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Trade Associations—Under the Spotlight for Competition Enforcement

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I. INTRODUCTION

The Competition Ordinance ("Ordinance"), Hong Kong's first cross-sector competition law, was enacted on June 14, 2012 and is finally set to come into full force on December 14, 2015. Trade associations play an important role in society by advocating a specific industry sector to the public and the government and representing the common interests of their members. Through this platform, members are able to discuss important issues affecting their businesses, the trends in the marketplace, and any legislation or policy proposed by the government that may be of relevance to them.

Importantly, members are able to make use of invaluable networking opportunities that come with joining a trade association to grow their business. Trade associations also hold valuable information about the relevant industry, such as news, professional development, and research materials to help members stay on top of market trends and developments. It is therefore clear that businesses can reap numerous benefits from joining a trade association. Given the benefits, it comes as no surprise that there are hundreds of trade associations in Hong Kong in different sectors and industries.²

With the coming into force of Hong Kong's competition law regime, many trade associations are reviewing their practices and such is the chilling effect of the many uncertainties inherent in competition law that some people are actively considering withdrawing their membership of associations. This article examines the key activities of trade associations and the competition law implications followed by a discussion of best practices to minimize the risks of a member or a trade association contravening the Ordinance. It concludes that so long as trade associations adopt certain best practices and a tailored and comprehensive compliance policy, there is no need for members to cease participating in the activities of trade associations.

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² The Trade and Industry Department has compiled a list of trade and industrial organisations in Hong Kong, including trade associations. The list is *available at* <https://www.tid.gov.hk/english/aboutus/publications/industrialsupp/hktio.html> (accessed September 9, 2015).

II. HONG KONG'S COMPETITION LAW AND TRADE ASSOCIATIONS

A. *Conduct Prohibited Under the Ordinance*

In short, the Ordinance prohibits three types of anticompetitive conduct:

- The First Conduct Rule³ prohibits anticompetitive agreements and concerted practices by businesses, including horizontal agreements between competitors (such as cartels) and vertical agreements (such as, potentially, resale price maintenance in a distribution agreement).
- The Second Conduct Rule⁴ prohibits businesses with a "substantial degree of market power" from abusing that power by acting anticompetitively. Examples of potentially abusive conduct include predatory pricing, refusal to deal, and exclusivity arrangements.
- The Merger Rule⁵ prohibits mergers that have or are likely to have the effect of substantially lessening competition in Hong Kong. At present, the Merger Rule applies only to mergers involving a telecommunications carrier license.

This article will focus on the First Conduct Rule and the Second Conduct Rule as they affect trade associations and their members. The Merger Rule is not relevant for the purposes of this article. Before considering the application of the First Conduct Rule and the Second Conduct Rule to trade associations, it is helpful to consider what these rules entail.

1. First conduct rule

Anticompetitive conduct caught by the First Conduct Rule is classified into conduct that has (1) the object of harming competition or (2) the effect of harming competition.

Conduct that is, by its very nature, harmful to competition in a market is regarded as conduct that has the object of harming competition. Hard-core cartels, i.e., agreements between competitors to fix prices,⁶ to share markets, to restrict output, or to rig bids, are considered as having the object of harming competition.⁷ Such activities fall within the definition of "serious anti-competitive conduct" under the Ordinance.⁸

Conduct that does not have an anticompetitive object may also fall foul of the First Conduct Rule if it has an anticompetitive effect, whether actual or likely. For an agreement to have an anticompetitive effect, it must have, or be likely to have, an adverse impact on an aspect of competition in the market, such as price, output, product quality, product variety, or innovation.⁹

³ Part 2, Division 1 of the Ordinance (hereafter references being to the Ordinance unless otherwise stated).

⁴ Part 2, Division 2.

⁵ Schedule 2, Part 2.

⁶ Price-fixing may also cover agreements on discounts, surcharges, or price ranges. Non-binding recommendations or guidelines may also amount to price-fixing.

⁷ FCR Guideline ¶ 3.7.

⁸ S.2(1).

⁹ FCR Guideline, ¶ 3.18.

2. Second conduct rule

As for the Second Conduct Rule, unlike in some jurisdictions, there is no threshold as to what constitutes a substantial degree of market power in Hong Kong. Where a business can profitably raise prices above the competitive level, or restrict output or quality below competitive levels for a sustained period, this would indicate that the business has a substantial degree of market power.¹⁰ Market share is simply one factor in determining market power.¹¹ Examples of other factors include a business' power to make pricing decisions and any barriers to entry to competitors into the market.¹² The evaluation of market power is a complex exercise that may require relevant economic analysis.

It should be noted that having a substantial degree of market power is not in itself objectionable—but if such a business engages in predatory pricing, tying and bundling, exclusive dealing, etc., it will have breached the Second Conduct Rule by abusing its market power.¹³

B. Application to Trade Associations

The First Conduct Rule and the Second Conduct Rule apply to "undertakings." An "undertaking" is defined as any entity, regardless of its legal status or the way in which it is financed, which is engaged in an economic activity.¹⁴

Although an association as such may not itself be an undertaking, the Ordinance specifically prohibits an undertaking, "as a member of an association of undertakings," from making or giving effect to a decision of the association which harms competition.¹⁵ This prohibition is intended to target indirect anticompetitive cooperation between undertakings through an "association of undertakings," an example of which is a trade association.

Trade associations themselves can also fall within the definition of "undertaking" to the extent that they are engaged in economic activity, and the Ordinance would then apply equally to a "decision" by a trade association and an agreement or a "concerted practice" by its members.¹⁶ This means that both members and trade associations can be liable under the Ordinance. Notably, although statutory bodies are exempt from the application of the rules under the Ordinance (even where they are engaged in economic activity),¹⁷ their members or any third parties dealing with statutory bodies are not.

The enforcement authorities, the Competition ("HKCC") and the Communications Authority, have jointly published Guidelines on the First Conduct Rule (the "FCR Guideline") and the Second Conduct Rule (the "SCR Guideline"), which shed light on their approach to interpreting and enforcing the Conduct Rules.

¹⁰ SCR Guideline, ¶ 3.2.

¹¹ S.21(3)(a).

¹² S.21(3)(b), (c).

¹³ S.21(1), (2); SCR Guideline, ¶ 5.1.

¹⁴ S.2(1).

¹⁵ S.6(1).

¹⁶ S.6(2).

¹⁷ S.3(1).

The FCR Guideline devotes a whole section on discussing possible anticompetitive activities of members of trade associations or trade associations. Although the SCR Guideline does not consider the position of trade associations specifically, that is not to say that the Second Conduct Rule is irrelevant. The Second Conduct Rule may also be applicable when trade associations provide services to their members, particularly where the trade association is the main or only provider of such services and enjoys a substantial degree of market power.

Overall, the recent wide coverage of the possible effects of the competition rules on trade associations is most likely to have a chilling effect on their activities and membership.

III. THE KEY PITFALLS FOR TRADE ASSOCIATIONS AND THEIR MEMBERS

A. Price Recommendations and Fee Scales

1. Likely to be anticompetitive by object

The HKCC has indicated that price-fixing by trade associations could be an early focus of investigation once the relevant provisions of the Ordinance come into full force, as happened in Australia when competition law was introduced there.¹⁸ While it is clear that requiring members to set particular prices is anticompetitive by object, the HKCC has also made it clear that “recommended fee scales” and “reference” prices of trade and professional associations are decisions of associations of undertakings that the HKCC would likely consider as having the object of harming competition.¹⁹

The HKCC considers that price recommendations issued by trade associations are with a view to members charging similar prices for their goods or services and that the very reason price recommendations are made is with the expectation that members will follow them.²⁰ If price recommendations are allowed, competitors would be able to indirectly fix prices through trade associations to overcome the prohibition on directly fixing prices. The FCR Guideline explains this as follows:

Non-binding price recommendations or fee scales of a trade association will likely be assessed as having the object of harming competition, as ultimately these arrangements may not differ in substance to a direct agreement or concerted practice between the members of the association.²¹

While it may be argued that a true recommended fee scale or mere guide, which are generally not adhered to by members or which can otherwise be justified (where for example the fees represent an upper level or are considerably lower than would be the case if normal rates were to be charged), may not be in breach, such arguments would need to be looked at in context including any regulatory background to the association in question (where for example scales are provided for by law and therefore outside the ambit of the Ordinance.)²²

¹⁸ See, *Watchdog sets sights on trade price-fixing*, S. CHINA MORNING POST (May 24, 2014).

¹⁹ FCR Guideline, ¶ 2.36.

²⁰ See, *Competition Commission warns trade groups ahead of new ordinance*, S. CHINA MORNING POST, (June 17, 2015).

²¹ FCR Guideline, ¶ 6.14.

²² An example being the Solicitors (Trade Marks and Patents) Costs Rules.

2. Potential exclusions

The reason trade associations recommend non-binding prices or fee scales in practice may simply be to protect consumers, the very purpose that competition law seeks to achieve. It may be that consumers need to know what the market price or a reasonable price for the goods or services in question is, so that they are not overcharged.

In this sense, depending on the circumstances of each case, it could be argued that a certain recommendation is necessary to achieve an overall economic efficiency, which is a recognized exclusion to the First Conduct Rule. The assessment criteria needed to be met to rely on an overall economic efficiency exclusion, as set out in the Ordinance, include whether the conduct contributes to improving production or distribution, or promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit.²³ However, it may be difficult to show that the same objective cannot be achieved by other methods that would be less likely to harm competition, for example, by way of historical information provided by third parties on market rates.

Smaller trade associations may also find comfort in the "agreements of lesser significance" exclusion to the First Conduct Rule. The First Conduct Rule will not apply to a decision of an association of undertakings in any calendar year if it has a "turnover" of not more than HK\$200 million for the turnover period.²⁴ "Turnover" for a trade association means the total gross revenues of all the members of the association whether obtained in or outside Hong Kong.²⁵ However, this exemption does not apply to "serious anti-competitive conduct."²⁶

B. Exchanges of Information

1. Case-by-case analysis required

While exchanges of information are considered usual in modern competitive markets, any anticompetitive effects of information exchanges will be considered on a case-by-case basis. What is clear is that exchanging information on intended product prices is anticompetitive by object as this would allow others to adjust their future prices to reflect the price of their competitors.²⁷ The same applies to exchanges of information to facilitate other cartel conduct.

According to the FCR Guideline,²⁸ factors that are more likely to suggest that exchanges of information may have the effect of harming competition include:

- a highly concentrated market (i.e. where there are few players);
- the frequency of information exchanges;
- the exchange of current, detailed, and individualized/company specific information; and
- limited access to the information exchanged.

²³ Schedule 1, s.1.

²⁴ Schedule 1, s.5(1)(c).

²⁵ Schedule 1, s.5(5)(b).

²⁶ Schedule 1, s.5(1)(2).

²⁷ FCR Guideline, ¶ 6.40.

²⁸ FCR Guideline, ¶ 6.46.

Apart from the characteristics of the information exchange, the characteristics of the market itself are also important in assessing whether the exchange of information has the effect of harming competition.

2. Information surveys by trade associations

Information surveys that trade associations often prepare for members can be problematic. Although such surveys can be used to (i) facilitate research, (ii) increase market transparency and customer knowledge, (iii) gauge customer demand, and (iv) improve products and services, they raise competition concerns if associations collect and circulate information about members' business practices and activities, such as "price, elements of price or price strategies, customers, production costs, quantities, turnover, sales, capacity, product quality, marketing plans, risks, investments, technologies and innovations."²⁹ Such information is considered competitively sensitive information which, if exchanged, would harm competition, especially in highly concentrated markets where there are few players with identical or similar product offerings. Such information sharing could therefore be caught by the First Conduct Rule.

This is not to say that all information surveys are necessarily anticompetitive. Exchanges of "historical, aggregated and anonymised data"³⁰ and general market information should not raise competition concerns. Likewise, the exchange of publicly available information that is equally accessible by all parties is unlikely to contravene the First Conduct Rule.³¹ In general, anticompetitive effects are also less likely where information is exchanged in public and is available to others, including consumers.³²

3. Best practices

To minimize the risk of trade associations contravening the Ordinance by information exchanges, the following practices may be considered:

- Information collected should be limited to historical data, with no indication of future pricing, production or marketing.
- Specific raw data, such as pricing, markets, output, costs, and customers should be kept confidential.
- The information that is circulated should be general and aggregated to ensure that the anonymity of data is preserved.
- The number of participants in the survey should not be so small as to make it unlikely that the results will remain anonymous.
- Participation in the information exchange should be voluntary.
- The benefits of exchanging the information should be documented to show the pro-competitive purposes of the exchange. These purposes should not be departed from.

²⁹ FCR Guideline, ¶ 6.39.

³⁰ FCR Guideline, ¶ 6.47.

³¹ FCR Guideline, ¶ 6.48.

³² FCR Guideline, ¶ 6.59.

- Publicly available information should, where possible, be relied on.

C. Meetings

1. Anticompetitive discussions

Discussions involving hard-core cartel conduct or other anticompetitive conduct may take place under the veil of trade association meetings. Depending on the number of members in a trade association, there is always the possibility that a member will become a whistle-blower and cooperate with the HKCC to avoid being fined or pursued for anticompetitive conduct.³³ Members should therefore be alert to such a possibility.

2. Best practices

A clear agenda should be circulated in advance of every trade association meeting, and members should refrain from straying beyond the scope of the agenda set. Proceedings at the meetings should be well-documented and minutes circulated afterwards to all members. This may help prove that members did not discuss competitively sensitive topics during the meeting. If such topics were discussed, they should be accurately recorded, together with any objections raised.

Generally, members should refuse to enter into anticompetitive agreements, or leave meetings if sensitive matters that could be anticompetitive are discussed at a meeting.

The attendance of legal counsel at trade association meetings can also help prevent members from straying into discussions that might raise competition concerns.

D. Certification Standards and Standard Terms

1. Certification standards

Trade associations may award certifications to members to recognize that they meet certain minimum industry standards. A certification may serve as a hallmark of quality, or promote the compatibility of a certain product with other products, or constitute a qualification to practice. Competition concerns will arise where such certifications or qualifications are not transparent, where for example members are required to sell only the certified products, are restricted in their pricing or marketing conduct, or are unjustifiably restricted from practicing.

2. Standard terms

The setting of standard terms by trade associations has numerous benefits. Standard terms allow consumers to compare the offerings of different service providers and may reduce transaction costs, facilitate market entry, and increase legal certainty. However, they should not harm price or product competition. The FCR Guideline states that:

If a trade association prohibits new entrants from accessing its standard terms and the use of those terms is vital for successful entry into the market, the Commission will likely consider such conduct as having the object of harming competition.³⁴

³³ At the time of writing, the HKCC has yet to publish its guidance on its leniency policy.

³⁴ FCR Guideline, ¶ 6.65.

3. Best practices

Trade associations should ensure that any certification is available to all members who meet the objective and reasonably quantified requirements for certification.

They should also ensure that the standard-setting process is open, and the standard terms do not harm price, product, or other competition and are non-binding and accessible to both members and non-members.

E. Membership and Event Participation Criteria

Membership of an association or participation in certain organized events such as trade shows may be essential for competing in a market. As such, the terms upon which an undertaking can join a trade association as a member or participate in an organized event can in some instances be anticompetitive if they exclude the entry of a new member. Any terms which are not transparent, proportional, non-discriminatory, and do not provide for an appeal procedure in the case of a refusal to admit a member may be seen as having either the object or effect of harming competition.³⁵ For example, a minimum turnover threshold requirement for membership is likely to be anticompetitive.

The Second Conduct Rule is also engaged when trade associations provide services to their members, particularly where the trade association is the main or only provider of such services and enjoys a substantial degree of market power. In such a case, the trade association should refrain from engaging in conduct which would amount to an abuse of its power, such as imposing barriers to entry as discussed above.

IV. CONCLUSION

Trade associations are likely to be a key focus for the HKCC, as may be clarified in its forthcoming guidance on enforcement priorities. In particular, price recommendations and fee scales might be easy targets for scrutiny.

Therefore, the key messages that trade associations should note are:

- Great care should be taken to prevent price-fixing from arising in the activities of a trade association.
- Unless justified, even non-binding price recommendations or fee scales of a trade association may be assessed as having the object of harming competition as being arrangements in substance no different from a direct agreement or concerted practice between members of the association.
- The terms upon which an undertaking can join a trade association as a member may be anticompetitive if they exclude the entry of a new member.

Given the tough stance that the HKCC has taken in the FCR Guideline, the important question members of association are currently facing is whether or not they should withdraw membership from trade associations due to the competition risks associated with being a member. The HKCC has provided much needed reassurance that there should be no reason

³⁵ FCR Guideline, ¶ 6.57.

under the Ordinance for members of trade associations to withdraw membership, as long as the trade associations take steps to ensure that they do not facilitate anticompetitive conduct. The brochure published by the HKCC specifically for trade associations should be a valuable resource for trade associations in relation to the do's and don'ts in their operations.³⁶

In view of the benefits of membership of a trade association, the better approach is for members to urge the association concerned to adopt best practices, as discussed above, as well as establishing a comprehensive and tailored compliance policy to minimize the risk of breach.

³⁶ *The Ordinance on Trade Associations*, Competition Commission (May 2015).