ICF's Response to Draft Guidelines Under Hong Kong's Competition Ordinance – Submitted 10 December 2014

Who we are

ICF (formerly GHK) is a leading economic and public policy consulting practice in Hong Kong. We have been advising both Government and private clients here for over 20 years, on the economics and financials of major transport, infrastructure and property developments.

We have hands-on knowledge and experience of issues in competition, having advised competition authorities, regulators and private clients in Hong Kong, Singapore, UK and European Union. Sectors we have analysed include healthcare, retail, advertising, consumer credit, transport (aviation, ports & shipping, bus, rail), energy and water.

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Introduction

ICF welcomes this opportunity to provide a response to the draft guidelines ("the guidance") issued by Competition Commission of Hong Kong (CCHK) on 9 October 2014.

We set out below our reflections on the draft guidelines, grouped as follows:

1. Overall view
2. First Conduct Rule (FCR)
3. Second Conduct Rule (SCR)
4. Merger Rule

1. Overall view

- Content
  - The substantive guidance on conduct rules appears, in broad terms, comprehensive in its coverage. It very much builds on the precedents established in other jurisdictions. The guidance is also noticeably tailored to the Hong Kong context. For example, clarity is provided on CCHK's interpretation of the Ordinance with respect to vertical agreements, and trade associations – both prevalent features of the business environment in Hong Kong.
  - On the procedural side, there is a notable gap on leniency programs – internationally, these have proved to be extremely effective in curbing anti-competitive cartel behaviour. We would welcome additional guidelines on leniency, and we understand that CCHK plans to release these separately.
  - We note that in Hong Kong there are many monopolies and oligopolies created through Government regulation, and regulated on an ongoing basis by Government Bureaux/Departments or by independent regulators such as the Communications Authority. We understand that CCHK plans to release a Memorandum of Understanding clarifying its role with respect to the Communications Authority. In addition to this, we would welcome guidance clarifying CCHK's role with respect to those other bodies (both within and outside of Government) responsible for sectoral regulation in Hong Kong.[1]

[1] In the UK, for example, there is detailed guidance on how the competition authority intends to work concurrently with sector regulators. Since 2013, the UK competition authority has assumed more of a lead role in ensuring application of competition law in the regulated sectors - for example, the competition authority has the power to take over cases that have initially been allocated to regulators.

- Advocacy Role
  - The guidance is clearly structured and presented. The hypothetical examples provided are helpful for demonstrating the practical meaning and relevance of technical terms. We believe that, as a user-friendly tool for supporting the business community in achieving compliance, the guidance compares favourably with equivalent guidance documents produced overseas.
  - We believe that the guidance could play a stronger advocacy role in championing the potential societal benefits of the competition regime. This could be achieved through, for example, adding real life cases / market studies, and quantifications of the potential benefits of enforcement.[2]

2. First Conduct Rule

Object or Effect of Harming Competition

- Parts of the guidance suggest that the object agreement would be defined in terms of the "degree of harm" to competition, e.g.:
  - *'so harmful to the proper functioning of normal competition in the market, that there is no need to examine their effects"* (3.4) and
  - *"whether an agreement entails such a sufficient degree of harm to competition that it may be considered as having the object of harming competition"* (3.5).
- However, elsewhere the guidance states that *"[t]he object of an agreement refers to the aims pursued by the agreement"* (3.6). This leads to ambiguity over whether object agreements would be defined in terms of their degree of harm, or their objectives, or both.
- By contrast, the comparable EU guideline establishes that *"whether an agreement has an anti-competitive object, regard must be had to the content of the agreement, the objectives it seeks to attain"* - there is reference only to the objective of the agreement and not to the degree of harm.
- It would be helpful for CCHK to clarify its interpretation of an object agreement.

Agreements that May Infringe the FCR

- No market share threshold
  - The lack of an indicative market share threshold is a notable departure from precedents established elsewhere (e.g. Singapore, EU). We regard this to be an appropriate response to the heterogeneity of market structures found in Hong Kong – barriers to entry are a key driver of market power, and in practice they vary substantially in their level across different markets. Setting a one-size-fits-all threshold therefore risks sending the wrong signal to business about what constitutes a 'safe' market share. There is also a risk that undertakings would make artificial adjustments to their operations and reporting in order to conform to the indicated thresholds, which would not serve the objectives of the Ordinance.
- Resale Price Maintenance (RPM)
  - We welcome the interpretation that there is a balance to be struck in enforcing the FCR in the context of RPM - whilst such agreements may have harmful effects on competition, this needs to be weighed against potential efficiency benefits (e.g. protecting sales services provided for the benefit of consumers, or encouraging inter-brand competition). This 'effects based' interpretation reflects the precedent established by RPM cases in the US.

Exclusions and Exemptions from FCR

- Agreements enhancing overall economic efficiency

[2] For an example of quantification of potential benefits of enforcement and market studies, see p.3 of "The Value of the Consumer Benefits of the Competition Regime", UK Department for Business Innovation and Skills, 2013, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266582/bis-performance-indicators-value-of-consumer-benefits-of-competition-regime.pdf

- The Ordinance includes a clause to ensure consumers receive a 'fair share' of the benefits accruing to agreements, in order for the agreements to qualify for an efficiency exemption. It would be helpful to clarify whether consumers in this sense refers to those in Hong Kong or to consumers in all jurisdictions.
- A similar clause on fair share for consumers appears in EU guidance – however, a review of relevant cases to date in the EU suggests that the outcomes of the cases have not been affected by the clause. We would welcome discussion in the guidance of possible circumstances under which the 'fair share' clause would have a material effect on the outcome of an investigation.

- Exemptions for specific sectors
  - There are no specifically exempted sectors - unlike in Singapore[3] and the EU[4]. We welcome the sector neutral nature of the guidance, which reflects the principle that all sectors should be treated the same.
  - Statutory bodies are exempted from the provisions of the Ordinance[5]. Some of these bodies compete directly with private sector undertakings, and as such the exemption may confer unfair advantages over their competitors. We would welcome clarification on whether it would be possible for CCHK to investigate the conduct of exempted statutory bodies, with a view to making recommendations to Government on the appropriate scope of exemptions.

3. Second Conduct Rule

Assessment of Substantial Market Power (SMP)

- No market share threshold.
  - The lack of a market share threshold is a notable departure from precedents established elsewhere. Again, we regard this to be an appropriate response to the heterogeneity of market structures found in Hong Kong – see response on FCR, above, for fuller discussion.

Abuse of SMP

- Abuses on pricing
  - We note that predatory pricing is specified as an abuse of SMP in the guidance, but 'excessive pricing' is not.
  - Excessive pricing:
    - EU legislation specifies as abuses of dominance both exploitative (excessive pricing) and exclusive (predatory pricing) pricing practices. By contrast, in the US there is no rule against excessive pricing. This reflects the following dynamic view of the market: eliminating the possibility of achieving monopoly profits would likely discourage new entry and so reduce competition - ultimately consumers are then worse off relative to a situation where they pay excessive prices.
    - Abuse is open ended in the Ordinance, so CCHK may still consider excessive pricing illegal. We would welcome clarification on whether or not CCHK considers excessive pricing to be covered by the Ordinance.
  - Predatory pricing
    - The guidance states that CCHK would *"consider the extent to which the predator undertaking is in the longer term able to "recoup" its short-term losses"*. In the US, demonstrating recoupment of short-term losses is an essential requirement for a predatory

[3] In Singapore, specific exemptions are in place for postal services, drinking water, wastewater, buses, trains, and container port

[4] In the EU, specific exemptions are in place for agriculture, insurance, postal services, professional services, transport and telecommunications

[5] Six exceptions to the exemption on statutory bodies are listed in LC Paper No. CB(4)166/14-15(03) available at http://www.legco.gov.hk/yr14-15/english/panels/edev/papers/edev20141124cb4-166-3-e.pdf

pricing ruling - but in the EU this is not the case. It would be helpful to clarify whether CCHK intends to use recoupment as a necessary condition for a predatory pricing ruling.

4. Merger Rule

Scope of Merger Rule

- At least initially, the merger rule would only apply to the telecommunications sector.
  - There are risks associated with implementing a rule on cartels without implementing in parallel a rule on mergers. Recent European experience suggests that breaking up a cartel may not be effective in the longer term - mergers may follow soon after, which could also be detrimental to competition.[6] Similarly, in the US after the enactment of the Sherman Act (which prohibited cartels) in 1890 there was a huge merger wave - the Clayton Act was enacted in 1914 partly to remedy this problem.
  - Similarly, in Hong Kong, firms might use mergers to circumvent the FCR. We understand that the application of the merger rule may be reviewed in future - we encourage CCHK to plan holistically across the three areas of conduct, taking care to guard against unintended consequences of its rules and actions. Whilst the guidance does provide for a merged entity to be broken up within six months after completion of the merger, breaking up a merged entity 'after the event' is likely to be more costly – we consider that the application of the merger regulation would be most effective when it stops the cycle before it starts.

Competition Assessment

- Market share thresholds
  - The market share thresholds indicated in the guidance appear somewhat stricter than those indicated in other jurisdictions (e.g. Singapore, EU). This may reflect the intention for the merger rule only to apply to the telecommunications sector, where typically barriers to entry are relatively high. The thresholds may need to be revisited should the scope of the merger rule be expanded to include other sectors.

[6] See, for example, Davies et. al., 'Mergers after cartels: How markets react to cartel breakdown' (2014) Centre for Competition Policy Working Paper 14-1, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2383534