



Hong Kong's first economy-wide competition law: A review of the law and challenges ahead

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INTRODUCTION

Traditionally seen as averse to regulation, perhaps best exemplified by the maxim “small government, big market,” Hong Kong has finally joined the growing ranks of Asian jurisdictions that formally regulate competition across all sectors of the economy. After two rounds of heated public consultations and a long legislative passage, Hong Kong’s first economy-wide competition law, the Competition Bill (“the Bill”), was formally signed into law, on June 21, 2012.

The Competition Ordinance (“the Ordinance”) imposes behavioral competition law provisions and prohibits anti-competitive conduct by multiple undertakings and unilateral anti-competitive conduct by a single undertaking. The merger control regime will remain confined to transactions involving telecommunications carrier licensees for now, although it is anticipated that the merger control regime may be extended in a few years. A Competition Commission (“the Commission”) equipped with investigatory powers will shortly be established, while adjudicatory powers will be vested in a specialist Competition Tribunal (“the Tribunal”). The Ordinance is expected to come into effect in one to two years’ time, while the Commission and the Tribunal will be constituted well before then to begin the substantial amount of preparatory work necessary to enforce the Ordinance.

This article will examine the key provisions of the Ordinance, the extent to which aspects of its implementation are unclear, and consider the challenges with enforcing the law.

CONTEXT UNDER WHICH THE ORDINANCE WAS ADOPTED

The Hong Kong regulatory context in which the Ordinance was adopted is significant for practical as well as academic reasons. It informs us on the manner in which the Ordinance will likely be interpreted, as well as the enforcement priorities of the Commission.

Hong Kong has largely been a laissez-faire economy that emphasizes introducing rules that allow free entry of goods and services; the origin of such free trade principles can be traced back to its origin on the world map as a trading port. Since the 1970s, focus gradually began to shift on transforming the city-state into a financial center, and after the handover to China in 1997, Hong Kong’s eyes quickly focused on becoming the gateway to China. Despite these changing policy objectives, Hong Kong has consistently focused on making it an attractive place to do business by passing laws and policies that allow ease of cross-border trading, as

exemplified by the lack of foreign investment restrictions and low corporate and personal taxes. Laws and regulations were introduced to facilitate these objectives, and to ensure the integrity of the financial and banking systems.

It was not until 1995 that the issue of Hong Kong's domestic competition policy first came to bear, when the last Governor of Hong Kong, Chris Patten, asked his business council to consider the issue of a competition policy for Hong Kong. This resulted in the establishment of the Competition Policy Advisory Group ("Compag") in 1997, an independent statutory body whose role is to investigate alleged anti-competitive conduct. Compag has proven to be largely ineffective as it has no legal powers of enforcement.

Separately, in the context of the Government's continuing bid to deregulate the telecommunications market, competition provisions were introduced in the telecommunications and broadcasting sectors in 2000. These sectoral rules were administered by the Telecommunications Authority and the Broadcasting Authority, with the former having accumulated a body of case law and issued guidance on the manner in which these rules are to be enforced.

Momentum continued to gather for a general, economy-wide competition law for Hong Kong. This culminated in two rounds of well-participated public consultations in 2006 and 2008, with the Competition Bill being introduced into the Legislative Council for deliberations in 2010 and its final adoption in June 2012, just a few weeks before the Bill would have lapsed.

The slow and deliberate manner in which Hong Kong's competition policy evolved may suggest a degree of reticence on the part of the public and certain parts of the Government about a competition law that applies to the entire domestic economy. The public debate that took place during the public consultations as well as during the legislative passage of the Bill clearly unveiled anxiety in the business community about a general competition law. Such concerns resulted in a number of special features of the Ordinance, like the introduction of certain turnover-based exemptions for small and medium sized enterprises ("SMEs") who lobbied against the Ordinance. In addition, private enforcement is now limited to follow-on actions (private actions for damages that require a prior regulatory infringement decision) and stand-alone private actions are not permitted. As a further concession, the merger control regime will regulate only transactions involving telecommunications carrier licensees.

It remains to be seen whether the Commission's enforcement approach will reflect the more conservative approaches taken by the government. The recent change of the government (the new Chief Executive, C.Y. Leung, was only sworn in on July 1, 2012), whose election campaign was largely focused on grassroots issues such as the availability of supply of public housing, suggests increased support for a more active enforcement regime than would have been the case under the previous government led by Donald Tsang, himself a tycoon.

CONDUCT PROHIBITED BY THE COMPETITION BILL

Despite the quirks of the new law, the Ordinance has adopted the internationally prevalent "three pillar" model of competition law and introduces the following three prohibitions: (a) the First Conduct Rule, which is concerned with anti-competitive conduct involving two or more separate undertakings; (b) the Second Conduct Rule, which is concerned with anti-competitive conduct of a single firm that abuses its "substantial degree of market power"; and (c) the Merger Rule, which seeks to regulate transactions that involve telecommunications carrier licensees.

The First Conduct Rule: Prohibition of Multi-party Agreements, Concerted Practices and Decisions

The First Conduct Rule is concerned with multi-party agreements, concerted practices and decisions that have the object or effect of preventing, restricting or distorting competition in Hong Kong. The First Conduct Rule is largely in line with the equivalent prohibition against anti-competitive agreements such as the Article 101 prohibition under the TFEU. There are some key elements to note:

The First Conduct Rule applies to "undertakings," defined as "any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity, and includes a natural person engaged in economic activity." The key phrase "economic activity" is elaborated on in draft papers issued by the government during the legislative process that was compiled to show the Bills committee (the LegCo body responsible for scrutinizing the bill) what may be included in the regulatory guidance that the Commission is required to issue. In these LegCo Draft Guidelines, references to "economic activity" is elaborated as "any activity consisting in offering goods or services on a market and which could, at least in principle, be carried on to make profits." This term seems to encompass all businesses and business people.

Such a definition of “undertakings” is very much consistent with international norms. The notion of undertakings is also consistent with the basis on which the Government has introduced exclusions from application of the Ordinance for certain statutory bodies. Statutory bodies are excluded from the application from the Ordinance on the basis that their primary function is not to engage in economic activity. Under the Ordinance, statutory bodies may still be subject to its prohibitions if they are expressly listed in a separate piece of secondary legislation. Of the 581 statutory bodies, there are currently six that will be subject to the Ordinance.

The second key concept, “agreement,” is interpreted by the Ordinance as “any agreement, arrangement, understanding, promise or undertaking, whether express or implied, written or oral, and whether or not enforceable or intended to be enforceable by legal proceedings,” thus capturing all formal and informal agreements between undertakings.

As to what might amount to an infringement of the First Conduct Rule, the Ordinance makes express reference to four types of agreements that would constitute “serious anti-competitive agreement”—namely, price-fixing, market allocation, fixing or limiting purchase/supply markets, and bid-rigging—but does not specify the other types of agreements that may be captured by the prohibition. “Serious anti-competitive agreement” was in fact introduced quite late during the legislative passage to address concerns by SMEs that serious infringement actions could potentially be taken against them by the Commission. The government’s response was to introduce a turnover-based exemption for SMEs whereby the First Conduct Rule would have no application if the combined turnover of the undertakings to an agreement that would have otherwise infringed the rule does not exceed HK\$ 200 million. Nevertheless, the Government also specifically provided a carve-out from the exemption by explicitly stating that if any such agreement should constitute a serious anti-competitive agreement then no exemption would be available. This position is consistent with those taken by other jurisdictions where such agreements are regarded as the most egregious forms of anti-competitive arrangement, and in some places, have been likened to a “cancer on society” and treated as a per se infringement of the law.

Aside from those four types of agreements referred to as serious anti-competitive agreements, the Ordinance does not provide any indication as to the other types of arrangements that may give rise to an infringement. Helpfully, the LegCo Draft Guidelines provide an indicative, non-exhaustive list of horizontal agreements to which the First Conduct Rule could potentially apply. Aside from the more

egregious types of anti-competitive agreements (e.g., collusive tendering), these Guidelines also make references to more commonplace business arrangements such as joint purchasing or selling, information sharing and the setting of technical or design standards.

It is anticipated that an effects analysis would be required before infringement can be established. Like many other jurisdictions, it is also anticipated that enforcement efforts would initially focus on those more serious anti-competitive agreements as these are typically considered to be the most harmful to competition. That has certainly been the track record in the relatively short history of the sector-specific competition law regime under the Telecommunications Ordinance, in which the Telecommunications Authority carried out investigations into hardcore price-fixing arrangements, and no cases have ever been brought against these other business cooperations that may have an anti-competitive effect.

As for vertical agreements, the view taken by the government throughout the debate and also in the LegCo Draft Guidelines is that these agreements are, in general, less likely to give rise to competition issues. However, the LegCo Draft Guidelines do note that vertical agreements that seek to limit access to the market for competing suppliers or that seek to limit competition between competitors could give rise to competition concerns. The Commission is required by the Ordinance to carry out a public consultation to issue guidelines on how it proposes to enforce the First Conduct Rule, and it is expected that the Commission will clarify how it proposes to treat vertical agreements, and whether it would be prepared to issue a block exemption in relation to such agreements. It will therefore be important for businesses to keep monitoring developments in this aspect of enforcement.

The Ordinance provides for exclusions from the prohibition for private undertakings, which can be obtained pursuant to a prior Commission decision or by way of self-assessment. There are several available exclusion grounds, including economic efficiency, on the basis that the agreement was made to comply with legal requirements and to carry out operations of general economic interest. The bar has been set quite high before an undertaking can apply for a prior Commission decision, as the Ordinance requires that the application involve a novel issue that has broader application than just the undertakings concerned.

Therefore one would expect that in the majority of cases, companies would need to assess their own situation to see if they can make use of the relevant exemption. Given the lack of detail around what these grounds of exclusion cover, it would be

important for companies to monitor available guidance from the Commission, relevant pronouncements made by the Telecommunications Authority (on the issue of efficiency only), and guidance in other jurisdictions such as the European Union.

Significantly, the Commission has the power to issue block exemptions, which are exemptions for specified categories of agreements. Examples of EU block exemptions are motor vehicles and research & development. Businesses should bear in mind that the issuance of a block exemption will open for public consultation, so it will be key to keep a close watch on developments and to participate in the process as much as possible in order to put forward views and have them be taken into account.

Separately, exemptions may also be awarded by the Chief Executive on public policy grounds, and in order to avoid conflicting with international obligations. However, such exemptions will most likely be invoked only rarely.

The Second Conduct Rule: Prohibition of Unilateral Abuse of Substantial Market Power

The Second Conduct Rule deals with abusive actions by an undertaking with significant market power, and it provides that “[a]n 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.”

As is the case elsewhere, a breach of the Second Conduct Rule would only be found where: (i) an undertaking has a substantial degree of market power and (ii) that undertaking has abused its market power with an anti-competitive object or effect.

The notion of what constitutes a “substantial degree of power in a market” is partially defined in the Ordinance. It involves considering the following factors: market share, power to make pricing and other decisions, barriers to entry in the relevant market, and any other factors that may be included in future guidelines to be issued by the Commission.

What is interesting about the Ordinance is that Hong Kong has deliberately opted to adopt a lower threshold than dominance, which is commonly adopted in most other competition law statutes. In fact, in papers issued by the government in April 2012, it was expressly proposed that a market share of as low as 25 percent could

give rise to the application of the Second Conduct Rule. While market share is not the only factor that the Commission would use to determine whether an undertaking enjoys a position of a substantial degree of market power, such a low threshold could nevertheless capture a larger number of undertakings than is the case elsewhere. For example, Europe sets an indicative presumption of dominance at a 40 percent market share, and China's rebuttable legal presumption of dominance is a 50 percent market share). This issue is particularly acute for the Hong Kong domestic economy, as it is not large and has fewer players in each sector. It is therefore possible that, unlike other jurisdictions where there are traditionally fewer abuse of dominance cases than there are cases taken under the prohibition against anti-competitive agreements, we could potentially see the reverse situation in Hong Kong.

The second limb of establishing an infringement requires an abuse of a substantial degree of market power. The Ordinance refers, "in particular," to conduct that is exclusionary in nature, and those that limit production, markets or technical development to the prejudice of consumers. Examples given in the relevant LegCo Draft Guidelines of such categories of abusive conduct is also in line with the international norms, which specify that predatory behavior could include predatory pricing (i.e., pricing below cost), tying/bundling, margin squeeze, and refusal to supply.

The currently available guidance in the form of case law by the Telecommunications Authority under the sector-specific competition laws and its published guidance are also consistent with the Second Conduct Rule, and is the way that it is envisaged that it would be enforced. Again, there have been decisions taken under the equivalent rule by the Telecommunications Authority, and this may well mean that when the Commission starts to enforce the Ordinance, it will not shy away from it as some other antitrust authorities have done, at least initially.

Exclusions and exemptions under the Second Conduct Rule are broadly similar to those under the First Conduct Rule, although they differ in that there is no exclusion on the grounds of economic efficiency, nor will the Commission grant block exemptions. As with the First Conduct Rule, there is a de minimis exemption for SMEs and it is set at the lower level of global annual turnover of which it does not exceed HK \$40 million.

The Merger Rule

The issue of whether the Hong Kong competition law should have a generally applicable merger rule was hotly debated during the public consultation. It was felt that such a rule would bring about high transaction costs, and that Hong Kong was not ready for it. As a compromise measure, it was decided that a merger rule would only be introduced for transactions that involve telecommunications carrier licensees, which is similar (although slightly broader) in scope to the current merger control rules under the Telecommunications Ordinance.

The Merger Rule has limited application and prohibits transactions involving telecommunications carrier licensees that have the effect of substantially lessening competition in a telecommunications market. The intent is to review the operation of the Merger Rule with a view to extending it to transactions in other sectors across the entire economy in a few years' time.

ENFORCEMENT AND ADJUDICATION

The Competition Commission

The Ordinance originally called for the Commission having both powers of investigation and adjudication. However, in response to feedback from both the consultation and during the legislative passage, it was ultimately decided that the Commission would only have powers of investigation, with all enforcement actions to be taken in the Tribunal, the adjudicatory body.

The Commission's key role is to investigate conduct that may contravene the Ordinance and to enforce the Ordinance. The Commission's powers are broad, and in accordance with Section 131 of the Ordinance, it may do "all such things as appear to it to be expedient ... in connection with the performance of its functions."

The Commission will be headed by a political appointee, the Chairperson, whose appointment is to be approved by the Chief Executive. The day-to-day operation of the Commission is to be overseen by the Chief Executive Officer.

The Chairperson, as leader of the Commission, will be responsible for the policy direction of the Commission and will decide the approach the Commission takes towards enforcement. It is still unclear as to whether the Commission will adopt a light-touch approach to enforcement or whether it will take a tougher line, as has been the case more recently in the financial services sector in Hong Kong. The appointment of the Chairperson of the Commission is a major decision and will be a good indication as to the approach we can expect to see from the Commission in enforcing the law.

Beyond the political issues, the Commission's effectiveness will also depend on the composition of the staff, both in terms of the number of staff and their experience.

The Competition Tribunal

The Tribunal will consist of judges of the Court of First Instance. The Tribunal will hear and determine applications made by the Commission, reviewable determinations, and private actions, among other matters.

The key challenge we envisage for the Tribunal will be the current lack of a competition law regime and the challenges this may pose to the judges sitting on the Tribunal, who may lack direct experience in ruling on competition law matters.

Aside from public enforcement, it is also possible to institute private follow-on damages actions. Initial proposals that permit stand-alone damages actions were eventually rejected, particularly because of SMEs' concerns that larger and well-funded corporations could simply institute actions against them opportunistically.

Penalties

Key penalties include fines of up to 10 percent of local Hong Kong turnover of the undertakings concerned for a maximum period of three years, and directors' disqualification orders for up to five years. The Tribunal may also award damages against both undertakings and individuals. Other sanctions the Tribunal may impose include orders for payment of costs and damages, disposal of operations, assets or shares, and declarations that an agreement is void or voidable.

CONCLUSION

The introduction of the competition law spells out a watershed moment for Hong Kong, which has traditionally boasted a laissez-faire economy with minimal regulation. Given the lack of experience with competition laws for most businesses in Hong Kong, compliance may be challenging. While the Ordinance largely follows international norms, it does have a number of features that are specific to Hong Kong. Such features include the turnover-based exemptions for SMEs, the adoption of a lower threshold of "substantial degree of market power" rather than dominance, and the express decision not to regulate mergers (save for transactions that involve telecommunications carrier licensees) for the time being.

The next few months will be key, as they will see the establishment of the Commission and the Tribunal. Once these bodies are in place, the Commission will make it a priority to begin public consultation on the preparation of the various guidelines. It will be important for businesses to participate in these processes as much as possible in order to have their views heard. It is crucial for the government to choose the Chairman of the Commission very carefully, as he or she would have significant influence on enforcement position and trends. Based on the experience of other new Asian competition regimes, Hong Kong can expect a period of transition for the Commission to gear up its internal resources and to start to engage with the public on the permissible boundaries under the Ordinance before serious infringement actions are taken. In the meantime, businesses would be well advised to review their business practices with a view to ensure compliance with the Ordinance.