Resource Pack for the Economics Curriculum (Secondary 4-6) – Elective Part 1:
The Competition Ordinance in Hong Kong
BACKGROUND

During the review of New Senior Secondary Curriculum and Assessment conducted by the CDC-HKEAA Committee on Economics in 2013, the sub-topic of Elective Part 1 “Anti-competitive Behaviours and Competition Policy” was updated. Starting from S4 in 2013/14, i.e. 2016 HKDSE Examination, students who study this part are expected to understand (i) the objectives of the Competition Ordinance; (ii) the first and second conduct rule; and (iii) the exclusions and exemptions. The detailed requirements of this updated sub-topic can be found in the Economics Curriculum and Assessment Guide (Secondary 4-6) – Supplementary Document (2013).

This resource pack is published to support the learning and teaching of the above-mentioned updated sub-topic. It is our honour to have Dr. LAW Cheung-kwok and Mr. WONG Kwok-ngon to develop this resource pack for the Education Bureau. Both of them are experts in competition law. We would also like to express our special thanks to the Competition Committee for reviewing the contents and providing valuable suggestions in the process of developing the resource pack.

This resource pack includes not only the illustration of the above contents but also authentic cases for facilitating the learning and teaching of the topic. Moreover, economics theories and empirical studies related to competition law are appended to this booklet for reference.

This resource pack and suggested discussion questions were uploaded to the website of the Education Bureau (http://www.edb.gov.hk) for teachers’ reference. If you have any comments and suggestions on this booklet, please send them to:

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PREFACE

My interest in the competition policy was initiated by my academic study and stimulated by my observations during my subsequent working experiences. I obtained my PhD degree in Economics from UCLA. Our teachers’ contribution in the “Theory of the Firm” significantly supplemented the theoretical background for the implementation of the competition law in various countries.

Also, I served as a member of the Consumer Council when Professor Edward CHEN Kwan-yiu was the Chairman. I participated in several studies relating to the competition environment of major industries. In 1996, when I was a legislative councilor, I initiated a motion debate in the Legislative Council on “Hong Kong should speedily introduce a comprehensive competition law for the purposes of promoting competition among enterprises and protecting consumer rights”. Currently, I am the Director of Economic Policy Programme of the Hong Kong Institute of Asia-Pacific Studies of the Chinese University of Hong Kong, a member of the Competition Policy Committee of Consumer Council, a researcher associated with two public think-tanks (SynergyNet and Community Development Initiative) respectively. Given these responsibilities, I have again engaged myself in the endeavor of promoting competition policy in Hong Kong in recent years.

Hong Kong’s Competition Ordinance was passed in 2012. This is a significant breakthrough in Hong Kong’s economic policy. The Law redefines the relationships between the government and firms, between large firms and SMEs, and between firms and consumers. In order to implement the Law effectively, it is most important to educate the public and promote the Law properly.

It is the greatest privilege of myself and Mr. Wong Kwok-ngon to participate in a project organized by the Education Bureau of the Hong Kong SAR Government, regarding the preparation of a teaching package for secondary school teachers on the Competition Ordinance in the Economics Curriculum. Mr. Wong and I have co-authored several books and this is the fourth book-project on laws relating to Hong Kong’s financial and economic subjects. Mr. Wong’s great legal knowledge and enthusiasm have assisted me to venture into the new world of law and economics. We wish to sustain our humble contribution in promoting the implementation of the Competition Ordinance and related polices in the future.

Readers of this booklet are secondary school teachers and students. We wish this booklet would enhance your interest and understanding in the Competition Ordinance. If you have any comments, please contact me by the following email address: ckwoklaw@netvigator.com.

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1. INTRODUCTION

Passed by the Hong Kong government in June 2012, the *Competition Ordinance* (the “Ordinance”) is one of the most important economic legislations in recent years. The Ordinance readjusts the relationships between the government and enterprises, among large enterprises themselves, between large enterprises and small and medium enterprises (SMEs), as well as between enterprises and consumers. As stipulated in the Ordinance, the objectives of its legislation are to “prohibit conduct that prevents, restricts or distorts competition in Hong Kong; to prohibit mergers that substantially lessen competition in Hong Kong; to establish a Competition Commission and a Competition Tribunal”. Hong Kong’s Competition Law is modeled on the relevant laws and regulations in the European Union (EU), Singapore, Australia and the United Kingdom.

The current laws in Hong Kong only prohibit an undertaking from engaging in any conduct that has an adverse effect on competition, rather than comprehensively and directly facilitate the competition in different markets. For those undertakings with a huge market share, as long as they do not take part in any “concerted practice” (the “first conduct rule”) or “abuse of market power” (the “second conduct rule”) to affect the interests of other undertakings and the consumers, they are not in breach of the Competition Law in Hong Kong. In addition, the Ordinance grants general “exemptions” to the economic and business activities of the Government and other statutory bodies, which is not in line with the spirit of similar laws in the EU and most of the developed countries.

Each and every country or region formulates its competition law against the particular social and political background of its own; yet the economic theories it relies are indeed the same. The regulation of competition policy on corporate conducts falls within the scope of normative economics. The law enforcer should answer the question “how to enforce the law so as to realize welfare maximization” by economic analysis.

Under the theoretical framework of classical economics, if the conditions or assumptions of “perfect competition” are fulfilled in all markets (including products and factors of production) and every producer and consumer in society adopts the decision of constrained maximization, at equilibrium, the “production efficiency” with the lowest cost as well as the “allocation efficiency” will then be achieved in the course of production in respect of the society as a whole.

The “production efficiency” and the “allocation efficiency” are ideal concepts of static analysis. The main assumption behind is that the demand and supply factors, production technologies, income, preferences remain the same. However, when all factors keep changing, a dynamic theory is required to explain the actual changes in market competition.
It is the goal generally accepted by most economists that a competition policy achieves both “static efficiency” and “dynamic efficiency”. However, there is no rigorous framework like the theories of classical economics to support such a policy goal for “dynamic efficiency”. Meanwhile, in the formulation of specific competition policies, the EU explicitly stipulates a diversified goal for “effective competition” in the definitions. It can almost meet the abovementioned goal as well as the expectation of the consumers.

As economics fails to provide sufficient objective standards and a complete theoretical framework to judge the extent for which the conducts of the monopolistic enterprises affect the price and its competitors shall considered to be illegal, therefore when the court quotes from economics to analyze monopolistic conducts and market power, it should establish a basis for judgment on its own. The basis for and outcome of court’s judgment would be constantly questioned by the economists and challenged by the enterprises concerned unless the court could accurately calculate the “efficiency loss” in the dynamic market environment and use it as a judgment standard.
2. OBJECTIVES OF THE COMPETITION ORDINANCE IN HONG KONG

2.1 Background of the Competition Law

Laws prohibiting anti-competitive agreements and conducts can be dated back to the Middle Ages or earlier in the England history. Canada and the United States set in motion the wave of modern competition laws (anti-monopoly), and formulated their own competition laws in 1889 and 1890 respectively. In the late 20th century, most industrialized countries had formulated competition laws in different forms. Indeed, after Singapore, the mainland of China, Taiwan and Malaysia have launched their competition laws; Hong Kong still maintains its laissez-faire policy and has become more and more isolated in the international community.

The Government formed the “Competition Policy Advisory Group” (COMPAG) in 1997 and conducted public consultation exercise on the formulation of the comprehensive competition laws in 2006 and 2008. Based on the public consultation exercise, the Competition Bill was submitted to the Legislative Council in July 2010 for deliberation where it underwent a series of heated discussion and several public hearings. The original draft of the Competition Bill is more consistent with the principles of the global competition laws for the reason that it has mainly made reference to the laws in Europe and other places. Before the legislation of the Ordinance, the prohibition on anti-competitive conducts was only applicable to the telecommunications sector and broadcasting sector in Hong Kong.

On 14 June 2012, the Legislative Council of Hong Kong passed the Competition Ordinance through the third reading, officially making it Cap. 619 of the Laws of Hong Kong. Technically speaking, the Ordinance has not come into effect, the effective date of which shall be determined by the Secretary for Commerce and Economic Development Bureau. The Government announced the members of the Competition Commission in June 2013 and began open recruitment of its senior management in September. The specific implementation of the Ordinance is expected to be commenced in 2015.

2.2 Legislative objectives of Competition Ordinance in Hong Kong

The Competition Ordinance aims at formulating a set of legal system for prevention of any behaviour which is harmful to market free competition and covers all industries and sectors. The Ordinance is composed of 12 parts and 177 sections. Basically, from idea to system design, the Ordinance is expected to follow closely the advanced judicial system of competition law in the world, especially the EU.
The 12 parts are namely:

Part 1. Preliminaries
Part 2. Conduct Rules
Part 3. Complaints and Investigations
Part 4. Enforcement Power of Commission
Part 5. Review by Tribunal
Part 6. Enforcement before Tribunal
Part 7. Private Action
Part 8. Disclosure of Information
Part 9. Competition Commission
Part 10. Competition Tribunal
Part 11. Concurrent Jurisdiction Relating to Telecommunications and Broadcasting
Part 12. Miscellaneous – This part covers miscellaneous items including fees, personal immunity of public officers, service of documents; indemnities of officers, employees and agents; penalty, offences, and consequential, related, transitional and savings provisions.

The Ordinance prohibits the following three kinds of anti-competitive conducts:

(i) Anti-competitive agreements, concerted practices and decisions
(ii) Abuse of market power
(iii) Merger and acquisition (only applicable to the telecommunications industry).

Two institutions would be established under the Ordinance: the Competition Commission, whose members are appointed by the Chief Executive, and is responsible for investigation and execution of law; and the Competition Tribunal, presided by a judge at the level of Chief Judge of the Court of First Instance of High Court. These two institutions would have fairly substantial investigative power and judicial power.

The Competition Tribunal is empowered to impose a penalty on the party in contravention of the competition rules capped at 10% of Hong Kong’s turnover recorded in the year of occurrence or compensation to the party suffering damages. EU can instead impose a fine up to 10% of the worldwide turnover. In addition, the Competition Commission can formulate, interpret and implement guidelines for the competition rules. Under such authorization, it can set up rules to facilitate competition with flexibility according to the special situation of the Hong Kong market.
2.3 Limitations of Hong Kong’s *Competition Ordinance*

Hong Kong’s *Competition Ordinance* has substantial limitations, which can be clearly seen when you take Australia’s as an example. As early as 1993, Hilmer Committee founded by the Australian government explicitly suggested that effective competition policies must address the following six issues:

(i) “Anti-competitive conducts” by enterprises;
(ii) Existing government regulatory policies with adverse effect on market competition;
(iii) Improper structure and conducts of public sector monopolies;
(iv) How could the government remain neutral in business competitions between the public sector and private enterprises;
(v) “Excessive pricing”; and
(vi) Owners may restrict other competitors to use the “essential facility” of certain industries, resulting in prevention of effective competition.

Hong Kong’s *Competition Ordinance* only focuses on the “anti-competitive conducts” (engaging in “concerted practices” (the “first conduct rule”) or “abuse of market power” (the “second conduct rule”) of private enterprises; while the five types of “anti-competitive conducts” set out below are still beyond regulation:

(i) In principle, the government will not comprehensively regulate and handle the economic and business activities of governmental and statutory bodies;
(ii) The government will not review or abolish existing policies that are in contravention of fair competition by means of this Ordinance;
(iii) The government will not restructure the market structure of the industries where monopoly already exists to promote competition of such industries;
(iv) Although regulating “mergers” is stipulated in the purpose of Hong Kong’s *Competition Ordinance*, the government will not comprehensively regulate mergers between different sectors. It is only applicable to the telecommunications industry (which has been stipulated in Section 7 of the Telecommunications Ordinance (Cap. 106)); and
(v) The Ordinance does not regulate “excessive pricing”.
3. THE FIRST CONDUCT RULE

The Competition Ordinance establishes two rules for the competition conducts promoted. These two rules aim at prohibiting the business community from making any agreement having adverse effect on competition and preventing an enterprise from abusing the substantial market power it enjoys in a relevant market respectively. How to apply and implement these principle provisions in specific situations is a rather meticulous and elaborate arrangement. The law authorizes the Competition Commission to formulate specific rules with reference to the competition provisions and cases in developed countries (especially the EU).

Section 6 of the Competition Ordinance, Cap. 619, prohibits “anti-competitive agreements” or “concerted practices and decisions”. It means that, an “undertaking” must not make or give effect to an “agreement” which is engaged in a “concerted practice” or as a member of an association of “undertakings”, make or give effect to a decision of the association, if the “object” or “effect” of this kind of agreement is to “prevent, restrict or distort competition in Hong Kong”. The prohibition imposed by this section is referred to as the “first conduct rule". The specific contents of the rule are to be formulated by the Competition Commission.

The contents of and reasons behind the prohibition of these kinds of “anti-competitive agreements” or “concerted practices and decisions” were further elaborated in the Competition Bill, for the reason that they would result in the following three kinds of effect:

(i) fixing purchase or selling prices or any other trading conditions directly or indirectly ;

(ii) limiting or controlling production, markets, technical development or investment ; and

(iii) sharing market or sources of supply.

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1 (1) An undertaking must not—
   (a) make or give effect to an agreement;
   (b) engage in a concerted practice; or
   (c) as a member of an association of undertakings, make or give effect to a decision of the association, if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong.

2 Unless the context otherwise requires, a provision of this Ordinance which is expressed to apply to, or in relation to, an agreement is to be read as applying equally to, or in relation to, a concerted practice and a decision by an association of undertakings (but with any necessary modifications).

3 The prohibition imposed by subsection (1) is referred to in this Ordinance as the “first conduct rule”.

The three contents above are based on relevant laws of the EU (Article 101 TFEU (Treaty on the Functioning of the European Union))\(^2\), which is directly compatible with international standards, thus having plenty precedents from the EU and other countries for reference. In the following, the EU laws can be compared with the Hong Kong laws.

From the comparison, we can see that basic wordings in the laws are the same, with further explanations on key wordings set out below. The paragraphs (a-d) of Article 101 TFEU were originally written down in the draft of the *Competition Ordinance*, but were deleted when the Ordinance entered into legislation. However, when the Competition Commission adopts specific guidelines to the “first conduct rule” in the future, the same provisions are probable to be supplemented, resulting in similar legal basis upon implementation of the law in Hong Kong.

The Ordinance further defines the “object of agreement” mainly by making an assumption that if an “agreement” or “concerted practice or decision” has more than one “objects”, and one of its objects is to “prevent, restrict or distort competition in Hong Kong”, it should be considered to be an “agreement” with an “object” to the detriment of competition under this Ordinance. (Please refer to Section 7: “Object” and “effect” of “agreement”).

The Ordinance adds a special provision here, stipulating that even if that object can be ascertained only by inference by the Competition Commission or the Competition Tribunal, an undertaking may be considered to have engaged in such an illegal agreement or conducts. Such a definition may reduce the burden of proof of the prosecution, which is different from the principle of evidence in common law (Balance of Probability is the standard of proof in civil cases; and Beyond Reasonable Doubt is the standard of proof in criminal cases).

The Ordinance does not give specific definition of “concerted practices”; thus, the court is allowed to make explanation in a fairly liberal manner. There are plenty of cases in this respect for reference in the EU.

\(^2\) TFEU Article 101

1) The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
   (a) directly or indirectly fix purchase or selling prices or any other trading conditions
   (b) limit or control production, markets, technical development, or investment
   (c) share markets or sources of supply
   apply dissimilar conditions to equivalent transactions with other trading practices, thereby placing them at a competitive disadvantage
3.1 Scope of Application and Important Concepts of the “First Conduct Rule”

Under the Competition Ordinance, it is a statutory requirement for the Competition Commission to issue “guidelines” explicitly indicating the manner in which the conduct rules should be interpreted and given effect to. The Competition Ordinance also required the Competition Commission to consult any persons it considered appropriate before issuing any such guidelines or making amendments to them. As Section 1 of the Competition Ordinance allows a phased commencement of different parts of the Ordinance, the government’s plans would be firstly to set up the new Competition Commission which would conduct consultations and prepare the “guidelines”, after the passage of the Competition Ordinance and before the main prohibition provisions coming into effect. During this transitional period, stakeholders, particularly the business community, are provided with sufficient time to better understand the contents of the new law, and put in place compliance and training programmes and make adjustment to their business practices as necessary.

Though the detailed “guidelines” on the “first conduct rule” has not been finalized, the contents would mainly be in line with international experiences and precedents. In the course of 2011/12 legislation, the government once submitted a discussion documents of the “guidelines” on the “first conduct rule” to the Legislative Council for reference, from which we could have an idea about the contents of the basic “guidelines” on the rule. The following text is directly extracted from the “guidelines” in the discussion content.

In terms of geographical application, Section 8 of the Competition Ordinance provides that the “first conduct rule” also applies to an “agreement” or a “decision” which is made or given effect to outside Hong Kong. It also covers any “undertaking” implementing such a “decision” outside Hong Kong.

(i) “Undertaking”

Under the law, an “undertaking” means any entity, regardless of its legal status or the way in which it is financed, engaged in economic activities, and includes a natural person or legal person engaged in economic activities. It means that “undertakings” could be companies, partnerships, individuals operating in sole proprietorship, cooperatives, societies, business chambers, trade association and non profit–making organizations. The key consideration in assessing whether an entity is an “undertaking” is whether it is engaged in economic activities. The term “economic activity” is a broad term that refers to any activity consisting in offering goods or services on a market and which could, at least in principle, be carried on to make profits. An “entity” may engage in economic activities in some of its functions but not others.
The “first conduct rule” only applies to agreements between two or more separate undertakings. It does not apply to agreements where there is only one “undertaking”, that is, between entities which form a single economic unit. Whether or not the entities form a single economic unit would depend on the facts of each case. Generally, if “undertaking” A has a high degree of operational and financial control over “undertaking” B, A and B are likely to be considered as a single economic unit. In particular, an “agreement” between a parent company and its subsidiary company, or between two companies which are under the control of a third company, will not be “agreements” between “undertakings” if the subsidiary has no real freedom to determine its course of action in the market and, although having a separate legal personality, enjoy no economic independence.

(ii) “Concerted Practices”

A “concerted practices” may exist where there is informal cooperation between competitors, without any formal “agreement” or “decision”. A “concerted practice” would be found to exist if parties, even if they did not enter into an “agreement”, knowingly substituted the risks of competition with cooperation between them. If a market is highly competitive, it would be expected that competitors have no choice but to respond to each other’s moves in the market. For example, if one competitor drops its prices, other competitors may quickly follow its lead; otherwise customers will turn to the competitor who dropped its prices. It is therefore important for the Competition Commission to consider any particular conduct within the overall economic context in establishing if a “concerted practice” exists in a particular business. The factors to be considered may include:

(a) whether the parties knowingly entered into practical cooperation;
(b) whether behaviour in the market is influenced as a result of direct or indirect contact between the “undertakings”;
(c) whether parallel behaviour resulting from contact between the “undertakings” leads to conditions of competition which do not correspond to normal conditions of the market; and
(d) whether the structure of the relevant market and the nature of the product involved are favourable to collusion. For example, whether there are only a few “undertakings” in the market and whether they have similar outputs.

(iii) Decisions by “Associations of Undertakings”

Trade associations are the most common form of “association of undertakings”, but relevant provisions are not limited to any particular type of association. The trade associations intend to promote the competitiveness of their industry sectors and their members are usually direct competitors against each other. The key consideration that the Competition Ordinance takes into
account is whether the “object” or “effect” of any particular “decision” made by the trade association, in whatever form it takes, is to influence the conduct or coordinate the activity of its members in some commercial matters. An association’s coordination of its members’ conducts in accordance with its constitution may also be considered as a kind of “decision” even if its recommendations may not have binding effect on its members, and may not have been fully complied with.

(iv) “Object” or “Effect” to “Prevent, Restrict or Distort Competition”

Many “agreements” between “undertakings” in the economy might be said to restrict the freedom of action of the parties concerned. That does not, however, necessarily mean that all such “agreements” are prohibited. Once the Competition Commission has established that “undertakings” have made an “agreement”, it must consider if the “agreement” was made with the “object” or “effect” of “preventing, restricting or distorting competition”.

(v) The “Object” Test

“Object” refers to the “objective purpose” of the “agreement” considered in the economic context in which it is to be applied, rather than the subjective intention of the parties when entering into the agreement. The assessment of whether an “agreement” has the “object” of restricting competition requires the “agreement” to be viewed within its economic context. One of the important considerations will be any evidence found in records of meetings between the “undertakings”. The “undertakings” usually will not have expressed the “object” of the relevant arrangement neatly, or expressly acknowledged that their intention was to act anti-competitively. Instead, more usually they will have expressed the end they have in mind more generally, such as acquiring any spare manufacturing capacity in the market to avoid “ruinous price competition” (i.e. keeping prices high) or to ensure “an orderly market” (i.e. keeping out additional competitors). In practice, it usually will be necessary to infer the object from the facts underlying the “agreement” and the specific circumstances in which it will operate or does operate (c.f. Clause 7(2) of the Ordinance which allows “that object can be ascertained only by inference”). If an “agreement” has more than one object, it will breach the “first conduct rule” if one of its objects is to “prevent, restrict or distort competition” (c.f. Clause 7(1) of the Ordinance). Where an “agreement” has as its “object” to “prevent, restrict or distort competition in Hong Kong”, it is not necessary for the Competition Commission to prove that the relevant “agreement” would have an anti-competitive “effect” in order to find an infringement of the “first conduct rule”. Nevertheless, the restriction of competition must be “appreciable”. If an “agreement” having an anti-competitive “object” would be likely to have only a minimal effect on market competition, then the “first conduct rule” may be held not to apply.
(vi) **The “Effect” Test**

If an “agreement” does not have an anti-competitive “object”, it will nevertheless infringe the “first conduct rule” if it has an appreciable anti-competitive “effect”. In assessing whether the conduct resulted in the “effect” of “preventing, restricting or distorting competition”, the Competition Commission will consider whether there has been an appreciable adverse effect on competition in the relevant market. One way of doing this is by assessing what the market conditions would most likely have been, in the absence of the conducts (i.e. the counter-factual) and making comparison. The Competition Commission will assess the “effect” of specified conduct on a case-by-case basis in the light of available evidence. By way of examples, the relevant “effects” might include:

(a) anti-competitive foreclosure of competitors;
(b) raising of barriers to entry; and
(c) withdrawal of products or services from the market or a reduction in the quality of the services offered.

In a highly competitive market, individual competitors inevitably enter and leave the market over time as they take their chances and as they fail. The Competition Ordinance instead is concerned with the fairness of the process of competition. The adverse “effect” on competition must be more than minimal before the Competition Commission will be concerned.

Appreciable Impact on Competition Test: case laws and “guidelines” available in other major competition jurisdictions suggest that the “first conduct rule” and the “second conduct rule” should only catch conduct which has an appreciable adverse impact on competition. Indeed, the notion of appreciable adverse impact forms the basis of the “de minimis principle”. The “de minimis principle” applies to both “agreements” which “prevent, restrict or distort competition” (e.g. certain conducts of small and medium enterprises will be “excluded”) and the “second conduct rule”.

(vii) **“Agreement”**

“Agreement” has a wide meaning and includes both legally enforceable and non-enforceable “agreements”, whether written or oral; it includes so-called “gentlemen’s agreements”. “Agreement” can be further divided into “horizontal agreement” and “vertical agreement”. In Contract Law, the stages where both parties have completed the negotiations can be described as a “contract” formed on legal basis, i.e. an “agreement” between both parties. The traditional way to prove the “agreement” between both parties is by means of offer and acceptance, where one party (the offeror) expressly indicates its willingness to make a contract in respect of certain terms and conditions. Once the receiving party accepts the offer, a binding “contract” is concluded. It must be
noted that an “agreement” itself is not a “contract” and thus has no “contractual” effect in a legal context. The “agreement” referred to in the *Competition Ordinance* also includes those which are still under negotiation.

There does not have to be a physical meeting of the “undertakings” for an “agreement” to be reached; instead, an exchange of letters or telephone calls may suffice. Generally, the requirement is that the “undertakings” arrive at a consensus on the actions that each undertaking will or will not take.

**(viii) Horizontal Agreement**

A “horizontal agreement” refers to an “agreement” made among independent “undertakings” for the purpose of cooperation. Some form of horizontal agreements is known as “Cartel Agreement”. Although there are arguments between the court and economists in the economic benefits of “vertical agreements”, any “Cartel Agreement” on price, quantity and sharing in the sales market is mostly considered as a breach of the law, because such “agreements” would have materially adverse effects on market competition. As a result, there is not much dispute over regulating “horizontal agreements”.

An “agreement” can be made by way of an “explicit agreement”, which is a document jointly signed by the “undertakings” or a voting by the associations of the same trade. An “agreement” can also be a “tacit agreement”, which is an “agreement” reached impliedly or a coordinated plan realized by certain systematic conducts between the “undertakings”, such as an “undertaking” deliberately announcing how it would adjust the price while its competitors making response in due course.

**(ix) Vertical Agreement**

A “vertical agreement” is an agreement made by two or more “undertakings”. Each operates (for the purposes of the “agreement”) at a different level of the production or distribution chain. So, it means an “agreement” made between enterprises in different production or marketing phases. Take an agreement between the seller and buyer of steel as an example. Where “undertaking” A produces raw materials while “undertaking” B uses the raw materials acquired from “undertaking” A as production inputs, A and B are in a “vertical” upstream and downstream (supply and demand) relationship.

If a supplier was vertically integrated (i.e. it has its own retail stores rather than rely on independent retailers), the “vertical agreement” may give rise to the issue of preventing competition. For instance, a supplier with a substantial degree of market power in a market could use the terms under its “vertical agreement” with retailers to limit access to the retailing market by other competing suppliers, and thus limit competition among retailers.
There are two opposing views in respect of the pros and cons of a “vertical agreement” towards economic operation. One is represented by the Chicago School in the United States which has given a general affirmation to economic benefits of vertical agreements. They considered that a “vertical agreement” in market economy is not necessarily a deliberate collusion among competitors and that the object of this kind of “agreement” is not necessarily to restrict production quantity or raise commodity prices. Parties involved in the “vertical agreement” may aim at promoting productivity rather than restricting it. This kind of agreement, therefore, is capable of increasing the wealth in society. The opposing group suggests conducting detailed economic analysis on “vertical agreements”, covering not only the structure of the market that the parties concerned situate and their positions in the relevant markets, but also their motivations to restrict competition. The analysis allows us to determine whether such conducts would constitute damaging effects on competition and thus any restrictions should be imposed accordingly.

The European Commission holds an objective attitude towards “vertical agreements”, regarding their effects on competition. It does not consider that the “agreement” would necessarily be promoting competition nor it is anti-competitive. The key lies on how to evaluate the impact of “vertical agreements” on market structure. If all of the “undertakings” of a vertical agreement restricting competition are positioned in the market with effective competition and such restrictions will not materially affect market competition, the “vertical agreement” will then have a positive effect on market competition. Otherwise, a “vertical agreement” will materially prevent competitors from accessing the market.
3.2 Specific Conducts Infringing the “First Conduct Rule”

In the discussion documents submitted to the Legislative Council by the government, specific examples of certain conducts that might breach the “first conduct rule” were given. It is believed that those conducts are the key points to be addressed in the future “guidelines”. The examples given are not divided into “vertical” or “horizontal” agreements (the Ordinance does not include such categorization itself).

(a) Examples of “Horizontal Agreement”

(i) Fixing prices directly or indirectly

This involves fixing either the price itself or the components of a price such as a discount, or controlling the amount or percentage by which prices are to be increased, or establishing a range restricting price movements. This is applicable to both “vertical” and “horizontal agreements”. Price-fixing may also take the form of an “agreement” by “undertakings” to restrict price competition, including an agreement to adhere to published price lists, or not to quote a price or not to set a price.

Competition may, for instance, be restricted despite the ability to exercise independent power by the “undertakings” to grant discounts or special deals on a published list price or ruling price.
Recommendations by a trade association in relation to price, or collective price setting or price coordination of any product may be considered as price-fixing, regardless of the form it may take. This could include any recommendation on prices and charges, including discounts and allowances.

An “agreement” may also fix prices by indirectly affecting the prices to be charged. It may cover the discounts or allowances to be granted, transport charges, payments for additional services, credit terms or the terms of guarantees, for example. This kind of “agreements” that have the object to fix prices of any product directly or indirectly will be regarded as restricting competition. (Please refer to the five cases in this chapter.)

(ii) **Bid-rigging**

Tendering procedures are designed to provide enterprises with opportunities for competition in order to obtain the best trading conditions. Any tenders submitted as a result of collusion or cooperation between the tenderers will, by their very nature, be regarded as restricting competition appreciably. An essential feature of the tendering system is that tenderers submit bids independently. Bid rigging occurs when two or more “undertakings” “agree” that they would not compete genuinely with each other for particular tenders, allowing one of the participants in the “agreement” to “win the tender”. Conducts of illegal “bid-rigging” include “agreement” to submit higher price than the tenderer that has been chosen to win; submission of tender containing terms that will be unacceptable; or “agreement” not to tender or withdrawing their tender. Participants in the “agreement” may take turns to be the winner. “Bid-rigging” can also occur in circumstances where the bidders take actions to reduce the competitive intension in the bidding process.
“Market sharing” refers to “agreements” between “undertakings” that divide up the market so that the “undertakings” are sheltered from competition. For instance, participating “undertakings” may “agree” to restrain from the following business actions: competing in the production of each other’s goods; selling in each other’s geographic territories; soliciting or selling to each other’s customers; or expanding into a market in which another participant is the rival.

“Undertakings” may “agree” to share markets, whether by territory, type or size of customers, or in some other ways. The agreements among the “undertakings” may not only on sharing the market but also fixing the price at the same time, especially if products involved are reasonably standardized. Such “agreements” will, by their very nature, be regarded as restricting competition appreciably.
(iv) **Agreements to Limit Output or Control Production or Investment**

“Output controls” can occur in the form of production or sales quota arrangements which involve “agreements” among “undertakings” to limit the volume or type of particular goods or services available in the market. Competitive intensity may be reduced if “undertakings” in an industry ‘agree’ to limit future investment plans. This kind of “agreements” includes “vertical agreements” and “horizontal agreements”.

(v) **Agreements to Fix Trading Conditions**

“Undertakings” may agree to regulate the terms and conditions on which products are to be supplied. If a trade association imposes on its members an obligation to use common terms and conditions of sale or purchase, this may restrict competition. Associations may also be involved in the formulation of standard terms and conditions applicable to its members. Depending on the facts of the case, this may be no more than a usual simplification of what might otherwise be complex and, to the buyer, potentially confusing conditions. Standard conditions are less likely to have an “appreciable adverse impact” on competition, if members are allowed to adopt different terms and conditions freely.
(vi) **Joint Purchasing/Selling**

Joint purchasing “agreements” are often concluded by small and medium-sized enterprises to achieve volumes and discounts similar to the bigger competitors. Competitors grouping together to exercise more leverage against sellers generally should not be regarded as adversely affecting competition because this conduct usually results in lower prices and better conditions of purchase. In particular, “agreements” among small and medium-sized enterprises to allow them to obtain favourable buying terms matching their much larger competitors in the market will normally give rise to no concerns under the *Competition Ordinance*. However, the cooperation of competing purchasers through a joint purchase “agreement” could create buying power if the purchasing “agreement” accounts for a sufficiently large portion of the total volume of a market. There would be an impact on competition if the purchasers of the joint purchasing “agreement” are exercising the buying power to foreclose competitors or to raise rivals’ costs. An example is to restrict the suppliers from selling the goods to the competitors. As another example, joint selling “agreements” to coordinate pricing policies of participating “undertakings” would eliminate price competition between the parties. This kind of “agreements” include “vertical agreements” and “horizontal agreements.”

(vii) **Information Sharing**

As a general principle, the more informed buyers are, the more effective competition is likely to be and so making information publicly available to buyers would generally not damage competition. If “undertakings” involved in competition exchange information generally and legally, this would not damage competition as well. Indeed, competition may be enhanced by the “sharing of information”, for example, on new technologies or market opportunities, particularly if consumers are also informed.

However, the exchange of information may have an “appreciable adverse impact” on competition, if it serves to reduce or remove uncertainties inherent in the process of competition. In the process of direct information exchange among competitors, this may establish predictability and certainty. Whether or not an exchange of information has an “appreciable adverse impact” on competition would depend on the circumstances of each individual case. As a general principle, it is more likely that there would be an “appreciable adverse impact” on competition the smaller the number of “undertakings” operating in the market, the more frequent the exchange, the more sensitive and confidential the nature of the information involved, and if the access to information exchanged is limited to certain participating “undertakings”, but to the exclusion of their competitors and buyers.
(viii) **Exchange of Price Information**

The “exchange of price information” usually leads to price coordination and therefore diminishes competition, which would otherwise be prevalent among the “undertakings”. The information exchanged can relate directly to the prices charged or to the elements of a pricing policy, for example, discounts, costs, terms of trade and rates and dates of price changes. A price announcement made in advance to competitors may be anti-competitive where it facilitates collusion. Price announcements made directly to buyers, on the other hand, may be pro-competitive. The more recent or current the information exchanged, the more likely that exchange could have an “appreciable adverse impact” on competition. There is unlikely an “appreciable adverse effect” on competition in respect of benchmarking study where the exchanged information forms part of the contents of inter-business comparison of the same industry and the information is collected and disseminated by an independent body with an aim to promote best industrial practices. Exchange of purely historical information that is aggregated, and which cannot be disaggregated is also unlikely to have an appreciable impact on competition.

(ix) **Exchange of Non-Price Information**

The exchange of information on matters other than price may have an “appreciable adverse impact” on competition, depending on the type of information exchanged and the structure of the market. For example, the exchange of historical, aggregated statistical data, information on output and sales, market research results and general industry studies are unlikely have an “appreciable adverse impact” on competition, since the exchange of such information is unlikely to reduce the commercial and competitive independence of individual “undertaking”. There may however be an “appreciable adverse impact” on competition if the information exchanged is current or recent, or concerns future plans. In particular, if the information could be disaggregated and individual “undertakings” could be identified.

(x) **Advertising**

Restrictions on “advertising”, whether relating to the amount, nature or form of advertising, have the potential to restrict competition. Whether the impact is appreciable depends on the purpose and nature of the restrictions, and the structure of the relevant market. Decisions made by trade associations aimed at curbing misleading advertising, or at ensuring that advertising is legal, truthful, honest and decent, are unlikely to have an “appreciable adverse impact” on competition.
(xi) **Standardisation Agreements**

An “agreement” on technical or design standards may lead to an improvement in production by reducing costs or raising quality, or it may promote technical or economic progress by reducing wastage and consumers’ information costs. The “agreement” may, however, have an “appreciable adverse impact” on competition in particular, if it includes restrictions on what the parties may produce, or is, in effect, a means of limiting competition from other sources, for example by raising entry barriers. “Standardisation agreements” which prevent the parties from developing alternative standards or products that do not comply with the agreed standards may also have an “appreciable adverse impact” on competition.

(xii) **Terms of Membership and Certification**

Rules of admission as a member of an “association of undertakings” should be transparent, reasonable, non-discriminatory and based on objective standards. Terms of membership will have an “appreciable adverse impact” on competition, if the effect of exclusion from membership is to put the “undertaking(s)” concerned at a competitive disadvantage. Similarly, procedures for expelling members of an association may have an “appreciable adverse impact” on competition, particularly if they are not based on reasonable and objective standards or there is no proper appeal procedure in the event of refusal of membership or expulsion.

An “association of undertakings” may certify or award quality labels to its members to demonstrate that they have met minimum industry standards. While such a scheme has benefits for consumers in the form of quality assurances, it may lead to a restriction of competition. Where manufacturers must accept additional obligations governing the products which they can buy or sell, or restrictions as to pricing or marketing, the scheme would likely have an “appreciable adverse impact” on competition.

(b) **Examples of “Vertical Agreement”**

(i) **Exclusive Selling**

In this case, the seller asks the manufacturer to sell the products to it only, regardless of whether there are other competitors in the market in which the seller is situated.

(ii) **Exclusive Purchasing**

In this case, the manufacturer asks the seller to sell its products or services only, regardless of whether there are other competitors in the market in which the manufacturer is situated. (Please refer to the Intel case in the United States.)
(iii) **Discriminatory Price Discount**

Suppliers offer different wholesale prices to different buyers, such as offering volume discount to those who buy a large quantity of goods or offering special discount to certain customers. (Please refer to the Intel case in the United States.)

(iv) **Resale Price Maintenance**

Suppliers impose restrictive rules on prices when the wholesalers resell the goods, such as fixed price, fixed minimum price or fixed maximum price. (Please refer to the Safeway case in Australia.)

(v) **Other Restrictions on Resale**

Manufacturers offer the seller with bundled selling by the addition of pre-sale services, after-sale services, or setting restrictions on sale regions in an unreasonable manner. (Please refer to the Ford case in Germany.)

Under the laws of the EU, “vertical agreements” can be granted full “exemption” under specific circumstances (including that the supplier’s market share is less than 30%) provided that the relevant “agreements” can enhance the economic operation efficiency of both parties and the final outcome is beneficial to the interests of consumers.
3.3 Case Study

Case (a) “Freight Fuel Surcharge Collusion” of Major Airlines in the World

<table>
<thead>
<tr>
<th>Background</th>
<th>Since 1999, major airlines in the world had secret negotiations to raise the fuel surcharge of international air freight. It aroused the attention of the relevant anti-competitive authorities in Europe and the US. Starting from 2006, the US and EU conducted investigations in a more extensive manner on the monopoly pricing conducts and drawn the conclusion that many international airlines had a monopoly on the pricing of international freight through collusion.</th>
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| Verdict by the US | (1) Verdict of the US Department of Justice - on 1 August 2007, the US Department of Justice announced the investigation results on the British Airways:

   (a) The British Airways agreed to reach a “plea agreement” with the US Department of Justice in respect of the two charges on its engagement in “collusion” to control airlines’ fuel surcharge and its interference with trade respectively; and

   (b) The British Airways pleaded guilty and was fined US$300 million. |
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<th>Verdict by the EU</th>
<th>Others</th>
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<tr>
<td>(1) In November 2010, the EU affirmed that the airlines colluded in monopoly on freight charge and decided to fine 14 airlines a total of €799,445,000.</td>
<td>Civil action for compensation -- Follow-on Action; some of the consignors in the US and UK have filed civil actions for compensation.</td>
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<tr>
<td>(2) In January 2011, 13 airlines lodged an appeal to the European Court of Justice.</td>
<td></td>
</tr>
<tr>
<td>(3) In 2012, the appellate court maintained the verdict of the European Commission.</td>
<td></td>
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</tbody>
</table>

(2) On 30 September 2008, the US Department of Justice announced that the person in charge of the freight company under the British Airways was sentenced to 8 months imprisonment and fined US$20,000 for engaging in and giving effect to the monopoly pricing conducts of the company.

(3) A total of 19 airlines (including the British Airways, Cathay Pacific Airways, Japan Airlines, Korean Airlines, Qantas Airways) were fined subsequently, totalling US$1.6 billion; another 3 senior executives were sentenced to prison.

Verdict by the EU

(1) In November 2010, the EU affirmed that the airlines colluded in monopoly on freight charge and decided to fine 14 airlines a total of €799,445,000.

(2) In January 2011, 13 airlines lodged an appeal to the European Court of Justice.

(3) In 2012, the appellate court maintained the verdict of the European Commission.
Case (b) “Price Fixing Collusion” of Dairy Product Enterprises in the mainland

(1) Since the melamine incident in 2008, foreign invested milk powder brands have controlled 70% of the market share in first-tier and second-tier cities in the mainland. There has been a wave of price surge in foreign milk powder in almost every year. According to the estimation of the Second Division of Bureau of Price Supervision and Anti-Monopoly of the National Development and Reform Commission, the average increase in prices of major milk powder brand has been 30% in the mainland since the melamine incident in 2008. Given the substantial market power of foreign-invested powder brands in the domestic high-end milk powder market and the continued surge in prices, the profit margin of middle- and high-end milk powder brands was more than 60%.

(2) According to the statistics released by China Diary Industry Association at the end of 2012, the average price of milk powder was RMB249 per kilogram in the globe, RMB278 per kilogram in the EU, RMB290 per kilogram in the US, while it was RMB333 per kilogram in the mainland. Thanks to the relatively high prices, the profit of dairy enterprises was considerable.

Background and investigation findings
(3) The income of foreign-invested diary enterprises keeps increasing. Take Mead Johnson as an example. Its sales revenue from Asian and Latin American regions in 2012 was approximately US$2.72 billion (with an annual growth rate of 11%), far exceeding the revenue of US$246 million from the European and American markets. In the first quarter of 2013, the net income from Asian and Latin American regions accounted for 73% of Mead Johnson’s total net income.

(4) Domestic dairy enterprises also had a finger in the pie. Take Biostime as an example. According to its 2012 annual report, its operating income for the year was RMB3.382 billion (with an annual growth rate of 54.5%), while its net profit was RMB743 million (with an annual growth rate of 40.9%).

(5) In the course of investigation, the authorities found that the enterprises concerned had adopted contractual agreements, direct penalties, indirect penalties and the like to control the surge in prices of downstream distributors, resulting in higher prices of major milk powder brands.

(6) In addition, since there is no way for distributors to obtain profit through price competition, many of them required the enterprises concerned to guarantee a high profit, leading to substantially restricted and the surge in the costs of distribution channels (the costs of distribution channel accounted for 20% to 40% of the selling price, while that in other foreign countries it was generally 4% to 14%). All these factors led to the continued surge in the price of major milk powder brands in the mainland.

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<th>Development</th>
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<td>Since March 2013, the Bureau of Price Supervision and Anti-Monopoly of the National Development and Reform Commission has, in response to complaining reports, conducted an anti-pricing monopoly investigation on milk powder manufacturers at home and abroad, including Biostime, Mead Johnson, Dumex, Abbott, Friso, Fonterra, Weyth, Beingmate, Meiji.</td>
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(1) Under Article 13 of the Anti-monopoly Law of the People’s Republic of China, “horizontal monopoly agreements” are prohibited: “For the purposes of this Law, “monopoly agreements” refer to agreements, decisions or other concerted actions which eliminate or restrict competition.” According to the investigation findings, vertical and horizontal monopoly agreements might have co-existed in the surge in prices by milk powder manufacturers.

(2) It is reported that the National Development and Reform Commission was aware of a questionable trend of infant formula milk powder industry in recent years. Once a infant formula milk powder manufacturer raised the price of its milk powder, other manufacturers would follow and different manufacturers would take turn to raise the prices. If the above situation could be verified, such potential collusion would likely have constituted concerted actions which restricted or eliminated competition.

(3) Article 14 of the Anti-monopoly Law prohibits fixed resale prices or setting a minimum resale price. Accusations against milk powder manufacturers included that distributors were asked to sell the products at a price above the minimum price specified by the manufacturers; otherwise a corresponding penalty would be imposed on them. Since this resale price maintenance would have limited competition in the market and was injurious to the interests of consumers, it constituted a vertical monopoly under Article 14 of the Anti-monopoly Law.

(4) The Anti-monopoly Law of the People’s Republic of China stipulates that a fine at the amount of 1% to 10% of the sales in the previous year shall be imposed on enterprises engaged in price monopoly or manipulation. Before this, the penalty for anti-monopoly was normally 1% of the sales in the previous year.
| Verdict | (1) Fine -- on 7 August 2013, the National Development and Reform Commission imposed penalties on 6 milk powder manufacturers which “colluded” in pricing (based on the sales in the previous year (in RMB)):

(i) Biostime -- 162.9 million (6%; that was the maximum penalty ratio for its severe violation of the rules and inactive improvement.)

(ii) Mead Johnson -- 203.76 million (4%)

(iii) Dumex -- 171.99 million (3%)

(iv) Abbott -- 77.34 million (3%)

(v) Friso -- 48.27 million (3%)

(vi) Fonterra -- 4.47 million (3%)

(2) Weyth, Beingmate and Meiji were exempted from penalty for their cooperation in the investigation, provision of important evidence and active improvement in their operational arrangements. |

| Others | Improvement measures:

(1) Before the penalty was imposed by the National Development and Reform Commission, milk powder manufacturers announced to lower the prices (on 3 July), with an average of 11%, in the hope of a relatively mild penalty.

(2) Biostime and Mead Johnson both said that they would pay the penalty on time instead of filing any administrative action or plea.

(3) The price of milk powder has begun to decrease and the sales channels of milk powder in the mainland are now having less barriers which is conducive to the fair competition in domestic dairy market and among enterprises, thus in the interests of consumers. |
Case (c) “Dual Pricing Contract” of GlaxoSmithKline in Europe

Background GlaxoSmithKline group is an important pharmaceutical products development and marketing and sales promoter in Europe. The pharmacy industry in Europe is under strict regulations in all countries. When a certain kind of medicine is sold in a certain country, the government concerned will impose an upper price limit. It would be illegal for the medicine supplier to reduce or stop supplying the medicine without the consent from the government.

Illegal conducts engaged

(1) The subsidiary of GlaxoSmithkline in Spain informed the European Commission of their wholesale operations in Spain that the company has signed contracts with 79 wholesalers (if a certain “vertical agreement” is under regulation, then an application for an “exemption” shall be made).

(2) In the contract, it was stipulated that there were dual pricing for 82 kinds of medicine: if the medicine was sold to hospitals (paid by national medical insurance), a price at the legal upper limit should be applicable (which was set at a flat rate); if the medicine was sold to other retailers or consumers, a higher price should be applicable (which constituted price discrimination in economics).
### Arguments by GlaxoSmithkine:

1. In the absence of “dual pricing”, parallel import (水貨) would make it impossible for the pharmaceutical company to charge a higher price in other countries legally, resulting in a reduction in its motivation for research and development. For the pharmacy industry, it is of great significance to provide sufficient incentives for innovation and invention.

2. In the absence of “dual pricing”, GlaxoSmithkline would not be able to guarantee the supply of sufficient medicine to all countries in the European Union because the latter would have purchased parallel goods from other places where prices were lower.

### Preliminary verdict

The European Union did not agree with such “dual pricing agreements” and “condemned” such a practice ("condemnation" is equivalent to disapproval). A contract requiring different prices for the same kind of transaction is anti-competitive. The “object” and “effect” of such practice was to impose higher price on the medicine exported. Glaxo decided to file an appeal.

### Verdict of appeal

GlaxoSmithkline eventually lost the court case; but some legal points are still controversial:

1. In principle, the court considered that the application of “dual pricing” against “parallel trade” was definitely anti-competitive.

2. Price restrictions in different countries are national practices and do not exclude all kinds of competition. The pharmaceutical companies can still have freedom of competition in respect of development and services.

3. This kind of “contract” would hinder the interests of end users. This is relatively more controversial because it should not be assumed that parallel import must be beneficial to consumers. The one who is benefited may only be the parallel goods trader.

4. Since the insurance companies participating in the national medical insurance programme are to pay for the medicine, they are also the consumers. It is obvious that their interests would be adversely affected by different price charges.

5. Since there are governmental subsidies for the costs of medicines in certain countries (such as the UK), parallel import is unfair to the government and the medical insurance. The court, however, considered that the impact would have been insignificant.
**Case (d) “Price Monopoly Agreement” Case of Shanghai Gold & Jewellery Trade Association**

<table>
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<tr>
<th>Background</th>
<th>Shanghai Gold &amp; Jewellery Trade Association convened a number of Chairman’s Meetings among its members (including Lao Feng Xiang, Liaomiao, Firstasia, Chenghuang Jewellery, Tianbao Longfeng) in July 2007, January and October 2009, February 2010 and November 2011.</th>
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| Illegal conducts concerned                                                                     | (1) In the meetings, the *Implementation Rules for Self-Regulation on the Prices of Gold and Platinum Jewelleries in Shanghai Gold Jewellery Industry* (上海黃金飾品行業黃金、鉑金飾品價格自律實施細則) was discussed and formulated, which agreed on the calculation method, calculation formula and the amplitude of price fluctuations in the retail prices of gold and platinum jewellery.  

(2) By applying the calculation formula set out in the *Implementation Rules for Self-Regulation on Prices*, the above-mentioned five gold and jewellery stores determined the retail list prices of their gold and platinum jewellery within the range of fluctuations, resulting in manipulation of the prices of gold and platinum jewellery. The legal interests of other operators and consumers were hindered.  

(3) Under Article 16 of the “Anti-monopoly Law of People’s Republic of China”, trade associations shall not organize the business operators in its own industry to engage in monopolistic conducts prohibited by the Anti-monopoly Law. |
### Verdict

1. Given that the trade association played a leading role in organizing gold and jewellery stores to reach and implement the monopoly agreement, resulting in a relatively serious breach of the laws and a relatively significant impact on society, a fine of RMB500,000, which was the maximum amount according to the laws, was imposed.

2. Five gold and jewellery stores, namely Lao Feng Xiang, Liaomiao, Firstasia, Chenghuang Jewellery and Tianbao Longfeng, were in breach of Article 13 of the Anti-monopoly Law in respect of the prohibition of monopoly agreement among competing operators to fix or vary commodity prices.

3. Taking into account that the five gold and jewellery stores had ceased the illegal conducts before the investigation, actively cooperated in the investigation and promised to take rectification measures, a fine amounted to 1% of the sales in the previous year at a total of RMB10,093,700 was imposed pursuant to the laws.

### Others

#### Improvement measures:

1. Shanghai Gold & Jewellery Trade Association and the five enterprises have already taken specific rectification measures.

2. The Association promised to review its mistakes in board meetings and issue documents to completely abolish the *Implementation Rules for Self-Regulation on Prices* and would never organize any meeting in respect of “self-regulation on prices”.

3. The five gold and jewellery stores indicated that they would reflect and improve the pricing mechanism that had been used for years, and promised not to take part in any activities or meetings held by any trade association in respect of price negotiations, nor any negotiations with other competing gold and jewellery stores on topics about prices, but would commit to independent pricing in accordance with the laws.
## Case (e) “Salary Agreements of Indonesian Maids” Case of Singaporean Maid Agencies

| Background | 16 maid agencies in Singapore were in breach of the Competition Law for reason that they agreed to raise the salary of Indonesian maids. The Competition Commission of Singapore said that the 16 agencies were among the top 20 agencies with the largest number of maids’ referral business and their manipulation on maids’ salaries would have affected the market price. The Competition Commission of Singapore commenced its investigation on these 16 companies in January 2013 when the media reported that the maid agencies had determined the maids’ salaries upon consultations. |
| Illegal conducts concerned | (1) Nation Employment Pte. Ltd. and Best Home Employment Agency, two large local maid agencies, convened a meeting with the persons in charge of another 14 companies in Keppel Club on 16 January. Upon discussions, it was agreed that the salaries of Indonesian maids would be increased from approximately SGD380 to SGD450.  

(2) They claimed that its objective was to address the shortage of maids by attracting more Indonesian maids to work in Singapore. |
| Verdict | (1) After the Competition Commission of Singapore possessed the evidence that those companies violated Article 34 of the Competition Act, it issued the proposed infringement decision (PID) of the Competition Act to companies concerned in May. The Competition Commission arrived at the verdict that this kind of meetings or discussions with the purpose of direct or indirect price fixing was illegal.  
(2) The Competition Commission of Singapore was aware that some of the companies claimed that they took part in the meetings in a passive manner, while some of them did not agree with the salary adjustment. None of them, however, had denounced that such discussion was illegal and decided to leave the meeting. Whether or not those companies had benefited from it was not relevant for the Competition Commission. It was a violation of the Competition Act that they stayed behind and discussed about the salary adjustment.  
(3) 12 of the companies submitted petitions for leniency judgments to the authorities while 4 did not make any justification but willing to accept the penalty.  
(4) Upon reviewing the petitions of the 12 companies, the Competition Commission of Singapore determined the penalty based on the turnover of the companies concerned and the extent of their cooperation in the course of the investigation. Five small companies including Comfort Employment and Jack Focus Management had to pay a fine of SGD5,000. The penalty received by Nation Employment was the highest at an amount of SGD42,317. All the penalties accounted for less than 1% of the annual revenue of the companies. |
| Others | Improvement measures: the companies concerned have submitted guarantee to the authorities undertaking that they would never take part in any “price fixing” activities in the future and would determine the salaries of the maids on their own. |
Case (f)  “Parallel Import Agreement” Case of Ford Motor Co., Ltd. in Germany

Background

(1) Ford is an international automobile brand founded in the US.

(2) Incorporated in the US, Ford of Europe has offices in the UK, Belgium and Germany and is responsible for the coordination and assignment of the business operations of all subsidiaries in Europe, including Ford-brand vehicles and components produced by Ford Motor Co., Ltd. in Germany.

(3) Ford Motor Co., Ltd is a company registered and incorporated in Germany by Ford of Europe under the German Law in Republic of Germany, and in its capacity as a manufacturing company for left-hand drive and right-hand drive Ford cars. A certain number of right-hand drive cars are manufactured in accordance with British specifications and sold in the UK, while a certain number of right-hand drive cars are manufactured in accordance with German specifications and sold in Germany.

(4) Ford UK has independent marketing plan and distribution network in the UK market.
| Illegal conducts concerned | (1) Ford Motor Co., Ltd entered into a main dealer agreement with Ford dealers in Germany, which was binding to all Ford dealers in the country.  
(2) This kind of “vertical agreement” could only be implemented with a "negative clearance" (i.e. consent) from the EU under the competition laws or an “exemption” pursuant to the law.  
(3) Since the spring of 1981, there was a surge in demand for right-hand drive vehicles in the German market for the reason that the selling price of the vehicle was much lower in Germany than in the UK, which was partially attributable to the fluctuation of exchange rates. The interests of Ford dealers in the UK were affected when a large number of British car customers went to Germany to buy right-hand drive cars.  
(4) On 27th April 1982, Ford Motor Co., Ltd issued a circular to Ford dealers in Germany stating that they could not take orders from British customers starting from 1st May and British customers had to purchase their right-hand drive cars through Ford dealers in the UK.  
(5) The European Office of Consumer Union suggested that the main dealer agreement form an effective tool for Ford Motor Co., Ltd to prevent “parallel import” if Ford dealers in Germany could not sell right-hand drive cars to British customers, thus depriving the rights and interests of all customers in EU members. |
| Justification | (1) Ford said that the circular was unilateral in nature, thus it was not a part of the “agreement”. So, It should not be regulated by the competition laws.  
(2) This kind of policy measures was necessary in the automobile industry.  
(3) There were precedents in the EU about selective sales arrangements in different markets.  
(4) Even if the circular was a part of the “agreement”, the extent of its anti-competitiveness was not excessive in comparing with any sales “agreement” of other automobile companies.  
(5) The halt in sales had nothing to do with the main dealer “agreement”. |
| Verdict | (1) An interim measure was passed by the European Commission requiring ‘Ford AG’ to withdraw the circular within 10 days.  
(2) The EU eventually ruled that Ford failed in the appeal. The court specified that the circular of Ford Motor Co., Ltd. had in fact prevented dealers in Germany from selling cars to other countries for business expansion. The EU Competition Commission regarded the circular as a part of the “agreement”.  
(3) The EU Competition Commission has the right to take into account all relevant situations before granting an “exemption”. |
4. THE SECOND CONDUCT RULE

Section 21 of the *Competition Ordinance*, Cap. 619, explicitly provides that an “undertaking” that has a substantial degree of “market power” in a market must not “abuse” that power by engaging in conduct that has as its “object” or “effect” the “prevention, restriction or distortion of competition in Hong Kong”.

According to the Ordinance, a conduct may, in particular, constitute such an “abuse” if it involves:

(i) predatory business strategies towards competitors; or
(ii) limiting production, markets or technical development to the prejudice of consumers.

The Ordinance sets out the following four factors which should be taken into consideration in judging whether or not an “undertaking” abuses its market power:

(i) the “market share” of the “undertaking”;
(ii) the power of the “undertaking” to make pricing and other decisions;
(iii) any barriers to entry in the relevant market by competitors; and
(iv) any contravention by the “undertaking” of the “guidelines” issued by the Competition Commission under Section 35.

The prohibition on anti-competitive conduct imposed by sub-section (4) of Section 21 is referred to as the “second conduct rule” in this Ordinance. This rule shall be formulated by the Competition Commission. Likewise, this legal principle of prohibiting the “abuse of market power” is transplanted from the relevant laws and regulations in the EU (Article 102 TFEU (Treaty on the Functioning of the European Union)).

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2 TFEU Article 102
Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.
Such abuse may, in particular, consist in:
(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
(b) limiting production, markets or technical development to the prejudice of consumers;
(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(d) making the conclusion of contracts 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 contracts.
4.1 Scope of Application and Important Concepts of the “Second Conduct Rule”

Similarly, under the Competition Ordinance, it is a statutory requirement for the Competition Commission to issue official “guidelines”, which is currently under the pipeline. In the course of 2011/12 legislation, the government submitted the discussion documents to the members of the Legislative Council for reference, from which we can further understand the contents of the basic “guidelines” on the “second conduct rule”. Most of the following texts are directly extracted and quoted from the “guidelines” in the discussion document.

In terms of geographical application, Section 23 of the Ordinance provides that the “second conduct rule” covers situation even if when the “undertaking” engaging in the conduct is outside Hong Kong or the conduct is engaged in outside Hong Kong. The important concepts of the “second conduct rule” are set out below (those mentioned in the “first conduct rule” are not repeated).

(i) Abuse of Market Power

“Undertakings” in different markets may compete against each other in terms of price, service, innovation and quality so that their products and services are to remain an attractive choice to consumers. When an “undertaking” has relatively larger influence over the market, it does not only have the ability to sustain prices higher than the competitive level, but may also implement anti-competitive strategies to affect other competitors in order to increase profits.

The Competition Commission may perform a two-step test to assess whether an “undertaking” is in breach of the “second conduct rule”: first, whether the “undertaking” has “a substantial degree of market power” in the market; and if it does, whether the “undertaking” has engaged in any conduct that has its “object” or “effect” to “prevent, restrict or distort competition in Hong Kong”, resulting in an impact on the market structure. If it does, it constitutes an “abuse of market power”.

The factors for considering whether an “undertaking” has “market power” should include the number of existing competitors. The relative market share of the dominant player would determine the competitive constraints that it can impose on the other competitors. On the other hand, the types and nature of barriers to entry and the availability for potential competitors to enter the market may also determine whether an “undertaking” has “market power”.

(ii) Market Share Threshold

There is no definition of “market share” threshold in the Competition Ordinance to determine a “substantial degree of market power”. In jurisdictions such as the EU, UK and Singapore, the
prohibition on “abuse of market power” is formulated on the basis of the concept of “dominance”. A definite percentage of “market share” is not specified under their competition laws. Based on the case law and “guidelines” issued by the competition authorities in these jurisdictions, different “market share” percentages in the range of 40% to 60% are adopted as indications that an “undertaking” may be dominant in a market. For example, the European Court of Justice has stated that dominance can be presumed in the absence of evidence to the contrary if an “undertaking” has a “market share” persistently above 50%. There are documents which point out that the European Commission normally takes 40% as the market share threshold for market dominance. In Australia, the threshold is 30% to 40%, while in Singapore, a higher percentage at 60% is adopted. In all these jurisdictions, however, the competition authorities do not rule out the existence of dominance by an “undertaking” at a lower market share if there is strong evidence of dominance.

In the EU and other countries, the court still takes a number of factors into consideration when it determines whether an enterprise is dominant in the market even if the market share is lower than 40%. Such factors include the business practice, vertical operation structure, profitability, cost structure, influence on prices, the extent of control over important factors of production, reputation in the market of the relevant enterprise. (Please refer to the cases in respect of Google, Intel and Safeway.)

“Market share” is not necessarily indicative to the existence of “market power”. In a highly competitive market, “market shares” may encounter sharp changes as “undertakings” constantly innovate to get ahead of each other. Rapid changes in “market shares” may indicate that barriers to entry (or expansion) in a market are low and therefore suggest the absence of “market power”. An “undertaking” is more likely to have “market power” if it has a high “market share” and has sustained that share over time.

(iii) **Entry Barriers**

“Entry barriers” are important in the assessment of potential competition. Even an “undertaking” with a large “market share” would unlikely have “market power” in a market where there are very low entry barriers. An “undertaking” with a large “market share” in a market protected by policies or other factors is likely to have “market power”. One of the examples of entry barriers is huge “sunk costs” which means those costs that must be incurred to compete in a market but not recoverable on exiting the market. Huge “sunk costs” can give an incumbent a strategic advantage. Besides, entry barriers to new entrants may arise if the use of key inputs and distribution outlets is in favour of an incumbent. The extent of economies of scale may also constitute barriers to new entrants. (Please refer to the cases in respect of Intel and Microsoft.)
(iv) The “Objective Justification” Defence

An “undertaking” may raise a defence to an accusation of “abuse of market power” where it can show that it has an “objective justification” for its behaviour. This is the principle established by overseas cases law and practices acceptable by their competition authorities. The “undertaking” concerned must be able to show that the otherwise abusive conduct is objectively necessary, and such necessity must be based on objective factors. The “undertaking” concerned must be able to show that without the aforesaid conduct, the products concerned cannot or will not be produced or distributed in that market. For instance, a refusal to supply might be justified by the poor creditworthiness of the buyer. (Please refer to the cases in respect of “margin squeeze” by Deutsche Telekom, “parallel import agreement” by Ford Germany and Microsoft.)

4.2 Specific Conducts in Contravention of the “Second Conduct Rule”

(i) Exclusionary Behaviour

“Exclusionary behaviour” refers to anti-competitive behaviour which harms competition (including contract and agreement), for example, by eliminating an efficient competitor, limiting competition from existing competitors, or excluding and rejecting new competitors from entering the market. An incumbent may prevent new entrants from entering the market by “predatory pricing”. (Please refer to the cases in respect of Intel in the US and TVB in Hong Kong.)

(ii) Predatory Behaviour

It includes setting prices unreasonably low that it forces one or more “undertakings” out of the market. For instance, if the price is below the production cost for a period of time -- “predatory behaviour” may be presumed in the absence of object justification for this pricing strategy.

(iii) Tying and Bundling

“Tying” occurs when the seller makes the sale of one product (the tying product) conditional upon the purchase of another product (the tied product) from the seller. “Bundling” refers to situations where a package of two or more goods is offered. “Tying and bundling” are common commercial practices that do not necessarily have anti-competitive consequences. For example, however, by tying itself, an “undertaking” with a substantial degree of “market power” may reduce the number of potential buyers that would be available for its competitors in the “tied” market and can create a barrier for new entrants, causing existing competitors to be marginalized. This is an anti-competitive conduct. (Please refer to the case in respect of Microsoft in the US.)
(iv) Margin Squeeze

A vertically integrated “undertaking” may, on one hand, sell its products to a downstream market, while on the other hand, operates its business in the downstream market as well. In such a case, the vertically integrated “undertaking” can reduce the margin between input price (e.g. wholesale price) available to wholesale customers and the price it sets in the downstream market (e.g. retail price) to retail consumers such that those equally efficient downstream competitors are unable to compete effectively. (Please refer to the “margin squeeze” case in respect of Deutsche Telekom.)

(v) Refusals to Supply and Essential Facilities

In certain circumstances, a “refusal to supply” of goods by an “undertaking” with “a substantial degree of market power” may be considered an “abuse of market power” if there is evidence of likely substantial damage to competition and if the behaviour cannot be objectively justified. Another example is a refusal to allow a rival to access to an “essential facility”. A facility could be regarded as “essential” only if it can be demonstrated that an access to it is indispensable for an “undertaking” to compete in a related market, and where duplication is impossible or extremely difficult due to physical, geographic, economic or legal constraints. (Please refer to the “crematory” case in respect of Burgess in the UK.)

4.3 Examples of “Market Power” Assessment in Hong Kong

Market power is the most important concept in the enforcement of the “second conduct rule”. It refers to the independent ability (which is unaffected by other competing peers or other market factors) of an enterprise in a particular market (providing specific products or services) to determine the price of the goods and the terms and conditions of the contract and services, which can eventually enhance the interests of the enterprise. Having a weaker negotiating position, its suppliers and consumers have to accept such a price and such terms and conditions of the contract and services. An enterprise with “market power” would be in breach of the “second conduct rule” if it had “abused its market power” to affect competition in that market. On the contrary, an enterprise would not have the capability to violate the “second conduct rule” if it is shown that the enterprise concerned has no “market power”. Furthermore, it is not a breach of the “second conduct rule” if an enterprise has “market power” but does not “abuse” it.

In addition, the definition of “relevant market” is also a key concept in the enforcement of competition policies. Such economic analyses are mainly based on the discussion of “market structure” put forward by classical economists: the scope of a market is not just limited to the physical venue where goods are exchanged, but also all the aspects where people and enterprises...
interact for selling, purchasing and exchanging of the relevant goods. Therefore, many scholars agree that the results of many cases in respect of “anti-monopoly” and “abuse of market power” will become apparent as long as the definition of “relevant market” is determined. The definition of “relevant market” is very complicated in terms of actual enforcement and three major economic concepts are required to be established by empirical testing:

(i) the definition of “relevant market for product demand” – demand substitutability between the relevant products (e.g. when we study whether there is a monopoly in the fresh beef market, we have to find out whether substitution in consumers’ choices exists among fresh beef, frozen fresh beef, fresh pork and frozen fresh pork, etc.);

(ii) the definition of “relevant market for product supply” – substitutability between different suppliers (e.g., when we study whether large supermarkets monopolize the drinks of a certain brand, we have to look into the competition among different suppliers such as other small supermarkets, grocery stores and convenience stores, etc.); and

(iii) the definition of “relevant geographical market”: barriers, travel-time required, potential competition, product differentiation of geographical transactions.

“Relevant market” refers to a basket of goods including those can be reasonably substituted and all other competing suppliers within a reasonable scope, in a particular geographical context. Where there is a small but significant and non-transitory increase in price (5% to 10%, SSNIP) in respect of the goods concerned, consumers can make their choices among other alternative products and other competing suppliers in such geographical environment.

Economic theories and the techniques applied to the Competition Law are very complicated, which are further elaborated in Appendix 1.5. It is not easy to accurately evaluate consumers’ responses to the changes in prices, and the assessment of “relevant market” can only be an “approximation”. The “market share” of the enterprise will be calculated based on the definition of “relevant market”. Such analytical framework of “relevant market” can also be applied to other cases in respect of “horizontal merger”, “anti-monopoly” and “abuse of market power”. The ground of enforcement in the US and EU are substantially the same.

Therefore, possessing “market power” is the prerequisite for the contravention of the “second conduct rule”. When investigations are carried out by the Competition Commission on enterprises involved in a case of possible contravention of the “second conduct rule”, the following two questions must be answered:

(i) What is the market of the enterprise? How is its “relevant market” defined?

(ii) How to assess and calculate whether or not an enterprise has “market power”? 
Two relevant case study reports published recently in Hong Kong, namely TVB’s “monopolization of artistes” prepared by the Communications Authority (9/2013) and possible exertion of pressure on suppliers by the “Two Supermarket Giants” prepared by the Consumer Council (12/2013), will be directly reviewed here for reference.

(a) TVB’s “Monopolization of Artistes” investigated by the Communications Authority

In 2009, ATV filed a complaint to the Communications Authority against the abuse of market power by TVB. In September 2013, the Communications Authority published the findings of its investigation and delivered its verdict.

In the case report in relation to TVB, when studying the household and personal audio visual entertainment market of TVB, the study defined that it included two markets: TV viewers and advertisers, which are two interrelated groups of consumers. The higher viewership of a TV programme, the more attractiveness it is to advertisers.

To delineate the outer boundary of the market of TV viewers, “reasonable substitute” is the first factor that must be studied. In terms of demand, the Communications Authority needed to determine whether TV viewers considered other audio-visual entertainment such as cinema, DVD viewing, and Internet-based contents, and pay-per-view programming as “reasonable substitutes” for TV programmes. Upon detailed study, the Communications Authority concluded that none of them were deemed to be “reasonable substitutes” by TV viewers, and thus they should be excluded from the “relevant market”. Due to the lack of price information related to TV viewer market, the

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4 For the TVB case, please refer to the assessment report prepared by the Communications Authority (CA 01/2013); and for the supermarket case, please refer to the “Grocery Market Study – Market Power of Supermarket Chains Under Scrutiny”, Hong Kong Consumer Council, 19 Dec., 2013.
SSNIP test (Please refer to Appendix 1.5) which is generally applied to this kind of anti-monopoly study, was not carried out.

However, the Communications Authority is of the view that free-to-air television and pay television are substitutes for each other and hence in the same TV viewing market.

The first and foremost factor to be considered in the assessment of market power is “market share”, including its changes over time. While a firm with a large “market share” is not necessarily dominant, it is generally true that a firm with a small “market share” is highly unlikely to be dominant.

The Guidelines to Application of the Competition Provisions of the BO (the “Application Guidelines”) set out a “market share” threshold of 50%, above which there is a rebuttable presumption of dominance. The Application Guidelines also state that, a licensee is unlikely to be individually dominant, in the absence of contrary evidence, if its “market share” is below 40%. Contrary evidence may include the existence of very weak competitors, substantial entry barriers to new competitors (those are factors on the supplier side) and limited countervailing power of individual viewers, which may still establish the dominance of a firm with less than 40% “market share”.

In terms of market share as measured by viewership, TVB had a 66% share in the overall TV viewing market in 2010. More importantly, TVB’s large “market share” has persisted for years. Its “market share” remained above 60% between 2006 and 2010. As a result, it is sufficient for the Communications Authority to establish a presumption that TVB was dominant in the market under the Application Guidelines.

The data for calculation of “market share” may be available from different sources including the annual investigation information about different industries from the Census and Statistics Department, the information submitted to the Communications Authority by TV stations on regular basis, the information provided by TV stations as required by the Communications Authority in the course of individual investigations, independent investigation reports commissioned by Communications Authority (such as the number of viewers and subscribers as well as viewership), other market surveys and academic researches.

In terms of market scope of TV advertising, “reasonable substitute” is also the first and foremost factor to be studied. The advertising market in Hong Kong includes televisions, newspapers, magazines, radio stations, interactive media, the MTR, buses and other media. Upon detailed study, the Communications Authority concluded that TV advertising differed from other types of advertising with a very limited scope for supply substitution. Other market factors, including entry
barriers, substantial sunk costs of entry, brand loyalty of viewers, were extremely advantageous to TVB. Therefore, the Communications Authority was of the view that the “relevant market” of advertising in which TVB operates was the overall TV advertising market in Hong Kong.

Under such a definition, TVB’s market share was persistently between 56% and 59% in the overall TV advertising market in Hong Kong from 2006 to 2009. Therefore, it is sufficient for the Communications Authority to establish a presumption that TVB possesses a dominant position in the TV advertising market under the Application Guidelines. Following the establishment of TVB’s market dominance (exceeding 50% in terms of both TV viewers and TV advertising), the Communications Authority commenced further investigation on the suspicious contravention of the “second conduct rule”.

(b) Possible exertion of pressures on suppliers by the “two supermarket giants” as investigated by the Consumer Council

In recent years, the Consumer Council has received a number of complaints related to the suspicious “abuse of market power” by the “two supermarket giants” (over suppliers, competitors and consumers). It was subsequently commissioned by the government to conduct a study on the subject. In December 2013, the Consumer Council published a report entitled *Grocery Market Study – Market Power of Supermarket Chains under Scrutiny*. The two objectives of the study are to:
(i) examine the possible existence of market power of relevant players in the various relevant markets in Hong Kong; and

(ii) determine whether there is any prima facie evidence of anticompetitive practice as alleged.

Since the Consumer Council is not the law enforcement agency of the relevant laws and regulations, the findings of this study can only serve as information collection and an attempt to analyse the relevant issues and offer recommendations based on the principles of the Competition Ordinance. The first question that the study has to address is the same as that in the TVB case. How is the “relevant market” defined?

It is rather complicated to define the “relevant market” when the “two supermarket giants” sell hundreds of grocery items. Subsequently, the identities of the competitors are defined so as to further calculate their “market shares”. The first step in assessing competition is to identify competitors that are in the relevant market. The key to identifying competitors that are in the same market is found in assessing the extent to which consumers regard different competitors as effective substitutes for each other. In other words, the stores that should be included in the same market are those to which consumers will switch when the store at which they are currently shopping increases prices, or limits choices or decreases service levels.

The Consumer Council’s information obtained through research and an “Exit Survey” on competition in the sector indicates that there are two kinds of grocery shopping in the market: (i) “one-stop shopping”, and (ii) “secondary shopping”. Supermarkets providing “one-stop shopping” facilitate consumers shopping in a place where a complete range of foodstuffs and household necessities is readily available for purchase. The Consumer Council further analyzed whether it is appropriate to adopt the concept of “one-stop shopping” for all types of grocery shopping in Hong Kong. In the final analysis, a “two relevant market” approach (since the study took the view that the purchasing pattern and motivation of consumers in convenience stores would be different to the ones here, they are thus excluded in the study) is found to be most appropriate. They are:

(i) one market for shopping for fresh produced and packaged food in supermarkets and wet markets; and

(ii) another market for shopping for household products and necessities in supermarkets and other retail outlets, such as personal care chain stores and independent drug stores.
Based on the definition of the “relevant market” above, it was estimated that:

(i) PARKnSHOP and Wellcome take up 28.6% and 33.9% shares in the food retail market respectively; and

(ii) PARKnSHOP (together with Watsons which is under the same corporate group) and Wellcome (together with Mannings which is under the same corporate group) account for 23.0% and 35.9% shares in the household necessities market respectively. The market share of PARKnSHOP and Wellcome are calculated at 11.8% and 14.1% respectively.

The remarks by So Kam-Leung, the Secretary for Commerce and Economic Development Bureau, were quoted in the Report: an undertaking would be assumed to have a substantial degree of market power if its market share was above 40%, while no substantial degree of market power would be assumed for a market share of 25%. For a market share between 25% and 40%, the determination shall be dependent on the specific situations. In this regards, the Consumer Council made the following conclusion in the Report: the relevant market for retailing of foodstuffs would be assumed as moderately concentrated. Given that the “two supermarket giants” have been having a market share below 40% but above 25% respectively, it could not be rejected that either one did not possess a “substantial degree of market power” that would warrant further scrutiny. With regard to the market for retailing of household necessities, there was no evidence suggesting a substantial degree of market power by either of the “two supermarket giants”, unless the “market shares” of Watsons and Mannings were included respectively.
### 4.4 Case Study

**Case (a) “Crematoria Service” Case of JJ Burgess in the UK (“Essential Facility”)**

<table>
<thead>
<tr>
<th>Background</th>
<th>With a history of 160 years, JJ Burgess is a company engaged in the provision of funeral services. Its competitor, Austins, has also been serving in funeral services since 1700. With great efforts, Austins successfully obtained the approval from Urban Planning Council and set up a crematorium in Stevenage and Knebworth which offered crematoria services for its own and other operators in the field.</th>
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<tr>
<td>Illegal conducts concerned</td>
<td>(1) In 2002, the relationship between the two companies went sour. Austins refused JJ Burgess’s access to the crematorium, named Harwood Park. JJ Burgess could still rent the crematorium indirectly through other players, but it was completely prohibited from using it since 2004. (2) JJ Burgess then filed a complaint to the Office of Fair Trading, (the “OFT”, which is responsible for the enforcement of competition laws and regulations in the UK and equivalent to the Competition Commission in Hong Kong) and requested a ruling against Austin which was alleged to be in contravention of the Competition Law and had abused its “market power”.</td>
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<tr>
<td>The original verdict</td>
<td>The OFT did not consider that there was an infringement by Austins for the following reasons: (1) The case involved two different markets: the funeral directing services market and crematoria services market, which operated in two geographic markets. (2) One of the conditions for the Urban Planning Council’s approval of building the crematorium was that Austins would allow other funeral companies to use the facility and Austins, in fact, it did so.</td>
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At the same time, most funeral directing services companies would also use other crematoria. There were other crematoria services available within a 30 km radius of the area and thus, competition did exist among crematoria services. If Austins raised its price, other funeral companies would turn to other crematoria services. In fact, Austins had not adopted discriminatory pricing.

According to the information from the National Association of Funeral Directors, Harwood Park Crematorium accounted for only 15.6% of the market share, far below the “market dominance” threshold of 40%.

During that period of time, there was also an increase in the business revenue of JJ Burgess.

Since the employees in both companies were hostile to each other, the case was more a commercial dispute rather than an anti-competitive conduct.

JJ Burgess lodged an appeal to the Competition Appeal Tribunal. The Competition Appeal Tribunal did not agree with the verdict by the OFT and replaced it with its own decision on the following grounds:

The Competition Appeal Tribunal emphasized on the neglect of consumers’ interests by OFT– funeral services were so special that generally public would not take into careful consideration, nor would they have much experience and time to find such services. All they wanted was to get it settled as quickly as possible. The OFT overlooked the insensitivity of consumers on price increases in this circumstance.

Given the gradual decrease in the mortality in the UK, consumers would pay more attention to their choices of services. Accordingly, new competitors might find it difficult to enter the market. Having market power in both areas, the conducts of Austins constituted an “abuse of market power”. It was a mistake for the OFT to adopt a 30 km radius as the geographic boundary of the market.
(3) The OFT failed to pay attention to or discuss the indispensible relationship between funeral directing services and crematoria services, and Austins was a vertically integrated enterprise.

(4) The OFT said it should respect the freedom of a businessman to choose its trading partners. The Court was of the view that in the absence of reasonable justification, it was to the detriment of consumers for an enterprise with market power to refuse its competitor access to an “essential facility”.

(The two companies reached a settlement before the verdict was issued by the Competition Appeal Tribunal.)
### Case (b) “Margin Squeeze” Case of Deutsche Telekom in Germany

| Background | Deutsche Telekom was accused of “abusing market power” for “margin squeeze”. (The European Court of First Instance concluded the case in 2008.) Deutsche Telekom is a spin-off company from the state-owned postal service by way of privatization, in which the German State holds 43% of its share directly or indirectly, while the remaining 57% of the shares are public stocks. The company offers telecommunications services such as telephone and Internet. The company was defeated in both of the two appeals (the European Court of First Instance and European Court of Justice both maintained the original verdict), and fined up to €120 million by the European Commission. |
| Illegal conducts concerned | (1) Deutsche Telekom used to be a state-owned enterprise which enjoyed franchise in the market. In 1998, it was ordered to open the fixed-line telecommunications market to its competitors. After five years, Deutsche Telekom still owned a 100% share in the upstream market (i.e. wholesale market of the fixed-line telecommunications network) and 95% share in the downstream market (i.e. various kind of fixed-line telecommunications services offered to households and the business sector), while many operators in the downstream market only accounted for 5% of market share. |
(2) The wholesale price of the telecommunications services is decided by the German government while the cap on retail prices is decided by the German Federal Network Agency.

(3) Deutsche Telekom was accused of charging too high for its wholesale prices but too low for its retail prices. For the reason that the price margin between the wholesale prices and the retail prices was too thin, competitors could hardly join the business in the downstream retail market.

(4) Besides, Deutsche Telekom was further accused of setting its retail prices lower than its ‘product-specific’ costs. That involved “predatory pricing” and constituted an “abuse of market power”.

| Justification | Deutsche Telekom considered that as the cap price was determined by the German authorities, Deutsche had been in full compliance with the regulatory laws in Germany. Deutsche Telekom argued that the company did not have any control over pricing in the upstream market (which was also regulated by the government). The EU should, therefore, only consider whether there was an “abuse of market dominance” in the retail market. However, both of the EU Competition Commission and the EU Court did not accept such reasons. |
| Verdict | (1) The EU ruled that the “state action” could not be used as the main reason in justification. The anti-competitive regulations in the EU are in fact much stricter than the Anti-trust Law in the US because an enterprise in the US would not be prosecuted under the Anti-trust Law as long as it had been in compliance with the sector-specific regulations.  

(2) EU Competition Commission would base on the inference to determine whether a “margin squeeze” actually existed. When an enterprise has dominant market power, it cannot facilitate the profit making of its affiliates in the downstream market by setting high prices in the upstream market, preventing other enterprises from competing for the relevant downstream market. |
| Others | The significance of this case is mainly attributed to the fact that “margin squeeze” by itself is an “abuse of market dominance”. Although there were other telecommunications lawsuits at the same time, the Deutsche Telekom case should not be strictly quoted for all situations. The strength of Deutsche Telekom was persistent. However, in emerging and volatile markets, it is normal to see that enterprises may grasp customers by lowering prices in a short term. It is not easy at all to prove whether an enterprise has adopted “predatory pricing”. |
Case (c) “Abuse of Market Power” Case of Google in the US

Background

Google is known for its powerful search engine and user friendliness. It is natural for a website giant with an average global market share of 90% to run other websites and even produce its own computers in the course of its business expansion. This in itself is not against the law. However, Google is accused of taking advantage of its strength in searching on Internet to facilitate the advertising and operations of its own products. This is a typical anti-competitive conducts in contravention of the “second conduct rule” in the Hong Kong Competition Ordinance.

Investigation by the EU was triggered by complaints from certain British and French companies which found that their rankings in Google search results were pushed down, with the effect that it was beneficial to Google’s related companies. It is because Google was, in fact, competing with these companies. Later on, even Microsoft lodged complaints against Google.
The EU accused Google of “abusing its market dominance”. The four accused aspects were as the following:

(1) There was a deceptive display in the Google search results -- in a general search, the vertical search services of Google would first provide information on its own company or business partners, which was different from the search results of other providers of the same services.

(2) Google scrapped unauthorized contents from other websites -- Google copied information of its competitors in its search services websites and put it in its subordinated websites of the same kind, such as, comments on the relevant books, movies, food and beverage, and traveling. Google explained that it was only providing the best information for consumers.

(3) Google added restrictions on search advertisements into its contracts with customers -- search advertisements are advertisements displayed next to the research results. Such restrictions would result in an "exclusionary agreement", which demanded customers to post search advertisements in Google only, so that there was no way for other advertisement service providers to join the competition. This kind of advertisements is vital to “online shopping”, “online movies”, “online magazines”, etc.

(4) Google restricted the portability of advertising across different web platforms -- by means of contractual terms, Google restricted other software developers to provide Adwords (the auction advertising platform of Google) and seamless transfer tools of other platforms.

Justification

At the beginning, Google expressed no intention to concede. The Chairman of the company agreed to have a dialogue with the EU Competition Commission, but would not agree that there was any contravention of the competition laws.
Verdict

(1) The EU investigation was commenced in full in February 2010. After two years of efforts, the EU issued an ultimatum to Google on 18 December 2012, demanding Google to submit detailed improvement plan within one month in order to put an end to the two-year investigation on the “abuse of market dominance”.

(2) By the end of 2013, the EU Competition Commission had not reached an official verdict. Considering Google’s powerful transnational status, the Chairman of the EU Competition Commission gave a hint, hoping that the four controversies could be settled peacefully, as long as Google could effectively improve the situation. Otherwise, Google would be fined €3.7 billion in accordance with the EU laws, which would take up 10% of Google’s global profits. If Google was not satisfied with the decision, it could withdraw its European services. But this would seem incredible.

Others

Google’s behaviours have been investigated by competition protection agencies all over the world and actions are being taken — legal departments in a number of states in the US (including Texas, New York, California, Mississippi and Oklahoma) are investigating whether or not Google has abused its market power and controlled search results to the detriment of its competitors. The Anti-trust Authorities of South Korea is conducting investigations especially in the search engine of mobile phones and searched the office of Google in May 2012 for the second time. Other countries including Brazil, Argentina and India have also carried out investigations. As at the end of 2013, no action whatsoever has been taken by the Hong Kong government against Google.
### Case (d) “Abuse of Market Power” Case of Intel in the US (“Exclusionary Contract”)

<table>
<thead>
<tr>
<th>Background</th>
<th>Since 2000, there are only two major central processing unit (CPU) manufacturers in the market. Intel takes up 70% of the market share, while the other one is Advanced Micro Devices. Inc. (AMD). With a 70% market share, Intel obviously confirmed the condition of possessing market dominance as stated in Article 102 of TFEU. In Hong Kong, it falls within the definition of having “a substantial degree of market power” as prescribed in the “second conduct rule” of the <em>Competition Ordinance</em>.</th>
</tr>
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</table>
| Illegal conducts concerned | (1) Between 2002 to 2005, Intel offered Dell (a computer manufacturer) rebates on the condition that Dell would only purchase CPUs from Intel.  

(2) At the same time, Intel offered HP (a computer manufacturer) rebates on the conditions that HP would use Intel CPU products for at least 95% of its business computers and that the remaining 5% of HP computers using AMD CPUs could only be sold to small and medium enterprises by direct sales. |
(3) Its rebates to NEC (a computer manufacturer) were subject to the use of at least 80% of Intel products in NEC desktop and laptop computers.

(4) In 2007, special rebates were offered to Lenovo (a computer manufacturer) on the condition that Lenovo must use Intel products for all of its laptop computers.

(5) Intel paid Media Satum Holdings (MSH), the largest computer retailer in Europe, cash rebates, which required MSH to sell Intel-based PCs only.

(6) Intel paid cash to computer producers directly including HP, Acer, and Lenovo, and requested them to cease or postpone the use of CPU (X86) from its competitor, AMD, and restrict the sales channels of these computers.

<table>
<thead>
<tr>
<th>Justification</th>
<th>Intel justified itself by two reasons:</th>
</tr>
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<td></td>
<td>(1) rebates were offered in response to the competition in market price, and</td>
</tr>
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<td></td>
<td>(2) those arrangements were made to increase the efficiency of the CPU market and had mild influence on AMD.</td>
</tr>
</tbody>
</table>

| Verdict | These conditional rebate contracts made by Intel were “exclusionary contracts”, whose “effect” was to overtly eliminate the competition opportunities of its competitors. It would reduce the choices of consumers and hinder the motivation for product innovation. In fact, other competitors except AMD had been forced out of the market. |

| Results | Intel was fined €1.06 billion and was required to cease the relevant anti-competitive conducts. |
### Case (e) “Abuse of Market Power” Case of Microsoft in the US
“Tying” and “control of key technical information”

<table>
<thead>
<tr>
<th>Background</th>
<th>In 1998, Sun Microsystems, whose main products were workstations, servers and UNIX operating systems, lodged a complaint against Windows NT for not making available its interfaces to the public so that other software could operate.</th>
</tr>
</thead>
</table>
| Illegal conducts concerned | (1) During its investigation, the EU inspected Windows’ arrangements and technologies in integrating streaming media. The preliminary conclusion of EU was that the “media player” in Windows software was a “tying” which violated the “second conduct rule”.  
(2) By not making available the technical information of its servers, Microsoft also prevented other software companies from providing relevant competitive services. That also contravened the “second conduct rule”. (Microsoft controlled the key technologies in the upstream, resulting in an unfair prevention of competition in relevant downstream services.) |
In 2004, the EU ordered Microsoft to pay a fine of €497 million (equivalent to US$794 million) and make available its server information within 120 days so that other software providers could freely interact with Windows through desktop computers and the servers. Microsoft was also required to develop a package of Windows without the “media player” within 90 days.

Microsoft paid the fine, but criticized that what the EU had set a new interpretation of the law. Such a new standard had an adverse impact on the motivation of creativity by the enterprises with market power.

Microsoft provided the “source code” but no detailed specifications. At the same time, Microsoft produced a new Windows XPN with a different name.

In 2006, the EU further fined Microsoft €280 million (equivallent to US$448 million), and warned that if Microsoft failed to follow and comply with the instructions from the EU for improving competition, it would be fined additionally €3 million on a daily basis (US$4.81 million).

Microsoft lodged an appeal against the verdict, pointing out that the verdict made by the EU in 2004 was vague and the responsibilities of Microsoft would also change over time. At that time, the EU Competition Commission was chaired by a new president and she was in full support of opening the “standard” and “source code”.

(1) Microsoft’s appeal against the EU Competition Commission’s verdict in 2004 failed in September 2007. The president of the EU Competition Commission did not accept Microsoft’s arguments, and said that everything was crystal clear. She was surprised that Microsoft, a very large corporation, would have said that it did not understand what the EU Competition Commission would like it to do to improve competition.

(2) Microsoft had to pay the entire fine and 80% of the legal expenses. It decided to give up the further appeal.

(3) In February 2008, the EU further fined Microsoft €899 million (US$1.444 billion), which was the highest amount of anti-competitive fine for the time being since the last 50 years. Due to certain calculation issues, the fine was subsequently reduced by €400 million. The EU further fined Microsoft €561 million in 2013 to prevent Microsoft from making agreement with other companies to settle the disputes privately.
Case (f)  “Abuse of Market Power” Case of Safeway in Australia
(“compelling” suppliers to carry out “resale price maintenance”)

Between 1994 and 1995, Safeway Supermarket was the largest buyer of three bread suppliers (namely Tip Top, Buttercup and Sunicrust) in Victoria, Australia. Those bread suppliers also supplied bread to certain independent retail stores.

1) Should Safeway discover that independent retail stores sold the bread in discount, it would stop selling the bread, remove the relevant products from the shelf and refuse to buy bread again from those suppliers. However, when the discount offered by the retail stores was over, Safeway would resume its purchase of bread from those suppliers. In other words, Safeway compelled the three suppliers to carry out “resale price maintenance” (or known as “minimum retail price”). Otherwise, Safeway would take counter measures.

2) Upon receipt of the complaints and conducting the relevant investigations, the regulatory authorities under Australian competition laws took legal action against Safeway in 1996, suggesting that the company tried to entice the three bread suppliers into taking actions to prevent independent retail stores from offering discount. It was likely that Safeway had abused its market power.
(1) Safeway vigorously defended itself and won the first lawsuit. However, the appeal made by the regulatory authorities was subsequently allowed. After several rounds of confrontations, the case was not concluded until 2003. In the end, Safeway was heavily fined AUD8.9 million, which was the highest penalty for anti-competition cases in Australia at that time.

(2) The Court of Appeal was of the view that Safeway possessed strong market power in the local wholesale market of bread. As a result, it would be able to acquire certain terms and conditions which would have been impossible in a market of mature competition. For example, Safeway could always purchase the bread with the best prices. Such a power was based on the fact that Safeway was the largest buyer for the three bread suppliers.

(3) Given the over capacity of those suppliers, it implied that if Safeway reduced its purchase from them, they did not have other big buyers to “turn to”.

(4) Safeway only accounted for 16% of the local wholesale market share, but the court still considered that Safeway possessed strong market power.

(5) Verdict of the court was on the ground that Safeway would not have taken those measures if it did not consider it had the power to persuade the bread suppliers. Those measures in the long run would only reduce its total turnover, and hence its profit.

The key message of the case is that the lawsuit altogether lasted for 10 years. If it was a victory of the implementation of the Competition Law, it could only be a painful one. In fact, it is difficult to prosecute large enterprises for anti-competitive conducts because they have ample resources for lawsuits. It is also difficult to prove that large enterprises have “abused market power” for it must be shown that the relevant conducts have been to the detriment of suppliers, as well as consumers and competition.
Case (g) “Monopoly over Promethazine Hydrochloride” Case of Shandong Shuntong and Huaxin in the mainland ("Market monopoly", “monopolistic marking up the price”)

Background

Compound Reserpine is an anti-hypertensive drug listed on the national essential medicine list. At present, many hypertension patients depend on this medicine on a long-term basis, with an annual consumption of 8 to 9 billion pills. At that time, there were only two enterprises in the mainland which manufactured Promethazine Hydrochloride, the main raw material for the production of Compound Reserpine.

Illegal conducts concerned

(1) On 9 June 2011, Shandong Weifang Shuntong Pharmaceutical Co., Ltd. and Weifang Huaxin Medicine Trading Co., Ltd. entered into Product Sales Agency Agreements with two manufacturers of Promethazine Hydrochloride respectively, monopolizing the domestic sale of Promethazine Hydrochloride. The main contents of the agreements were:

(i) the two companies were exclusive domestic sales agents of Promethazine Hydrochloride for the two manufacturers; and

(ii) the two manufacturers could not supply goods to any third party without authorization from Shuntong and Huaxin.
(2) After the two companies controlled the source of the raw material, they raised the selling price from less than RMB200 per kilogram to RMB300 to 1,350 per kilogram. Many manufacturers of Compound Reserpine could not bear such higher prices and ceased their production in July 2011. There was then an acute shortage of supply of Compound Reseroinine in the market.

Verdict

(1) At the end of 2012, the National Development and Reform Commission conducted investigations against Shuntong and Huaxin in respect of their illegal control over the raw material of Compound Reserpine and raises in prices to make huge profits, resulting in the cease of production by the pharmaceutical companies. A severe punishment was eventually concluded.

(2) The National Development and Reform Commission emphasized that operators should strictly comply with, inter alia, the Anti-monopoly Law and the Price Law. They must not abuse their monopoly position to implement monopolistic pricing, exclude or restrict competition, or mark up the price for a huge profit to the prejudice of consumers.

(3) The National Development and Reform Commission confiscated Shuntong’s illegal income of RMB377,000 and imposed a fine of RMB6.5 million, in a total amount of RMB6.877 million. It also confiscated Huaxin’s illegal income of RMB52,600 and imposed a fine of RMB100,000, in a total amount of RMB152,600.

(4) In accordance with the Anti-monopoly Law, the National Development and Reform Commission ordered the two Shandong companies to stop the illegal conducts immediately and cancel their sales agreements with the two Promethazine Hydrochlorid manufacturers.
Case (h) “Monopoly over Ticket Sales” Case of SISTIC in Singapore (“Exclusionary contract”)

Background SISTIC monopolized over the “ticket sales” services with a market share of 85% to 95%. SISTIC is basically a governmental enterprise in Singapore. (65% owned by Singapore Sports Council, a government body, and 35% owned by the Esplanade Theatres which in turn is 100% owned by the Ministry of Information, Communication and the Arts.)

Illegal conducts concerned SISTIC entered into contracts with a total of 19 event organizers (including The Esplanade Co. Ltd and Singapore Sports Council), pursuant to which it had become the sole ticket sales company of all events. It meant that 60% to 70% of other ticket sales companies were excluded from the market.
| Verdict | (1) Upon investigations and economic analysis, the Competition Commission of Singapore considered that SISTIC should be punished for its contravention of the competition laws. A fine of S$989,000 was imposed, which was the highest penalty ever imposed on a single company by the Competition Commission of Singapore in history.  
(2) SISTIC was the first company which violated Section 47 (abuse of a dominant position) of the Competition Act in Singapore and received punishment from the Competition Commission in Singapore.  
(3) SISTIC had to revise the agreements to ensure that the terms requiring the appointment of SISTIC as the sole ticket agent were removed and measures were taken to prevent the same thing would happen again. |
**Case (i) “Abuse of Market Power” Case of TVB in Hong Kong**

(“Monopolization of artistes” and “exclusionary contract”)

**Background**

On 10 December 2009, ATV officially lodged a complaint with the Hong Kong Broadcasting Authority (the “Authority”, which officially became part of Communications Authority on 1 April 2012) against TVB, alleging that certain clauses in the TVB’s contracts with its artistes and singers and certain informal policies and business practices pursued by TVB violated the provisions concerning competition in Broadcasting Ordinance.

**Illegal conducts concerned**

Pursuant to Sections 13 and 14 of the Broadcasting Ordinance, Cap 562, ATV complained TVB for its monopolisation of artistes:

(i) Unilaterally extending the contracts of artistes;

(ii) Exclusive contracts with harsh and unreasonable terms;

(iii) Requiring film production companies that hired TVB artistes to undertake that the film would not be sold to other television (“TV”) broadcasters in Hong Kong;

(iv) Prohibiting artistes who worked in mainland-produced dramas from using their own voices and from attending promotions regarding the concerned dramas in Hong Kong;

(v) Prohibiting artistes on serial-based contracts with TVB from promoting productions of other TV stations which also featured the artistes concerned; and

(vi) Imposition of dialect restrictions on artistes.
Verdict

(1) After preliminary investigation in respect of the complaint, the Authority decided on 28 August 2010 to launch a full investigation into some of the contractual clauses and policies alleged in ATV’s complaint. The Authority also commissioned an economic consultant of the government to define the relevant markets and assess TVB’s market power and to develop an economic analysis framework to assess the effects of TVB’s conducts.

(2) The decision by the Authority in September 2013 suggested that TVB had committed an infringement of Sections 13(1) and 14(1) of the Broadcasting Ordinance by adopting the following practices during the period from 2007 to 2010:

(i) TVB prohibited artistes or singers who had “serial-based contracts”, “one-show contracts” or singer contracts, from or required such artistes or singers to seek consent from or “notify” TVB for, appearing on or providing services to other TV stations in Hong Kong.

(ii) TVB prohibited artistes who had “serial-based contracts”, “one-show contracts” from, or required such artistes to seek consent from TVB for, appearing on other TV stations in their original voices or attending promotional activities of other TV stations for TV programmes and drama productions featuring these artistes.

(iii) TVB required, formally or informally, its singers and artistes to refrain from speaking Cantonese on other TV stations in Hong Kong.

(3) The Authority was of the opinion that TVB’s various exclusive clauses: no original voice, no promotion and no Cantonese policies had the purpose and effect of preventing, distorting or substantially restricting competition in the relevant market by impairing rival TV stations’ ability to compete with it. It actually and potentially foreclosed rivals’ legitimate access to an essential input for TV programme production.

(4) Such foreclosure had produced and had the potential to continue to produce a significant detriment to TV viewers by causing a deterioration of quality of rivals’ programme offerings.

(5) Penalty – for the infringement referred to above, the Authority imposed a financial penalty of HK$900,000 on TVB. In setting this fine, the Authority had taken into account the submission of TVB, and the gravity of the violations in terms of both scope and duration.
(6) The Authority directed TVB under Section 16 of the Broadcasting Ordinance to bring to an end the infringement referred to above, and refrain from repeating or engaging in any act or conduct which had an equivalent purpose or effect to that referred to above.

| Justifications | TVB had been very cooperative in the Authority’s investigation;  
|                | ATV’s complaint was in absence of grounds. TVB found the Authority’s accusation disappointing, regretful and groundless;  
|                | TVB was the cradle for talents in the show business in Hong Kong and had cultivated thousands of popular singers and actors over the years, many of which had achieved international fame, winning glory for the Hong Kong people. Such an outstanding achievement was entirely based on the excellent artist policies and huge input of resources by TVB;  
|                | There were numerous artistes without contracts with TVB in the market. TVB’s artist policies, therefore, by no means had any impact on the operations of other TV stations or the overall development of the industry. |

| Others | Improvement measures – TVB has unilaterally taken measures to remove certain “exclusionary clauses” in its renewal contracts with singers and agreed not to enter into or renew one-show contracts with artistes. |
During the consultation process of the *Competition Ordinance*, what caused the most discussions and concerns from the public was that there are a lot of “exclusions and exemptions” in the Ordinance. Although there are similar cases for the same kind of ordinances abroad, it still, in no doubt, caused controversy, including the fact that the ordinance is not applicable to the government itself nor any statutory bodies and their activities for the reason that the activities organized by the public sector are non-economic by nature. An “exemption” means that a particular conduct is permitted and not subject to regulation upon application to the Competition Commission. An “exclusion” means that a particular conduct which would likely lead to potential infringement of the competition laws or involve mild effect is not subject to regulation.

In the competition laws in Hong Kong, certain “agreements” or institutions are granted “exemption” or “exclusion” in the following circumstances:

(i) The grant of an “exemption” on an “agreement” based on the ground of “economic benefits”;
(ii) The grant of an “exemption” to an “enterprise” based on the ground of “public interests”;
(iii) The “service of economic interests”
(iv) For public policy reasons
(v) The Ordinance is not applicable to the government or statutory bodies;

(Remarks: Please refer to Appendix-2 for the details of the “Exemptions” and “Exclusions” from the *Competition Ordinance* in Hong Kong.)
APPENDIX

Appendix 1

The Economic Theories and Empirical Study of the competition law

Appendix 1.1

“Perfect Competition” and “Welfare Loss” Theories are the Foundations of Competition Policies

Each and every country or region formulates its competition law against the particular social and political background of its own; yet it would rely on the same economic theories. The regulation of competition policy on corporate conducts falls within the scope of normative economics. The law enforcer should answer the question “how to enforce the law so as to achieve welfare maximization” based on economic analysis.

In the following sections, we will try to introduce in a comprehensive manner the economic theories and major international empirical studies in the formulation and enforcement of the competition laws so as to strengthen the understanding of this important piece of economic legislation. Although the introduction is not a complete academic exposition, we believe that it is sufficient for the teachers of the competition laws to master the economic theory foundation behind this complicated legislation.

Under the theoretical framework of classical economics, if the conditions or assumptions of “perfect competition” are fulfilled in all markets (including products and factors of production) and every producer and consumer in society adopts the decision of constrained maximization, at equilibrium, the entire society’s production will be able to achieve “production efficiency” with the lowest cost and “allocation efficiency” as well.

This “allocation efficiency” also meets the welfare criteria of Pareto Condition. (It is impossible to reallocate resources in society so that at least one single person is entitled to additional benefit without any prejudice to the vested interest of the other's). This is the ideal state in theory, but it does not really exist due to the many strict assumptions behind. As a result, it is also impossible for identification through observations. This is also one of the major practical difficulties in the implementation of competition policies and the reason why its implementation would definitely be questioned in many different aspects.

Consequently, “market failures” and a certain degree of production and allocation inefficiency will occur if the actual operation of a particular or a number of markets does not meet the conditions of “perfect competition”. If a substantial number of the markets in an economic system were not having “perfect competition”, “market failures” would prevail. In that case, a huge loss would be suffered by the entire society.
A market deviating from the ideal state of “perfect competition” is exactly what the decision-makers and economists need to ponder over: what content should be included in the competition laws and policies in order to drive the market towards or resume the ideal state to achieve “production and allocation efficiency”? (Bishop and Walker, 2002; Kerber and Schwalbe, 2007) Besides, “production efficiency” is only a necessary, rather than a sufficient condition, of “allocation efficiency”. To enhance the “production efficiency” within a market with “imperfect competition”, the purpose of competition laws should be enhancing the competitiveness of market, drawing on the inference that the fiercer the competition, the higher the “production efficiency”.

According to the theory of “perfect competition”, the implication for competition policies is simple and straightforward: the purpose of the competition law should be enhancing competition in each and every market within the economy in order to increase the “production efficiency” of the market, and subsequently improving the “allocation efficiency” of the overall resources. As a result, the implementation of competition laws and the verdicts from the court should be able to compel every enterprise to set a price close to the marginal cost in the market with “imperfect competition”. Meanwhile, such enterprises should also have motivations to optimize its cost structure on an ongoing basis to achieve the lowest cost and maximum profit.

The theory that monopolistic enterprises would lead to “welfare loss” was first reflected in the “deadweight loss” concept of traditional welfare economics. As a concept extended from traditional welfare economics, the “deadweight loss” is very easy to be inferred theoretically. It is, however, also based on many rigorous assumptions (Fan & Chong, 1992):

(i) All enterprises in the perfectly-competitive industry set the same price;
(ii) Monopolistic enterprises and enterprises in perfect competition face the same demand curve;
(iii) All enterprises aim at “profit maximization” in their operations;
(iv) The “marginal utility of income” of producers is the same as that of the consumers;
(v) The “cross elasticity of demand” between different products is zero.

Obviously, all such assumptions are not easy to be established. Economists have studied such assumptions on an ongoing basis and introduced more practical adjustments in order to induce a more accurate conclusion on different conditions.

Besides, the “production efficiency” and “allocation efficiency” are both concepts of “static analysis”. The main assumptions behind is that production technologies, income, preferences remain the same. However, when all factors keep changing, a dynamic theory is required to explain the actual changes in market competition.
Appendix 1.2
“Production Efficiency” and “Dynamic Efficiency” are Important Policy Considerations

The deduction that increasing competition is equivalent to enhancing efficiency faces new challenges, during all these years when every country has been promoting competition policies. Many conducts by enterprises, including various kinds of “vertical agreements” and “mergers and acquisitions” in the production chains, would probably lessen market competition, but the “production efficiency” is in fact enhanced.

Therefore, when the increase in competition trades off with the “production efficiency”, should competition or efficiency take the lead? If the “production efficiency” takes the lead, many “mergers and acquisitions” and “vertical agreements” should not be investigated or prohibited. Indeed, this is the point of view from the Chicago School.

Some economists (like Williamson, 1968) considered that monopolistic enterprises would achieve a lower production cost in the future as compared with the level achieved under current competition market due to “economies of scale” and active “R&D” efforts. This is called “dynamic efficiency”. In addition, upon mergers and acquisitions, the enterprises would possibly result in more efficient production and R&D activities to the relevant market. Since “technological innovation” is an important factor in enhancing long-term economic development, mergers and acquisitions may also promote “dynamic efficiency” (Aghion, Bloom, Blundell, Griffith and Howitt, 2005).

However, other scholars further elaborated on the theory that monopolistic enterprises would result in “deadweight loss”. For example, Leibenstein (1996) considered that when an enterprise monopolized over an industry, it might not have the motivation to retain the production cost at the lowest level due to the absence of pressure from rivals. This phenomenon is called “X-inefficiency”. Besides, as Posner (1975) suggested, monopolistic enterprises might offer bribes or take other economic measures (like expansion of production capacity and advertising) to secure or acquire its monopolistic position in the market, thus lessening its monopolistic profit. The costs incurred by this kind of “rent seeking” activities are also a kind of loss suffered by society.

The different analyses and conclusions by Leibenstein and Williamson both would require market information of the industry to verify the actual situation. Although the overall social welfare may be enhanced in a monopolistic market, it may also involve transferring a part of consumers’ benefits to manufacturers’ as the cost (due to the raise in prices), thus leading to the problem of how to protect consumers’ interests.
Under such circumstances, competition laws in all countries consider it as a serious crime for enterprises to undertake “collusion” among themselves to realize monopoly in the industry. It includes “collusion” agreements in terms of prices, quantities and market divisions. However, taking into account of “dynamic efficiency” and certain special economic situations, certain “exemption clauses” would be introduced for some of the “agreements” among firms, including:

(i) unifying specifications of goods to lower costs, improve quality or enhance efficiency;

(ii) conducting research and development of goods jointly to enhance technologies, improve quality, lower costs or enhance efficiency;

(iii) enhancing the operating efficiency or competitiveness of small and medium enterprises; and

(iv) enhancing the competitiveness of domestic enterprises in international trade.

In fact, competition is a dynamic process of “discovery” (Hayek, 1978), a process of discovering new technologies, new knowledge and new business models. Besides, according to the analysis by scholars in management science (Prahalad and Hamel, 1990), the basis of competitive advantage for an enterprise is its “core competence” which could turn its short-term advantage into a long-term one by sustainable development. Theories from neoclassical economics are yet to effectively integrate “technological innovation” with other relevant dynamic theories. On the other hand, “perfect competition” theory is only an operating model to analyse the market situation if there were infinite suppliers, rather than a complete theory explaining competition (Demestz, 1982).

Most economists would generally accept the objective that a competition policy should achieve both “static efficiency” and “dynamic efficiency”. However, there is no rigorous theoretical framework, similar to the theory of classical economics, supporting the policy objective of “dynamic efficiency”. It could only be considered as a subjective consensus among economists (Kerber and Schwalbe, 2007). Meanwhile, in the formulation of specific competition policies, the European Union explicitly stipulates diversified objectives for the definition of “effective competition”. It largely fulfils the theoretical criteria as well as the expectation of the consumers. However, in respect of a number of cases concluded earlier in Europe and the US, especially those involving “mergers and acquisitions”, the court had not given sufficient consideration to the long-term effect of “dynamic efficiency” at that time (Kirchner, 2007).
Appendix 1.3

“Total Social Welfare” versus “Consumer Welfare”

In the promotion of “anti-monopolistic” policies, “static efficiency” and “dynamic efficiency” should both be considered in order to enhance consumers’ interests. This is the policy objective receiving wider consensus. However, policies in respect of prohibiting the “abuse of market power” are still subject to greater doubts in the academic circle for the reason that they involve the “redistribution of benefits”.

Here, “total social welfare” in a particular market includes the welfare of both producers and consumers. So how this should be compared with “consumer welfare” alone (Crampton, 1994)? Contradictions will easily arise in making judgements (Neven and Roller, 2000; Williamson, 1968).

In an investigation on whether a certain “merger and acquisition” would affect consumers, it is only necessary for us to assess whether the prices of the products would increase or decline after the merger within a short time, if “consumer welfare” is used as the only benchmark. This, obviously, is not enough, because the newly merged enterprise may achieve a larger operation scale, more technological innovations, and better quality and diversity in its products over a period of time. Therefore, many economists consider that “total social welfare” should be considered as the objective of the implementation of competition laws (in which the interests of producers are included as well). The relevant “distributional effects” should then be dealt with by means of taxation and other social policies (Kaplow and Shavell, 1994).

Since the welfare principle of Pareto Condition is very rigorous, most public policies fail to meet such a standard. Therefore, another “principle of welfare maximization” which covers a larger scope, namely the Kaldor-Hicks Welfare Criterion, is suggested in welfare economics. The principle of “total social welfare”, which focuses on whether the relevant business conducts could bring more social welfare, has become an important foundation for reference by courts all over the world. In the further development of the theory, some scholars suggested that “consumer welfare” should be adopted in competition policies when daily necessities are involved. For cases involving non-daily necessities, “total social welfare” may be the major element of policy considerations (Kerber and Schwalbe, 2007).
Appendix 1.4

Competition Policies Evolving from “Structurist” to “Behaviourist”

The anti-monopoly law passed in 1890 in the US, the Sherman Act, affected the development of different industries directly. Based on the systematic studies on industries, American scholar, Mason, put forward the basic theory of “industrial organization” in 1939, which was further developed and made known by Bain (1959) and others, thus establishing the theoretical perspective of industrial Structurist. It is suggested that differences in market structures would determine conducts of enterprises in different industries, which would in turn reflect in the prices of products and eventually the overall performance of the industry. Its extended conclusion for the policy is: the key to the success of anti-monopoly policies is that the government should control the market structure of industries. This stance has been well supported by most American economists since 1950.

However, according to the recent theory proposed by the Behaviourists (the basic theoretical foundation was provided by studies of the Chicago School; please also refer to Kwoka and White (1998); Jolls, Sunstein and Thaler (1998); Tor (2002)), there are many reasons why monopolistic enterprises exist in the market and not all of them are required to be replaced for the reasons that: (i) it is probably the result of the long-term fierce competition in market; and (ii) only one player can be accommodated in a particular market which requires an investment of substantial fixed costs. The introduction of additional producers would only reduce cost efficiency of the entire industry, which is to the prejudice of consumers.

Behaviourists consider that if competition policies are focused on the control over market structure, as proposed by the “Structurist”, it would probably lower the “production efficiency” of enterprises and cause damages to the entire society. The appropriate concern is whether monopolistic enterprises have “abused market power” and thus resulted in unfair competition in the market to the prejudice of consumers. These monopolistic enterprises may adopt misconducts to “abuse market power”, including (Fan & Chong, 1992):

(i) if an monopolistic enterprise has a certain degree of “monopsony power”, it may impose “price squeezing” on upstream suppliers, which is unfair to other competitors;

(ii) if a monopolistic enterprise is a supplier and it imposes “price discrimination” on downstream buyers, it will constitute unfair competition against some buyers;

(iii) if a monopolistic enterprise is a supplier and it requires downstream buyers to buy products along with other products that they are not willing to buy (or other relevant products with stronger competitiveness and more choices), this kind of “tie-in sales and bundling” will unreasonably increase the operation costs of downstream buyers;
(iv) if a monopolistic enterprise is a supplier and it requires downstream retailers to carry out “retail price maintenance”, this will prevent the competition between downstream retailers;

(v) if a monopolistic enterprise is a supplier and it requires buyers to deal with it only but not with its competitors in the industry (“exclusionary clauses”), this will affect the operations of other competitors;

(vi) if a monopolistic enterprise is a supplier and it “refuses to sell” the goods to a certain downstream buyers without reasonable grounds, the normal operations of those downstream buyers will be adversely affected;

(vii) if a monopolistic enterprise adopts “predatory pricing” and set its selling prices lower than its average costs, or even lower than the average variable costs, its purpose and effect are to affect smaller-scaled competitors adversely or potential competitors who intend to enter the market;

(viii) if a monopolistic enterprise expands its production capacity, in order to prevent new competitors from entering the market; and

(ix) if an enterprise reduces its production output to raise prices, it is to the prejudice of consumers.

All in all, the Behaviourist considers that competition policies should make reasonable analysis or judgement based on whether or not the business conducts of certain monopolistic enterprises will lead to unfair competition in the market. Whether an enterprise has a monopolistic position shall not be used as the only ground for regulation and interference (which is the inference of the Structurist). In the implementation of competition laws and anti-monopoly laws by countries in Europe and the US, the application of “abusing market power” as the foundation of interference is reinforced. Law enforcement agencies will at first identify “market power” (firstly define the “market” and then assess the “market power” based on the “market share”); secondly, they will study and judge the casual effect of “abuse”.
Appendix 1.5
Definition of the “Relevant Market”

The definition of “relevant market” is also a key concept in the enforcement of competition policies. Such economic analyses are mainly based on the exposition of “market structure” put forward by classical economists: the scope of a market is not just limited to the physical venue where goods are exchanged, but also all the aspects where people and enterprises perform sales, purchase and exchange of the relevant goods. Therefore, many scholars agreed that the results of many cases in respect of “anti-monopoly” and “abuse of market power” would become apparent once the definition of “relevant market” had been finalized. The definition of “relevant market” is very complicated during the actual enforcement of the law and three major economic concepts are required to be established by empirical testing:

(I) the definition of “market for relevant product”:

(i) demand substitutability among relevant products (e.g. when we study whether there is a monopoly in the fresh beef market, we have to examine whether substitution in consumers’ choices exists among fresh beef, frozen fresh beef, fresh pork and frozen fresh pork.); and

(ii) supply substitutability among different suppliers (e.g. when we study whether large supermarkets monopolize the drinks of a certain brand, we have to examine the competition among other suppliers such as other small supermarkets, grocery stores and convenience stores.)

(II) the definition of “relevant geographic market”-- barriers, time, potential competition, product differentiation in transactions within different geographic districts.

“Relevant market” refers to a basket of goods which could be reasonably substituted from consumers’ point of view and supplied by all competing suppliers within a reasonable geographical context. In particular, when there is a small but significant and non-transitory increase in the price (5% to 10%, SSNIP) of the good concerned, consumers could make their choices among these alternative products and through other competing suppliers.

Under such a complicated concept, law enforcement agencies in every country have to devise a set of practical and transparent methods for enterprises to follow. For example, when the US Department of Justice investigates the “horizontal merger” of an enterprise, the definition of “relevant market” adopted is based on the following analytical framework (US Department of Justice and Federal Trade Commission, 2010). The Department of Justice will adopt a “hypothetical monopolist
test”, starting with the most important products concerned (e.g. in a merger case engaging two American airlines, the acquisition will mainly affect some short-distance point-to-point domestic flights, while their substitutes would include travels by train, bus and private car), followed by a gradual addition of certain quality substitutes as considered by consumers under the current prices. The second step is to assume that there is a small but significant and non-transitory increase in the prices of the products concerned and estimate how many consumers will choose other substitutes accordingly. Apart from making references to relevant international cases and economic theories, surveys on consumer behaviours will also be undertaken.

Should many consumers choose to leave and the enterprise concerned fails to make a profit from the increase in prices, it means the proposed market is too small. The Department of Justice will have to redefine the market scope, increase the number of substitutes and then repeat the above process. When most of the consumers do not choose other substitutes even though there is “a small but significant and non-transitory increase in the prices”, this basket of products will be considered as the products of the “relevant market”. As a result, the “market share” of the merged enterprise will be calculated based on the definition of the “relevant market”.

What is “a small but significant and non-transitory increase in prices”? The general definition given by the US Department of Justice refers to a 5% increase in the price of the product, which persists for a year. However, the scale and time of the increase in prices are subject to adjustments according to different nature of the industry in individual cases. Of course, if the relevant enterprise produces a basket of products, the aforesaid research will be extended to cover the more important products. It is not easy to evaluate consumers’ responses to changes in prices accurately, and the assessment of “relevant market” can only be an “approximation”.

This research and analytical framework of the “relevant market” does not only apply to cases of “merger and acquisition” in the US. It is also applied to other cases of “anti-monopoly” and “abuse of market power”. The basis for law enforcement in the European Union is more or less the same.
Appendix 1.6

Implications from the Chicago School on Competition Policies

Studies by the Chicago School mainly emphasized that “production efficiency” should be the only objective for competition policies. Under such a presumption, economists also pay great attention to the anti-competitive cases with possible erroneous judgement by the authorities or the courts and the social costs incurred. Rubin (1995) published a very important research in which he studied 23 very important cases on anti-competitive conducts which had been widely studied by economists. From the perspective of economic efficiency, less than 50% of the cases were correctly determined by the court. The remedial measures put forward by the courts upon these cases with “erroneous judgment” might be even worse. With such a performance and outcome of court decisions, many economists agreed that if no investigations and further legal actions were taken by the government in respect of all those cases, it might have brought greater total economic benefits to society.

Besides, in the consideration of Klein, Crawford and Alchian (1978), vertical integrations of enterprises and other long-term contracts formed in the market were only a reflection of different contractual contents and the relevant transaction costs involved in different enterprise structures. Furthermore, Manne (1965) held that mergers and acquisitions in the market were all about enterprises with high production efficiency acquiring those with lower production efficiency, aiming at creating more values and enhancing production efficiency. The development of these theories provides more diversified perspectives for analysis on the possible anti-competitive conducts involved in the mergers and acquisitions.

Therefore, when countries are reviewing important cases of mergers and acquisitions in recent years, the following factors are taken into consideration:

(i) whether the merger will eliminate competent competitors, resulting in seriously impact on competition;

(ii) the extent to which substitutes are available in the market;

(iii) the accessibility of market entry; and

(iv) the changes in innovation environment of the market.
In addition, Stigler (1971) conducted another enlightening study on the relationship between the regulator and the regulated. His conclusion was that the regulator would gradually be controlled by the regulated and the regulator’s policies would be affected by the regulated. This would further strengthen the interests and monopoly position of the regulated. Therefore, he questioned the effectiveness and necessity of regulations.

In the context of competition policies, the original purpose of regulation is to facilitate the effective operation of the market and protect consumers. The analysis of the Chicago School on “predatory pricing” and “retail price maintenance” has significant influence on the implementation of competition laws. They suggested that it would not be easy to prove that enterprises had adopted “predatory pricing” strategies from both theoretical imputation and analysis of actual cost data perspectives. In respect of the study on “retail price maintenance”, they even found that there were many causes leading to efficiency enhancement.

Everyone in society shows concerns about the operation of the “oligopolistic market”, as all enterprises are having the motivation to “collude” or establish a “cartel” in order to raise selling prices and divide the market among themselves. Yet free-market economists always emphasize that the cost of maintaining a “cartel” is substantial while new entrants can also challenge the existing alliances. Besides, members would also cheat against each other and the “cartel” could eventually collapse. Therefore, there is no need for the government to introduce legislation for prohibition. However, cases in the European Union, demonstrated that many “cartels” could be maintained for more than 10 years and their multi-nationality and comprehensiveness were shocking. There has been insufficient capability for automatic adjustment in the market. During this process, consumers and other manufacturers would have to suffer from substantial losses even if the “cartels” could collapse eventually. In a political environment where people have been increasingly demanding for economic justice, it is very important for the people to see that the government is willing to uphold justice.

In recent years, the European Union has strengthened the protection of consumers’ interests in its verdicts. As a result, the prohibition of the “cartels” and the “abuse of market power” are the primary objective of law enforcement. The “production efficiency”, which is emphasised by the Chicago School as the only benchmark for consideration in this kind of cases, has basically been replaced by more diversified policy objectives (Werden, 2004; Bishop and Walker, 2002; Lande, 1989).
Appendix 1.7
The Empirical Relationship Between Competition Policies and Economic Development

The Chicago School has been constantly challenging the implementation and decisions of competition laws. These economists considered that there had been serious deviations and errors, dubious results and contradictions in law enforcement. Their empirical studies have clarified a number of uncertain theories and led to new directions for certain policy implementations. These are of great significance and assist in the implementation of competition policies in every country. More importantly, “production efficiency” has evolved from a static consideration into a diversified dynamic concept, which is critically enlightening to European Union and the US in the decision on many important court cases.

With regard to the empirical study on “welfare loss”, since the “X-inefficiency” and “rent seeking” theories involved many technical issues. Most of the studies on monopolistic “welfare loss” were focused on the estimation of “deadweight loss” in the first stage. Unfortunately, the conclusions of all these studies were very different and their implications on policies are also ambiguous.

In recent years, the relationship between competition policies and economic performance has received increasing attention from governments in all countries. Therefore, the effectiveness of the implementation of competition laws is also the research subject of many economists and relevant authorities (Gal, 2004; Hylton and Deng, 2007; Nicholson, 2008).

Theoretically, the implementation of competition policies serves the purpose to improve the “production efficiency” and “consumer welfare” of the overall economy. Based on this argument, we could test if competition laws could influence the economic growth and employment in a country. The study by Crandall and Winston (2003) concluded that it could not be clearly proved that the various measures taken by the enforcement authorities of competition policies had direct contributions to economic growth. Besides, there were only vague conclusions suggested by other relevant studies (e.g. Aghion, Bloom, Blundell, Griffith and Howitt, 2005) on the relationship between competition laws and changes in productivity and price stability.

On the other hand, however, a number of new studies suggested that there was a high correlation between the implementation of competition laws and economic growth and total factor productivity (Dutz and Hayri, 2000; Borrell and Tolosa, 2002). In this regard, Sinderen and Kemp (2008) analysed the information collected in the Netherlands from 1998 to 2007. As a result of the implementation of competition policies by the government, it was estimated that the “consumer
welfare" had altogether increased by about €4.2 billion, the economic production increased by 0.5%, the employment rate increased by 0.4% and the productivity rose by 0.1%.

Although the study in the Netherlands only focused on a relatively small economy, the conclusion in a recent article by Ma (2010) was more enlightening. Based on the data from 101 countries with competition laws, it was revealed that the performance of competition laws in different countries had directly related to their stages of economic development. In developing countries, the ability of their competition laws to improve the economic situation was very limited if their overall institutional structures had been below certain level. Yet, there was, in fact, no definite positive or negative impact on promoting market competition.

For developed countries or moderately developed countries, the influence of competition laws on economic growth was subject to the “enforcement efficiency” of the relevant regulations by the governments if their overall institutional structures had exceeded certain level. In a country without sufficient “enforcement efficiency” on competition laws, a set of rigid competition laws might not only fail to promote productivity, but also weaken the drive for economic growth. On the contrary, for a country with good “enforcement efficiency”, its competition laws would have positive impacts on its economic growth and productivity.

Additionally, operation costs of the relevant enforcement agencies for competition laws are usually funded directly by the government and thus they are easy to be assessed. But the benefits of enforcement are difficult to be evaluated. Therefore, many countries have taken administrative measures in recent years to require an assessment on benefits brought by the enforcement of competition laws by relevant agencies. For example, the British government sets an objective on costs and benefits for the Office of Fair Trading: resulting benefits for consumers should be five times of the operation cost. This objective ensures that the tax payment from tax payers is utilized effectively, and it also serves as a management tool. However, the effectiveness of such a quantitative assessment on consumer benefits by relevant governmental departments has been questioned by many economists.
Appendix 1.8
Concluding Remarks

In economics, competition theories have been developed in various connotations. To what degree of competition should the *Competition Ordinance* achieve? It is basically a subjective decision made by the government on behalf of the people. The competition law involves enormous economic interests. Its enforcement should take into the account of the political and social aspiration of the people and encounter many theoretical and operational uncertainties. A competition law that can fulfil both social and economic needs should address the following four questions:

(i) What degree of “static efficiency” and “dynamic efficiency” would the competition policy aim to achieve?

(ii) What would be the cost involved for the competition policy to protect “consumers’ interests”?

(iii) What extent of protection would the competition policy provide so that small and medium enterprises are prevented from unfair treatment by large enterprises?

(iv) How much “total social welfare” would the competition policy be willing to give up, in order to reduce the “benefits redistribution” caused by an “abuse of market power”?

Since economic theories fail to provide precise and objective standards, it is difficult to assess clearly the extent of which a monopoly would affect prices and its competitors, and that should be considered as illegal by law. Therefore, when the court relies on economic theory to analyze monopolistic conducts and market power, it has to establish a basis for objective decisions of its own. Unless the court could accurately estimate the “efficiency loss” and use it as the decision standard, otherwise the court’s rationales and decisions would be constantly questioned by economists.
Appendix 2

Details of “Exemptions” and “Exclusions” from the *Competition Ordinance*

The Chief Executive in Council may, by order published in the Gazette, exempt a particular class of conduct from the application of the “first conduct rule” or the “second conduct rule”, if the Chief Executive is satisfied that there are exceptional and compelling reasons of public policy for doing so. Additional conditions and limitations may be attached to the exemption order. It is not explicitly prescribed in the Ordinance that under what circumstances should the Chief Executive exercise the power of exemption, because after all it is a discretion to be exercised in exceptional circumstances. Based on international experience, it may include the “acquisition agreement” between banks during financial crisis.

The Chief Executive may also grant exemption in order to avoid a conflict with an international obligation. This may involve civil aviation agreements and other provisional agreements or international arrangements referred to in the *Basic Law*.

Apart from individual activities, in whole or in part, that should be regulated as explicitly prescribed by the Chief Executive in Council, all “statutory bodies” are not regulated by the major conduct rules of the *Competition Ordinance*. “Statutory bodies” mean bodies of persons, corporate or unincorporated, established or constituted by or under an ordinance or appointed under an ordinance. At present, the government only places 6 out of 581 statutory bodies in Hong Kong under the regulation of the *Competition Ordinance*. There is still no answer to the timeframe on the revision of the relevant regulation scope by the government.

There are also similar situations abroad that similar law is not applicable to the government. The statutory or governmental services included refer to transportation, water supplies, power supply or postal services. During the consultation of legislation, the reason given by the government was that relatively fewer services are provided by the public sectors in Hong Kong. For the non-commercial services provided by the government, an “exemption” is reasonable. However, the grounds for an exemption from competition are relatively weak if the government is also engaged in commercial activities.
Appendix 2.1

“Exemptions”

(a) *The application of the “block exemption” orders as prescribed in Section 15 of the Competition Ordinance:*

(i) If the Commission is satisfied that a particular category of “agreement” is an excluded agreement, it may issue a “block exemption” order in respect of that category of agreement.

(ii) The Commission may, either of its own volition or on application by an “undertaking” or an “association of undertakings”, issue a “block exemption” order.

(iii) The Commission may, in a “block exemption” order, impose conditions or limitations subject to which the block exemption order is to have effect; and specify a date from which the order is to cease to have effect.

(iv) The Competition Commission must specify in the block exemption order a date, being a date not more than 5 years after the date of the order (the “later date”), upon which it will commence a review of the block exemption order.

(v) In this section, an “excluded agreement” means an agreement that is excluded from the application of the “first conduct rule” by or as a result of Section 1 (Agreements enhancing overall economic efficiency) of Schedule 1.

(b) *The “exemptions” on “public policy grounds” as prescribed in Section 31 of the Competition Ordinance:*

The Chief Executive in Council may, by order published in the Gazette, exempt a particular “agreement” or a particular class of agreement from the application of the “first conduct rule”, or a “conduct” or a class of conduct from the application of the “second conduct rule”, if the Chief Executive is satisfied that there are exceptional and compelling reasons of “public policy” for doing so.

(c) *The “exemption” to avoid conflict with “international obligations” as prescribed in Section 32 of the Competition Ordinance:*

The Chief Executive in Council may, by order published in the Gazette, exempt a particular “agreement or a particular class of agreement from the application of the “first conduct rule” or the “second conduct rule”, if he or she would like to avoid a conflict with an “international obligation that directly or indirectly relates to Hong Kong.
An “international obligations” includes an obligation under:

(i) an air service agreement or a provisional agreement referred to in Article 133 of the *Basic Law*;

(ii) an international arrangement relating to civil aviation; and

(iii) any agreement, provisional arrangement or international arrangement designated as an international agreement, international provisional arrangement or international arrangement by the Chief Executive in Council by order published in the Gazette.
Appendix 2.2
“Exclusions”

(a) The “exclusion” conditions referred to in Schedule 1 as prescribed in Section 30 of the Competition Ordinance

Subject to the “exclusion” conditions referred to in Schedule 1 as prescribed in Section 30 of the Competition Ordinance, the “conduct rules” do not apply in any of the relevant “agreements”. The general “exclusions” from “conduct rules” apply to those “agreements” enhancing overall economic efficiency. The basic principles for granting the “exclusion” are that such “agreement”:

(i) contributes to improving production or distribution, while allowing consumers a fair share of the resulting benefit; or

(ii) contributes to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit; and

(iii) does not afford the undertakings concerned the possibility of eliminating a substantial part of the market competition.

Furthermore, neither the “first conduct rule” nor the “second conduct rule” applies to an “undertaking” entrusted by the government with operation of services of general economic interest in so far as the “conduct rule” would obstruct the performance, in law or in fact, of the particular tasks assigned to it.

(b) Protection for small and medium enterprises

It is apparent that only large enterprises or even multinational enterprises with money and power are able to monopolize the market through “agreements”. As a result, the targets for protection under the ordinances in every country are small and medium enterprises. Even though small and medium enterprises intend to enter into a certain “agreements” which are to the detriment of the market in definition, the negative effect of those “agreements” on competition is rather insignificant since they only take up a fairly small market share.

In this regard, the Competition Ordinance also set out provisions (the general “exemptions” from the “first conduct rule” in (Schedule 1) to lessen the concerns from small and medium enterprises. An agreement between “undertakings” would be “exempted” if the combined “turnover” of the “undertakings” for the turnover period does not exceed HK$200,000,000 (paragraph 5). It does not, however, apply to an “agreement” involving hardcore conducts which include controlling prices, bid-rigging, distributing market, restricting production. In addition, the “second conduct rule” does not apply to conducts engaged in by an “undertaking” if the “turnover” of which does not exceed $40,000,000 (paragraph 6).
Appendix 3

Functions and Powers of the Competition Commission

The Competition Commission (the “Commission”) is the “statutory body” responsible for the enforcement of unfair competition provisions in the Competition Ordinance, and its power and scope of work are regulated by law. The Commission is not a servant or agent of the government and does not enjoy any status, immunity or privilege of the government. The Commission can be considered as an independent body such as the Securities and Futures Commission.

In respect of the arrangement under the law, the Commission has a two-tier structure in which the decision-making level is appointed by the Chief Executive with 5 to 16 members, including the chairperson. Below this committee, there is another level. The administrative affairs of the Commission are led by the Chief Executive Officer, who is appointed by the Commission with the approval of the Chief Executive. The Commission is regulated by the Prevention of Bribery Ordinance and the Ombudsman Ordinance and is subject to the value for money audit by the Director of Audit.

Appendix 3.1

“Statutory Functions” of the Competition Commission

Under Section 130 of the Competition Ordinance, the Commission has the following “statutory functions”:

(i) to investigate conduct that may contravene the competition rules and enforce the provisions of the Ordinance;

(ii) to promote public understanding of the value of competition and how the Ordinance promotes competition;

(iii) to promote the adoption by undertakings of appropriate internal controls and risk management systems, to ensure their compliance with the Ordinance;

(iv) to advise the government on matters affecting competition in markets in Hong Kong; and

(v) to promote research into the market, and study legal and economic policies to promote the development in strengthening competition in Hong Kong.
Appendix 3.2
“Statutory Powers” of the Commission

Under Section 131 of the *Competition Ordinance*, the Commission has the following “statutory powers”:

(i) to make, give effect to, assign, vary or rescind any agreement or accept the assignment of any agreement;

(ii) to receive and spend money;

(iii) to borrow money with the approval of the Financial Secretary;

(iv) to invest funds of the Commission that are not immediately required, in a manner approved by the Financial Secretary; and

(v) to become a member or affiliate of any international body, whose functions or objects include the promotion of competition or competition law, with the approval of the Chief Executive.
Appendix 3.3

The Commission’s Power to Conduct Investigations

Under Section 39 of the Ordinance, the Commission has the power to conduct investigations. The Commission may conduct an investigation into any conduct that constitutes or may constitute a contravention of a competition rule of its own volition; or where it has received a complaint; or where the Court of First Instance or the Tribunal has referred any conduct to it for investigation; or where the government has referred any conduct to it for investigation. The Commission may only conduct an investigation provided that it has reasonable cause to suspect that a contravention of a competition rule has taken place, is taking place or is about to take place.

The Commission also has strong power to conduct investigations and law enforcements. It is entitled to require the relevant person to produce to it any document and information and attend before it (under Sections 41 and 42 of the Ordinance). Upon receiving a warrant from the Court of First Instance, the Commission may enter and search any premises and detain any evidence and possession (under Section 48). It is only required by the Ordinance that there are “reasonable grounds” for the Commission to suspect that a contravention of a competition rules has taken place, are taking place or is about to take place.

On the other hand, a person who, without reasonable excuse, fails to comply with the investigation power of the Commission or obstructs the investigation of the Commission (under Section 54), or refuses to cooperate with the Commission, is liable to a criminal punishment (under Section 52). If a person provides false or misleading documents or information when he/she is required to produce such documents (under Section 55), or intentionally or recklessly destroys or otherwise disposes of it, falsifies it or conceals it; or causes or permits its destruction, disposal, falsification or concealment, the person is liable to a fine of HK$1,000,000 and to imprisonment for 2 years (under Section 53). In this regard, the Commission’s power to conduct investigations is comparable with that of the Securities and Futures Commission or even that of the Independent Commission against Corruption.
Appendix 3.4
Infringement Notices

After the completion of a particular investigation but before the legal procedures commence in the “Tribunal”, the Commission may issue an “infringement notice” to the person in contravention of the rules, requiring him/her to give up certain anti-competition conducts in return of a termination of the Commission’s investigation and legal procedures. This is the power to make reconciliation and avoid proceedings.

Appendix 3.5
Leniency Agreements

The Ordinance reserves certain power for the Commission not to enforce the rules under certain circumstances. Of course, the exercise of this kind of power is conducive to the spirit of the Ordinance to combat unfair competitive conducts, but it will also bring out other problems.

When the Commission is exercising its mandatory enforcement power (including investigations on the crimes and search for evidence), it may accept from the person concerned a commitment to take any action or refrain from taking any action that the Commission considers appropriate to address its concerns about a possible contravention of competition rules, and make a “leniency agreement” based on the commitment. Thereafter, the Commission may agree not to commence or even terminate an investigation, or if the investigation is completed, not to bring proceedings in the “Tribunal” or, if it has brought proceedings, to terminate them.

Under Section 80 of the Ordinance, the Commission may, in exchange for a person’s cooperation with the Commission in an investigation or in other legal proceedings under the Ordinance, make a “leniency agreement” with the person, on the terms it considers appropriate, that it will not bring or continue legal proceedings against him/her. Both of the Commission and the leniencee may terminate a leniency agreement.

The Commission must not, while a leniency agreement is in force, bring or continue proceedings for a pecuniary penalty. This kind of “leniency agreement” is applied in exchange for the cooperation of such person or undertaking with the Commission in an investigation or in legal proceedings under the Ordinance.
The Ordinance (i.e. Section 81) stipulates that the Commission may terminate a leniency agreement under the following situations:

(i) the other party to the agreement agrees to the termination;

(ii) it has reasonable grounds to suspect that the information on which it based its decision to make the agreement was incomplete, false or misleading in a material particular;

(iii) the other party to the agreement has been convicted of an offence for failure to cooperate in the complaint or the investigation; or

(iv) the other party to the agreement has failed to comply with the terms of the agreement.

Before terminating the agreement, the Commission is required to give the other party to the agreement or to any other person who appears to be likely benefit from the agreement an opportunity to make a representation for its consideration.

This kind of arrangement about special power empowers the Commission a dual functions of law enforcement and juridical functions. This can increase the flexibility of its enforcement on and dealing with competition matters, the system of which is similar to that of the European and American countries. There exists numerous international precedents and experience for reference. On the other hand, the problem in Hong Kong lies in the absence of a system to supervise the Commission to ensure its fairness, transparency and independence.
Appendix 3.6

Competition Tribunal

Apart from the establishment of the Competition Commission which is responsible for the enforcement of the Ordinance, the Ordinance also set up a Competition Tribunal (the “Tribunal”) under the Judiciary, which is responsible for the overall “review” of the decisions made by the Commission. The Tribunal is “a superior court of record” at a level equivalent to the Court of First Instance of the High Court. The Tribunal consists of the judges of the Court of First Instance appointed in accordance with the High Court Ordinance. On the other hand, a “private action” is heard by the Tribunal, while the application for the fine imposed is raised by the Commission and reviewed by the Tribunal. Being the same as other orders, it forms the pattern of “judicial enforcement” where the Commission and the Tribunal are interdependent on each other.

Members of the Tribunal can be divided into “judicial” members with judicial experience, taken up by judges or former judges, and “non-judicial” members with expertise in economics, business or competition laws. The Tribunal is chaired by a judicial member. Judicial members are recommended by the Chief Justice of the Court of Final Appeal and appointed by the Chief Executive, while the non-judicial members are simply appointed by the Chief Executive. The Tribunal will carry out the “review” hearing in form of a panel instead of a court. Each panel consists of three members, with one judicial member appointed as the president and the addition of at least one non judicial member with expertise in economics.

The power enforcement of the Tribunal is not bound by the general rule of evidence in the court, so that it can conduct hearings in a simple and convenient way to increase its efficiency. The Tribunal is responsible for “reviewing” the cases based on the evidence submitted by the Commission, and it also has the power to take over new evidence. The Tribunal has the right to suspend the effect of the Commission’s decision before making its determination based on the “review”. If a party is not satisfied with the decision of the Tribunal, it can file an appeal to the court of appeal, but the appeal is limited to on points of law and the punishment imposed.

“Reviewable determination” is specified in the Ordinance, including a decision regarding the “first conduct rule” and the “second conduct rule” made by the Commission and its rescission, the variation, replacement or revocation of a commitment made by the Commission, a decision relating to the termination of a “leniency agreement” made by the Commission and a decision relating to a “proposed merger” made by the Commission. An application for review by the Tribunal must first made with the leave of the Tribunal, provided that the Tribunal is satisfied that the “review” has a
reasonable prospect of success, or there is some other reason in the interests of justice why the “review” should be heard. The “review” must be proposed within 30 days upon the decision of the Commission is made.

Both the Commission and Tribunal have the right not to accept unreasonable cases. That is a response to the concerns from small and medium enterprises for fear that large enterprises will casually make use of the Competition Law to take unnecessary legal actions against the trade practices of small and medium enterprises. According to the government, small and medium enterprises are seldom the enforcement object of the regulatory agencies in overseas law enforcement, and the government promises to appoint experienced members from small and medium enterprises to the Commission to ensure that their operations are free of unreasonable judicial interference. All in all, the Commission plays the lead and the Tribunal serves a supervisory function by “reviews”.
Appendix 3.7

Fine

Under Division 2, Part 6 of the Ordinance:

(i) If, after carrying out such investigation as it considers appropriate, the Commission considers
it appropriate to do so, it may apply to the Tribunal for a “fine” to be imposed on any person it
has reasonable cause to believe has contravened a competition rule; or has been involved in
a contravention of a competition rule.

(ii) If the Tribunal is satisfied, on application by the Commission, that a person has contravened
or been involved in a contravention of a competition rule, it may order that person to pay the
government a “fine” of any amount it considers appropriate.

In determining the amount of the “fine”, the Tribunal must have regard to the following factors:

(i) the nature and extent of the conduct that constitutes the contravention;

(ii) the loss or damage caused by the conduct;

(iii) the circumstance in which the conduct took place; and

(iv) whether the “undertaking” has previously contravened the *Competition Ordinance*.

The amount of a “fine” imposed in relation to conduct that constitutes a single contravention may
not exceed in total 10% of the “turnover” (i.e. the total gross revenues obtained in Hong Kong)
of the “undertaking” concerned for each “year” (i.e. a financial year) in which the contravention
occurred; or if the contravention occurred in more than three “years”, 10% of the “turnover” of the
“undertaking” concerned for the 3 “years” in which the contravention occurred that saw the highest,
second highest and third highest “turnover”.
Appendix 3.8
Follow-on Right of Action

Under the “follow-on right of action” in Section 110 of the Ordinance, a person who has suffered loss or damage as a result of any act that has been determined to be a contravention of a conduct rule has a right of action under this section against any person who has contravened or is contravening the rule; and any person who is, or has been, involved in that contravention. Unless otherwise specified in Section 113, a claim to which this section applies may only be made in proceedings brought in the Tribunal. On the other hand, like other civil proceedings with time limitations, a “follow-on action” should be brought within 3 years after the Tribunal or appellate proceedings are completed.
Appendix 4

Mergers and Acquisitions (Applicable to the Telecommunications Industry only)

Appendix 4.1

Provisions of the Ordinance

Merger rules are formulated by the Competition Ordinance to regulate the third category of important conducts, “mergers and acquisitions”. “Mergers and acquisitions” under the Ordinance is only applicable to the telecommunications industry at present.

In Hong Kong, provisions have already been imposed to regulate unfair competition in individual industries. The “first conduct rule” and the “second conduct rule” have appeared in the Telecommunications Ordinance and Broadcasting Ordinance. In 2013, TVB was determined as “abusing market power” based on the Broadcasting Ordinance.

Theoretically speaking, the Competition Commission can replace the existing Office of the Communications Authority (Office of the Telecommunications Authority and Broadcasting Authority were merged in 2012). Yet, the Office of the Communications Authority has accumulated a considerable amount of experience and expertise in the regulation of the industry. As a result, the Competition Ordinance makes an arrangement of “concurrent jurisdiction”, which means that in the enforcement of the Ordinance, the Competition Commission has “concurrent jurisdiction” with another regulator and both authorities can proceed with law enforcement. In the actual situation, the Competition Commission and the Office of the Communications Authority have prepared and signed a memorandum of understanding to specify the working relationship of each other.

Schedule 7 in the Ordinance establishes a merger rule for a “carrier license” (a “carrier” within the meaning of the Telecommunications Ordinance). This Schedule applies to a merger when the arrangements for the creation of the merger take place in or outside Hong Kong, the merger takes place outside Hong Kong, or any party involved in the merger is outside Hong Kong. The rule prohibits any merger with the effect of “substantially lessening competition”, which is focused on the specific “effect”. An undertaking must not directly or indirectly carry out a merger that has such an effect.
Under the Ordinance, there are a number of factors to be considered in determining whether a merger has the effect of “substantially lessening competition”:

(i) the extent of competition from competitors outside Hong Kong;
(ii) whether the acquired undertaking has failed or is likely to fail in the near future;
(iii) the extent to which substitutes are available in the market;
(iv) the existence and difficulties of any barriers to market entry;
(v) whether the “merger” would result in the removal of an effective and vigorous competitor;
(vi) the degree of countervailing power in the market; and
(vii) the nature and extent of change and innovation in the market.
### Appendix 4.2

#### Case Study

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<tr>
<th>Case</th>
<th>“Merger” of Three Giant Telecommunication Corporations in Europe</th>
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<td><strong>Background</strong></td>
<td>Three giant telecommunication corporations in Europe are all with solid background. Founded in 1924, Telefonica is the fifth largest fixed network and mobile telecommunications operator with operations all over the world and a shareholding of 9.6% in the China Unicom last year. Vodafone is one of the major multinational mobile phone and communication network corporations in the world with investments in 27 countries and cooperation with local mobile communication operators. Everything Everywhere (EE) is the largest mobile network operator in the UK with a client base of 280,000 and its holding companies are Deutsche Telekom and Orange.</td>
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<td><strong>Conducts</strong></td>
<td>The three corporations decided to set up a joint venture and launch a comprehensive promotion of 4G telecommunications services in the UK upon the approval of the European Union. Telefonica and Vodafone had received approval from the Office of Fair Trading earlier for cooperation in network engineering which was target to provide 2G and 3G telephone services for 98% of the British population. Vodafone had been providing express 4G telephone services in London free of charges.</td>
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<td><strong>Process</strong></td>
<td>The European Commission conducted investigation in accordance with “merger rules” because mobile commerce was an emerging business model and would possibly bring fundamental changes in consumers’ purchasing habits. Upon preliminary investigation, the European Commission was of the view that there was potential competition issue and commenced an in-depth investigation in April 2012.</td>
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| **Verdict** | The conclusion from the European Commission was that the alliance between the three corporations was unlikely to constitute apparent obstruction to market competition and it was in compliance with the “merger rules”. The reasons for the approval were:  

(i) Mobile commerce (including wholesale, retail, advertising or information analysis) was a recent development in mobile phone as a commercial platform, in which many enterprises were interested in joining and had developed different technologies for it. The joint venture would not prevent the other competitors from development. |
(ii) There had already been many competitors in the market and the same kind of services had been developing. Some of them had accumulated substantial market capacity and experience in serving consumers. Many consumers were also experienced in online payment. The European Commission did not consider that the joint venture of the three corporations would increase the difficulties for new competitors to enter the market. The new company could not obstruct innovations and the mobile commerce market would develop in a more creative manner.

(iii) The European Commission discovered in its investigation that different modes of payment had already existed and new modes were appearing. Some of them depended on the application of a SIM card in mobile phones to store user information, such as bank accounts. The use of such a mode would sometimes rely on service providers, such as the systems of the three corporations. However, other modes did not depend on this technology, and thus it is impossible for the merger of the three corporations to technically prevent the use and development of other modes. For example, credit card had never relied on the use of a SIM card.

Others

The merger of the three giant telecommunication corporations was finally approved by the European Commission in September 2012. The joint venture aims at clearing the existing obstacles in mobile phone online payment. Upon the merger, a single mobile payment system will be set up to allow commercial activities be conducted by mobile phones.
REFERENCES


The Competition Ordinance in Hong Kong