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BRIEFING

HONG KONG COMPETITION ORDINANCE JANUARY 2015

- THE ORDINANCE WAS PASSED IN JUNE 2012, BUT WAS ONLY PARTIALLY IMPLEMENTED IN JANUARY 2013
- SINCE THEN THE HONG KONG COMPETITION COMMISSION AND THE COMPETITION TRIBUNAL HAVE BEEN ESTABLISHED AND THE COMMISSION HAS ISSUED ITS GUIDELINES
- THE DRAFT GUIDELINES WERE PUBLISHED BY THE COMMISSION ON 9 OCTOBER 2014. THEY REPRESENT THE LAST STEP BEFORE FULL IMPLEMENTATION OF THE ORDINANCE
- WITH THE IMMINENT PROSPECT OF THE ORDINANCE COMING FULLY INTO FORCE, NOW IS THE TIME TO REVIEW AND, IF NECESSARY, AMEND PRACTICES TO ENSURE COMPLIANCE



INTRODUCTION

The Competition Ordinance ("**Ordinance**") has been a long time coming to Hong Kong (a possible competition law was mooted as early as 1997). But now, following the issue of recent guidelines, we are approaching the Ordinance's full implementation. The Ordinance was passed in June 2012, but was only partially implemented in January 2013 in order to allow the establishment of the Hong Kong Competition Commission ("**Commission**") and the Competition Tribunal ("**Tribunal**"), and for the Commission to then issue its guidelines.

Having made good progress in the recruitment and formation of the Commission, the draft guidelines ("**Guidelines**") were published by the Commission on 9 October 2014. These Guidelines represent the last step before full implementation of the Ordinance.

The Ordinance

In summary, the Ordinance prohibits three forms of behaviour and imposes three rules (the "**Rules**") intended to prevent and discourage anti-competitive conduct:

- Agreements between undertakings that have the object or effect of preventing, restricting or distorting competition in Hong Kong are prohibited ("**First Conduct Rule**");

"THE ORDINANCE PROHIBITS THREE FORMS OF BEHAVIOUR AND IMPOSES THREE RULES INTENDED TO PREVENT AND DISCOURAGE ANTI-COMPETITIVE CONDUCT."

“THE ORDINANCE HAS EXTRA-TERRITORIAL APPLICATION INSOFAR AS AGREEMENTS AND CONDUCT WHICH TAKE PLACE OUTSIDE HONG KONG, BUT WHICH HAVE THE OBJECT OR EFFECT OF PREVENTING, RESTRICTING OR DISTORTING COMPETITION IN HONG KONG, ARE CAUGHT BY THE ORDINANCE.”

- Undertakings with a substantial degree of market power must not abuse that power by engaging in conduct which have the object or effect of preventing, restricting competition in Hong Kong;
- Mergers that have or are likely to have the effect of substantially reducing competition in Hong Kong can be blocked (“**Merger Rule**”, which currently only applies to the telecommunications sector)¹.

Each of these Rules is subject to a number of exclusions and exemptions. For example, the Second Conduct Rule does not apply to undertakings whose annual turnover is below HKD40 million. There is also a more general "efficiency exclusion" which excludes from the scope of the First Conduct Rule any agreement which, in the opinion of the Commission, enhances overall economic efficiency in Hong Kong.

The Ordinance has extra-territorial application insofar as agreements and conduct which take place outside Hong Kong, but which have the object or effect of preventing, restricting or distorting competition in Hong Kong, are caught by the Ordinance.

The Commission and Tribunal

As noted, the Commission and Tribunal have now been established. The role of the Commission to date has been to issue the Guidelines, but, following full implementation of the Ordinance, it will be responsible for investigating and bringing enforcement actions before the Tribunal. The Communications Authority and the Commission have concurrent jurisdiction for the investigation of the First and the Second Conduct Rule in the telecommunications sector.

The Tribunal will adjudicate on competition cases brought by the Commission or via private actions. It will have wide powers to impose a range of sanctions including financial penalties, prohibitions, director disqualifications, damages and other orders.

Guidelines

The six Guidelines issued by the Commission are listed below. The first three relate to the Ordinance's substantive rules:

- Guideline on the First Conduct Rule;
- Guideline on the Second Conduct Rule;
- Guideline on the Merger Rule;

And the remaining three address the procedural rules:

- Guideline on Complaints;
- Guideline on Investigations;
- Guideline on Applications for Decisions, Exclusions, Exemptions and Block Exemption Orders.

The Competition Commission has indicated that final Guidelines will be subject to consultation with the Legislative Council ('**Legco**'). The Commission aims to complete all preparation work by the first half of 2015. Once the final Guidelines are adopted, a date will be set by the Government for full implementation of the Ordinance.

¹ For the time being, the Merger Rule is to apply only to merger activity in the telecommunications sector, i.e. holders of carrier licenses under the Telecommunications Ordinance.

“THE DRAFT GUIDELINES ARE EXTENSIVE AND INCLUDE A WIDE RANGE OF USEFUL EXAMPLES ILLUSTRATING WHAT WILL BE (AND WHAT WILL NOT BE) CONSIDERED ANTI-COMPETITIVE CONDUCT.”

The draft Guidelines are extensive and include a wide range of useful examples illustrating what will be (and what will not be) considered anti-competitive conduct. The Guidelines provide insight as to the Commission's interpretation of the Ordinance and how its future enforcement model will take shape. The Guidelines clearly draw on precedents from other jurisdictions, in particular UK and European Union competition law concepts, as is evident when comparing the Guidelines with the EU guidance on horizontal agreements, concerted practices and information exchanges, considered in more detail below.

The Guidelines have not set out developed guidance on the Commission's leniency policy, nor on the application of the Ordinance to small and medium sized enterprises ("SMEs"). However, they do indicate that the Commission intends to do so in the future – further clarification in these areas will be welcomed, as the exclusion for undertakings whose annual turnover is below HKD40 million only applies to the Second Conduct Rule.

Points to Note in the Guidelines

Vertical agreements

It had been expected by many that an exclusion for vertical agreements (agreements between undertakings operating at different levels of the supply chain – for instance a distributor and retailer) might be introduced. It is now clear from the Guidelines that vertical agreements are also caught by the First Conduct Rule.

The Guidelines give resale price maintenance ("RPM") as the key example of the type of clause that would be found to render vertical agreements anti-competitive. RPM allows a supplier or distributor to set a minimum price on a product that retailers must observe when selling it. Examples of how RPM may restrict competition would be by (1) facilitating coordination between competing suppliers (through enhanced price transparency), (2) by undermining suppliers' incentives to lower prices to distributors and (3) by limiting "intra-brand" price competition. The Commission has indicated that it may treat RPM as "Serious Anti-Competitive Conduct", which in practical terms means that the Commission is not required to issue a warning notice before bringing proceedings for breach of the Ordinance. This is a harder stance than expected by many retailers in Hong Kong, so it is likely that objections to this have been raised during the consultation period.

It is worth noting that in Singapore, vertical arrangements are generally exempt from the application of the competition laws.

The Commission will permit the setting of recommended or maximum resale prices provided these are not combined with measures that mean that the maximum resale price is, in reality, a fixed or minimum price (and so will be treated by the Commission as RPM). Whilst it looks like the Commission will exercise some flexibility (especially where it can be shown that such agreements enhance overall economic efficiencies (the general exemption)) and examine instances of RPM on a case-by-case basis, this will raise some concern in the retail sector, as such agreements are not uncommon in Hong Kong.

In addition, exclusive distribution and customer allocation agreements are also permitted, again, provided these do not result in anti-competitive effects.

Concerted practices

The First Conduct Rule applies to agreements and "concerted practices", however, it does not define this term. The Guidelines assist here, and define a concerted practice as a form of cooperation, falling short of an agreement, where

undertakings knowingly substitute practical cooperation for the risks of competition.

The Guidelines specify that "undertakings are precluded from any direct or indirect contact with other undertakings, where the object or effect of that contact is to influence the conduct on the market of an actual or potential competitor, or to disclose to such a competitor the course of conduct which they have decided to adopt or contemplate adopting in the market." In practice of course there is a difficult distinction to draw here between a concerted practice, as defined, and market participants adapting themselves to the existing or anticipated conduct of competitors (so called 'parallel behaviour', which is permitted), a strategy often synonymous with a well-functioning competitive market. The Commission would need to be satisfied that the pre-meditated object or effect of such a concerted practice was to manipulate the market.

Associations

Trade associations, cooperatives and associations are commonplace in Hong Kong. For the purposes of the Ordinance, a "decision" of an association can be captured under the First Conduct Rule. A "decision" in this context is defined widely, and examples given in the Guidelines include the rules or constitution of an association or rulings of the management committee. In fact, the Guidelines go further and advise that a decision can be a breach of the Ordinance where it reflects an association's objective intention to coordinate the conduct of its members in the market in accordance with the terms of the recommendation. The Guidelines state that there will still be a breach even where such a decision is non-binding on the association's members, and even if the association's members have not complied with that decision. Membership of associations and certification given by associations is also addressed in the Guidelines: In essence, where membership of an association (and so the ability to state that the undertaking is certified by that association) can be seen as an essential pre-condition for competing in a market, exclusion from membership can significantly impact an undertaking's effectiveness as a competitor and, therefore, will be seen as anti-competitive.

Exchange of Information

The Guidelines state that the Commission will consider exchanges of information between competitors on future prices and quantities as having the object of restricting competition. The Commission's view is that the exchange of information might be used to facilitate a cartel.

The Guidelines also confirm that even an indirect exchange of information between competitors via a third party supplier or distributor "conduit" can breach the First Conduct Rule. This is the phenomenon known in competition law as "hub and spoke" agreements, where the competitors may pass on information to, for example, a common supplier, in the knowledge that the information will then be passed on to their competitors, effectively leading to horizontal coordination via a third party.

Standard terms

Standard terms relating to the supply of products are common, for example in the insurance and banking sectors. However, standard terms relating to price can harm price competition where those terms become an industry standard. In addition, standard terms which define the nature, or relate to the scope, of the product could result in limiting product variety and innovation – again, that could then be seen as anti-competitive by the Commission, depending on the circumstances.

“...THERE IS A DIFFICULT DISTINCTION TO DRAW HERE BETWEEN A CONCERTED PRACTICE, AS DEFINED, AND MARKET PARTICIPANTS ADAPTING THEMSELVES TO THE EXISTING OR ANTICIPATED CONDUCT OF COMPETITORS...”

The Guidelines note that, as a general rule, standard terms which do not affect price are unlikely to raise concerns under the First Conduct Rule so long as participation in the process for adopting the terms is open and the standard terms are non-binding and accessible to all market participants.

Significant market power

The Second Conduct Rule prohibits "abusive" behaviour by undertakings with a substantial degree of market power. The Guidelines state that undertakings are more likely to be considered as holding a substantial degree of market power where they are in a position to be able to manipulate prices in the market for sustained periods without damaging their profits, a commonly held conception of market power. The Guidelines also state that undertakings are more likely to have a substantial degree of market power where they also have a high market share.

Whilst the Guidelines give suggested methods of calculating market share (defining the relevant market by incorporating factors such as product and geographic market boundaries), they fall short of giving an indication of what constitutes a high market share.

This has been an interesting area to observe during the development of the Ordinance. It had previously been suggested that a level of 25% and above would be sufficient to warrant an investigation in a smaller market such as Hong Kong. Looking at other jurisdictions for guidance:

“WHILST THE GUIDELINES GIVE SUGGESTED METHODS OF CALCULATING MARKET SHARE ... THEY FALL SHORT OF GIVING AN INDICATION OF WHAT CONSTITUTES A HIGH MARKET SHARE.”

- in the EU, an undertaking with a market share of 50% and above is presumed dominant (this presumption is rebuttable);
- in Singapore, the threshold is 60% and above;
- mainland China also adopts a 50% and above level for presumed market dominance.

Further, it is interesting to note that the Guideline on the Merger Rule gives a figure of 40% as a level below which no further investigation will typically be necessary (see further below).

The approach in the Guideline for the Second Conduct Rule is an unexpected departure and will be an area to watch, both in the final Guidelines and as the first investigations by the Commission are made.

Merger Rule

For the time being, the Merger Rule only applies to the telecommunications industry and, as such, prohibits any merger by holders of telecommunications carrier licences under the Telecommunications Ordinance that has, or is likely to have, the effect of substantially lessening competition in Hong Kong. As in Singapore, merger notification is voluntary and businesses need to self-assess against the possible risk of an order to undo a merger at a later stage. Notification is to be made to the Commission. It is expected that the Commission will cooperate with the Communications Authority, given the Authority's experience in this sector.

The Guideline on the Merger Rule sets out: the scope of the Merger Rule; an assessment of the competitive effects of a proposed merger; the Commission's explanation of exclusion and exemptions from the Merger Rule; and other processes and enforcement procedures.

Of note is the fact that the Commission considers that where the merged entity has a market share of less than 40% and the post-merger combined market share of the top largest firms is less than 75% it will take the view that it is unlikely that

there will be a need to take further action (which, in fact, confirms the position previously adopted by the Telecommunications Authority).

Procedure

The procedural Guidelines elaborate on how the complaints, decisions, block exemptions and investigations regimes will operate.

One important area to note is that the Guidelines allow the Commission to adopt block exemption orders and also to consider applications for a decision conferring immunity from action under the First or Second Conduct Rule, as applicable. However, the Commission is only required to consider an application under certain circumstances, including where the application poses novel or unresolved questions of wider importance or public interest in relation to the application of exclusions of exemptions under the Ordinance. The Guidelines do not, however, provide assistance on what "novel or unresolved questions of wider importance or public interest" might include.

Further guidance is expected in relation to the Commission's leniency policy, its enforcement priorities and the application of the Ordinance to SMEs.

Conclusions

The detailed Guidelines shed light on how the Commission will interpret and apply the Ordinance upon its expected entry into force this year. Further guidance is expected, specifically in relation to leniency and the application of the Rules to SMEs.

As to the efficiency exclusion (the Guidelines refer frequently to "efficiency"), experience from other jurisdictions suggests that there will be relatively few cases where conduct is found to be anti-competitive per se and therefore prohibited as in many instances the conduct can escape sanction on the grounds of a resulting economic efficiency.

The Commission has been consistent in its expectation that businesses operating in Hong Kong should make all necessary preparations for implementation of the Ordinance. With the imminent prospect of the Ordinance coming fully into force, now is the time to review and, if necessary, amend practices to ensure compliance (if this exercise has not been conducted already).

“THE DETAILED GUIDELINES SHED LIGHT ON HOW THE COMMISSION WILL INTERPRET AND APPLY THE ORDINANCE UPON ITS EXPECTED ENTRY INTO FORCE THIS YEAR.”

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