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Getting Ready: The First Two Years of the Competition Commission in Hong Kong

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Competition Commission (Hong Kong)

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Rose Webb, Tim Lear, Philip Monaghan, & Derek Ritzmann[1]

I. INTRODUCTION

When an economy-wide competition law finally commences in Hong Kong in December 2015, a fully operational competition authority will be ready to begin enforcing the law. More than two years will have passed between the first appointments to Hong Kong's Competition Commission ("HKCC") and the proposed commencement of the substantive competition rules in the Competition Ordinance ("Ordinance") on December 14, 2015.

As this article outlines, this phased introduction of the law has given the HKCC an invaluable opportunity to become fully prepared for Hong Kong's entry into the growing ranks of Asian competition regimes. It has also afforded the business sector the chance to review and adjust their commercial arrangements in order to ensure compliance from day one.

II. HONG KONG'S COMPETITION LAW

As an autonomous Special Administrative Region of the People's Republic of China, Hong Kong has its own law-making powers and remains within the common law system. The Ordinance, Hong Kong's first cross-sector competition law, was passed by Hong Kong's Legislative Council on June 14, 2012.

Hong Kong has had a competition regime applying to the telecommunications and broadcasting sectors since 2000. In 2006, after many years of debate, a policy review by the Government recommended the introduction of a generally applicable competition law. Following public consultation on draft provisions during 2008, a Competition Bill was introduced into the Legislative Council in 2010. The Bill's passage through the Legislative Council was hotly contested. The Competition Bills Committee held a total of 38 meetings and received submissions from over 350 organizations and individuals.

The Ordinance is similar to competition laws around the world with provisions drawn to varying extents from the laws of the European Union, United Kingdom, Singapore, and Australia. The Ordinance contains (i) the three typical prohibitions on anticompetitive agreements (First Conduct Rule), (ii) prohibition on the abuse of substantial market power (Second Conduct Rule), and (iii) restrictions against mergers that substantially lessen competition (Merger Rule). At present the Merger Rule applies only to certain undertakings in the telecommunications sector.

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However, the Ordinance also contains a number of features unique to Hong Kong, some of which reflect various refinements made during the course of the Legislative Council debate.

The Ordinance also provides for the establishment and operation of the HKCC as an independent statutory body and the formation of a Competition Tribunal within the Hong Kong court system. Hong Kong's Communications Authority is given concurrent jurisdiction in respect of anticompetitive conduct in the telecommunications and broadcasting sectors.

The HKCC will not have the power to impose pecuniary penalties directly, but will be required to bring a case to the Competition Tribunal and prove that a contravention has occurred. In this respect the Hong Kong regime is similar to that of other common law jurisdictions such as the United States, Canada, Ireland, Australia, and New Zealand. However, unlike these jurisdictions, only the HKCC has standing to bring alleged contraventions to the Tribunal in the first instance. A "follow-on" action is available to those who have suffered loss or damage as a result of anticompetitive conduct. A range of other remedial tools, such as a commitments mechanism, are also available to the HKCC.

III. THE FORMATION OF THE HKCC

The provisions of the Ordinance relating to (i) the establishment of the HKCC, (ii) the short title, (iii) the commencement, (iv) the interpretation, and (v) the issue of guidelines by the HKCC came into operation on January 18, 2013.

The Chief Executive of Hong Kong appointed the Chairperson, the Hon Anna Wu Hung-yuk, and 13 other Members of the HKCC for three-year terms commencing in May 2013. The Chairperson and the Members are all non-executive appointments drawn from professions and sectors such as law, economics, consumer protection, financial services, commerce and industry, and small and medium enterprises ("SMES").

To support the setting up of the HKCC a group of civil servants was temporarily seconded to the HKCC. They found offices for the HKCC and established governance, financial, and personnel systems. Most crucially they assisted the Chairperson and Members in recruiting permanent staff for the HKCC.

In line with Hong Kong's outward looking and international character, the HKCC's recruitment is not restricted to residents of Hong Kong. Following a global recruitment exercise, the HKCC's staff includes those with experience in overseas competition agencies and in the practice of competition law in other jurisdictions. Local employees were found from Hong Kong law firms, other enforcement agencies, and government service.

The first permanent staff members, primarily in corporate roles, were employed from early 2014. From March 2014 the overseas members of the team started arriving in Hong Kong and joined their locally recruited colleagues. Additional staff joined during the course of the year. In early September, the HKCC's Chief Executive Officer, Dr. Stanley Wong, commenced duty. A further recruitment round conducted at the end of 2014 brought staff numbers up to 50 by the middle of 2015.

One early step taken by the HKCC was to join the International Competition Network ("ICN") in December 2013 and to attend OECD competition related activities. The HKCC also engaged closely with other competition authorities in Asia. The HKCC Members, and the staff

(once they came on board), found that participation in international fora and bilateral contacts with other competition agencies were invaluable in establishing the HKCC's operations.

IV. THE HKCC'S GUIDELINES

Drafting and consulting on the guidelines has been one of the HKCC's main pre-commencement tasks. The early commencement of those parts of the Ordinance requiring the issue of guidelines reflected the Government's undertaking that guidelines would be published by the HKCC prior to commencement of the competition rules. This arrangement is rather unusual when compared to most other jurisdictions where guidelines, especially those relating to the substantive interpretation of the competition rules, are usually based on actual enforcement experience and case law accumulated over time.

In October 2014, initial drafts of six guidelines—the *Guideline on the First Conduct Rule*, *Guideline on the Second Conduct Rule*, *Guideline on the Merger Rule*, *Guideline on Complaints*, *Guideline on Investigations*, and *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders*—were published for public consultation. Following consideration of the 64 submissions received, revised drafts of the guidelines were published in March 2015 and further comments invited. The March 2015 drafts were also presented to the Legislative Council for consultation as required by the Ordinance.

The final versions of the guidelines were published at the end of July 2015.

A. The Approach to Guidelines on the Conduct Rules

As general guidance on how the HKCC will interpret and apply the two conduct rules prohibiting anticompetitive agreements and abuse of substantial market power, the *Guideline on the First Conduct Rule* and the *Guideline on the Second Conduct Rule* provide detailed explanations on key concepts such as "undertaking," "object or effect" of harming competition, "serious anti-competitive conduct," and outline the HKCC's intended methodology for defining relevant markets and assessing (substantial) market power.

There was limited practical experience of competition law in Hong Kong to draw upon when preparing these guidelines. While influenced by foreign jurisprudence, the Ordinance is tailored to Hong Kong and does not precisely mirror competition law existing elsewhere. When interpreting the conduct rules, the HKCC drew upon international best practices wherever appropriate and consistent with the text of the Hong Kong legislation.

There were, however, certain difficulties in applying this approach where international practices are not settled, or where the Ordinance created new concepts that are specific to Hong Kong. For example, there are significant differences between jurisdictions in the treatment of resale price maintenance. During the public consultation, some offered the opinion that given the alleged pervasiveness of resale price maintenance in Hong Kong, the HKCC should consider giving a "light touch" to its enforcement, and that it should only be considered with reference to its effect on competition. Others submitted that the HKCC should use its guidelines to carve out vertical agreements, including resale price maintenance, completely from the First Conduct Rule.

After careful consideration and review of the comments received during the public consultation, the HKCC concluded that, without having yet established any enforcement

experience, it should give the statute its natural meaning which allows for resale price maintenance to be considered as either having the object or effect of harming competition.

This approach has been consistently applied throughout the guidelines.

It should also be remembered that the Competition Tribunal and other courts will be responsible ultimately for interpreting the Ordinance. The HKCC has refrained from broadening or narrowing natural interpretations until the Competition Tribunal or other courts have determinatively done so. For the same reason, the HKCC is of the view that it would be inappropriate to use the conduct rule guidelines to create any presumptions or new thresholds such as a market-share based level of appreciability or market-share safe harbors, which are not explicitly provided for in the Ordinance.

Instead, the HKCC used hypothetical examples that reflect market situations likely to be found in Hong Kong to explain the relevant theories of harm and the HKCC's intended analysis. The inclusion of these hypothetical examples in the guidelines was welcomed during the public consultation as a helpful way to demonstrate the practical application of the Ordinance.

Unlike the conduct rules, which will apply to undertakings in all sectors, the Merger Rule will only apply to mergers involving licensees under the Telecommunications Ordinance. The *Guideline on the Merger Rule* inherited some of the tested analytical and procedural approaches from the Telecommunications Authority's (now Communications Authority) *Guidelines on Merger and Acquisition in Hong Kong Telecommunications Markets* published in 2004.

While the analytical framework in respect of issues such as (i) what constitutes a merger, (ii) market definition, and (iii) competition assessment has now been aligned with the conduct rule guidelines, indicative safe harbors that have been proved pertinent to the telecommunications sector in Hong Kong are retained in the new guideline. Safe harbors like these, however, do not replace the need for case-by-case analysis in light of the prevailing market conditions.

B. The Approach to Guidelines on Procedural Matters

In addition to releasing guidelines on the substantive competition rules, the Ordinance required the HKCC to release guidelines on a range of its procedures. These are found in the *Guideline on Complaints*, *Guideline on Investigations*, and *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders*.

The *Guideline on Complaints* emphasizes that the HKCC encourages parties to complain about possible contraventions of the Ordinance. Complaints may be made in various forms, including anonymously, and do not require complainants to meet specific formal requirements for their complaints to be considered. However, if a complainant does not provide sufficient information or promptly respond to HKCC requests for information, it is unlikely that the complaint will proceed to further assessment.

During the consultation process, some businesses were concerned that this may place an undue burden on them (as the subject of a complaint), and suggested the HKCC should impose more stringent evidentiary requirements. Others proposed that there be some "legitimate interest" between the complainant and the conduct of concern. This response may have been

influenced by a misapprehension that the HKCC receiving a complaint inevitably means that the subject of the complaint would be drawn into an investigative process, regardless of the merits of the complaint. Both the Ordinance and the guidelines make it clear this is not the case.

The Ordinance is quite prescriptive on how investigations are to be conducted. Accordingly the *Guideline on Investigations* supplements the Ordinance only where the HKCC considers it necessary.

One area where the HKCC has clarified its approach is that, wherever possible, it will conduct investigations in confidence while making the outcomes of investigations public. Tribunal proceedings will usually, subject to the Tribunal Rules, be conducted in hearings open to the public. However the Ordinance allows for resolution of enforcement matters other than by commencing Tribunal proceedings. Publicizing outcomes such as issuing a Warning Notice or accepting a commitment will allow stakeholders to understand and scrutinize the HKCC's reasoning in these other cases.

The Ordinance contains a number of exclusions and exemptions. Once the Ordinance is fully operational the HKCC will have the power to issue Block Exemption Orders, either on application by undertakings or on the HKCC's own initiative, and to make decisions on the applicability of other statutory exclusions and exemptions to an undertaking's specific circumstances ("Decisions").

There is no need for a prior HKCC Decision or Block Exemption Order for undertakings to take advantage of the Ordinance's exclusions or exemptions. Undertakings to whom these exclusions and exemptions apply do not contravene the Ordinance. This differs from some other jurisdictions, where a competition authority must issue a block exemption or make some other decision before undertakings may rely on an exclusion or exemption.

The *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders* deals with the process by which the HKCC will consider applications for Decisions or Block Exemption Orders, and how the HKCC will consider issuing a Block Exemption Order on its own initiative.

As the HKCC is the initial decision maker in these circumstances, the guideline emphasizes that its consideration of whether to make a Decision or issue a Block Exemption Order will be a public process where relevant stakeholders will be consulted and applications, submissions, and decisions are published wherever possible.

V. OUTREACH AND EDUCATION

As a jurisdiction where many people are new to the concept of competition law, one of the primary tasks of the HKCC over the past two years has been promoting the benefits of competition and helping the Hong Kong business community become ready, willing, and able to comply with the Ordinance.

From the middle of 2014, the HKCC actively reached out to the Hong Kong public and businesses. In the early days of direct engagement there were clearly a number of misconceptions about the Ordinance and what types of conduct it was designed to prevent. For example, many small businesses thought that they would be accused of abusing market power. In one seminar provided by the HKCC for SMEs an attendee expressed concern that the Ordinance would

prohibit "bundling," thereby preventing the combined sale of coffee with cake. However, it was also clear that there were a number of very sophisticated players in the market, with a long history of interaction with competition laws in other Asian jurisdictions and globally.

In short, there was a very wide variance in understanding the purpose of competition law and role of the HKCC. While at this stage the results are anecdotal, the HKCC considers this gap has now narrowed following its extensive outreach and consultation efforts.

First, the HKCC has directly engaged with key stakeholders to provide detailed information about the benefits of competition, the Ordinance, and the HKCC itself. In the 2014 financial year, HKCC staff conducted 130 briefings and meetings and held five major seminars targeting groups such as SMEs in a mix of Cantonese and English. Through this direct engagement, some 4,500 representatives of major chambers, industry associations, SMEs, professional bodies, and consumers were reached. Based in part on feedback from these engagements, the HKCC also released education material to supplement the guidelines, such as brochures directed at SMEs and trade associations.

Second, to tie in with this engagement and consultation strategy, TV and radio advertisements were broadcast from October 2014 to educate the public about the benefits brought by competition law to both consumers and businesses. An educational video on cartels was also produced to explain the key concepts of common anticompetitive conduct and the importance of compliance.

This coincided with an extensive advertising campaign on print, bus, mass-transit, and online platforms including Yahoo, Facebook, and YouTube from October 2014 to January 2015. A second media campaign conducted solely on public transport (which is used by 90 percent of the Hong Kong population) using an educational video on cartels was launched to tie in with the release of the revised draft guidelines in March 2015. In July 2015, a ten-part series of one-minute educational spots starring well known Hong Kong television personalities aired at prime time on Hong Kong's largest free to air television network. This series dramatized examples of potential anticompetitive conduct, such as price-fixing, based on the examples provided in the HKCC's guidelines. The 10 episodes are also available on the HKCC website (www.compcomm.hk).

These promotions have been supplemented by an active and engaged local media. The HKCC has held various media briefings and interviews to keep local and international media abreast of latest development and progress of the HKCC's work. These updates have led to significant reporting about the Ordinance and the HKCC. For example, the publication of the HKCC's draft and revised draft guidelines made the prime time evening news, with a major news broadcaster animating examples from the guidelines to explain issues such as market definition, market power, and concerted practices.

The HKCC has launched a Distinguished Speaker Lecture Series to provide a platform for outstanding thinkers on competition law and policy to share their views with the growing Hong Kong competition law community, Government, business leaders, and the general public. This series has hosted talks from Mr. Eduardo Pérez Motta and Sir Christopher Bellamy QC, with a further lecture planned for late 2015.

The improved awareness of the Ordinance and the HKCC has led to increasing contacts enquiring about conduct that people are concerned may contravene the Ordinance. So far the HKCC has limited its response to assisting these people where possible and recording these queries. As the date of full commencement approaches, the HKCC will, in appropriate cases, contact businesses and other relevant parties directly if the HKCC considers that their conduct or practice may be considered anticompetitive and, therefore, likely to contravene the Ordinance after full commencement.

VI. ENGAGING IN THE POLICY DEBATE

During this pre-commencement phase the HKCC has already actively participated in wider Government policy debates that have a competition dimension. The HKCC's statutory functions include "to advise the Government on competition matters in Hong Kong and outside Hong Kong]" and "to conduct market studies into matters affecting competition in markets in Hong Kong."

The market studies function is used in three main ways: first, as an opportunity to study markets of interest; second, to identify markets, conduct, or parties that may raise competition concerns and to inform future enforcement priorities; and third, to identify systemic competition risks that are best resolved by Government policy and to inform the HKCC's policy advice to the Government. The HKCC has commenced generating a commensurate range of work products, ranging from targeted public submissions of Government to confidential internal studies, and it will in due course issue a comprehensive public market studies report where appropriate.

Because of this proactive approach, the HKCC has been able to make contributions to several policy debates even before substantive commencement of the Ordinance. Based on the study of the market for building management services in Hong Kong's many large housing estates, a submission was made to the Government's public consultation in support of proposed changes to relevant laws, as the HKCC judged these changes to be likely to enhance competition in that market. The HKCC also made a submission to the Government's public review into the future of the electricity market, supporting the Government's stated objective of introducing competition into this market and outlining the ways in which this could be achieved.

Substantial and ongoing competition research is being conducted into a number of markets that are the subject of public interest, including automotive fuels markets and the tender markets for housing estate renovation. The HKCC, as an independent statutory authority, will continue to give independent policy advice to arms of Government on matters related to competition.

VII. OTHER STEPS TOWARDS COMMENCEMENT

As noted above, the Ordinance provides for the HKCC to have concurrent jurisdiction with the Communications Authority in respect of undertakings in the telecommunications and broadcasting sectors. As soon as practicable after commencement of the Ordinance, the HKCC and the Communications Authority are required to enter a Memorandum of Understanding ("MOU") for the purpose of coordinating the performance of their functions. The HKCC has worked closely with the Communications Authority on a number of the preparatory steps,

including the joint publication of the guidelines. Drafting of the MOU is well advanced so as to have it ready for formal signing soon after commencement.

In addition to the Communications Authority, the HKCC has used this pre-operational phase to develop relationships with other Hong Kong agencies, including the Consumer Council, the Securities and Futures Commission, the Urban Renewal Authority, and the Hong Kong Monetary Authority.

The Ordinance specifically empowers the HKCC to enter leniency agreements where, in return for co-operation, the HKCC will agree not to bring proceedings for a pecuniary penalty. As part of its preparatory work, the HKCC has been formulating its approach to entering into leniency agreements and has recently published a draft policy for public comment. The HKCC has also been considering its enforcement priorities, and a document explaining these will also be published before commencement of the Ordinance.

VIII. CAPACITY BUILDING

In addition to drafting the guidelines and engaging with the public and business community, the HKCC has focused on internal capacity building.

Effective investigations require a range of skill sets, procedures, and, in the Hong Kong context, language abilities. To this end, much time has been devoted to developing internal procedures, work processes, and software to handle complaints, case-work flows, documents, and evidence in multiple languages.

Staff development and training have also been a key focus. Members of the HKCC's staff team have been provided support to study, attend domestic and international workshops, and work within other competition authorities. Visiting lawyers, economists, academics, and competition authority members have regularly presented to staff and HKCC Members on their areas of expertise. Finally, internal training focusing on core skills is being rolled out to promote a consistent and considered approach to every matter that comes before the HKCC.

As noted above, the HKCC has received excellent assistance from other competition authorities and international bodies such as the ICN and OECD in developing and implementing its policies and procedures.

The flipside of course is that expectations on the HKCC are, probably appropriately, high. The maturity of analysis and process that may have taken other (now established) competition authorities decades to achieve will be expected in a much shorter timeframe in Hong Kong.

IX. CONCLUSION

The relatively long period between formation of the HKCC and full commencement of the Ordinance has been used to good effect by the HKCC to prepare Hong Kong for the introduction of competition law. Businesses have had time to familiarize themselves with the law, and have benefitted from comprehensive guidelines and the HKCC's outreach activities. The public's understanding of the purpose and benefits of competition law has increased. Media commentary is increasingly focusing on competition-related issues.

Importantly, the HKCC itself has been able to use this preparatory phase to prepare itself for the implementation of the law. Just as it has sought to have Hong Kong ready, willing, and

able to comply with the Ordinance, the HKCC will be fully prepared to undertake the task of ushering in a long anticipated change to Hong Kong's economic and legal environment.

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Exclusions and Exemptions Under the Hong Kong Competition Ordinance

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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 excluded[3] 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 efficiencies[4] whose benefit should be shared with consumers, (ii) should not impose restrictions that are not indispensible 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.

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Resale Price Maintenance Under the Hong Kong Competition Ordinance—An Uneasy Compromise

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Resale Price Maintenance Under the Hong Kong Competition Ordinance—An Uneasy Compromise

Mark Jephcott, Adelaide Luke, Lisa Geary, & Molly Herron[1]

I. INTRODUCTION

The treatment of resale price maintenance ("RPM") under Hong Kong's soon-to-be operational competition regime is a hot topic in the region.

RPM, the practice under which a manufacturer/supplier establishes fixed or minimum (or, in certain circumstances, maximum or recommended) resale prices that a distributor/retailer must observe when reselling the contract goods or services,[2] is reported to be commonplace in Hong Kong. RPM can be achieved directly (for example, via a clause in a distribution agreement) or indirectly (for example, by fixing the level of discounts which a distributor may grant from a particular price level, applying penalties for failure to adhere to a prescribed resale price, and/or tying rebates or other benefits to adherence to a recommended resale price).

RPM is a subject that has engendered significant debate in recent years and has been subject to considerable scrutiny from competition authorities globally. However, the treatment of RPM and the level of enforcement activity do vary from jurisdiction to jurisdiction. In Taiwan, for example, RPM was considered to be *per se* illegal and has been the subject of extensive enforcement action in recent years.[3] This hard-line stance can also be seen at the EU level, where RPM remains presumptively problematic (albeit with little enforcement activity by the EU Commission itself). At the other end of the spectrum, Singapore's competition law contains a broadly worded exemption from the prohibition on anticompetitive agreements for vertical arrangements including RPM (albeit that this exemption is not absolute). Many other jurisdictions, such as the United States (at least at the federal level), adopt a "middle-ground" by subjecting RPM arrangements to a "rule of reason" effects-based assessment.

Hong Kong currently stands out as possibly the most developed economy in the world not

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[2] A related practice common in the e-commerce world is the imposition of internet minimum advertised prices ("IMAPs"), whereby the supplier of a product/service imposes restrictions on what prices a distributor/retailer can display on online channels. While such IMAPs in theory may not involve an actual restriction on the ultimate sales price, in practice such provisions may restrict competition in the same manner as outright RPM.

[3] With fines being imposed across a variety of industries, from pet nutrition to board games to mobile phones. The Taiwanese rules were, however, amended in 2015 to provide that RPM can be permissible where there are "justifiable reasons" (stated to include consideration of factors such as the enhancement of pre-sales services and the prevention of free-riding). It remains to be seen how willing the competition authority will be to conduct "rule of reason" type assessments and accept these justifications in practice.

yet to have a comprehensive competition law in force.[4] Barring any last-minute legislative delays, this is expected to change on December 14, 2015 when the Hong Kong Competition Ordinance ("Ordinance"), which has been on the statute books for over three years, comes into full force.

Considerable interest has surrounded the treatment of RPM under the Ordinance's prohibition on anticompetitive agreements (the First Conduct Rule) and the accompanying guidelines including the Guideline on the First Conduct Rule ("Guideline")[5] issued by the Hong Kong Competition Commission ("HKCC"). During its consultations on earlier drafts of the Guideline, the Commission received numerous submissions expressing views on the appropriate treatment of RPM under the Guideline and the Commission has also apparently received a number of queries and complaints regarding RPM ahead of full implementation of the Ordinance.

The level of debate is broadly reflective of the multitude of views that exist among competition authorities, businesses, and legal/economic practitioners regarding RPM. It also demonstrates the importance of RPM in a small economy such as Hong Kong, which has a substantial focus on retail and distribution.

The purpose of this article is to outline the Commission's stated approach to the assessment of RPM practices and to assess where the Hong Kong regime (as reflected in the Guideline) would appear to sit on the worldwide spectrum of RPM enforcement. It also considers the practical implications of this approach for Hong Kong businesses, and businesses that operate regionally in Asia Pacific.

II. THE POLICY BACKGROUND: WHY IS THERE SUCH A DEBATE ABOUT RPM?

The appropriate treatment of RPM under competition law provokes strong, and divergent, viewpoints. Certain businesses, for example some suppliers of branded goods, will argue vehemently that control over their supply chain via RPM is necessary to maintain a quality image or to ensure that resellers invest adequately in promotional activities or customer services. Some resellers may maintain RPM is necessary in order to ensure they have sufficient margin to make such investments/to prevent undercutting by other resellers "free-riding" on these investments. Other businesses, for example some resellers (often online "e-tailers") with a low-cost, low-price business model, will argue that RPM, when practiced by suppliers, hinders their entry or expansion, and will be quick to challenge such behavior as anticompetitive. [6]

In terms of competition policy and economics, some divergence of viewpoints is inevitable given that vertical agreements, including RPM, can have both pro-competitive and anticompetitive effects. Much has been written on this topic, but a brief summary follows.

RPM may harm competition at the supply level, for example, by facilitating collusion through increased pricing transparency (at least where RPM is widespread) or hindering access

[4] The current regime applies only in the telecommunications sector.

[5] *See, Guideline on the First Conduct Rule*, published by the HKCC and the Hong Kong Communications Authority on July 27, 2015, *available at* http://www.compcomm.hk/en/guidelines.html.

[6] The Office of Fair Trading, the U.K.'s legacy competition authority, has, for example, noted that RPM was its "most complained about" practice.

to distributors by smaller suppliers. At the distribution/retail level RPM may again facilitate collusion between downstream competitors, and is likely to reduce intra-brand competition as resellers can no longer compete on price, and new entrants may be prevented/hindered by an inability to gain market share by undercutting on price. This is likely to lead to higher prices for consumers.

It is generally recognized, however, that RPM can potentially give rise to pro-competitive effects. RPM may promote competition on non-price aspects that may be important to customers. In particular, it may promote inter-brand competition by providing signals as to quality certification, or may reduce free-riding by other distributors in respect of, for example, pre-sales services (thus maintaining incentives for resellers to offer these services). Such arguments are often put forward in relation to hi-tech, complex or "experience" products, with a common example being a customer testing such a product (such as a home cinema system) and receiving advice from sales staff in the expensive bricks and mortar show room of a high-end retailer, only to actually purchase the product from a cut-price e-tailer not offering these services.

While recognizing the validity of these arguments, competition authorities in some jurisdictions can be reluctant to accept their application to particular facts, given that there may be other methods to secure the same outcome (such as by securing contractual commitments to pre-sales services). The resulting uncertainty has the potentially negative impact that, due to concern about compliance with competition law, businesses adopt a cautious approach and do not enter into arrangements that may in fact be overall pro-competitive.

In light of the above, there has been continued debate in mature competition law regimes as to how to appropriately categorize RPM in terms of a competition authority's enforcement framework. This debate has focused, in particular, on two questions: (1) whether RPM is regarded as presumptively legal or illegal and (2) who bears the burden of proof. This debate reflects the fact that the practice may have different overall effects on competition depending on the factual circumstances. Further, there is concern about providing sufficient legal certainty to businesses.

This policy issue was considered carefully by the EU Commission at the time at which it issued a new version of its guidelines on vertical agreements in 2010,[7] in which it, largely, maintained its anti-RPM stance (see further below). In contrast, other regimes, such as the United States and Brazil, have recognized the potential pro-competitive effects of RPM by shifting in recent years from applying an assessment standard that categorizes RPM as *per se* problematic to a "rule of reason" effects-based approach.

It is against this background that the debate in Hong Kong occurred; the approach ultimately adopted by the Commission within its Guideline is discussed below, but of course the impact on Hong Kong markets will depend on how the Commission applies this Guideline to individual cases and whether the Hong Kong Competition Tribunal ("Tribunal") endorses the approach of the Commission.

In respect of the wider policy picture and the likely enforcement priorities of the Hong

[7] *See,* http://ec.europa.eu/competition/antitrust/legislation/vertical.html.

Kong authorities in practice, while there remains considerable enforcement of classic RPM worldwide,[8] recent enforcement attention in a number of jurisdictions with established competition law regimes has focused on more complex forms of RPM where the RPM is ancillary to, or supportive of other forms of, potentially anticompetitive behavior. Topical examples include RPM related to "most favored nation" ("MFN") clauses or "best price guarantee"/"price parity" provisions, where a supplier may need to impose RPM on some resellers/platforms in order to meet an MFN or best price guarantee obligation to another reseller/platform.[9]

It is likely, however, that in Hong Kong both businesses and the Commission will need to first get to grips with straightforward RPM. They will also need to grapple with the separate, but related, prior question of when the setting of resale prices by a supplier amounts to an agreement or concerted practice between independent undertakings within the meaning of the Ordinance. This depends on whether the supplier and the distributor should be regarded as separate entities in competition law terms, or whether the distributor is acting as a "genuine agent" of the supplier simply entering into contracts on its behalf and should be treated as part of the same undertaking, such that the supplier setting prices would not fall within the scope of the First Conduct Rule at all.

III. RPM UNDER THE ORDINANCE

As is the case in many other jurisdictions, the First Conduct Rule prohibition on anticompetitive agreements does not refer specifically to either vertical agreements (between undertakings at different levels of the supply chain, such as RPM) or horizontal agreements (between competitors). Instead, it applies to any agreement or concerted practice that has the object or effect of preventing, restricting, or distorting competition in Hong Kong.[10] However, absent a specific exclusion for vertical agreements, it is clear that these agreements can fall within the prohibition, a position that has been confirmed by the Commission within its Guideline.[11]

Again, the definition of agreements constituting "serious anti-competitive conduct" ("SAC") under the Ordinance[12] does not specifically refer to vertical or horizontal agreements. This definition lists classic horizontal agreements, such as bid-rigging and market-sharing. Importantly for these purposes, however, the list includes conduct involving "fixing, maintaining,

[8] In particular by national competition authorities (such as in Germany and the United Kingdom) in Europe, but also by competition authorities in Asia Pacific, both in established regimes (such as Australia) and within relatively new regimes (such as China and Malaysia).

[9] *See* for example the various investigations across Europe, and most recently in Australia, into the arrangements between online travel agents and hotels in relation to room rates, and the investigations by the German and U.K. competition authorities into Amazon's terms and conditions for resellers on its Marketplace platform.

[10] Unless the agreement/concerted practice can be justified on efficiency grounds on the basis of the criteria set out in Section 1 of Schedule 1 to the Ordinance.

[11] *See* Guideline, *supra* note 5, at ¶ 6.1.

[12] Categorization of conduct as SAC is very significant as this has important procedural consequences. These include the fact that the "Agreements of lesser significance" provisions within Section 5 of Schedule 1 to the Ordinance excluding certain *de minimis* agreements from the First Conduct Rule do not apply to SAC, and that there is no requirement in the case of SAC for the Commission to issue a "warning notice" before bringing infringement proceedings before the Tribunal.

increasing or controlling the price for the supply of goods or services" which, absent any statutory limitation of SAC to agreements between competitors, may be interpreted to include RPM, aka vertical price-fixing. The Commission adopts this interpretation within its Guideline, stating that in some circumstances RPM may amount to SAC (see further below). [13]

IV. RPM UNDER THE GUIDELINE

A. Background to the Guideline

Following two rounds of draft guidelines and an extensive consultation process, on July 27, 2015 the final versions of the Commission's suite of guidelines on the Ordinance were published, including the Guideline on the First Conduct Rule.[14]

While the Tribunal will be the ultimate arbiter of the meaning and application of the Ordinance, the guidelines set out the general approach which the Commission intends to apply, and, as such, are an invaluable resource for businesses.

B. Assessment of RPM Under the Guideline[15]

As noted above, there was considerable debate during the gestation of the Guideline as to how the Commission should approach RPM. The Commission appears to have initially considered whether to adopt some form of exemption for vertical agreements, and potentially RPM, under the Ordinance.[16] Conversely, it also appeared to take the view in an earlier version of the Guideline that it considered RPM to have the "object" of harming competition.[17]

In the final Guideline it has adopted an apparent compromise position, taking the view that "RPM arrangements have an inherent potential to harm competition in Hong Kong"[18] and therefore a "light touch" approach is not warranted. It has, however, recognized that "in certain cases RPM arrangements may be made for a pro-competitive purpose" and therefore would not automatically infringe the First Conduct Rule in all cases.

Within the final Guideline the Commission is therefore clear that RPM constituting fixed- or minimum-resale prices (whether set directly or indirectly) may infringe the First Conduct Rule. However, whether such RPM infringes the Ordinance in an individual case is less clear because, although the Guideline contains some useful insights into the Commission's likely approach to the assessment of RPM, the Commission has adopted an enforcement framework that allows it considerable leeway in its assessment. In summary:

- RPM "may" be regarded as having the "object" of restricting competition, and can therefore be regarded as problematic without any requirement for the Commission to

[13] *See* Guideline, *supra* note 5, at ¶¶ 5.5-5.6.

[14] *See* http://www.compcomm.hk/en/guidelines.html.

[15] *See* Guideline, *supra* note 5, at ¶¶ 6.71-6.84.

[16] "Some competition authorities…provide exemptions to smaller firms engaging in [RPM]," *see*, *Getting prepared for the full implementation of the Competition Ordinance*, Competition Commission (May 2014), *available at* http://compcomm.hk/en/pdf/consultations-en.pdf.

[17] *See* ¶¶ 3.7 and 5.6 of the October 2014 Draft Guideline to the First Conduct Rule.

[18] Competition Commission, *Guide to the Revised Draft Guidelines Issued under the Competition Ordinance*, ¶44 (March 2015), *available at* http://www.compcomm.hk/en/pdf/consultations/2015/Guide_e_0329.pdf

establish it has actually affected competition on the market.

- Not all RPM will, however, automatically be regarded as having the object of restricting competition; this depends on the content of the agreement establishing the RPM, the way the arrangement is implemented, and the relevant context.
- RPM may, in some circumstances, amount to SAC.
- If RPM does not have the object of harming competition, the Commission will assess whether it nevertheless has the effect of restricting competition.
- Even where the RPM is found to have the object or effect of restricting competition, and therefore in principle infringes the First Conduct Rule, it is open to the parties to put forward evidence of economic efficiencies such to justify the arrangement under Section 1 of Schedule 1 to the Ordinance.

The Guideline does not articulate in detail when RPM will be regarded as having the object of restricting competition, or provide any safe harbors where no object can be assumed. It does, however, give examples of where the Commission will, or is likely to, find RPM to constitute an object infringement,[19] and include a description of the Commission's likely assessment of a number of hypothetical factual scenarios. The Guideline also provides some hypothetical examples where RPM "possibly" would not constitute an object infringement (for example where utilized in a franchise distribution system for the purposes of organizing a short-term coordinated promotional price campaign), and as to the likely effects assessment in these cases.

The Guideline contains even less commentary on when RPM will be regarded as sufficiently serious to constitute SAC, although again the Commission provides some hypothetical examples where RPM is likely to be regarded as SAC. In relation to efficiency defenses, the Commission does give some examples of where such arguments may be made, for example to avoid a free-rider problem, but makes it clear that compelling evidence would be required in order for these to be accepted.

In relation to recommended or maximum prices, the Guideline unsurprisingly provides that where in reality these operate as fixed or minimum prices, these will be assessed in the same manner as fixed or minimum RPM. Where there are genuine recommended or maximum prices, these will not be regarded as having the object of restricting competition, but will be subject to an effects analysis; considering, for example, whether they serve to establish a "focal point" for distributor pricing and whether the supplier has market power.

C. Agency vs. Distribution

Finally, the Guideline includes guidance on the related question of whether a distributor is to be regarded as a separate independent undertaking (such that the First Conduct Rule would apply to pricing restrictions and other aspects of the agreements between the supplier and

[19] For example where there is evidence that the RPM was implemented by a supplier in response to pressure from a distributor seeking to limit competition from its competitors, or if the RPM is implemented by a supplier solely to foreclose competing suppliers.

distributor) or as a true agent (in which case the First Conduct Rule would not apply to restrictions imposed on the agent in so far as they relate to the contracts concluded on behalf of the supplier). As per the approach in the European Union, the question of whether the agent is a true agent is stated to depend on the extent to which the agent bears risks in relation to the contracts concluded on behalf of the supplier, with the Guideline setting out examples of costs and risks to be taken into account.[20] Although this guidance is useful, these assessments are inherently difficult in practice, in particular at this stage, in the absence of any decisional practice from the Commission/Tribunal.

D. Conclusion on the Guideline

Overall, while the recognition within the final Guideline that not all RPM has the object of restricting competition is welcome, and the Guideline contains some helpful examples, the guidance is carefully caveated and the Commission retains considerable flexibility as to assessment in individual cases. The examples provided of conduct that is unlikely to infringe the First Conduct Rule (at least by object) are narrowly drawn, and there is very limited explanation of the type of RPM conduct that could be considered SAC.

It is clear that the Commission has given some consideration to this issue, in light of changes made between the various iterations of the Guideline and based on public statements by Commission officials. The Commission will likely have deliberated on the various submissions it received during the consultation process, some of which advocated a more lenient treatment of RPM under the Guideline. It will also have considered the approaches to RPM that are adopted in established competition law jurisdictions worldwide while taking into account the specific characteristics of the Hong Kong economy.

However, the compromise position reached in the Guideline provides relatively little in terms of legal certainty as to the circumstances in which RPM may be acceptable.

Further guidance may be provided in due course by the decisional practice of the Commission and the Tribunal, but in the meantime businesses will have to tread very carefully in this area.

V. HOW DOES THE APPROACH IN HONG KONG COMPARE TO OTHER JURISDICTIONS?

As can be seen from the above, the Commission has sought to reach a balance between retaining its ability to categorize RPM arrangements as object infringements—and even SAC—and recognizing that in some cases RPM may be unproblematic or in fact pro-competitive. In this sense the proposed approach in Hong Kong, at least on paper, is not as strict as in those jurisdictions, such as Australia, Japan, and (previously) Taiwan, where RPM is assessed under a *per se* standard and assumed to be problematic.

The Commission also appears to be taking a more flexible approach than that of the EU Commission, which presumes all RPM to have the object of restricting competition and that it is unlikely that the conduct can be justified on efficiency grounds—the burden of proof then

[20] *See* Guideline, *supra* note 5, at ¶¶ 2.11-2.17.

switching to the parties to demonstrate such justification.

However, the approach is stricter than in those jurisdictions that carry out an effects-analysis in all cases under a rule of reason standard (such as the United States at a federal level, and, potentially, Indonesia), and those that provide safe harbors for vertical agreements that extend to RPM (such as Singapore). If RPM enforcement is viewed as a continuum in which *per se* approaches are plotted to the left and exemptions for all vertical agreements to the right, then based on its theoretical framework Hong Kong will sit to the center-left of this line.

How the Hong Kong approach fits on the continuum in practice will of course depend on how the guidance is actually applied, and whether RPM is taken up as an enforcement priority by the Commission. Indeed, it will be very interesting to see how, and to what extent, RPM is reflected in the Commission's forthcoming statement of its enforcement priorities.

However, it is clear that the Guideline adds yet another nuance to the already patchwork nature of RPM enforcement within Asia Pacific (as well as globally). Even looking more narrowly at Greater China, approaches differ from jurisdiction to jurisdiction and even within jurisdictions, with the approach in Mainland China arguably diverging between the more hard-line "restriction by object" stance which appears to be being taken by the National Development and Reform Commission,[21] and the judicial approach (to date) making it clear that an anticompetitive effect must be demonstrated and therefore that a rule of reason assessment is required.[22]

This variety of approaches presents challenges for companies doing business in the region, meaning that identical distribution arrangements cannot be used on a pan-Asia Pacific basis unless an approach is taken which applies the strictest legal position across all jurisdictions. However, this may be an unnecessarily restrictive approach to take in respect of some jurisdictions that adopt a more permissive approach to RPM.

VI. IMPLICATIONS OF THE APPROACH TO RPM FOR HONG KONG BUSINESSES

So where does this leave Hong Kong businesses (and overseas companies doing business in Hong Kong) assessing their distribution arrangements?

Given the lack of certainty arising from the compromise approach adopted within the Guideline, and the real risk of RPM practices being found to constitute SAC (with the consequences that follow), a prudent approach, at least until some decisional practice exists, would be to assume that the imposition of fixed or minimum resale prices will infringe the First Conduct Rule and therefore need to be avoided unless very clear exceptional circumstances—verified by a careful legal and economic assessment—apply. Potential examples may include where this relates to a short-term promotion for a new product or there is a real free-riding problem that cannot readily be resolved through other solutions (such as service requirements).

Businesses will need to take care to ensure not only that their written contractual

[21] With significant enforcement activity occurring in a variety of sectors, including premium liquor, baby formula, contact lenses, and automotive distribution, at both a national and regional level (*see* most recently the fines imposed by the Guangdong Development and Reform Commission on Dongfeng-Nissan).

[22] *See* the 2013 Shanghai High People's Court ruling in *Rainbow v Johnson & Johnson*.

arrangements preserve resale pricing freedom for distributors/retailers, but also that this freedom is available in practice. For example, rebates or other rewards/incentives must not be linked to resale pricing, discounting should not be subject to pre-approval processes, and termination or reduction of supply must not be linked to resale prices in any way (with genuine reasons for cessation or changes to supply arrangements being documented carefully).

Finally, although one method for retaining control over resale pricing while remaining in compliance with competition law is to move from a distribution to an agency model, businesses will need to be alive to the fact that just because a reseller is labeled an "agent," this does not mean it will be regarded as such under the Ordinance, and therefore a careful assessment of the reality of the relationship will need to be carried out.

As with other aspects of the Ordinance, businesses need to assess carefully their practices (including any global or pan-regional distribution agreements applying to Hong Kong that currently provide for resale price-fixing) now to determine whether any changes need to be made prior to the entry into force of the Ordinance in December, and to ensure that clear compliance policies, procedures, and training are in place.

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Treatment of Resale Price Maintenance in Hong Kong

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Treatment of Resale Price Maintenance in Hong Kong

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I. INTRODUCTION

Three years after its enactment, the Competition Ordinance of Hong Kong ("Ordinance") is set to come into force on December 14, 2015. This article reviews the conceptually framework which the Hong Kong Competition Commission ("HKCC") will be adopting in assessing resale price maintenance ("RPM"), one of the issues at the center of interest in Hong Kong before and after the enactment of the Ordinance.

Emphases will be on the theories of harms, recognized pro-competitive effects of RPM, and the role of intra-brand competition relative to inter-brand competition, as contained in the official guidelines published in July 2015. This article also provides some historical background regarding the occurrence of, and various views about, RPM in Hong Kong in order to fully understand its seemingly "near per se illegal" treatment of RPM.

II. HISTORICAL BACKGROUND

RPM has received great attention in Hong Kong since the mid-1990s when Hong Kong first started discussing introducing competition law, as initiated by the Hong Kong Consumer Council.

In 1996, the Consumer Council received two complaints, one of which was from Carrefour, a French supermarket chain. Carrefour had just entered the Hong Kong supermarket sector, which was highly concentrated with the two local supermarket chains occupying as much as 70 percent of the market. To attract customers, Carrefour adopted an aggressive pricing policy where each week a significant number of products were for sale at below the recommended resale price (recommended discounted price in some cases). This led to complaints by suppliers to Carrefour and threats that supplies would be withheld until Carrefour returned to the agreed price level. In some cases these threats were carried out.

Carrefour supplied the Consumer Council with the names of 22 companies that it claimed had put pressure on it to return to recommended prices. Seven of the 22 companies contacted by the Consumer Council confirmed having told Carrefour that they would take action to enforce RPM.[2]

In another complaint, a discounted chain retailer, Pricerite, sold mattresses from several suppliers below the recommended resale price, which led a supplier to immediately withhold supplies, as well as refuse to deliver to customers who had purchased the under-priced mattresses during the promotion period. In its response to the enquiry from the Consumer Council, the

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[2] Hong Kong Consumer Council, *The Practice of Resale Price Maintenance in Hong Kong*, *available at* http://www2.consumer.org.hk/p253/resale_e.htm.

supplier, which had a network of around 1,000 retail stores in Hong Kong, justified its three-year old RPM policy as a strategic initiative to enhance sales and sales service. The supplier also restructured its retail network and selected 120 out of the 1,000 outlets to operate as exclusive distributors.

Based on its inquiries with the relevant parties, the Consumer Council concluded in its research report that "RPM exists in Hong Kong. … This evidence of the existence of RPM provides support for the recommendations made by the Council that Hong Kong should enact a comprehensive Competition Law and establish a Competition Authority to enforce it."[3]

In November 2011, the Competition Policy Advisory Group ("COMPAG") of Hong Kong[4] received two complaints, alleging that the following practices of some supermarket chains and retail chain stores with market power were anticompetitive:

- Certain supermarket chains were alleged to have pressured a soft drinks supplier not to supply soft drinks to a local retailer who had refused to comply with the recommended price for a particular soft drink set by the supplier.
- A supermarket chain was alleged to have pressured a supplier not to supply instant noodles of a particular brand to a local retailer if the retailer refused to comply with the recommended price for the product set by the supplier.
- Certain retail chain stores were alleged to have pressured a supplier of electrical appliances to request a local retailer (to which the supplier supplied products) to increase the price of some of the electrical appliances to the level of the recommended prices set by the supplier.

While none of the three cases were prosecuted due to insufficient information and evidence at the time of the complaints—when Hong Kong had not yet established a general competition law[5]—these cases seem to have influenced greatly the attention and position of the HKCC toward RPM, as we shall see below.

III. RPM UNDER THE COMPETITION ORDINANCE: THE FIRST CONDUCT RULE

After more than a decade-long debate and two rounds of public consultation, Hong Kong enacted the Ordinance in 2012. The First Conduct Rule of the Ordinance prohibits anticompetitive agreements and concerted practices and decisions having the object or effect of preventing, restricting, or distorting competition in Hong Kong. It applies to both horizontal and vertical agreements.

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[3] *Supra* note 2.

[4] Chaired by the Financial Secretary of Hong Kong, COMPAG was established in December 1997 to provide a high-level and dedicated forum to review competition-related issues in Hong Kong. It promulgated a Statement on Competition Policy in May 1998 to provide an overarching policy framework to guide sector-specific efforts to promote competition. COMPAG gives advice to government bureaux and departments in reviewing policies and practices from the competition standpoint, and in proposing new initiatives to promote competition in different sectors.

[5] *See* COMPAG Annual Report (2011-2012), *available at* http://www.compag.gov.hk/report/Compag_Report_2011-12_Eng.pdf

In July 2015, the HKCC published its Guideline on the First Conduct Rule ("Guideline"), along with five other guidelines on (i) the Second Conduct Rule, (ii) mergers, (iii) complaints, (iv) investigations, and (v) exclusions and exemptions. The HKCC is of the view that while generally less harmful to competition as compared to horizontal agreements, some vertical agreements may, nonetheless, cause harm to competition.

The Guideline defines RPM in the following way: RPM occurs whenever a supplier establishes a fixed or minimum resale price to be observed by the distributor when it resells the product affected by the RPM obligation. The Guideline also makes a distinction between direct RPM and indirect RPM. RPM can be achieved indirectly, for instance, by fixing the distributor's margin or the maximum level of discount the distributor can grant from a prescribed price level. The supplier might also make the grant of rebates or the reimbursement of promotional costs subject to the observance of a given price level by the distributor, or link the prescribed resale price to the resale price of competitors. The supplier might equally use threats, intimidation, warnings, penalties, delays in, or the outright suspension of, deliveries to achieve RPM. While having no legal binding effect, the Guideline sets out how the HKCC intends to interpret and give effect to the First Conduct Rule.

Schedule I to the Ordinance contains a general exclusion for agreements of lesser significance. Pursuant to that provision, the First Conduct Rule does not apply to an agreement between undertakings (or a concerted practice engaged in by undertakings) in any calendar year if the combined turnover of the undertakings does not exceed HK$200 million (approximately U.S. $25.8 million). Here turnover means the total gross revenues of an undertaking, whether obtained in or outside Hong Kong.

However, this general exclusion rule is not available to agreements that are deemed to concern "serious anti-competitive conduct." The list of "serious anti-competitive conduct" includes price-fixing, market-sharing, production/sales quota, bid-rigging, and RPM in some cases, as we shall see below.

There is also a general exclusion for agreements enhancing overall economic efficiency in Schedule 1 to the Ordinance.

A. The Theories of Competition Harms about RPM

The Guideline (paragraph 6.72) states that RPM can restrict competition in a number of ways:

i. RPM facilitates coordination between competing suppliers through enhanced price transparency in the market.

ii. RPM undermines suppliers' incentives to lower prices to distributors and distributors' incentives to negotiate lower wholesale prices.

iii. RPM limits "intra-brand" price competition by restricting the ability of distributors to offer lower sales prices for the affected brand as compared with prices offered by competing distributors of the same brand. This will be a particular concern where there are strong or well-organized distributors operating in a market. RPM facilitates coordination between distributors on the downstream market affected by the RPM.

iv. RPM prevents the emergence of new market participants at the distributor level and will generally hinder the expansion of distribution models based on low prices (for example, the emergence of discounter distributors).

v. Where RPM is implemented by a supplier with market power, this may have the effect of excluding smaller suppliers from the market. Distributors are incentivized to only promote the product affected by the RPM causing harm to consumers.

Theory (i) and the second part of theory (iii) above are the conventional concerns over RPM—that they can be used by upstream suppliers to facilitate upstream collusion or by downstream distributors—which are recognized and accepted by most antitrust jurisdictions in the world. The HKCC further adds that, in those contexts, it may have particular concern where RPM is employed by multiple suppliers in the market, RPM is otherwise common, or where there is evidence that the RPM conduct is distributor driven.

Regarding theory (iii), the Guideline clarifies that the HKCC interprets the First Conduct Rule as prohibiting not only restrictions on inter-brand competition but also restrictions on intra-brand competition (footnote 38). This position is reflected in other parts of the Guideline as well. When evaluating agreements on exclusive distribution and exclusive customer allocation, the HKCC will assess how intra-brand and inter-brand competition is affected (paragraph 6.86).

One may try to make sense of the emphasis on intra-brand competition, as well as inter-brand competition, in the following way. In a small economy like that of Hong Kong, where downstream retailing markets tend to be concentrated due to geographic constraints, perhaps the need to protect intra-brand competition becomes greater compared to large economies where protection of inter-brand competition is perhaps more important.[6]

Theory (iv) above, namely that RPM may be used to deter entry at the resale level, can be understood to reflect the concerns in the real RPM cases in Hong Kong whereby larger supermarkets pressured suppliers to impose RPM on new/discounted retailers.

Theory (v), namely that larger suppliers may use RPM to reduce retailer incentives to carry competing products, particularly from smaller rivals or new entrants, is also a sensible one. This theory of competition harm was discussed in the *Leegin* case where the U.S. Supreme Court noted a series of potential sources of competitive harm, including that a manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants.[7]

This competition concern has been confirmed in a formalized equilibrium analysis by Asker & Bar-Isaac who developed a game-theoretical model which predicts that RPM, slotting fees, loyalty rebates, and other related vertical practices can allow an incumbent manufacturer to transfer profits to retailers.[8] If these retailers were to accommodate entry, upstream competition

[6] For emphasis on inter-brand competition, see, e.g., K.G. Elzinga, & D.E. Mills, *The Economics of Resale Price Maintenance*, ISSUES IN COMPETITION LAW AND POLICY (K. G. Elzinga & D. E. Mills, eds., 2008).

[7] *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

[8] J. Asker & H. Bar-Isaac, *Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals*, 104(2) AMER. ECON. REV. 672-686 (2014).

could lead to lower industry profits and the breakdown of these profit transfers. Thus, in equilibrium, retailers can internalize the effect of accommodating entry on the incumbent's profits. Consequently, if entry requires downstream accommodation, entry can be deterred. The HKCC is to be applauded for having incorporated the most up-to-date insight and development in industrial economics into the Guideline.

B. "Near Per Se Illegal Approach" Toward RPM

From the published Guideline and earlier statements of the HKCC about its draft guidelines, it appears that HKCC has adopted a "near per se illegal approach" toward RPM.

The HKCC initially viewed RPM as *per se* illegal, based on the above five theories of harms on competition. The Draft Guideline on the First Conduct Rule, published on October 9, 2014, stated, "where an agreement involves direct or indirect RPM, the Commission takes the view that the arrangement has the object of harming competition" (paragraph 6.64). During the public consultation period, the HKCC received 64 submissions from the business sector, trade associations, political parties, and public organizations etc., expressing views towards the published draft guidelines. A majority of the submissions were about the Draft Guideline on the First Conduct Rule, centering on such issues as RPM, information exchange among competitors, and collective bargaining.

The HKCC's position toward RPM has changed somewhat, as reflected in the Revised Guidelines on the First Conduct Rule, published on March 30, 2015. There, the HKCC stipulated that RPM is harmful to competition, although the practice may not always have the object of harming competition. Depending on the content of the agreement, its implementation, and the relevant context, an RPM arrangement may be assessed on the basis of its effects.

In its press release on the revised guidelines, the HKCC stated that it "maintains its view that RPM arrangements have an inherent potential to harm competition in Hong Kong. The Commission considers that RPM may have the object of harming competition and there may be circumstances when it amounts to Serious Anti-competitive Conduct." The revised guidelines contain additional examples of situations where RPM arrangements will be assessed as having the object of harming competition and/or where they might amount to "serious anti-competitive conduct."

In the final version of the Guideline published on July 27, 2015, the HKCC maintains that "for the reasons set out in paragraph 6.72 of this Guideline, where an agreement involves direct or indirect RPM, the Commission takes the view that the arrangement may have the object of harming competition." However, whether this is in fact the case turns on a consideration of the content of the agreement establishing the RPM, the way the arrangement is implemented by the parties, and the relevant context. If an RPM agreement does not have the object of harming competition, the HKCC will assess whether the RPM causes harm to competition by way of its effects.

The Guideline recognizes that vertical price restrictions, including RPM, may sometimes lead to efficiencies. While efficiencies must be assessed on a case-by-case basis, the Guideline provides one scenario where RPM can improve upon efficiency. In particular, the Guideline states that the RPM may help address the so-called free riding problems at the distribution level

where the extra margin guaranteed by the RPM structure encourages parties to provide certain sales services for the benefit of consumers. The Guideline further elaborates that this efficiency may have some relevance in the case of "experience" goods or complex products.

While this recognition of a possible pro-competitive effect of RPM is in line with the development of modern industrial economics and international best practice, the HKCC emphasizes that "the Commission would expect to see compelling evidence of an actual free rider problem."

C. RPM as Serious Anticompetitive Conduct

The Guideline provides an example of RPM having the object of harming competition. "For example, RPM will be considered as having the object of harming competition if there is evidence that the RPM was implemented by a supplier in response to pressure from a distributor seeking to limit competition from competitors of the distributor at the resale level." This situation is illustrated in more detail in Hypothetic Example 16 of the Guideline:

> HomeStore is the owner of a wide number of household goods shops across Hong Kong. HomeStore is a significant customer of CleanUpCo for a number of daily use products which are widely available in supermarkets, convenience stores, specialist stores and smaller shops.
>
> HomeStore is concerned that its competitors, including other large chain stores and smaller independent stores, are offering CleanUpCo's products at a lower price than HomeStore. HomeStore is concerned that its competitors' pricing decisions will impact on the profitability of a number of important business lines in its stores. HomeStore therefore pressures CleanUpCo to require its customers to sell CleanUpCo products across Hong Kong at a fixed retail price determined by CleanUpCo. As HomeStore is a significant customer of CleanUpCo, CleanUpCo implements the RPM policy.

The HKCC would view this arrangement as having the object of harming competition. The Guideline explains its reasoning behind this view as follows: "HomeStore's insistence on CleanUpCo introducing a fixed retail price across Hong Kong has an inherent ability to harm competition. In this scenario, the purpose of the arrangement is merely to protect HomeStore from the competitive pricing of its competitors." In addition, the Guideline further elaborates that there would be unlikely to be sufficient justifications for the RPM practice to satisfy the terms of the general exclusion for agreements enhancing overall economic efficiency.

This example is almost identical in nature to the RPM complaints received by the COMPAG in 2012 as mentioned earlier. The Guideline in this part clearly targets the type of RPM that has been observed in Hong Kong's supermarket sector.

The Guideline further states that "[t]he Commission would also consider the RPM in the example to be Serious Anti-Competitive Conduct under the Ordinance," making it join the category of hard-core cartel agreements (price-fixing, market division, production/sales quota, and bid-rigging). This classification has strong implication because the general exclusion for agreements of lesser significance as mentioned earlier does not apply to agreements considered to be "serious anti-competitive conduct" under the Ordinance.

IV. CONCLUSION

RPM has been common in Hong Kong and received great attention both before and after Hong Kong enacted the Competition Ordinance in 2012. The HKCC's position toward RPM, and its theories of harms as spelled out in the Guideline on the First Conduct Rule, are generally in line with both insight from modern industrial economics and international best practices. While recognizing the possible pro-competitive effect of RPM, however, the HKCC seems to have adopted a "near per se illegal approach" toward RPM by requiring "compelling evidence of an actual free-rider problem" in an RPM defense. The HKCC also emphasizes the need to protect both intra-brand competition and inter-brand competition.

Given the high attention received by RPM in Hong Kong historically and the fact that the retailing industry (not including the upstream markets) amounts to about 4 percent of Hong Kong's total employment, and about 10 percent of its GDP, one would not be surprised to see immediate enforcement action against RPM after the Ordinance comes into force in December 2015.

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How Will Hong Kong's Competition Law be Enforced?

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How Will Hong Kong's Competition Law be Enforced?

Danny Leung & Stephanie Tsui[1]

I. INTRODUCTION

The Hong Kong Competition Ordinance ("Ordinance") is scheduled to come into force on December 14, 2015, providing the first comprehensive competition regime in Hong Kong. Prior to its enactment, competition provisions in Hong Kong only covered the broadcasting and telecommunications sectors and were overseen by the Communications Authority.[2]

Since the Ordinance was passed into law in 2012, the Government and the newly established Hong Kong Competition Commission ("HKCC") have gazetted the Competition Tribunal Rules and other subsidiary legislation relating to the procedure and operation of the Competition Tribunal ("Tribunal"). The HKCC and Communications Authority have jointly published six guidelines on their general approach of the Ordinance. At the time of writing, it is expected that additional guidance will be published soon on leniency policies, enforcement priorities, and the Memorandum of Understanding between the HKCC and the Communications Authority on how the two authorities will coordinate their concurrent enforcement powers.

In this article, we examine the different stages of enforcement for the new law; we will consider the investigation process, formal enforcement proceedings, and finally private damages actions. We will not cover the substantive provisions of the law in detail.

We highlight at the outset some of the most salient distinguishing features of the Hong Kong regime:

- There are two phases of the investigation process: the "initial assessment phase" and the "investigation phase."
- The Hong Kong enforcement regime comprises two separate bodies: the HKCC and the Tribunal. In contrast to many other jurisdictions whereby the competition authority itself decides on the imposition of penalties, the HKCC only has the power to investigate alleged contraventions (with limited enforcement powers). If the HKCC believes the alleged contravention justifies a pecuniary or other penalty, it will have to prove its case before the Tribunal, a separate specialized court of superior record with primary jurisdiction to hear and adjudicate competition cases.

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[2] The HKCC is now the principal authority responsible for enforcing the Ordinance but shares concurrent jurisdiction with the Communications Authority in relation to competition matters in the broadcasting and telecommunications sector. The Communications Authority also regulates mergers of undertakings that hold a carrier licence under the Telecommunications Ordinance.

- The Ordinance explicitly provides for follow-on private actions only. There is no express provision for stand-alone actions.
- There are no criminal penalties for contravention of the conduct rules. Criminal penalties are only provided for non-compliance with investigations and breach of specified provisions of the Ordinance.

II. INVESTIGATION PROCESS

A. Power to Conduct Investigation

Under Section 39 of the Ordinance, the HKCC may initiate an investigation either on its own motion or if an alleged anticompetitive conduct has been referred for investigation by the Court of First Instance, Competition Tribunal, Government, or a complainant. The HKCC may only initiate an investigation if it has reasonable cause to suspect that anticompetitive conduct has been committed.

If the HKCC decides to investigate an alleged contravention of the competition rules, it will generally do so in two phases: the initial assessment phase and the investigation phase.

At the initial assessment phase, the HKCC will seek information from the relevant parties on a voluntary basis or review publicly available information such as market surveys and industry reports to decide if there is sufficient evidence to establish reasonable cause to suspect a contravention of the competition rules, and whether it is reasonable to initiate an investigation. In determining whether or not to investigate an alleged conduct, the HKCC will exercise its discretion under the Ordinance and will consider a range of factors, including the potential impact of the alleged conduct on competition and consumers, as well as its own resources and enforcement priorities.

After the initial assessment phase, the HKCC may choose to close the investigation, refer the matter to another agency, or accept a voluntary resolution of the matter. It may also decide to proceed to the investigation phase where it can exercise its compulsory document and information gathering powers under the Ordinance. The HKCC may first invite parties to make voluntary submissions, which will include the background facts as well as legal and economic arguments with evidence in support of those arguments.

At any stage of the investigation, the HKCC and the parties may approach each other to discuss the matter and propose a resolution to the HKCC's concerns. The HKCC may accept a commitment under Section 60 of the Ordinance for a company to alter its behavior on the condition that it will not launch proceedings before the Tribunal.

This two-stage process of handling investigations was adopted by the Communications Authority for investigations into possible contraventions of the Telecommunications and Broadcasting Ordinances. Similar to the HKCC, at the first stage, the Communications Authority will first look at whether there is a case to answer and take into account its enforcement priorities before proceeding to the formal investigation stage. At the investigation stage, the Communications Authority can use its information gathering powers, which are similar to the powers given to the HKCC (as will be discussed in detail below).

The Communications Authority may also conduct a public consultation if an issue is expected to significantly impact the broadcasting industry as part of its investigation and to give an opportunity for stakeholders to express views. This contrasts with the HKCC, which has stated that it intends to investigate in private to protect the interest of the parties involved. The HKCC may also have considered that publicizing a matter under investigation will impede its ability to investigate.

B. Information Gathering Powers

At the investigation phase, the HKCC has a range of tools at its disposal to collect evidence, including the power to:

- issue notices under Section 41 of the Ordinance requiring a person to provide documents or information,
- issue a notice under Section 42 of the Ordinance requiring a person to give evidence before the HKCC on any matter reasonably believed to be relevant to the investigation, and
- apply for a warrant under Section 48 of the Ordinance to enter and search any premises to obtain documents and any other materials relevant to the investigation.

Section 41 and 42 notices may be directed not only to the party under investigation but can extend to their competitors, suppliers, and customers or any other third parties. The information sought under the Section 41 notices can be recorded in any form (e.g. metadata, correspondence, databases, and draft documents) and will often include questions or other requests to provide the HKCC with information in a particular format. Any person will not be excused from providing further particulars of a document or answering a question on the grounds of self-incrimination.

Section 48 of the Ordinance allows the HKCC to apply to the Court of First Instance for a warrant to enter and search any premises to obtain documents and any other materials relevant to the investigation. A warrant will be issued if the judge in the Court of First Instance is satisfied that there are reasonable grounds that the premise in question contains, or is likely to contain, materials relevant to the investigation. The search warrant can apply to a premise not directly related to the party under investigation, such as a supplier or customer.

Upon obtaining a warrant from the Court of First Instance, HKCC officials may conduct dawn raids and confiscate documents. They may use reasonable force to enter the premises and take measures to preserve evidence that it considers may be tampered with or destroyed. Despite its power to conduct dawn raids, the HKCC has stated that it will normally conduct search and seizure activities during office hours.

If there is no one present at the premises, the HKCC officers will try to contact the occupier and will wait a reasonable amount of time for someone to arrive. The Ordinance does not require that legal representatives be present during a search, but upon a party's request and where no in-house legal representative is at the premises, the HKCC officials will wait a reasonable amount of time for external legal advisers to arrive. If the officials feel that the search will be compromised or that the legal advisers cannot arrive in a timely manner, it will begin its

search immediately. Failure to comply with Sections 41, 42, and 48 of the Ordinance without reasonable excuse is a criminal offense.

The concept of dawn raids is not foreign in Hong Kong. Other enforcement authorities, such as the Independent HKCC Against Corruption, the Police, and the Securities and Futures Commission ("SFC") conduct dawn raids on a frequent basis. We expect that dawn raids conducted by the HKCC in the future will be similar to dawn raids conducted by other authorities in Hong Kong. When a company faces a dawn raid, it should immediately contact its legal adviser, review the terms of the search warrant carefully, and seek to agree with the authority on the scope of the search before proceeds.

In past cases, blanket claims of privilege were frequently used and parties usually agreed on a protocol for dealing with privileged materials which would, until recently, typically involve sealing the documents and bringing the documents to a judge to determine whether the materials are privileged. In certain circumstances, a magistrate may issue a search warrant with imposed conditions on the seizure of legal professional privileged materials. Due to parties routinely claiming privilege over a large volume of documents covering images of computer hard drives and emails, the Court of Appeal has set down guidelines on how a party should bring claims of privilege, which will be discussed in the section below.

C. Legal Privilege

Section 58 of the Ordinance allows the HKCC's investigation powers to extend to privileged materials. Nonetheless, the party under investigation can claim that the materials are subject to legal professional privilege and refuse to provide the materials. This right and entitlement under the Ordinance is mirrored in many other ordinances and is enshrined in Hong Kong's Basic Law.

In the landmark decision *CITIC Pacific Limited v Secretary of Justice and Commissioner of Police,*[3] the Hong Kong Court of Appeal rejected the narrow definition of "client" adopted in *Three Rivers (No.5,)*[4] the leading but controversial English Court of Appeal case, and extended the meaning of "client" from the core client team (typically in-house lawyers and certain directors) to all employees in the company. It was confirmed that as long as the dominant purpose of the document was for legal advice, the document would be considered privileged.[5]

This has broad implications for companies who regularly handle internal investigations. Prior to July 2015, these early stages of enquiry might not necessarily be covered by legal advice privilege, yet it is these materials (i.e., internal interviews, correspondences on possible contraventions, and internal reports) that tend to be most sensitive and are part of a necessary process required prior to determining whether legal advice is needed. The Court of Appeal noted the reality of today's corporations, where necessary information may have to be acquired by management from employees in different departments or various levels of a corporate structure, in order to provide suitable instructions to lawyers. Privilege should cover documents created by

[3] *CITIC Pacific Limited v Secretary of Justice and Commissioner of Police,* CACV No. 7 of 2012, 29 June 2015.

[4] *Three Rivers District Council v Governor and Company of the Bank of England (No 5)* [2003] QB 1556.

[5] "Serious anti-competitive conduct" is conduct such as price-fixing, market allocation, limiting production, or supply- and bid-rigging.

a client for the purpose of obtaining advice even though it contains factual information, including preparatory material.

Further, the *CITIC Pacific* case sets out guidelines on how a company should claim privilege for documents seized by a regulator. CITIC Pacific was under investigation by the SFC in relation to a profit-warning announcement issued in October 2008. The SFC obtained 27 search warrants, which resulted in a large amount of documents and computer hard drives seized. CITIC made a blanket claim of legal professional privilege in respect of all the materials. In this instance, the Court was asked to examine and assess a large number of documents over which privilege was disputed, without proper assistance of the parties. On account of the unsatisfactory nature of the procedure, the Court set out guidelines for future disputes. The guidelines include:

- a requirement that the person claiming privilege ("Claimant") to properly identify the materials, specify the nature of the privilege claimed, and provide a supporting statement setting out the basis of the claims and the full factual context. Any blanket claim of privilege will be rejected by the Court;
- the Claimant must consider giving a limited waiver for specified personnel from the other side and/or an independent lawyer to examine the documents; and
- further detailed steps to be followed in the event the Court is asked to give a determination.

The HKCC intends to publish a procedure for handling claims relating to legal professional privilege resulting from the HKCC's use of its investigation powers, including its power to search and seize under Section 48 of the Ordinance, which we expect will be very similar to the guidelines set out in the *CITIC Pacific* judgment.

D. Confidentiality

Section 125 of the Ordinance imposes a general obligation on the HKCC, and persons appointed to assist the HKCC, to preserve the confidentiality of any confidential information provided to or obtained by the HKCC. However, under Section 126, the HKCC may disclose confidential information if necessary when carrying out any of its functions authorized by the Ordinance. The Ordinance gives the opportunity for parties to make claims of confidentiality, although in certain circumstances, the HKCC may disclose confidential information without the consent of the parties. This approach is similar to that adopted by the Communications Authority.

Under Section 378 of the Securities Futures Ordinance ("SFO"), SFC investigations are subject to secrecy obligations. As a result, generally parties subject to an SFC investigation notice are prohibited from disclosing even the fact that they are recipients of such notice. This is a useful tool that SFC relies on to ensure that their investigations are not made known to the public. The HKCC has stated a preference to keep its investigations confidential in order to protect the interests of all persons involved and to complete its investigation in an expeditious manner. Yet, interestingly, the confidentiality obligation under the Ordinance is worded differently to the secrecy obligation under Section 378 of the SFO. It will be interesting to see what tools the HKCC will employ to ensure their investigations remain confidential.

E. Leniency and Immunity

As in many other jurisdictions, Section 80 of the Ordinance provides that leniency can be granted to an individual, cooperation, or partnership in exchange for cooperation in an investigation. The HKCC can enter into a leniency agreement with companies under investigation, committing not to bring or continue proceedings before the Tribunal on any terms it considers appropriate.

Unlike many other jurisdictions, the leniency program in Hong Kong is not limited to only cartel cases, and can be granted in respect of other types of conduct. The Ordinance also does not provide an automatic benefit of leniency for the first person who informs the HKCC of a contravening conduct, as is common in some jurisdictions. It is at the discretion of the HKCC whether it will offer leniency. As competition authorities around the world, especially in Europe, rely heavily on whistleblowers and leniency applicants to detect anticompetitive conduct, the lack of clear legal guarantees to protect the content of leniency applications can be a deterrent for parties to report anticompetitive conduct. Furthermore, the lack of employee protection laws could also discourage whistleblowers from coming forward for fear of losing their jobs.

The HKCC's approach to leniency will also have a direct effect on potential plaintiffs' right to bring a private damages action (discussed further below). Where the HKCC chooses not to pursue an enforcement action before the Tribunal, and there is no formal finding of a contravention of the conduct rules, private parties will effectively be prevented from bringing a follow-on action. It will be necessary to balance the need for an effective whistleblowing and leniency regime, as well as an early resolution process in the form of commitments, against access to justice for plaintiffs who have suffered damage.

In the European Union, leniency recipients are generally addressees of the competition authority's decision, so follow-on claims can still be made against them. It remains to be seen whether the HKCC envisages that the leniency applicant will be a party to Tribunal proceedings and be an addressee of the Tribunal's decision.

There may also be a risk of judicial review proceedings being initiated against the HKCC if it decides not to pursue an investigation, or to accept a leniency application/commitment without a determination or admission of a breach of a conduct rule, and private parties are thereby barred from making a follow-on claim. To address this risk, the HKCC will need to adopt a consistent and well-reasoned approach in its decision whether or not to pursue complaints.

The Ordinance is unclear whether the HKCC will apply a “sliding scale” of penalty reductions for subsequent leniency applicants, as is the case in Europe and other parts of the world. However, the strict wording of the Ordinance appears to only permit the HKCC to enter into leniency agreements and forego its right to initiate proceedings.

It is also unclear whether a leniency agreement will be available once an investigation has commenced. At the time of writing, the HKCC is expected to publish a guideline on leniency agreements in the coming months, which will hopefully clear up the unpredictability of the leniency program.

III. ENFORCEMENT POWERS OF THE HKCC

After conducting its investigation, the HKCC may choose to take no further action. This is more likely to occur if the party immediately ceases the allegedly contravening conduct.

If the HKCC finds that a company has engaged in anticompetitive conduct, it may issue warning notices, infringement notices, or accept a commitment under Sections 82, 67, and 60 of the Ordinance respectively. Warning notices and infringement notices impose a specified amount of time for the party under investigation to cease its contravening conduct or follow certain requirements issued by the HKCC. A warning notice must be given for conduct that is not considered "serious anti-competitive conduct" before the HKCC can initiate proceedings before the Tribunal. If the party fails to comply with the warning notice, infringement notice, or commitments, the HKCC will commence proceedings before the Tribunal.

Unlike the Communications Authority under the Telecommunications Ordinance or Broadcasting Ordinance, the HKCC does not have the power to impose fines or other punishments for breaches of the Ordinance. At the conclusion of an investigation, the Communications Authority can publish a decision; impose warnings, directions, and penalties; and suspend or revoke licenses. The HKCC may only bring proceedings before the Tribunal, which is empowered to determine breaches of the Ordinance and to impose sanctions.

IV. ENFORCEMENT PROCEEDINGS IN THE TRIBUNAL

A. The Tribunal

The Tribunal is a specialized superior court of record established under the Ordinance, which sets out the basic rules for the operation and powers of the Tribunal and the appointment of its President and Deputy President.[6] It has primary jurisdiction to hear and adjudicate on (i) cases of alleged breaches of the competition rules, (ii) reviews of certain determinations of the HKCC and the Communications Authority,[7] (iii) follow-on private actions, and (iv) alleged breaches raised as a defense in proceedings before the Court.

The Tribunal may impose a broad-range of sanctions, including pecuniary penalties, director disqualification orders, awards of damages in follow-on actions, and various other ancillary orders. Under Section 93 of the Ordinance, the Tribunal may impose a pecuniary penalty of up to 10 percent of the turnover of the companies involved for up to three years in which the contravention occurred.

The establishment of the Tribunal as part of Hong Kong's independent judicial framework demonstrates the prosecutorial nature of competition law enforcement in Hong Kong. If the HKCC believes the alleged contravention of the conduct rules justifies a pecuniary or other penalty, it will need to prove its case before the Tribunal in order for the appropriate

[6] With effect from August 1, 2013, the Hon. Mr. Justice Godfrey Lam Wan-ho was appointed as the President and the Hon. Madam Justice Queeny Au-Yeung Kwai-yue as the Deputy President, each for a term of three years.

[7] Reviewable determinations are in respect of: (i) exemptions or exclusions; (ii) rescission of a decision regarding exemptions or exclusions; (iii) issue, variation or revocation of a block exemption order; (iv) variation of commitments made by undertakings to take or refrain from taking action that may contravene a competition rule; (v) release of commitments; and (vi) termination of a leniency agreement.

penalties to be imposed. This is in contrast with certain other jurisdictions, including in Europe, that follow an inquisitorial approach to enforcement whereby the competition authority itself decides on the imposition of penalties.

The requirement of court proceedings in competition enforcement will likely prove to be costly, and enforcement procedures lengthy. This may pose a significant burden on competition law enforcement, particularly in the early days of the competition regime when there are few established legal principles in Hong Kong. Nonetheless, putting the decision-making power in the hands of a neutral tribunal under the prosecutorial approach may provide greater transparency and credibility, and improve due process generally.

The general approach adopted by the Ordinance is that the Tribunal will largely have the same powers and procedure as the Court of First Instance of the High Court. The Tribunal will in function essentially be a part of the High Court, particularly in light of the transfer of cases between the Tribunal and the High Court in certain circumstances as contemplated in the Ordinance.

B. Rights of Audience

As in the High Court, a party may act in person in Tribunal proceedings and a corporate litigant may be represented by its director with the Tribunal's leave. The Judiciary has also proposed a reserve power for the Tribunal to allow any other person to appear on the party's behalf. Although not entirely clear on the point, and unlike in proceedings before the Communications Authority, this does not appear to allow representation by solicitors without higher rights of audience. Moreover, barristers appearing from overseas (who are likely to have valuable experience in this area) will still be required to go through the hoops of case-by-case admission with no fast-track procedure.

C. Procedural Rules

To cover procedure, the Tribunal has its own set of procedural rules, the Competition Tribunal Rules ("Rules"), in addition to other subsidiary legislation.

The Judiciary's approach has been to harmonize the Rules with the existing Rules of the High Court where appropriate. Where neither the Ordinance nor the Rules address a particular matter, the relevant Rules of the High Court will apply as the default position. Proceedings before the Tribunal should therefore largely resemble litigation proceedings in the High Court.

It may be queried whether the modeling of the Rules on existing High Court procedure is consistent with Section 144(3) of the Ordinance, which states that proceedings before the Tribunal are to be conducted with "as much informality as is consistent with attaining justice." In this regard, the policy behind the Rules has been to balance the need for informality in proceedings with the need for certainty in procedure and the desire for a set of rules that will be familiar to most users of the Tribunal.

D. Overview of the Rules

Part 1 of the Rules sets out the general provisions of procedure for proceedings before the Tribunal, including for the commencement of proceedings, service of proceedings, discovery and inspection of documents, case management, hearings, and appeals.

Parts 3 to 6 of the Rules set out specific provisions for actions arising under the Ordinance, namely for reviews of reviewable determinations, enforcement cases brought by the HKCC, private follow-on actions, and cases transferred from the High Court (where, for example, the alleged contravention of a conduct rule is raised as a defense to an action).

The schedule to the Rules sets out prescribed forms for various applications and summonses under the Ordinance, including forms for general originating notice of application, notice of appeal, leave to intervene in proceedings, and other applications.

E. Distinguishing Features of the Rules

Although modeled on High Court practice, there are certain features of proceedings before the Tribunal that distinguish them from the Rules of the High Court.

The desire for expediency in competition cases—due to their commercial nature and importance—is reflected in particular under Rule 18, which provides for the validity of originating documents filed for commencing proceedings to be six months, compared to 12 months for writs issued by the High Court.

Similarly, under Section 111(3) of the Ordinance, the time limit for commencing private follow-on actions is three years after the relevant decision by the Tribunal or the High Court was made, in contrast to the six-year limitation period for actions founded in contract or tort in the High Court. This also reflects the fact that there will have been an enforcement stage where the relevant determinations were made, during which a plaintiff would have been able to consider the merits of a follow-on action.

Another feature of the Rules is that they specifically make provision for the handling of confidential documents, which is very likely to be an area of concern in competition cases. The relevant provisions are:

- Rule 24(3), which allows the Tribunal to refuse an order for discovery and production of a document having regard to all the circumstances of the case, including whether the information contained in the document is confidential; and
- Rule 37, which allows a party to apply for an order to treat a document as confidential.

Section 88(1) of the Ordinance states that an application for the review of a reviewable determination of the HKCC must be made within 30 days of the relevant determination. Such reviewable determinations are set out in Section 83 of the Ordinance, and include, for example, a decision relating to the issue of a block exemption order.

It is worth noting that Rule 60 of the Rules requires that an application for leave to review a reviewable determination be supported by affidavit. Where the evidence is substantial or involves complex economic issues, the requirement to prepare an affidavit within the 30-day time limit may prove to be onerous. In such cases, the intended applicant may consider an application to the Tribunal to extend time to apply for leave.

It is expected that the Judiciary will issue practice directions for proceedings before the Tribunal, which should shed further light on the practical aspects of Tribunal procedure and clarify provisions of the Rules.

V. PRIVATE ACTIONS

The provisions for private damages are contained in Part 7 of the Ordinance. Section 110 provides a follow-on right of action for any person who has suffered loss or damage as a result of any act that has been determined to be a contravention of a conduct rule.

Follow-on claims must be brought in the Tribunal, whether or not the cause of action is solely the defendant's contravention, or involvement in a contravention, of a conduct rule. Where proceedings are commenced in the High Court, the High Court must transfer full or part of the proceedings to the Tribunal, except in the case where the Court considers such transfer not to be in the interests of justice. Equally, the Tribunal must transfer part of the proceedings to the High Court if not all of the case relates to competition but falls within the jurisdiction of the Court.

A. No Explicit Right to Stand-Alone Action

In the context of a growing consensus in many jurisdictions that private damages actions should play a significant role in competition law enforcement, complementing the public enforcement regime, it may be surprising that Hong Kong has not chosen to introduce an express right to stand-alone damages actions into its new regime. In particular, the relatively cumbersome prosecutorial enforcement process may pose additional challenges for the public enforcement process.

The right to bring stand-alone actions was contained in the original draft law, but was removed at an early stage in response to a fear by SMEs that large players would use private actions to harass and pressure them. However, the Government has stated that it will reconsider the introduction of a stand-alone right of action after the Ordinance has been in action for a few years.

Sections 118-121 of the Ordinance cover circumstances where a contravention has been alleged but no infringement decision has been made. We consider that these sections may be viewed as a possible route by practitioners and plaintiffs to bring stand-alone actions, or to force the HKCC to investigate a particular market sector. Section 118 allows the High Court or the Tribunal to refer an alleged contravention or alleged involvement of a contravention to the HKCC for investigation. The High Court or Tribunal may do this of its own motion or on application by a party to the proceedings. Sections 120-121 apply to proceedings involving an alleged contravention that are brought by a person other than the HKCC and allow the HKCC to intervene in such proceedings. Irrespective of whether this will in practice provide a route for stand-alone actions, it is clear that follow-on actions will be much more likely.

The High Court and Tribunal are bound by earlier decisions of the High Court and the Tribunal as to whether there has been a breach of the conduct rules. This will be helpful to plaintiffs, because liability is already established and they will need to prove only the level of damages and causation. However, there is an issue as to which parts of an earlier decision is binding, as the English Courts have held that the binding part of the decision is restricted to the finding of the infringement itself. Findings of fact are not binding and can in theory be challenged in follow-on damages proceedings. However, re-litigating findings of fact on which the decision was based may be an abuse of process.

B. Level of Damages

In Hong Kong, damages are generally awarded to compensate for loss and damages and are not on a punitive or exemplary basis. This is to be contrasted with the position in the United States, and comparable to the position in the United Kingdom.

Unlike the pecuniary penalties for enforcement proceedings initiated by the HKCC, the level of damages will not be limited to a percentage of total gross revenues but will be assessed on a commercial basis based on actual loss suffered.

Under common law principles, claimants will need to prove causation and loss on a "but for" basis (i.e., the loss would not have been caused "but for" the defendant's breach of competition law) and show that the type of loss suffered was reasonably foreseeable. Quantification of the loss will also be a challenging area and will result in a battle for the best economic arguments.

VI. CONCLUSION

After decades of debate and drafting, the Hong Kong competition law will finally come into full effect on 14 December 2015. The implementation of Hong Kong's competition law will be a major change to market practices in Hong Kong, one of the last developed economies to not be covered by a comprehensive competition regime.

The Ordinance and the HKCC's guidelines are extensive and well structured, and there are a lot of commonalities with established competition laws in other jurisdictions. In particular, the competition regime in Europe will provide some much needed guidance in the early days of the Hong Kong competition regime.

Nonetheless, there are a still few distinctions in Hong Kong. The Hong Kong system is unique in the sense that its enforcement regime comprises of two separate bodies, namely the HKCC and the Tribunal. Unlike in many other jurisdictions, the HKCC can only conduct investigations and cannot impose penalties. Instead, the HKCC will have to prove its case and justify any penalty before the Tribunal. This will likely pose a significant burden on competition law enforcement, especially when the HKCC is still establishing its footing. Yet, the benefit of a neutral tribunal would no doubt provide greater transparency and credibility to the enforcement process.

In addition, the Ordinance explicitly provides for follow-on private actions only and there is no express provision for stand-alone actions. It will take some time before we see these private action proceedings being brought in Hong Kong. As there will be no statutory limit on the level of damages awarded to a private litigant, this may prove to be the real sting in the tail.

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Sanctions for Cartel Conduct in Hong Kong: Past and Present

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Sanctions for Cartel Conduct in Hong Kong: Past and Present

Sandra Marco Colino[1]

I. INTRODUCTION

Before the end of 2015, Hong Kong's first cross-sector competition law will at long last be fully operational. The Hong Kong Competition Ordinance ("Ordinance") was passed in June 2012,[2] and its adoption put an end to what appeared to be an interminable discussion as to the pros and cons of introducing such legislation for the region's economy.[3] The government recently announced that all provisions of the Ordinance are to enter into force on December 14, 2015,[4] three-and-a-half years to the day since the law was adopted.

During this seemingly long implementation period, things have begun to take shape, albeit slowly: The government has published the list of statutory bodies that will be exempt from the application of the law; the institutional framework has been set up, with the creation of the Competition Commission and the Competition Tribunal; the final version of the Competition Commission's first six Guidelines is expected to see the light anytime now, following the publication of initial drafts in October 2014 and revised drafts in March 2015;[5] and a draft leniency policy for cartels has just been announced, with a public consultation currently underway.[6]

This article examines whether the new law is adequately equipped to tackle cartels in Hong Kong, and it does so by focusing on the penalties available under the Ordinance. Cartels are contrary to the First Conduct Rule, which prohibits joint conduct between companies with

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[2] Hong Kong S.A.R., Competition Ordinance, Ordinance No. 14 of 2012 A1347.

[3] Already in the mid-1990s, the Consumer Council recommended setting up a competition authority to tackle anticompetitive practices, but the Competition Bill did not materialize until 2010. *See* www.scmp.com/article/715317/15-years-draft-competition-law-comes-legco.

[4] Competition Ordinance (Commencement) No. 2 Notice 2015, L.N. 156 of 2015, B2567, *available at* www.gld.gov.hk/egazette/pdf/20151929/es220151929156.pdf.

[5] Three substantive guidelines (First Conduct Rule, Second Conduct Rule, and Mergers) and three procedural guidelines (complaints, investigations, and applications for exclusions and exemptions) were adopted. The texts are *available at* www.compcomm.hk/en/draft_guidelines_2015.html.

[6] The draft leniency policy is *available at* http://compcomm.hk/en/pdf/consultations/Draft_Leniency_Policy_Eng.pdf.

anticompetitive object or effect in Hong Kong.[7] However, since such practices tend to be highly lucrative and difficult to detect, they are still terribly enticing for firms.

In order to successfully deter collusion, the Ordinance ought to remove the temptation by implementing penalties that are sufficiently frightening to encourage compliance, and that are high enough to eradicate the financial benefits of cartels. The need for robust punishment is even more notorious in Hong Kong, where even the most harmful collusive practices have traditionally been regarded as perfectly acceptable forms of business.

At first glance, the sanctions in the Ordinance certainly seem to have the ability to act as a potent deterrent for lucrative cartels. When a company is found to have breached the Ordinance, corporate remedies and pecuniary penalties may be imposed. In addition, individual sanctions are also available, and directors may be disqualified in certain cases. Harsher sanctions may be imposed on individuals who breach the procedural rules, including fines and even imprisonment.

However, the resilient skepticism towards competition legislation in Hong Kong did require making certain concessions in order to find sufficient support in the Legislative Council for the law to pass. With respect to fines, it was agreed that the turnover to be considered when calculating the amount of the fines would be local, rather than global. In addition, although the Ordinance does refer to damages for harm stemming from anticompetitive conduct,[8] the exclusion of a stand-alone private right of action effectively reduces the possibility of obtaining compensation to those cases where there has been a finding of a breach of the law.

This article discusses the suitability of these penalties now available in Hong Kong. Part II examines punishment under the sector-specific competition rules in telecommunications and broadcasting, which were the only competition regulations in the region before the Ordinance was adopted. The penalties introduced by the Ordinance are assessed in Part III. Finally, conclusions are drawn.

II. BEFORE THE COMPETITION ORDINANCE: SECTOR-SPECIFIC COMPETITION RULES FOR TELECOMMUNICATIONS AND BROADCASTING

The only competition provisions applicable in Hong Kong before the Ordinance can be found in the Telecommunications Ordinance ("TO")[9] and the Broadcasting Ordinance ("BO"),[10] and affect only these sectors. The TO and the BO contain prohibitions of anticompetitive agreements and abuse of dominance, but being sector-specific, their scope is very narrow. Within broadcasting, the application of the BO is further restricted to the television program service market. Moreover, in the *Guidelines to the Application of the Competition Provisions of the Broadcasting Ordinance*, subsequently issued by the Broadcasting Authority (now

[7] Competition Ordinance, First Conduct Rule (Subdivision 1, Section 6).
[8] Schedule 3(1)(k).
[9] Telecommunications Ordinance (Cap 106), sections 7K and 7L.
[10] Broadcasting Ordinance (Cap 562), Sections 13 and 14, hereinafter "BO."

Communications Authority, stipulate that only conduct in downstream markets is considered for the application of the competition provisions.[11]

Both the TO and the BO expressly refer to the possibility of bringing an action for damages or "other appropriate remedy, order or relief."[12] In practice, such actions are very limited, in part because of the narrow scope of application of the competition provisions and in part because most of the remedies imposed do not go further than a warning letter equivalent to a cease-and-desist order.

Importantly, in addition to these remedies, fines can be imposed for "very serious" breaches of competition rules. The default system is the application of fines of a fixed amount set at HK $200,000 for first-time wrongdoers, which could increase up to HK $1 million in the case of repeated violations of the law.[13] Fines based on turnover are only exceptionally contemplated in the TO and BO for extremely serious breaches, in which case the financial penalties described above would "not be adequate."[14] In such cases, the Court of First Instance could choose the more substantial fine of either up to 10 percent of the licensee's turnover in the relevant market,[15] or HK $10million.

Various guidelines have been issued by the Telecommunications and the Broadcasting Authorities with respect to competition law enforcement. Of particular interest for our purposes are the *Guidelines on the Imposition of Financial Penalty under Section 36C of the Telecommunications Ordinance*,[16] published in 2002. There is a three-stage process described for the calculation of the amount of the fines:

- the basic amount is obtained on the basis of the gravity of the infringement;
- that amount will be adjusted upwards in the case of recidivism, allowing enforcers to multiply the penalty by the number of previous infringements; and
- the amount will once again be amended upwards or downwards depending respectively on a series of aggravating and mitigating factors.

Although it is safe to assume that cartels would be considered one of the most serious violations of the law, there are no details as to the kinds of breaches that are to be considered serious enough for financial penalties to apply. Nor is it clear, when they do apply, whether they will be set according to the fixed amounts referred to in the law, or how are they to be calculated in relation to turnover.

In principle, the sector-specific legislation could allow cartels in these sectors to be fought with the imposition of stiff fines of up to 10 percent of turnover. Also, the remedies available—in particular the possibility to obtain damages—could be used to repair the harm caused by the

[11] Guidelines, ¶ 13.

[12] Section 29A of the TO, and Section 15 of the BO.

[13] Section 36C of the TO and Section 28 of the BO.

[14] Section 36C of the TO and Section 28 of the BO.

[15] There is no reference to this turnover being limited to Hong Kong, so it can be understood to refer to global, rather than local, turnover.

[16] *Available at* http://tel_archives.ofca.gov.hk/en/legislation/guideline_6d_1/guideline_6d_1_150402.pdf (last visited on August 14, 2013).

illegal anticompetitive behavior, and to make unlawful behavior even more costly. Yet the limited scope of the ordinances and the reservation of the more severe fines for extreme and blatant violations have meant that, in practice, very few cases have led to the imposition of any substantial penalties. The lack of enforcement is particularly notorious in the broadcasting sector. To date, the only fines imposed for the infringement of the BO's competition provisions amounted to HK $500,000 (imposed on TVB) and HK $350,000 (imposed on Galaxy) for TVB's infringement of the firewall provisions in the license of Galaxy.[17] No cases of collusion have prospered.

Even without entering into specific calculations, it is clear that such fines are nowhere near sufficient to remove all illegally earned profits, and they are far from constituting a substantial percentage of the turnover of these companies. Needless to say, the deterrent effect of such a regime is, at best, extremely low. The chances of being investigated and punished are minimal, and punishment is virtually insignificant.

III. PENALTIES UNDER THE COMPETITION ORDINANCE

The Ordinance contains a relatively wide spectrum of penalties that may be used both against corporations and individuals, including fines, director disqualification, and even imprisonment. With respect to administrative fines for breaching a competition provision, once the Competition Commission has issued an infringement decision, the Tribunal has the power to order the person who has breached the law "to pay to the Government a pecuniary penalty of any amount it considers appropriate."[18]

The Ordinance refers to any "person," potentially including both legal and natural persons. Although the reference to "any amount" apparently gives the Tribunal absolute discretion to set the amount of the penalty, the powers of the Tribunal do have boundaries. Fines are capped at 10 percent of the undertaking's local turnover for each year of infringement and for a maximum of three years, taking into consideration the years with the highest turnovers in the case that the violation lasted longer.[19] When it comes to determining the specific level of the fine within these parameters, the Tribunal is required to take various factors into consideration, including the nature and extent of the conduct, any loss or damage consequential to the illegal act, the circumstances of the case, and recidivism.[20]

The double limitation—local turnover, and turnover during maximum three years—imposed on the discretion to set fines is fairly disappointing, more so as the original 2010 Competition Bill included potentially harsher penalties, with the consideration of worldwide turnover. The Bill was amended in order to respond to concerns of small- and medium-size enterprises ("SMEs") regarding the penalties that they could face. However, small businesses are less likely to operate internationally, and the exclusion of turnover obtained outside Hong Kong

[17] For the analysis of this and other cases in the broadcasting sector, *see* T. Cheng, *Competition Law Enforcement in the Television Broadcasting Sector in Hong Kong: Past Cases and Recent Controversies,* 33(2) WORLD COMPETITION (2010).

[18] Ordinance, Section 93(1).

[19] *Id.* Section 93(3).

[20] *Id.* Section 93(2).

is bound to have very little impact on the fines they would be subject to. Yet larger firms engaged in wider cartel activity beyond national borders may benefit. Guidelines on the method for calculating fines have to date not been published, so how these issues will be addressed in practice is still pending clarification.

Adding to these limitations is the removal of a stand-alone private right of action from the Ordinance.[21] Private proceedings will only be pertinent where "a contravention of a conduct rule" has been previously established, and must stem from a follow-on action.[22] This amendment noticeably restricts the possibility of obtaining damages resulting from anticompetitive conduct.

More generally, the Ordinance gives the Tribunal considerable powers to adopt behavioral and structural remedies when there has been a contravention of the competition provisions. Among the most important powers, the Tribunal is given the possibility to require paying damages on its own initiative to "any person who has suffered loss or damage" relating to the breach.[23] It may also ask for the payment, "to the Government or to any other specified person," of any profit gained or loss avoided for engaging in the anticompetitive conduct.[24]

Whether this task can be easily attained in practice is far from clear. For instance, the disgorgement of profits is a remedy that is hardly ever used in those jurisdictions in which it is available, like the United States.[25] Nonetheless, discarding disgorgement appears to be related to a conscious choice by U.S. enforcers to prevent over-deterrence in a system in which courts are allowed to triple the amount of damages a defendant must pay to a plaintiff.[26] Therefore, whereas the value of this remedy might be questionable in jurisdictions with many punitive and compensatory measures, it might prove very valuable in Hong Kong to ensure compliance with the law.

There are additional sanctions that might make up for some of the limitations of corporate penalties described above. Of particular importance is the power of the HKCC to issue director disqualification orders, which can be applied for substantive breaches of the law.[27] The disqualification may be of up to five years, and will prevent the person affected from being a director, liquidator, receiver of a company's property, or directly involved "in promotion formation or management of a company." A requirement for this penalty to apply is that the Tribunal considers that the performance of director duties "makes the person unfit to be concerned in the management of a company." As a result, the Tribunal is afforded wide discretion to order disqualification. The extent to which this potential deterrent may be useful in practice depends on the interpretation given in case practice. The Guidelines enacted to date do not provide any explanations in this regard.

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[21] *Id.* Section 108.

[22] *Id.* Section 110.

[23] *Id.* Schedule 3 (k).

[24] *Id.* Schedule 3 (p).

[25] Disgorgement as a remedy has been recognized by the U.S. Supreme Court in, *inter alia*, *US* v. *Paramount Pictures* 334 U.S. 131, 171–72 (1948); *US* v. *Grinnell* 384 U.S. 563, 577 (1966); and *US* v. *United Shoe Machinery Corporation* 391 U.S. 244, 250 (1968).

[26] E. Elhauge, *Disgorgement as an Antitrust Remedy* 76(1) ANTITRUST L.J. 79-95, at 83 (2009).

[27] Ordinance, Sections 101 and 102.

In addition to these sanctions, further penalties may be imposed on both individuals and corporations that commit an offense relating to an investigation. Pressure is placed on those individuals in charge of making corporate decisions in two ways: first, there may be individual fines and jail terms; and second, when a company is found guilty of an offense, for the application of the penalties of the Ordinance it is understood that the "director, manager, company secretary or other person also commits the offence."[28]

Although cartel participation itself does not constitute an offense, some procedural breaches are criminalized. Among the most severely punished offenses are: destroying, falsifying, or providing false documents;[29] obstructing a search; contravening a disqualification order;[30] or violating the preservation of confidentiality (even in the case of third parties).[31] In such cases, the fines on individuals may be as high as HK $1 million, and there may be additional jail terms of up to two years. If convicted on a summary basis for these same offenses, level six fines may be imposed (currently up to HK $100,000) as well as six months' imprisonment.

Other offenses carry somewhat lighter penalties, ranging from fines of HK $200,000 and imprisonment up to a year to level four fines (HK $25,000) and jail terms of up to three months. These include failure to comply with a requirement or prohibition,[32] ordering not to disclose material,[33] providing false information in criminal proceedings,[34] taking revenge on employees who may have cooperated in the investigation and provided incriminatory evidence,[35] or obstructing persons in the enforcement of the Ordinance.[36]

While the Ordinance seems to fall short of setting solid corporate penalties for substantive breaches of competition law, the individual sanctions on individuals that are available for substantive and procedural violations in the terms set out above are second to none. In the European Union, for instance, procedural breaches carry at most fines of up to 1 percent of turnover in the preceding business year.[37] There are no disqualification orders in EU competition law, although some Member States such as the United Kingdom do provide that possibility in the application of national competition law.

The new Hong Kong competition law seems to place the weight of punishment on the individuals who are in charge of corporate decisions relating to collusion. Since it is people who are responsible for a company's participation in a cartel, and they may benefit from the illegal conduct may revert on them more or less directly, focusing on punishing natural persons seems not only justifiable, but also necessary given the limitations of the corporate penalties. Moreover, penalties on individuals undeniably carry an enormous pressure to comply with the law.

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[28] *Id.* Section 175(1).
[29] *Id.* Sections 53-55.
[30] *Id.* Section 105.
[31] *Id.* Sections 125 and 128.
[32] *Id.* Section 52.
[33] *Id.* Section 151.
[34] *Id.* Section 172.
[35] *Id.* Section 173.
[36] *Id.* Section 174.
[37] Article 23(1) of EU Regulation 1/2003.

It is questionable whether sanctions on individuals will fully compensate the relatively limited corporate fines for cartel involvement. With the exception of director disqualification orders, the more severe individual penalties are aimed at sanctioning collusion, but at offenses committed during the investigation. Therefore, the impact of the envisaged punishment might be drastically reduced.

One example might be in the case of a company with a substantial worldwide turnover—of which the Hong Kong turnover is only a small fraction—which is found to be part of a lucrative cartel, in operation for decades, contrary to the First Conduct Rule. The company might well cooperate with the authorities and comply with the procedural requirements of the Ordinance. In such a scenario, the fines that might be imposed on the company will only affect its Hong Kong turnover in three of the years the infringement took place, and no individual fines or jail terms will come into play. Disqualification orders would be available, but the effectiveness of this weapon depends on the Tribunal's interpretation of the requirements contained in the Ordinance.

IV. CONCLUSIONS

Adequate punishment for cartel behavior is fundamental for ensuring compliance with competition law. The absence of any form of cross-sector competition law in Hong Kong in the past, until 2012, coupled with the very limited scope and strength of the penalties available in those sectors with competition provisions, meant that virtually any cartel could go by scot-free. In a jurisdiction in which cartels were until recently considered a valid form of business, it is imperative that the early enforcement decisions send out the right signal and lay down the ground for a robust cartel-busting regime.

The new Ordinance is certainly bound to improve the current state of play when it comes into full operation in mid-December 2015. The corporate and individual sanctions available, if used to their full potential, could really force businesses to think twice before colluding. But the lengthy and challenging process for adopting the Ordinance has undeniably left a mark on its potential to effectively punish and deter.

In order to maximize the deterrent effect of the penalties envisaged in the Ordinance, it would be very useful if enforcers would, first and foremost, clarify the way fines are to be calculated. In addition, the sanctions for individuals, including director disqualification and fines, should be used to their full potential in cartel cases, given the severity of the violation. Guidelines clarifying these aspects would be welcome.

Despite these concerns, Hong Kong's new competition law has the potential to transform how cartels are perceived in this jurisdiction. The cost of detection has undoubtedly been raised, and there are now significant personal consequences for those seeking to increase profits through collusion. The message of the new regime is clear: Cartels are serious breaches of competition law, and the law provides harsh punishment for such violations. It is hoped that enforcement that will follow the imminent entry into force of the Ordinance will confirm the tough stance on cartels.

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Trade Associations—Under the Spotlight for Competition Enforcement

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Henry Wheare[1]

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 Rule[3] 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 Rule[4] 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 Rule[5] 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]

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[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.

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[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]

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[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.

- Publically 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 & Trade Associations,* Competition Commission (May 2015).