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BY FAX & BY POST

Economic Development Branch (Division A),
Economic Development and Labour Bureau,
2/F, Main Wing, Central Government Offices,
Lower Albert Road,
Central, Hong Kong.
(By fax to: 2868 4679)

Dear Sir,

Competition Law for Hong Kong

In response to the Economic Development and Labour Bureau's public discussion document of November 2006, please find attached Cathay Pacific Airways' reply to the "20 Key Questions" posed by the document.

Cathay Pacific Airways is supportive of the Government's initiative of introducing a competition law in Hong Kong and welcomes the opportunity to express opinion on the adoption and implementation of Hong Kong's competition policy.

The formulation of a Competition Law is a notable milestone for Hong Kong and its structure and method of introduction are of the highest importance. It stands to benefit Hong Kong's economy and world standing when drafted to address the characteristics of Hong Kong's economy but, equally, the drafting must be at pains to avoid placing unnecessary burden on the economy which is itself the lifeblood of Hong Kong's success.

I trust Cathay Pacific's response will provide helpful guidance in this regard.

Yours faithfully,



PHILIP N L CHEN

“Promoting Competition – Maintaining our Economic Drive”

Response from Cathay Pacific Airways to the Economic Development and Labour Bureau’s Public Discussion Document of November 2006.

Cathay Pacific Airways Limited welcomes both the Hong Kong Government’s publication of its public discussion document on the way forward for competition policy in Hong Kong and the opportunity to express our opinion on the adoption and implementation of Hong Kong’s competition policy. Please find below Cathay Pacific’s response to the “20 Key Questions” posed by the discussion document.

The need for a New Competition Law - Considerations

1 Does Hong Kong need a competition law?

Cathay Pacific believes that the introduction of a competition law in Hong Kong would benefit Hong Kong’s economy. As Asia’s World City, Hong Kong should maintain its rank within the international community by maintaining a modern and fair economy where internationally accepted standards of competition are clearly seen to apply. Open trade and competition are already part of Hong Kong’s economy and the introduction of a competition law would be a natural fit for Hong Kong.

2 Should any new competition law extend to all sectors of the economy, or should it only target a limited number of sectors, leaving the remaining sectors purely to administrative oversight?

Cathay Pacific is in favour of a cross-sector competition law embracing Hong Kong’s economic activity as a whole. This would allow a level-playing field across all sectors of the economy and make enforcement of competition policy coherent and transparent. Since antitrust principles are very flexible in their application, any industry-specific idiosyncrasies can be properly handled by the competition authority in the exercise of its discretionary powers. For similar reasons, Cathay Pacific also favours the implementation of a single test that would apply to all economic sectors.

Cathay Pacific’s opinion is that consistency in the application and enforcement of competition law across all economic sectors in Hong Kong would give the law greater legitimacy as it could not be challenged or undermined by any other sector-specific concerns or interests.

Moreover, a sector-specific competition law could potentially be too narrow in its application and thus create situations whereby companies with cross-sector activities would be unable to assess whether or not competition law applies to their activities. Business activities evolve quickly and too narrow a scope of application of the law would create a lack of flexibility and so lead to legal uncertainty.

This would mean in practice that all sectors (including the telecommunications and broadcasting sectors) would be subject to one and the same competition law and be

governed by one common regulator. This is dealt with in more detail under question 14 below.

3 Should the scope of any new competition law cover only specific types of anti-competitive conduct, or should it also include the regulation of market structures, including monopolies and mergers and acquisitions?

Cathay Pacific strongly believes in fair competition. Fair competition does not mean equality in outcome, but rather for the best and most agile companies to provide quality services at the best price. It is a natural consequence of fair competition that some markets are characterized by a high degree of concentration. In order to ensure a general understanding of this phenomenon, the Government's literature on competition would be well served to explain this point.

Cathay Pacific's position is that merger control rules should not be introduced. Specific merger control rules constitute an unnecessary burden on business given that merged firms remain subject to the rules prohibiting abuses of dominance and restrictive practices.

Cathay Pacific's experience with merger control rules is that they impose a significant burden on businesses which is not warranted by such rules' intended benefits. The burden includes: significant resources devoted to providing market information to the competition authorities; delays in closing the transaction pending merger review; legal fees; regulatory fees; etc. Cathay Pacific believes that in most instances merger control rules are but another tax on mergers. It is Cathay Pacific's understanding that in countries that have merger clearance mechanisms, the overwhelming majority of notified cases are cleared unconditionally.

If at some point in the future a merger control regime is to be considered, Cathay Pacific advocates a "light touch" approach that would limit the burden imposed on the parties. The rules applied by the United Kingdom's antitrust authorities provide a good model. The model involves a voluntary notification system, whereby parties may choose to notify their transactions if they meet reasonably defined thresholds. Parties remain free to close the transaction pending merger review. The information required by the authority must be limited to what is strictly required for the purpose of assessment of the transaction: primarily market information and data on the parties' respective positions on the relevant markets.

In keeping with modern economic principles, competition authorities should recognize the benefits of economies of scope and scale, and only be concerned with possible effects on buyers and suppliers. The aim of competition law is to protect the proper functioning of the market, not to protect competitors from more efficient firms.

4 Should a new competition law define in detail the specific types of anti-competitive conduct to be covered, or should it simply set out a general prohibition against anti-competitive conduct with examples of such conduct?

Companies should have a clear understanding of the specific types of conduct that are prohibited and a list of offences would provide legal certainty. However, having a defined list of specific offences may have a straight-jacket effect leading to artificial legal constructions, and would result in inflexibility in antitrust enforcement. In Cathay Pacific's view, a proper way of ensuring legal certainty while retaining flexibility would be to adopt in the law a general behavioural standard accompanied by a list of examples of anti-competitive conduct. This would be supplemented by an obligation for the competition regulator to adopt guidelines setting out in detail its enforcement policy as regards the types of prohibited conduct, the type and extent of effects such conduct must have on the market to be prohibited, market definition methodology, etc. In addition, Cathay Pacific expects the future authority in its guidelines to recognize that industry cooperation may have significant pro-competitive effects and benefits to the economy. For example in the airline industry cooperation is essential on a number of issues for the smooth and safe transfer of passengers from one airline to another as part of their journey.

It is essential that legal certainty and enforcement clarity be achieved before the entry into force of any competition law. This will be achieved by the issuance of guidelines but also through education of the entire community including business and the enforcement authorities. In this regard it is noteworthy that the Singapore competition authorities first conducted an extensive education programme for businesses before the entry into force of their competition act.

5 Should a new competition law aim to address only the seven types of conduct identified by the CPRC, or should additional types of conduct also be included, and should the legislation be supported by the issue of guidelines by the regulatory authority?

See answer to question 4 above.

6 In determining whether a particular anti-competitive conduct constitutes an infringement of the competition law, should the "purpose" or "effect" of the conduct in question be taken into account? Or should such conduct on its own be regarded as sufficient in determining that an infringement has taken place?

In Cathay Pacific's experience, many competition authorities have distinguished between "*per se*" offences of the conduct on its own which do not require that an effect be shown on the market, from "*rule of reason*"-type offences where an effect must be shown. The "*per se*" model may be suitable for jurisdictions that have had competition laws for a long time as an established body of cases provides clarity of interpretation. However, in Hong Kong this is not the case and leaving this decision to the competition regulator would lead to uncertainties in Hong Kong. Moreover, "*per se*" offences are no longer in line with modern economic thinking which advocates an effects-based antitrust enforcement. As a result, Cathay Pacific would suggest that a demonstration of restrictive effects on the market be a requirement for all competition law infringements, as Cathay Pacific understands is the case in Canada.

This question leads to another issue that has not been discussed at great length in the consultation paper: the need to assess conduct on a properly defined market. Market definition is an essential part of competition law enforcement, which should already be addressed at this early stage. In particular in view of Hong Kong's small geographic footprint, it is essential to recognize that many markets will have a geographic scope extending beyond the territory of Hong Kong. For example, Cathay Pacific's experience is that there is intense competition amongst airlines flying from and to airports in the greater Pearl River Delta region and not just from Hong Kong International Airport. Cathay Pacific's experience is in line with the practice of foreign antitrust authorities around the world: air cargo transport markets are typically regarded as extending to entire continents; passenger air transport markets have consistently been defined as extending to nearby airports. It would therefore not be consistent with international competition law practice to reduce the scope of air transport markets to the Hong Kong territory.

A consequence of the proper assessment of market definition is that the authority should be able to control the behaviour of all players affecting a market that includes the Hong Kong territory. Certain behaviour outside of Hong Kong may have effects in the Hong Kong territory, and the authority should be vested with the appropriate powers to address these issues, in cooperation with foreign authorities.

7 Should any new competition law allow for exclusions or exemptions from the application of some or all aspects of the law, and if so, in what circumstances should such exemptions apply?

Cathay Pacific believes that the use of exemptions is an essential tool which allows for some flexibility in the enforcement of competition law. Exempting general economic sectors would have the same downsides as sector-specific antitrust rules and should thus be avoided. However, competition authorities in Hong Kong should be empowered to grant exemptions from the application of the prohibition on restrictive practices when the benefits to Hong Kong's economy and Hong Kong's consumers of certain business arrangements outweigh the negative consequences of their restrictive effects.

In the interest of legal certainty, Cathay Pacific would support the possibility of applying for an exemption. This practice is widely used in other jurisdictions where the relevant authority adopts detailed guidance in the form of guidelines or "block exemptions", with the possibility to apply for individual exemptions in some cases. The relevant authority would also have the power to exempt individual behaviour on their own initiative when reviewing individual cases.

Concerning the factors to be taken into account when assessing whether to grant an exemption, Cathay Pacific recommends referring to the variety of tests in foreign antitrust rules, which all relate directly or indirectly to the public interest. The authority usually assesses whether a specific type of agreement, which restricts competition, is outweighed by the benefits it brings, usually to the general interest of consumers or customers. This for example, is the case for codeshare agreements between airlines: these agreements may sometimes have elements of restriction, but

competition authorities typically recognize that their benefits for the travelling public (increased connectivity and other efficiencies) outweigh any restrictive effects.

The question of exemptions also leads to the issue of whether competition law should apply to public bodies, which is not discussed in the consultation paper. In Cathay Pacific's experience, antitrust law provisions worldwide apply only to economic operators, be they privately owned or state enterprises. They do not apply to Government actions where Government is acting as a Sovereign body pursuing the public interest. To Cathay Pacific's knowledge, no current antitrust statute constrains the acts of Government acting in the public interest. In many countries the Government, as a sovereign body, can adopt laws and regulations that have competition distorting effects without these being subject to the competition laws. Hong Kong's competition law should ensure that the Government remains able to use other tools of economic regulation where it sees fit. This is particularly important in economic sectors where the Hong Kong SAR is bound by international obligations, such as those deriving from Bilateral Air Services Agreements concluded with many countries.

Finally, in line with international standards, Cathay Pacific favours the adoption of either a "de minimis" rule or an exemption whereby any activity in a market that does not represent "a substantial part" of the national market should not be subject to competition law. This avoids imposing an unnecessary burden on small enterprises whose activities are limited to small markets.

8 Which would be most suitable of the three principal options set out in Chapter 4 for a regulatory framework for the enforcement of any new competition law for Hong Kong? The options are -

- **Option One: A single authority with power to investigate and adjudicate**
- **Option Two: Separation of enforcement and adjudication**
- **Option Three: Adjudication by a specialist tribunal**

Cathay Pacific favours a dual structure regulatory framework and would therefore favour option two, but wishes to stress that both parts of the authority should adhere to the principles of legal certainty and clarity.

9 Regardless of the option you may prefer, should the regulator be self standing or should a two-tier structure be adopted, whereby a full-time executive is put under the supervision of a management board made up of individuals appointed from different sectors of the community?

Cathay Pacific supports the appointment of an independent regulator.

Enforcement and other Regulatory Issues

- 10 In order to help minimise trivial, frivolous or malicious complaints, should any new competition law provide that only the regulatory authority has the power to conduct formal investigations into possible anti-competitive conduct?**

Cathay Pacific favours the approach under which only the regulatory authority has the power to conduct formal investigations into possible anti-competitive conduct. This would allow a uniform application of the law. Companies under investigation would deal with only one authority and with only one set of rules.

- 11 What formal powers of investigation should a regulatory authority have under any new competition law?**

Cathay Pacific is of the opinion that the regulatory authority should have the powers of investigation that are in line with international standards of competition legislation, including those listed in the discussion paper. Cathay Pacific's position is that the regulatory authority should issue guidelines explaining such powers to companies which are likely to be affected by them (description of the powers it has, when and how they can be used, the extent of each power and the procedure that must be followed). Further, and importantly, a proper mechanism of checks and balances must be established to control the use made by the authority of its investigation powers.

- 12 Should failure to co-operate with formal investigations by the regulatory authority be made a criminal offence?**

Failure to co-operate with formal investigations by the regulatory authority should not be made a criminal offence. Criminal sanctions are typically reserved for the most unacceptable forms of social behaviour and thus civil rather than criminal sanctions would be more appropriate.

- 13 How might a competition regulatory authority deal with the disclosure of information that comes to its knowledge having regard to the need to protect various categories of confidential information on the one hand, and the need to make appropriate disclosure in order to take forward an investigation when the circumstances so require?**

Cathay Pacific is of the opinion that the regulatory authority should deal with the disclosure of information in line with international practice. Other major competition regimes (such as in the United States, the countries of the European Union and in Singapore) all recognise the fact that the information provided to the regulator should be protected by appropriate confidentiality provisions. During investigations, companies should be made aware of the extent to which they may be able to prevent the disclosure of their documents (for example on grounds of legal professional privilege or because they contain commercially sensitive information). Confidential information should otherwise only be disclosed with the agreement of the relevant company.

14 Should the existing sector specific regulators that also have a competition role continue to play such a role if a cross-sector competition regulatory authority were to be established?

As explained above, Cathay Pacific is of the opinion that there should be only one competition regulator. However, the experience and insights into the Hong Kong economy and the application of competition law gained by the telecommunications and the broadcasting authorities could be kept by integrating their staff currently dealing with competition law within the new competition authority.

15 Should breaches of any new competition law be considered civil or criminal infringements? What levels of penalty would be suitable?

Cathay Pacific's position is that there should be no criminal sanctions for infringement of competition law. Civil sanctions such as fines should initially be moderate until companies become accustomed to the new law.

16 Should any new competition law include a leniency programme?

Cathay Pacific is in favour of a leniency programme as this would increase the flexibility of the law.

17 Should any new competition regulator be empowered to issue orders to "cease and desist" from anti-competitive conduct?

Cathay Pacific believes that empowering the competition regulator to issue "cease and desist" orders would create an effective anti-trust enforcement. Ordering to cease and desist from anti-competitive conduct should in Cathay Pacific's view be the first step before any sanctions would be applied.

18 As an alternative to formal proceedings, might any new competition regulator have the authority to reach a binding settlement with parties suspected of anti-competitive conduct?

As explained above, Cathay Pacific favours flexibility in enforcement. Settlement procedures appear to be a flexible and efficient way of putting anti-competitive conduct to an end.

However, this would raise further issues such as the legal value of settlement and other such decisions (whether they are binding, whether they can be appealed etc). This would need to be further explained in order to provide legal certainty.

19 Should any new competition law allow parties to make civil claims for damages arising from anti-competitive conduct by another party?

It is generally accepted under tort law that a party which suffers damages as a result of violation of statutory provisions can claim remedies in compensation for the harm suffered provided specific conditions are fulfilled. Cathay Pacific therefore believes that the possibility to make such claims already exists under general tort law.

In Cathay Pacific's view it would not be appropriate to introduce special remedies over and above those that may already exist.

20 How should any new competition law address the concerns that our businesses, especially our SMEs, may face an onerous legal burden as a result of such civil claims?

Cathay Pacific's position, as explained in question 7, is that it favours the adoption of either a "*de minimis*" rule whereby agreements between small and medium undertakings which do not entail an appreciable restriction of competition would not be subject to competition law unless specific conditions are met. Cathay Pacific also favours the adoption of a statutory test exempting in effect any activity in a market which does not represent "a substantial part" of the national market.

Cathay Pacific Airways Limited
5th February 2007