HKGCC

Hong Kong General Chamber of Commerce
香港總商會1861

香港總商會
香港金鐘道統一中心廿二樓
Hong Kong General Chamber of Commerce
22/F United Centre,
95 Queensway, Hong Kong
Tel (852) 2529 9229
Fax (852) 2527 9843
Email chamber@chamber.org.hk
www.chamber.org.hk

Helping Business since 1861

24 April 2015

Ms Rose Webb
Senior Executive Director
Competition Commission
36/F., Room 3601, Wu Chung House
197-213 Queen's Road East
Wanchai
Hong Kong

Dear Rose,

Revised Draft Guidelines on the Competition Ordinance

Hong Kong General Chamber of Commerce ("HKGCC") appreciates the opportunity to comment on the revised draft Guidelines on the Competition Ordinance, which were published on 30 March 2015.

HKGCC welcomes the Commission's efforts to provide greater clarity in areas such as information exchange and joint ventures, and the addition of further hypothetical examples. These efforts will help increase businesses' understanding of what is a very complex area of law, with which many of them will be unfamiliar.

Nevertheless, HKGCC still has a number of important concerns on the revised draft Guidelines, which we hope the Commission will take into account before they are finalised:

1. The Chamber remains concerned at the Commission's interpretation of the term "object" and the extension of the category of "by object" infringements beyond the four "Serious Anticompetitive Conducts" specified in the Competition Ordinance. It was clear at the time that the concept of Serious Anticompetitive Conduct was introduced into the Competition Bill that the four conducts that have been categorised as serious anti-competitive conduct are so categorised because they are the most

capable of having a serious effect on market competition and should be the focus of First Conduct Rule enforcement activity. It remains unclear what basis there could be for assuming that conducts outside of those four conducts might be regarded as serious anti-competitive conduct or subjected to a presumption that they are inherently anticompetitive, in view of the legislative history. It also remains unclear how such an approach could be applied to second conduct rule cases, which necessarily require an effects analysis of whether the use of market power has had an exclusionary effect on competition.

2. The Chamber welcomes the suggestion that it will make broader use of an effects analysis for RPM. However, the unfortunate, and we are sure quite unintended, consequence is that there is now no clarity about cases in which RPM may be seen as an objects-restriction, or an effect-restriction – which means that businesses (and the Commission) will systematically have to conduct a dual analysis (both under object and effect). This will as a result give little comfort, and will mean that companies will have to operate on the basis of the worst case scenario, meaning that consumers will be deprived of the benefits of RPM that are identified at paragraph 6.77 of the First Conduct Rule guidelines. It would also be helpful to have some guidance on the proposed expansion of by object to information exchange, including whether it is being proposed this would apply to communications via third parties and whether it will be strictly limited to exchange of future pricing information and, if not, precisely what other categories of information exchange would be regarded as by object infringements.

3. In the Second Conduct Rule guidelines, paragraphs 4.14 and 5.6 (a) suggest that merely setting prices below average variable cost ("AVC") may have the object of harming competition. However, selling products or services below cost, or giving them away free, is a common everyday market practice, and is invariably pro-competitive, pro-consumer, and efficient. Retailers may wish to clear old stock (whether food, clothing or other products) to make way for new items. This enables consumers to enjoy welcome bargains and to enjoy the benefit of new products more quickly. It is also more efficient and less wasteful to sell old stock below cost than to throw it away.

   Retailers may also wish to introduce a new product or service at a specially discounted price or free of charge to stimulate demand, so that they can enjoy a return on future sales (this is a very common feature of online services, for example), or offer free gifts to generate sales of other products or services: again these are common commercial practices which should be encouraged, not discouraged. The fact that the retailer in question is perceived to have a substantial degree of market power (itself an imprecise concept) should not alter this.

We appreciate that the Commission has said (in paragraph 4.5 of this guideline) that the efficiencies of conduct will be taken into account. But businesses should not be subject to the burden (and cost) of proving that these everyday pro-competitive practices are efficient and cause no net harm to consumers, when they are clearly pro-competitive in the first place. We presume that this is not the Commission's intention, and we strongly urge the Commission to clarify in the Guideline that such practices will not be regarded as having the object or effect of harming competition. The addition of some additional hypothetical examples to demonstrate that such practices will not be regarded as abusive would be useful for this purpose. For other conducts, such as RPM, the Guidelines clearly acknowledge a number of real life situations which can very well justify the use of RPM (e.g. short term promotions, new product launches, etc). Such examples for below cost pricing would be both consistent with the approach taken to guidance on RPM and of considerable assistance to businesses in planning their pricing policies.

The Chamber would encourage the use of more measures than just average AVC as a benchmark. In the United States, many benchmarks can be used in assessing the conduct (not just AVC), and the ability to recoup must be established.

The Chamber is concerned to see conduct such as exclusive dealing being added to the list of conducts that may be treated as "object" infringements by the Commission. There are various very legitimate commercial reasons why a firm, even one with market power, would wish to deal on an exclusive basis and this should only be of potential concern if it has a material foreclosure effect.

We would ask for more practical guidance as to the boundary between object and effect cases. While section 4.13 says that most conduct will be assessed by reference to the actual or likely effect of the conduct, there remains considerable uncertainty as to whether and when predatory pricing and exclusive dealing will be considered under the object or the effect approach. Companies will be required to take an unnecessarily cautious approach if this uncertainty is left unchecked, thereby having a chilling effect on competition.

4. In the First Conduct Rule guideline, paragraph 3.26 states that, for an agreement to have the effect of infringing the rule, the effect "must be more than minimal". However, footnote 17 states that this does not apply to an agreement which has the object of harming competition. It states that an agreement may have the object of harming competition, even if the parties have a very small share of the market. This will be of great concern to small businesses in Hong Kong, which had been led to believe that they had little to fear from the Competition Ordinance.

With respect, HKGCC believes that footnote 17, which appears to draw on the controversial *Expedia* decision in Europe, is not appropriate in the Hong Kong setting. If, as a matter of policy, agreements only have the effect of harming competition if the harmful effect is more than minimal, the same should logically apply to an agreement which has the object of harming competition. The essential practical distinction between object and effect is that, with object (unlike effect) the effect is presumed, and a full effects analysis is not required. However, logically, the threshold for harm should be the same, i.e. more than minimal. To hold otherwise would be hard to reconcile with the Commission's view that the economic context has to be assessed, to determine whether an agreement has the object of harming competition. It is also difficult to reconcile with best practice, which says that competition law should only be brought to bear on conduct which is capable of having an appreciable detrimental impact on competition

Necessarily, an agreement can only harm competition either "by object" or in effect if the expected or actual harm is appreciable. As two competition experts have said:

> *"...the fact that there is no need to prove anti-competitive effects in the case of object restrictions does not mean there is no quantitative component to object analysis at all. There is a rule that any restriction of competition must be appreciable: even a restriction of competition by object could fall outside Article 101(1) if it is likely that the impact on the market is minimal"*[1]

We believe that it is inappropriate for Hong Kong to take such an intrusive approach in this regard, given its traditional preference for light-handed regulation and the significant detrimental impact such an approach could have on small businesses in Hong Kong. We would therefore strongly urge the Commission to delete footnote 17, and to make clear that the requirement that the harm be more than minimal applies in "object" as well as "effect" cases.

5. The clarification that has been provided in relation to the Commission's approach to market definition is welcomed. The Chamber is concerned, however, at the suggestion that supply-side substitutes will not be factored in at this stage in the analysis.[2]

   The European Commission has observed that competitive constraints can arise from demand-side substitutability or supply-side substitutability, and that both types must be recognised within market definition analysis.[3] It was recognised in making this

[1] Whish and Bailey *Competition Law*, Oxford University Press, 7ed, 2011, p 120..
[2] Paragraph 2.34 of the Draft Guideline on the Second Conduct Rule.
[3] See http://ec.europa.eu/competition/sectors/media/documents/european_economics.pdf at page 111, para A1.68.

comment that demand-side substitutability and supply-side substitutability play different roles in market definition analysis, in that:

- demand-side substitutability is what defines whether the possibility of trade in one product constrains the price of another product, and is the determinant of the market definition in terms of the products that are in the relevant market, whereas
- supply-side substitutability identifies the scope for the existence of assets or businesses on the supply-side to constrain prices and is therefore used to define the markets in terms of the firms or types of firms that compete in them.

As one of the leading antitrust economists, Franklin Fisher, put it:[4]

> *"The object of the market definition exercise is to assist in the evaluation of the market power of a firm (or group of firms). As we have seen, this implies that market definition must be approached in terms of the constraints on the firm or firms in question. Even though there may be no single completely satisfactory answer to the market definition question, the process of analyzing demand and supply substitutability and the process of evaluating the relative strength of different constraints is indispensable to the analysis of market power itself."*[emphasis added]

The risk in not looking at supply-side constraints when defining the market is that market share is overstated and undertakings that are exerting, or could exert, competitive constraints on the undertaking that is being examined are not sufficiently factored into the analysis. In this regard, it is noted that in paragraph 3.1 of the Guidelines on the Second Conduct Rule reference is made to the analysis of market power looking at *"ongoing rivalry between undertakings in a relevant market and in terms of price, service, innovation and quality to which each undertaking must react if its products are to remain attractive to consumers*". If the approach in paragraph 3.1 is applied in practice, and the Commission has defined the market to exclude supply-side constraints (i.e. the firms or types of firms that compete or could compete in the market), necessarily, it appears that they would not then be factored into the assessment of rivalry in the market.

The Chamber would urge the Commission to consider the firms or types of firms that may compete in any given market at the stage of defining the market, so that both the product dimension and the participants (including potential entrants) are duly accounted for in the analysis. Early consideration of supply responses that would be immediate (or nearly so) and with no or little investment would allow for early

[4] "Market Definition: A User's Guide", Franklin M. Fisher, MIT.

resolution of cases where supply side substitutability alone answers the market definition (and market power) question.

In the event that the Commission maintains its current approach, it would be of assistance if the Guidelines could explain more clearly how supply-side substitutability is factored into consideration of competitive constraints. At present, it appears that supply-side substitutability is being conflated with new entry and only being considered in the assessment of barriers to entry. The distinction between supply-side substitutability and entry is generally regarded as arising from the nature of the costs involved in switching production from one output to another, and the time required to carry out the switch. Where the same capital resources can be used in the production of various outputs and the switch can take place over a relatively short time period and at low risk, these outputs might be regarded as supply-side substitutes. If, on the other hand, significant resources and risks (e.g. sunk costs) are required to switch production, then it is more appropriate to view the possibility of the switch as potential entry. Franklin Fisher's observations on this are noteworthy:

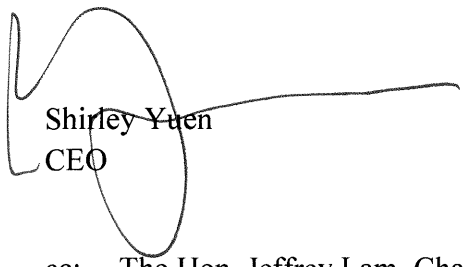
> *"Supply substitutability involves firms that do not currently produce demand-substitutable products but could readily do so in the event of such an attempt to exercise power. Clearly, the distinction between supply substitutability and ease of entry is one of degree, rather than of kind. As the anti-fouling-paint example shows, however, there are times when entry is so easy (supply substitutability so great) that defining the market to exclude such potential suppliers of demand-substitutable goods makes market definition a fairly useless exercise even if it need not lead to the wrong conclusion."*

6. The further clarification on distribution that has been provided in the revised guidelines is welcome and we are grateful for the Commission's efforts to help businesses to understand the approach that the Commission proposes to take. It would be helpful if the Guidelines could also clarify the Commission's views on dual distribution (i.e where (1) the supplier is a manufacturer and distributor of goods, while the buyer is only a distributor and not also a competing undertaking at the manufacturing level, or (2) the supplier is a provider of services operating at several levels of trade, while the buyer operates at the retail level and is not a competing undertaking at the level of trade where it purchases the contract services).

In making these further submissions on the revised guidelines, the Chamber would wish to record that it reiterates and maintains the points it has made in earlier submissions that have been made on the guidelines but not taken up by the Commission in the revised guidelines. We continue to urge the Commission to consider the need for safe harbours, a block exemption for vertical agreements, alignment of the four categories of Serious

Anticompetitive Conduct with the concept of "by Object", not publishing warning notices and the various other submissions that have been advanced by the Chamber.

Yours sincerely,



Shirley Yuen
CEO

cc: The Hon. Jeffrey Lam, Chairman
Legislative Council Panel on Economic Development