

SUBMISSIONS REGARDING THE HONG KONG COMPETITION COMMISSION'S

CONSULTATION ON REVISED DRAFT GUIDELINES ON:

- 1. THE FIRST CONDUCT RULE**
- 2. THE SECOND CONDUCT RULE**

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Submissions Regarding the Hong Kong Competition Commission's Consultation on Revised Draft Guidelines on the First Conduct Rule and the Second Conduct Rule

1. INTRODUCTION

- 1.1 AXA China Region Insurance Company Limited and AXA General Insurance Hong Kong Limited (together "**AXA**") welcome the opportunity to make submissions in response to the public consultation on the Revised Draft Guidelines on the First Conduct Rule and the Second Conduct Rule (together the "**Revised Draft Guidelines**") published jointly by the Hong Kong Competition Commission (the "**Commission**") and the Communications Authority under the Competition Ordinance (Cap. 619) (the "**Ordinance**").
- 1.2 AXA appreciates the Commission's willingness to take into consideration submissions made by the public previously during the consultation on the draft guidelines under the Ordinance published on 9 October 2014. The Revised Draft Guidelines are extensive, comprehensive and user-friendly. They provide a useful insight into how the Commission may approach certain important issues that may arise under the Ordinance.
- 1.3 We believe that there could be further elaboration and clarifications in the final guidelines which would help to provide better business certainty to the Hong Kong business community. These are essential for the effective planning and implementation of relevant compliance programmes by businesses. We set out below our submissions on the Revised Draft Guidelines.

2. REVISED DRAFT GUIDELINE ON THE FIRST CONDUCT RULE

Effect of Harming Competition: How is Market Power Assessed under the First Conduct Rule?

- 2.1 The First Conduct Rule may be contravened if an agreement has an anti-competitive effect and the Commission will consider both actual and likely effects flowing from the agreement. Paragraph 3.21 of the Revised Draft Guideline on the First Conduct Rule provides that when assessing the actual or likely anti-competitive effects of an agreement, the Commission will consider the extent to which the undertakings concerned have market power in a relevant market. Paragraph 3.23 further explains that market power is, however, a matter of degree. The degree of market power for concerns to arise under the First Conduct Rule is not the same as the degree of market power required for concerns to arise under the Second Conduct Rule and is typically less.
- 2.2 While Section 21(3) of the Ordinance sets out a non-exhaustive list of matters that may be taken into account in determining whether an undertaking has a substantial degree of market power in a market under the Second Conduct Rule, the Ordinance does not provide the equivalent for the First Conduct Rule.

- 2.3 Paragraph 3.24 of the Revised Draft Guideline on the First Conduct Rule gives some guidance on how market power of the parties to an agreement will be assessed. This is a multi-factor assessment and the list of factors provided in the guideline is non-exhaustive. The open-ended nature of the guidance, coupled with the absence of relevant provisions in the Ordinance, create considerable unpredictability on the market power assessment.
- 2.4 Despite requests raised in earlier submissions, the Commission has not adopted the approach of establishing a “safe harbour” (i.e. a pre-defined threshold of market share within which the undertaking concerned may be presumed to be not having significant market power and be compatible with the First Conduct Rule) in the Revised Draft Guideline on the First Conduct Rule.
- 2.5 While we appreciate the risk of over reliance on a “safe harbour” threshold and that the varying nature of different industries may make it difficult to establish a cross-industries universal threshold, we still consider necessary to have a “safe harbour” threshold of at least an indicative nature. Such indication would certainly help create better business certainty and reduce compliance cost for business.

Exclusive Distribution

- 2.6 This area is relevant to insurers, particularly in the context of bancassurance arrangements. In Asia, we have seen a good number of regional bancassurance distribution agreements in the past few years which are exclusive with terms of up to 15 years. In the European Union, agreements between parties with a significant market position which require a distributor to sell the products of one supplier only may be unenforceable if their duration is longer than 5 years. It is important for us to have a better understanding on the Commission’s view with respect to bancassurance distribution arrangements going forward.
- 2.7 Paragraph 6.86 of the Revised Draft Guideline on the First Conduct Rule provides that exclusive distribution agreements will not generally be considered by the Commission as having the object of harming competition. These agreements may raise competition concerns however if they have any anti-competitive effect (for example by foreclosing competing suppliers).
- 2.8 Hypothetical Example 19 illustrates that a distribution agreement with an exclusive territory arrangement and a non-compete clause may give rise to concerns under the First Conduct Rule in some cases. However the example does not demonstrate how the analysis of effects or likely effects on competition discussed in Paragraph 6.86 of the Revised Draft Guideline on the First Conduct Rule would be applied in practice. It would be helpful if the Commission can provide further guidance and illustration in the final guideline on how the various factors discussed in Paragraph 6.86 of the Revised Draft Guideline on the First Conduct Rule, such as intra-brand and inter-brand competition, extent of territorial and customer sales limitations, would put into play in an effect analysis of an exclusive distribution arrangement. The example also does not provide sufficient details on why no evidence of anti-competitive effect is found on the

facts of this case. Further explanations on this in the final guideline would be useful.

Exclusions and Exemptions from the First Conduct Rule

- 2.9 Schedule 1 to the Ordinance provides 5 general exclusions in respect of the First Conduct Rule and the exemption of “agreement enhancing overall economic efficiency” would be the most relevant to many businesses including insurers.
- 2.10 Paragraph 6.66 of the Revised Draft Guideline on the First Conduct Rule points out that some categories of insurance policy with standard terms on the risks covered may raise concerns under the First Conduct Rule as these may potentially limit product variety and innovation. Hypothetical Example 15 illustrates that in some circumstances, standard terms in insurance contracts can entail efficiencies and be justified under the efficiency exemption.
- 2.11 Section 1 of Schedule 1 to the Ordinance provides that for this efficiency exclusion to apply, an undertaking has to satisfy the following cumulative conditions:
- (a) the agreement contributes to -
 - (i) improving production or distribution; or
 - (ii) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit;
 - (b) the agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the objectives stated in paragraph (a); and
 - (c) the agreement does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question.
- 2.12 Paragraph 2.7 of the Annex to the Revised Draft Guideline on the First Conduct Rule identifies 5 elements of which an undertaking must provide convincing evidence to satisfy condition (a) of the efficiency exclusion:
- (a) the efficiencies, which must be objective in nature;
 - (b) a direct causal link between the efficiencies and the agreement;
 - (c) the likelihood and magnitude of each efficiency;
 - (d) how each efficiency will be achieved; and
 - (e) when the efficiencies will be achieved.
- 2.13 This imposes an unduly high burden on the undertaking. Matters such as when efficiencies will be achieved would be difficult to ascertain in practice. Also efficiency is a relative term (i.e. measurement is derived by comparing with a base case) and it is questionable what should be a reasonable and appropriate base case to adopt for deriving efficiency. There is no guidance in the Revised Draft Guideline on the First Conduct Rule. We recommend that the final guideline includes some discussion on this.

- 2.14 Paragraph 2.15 of the Annex to the Revised Draft Guideline on the First Conduct Rule explains that for the purpose of condition (a), a “fair share” means that the benefits accruing to consumers must at minimum compensate them for the actual or likely harm to competition associated with the relevant restrictive agreement. The overall impact for consumers must at least be neutral. This requirement makes sense theoretically, but in practice it would be very difficult for an undertaking to prove that the actual or likely benefit is equal to or more than the harm, as some benefits are impossible to be quantified, such as future product innovation and easier comparison of products by consumers.

3. REVISED DRAFT GUIDELINE ON THE SECOND CONDUCT RULE

Assessment of Substantial Market Power

- 3.1 Paragraph 3.2 of the Revised Draft Guideline on the Second Conduct Rule provides that the ability to profitably charge prices above competitive levels, or to restrict output or quality below competitive levels, for a sustained period of time can represent substantial market power.
- 3.2 The Commission is reluctant to set any market share threshold for the purpose of market power assessment under the Second Conduct Rule. We appreciate the potential risk of over-emphasizing on market share. While it may lead to false presumptions of market power without due consideration of industry conditions, the absence of any indicative market share threshold for key industries would create high uncertainty for business. We believe that some indication on market share (even just an indicative range of figures) at which an undertaking might be viewed as having substantial market power would be welcomed by business.

Exclusions and Exemptions from the Second Conduct Rule

- 3.3 The Ordinance does not provide a comparable efficiency-based exclusion for conduct within the scope of the Second Conduct Rule as for the First Conduct Rule under Section 1 of Schedule 1 to the Ordinance. However Paragraph 4.5 of the Revised Draft Guideline on the Second Conduct Rule states that undertakings may wish to argue that the conduct in question entails efficiencies sufficient to guarantee no net harm to consumers and so does not contravene the Second Conduct Rule.
- 3.4 It is not entirely clear whether an undertaking can always invoke this justification under the Second Conduct Rule when Section 1 of Schedule 1 to the Ordinance clearly applies to the First Conduct Rule only, or it is in the absolute discretion of the Commission to accept this efficiency justification. It is also uncertain whether an undertaking would be required to satisfy the cumulative conditions under Section 1 of Schedule 1 to the Ordinance when relying on this efficiency-based justification under the Second Conduct Rule, or the Commission will adopt a looser approach once it decides to accept reliance of this justification by an undertaking. We seek the Commission to provide clarification on these in the final guideline.

- 3.5 Even if this efficiency based justification is available under the Second Conduct Rule, it would be challenging for an undertaking to demonstrate 'no net harm'. Some benefits are just impossible to be quantified.