction.

20. The Ordinance also provides (section 13(4)) that the CA may on an application made to it by a licensee in a form specified by the CA and on prescribed grounds, exempt anti-competitive conduct specified in the application. There is no such prescribed grounds for the time being but the Chief Executive in Council may consider and produce details of the grounds upon which the CA may exempt anti-competitive conduct, if deemed necessary, at a later stage. It should however be noted that there is no power to grant exemptions from the prohibition against the abuse of a dominant position.

21. Competition issues arising from artists' contracts with licensees are not exempted from the provisions of the Ordinance and as such are subject to the same prohibitions as any other agreement. However, it is unlikely that any individual artist's contract with a licensee in itself could have the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market subject to regulation by the CA under the Ordinance. Nonetheless it must be said that even individual agreements may fall foul of the competition provisions in certain circumstances depending on a number of elements. These, for example, may include the immense popularity of the artist; the restrictive terms in the agreement being repeated in a number of similar contracts affecting other artists; and the licensee in question being dominant in the relevant market. However, issues arising from or concerning artists' contracts will be dealt by the CA in the same way as any other competition case.

## **B. COMPETITION ANALYSIS FRAMEWORK**

### **Introduction**

22. In a competitive market for television services, firms will behave in such a way as to obtain maximum competitive advantage over rivals. This is part of the workings of a healthy competitive process and should provide viewers with a wide range of services, including some of high quality, and innovative television at reasonable prices, reflecting the efficiency of licensees.

23. The aim of competition policy is to encourage and enhance the competitive process, but the line between vigorous but fair competition and anti-competitive or abusive conduct can be a fine one. Competition policy does not protect particular businesses which may be adversely affected by fair competition – inevitably there are winners and losers from competition – but it is designed to protect the competitive process itself. It provides a mechanism under which competitors who believe they are suffering from unfair competition can make their position known and for the allegations to be investigated thoroughly and effectively.

24. Whilst it is possible to list and prohibit certain conducts that are likely to prevent, distort or substantially restrict competition, no such list can ever be exhaustive. What matters is the purpose or effect of a conduct and not the conduct itself, or its form. For this reason, it is

important to carry out an analysis of the particular factors affecting competition in each case - and be prepared to revisit this analysis should market conditions change.

25. From an economic perspective there is a need to base all analyses of competition in a market context which in turn entails defining the relevant economic product markets before proceeding to analyse the extent of competition within that market.

26. The framework for competition analysis is currently based on international best practice and applies a sequential methodology comprising three broad stages:

- (a) Stage 1: Defining the relevant market in which the party(ies) (more specifically, the product(s)) under review operate;
- (b) Stage 2: Assessing market competition to identify whether the party(ies) have market power, i.e. whether the licensee is dominant and/or whether the presence of agreements or conducts give the licensee(s) market power; and
- (c) Stage 3: Assessing whether the conduct under review has the purpose or effect of preventing, distorting or substantially restricting competition in the defined television programme service market.

27. However, it is important to be clear that these stages should not be regarded as separate, self-contained exercises. The purpose of defining the relevant market is to provide a framework within which to analyse the operation of competition – market definition is not an end in itself. There is an interaction between the stages, not least because there is often an overlap in the sort of information required to define the relevant market and to assess the extent of competition. Therefore the CA would not apply the guidelines as a linear, step-by-step progress that invariably follows the exact order of the three stages as set out above. An integrated approach to competition analysis may be adopted as appropriate. Market definition can help inform competitive effects while competitive effects can help inform market definition. The CA's central focus remains in evaluating whether the alleged anti-competitive conduct has, or is likely to have, an anti-competitive effect.

28. Although television broadcasting has some special economic characteristics, in particular high fixed costs and low or zero marginal costs, these do not, in the CA's view, require a fundamentally different analytical approach; they can be taken into account in the analysis. Accordingly, the competition analysis framework can be applied in any competition case and is consistent with the conceptual approach adopted by other competition authorities and regulators.

29. For the purposes of these guidelines, the CA believes that it would be useful to provide guidance of how it will undertake competition analysis. As such, the details provided in the following sections reflect the experience of other comparable jurisdictions that apply similar powers to those contained in the Ordinance as well as the CA's own experience in the implementation of the competition provisions in the Ordinance. **The CA takes the view that while previous cases can be informative, they should not be regarded as binding with respect to future decisions.** However, the CA would adopt the general approach to competition analysis as set out below.

## **Stage 1: Market Definition**

30. The first stage in the competition analysis is the definition of the market, or markets, relevant to the alleged anti-competitive conduct. Market definition is not an end in itself, but a tool used to identify and define the boundaries in which competition takes place.

31. The key to the prohibition on anti-competitive conduct and abuse of dominance is the requirement to establish that the conduct of a licensee has the purpose or effect of preventing, distorting and substantially restricting competition in a television programme service market. Since the scope of the prohibitions specifically covers the downstream television programme service market or markets (please refer to paragraphs 13 and 14 above), the process of market definition primarily involves the identification of a downstream market(s). However, conduct in an upstream or related market may affect the relevant downstream market, which also requires establishing (as the case may be) the relevant upstream or related market(s).

32. In the context of competition analysis, firms that constrain each other through the supply of close substitutes are said to compete in the same market. The process of market definition thus involves the identification of close substitutes, from both the demand side and the supply side. It starts with (a) those demand and supply conditions associated with the products or services supplied by the firm under investigation in respect of which there is some competition concerns; and (b) the geographical area within which the products or services are supplied or purchased.

33. The approach to market definition is a conceptual framework and is not intended to be applied mechanically. Accordingly the CA would not necessarily follow each step indicated below in every case. The CA would look at the evidence which is relevant to the case in question and, to some extent, would be constrained by the evidence available. In particular, it may be clear in some cases that, although more than one market definition could potentially be used in the analysis, the conduct under examination would not be considered a breach of the competition provisions on any reasonable market definition. In such cases, it would not normally be necessary to establish which of the potential market definitions is correct.

### ***Demand-side Substitution***

34. On the demand side, the CA would need to consider the choices available to customers and viewers, how the choices between different television programme services are made and whether there are restrictions on those choices being made. The key issue is the extent to which the availability of alternative products can impose a constraint on the way in which a firm prices a particular product. Demand substitution constitutes the most immediate and effective disciplinary force on the suppliers of a given product, in relation to their pricing decisions as well as other factors affecting the terms on which services are available to customers and viewers. Its assessment requires an understanding of the particular services (for example, the importance of price in relation to other features such as quality and content) and the possible alternatives available.

35. In terms of assessing the scope for demand-side substitution, the main factors that the CA would therefore take into account are:

- (a) evidence of how customers had reacted to previous changes in relative prices;

- (b) the extent to which consumers would incur costs in switching from one product to another and also the time frame which consumers would need to organise such a shift; and/or
- (c) evidence that suppliers base their business decisions on the prospects of consumer substitution between products in response to relative price changes.

36. This list is not intended to be exhaustive but is intended to illustrate the sorts of evidence that could be used to support arguments about the extent of substitution.

37. Demand substitutability and thus market definition will depend on the circumstances of each case and customers' and viewers' needs and preferences in Hong Kong. In the context of programmes and viewers' interests, a broad assessment of the nature of the service (taken as a whole as well as in its component parts) and its likely substitutes for viewers – having regard to viewers' preferences – produces an initial market definition. Any services that are likely to benefit from viewers switching from the other service should be included in the market definition and those that would not should be excluded.

#### ***Switching Costs and Demand-side Substitution***

38. Switching costs need to be considered in the definition of market as the imposition of such costs can affect consumer behaviour and, therefore, assessment of demand-side substitution. Consumers may not consider two homogenous products to be substitutable if switching costs are high.

39. For example, switching costs have been an important consideration in the definition of the relevant market for pay-TV services in other jurisdictions. In the UK case, pay-TV services provided by both cable and satellite distribution systems were deemed to be in the same market, i.e. they were found to be effective substitutes. This conclusion was based on a consideration of the role of price and non-price factors in a subscriber's decision-making. Although many subscribers had invested in satellite dishes, this did not appear to deter subscribers from switching from satellite to cable (sometimes assisted by the practice of some cable companies of buying-back dishes). Moreover, non-price factors, such as aesthetic considerations and the volume and range of programming, were not sufficient in themselves to determine a viewer's decision to subscribe to, or switch between, pay-TV suppliers.

40. In order to identify demand-side substitutes, a variety of different sources of evidence will be sought. The CA would make use of any audience research, market research (including focussed surveys of subscribers and potential subscribers), as well as other statistical data, including, where possible, trends in relation to prices, product ranges and subscriber demand.

#### ***Supply-side Substitution***

41. Supply-side conditions are also important in defining the relevant market. Supply substitutability relates to the ease and speed with which firms could switch to the supply of the product or service in question, in response, for instance, to a price change or a change in viewing habits, that would make it profitable to do so. For example, viewers of a weather channel may only consider existing suppliers of weather channels to be effective alternatives.

A consideration of only the demand conditions, i.e., what viewers perceive to be substitutes in the range of channels currently available to them, may lead to a market definition that only embraces these channels. There may however be, say, a supplier of news channels, or providers of non-broadcast news (say a news agency) or weather reports, that could – in a response to a hypothetical increase in the price of the weather channel or some other factors – launch a rival weather channel within a short period (without having to invest substantially in new resources). The relevant market could, therefore, include this supplier in recognition of the competitive restraint that it imposes – even if viewers themselves do not currently recognise it as an alternative.

42. In order to determine whether there are supply-side substitutes, and whether these act as constraints on the behaviour of existing market participants, the CA may seek evidence on:–

- (a) the technology and other requirements required to offer a product or service of comparable functionality into the market under review;
- (b) spare capacity within the industry;
- (c) information on the willingness of consumers to switch to new suppliers following a small but significant and non-transitory increase in price (SSNIP), possibly via market research; and
- (d) information on past supply-side substitution and that in similar markets in other countries.

### ***Geographic Markets***

43. The relevant market is also defined in terms of a particular geographic area to or from which the products or services are supplied or purchased: e.g. part of Hong Kong, the whole of Hong Kong. In trying to define the geographical boundaries to a product/service market, the key aim is to identify an area sufficient to include only those alternative services, which represent a competitive restraint on the behaviour of a hypothetical monopolist. Given the size of Hong Kong, it is likely that in most cases the geographical market will be for the whole of Hong Kong Special Administrative Region. However, depending on the case under investigation, it is possible (though unlikely at present) that alternative geographic market definitions could include a part of Hong Kong or possibly Hong Kong and some other region or country.

44. For market analysis purposes, the CA may have to examine possible wider geographic markets to assess the real environment that licensee concerned has to compete in. It should, however, be noted that the CA does not have jurisdiction over television markets outside Hong Kong. It is also important to note that the geographic scope of a market does not automatically align with the area in which a supplier operates, but depends on a proper analysis of demand and supply conditions, as well as the scope for imports. Cultural, linguistic (particularly the availability of alternative Cantonese content) and social preferences have a significant impact on the geographic market definition for television broadcasting.

### ***Temporal Markets***

45. Markets may also need to be defined in terms of time. This temporal dimension to



markets is particularly relevant to television broadcasting. For example, the scope and duration of the coverage of a live premium sports event is likely to have much greater value (and, hence, scope for anti-competitive conduct in the exploitation of the relevant rights) than a repeat the value of which will decline rapidly over time and which may not be seen as an effective substitute.

## **Stage 2: Assessment of Market Power**

46. The next stage in the competition analysis framework, having defined the relevant markets, is to assess whether licensees in those markets have the potential ability to behave in an anti-competitive manner, i.e. whether one is dominant or whether they have market power. Only a licensee with market power (or a group of licensees acting together that jointly possess market power) can behave in a potentially anti-competitive manner.

47. Effective competition in a market implies that all firms within that market are constrained in the way that they can behave, i.e. they cannot act without significant competitive restraint from their competitors, consumers and/or suppliers. If a single firm (or several firms acting together) is capable of independently setting prices or any other term on which services are made available to viewers that would imply a lack of competitive restraints on those firms. This firm (or these firms) is said to possess market power and possesses more market power than any of its competitors.

48. Accordingly, the second step in the competition analysis is to assess the degree of market power held by licensees within the relevant markets.

49. In most cases, due to the inter-relationships between market structure, the firms' conduct and financial performance, no **single** piece of evidence can provide a reliable indicator of the degree of competition in a market. Important factors, however, include market shares (and the degree of concentration or distribution of shares between firms) and any changes in these shares over time. However, market shares, which are often used as a means to indicate the extent of competition, only give a partial picture at a particular moment in time and may not provide an accurate representation of actual competitive forces in a market. Consequently, it will be necessary to look at a range of factors in order to build up a picture of the operation of competition in that market.

50. Other factors that would need to be considered normally include: the potential for entry and exit from the market, including the existence and scale of any barriers to market entry; the extent of countervailing buyer power and the presence of supplier countervailing power. The existence of these factors may be sufficient to prevent a licensee with substantial market share from acting without significant competitive restraint. In practice, it is necessary to balance available evidence – qualitative as well as quantitative – before coming to an overall judgement. The key objective of this stage of the analysis is, however, to identify whether there are constraints on a licensee's conduct and how effective these are. The principal factors to be considered in determining whether a licensee has market power could be classified as follows:

- (a) the behaviour of existing competitors (evidence on the degree of competition between existing firms in the relevant market, for example movements in market share, price trends, profitability);

- (b) the scope for potential competition imposed on existing firms in the market by firms outside the market (evidence of competitive restraints – particularly barriers to entry); and
- (c) the strength of countervailing buyer power (evidence of competitive restraints imposed on existing firms in the market by buyers of the products or services that they sell).

These factors which may constrain market power are considered in turn below.

### ***Existing Competitors and Market Shares***

51. The evidence used to define the relevant markets will be relevant to establishing the degree of competition between existing firms. The threat of customers or viewers switching to an alternative product or service, or other suppliers launching rival services constitutes a rigorous competitive discipline on the behaviour of the incumbent firms. The analysis of demand and supply substitutes as part of the market definition stage provides important evidence about the degree of existing competition and this helps to build up a picture of the market structure.

#### Market Structure

52. At a very basic level this is the number and identity of firms in the market, together with the distribution of market shares within the market: i.e. how concentrated a market is. At the same time additional information such as who the principal competitors are, whether there are different types of companies competing in different segments of the market (e.g. serving different customer groups) etc, is important in order to build up a picture of the market.

#### Market Shares

53. The market shares of existing firms can be a helpful piece of evidence. The development of market shares over time provides a useful picture of market structure, how this has evolved and gives an **initial** guide as to those firms likely to hold market power. Although market share alone is a poor measure of market power, it is unlikely that a licensee without a significant share of the relevant market would have sufficient market power to behave anti-competitively on its own. If the relevant market has been defined correctly and licensees have very **low** market shares, then they will generally not possess market power, and an investigation can normally be dropped at an early stage. A licensee with a persistently **high** market share relative to its competitors – and one that is increasing over time – may be more considered to have market power.

54. It is important to emphasise, however, that a licensee with a relatively high market share may not hold market power. It may be the case that a licensee with a high market share could still be unable to act without significant competitive restraint from its competitors, customers and suppliers due, for example, to very low barriers to market entry and therefore the potential for new market entry or expansion by other operators. It may also be the case that a licensee with a relatively low market share in absolute terms is able to act without significant competitive restraint from its competitors, consumers and suppliers due to the substantially

smaller market shares of its many competitors and the absence of any external competitive restraints (from potential new market entrants or large buyers). Market share must, therefore, be treated only as a guide and examined alongside all the other sources of equally important evidence.

### Market Share Guidelines

55. In relation to market share, the CA expects to adopt the following quantitative guidelines unless specific circumstances require otherwise. These are:

- (a) **In relation to the prohibition on abuse of dominance**, that a licensee is unlikely to be individually dominant in a defined television programme service market, in the absence of factors suggesting otherwise, if its market share is below 40 per cent. There will be, however, a presumption of dominance, in the absence of evidence to the contrary, if a licensee has a market share **persistently** above 50 per cent.
- (b) The CA recognises that high market shares at a given point are not necessarily indicative of market power. Therefore, the presumption explicitly refers to a market share **persistently** in excess of 50 per cent (e.g. for a period of more than 12 months). There is therefore a need to examine changes in the pattern of market shares over time. This will also mean that just because a licensee is first into a new market that licensee will not automatically be presumed dominant in that market.
- (c) A licensee could be considered as dominant even if it records a market share less than 40 per cent if consideration of other factors, for example, the existence of very weak competitors, substantial barriers to market entry and limited buyer/supplier countervailing power, provides strong evidence of dominance by that licensee.
- (d) **In relation to the prohibition on anti-competitive conduct**, that market power is unlikely to exist, i.e., that agreements among would-be competitors in the same market will not generally have substantial effects, if the combined market share of the parties is less than 25 per cent. At market shares in excess of 25 per cent agreements will be considered on a case-by-case basis and the CA may still find that effects on competition are not substantial. Other factors such as the content of the agreement under review, the structure of the market(s) affected by the agreement, barriers to entry and countervailing buyer power will be considered in determining whether the agreement has a substantial effect. On the other hand, certain conduct may be found to have a substantial effect even where the combined market share falls below the 25 per cent threshold. These are covered in the Stage 3 analysis.

56. Market shares may be calculated on several different bases: For example, according to the value of the services provided, the number of subscribers, the hours of viewing or the share of advertising revenue. Which method is most relevant will depend on the particular case and, in some cases, more than one method may be appropriate.

57. When applying the market share thresholds, or for that matter in looking at the conduct of a licensee, the Ordinance expressly provides that it is the relevant market share and the conduct not only of the party or parties under direct investigation but also that of other companies/entities which are associates of the licensee (Section 15(1) of the Ordinance refers). This is to ensure that licensees do not seek to avoid their obligations through the use of subsidiary companies or agents etc.

### ***Potential Competition and Barriers to Entry***

58. A key competitive restraint on firms within a market may arise from the threat of a new firm currently outside that market investing in the necessary resources and entering as a new rival or a firm currently within the market from expanding its operations in response to a competitor's business conduct. For example, a firm with a large market share will probably be unable to sustain high margins in service provision in the long run (i.e. wield market power) if barriers to entry are low because the potential to earn abnormal profits will attract new entrants into the market which will put downward pressure on prices.

59. In assessing the potential for entry to act as a competitive restraint, the CA would have regard to different factors including, but not limited to, the following:

- (a) recent history of movements into and out of the market;
- (b) extent to which past entrants have successfully acquired market share and the costs associated with acquiring that market share;
- (c) direct evidence of barriers to entry, expansion and exit;
- (d) probability of entry by players in related markets or by start-ups;
- (e) costs of exiting the market which may deter entry;
- (f) potential impact of technological change on barriers to entry; and
- (g) likely response of incumbent firms to entry or expansion.

60. The potential adverse impact on competition of barriers to entry cannot be over emphasised. There are many different sources of potential entry barriers and therefore the analysis will be tailored to reflect the circumstances of each case and will necessarily change from time to time (particularly in television broadcasting where technology develops quickly). However, it is possible to distinguish two broad sources of entry barriers: absolute advantages and structural advantages. Both of these are relevant to television broadcasting and are examined briefly below.

#### Absolute Advantages

61. Regulation can create absolute barriers to entry, for example, via a moratorium on new licences. Nevertheless, in Hong Kong, all sectors of the television programme service market have been fully liberalised and there is no pre-set limit on the number of licences.

#### Structural Advantages

62. There exist a number of main structural barriers to entry in the television programme

service market, including but not limited to:–

- (a) High minimum efficient scale and large proportion of sunk costs associated with the industry which may constitute a deterrent to potential entry. This is particularly the case for a new broadcaster where the cost of providing a new service may involve costs which cannot be recovered or easily recouped within an appropriate timeframe.
- (b) “First mover” advantage may be considered as barriers to entry as the result of another firm establishing itself in a market first and using this fact to deter other firms from entering (although it should be stressed that being first into the market by itself will not be penalised, nor will successful and fair exploitation of a market position).
- (c) Importance of being able to acquire key content may reinforce the first mover advantage, where incumbents with an existing customer base have an automatic advantage over new entrants because the larger customer base allows the incumbents to bid more and deter the entry of competitors.
- (d) The above also relates to barriers to entry caused by constraints on end-user behaviour, including high switching costs and strong brand awareness of incumbent operators.
- (e) Need to access delivery platforms. This is particularly important for new entrants who need to secure carriage in order to access end-users. In recent years, however, the increasing use of telecommunications networks for the delivery of video content has created a wider range of delivery platforms and, therefore, reduced this structural barrier to entry.
- (f) Vertical integration. Vertical integration, such as the ownership of studios producing television programmes as well as of a television station, in itself does not necessarily imply that a licensee is dominant. Vertical integration can achieve economic efficiency and provide consumer benefits, e.g. increased efficiencies in the production, distribution, and marketing of television programming, which may translate into lower prices. Consequently, the CA would not view vertical integration per se negatively. However, where a licensee is dominant in one market and is vertically integrated into upstream or downstream markets related to that market, then it may have the ability to affect adversely the upstream or downstream markets in question. This can be achieved by leveraging its dominance in one market into another related market.

### ***Countervailing Buyer Power***

63. The strong position of a licensee with relatively high market share may be offset by bargaining power on the part of the buyers of the finished product or service such that prices are determined by their relative bargaining power. The significance of any bargaining power held by the buyer relative to the potential market power of the supplier depends on the market characteristics. Buyer power is significant if, in the absence of that buyer, prices charged by the supplier would have been higher. Factors that may determine the ability of buyers to constrain

suppliers include, but not limited to, the following:

- (a) the availability of alternative suppliers;
- (b) the buyer switching costs;
- (c) the feasibility of buyers setting up their own supply arrangements;
- (d) the extent to which buyers can credibly threaten to stop purchasing other products sourced from the supplier; and / or
- (e) the ability of buyers to impose costs on suppliers by for example, delaying purchases.

64. A buyer is more likely to possess countervailing power, if the buyer purchases a large proportion of the producer's output. Given the fragmented demand nature of television programme service market(s), it is unlikely that a single end-user will account for such a proportion of an operator's revenues or sales that it is able to exert countervailing buyer power. However, in certain limited cases, it is possible that a single large buyer of television programme services, e.g. housing estates, hotel chains, hospital groups, the public sector or a public entertainment chain, could account for a significant share of an operator's output and thereby have countervailing buyer power.

#### ***Other Relevant Factors***

65. It is difficult to provide a comprehensive list of all the factors that might be important in the consideration of the extent of competition in any given market. The above section has focused on the main issues for the television programme service markets. The objective of gathering this information is to gain a better understanding of how a particular market actually functions and that necessitates going beyond just examining the structure of the market as the factors that are important to the operation of competition will vary from market to market. For example, in a market where the product is basically homogeneous, firms are likely to compete solely on the basis of price. In other markets, like broadcasting, where customers are prepared to accept price/content trade-offs, firms may attempt to differentiate their products and other factors such as branding and advertising spend can become more significant. Other issues such as:

- (a) the way in which competition is organised, e.g., whether there are formal tendering processes;
- (b) the rate of 'churn' of customers – which could be taken to indicate that customers were actively switching between suppliers;
- (c) the importance of branding (e.g. brand loyalty/reputation effects); and
- (d) the importance to firms of being able to offer a complete portfolio of services to customers

can all be important in assessing competition in a television programme service market. In all these instances, input from the industry (both in terms of suppliers and customers) will be particularly important.

## ***Review***

66. Once the various sources of evidence for market power have been assimilated and reviewed, a clear picture of the extent of market power in the relevant market should emerge. If there is found to be no market power (whether arising from a dominant position or from the existence of agreements or conducts between firms) no further action by the CA will be taken. In the presence of market power, further analysis of the alleged anti-competitive conduct will be necessary to establish whether the conduct has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market as prohibited by sections 13 and 14 of the Ordinance respectively.

## **Stage 3: Assessment of Conduct**

67. Once market power and/or dominance had been established, the CA will assess, as a third stage of the competition analysis, whether there is any anti-competitive conduct or any abuse of a dominant position that shall be prohibited by the Ordinance. Both prohibitions depend on establishing that the conduct in question has the purpose or effect of preventing, distorting or substantially restricting competition.

### ***Anti-competitive conduct, including agreements and other arrangements***

68. Where the CA establishes the existence of an agreement, formal or otherwise, or conduct, it will seek to ascertain whether the agreement, conduct etc. has the purpose or effect of preventing, distorting and substantially restricting competition. This constitutes the Substantial Effect Test.

69. Based on overseas experience, the CA takes the view that agreements will generally have no substantial effect on competition – and thus not be prohibited – if the parties' combined share of the relevant market does not exceed 25 per cent, although there will be circumstances in which this is not the case. This might arise where, for example, the agreement reduces competition in an already highly concentrated market or that the parties to the agreement are so much larger than the other companies in the industry so that it would amount to a restriction of competition.

70. The Ordinance provides (section 13(2)) some examples of the type of anti-competitive conduct that may be caught by the Ordinance and the guidelines above indicate the approach that the CA intends to use in investigating such cases. Examples of such conduct may include, but are not limited to:–

- (a) direct or indirect agreements to fix the price in a television programme service market;
- (b) conduct preventing or restricting the supply of goods or services to competitors;
- (c) direct or indirect agreements between licensees to share any television programme service market between them on agreed geographic or customer lines;

- (d) limiting or controlling production, markets, technical development or investment;
- (e) applying dissimilar conditions to equivalent agreements with other trading parties, thereby placing them at a competitive disadvantage;
- (f) making the conclusion of agreements subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such agreements.

71. In addition, the CA will generally regard any agreement between parties which:

- (a) directly or indirectly fixes prices or shares markets;
- (b) imposes minimum resale prices; or
- (c) is one of a network of similar agreements which have a cumulative effect on the market in question

as being capable of having a substantial effect even where the combined market share falls below the 25 per cent threshold.

72. Even when the parties' combined market share is higher than 25 per cent, the CA may find that the effect on competition is not substantial. Other factors, for example, the content of the agreement, the scope and extent of the agreement especially relative to other market activities and the structure of the market or markets affected by the agreement will be considered in determining whether the agreement has a negative effect on competition. It does not automatically follow that, an agreement between two or more parties with a combined market share higher than 25 per cent will have a substantial effect on competition.

### Price Fixing

73. Price fixing is a form of collusive or cartel behaviour whereby firms that should be competing against each other tacitly or otherwise make agreements that have the purpose or effect of fixing, controlling or maintaining the price of products or services. For example, they may engage in agreements to buy or sell at a specified target, minimum or maximum prices, to standardise markups, discounts or credit terms to purchasers, or to rig bids. In many respects, price fixing is similar to market sharing agreements (which is covered in a following section).

### Vertical Restraints

74. Vertical restraints typically refer to agreements between firms at different levels of the supply chain which restrict the commercial freedom of one or more parties to the agreement or other competitors. The majority of vertical restraints are benign or even beneficial, particularly if there is effective competition in both the upstream and downstream markets. Under circumstances where market power exists in the upstream or downstream level, however, vertical restraints can have the purpose or effect of preventing, distorting or substantially restricting competition. Examples of such vertical restraints may include, but not limited to, the



following:–

- (a) resale price maintenance whereby suppliers specify a minimum price below which products or services are not to be resold (minimum resale prices);
- (b) selective distribution in which a supplier only supplies to a limited number of acquiring parties, often on an exclusive basis;
- (c) excessively long-term supply arrangements where the impact on competition in the relevant market, the economic characteristics of the service contracted for (e.g. scale of investment required, write-off period etc.), and the availability and terms and conditions of shorter-term contracts for the same service determine if the arrangement is excessively long; and
- (d) exclusive dealing arrangements whereby one party to the agreement imposes restrictions on the other's ability to choose with whom, or in what, it can trade may result in market foreclosure.

#### Market-sharing Agreements

75. Market-sharing agreements concern competing firms agreeing to divide up their market either geographically or by classes of customers so that the parties to the agreement are protected from competition. They may take several forms such as agreements to refrain from producing one another's products, sell in one another's locations, or sell to one another's customers.

76. The potential for market-sharing agreements in the television broadcasting sector is limited, although as mentioned above, exclusive dealing arrangements may sometime be regarded as attempts to share markets and could be duly prohibited.

#### ***Abuse of dominant position***

77. In relation to an abuse of a dominant position of a licensee, abuse will be shown if a licensee is found to be exploiting its dominance, to the detriment of the competitive process and the interests of competitors, suppliers, and customers/viewers (whether directly or indirectly). The Ordinance states (section 14(4)) that if a dominant licensee has engaged in conduct which has the purpose or effect of preventing, distorting, or substantially restricting competition in a television programme service market, then that licensee will be deemed to have abused its dominant position.

78. Examples of conduct that may constitute an abuse of a dominant position (section 14(5) of the Ordinance) include, but are not limited to:–

- (a) predatory pricing;
- (b) price discrimination;

- (c) making the conclusion of agreements subject to acceptance by other parties of terms or conditions which are harsh or unrelated to the subject of the agreement;
- (d) discrimination in the supply of services to competitors.

These are no more than examples and are not exhaustive. The important issue is whether the dominant licensee is using its dominant position in an abusive way. This may occur if it uses practices different from those normally adopted in the course of competition in the market with the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market.

79. Where the conduct of a dominant licensee is in breach of section 14 of the Ordinance there is no power to grant exemptions. Any mitigating factors that may exist may affect the enforcement action taken.

### Predatory Behaviour

80. Low prices or price reductions are normally seen as a benefit from, and the successful result of, the process of competition. However, not all price reduction is pro-competition. In particular, predatory pricing – where a dominant licensee uses its financial resources to deliberately sacrifice profit by setting per unit prices at less than cost (specifically the marginal cost of production of each unit) to eliminate or weaken more efficient competitors so that longer-term profit will be enhanced – is anti-competitive because it seeks to exclude competition. However, it may be difficult at times to accurately determine the marginal cost. Average variable cost is commonly accepted as a reliable estimate of marginal cost and will be used by the CA to proxy for marginal cost.

81. There are three factors that are important to consider in the context of evaluating whether a price reduction is evidence of a predatory strategy:

- (a) *feasibility*: this involves examining the structure of the market and the characteristics of the alleged predator in order to establish whether predation (including recoupment of profit once rivals are driven out or weakened) is a feasible strategy;
- (b) *incremental losses*: incremental loss is change in loss that results from the particular decision such as price reduction. However, it should be noted that although in such a case the losses may increase, it does not follow that the firm is not covering its costs. A predatory pricing strategy involves the deliberate sacrifice by a dominant licensee of short-term profit by pricing products at less than the marginal cost of production which means that it is necessary to consider the effects of the alleged predatory action upon the profitability of the alleged predator; and
- (c) *intent*: whether there is evidence that the alleged predator intends to drive a specific competitor out of the market.

82. Predation includes exclusionary pricing; an example of which may be offering increasing discounts for each additional channel a subscriber purchases which are unrelated to costs. These discounts may be such that it is impossible for a new entrant to compete on price for subscribers who already take one or more channels from the incumbent firm. However, as with all other types of conduct, what matters is the effect of the conduct in question. In a fully competitive market, discounting is normally a sign of healthy competition.

### Refusal to Supply

83. Refusal to supply products (e.g. programming materials) or services (e.g. access to transmission facilities) by a dominant licensee on reasonable commercial terms constitutes anti-competitive conduct if it has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market.

### Mandatory Product Bundling

84. The CA does not consider bundling *per se* to be anti-competitive. Both dominant and non-dominant licensees can offer product bundles to end-users.

85. The issue is whether a dominant licensee undertakes mandatory product bundling. Mandatory product bundling generally means the tying of the supply of one service or product in which the supplier is not dominant to the supply of other in which the supplier is dominant, i.e. forcing consumers of products in which the supplier is dominant to take products in which it is not dominant. This conduct is anti-competitive in that it forces consumers to take products from the dominant operator which they may have taken from other suppliers. This distorts market competition.

86. Although in some cases mandatory product bundling may have anti-competitive effects, the issues are likely to be complex. Factors that will need to be taken into account in considering whether a particular agreement is anti-competitive include the technical and economic feasibility of unbundling and whether there is an exclusionary effect. For example, allegations have been made in some jurisdictions that bundling of television services and telephony is potentially anti-competitive. This issue will become increasingly important as all operators seek to derive market advantages by cross-selling and bundling their products (the triple-play and quad-play product strategies). These developments are generally pro-competitive and provide consumer benefits, provided that dominant licensees do not undertake mandatory product bundling. In addition, there are certain forms of bundling that, even though the licensee also offered to supply different parts of the bundle separately, may be similar in effect to predatory behaviour (see paragraph 80), a margin squeeze and cross-subsidy (see paragraph 87). They would constitute an abuse where there is the purpose or effect of preventing, distorting or substantially restricting competition.

### Cross-subsidy

87. The assessment of cross-subsidy raises similar issues to those raised by predatory pricing and in practice will tend to be investigated in a similar manner. Cross-subsidies refer to a situation where a licensee allocates all or part of the costs of its activity in one product or geographic market in which it is non-dominant to its activity in another product or geographical

market in which it is dominant, i.e. it leverages its dominance in one market to a market in which it is non-dominant through financial transfers. Predatory pricing involves the short-run sacrifice of profits in order to force competitors to exit followed by the recoupment of those losses in the longer run through pricing above the competitive level. However, whereas predation tends to be seen mainly as a single-product issue (dealing with a pricing strategy in respect of one particular product) cross-subsidy tends to be mainly a cross-product issue (low prices for one product being funded by high prices for other products) and does not necessarily, therefore, involve a short-run sacrifice of profits.

88. The fact that an activity is in receipt of a cross-subsidy is not itself an infringement of the prohibitions. The CA recognises that cross-subsidies can in fact be pro-competitive. The key issue is whether the cross-subsidy has the purpose or effect of preventing, distorting or substantially restricting competition in a television programme service market. For example where a licensee is financing losses in a market where it is not dominant from profits made in another market where it is dominant, there could be a significant effect on competition in breach of the prohibition on abuse of dominance.

89. A cross-subsidy will normally be deemed to exist where a licensee's revenues from an activity (e.g. a new business or a new product) fail to cover the costs associated with that activity (or, equally, fail to generate an 'adequate return') over its economic lifetime (as expected at the point when the cross-subsidy is provided). That is, the fact that accounting profits for a particular period, such as a year, are negative, would not be sufficient to establish that an activity was in receipt of a cross-subsidy. The question of whether or not a cross-subsidy exists, has to be related to the economic life of the underlying assets involved, not just a consideration of past losses but also of future revenue streams. It is the profitability of the activity as a whole over time which matters. One important element of the analysis will be a review of the underlying assumptions that are made about the development of the project and in particular those relating to the future competitive conditions in the market. It would be unreasonable to expect a licensee to meet the targets set out in a business plan for a new service in their entirety. However, where a business case has been developed on the basis of unjustified and implausible assumptions at the outset and/or there has been a failure of a licensee to take remedial action once it had become apparent that it would not meet the targets set out in the business plan, this could be regarded as evidence of an anti-competitive purpose behind the cross-subsidy.

### *Use of Evidence in an Assessment*

90. The CA may obtain evidence from various sources including licensees, other interested parties and expert advisors (including those appointed by the CA). The CA would review all arguments and evidence submitted and would make its own judgement on the relative merits of each submission. As a general principle, the CA would prefer arguments that are logical, structured and consistent more favourably.

91. The CA would prefer arguments that are based on evidence rather than hypothetical. It is not considered sufficient to provide allegations without any supporting, relevant and compelling evidence. The CA would also prefer evidence that is based on and reflects "present realities" rather than projections or predictions. This reflects the risks inherent in developing projections and the increasing uncertainty associated with longer term projections. For

example, when determining the impact of business conduct on a market structure, the CA would tend to base its arguments on existing structures and historic trends rather than the potential market structure given a set of future developments and assumptions.

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