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I. INTRODUCTION

After years of intense political debate and rounds of public consultations, the Hong Kong Competition Ordinance (“Ordinance”) is finally due to come into force on December 14, 2015. Much of the controversy to which this first cross-sector antitrust regime in Hong Kong gives rise turns on the exclusions and exemptions that will be available to certain persons, activities, and conduct, including possibly categories of agreements covering entire sectors of the economy.

Under the Ordinance, exclusions and exemptions can take different legal forms and can be based on a variety of grounds. Some are highly circumstantial and Hong Kong-specific (e.g., the statutory bodies exemption), while others appear to be based on established EU competition law principles (e.g., the exclusion for economic efficiency). However, in a notable departure from the post-modernization EU regime, the Hong Kong legislator has stopped short of a system relying on pure self-assessment to determine the availability of an exclusion or exemption, introducing instead a mixed regime enabling undertakings either to self-assess, or to apply to the Competition Commission (“HKCC”) for a decision in this regard.

Highlighting the intrinsic political nature of some of these exclusions and exemptions, a feature of the Hong Kong regime is the fact that exemptions and exclusions are not left to the exclusive discretion of the HKCC. Rather, the Hong Kong Chief Executive has retained some degree of oversight through the power to grant exemptions and exclusions notably in relation to “special situations” or wider public interest grounds. This is not dissimilar to the U.K. rules, which provide that the Secretary of State can exclude the application of the rules prohibiting anticompetitive agreements where there are “exceptional and compelling reasons of public policy for doing so.”²

Another notable feature of the Hong Kong regime is that, while the HKCC acknowledges that vertical agreements are less likely to harm competition than horizontal ones, it has provided no indication that it intends at this time to introduce a general vertical block exemption, as exists in Europe. While it is understandable that the HKCC may not wish to act precipitously, the current position is disappointing, as many stakeholders had called for such exemption during public consultations, drawing from the Singaporean example and highlighting the need for legal certainty particularly in the first years of enforcement.

This article explores these themes in more depth, looking at the different types of

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² *UK Competition Act 1998*, Schedule 3, ¶ 7.

exclusions and exemptions under the Hong Kong regime, the application process, and the practical issues businesses need to consider before considering an exemption.

II. THE APPLICABLE RULES

The Hong Kong regime differentiates between “exclusions” on the one hand and “exemptions” on the other, mirroring the language of the E.U. and U.K. competition regimes. In effect, agreements and conducts that are “excluded” are outside of the scope of competition rules as a result of their nature and characteristics, while “exempted” agreements and conducts would normally be subject to competition rules, but have been exempted by the decision of a public authority.

A. General Exclusions Under Section 30 of the Ordinance and Schedule 1

Section 30 of the Ordinance provides that the conduct rules do not apply to conduct which is excluded by, or as a result of, Schedule 1 of the Ordinance. Each relevant scenario is set out below.

1. Agreements enhancing overall economic efficiency

Pursuant to Section 1 of Schedule 1 of the Ordinance, agreements enhancing overall economic efficiency are excluded³ from the First Conduct Rule (“FCR”). The Second Conduct Rule (“SCR”) is not capable of benefiting from this exclusion. The wording closely follows the language of Article 101(3) in the Treaty on the Functioning of the European Union (“TFEU”), requiring cumulative conditions. The agreement (i) should bring about efficiencies⁴ whose benefit should be shared with consumers, (ii) should not impose restrictions that are not indispensable to the attainment of the efficiency objectives, and (iii) any restrictions should not have the ability to eliminate competition in respect of a substantial part of the goods and services in question.

Noticeably, the requirement that consumers should be afforded a “fair share” of the benefits stemming from the efficiencies was not included in the initial Bill, but rather was included shortly before the final vote on the legislation, at the insistence of the legislators.⁵ Commentators saw in this change the clear demonstration that the Ordinance would be tasked with pursuing consumer welfare above all.

It is notoriously difficult, in Europe, to rely successfully on the Article 101(3) TFEU “economic efficiency defence.” In the heated debate over the qualification of certain restrictions as being “by object” or “by effect,” the HKCC has hinted that it would consider with an open mind the use of the efficiency defense. However, the evidentiary burden remains extremely

³ The use of the term “exclusion” versus “exemption” in the Ordinance is not entirely logical, nor is it in line with international standards. Thus, a disapplication of the rules on economic efficiencies grounds is generally understood to be an exemption. However, Schedule 1 refers to an “exclusion” in this case. The authors do not think that this choice of terminology carries a particular legal meaning but, rather, is the outcome of the protracted drafting process.

⁴ The agreement should in particular contribute to improving production or distribution, or promoting technical or economic progress.

⁵ Legislative Council, LC Paper No. CB(1)1881/11-12, Paper for the House Committee meeting on 18 May 2012, ¶ 17.

onerous, and the poor track record of success of this defense in Europe is not encouraging. At this point, businesses would be hard-pressed to rely confidently on this exclusion alone as they assess their business practices.

2. Compliance with legal requirements

Pursuant to Section 2 of Schedule 1, neither conduct rule applies to agreements that are made for the purpose of complying with legal requirements. A “legal requirement” is defined as a requirement imposed by or under an enactment in force in Hong Kong, or by any national law applying in Hong Kong (here referring most likely to laws of the People's Republic of China, enacted in Beijing yet also applicable in Hong Kong).

It is expected that this exclusion will be strictly construed, capturing only legislation of a certain level such as ordinances and, most likely, subsidiary legislation. The question is open for rules issued by independent statutory bodies and, arguably, the exclusion would not cover guidelines or policies of self-regulated bodies even when they seek to interpret or implement regulations of higher stature. In some cases, this may reveal delicate conflicts or inconsistencies, leading to legal uncertainty.

3. Services of general economic interest

Neither conduct rule applies to undertakings entrusted by the Government with the operation of services of general economic interest (“SGEI”), in so far as competition rules would obstruct the performance of the service. The term “general economic interest” is not defined in the Ordinance, and this may be the subject of protracted debates if companies claim they have been entrusted with such services.

In Europe, the EU Commission has sought to clarify the meaning of SGEI in a 2011 communication, stating that SGEIs are “economic activities which deliver outcomes in the overall public good (or would be supplied under different conditions in terms of quality, safety, affordability, equal treatment or universal access) by the market without public intervention.”⁶ Although the HKCC has not indicated its intention to explain the meaning of SGEIs, the EU definition may offer sound guidance, although it is of note that this exemption is sparingly applied in Europe and the same could be the case in Hong Kong.

4. Mergers

The Ordinance does not provide for a general merger control regime, meaning mergers (except those in the telecoms sector) are not subject to the conduct rules. Some of the early studies commissioned by the Government suggested the adoption of a “light-touch merger control regime”⁷ but it was ultimately decided that mergers should, for now at least, be excluded from the regime.

5. De minimis

⁶ Communication, *A Quality Framework for Services of General Interest in Europe* (COM(2011) 900 final) adopted on December 20, 2011, p. 3.

⁷ Ping LIN & Edward K. Y. CHEN, *Fair Competition under Laissez-Faireism: Policy Options for Hong Kong*, *Lingnan University of Hong Kong* 18 (March 2008).

Agreements, concerted practices, and decisions of associations of undertakings between firms whose combined turnover is lower than HK \$200 million (about U.S. \$26 million) are excluded from the FCR,⁸ to the extent, however, that such agreements do not include serious anticompetitive conduct.⁹ Conduct by a company whose turnover is lower than HK \$40 million (about U.S. \$5.2 million) is excluded from the SCR.¹⁰

These exclusions are designed to protect small- and medium-sized enterprises (“SMEs”), which expressed major concerns during the legislative debate about their exposure under the Ordinance and additional compliance costs. However, the fact that the FCR exclusion does not apply to serious anticompetitive conduct considerably limits the relief that SMEs were hoping to draw from these provisions.

B. Public Policy Exemption Under Section 31 of the Ordinance

As is the case in some other jurisdictions,¹¹ the Chief Executive in Council has the power, by order published in the Gazette, to exempt from either, or both, conduct rules agreements or conducts on public policy grounds, if there are exceptional and compelling reasons to do so. Examples of such exemptions include, for instance in the United Kingdom, exemptions in the defense sector mainly, but also in relation to oil and petroleum products in the event of significant disruption to supply of these products.¹²

This exemption varies from the SGEI exclusion in two key ways. First, the public policy exemption is likely to relate primarily to issues of national security and safety, while the SGEI exclusion is designed to allow offering services to the public, notwithstanding the fact that some of the practices involved in the provision of such services may be anticompetitive. Second, the SGEI exclusion applies as a result of the nature of the services involved, while the public policy exemption requires the intervention of the Chief Executive in Council.

C. International Obligations Exemption Under Section 32 of the Ordinance

The Chief Executive in Council can also exempt by order published in the Gazette agreements or conducts if he or she is satisfied that it is necessary to avoid a conflict with international obligations that directly or indirectly relate to Hong Kong. The Ordinance defines “international obligation” to include air service agreements, international arrangements relating to civil aviation, and any other international agreement designated as being an international obligation by the Chief Executive by order published in the Gazette. This follows a similar provision under U.K. competition law.¹³

D. Statutory Bodies

Under Section 3, large parts of the Ordinance, particularly the conduct rules and the

⁸ Ordinance, Section 5 of Schedule 1.

⁹ Serious anticompetitive conduct includes, essentially, price-fixing, output restriction, market-sharing, and bid-rigging (Section 2 Ordinance). In the First Conduct Rule Guideline, the HKCC has indicated that resale price maintenance, in some circumstances, could amount to “serious anti-competitive behavior.”

¹⁰ Ordinance, Section 6 of Schedule 1.

¹¹ *Supra*, note 2.

¹² RICHARD WHISH & DAVID BAILEY, *COMPETITION LAW*, 376 (2015).

¹³ *UK Competition Act 1998*, Schedule 3, ¶¶ 6(2) and 6(3).

enforcement provisions under Part 4 and 6 of the Ordinance, do not apply to statutory bodies, unless the Chief Executive decides to re-apply the rules by regulation.

Statutory bodies are still subject to Part 3 of the Ordinance, which means that they can be investigated (e.g. the HKCC could raid a statutory body in the hope to find evidence possibly incriminating third parties). In addition, anticompetitive agreements entered into with statutory bodies may still be caught under the FCR, with the non-statutory body potentially being penalized, even though the statutory body is exempt.

This exclusion was extremely controversial during the legislative debate and remains probably the most distinguishing (and weakest) feature of the Hong Kong regime as compared to its peers. This is for two main reasons. First is the sheer magnitude of the exclusion, with a total of 581 such bodies in Hong Kong, only six of which have been brought back under the ambit of the Ordinance by regulation.¹⁴

Second, as the exclusion is based on a pure administrative definition of “statutory body,”¹⁵ there is a wide-spread sentiment that the system is not based on justifiable reasons (e.g., the exclusion only being available to the parts of a statutory body performing services of general economic interest) but rather on political and private interest motives (i.e. the exclusion of statutory bodies that are otherwise fully engaged in highly competitive economic activities). As such, the regime would simply be incapable of achieving its main goal—to level the playing field.

The situation may change over time, but it will take political resolve to get out of this trap.

E. Specified Person or Activities Exclusion

Finally, Sections 4 and 5 of the Ordinance provide that the Chief Executive may, by regulation, exclude from the competition rules certain “specified persons” and persons engaged in “specified activities” (as defined in the regulation). In such cases, the scope of the exclusion is identical to that provided under Section 3 for statutory bodies. The Hong Kong Stock Exchange was the beneficiary of the first-ever exclusion granted by the Chief Executive under the Ordinance,¹⁶ singling out the critical role played—in the eyes of the Government—by the Exchange in the Hong Kong economy.

III. APPLICATION PROCESS

A. Application for Decision

Under Sections 9 and 24 of the Ordinance, companies may approach the HKCC for a decision as to whether an agreement or conduct is excluded or exempt from the conduct rules

¹⁴ *Competition (Application of Provisions) Regulation*, (Cap 619A), 7 July 2015. The six statutory bodies that do not fall within the exemption are: (1) Ocean Park Corporation, (2) Matilda and War Memorial Hospital, (3) Kadoorie Farm and Botanic Garden Corporation, (4) The Helena May, (5) Federation of Hong Kong Industries, and (6) the general committee of the Federation of Hong Kong Industries.

¹⁵ Section 2 of the Ordinance defines a statutory body as “a body of persons, corporate or unincorporated, established or constituted by or under an Ordinance or appointed under an Ordinance.”

¹⁶ *Competition (Disapplication of Provisions) Regulation*, (Cap 619A), February 16, 2015, excluding from the main provisions of the Ordinance specified entities within the Stock Exchange group (in particular, the parent company, the securities and futures exchanges, and the clearing houses).

under any of the above grounds. Obviously, for exclusions or exemptions that first require a decision by the Chief Executive in Council, by order or by regulation, it would be necessary to secure this first step before seeking a decision by the HKCC. In these cases, therefore, the process may involve a fair amount of Government lobbying. It is much less likely to be the case in relation to exclusions granted under Schedule 1 of the Ordinance.

The HKCC is not required to consider an application, unless certain cumulative conditions are met.¹⁷ The HKCC's guidelines on applications for exemptions,¹⁸ published in July 2015, set out the details of the application procedure.

After an initial and optional consultation with the HKCC, parties wishing to make an application must submit a Form AD setting out clearly the grounds for the application and provide substantial documentary evidence, including detailed information relating to the parties, affected suppliers and customers, market data, etc. Thereafter, the HKCC will decide whether to consider the application. If so, it will publish a "notice of application" together with a non-confidential version of the application and will seek the views of competitors, suppliers, customers, and third parties.¹⁹

Despite repeated requests during the guidelines consultation process, the HKCC has not provided an indicative timeframe for assessing applications, simply stating that timing would depend upon the complexity of the case and availability of resources. This is important because, during that period, the parties are exposed to heightened risk of enforcement and maximum legal uncertainty.

There will be a cost for lodging applications, which will vary depending upon the type of exclusion or exemption that is requested. Fees range from HK \$50,000 (about U.S. \$6,500) for decisions relating to exclusions based on legal requirements, SGEI, mergers, and *de minimis* exclusions; to HK \$100,000 (about U.S. \$13,000) for an application for a decision based on the economic efficiency defense costing; and, finally, up to HK \$500,000 (about U.S. \$65,000) for a decision in relation to a block exemption order.²⁰

B. Applications for a Block Exemption Order Under Section 15

Any company or association thereof may apply to the HKCC for a block exemption order, which exempts a whole category of agreements from the FCR and can be relevant to a whole sector. The application process is similar to that for individual decisions but the HKCC has noted that it will only issue block exemption orders as "an exceptional measure,"²¹ taking into consideration whether the resources required to issue such an order are likely to be proportionate

¹⁷ Under Section 9(2) of the Ordinance, the conditions are: (i) the application poses novel or unresolved questions of wider importance or public interest in relation to the application, (ii) the application raises a question for which there is no clarification in existing case law or decisions of the Commission; and (iii) it is possible to make a decision on the basis of the information provided.

¹⁸ HKCC Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders, July 2015.

¹⁹ Ordinance, Sections 10(1) and 25(1), and *Exemptions Guideline*, *id.* at ¶ 6.2.

²⁰ *Competition (Fee) Regulation*, L.N. 155 of 2015.

²¹ *Guideline*, *supra* note 18, ¶ 11.3.

to the expected public benefit it will bring about.²²

A block exemption order may be subject to conditions and limitations, and will be subject to periodical review. As noted above, a fee of HK \$500,000 will be incurred for the HKCC to issue a block exemption order but there do not appear to be any additional fees for the HKCC to periodically review the block exemption.

The HKCC does not have the power to issue block exemption orders before the entry into force of the Ordinance. Nevertheless, some industries—such as the shipping liners—have publicly expressed an interest in seeking an order and it is reported that preliminary discussions have started with the HKCC.

While it was common practice in Europe to have multiple sector-specific exemptions, the European Commission has moved away from this model to adopt a simpler approach of one umbrella vertical exemption, and only a very limited number of sector-specific exemptions. In Hong Kong, it will be interesting to see how many sectors come forward with hopes of a block exemption once the Ordinance comes into force and, more importantly, how wide the scope of any block exemptions granted will be.

IV. PRACTICAL CONSIDERATIONS

A. Self Assess or Apply for an Exemption?

While parties may wish to seek the certainty of a decision or block exemption order confirming that an agreement or conduct benefits from an exclusion or exemption, the Hong Kong regime also entrusts companies to self-assess their conduct in order to determine whether they benefit from an exclusion or exemption.

Approaching the HKCC for a decision aims at providing increased legal certainty. However, there is a serious chance that the application may be rejected (or only partially granted), leaving the HKCC with knowledge of potentially compromising conduct. The HKCC has explicitly stated in its guideline on exemptions that any discussions and exchanges with the HKCC in the context of the application are not on a “without prejudice” basis, in order to prevent possible frivolous or hopeless applications.²³ As a result, many undertakings may be hesitant to engage in discussions with the HKCC, knowing that the substance of their discussions could be used against them in a subsequent investigation.

B. Interim Exemption During Application?

In the consultation process on the HKCC’s guidelines, some parties requested that the HKCC issue interim exemptions or statements that it will not enforce against certain conduct, while reviewing applications for exclusions and exemptions.²⁴ However, this proposal was not retained by the HKCC in the final version of its guidelines.

Moreover, the Chief Executive of the HKCC has made clear that the HKCC can only

²² *Id.*

²³ *Id.* at ¶ 4.1.

²⁴ *Draft Guidelines under the Competition Ordinance – 2014, Submissions Received*, “Hong Kong Liner Shipping Association,” p. 4.

consider an application for a block exemption after the Ordinance has become fully operational, and that the HKCC is tied by the procedure provided for in the Ordinance, including the need to review representations made by other parties, publish a notice of proposed block exemption for further consultation, and consider further market enquiries before issuing a block exemption.²⁵ While this position may be debatable from a legal standpoint, it is the HKCC's current stance and it may in effect discourage many entities from considering making an application.

C. Who Should Apply for a Block Exemption Order?

In relation to block exemption orders, trade associations are empowered to make applications under the Ordinance, and in practice they tend to take the lead in discussions. Members of these associations who have an interest in lodging an application for a block exemption order ought to consider with caution whether to let the association drive the application, or whether to take an active role as a leader or, even, lodge a separate application. Indeed, the interests of the association and those of their members may not be fully aligned; furthermore, any information or document communicated by the association to the HKCC may expose its members and could be held against them.

V. CONCLUSION

The HKCC has a strong policy interest in assessing applications thoroughly rather than deciding too quickly on issues that have far-reaching consequences for the competitive landscape. As such, the application process for decisions for exclusions and exemptions is likely to take time and, during that time, parties are exposed.

As frustrating as a protracted application process may be, companies should understand that a poorly cut exemption containing numerous conditions and limitations could be more detrimental to them than relying on self-assessing current behavior and determining internally whether it is likely to breach the law.

The HKCC has already made it known that it is a highly approachable institution. However, companies should exercise great caution in assessing their position before seeking to increase formally the legal certainty of their position.

²⁵ *Legislative Council, Panel on Economic Development*, "Minutes of meeting held on Monday, 27 April 2015," ¶ 23.