A Competition Law for Hong Kong

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The Competition Ordinance 2012 was adopted by the Hong Kong Legislative Council on June 14 and signed into law by the Chief Executive on June 21.[1] The Ordinance represents a major milestone on the way towards comprehensive competition policy reform in Hong Kong. It establishes a Competition Commission with wide-ranging investigative powers and a Competition Tribunal that can apply severe sanctions. Many forms of competition restrictions that were hitherto tolerated are prohibited under the law.

But the adoption of the Ordinance, while a significant step, is not the last one. The Ordinance will enter into force at a date to be set by the Secretary for Commerce. The Administration has indicated that the institutional provisions would take effect first to allow for the establishment of the new authorities, with the substantive provisions of the Ordinance becoming effective later, presumably after initial enforcement guidelines are issued by the Competition Commission. The Commission is required to consult the public on proposed guidelines. As a result, it would be surprising if the new competition regime were to become effective before 2014.

A brief description of the tortuous legislative history may shed some light on the challenges ahead for the Competition Commission. This is the focus of our first section. The following sections describe the scope of the Ordinance and its enforcement mechanisms.

I. A DIFFICULT GENESIS

The introduction of cross-sector competition law was first proposed within the Legislative Council in the 1990s.[2] Nearly 20 years of debate, expert reports, public consultations, hearings, and bills committee meetings ensued. The process concluded with a final five-day flourish of plenary debate in the Legislative Council, and the Competition Ordinance was adopted a little after 10:00 P.M. on June 14. Rarely has a competition law statute generated so many discussions.

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1 An Ordinance 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; and to provide for incidental and connected matters; Ordinance No 14 of 2012, HONG KONG OFFICIAL GAZETTE (June 22, 2012), p. A1323.

2 See Motion for the adoption of legislation on fair trade, moved by Dr. Law Cheung-kwok, *Official record of proceedings of the Hong Kong Legislative Council* of May 29, 1996, with a discussion of a similar motion introduced in 1992 by the Honorable Fred Li.

Behind the political folklore lie real issues worthy of debate. Why would Hong Kong, an economy consistently rated as among the world's most competitive, need to adopt legislation and create dedicated institutions to preserve market competition? Is the primary goal of the Ordinance to enhance allocative efficiency in the Hong Kong markets, or is it to ensure that Hong Kong consumers get a fairer share of economic efficiencies, in a context where many goods and services produced in Hong Kong are exported and consumed abroad?

The original Competition Bill introduced by the Government in July 2010 provided few answers to these questions. It contained extremely detailed provisions on procedure and institutions but very little detail on substance. Unfortunately, the legislative debate did not add much clarity. Most of the arguments heard during the Bills Committee meetings related to the impact of the law on small and medium enterprises ("SMEs") and on the appropriate level of sanctions. Government representatives did explain the Administration's policy intent on a few matters, but overall the legislation that was ultimately adopted fails to embody a clear economic policy.

This of course is nothing new to competition law practitioners, who have long had to deal with the very broad principles-based provisions of competition legislation elsewhere. The loose wording of the US Sherman Act and of the relevant articles in the EU Treaties has allowed major shifts in competition policy over time. The Hong Kong law is in this respect very similar to that adopted in other jurisdictions, as it leaves a large degree of flexibility to courts and enforcers in setting competition policy.

The lack of a clear articulation of policy objectives is nevertheless unfortunate. Different economies may justify different objectives and legal tests.[3] Many of the jurisdictions that have introduced competition law in the last two decades did so at the time their markets were deregulated and their economies were transitioning towards market-based principles. Policy objectives in this context were relatively straightforward, and these jurisdictions could rely on foreign (mainly EU) precedent when interpreting their regimes. In contrast, Hong Kong has for a long time been an open market economy largely free of government intervention, and there are no signs that the markets where the State's influence is strong (such as land supply) will be deregulated soon. In other jurisdictions, adopting competition law meant less market regulation. In Hong Kong the adoption of the Competition Ordinance is perceived as an increase in regulation.

The original Hong Kong context may therefore have warranted the inclusion of clear guiding principles in the Ordinance. The lack of clarity in this regard leaves a number of important questions open, and it will be up to the Competition Commission to set a path for Hong Kong's competition policy.

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3 *See* Thomas K. Cheng, *Convergence and Its Discontents: A Reconsideration of the Merits of Convergence of Global Competition Law*, 12 CHI. J. INT'L L. 433 (2012).

II. PERSONS SUBJECT TO THE COMPETITION ORDINANCE

In line with EU law, the Ordinance applies to "undertakings." Any entity engaged in economic activity, regardless of its legal status or the way in which it is financed, is subject to the Ordinance.

The Ordinance contains a patchwork of exclusions and exceptions mainly benefiting SMEs and statutory bodies. However, as a consequence of the way they are structured, virtually no undertaking—including SMEs and statutory bodies—can afford to completely ignore the provisions of the Ordinance.

A. Statutory Bodies

Section 3 of the Ordinance excludes all statutory bodies from the scope of the substantive provisions of the law, except for those statutory bodies listed in a separate regulation that will be adopted by the Chief Executive in Council. Under current proposals, the Government will adopt a regulation that would subject the activities of six statutory bodies to the Ordinance, out of a total of 581 such bodies in Hong Kong. Despite the exclusion, the Administration stated during the legislative debate that it will ensure that these bodies would still be required to act consistently with the principles underlying the competition rules.[4]

Rather mystifyingly, the Ordinance abandons the notion of undertaking in favor of a legalistic approach: only those persons that are incorporated as a statutory body will be excluded. This peculiar approach suggests that statutory bodies must comply with the substantive provisions of the Ordinance as soon as they engage in economic activity through a private law subsidiary. The approach is similar to that under the Singapore Competition Act, and Government-owned entities in Singapore know that the exclusion only affords limited protection.[5]

B. Small and Medium Enterprises

Sections 5 and 6 of Schedule 1 exclude certain conduct by undertakings whose turnover remains below certain thresholds. These exclusions are, however, partial—some hardcore conduct is never excluded—and are in some cases

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4 *See* Gregory So Kam-leung, Secretary for Commerce and Economic Department, Speech, *Official record of proceedings of the Hong Kong Legislative Council* (June 6, 2012).

5 *See* Section 33(4) of the Competition Act. The first decision of the Competition Commission of Singapore finding an abuse of dominance concerned a government-linked company, SISTIC. At the time of the hearing, SISTIC was owned 65 percent by the Singapore Sports Council (SSC) and 35 percent by The Esplanade Co. Ltd. (TECL). TECL was a public company limited by guarantee and owned by the Ministry of Information, Communications and the Arts. SSC was a statutory board under the oversight of the Ministry of Community Development, Youth and Sports. *See Notice of Infringement Decision issued by the Competition Commission of Singapore - Abuse of a Dominant Position by SISTIC.com Pte Ltd*, June 4, 2010, Case number: CCS 600/008/07. SISTIC in its appeal (which was rejected on May 28, 2012) did not contest the finding that it was subject to the Competition Act.

impractical (for example, the exclusion from the prohibition on restrictive arrangements only applies when the combined turnover of all undertakings involved is below the threshold).

C. Other Specified Persons

Finally, pursuant to section 4 of the Ordinance, the Chief Executive in Council may also disapply the substantive provisions in relation to a "specified person" or "persons engaged in specified activities." The Ordinance does not provide any criteria for such exclusion, despite calls for more guidance from several Legislative Councilors during the review of the Bill.

III. THE SUBSTANTIVE COMPETITION RULES

The Ordinance introduces two of the traditional three pillars of a competition law regime: a prohibition on restrictive agreements and a prohibition on the abuse of market power.

Despite its full title ("An Ordinance [...] to prohibit mergers that substantially lessen competition in Hong Kong") and references to "the merger rule," the Ordinance does not introduce a comprehensive merger control regime. Rather, it modernizes the existing rules for review of concentrations involving telecommunications carrier licensees. Merger activity in other sectors of the economy is clearly out of scope. Section 4 of Schedule 1 expressly keeps mergers out of reach from enforcement of the two conduct rules, although it is not clear whether ancillary merger restrictions such as non-compete covenants are also excluded.

A. The First Conduct Rule: The Prohibition on Restrictive Agreements

The Ordinance adopts in section 6 a general prohibition on anticompetitive agreements and concerted practices between undertakings as well as decisions of an association of undertakings which have the object or effect of preventing, restricting or distorting competition in Hong Kong. The rule applies irrespective of whether the conduct took place in Hong Kong or abroad, as long as its object or effect is to prevent, restrict, or distort competition in Hong Kong.

While the substantive legal test under the first conduct rule is the same for all conduct, the enforcement focus is expected to be on serious anticompetitive activity, which the Ordinance defines as price-fixing, market sharing, output restrictions and bid-rigging. This is because of specific procedural rules that will apply to non-serious anticompetitive conduct.

The first conduct rule does not distinguish between horizontal and vertical arrangements. The Administration stated during the legislative process that, in its view, vertical restrictions would only raise competition issues when they involve suppliers with market power or when a supply agreement is entered into among

competitors.[6] It will be up to the Competition Commission to set the policy in this regard.

B. The Second Conduct Rule: The Prohibition on the Abuse of Market Power

Section 21 of the Ordinance 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. Again, the rule applies irrespective of whether the conduct took place in Hong Kong or abroad.

It is noteworthy that the Ordinance refers to the substantial degree of market power test rather than the more commonly used dominance test. After arguing for a while that there was little difference between the two tests, the Government representatives stated that the Administration wished to retain a lower market power threshold in the Ordinance, as several sectors of the economy—mainly food retail markets—have an oligopolistic structure.[7] While intent on adopting a low threshold, the Secretary for Commerce mentioned during his final policy address that a market share of 40 percent may be indicative of a substantial degree of market power, and that undertakings with a market share below 25 percent should benefit from a safe harbor as they would be unlikely to possess market power.[8] Despite these policy statements, the law itself does not provide guidance on the meaning of "a substantial degree of market power," and it will be up to the Competition Commission to form a view.

Section 21 provides an illustrative list of conduct that may constitute an abuse of market power: predatory behavior towards competitors; and limiting production, markets or technical development to the prejudice of consumers. The law provides no example of exploitative abuse.

In a bizarre twist, Schedule 8 of the Ordinance introduces a new specific rule for exploitative abuses in the telecommunications sector for licensees in a dominant position. The specific reference to exploitative abuses in this ad hoc provision may suggest that these are not meant to be captured under the general abuse of market power regime under section 21. Again, it will be up to the Competition Commission to provide guidance on these questions.

C. Exemptions and Exceptions

Sections 31 and 32 of the Ordinance list the only two real exemptions in the law: the Chief Executive in Council may (but has no obligation to) exempt certain agreements or conduct on public policy grounds or to avoid conflict with

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6 *See* Draft Guidelines on the First Conduct Rule, ¶ 2.5, Commerce and Economic Development Bureau, CB(1)2336/10-11(01), May 2011.

7 *See* Responses to outstanding issues arising from previous meetings, ¶ 11, Commerce and Economic Development Bureau, CB(1)1450/11-12(02), March 2012.

8 *See* So Kam-leung, *supra* note 4.

international obligations. The Chief Executive in Council retains relatively broad discretion whether to grant exemptions under these sections.

All other causes for exclusion, which are listed in Schedule 1, are designed as exceptions: parties must benefit from the exclusion as soon as specified conditions are met. Parties may therefore self-assess whether the conditions for exclusion are met. These five exclusions are as follows:

- neither of the conduct rules applies to conduct if it is made to comply with a binding Hong Kong legal requirement;
- neither of the conduct rules applies to undertakings entrusted with the operation of services of general economic interest insofar as these rules would obstruct the performance of these services;
- the first conduct rule does not apply to agreements that enhance economic efficiency, when certain conditions (including that a fair share of benefits accrues to consumers) are met;
- the first conduct rule does not apply to agreements and concerted practices between undertakings or decisions by associations where the aggregate annual turnover of the undertakings involved does not exceed HKD200 million, except where the conduct qualifies as serious anticompetitive conduct; and
- the second conduct rule does not apply to undertakings whose annual turnover is below HKD40 million.

While the Ordinance does not expressly exclude competition restrictions that are not appreciable, the Competition Commission may well consider that restrictions involving undertakings with small market shares will not be caught by the conduct rules. Further, despite the lack of an express efficiency exclusion under the second conduct rule, undertakings with market power are also expected to be able to rely on an objective justification defense.[9] The Competition Commission will provide guidance on these questions in its guidelines.

Overall, save for the turnover-based exclusions in favor of SMEs, the regime is broadly in line with the law in the EU or in Singapore.[10]

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9 *See* Draft Guidelines on the Second Conduct Rule, ¶ 6.4, Commerce and Economic Development Bureau, CB(1)2618/10-11(01), June 2011.

10 In Singapore, the section 34 prohibition does not apply to the matters specified in the Third Schedule to the Competition Act by virtue of section 35. These are (i) an undertaking entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly, insofar as the prohibition would obstruct the performance, in law or fact, of the particular tasks assigned to that undertaking; (ii) an agreement to the extent to which it is made in order to comply with a legal requirement, that is any requirement imposed by or under any written law; (iii) an agreement which is necessary to avoid conflict with an international obligation of Singapore, and which is also the subject of an order by the Minister; (iv) an agreement which is necessary for exceptional and compelling reasons of public policy and which is also the subject of an order by the Minister; (v) an agreement which relates to any product to the extent to which any other written law, or code of practice issued under any written law, relating to competition gives another

IV. ENFORCEMENT

The Ordinance establishes two enforcement bodies: the Competition Commission and the Competition Tribunal. The former is to investigate and bring cases before the latter, which will hear and make the final decisions.

A. The Competition Commission Investigates and Provides Guidance

The Commission is a new authority comprising between five and 16 members appointed by the Chief Executive for a renewable three-year term.

One of the Commission's principal tasks is to investigate possible infringements. It has wide-ranging investigation powers, including the power to order the production of documents and other information, and to hear relevant persons. It can also conduct surprise on-site inspections ("dawn raids") after obtaining a warrant from the Court of First Instance. It may also conclude leniency agreements granting beneficial treatment in return for a person's cooperation in an investigation.

The Commission is also vested with some remedial powers: it can put a violation to an end by accepting commitments from investigated parties or by sending warning notices.

The Commission is tasked with providing guidance through the adoption of guidelines or the issuance of individual guidance decisions on whether conduct benefits from an exclusion or an exemption. The Commission can also adopt block exemption orders, on application or of its own motion, if it is satisfied that a particular category of agreements enhances economic efficiency.

Finally, it has an advocacy role, i.e., it must promote public understanding of competition law and the adoption of compliance mechanisms by businesses.

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regulatory authority jurisdiction in the matter; (vi) an agreement which relates to any of the following specified activities: the supply of ordinary letter and postcard services by a person licensed and regulated under the Postal Services Act; the supply of piped potable water; the supply of wastewater management services, including the collection, treatment and disposal of wastewater; the supply of scheduled bus services by any person licensed and regulated under the Public Transport Council Act; the supply of rail services by any person licensed and regulated under the Rapid Transit Systems Act; and cargo terminal operations carried out by a person licensed and regulated under the Maritime and Port Authority of Singapore Act; (vii) an agreement which relates to the clearing and exchanging of articles undertaken by the Automated Clearing House established under the Banking (Clearing House) Regulations; or any related activities of the Singapore Clearing Houses Association; (viii) vertical agreements other than vertical agreements as the Minister may by order specify; (ix) an agreement with net economic benefit; (x) any agreement that is directly related and necessary to the implementation of a merger; and (xi) any agreement (either on its own or when taken together with another agreement) to the extent that it results, or if carried out would result, in a merger.

B. Different Procedures Depending on the Seriousness of the Alleged Infringements

During the legislative process, many SMEs argued that the indiscriminate treatment of all anticompetitive conduct in the Bill would represent a significant burden, as there was no guarantee in the statute that an inadvertent breach of a less serious nature would not attract a heavy fine.

To assuage these concerns, the enforcement regime ultimately retained in the Ordinance distinguishes between serious and non-serious anticompetitive conduct:

- if the alleged infringement amounts to one of the four types of serious anticompetitive conduct under the first conduct rule or if an infringement of the second conduct rule is alleged, the Commission may either directly bring proceedings in the Tribunal, or first issue an infringement notice, offering not to bring those proceedings on condition that the defendant makes a commitment to comply with requirements of the notice;
- if, on the other hand, the alleged infringement does not amount to serious anticompetitive conduct under the first conduct rule and if no infringement of the second conduct rule is alleged, the Commission must first issue a warning notice requesting the relevant undertaking to cease the relevant conduct; should the undertaking fail to rectify the anticompetitive conduct in compliance with the warning notice, the Commission may bring proceedings against that undertaking, but only in respect of the period after the warning notice has been issued.

C. The Competition Tribunal Hears Cases, Imposes Remedies and Grants Follow-on Damages

The Competition Tribunal is a new court established by the Ordinance. The existing judges of the Court of First Instance will sit as a specialized jurisdiction, following specific procedures likely to be less formal than in civil cases.

A range of remedies is available to the Tribunal for contravention of a competition rule. These include a maximum pecuniary penalty of 10 percent of the local turnover of the infringing undertaking for each year of infringement (up to a maximum of three years), damages, interim injunctions and director disqualification orders for a maximum duration of five years.

Persons who have suffered loss or damage as a result of a contravention of the conduct rules will have a right of action before the Competition Tribunal. However, proceedings may only be brought after a contravention has been established. It is not entirely clear whether parties to a contractual dispute could invoke a violation of the Ordinance without first having to wait for a decision from the Competition Commission or the Competition Tribunal.

V. CONCLUSION

Once the new authorities will have been established, the Competition Commission will prepare guidelines for public comment. As many policy questions remain open, one may expect significant debate to occur in the context of these consultations. It may well be that the initial guidelines will only provide a high-level direction. The enforcement model nevertheless provides a good framework for authorities to develop competition policy without making companies bear too many of the costs resulting from the remaining uncertainties.

As was the case in many other competition law jurisdictions, it will take time before a clear policy emerges under the Ordinance, and even longer before its effects are felt on the Hong Kong markets.