Hong Kong Competition Commission publishes long-awaited draft guidelines to Competition Ordinance

Background

On 14 June 2012, Hong Kong's Legislative Council ("LegCo") passed the Competition Ordinance (the “Ordinance”), which introduces the first economy-wide prohibitions of anti-competitive agreements and abusive conduct in Hong Kong.

Pursuant to the legislation, prior to the substantive provisions of the Ordinance coming into force, the newly appointed Hong Kong Competition Commission ("HKCC") is obliged to issue guidelines on the interpretation of certain aspects of the Ordinance (the “Guidelines”) and it must consult with LegCo and other appropriate persons on the content of the Guidelines, prior to them being finalised. The HKCC has emphasised that the Guidelines do not change the law and it will be for the Competition Tribunal and other courts to determine the legal position if businesses disagree with the approach taken by the HKCC.

On 9 October 2014, the HKCC published the Guidelines in draft form for public consultation. The Guidelines fall into two principle categories: those that relate to the procedure for handling complaints, conducting investigations and applications for exclusions and exemptions (the “Procedural Guidelines”) and those that relate to the First and Second Conduct Rules and the Merger Rule as set out in the Ordinance (the “Competition Rule Guidelines”).

The public consultation period ends on 10 November 2014 for the Procedural Guidelines and 10 December 2014 for the Competition Rule Guidelines. Once the HKCC has considered the submissions received, it will produce final draft Guidelines for consultation with LegCo and other appropriate persons, as a necessary step before the Competition Ordinance can come into full effect.

Once the Guidelines have been finalised, the substantive provisions of the Ordinance will come into force on a day to be appointed by the Secretary for Commerce and Economic Development. The HKCC is aiming to finish all its
preparation work by the first half of 2015, paving the way for the full implementation of the Ordinance on a date yet to be set by the Government.

Although not binding as legislation on the Competition Tribunal or the Hong Kong courts, the final Guidelines will be influential in practice, clarifying the enforcement approach of the HKCC, and assisting businesses to determine whether their conduct complies with the Ordinance.

**Competition Rule Guidelines**

**First Conduct Rule (anti-competitive agreements and concerted practices)**

**Serious anti-competitive conduct and object restrictions**

The Guidelines confirm that the serious anti-competitive conducts (price fixing, market sharing, output restrictions and bid rigging) will be considered to be object restrictions, and thus will not require any determination as to their effects on competition. There has been a trend by regulators in Europe to extend the scope of what constitutes an object restriction, as it means they do not have the burdensome task of establishing the effects on competition, and the Guidelines leave it open for the HKCC to do the same.

The Guidelines further state, however, that not all object restrictions will be considered to amount to serious anti-competitive conduct. This may apply, for example, to resale price maintenance (“RPM”). This has procedural implications in terms of whether a warning notice will be issued prior to any investigations being commenced.

Although likely to be regarded unfavourably by the business community, the Guidelines confirm that warning notices will be made public on the HKCC’s website.

**Resale maintenance price**

As a general rule, the HKCC considers that RPM is by its nature harmful to competition and will be treated as an object restriction, absolving the HKCC of the need to prove any anti-competitive effects on the market. However, the Guidelines lack clarity, as they do not provide certainty on whether RPM falls under the definition of serious anti-competitive conduct, instead stating that RPM may amount to serious anti-competitive conduct in certain cases, without clarifying what those cases may be.

The HKCC recognises that RPM may lead to efficiencies and the Guidelines provide that where a company can defend an RPM on efficiency grounds, there will be no infringement of the First Conduct Rule. Since the burden lies on the HKCC to prove a restriction of competition, but on the defendant to justify any restriction on efficiency grounds, this approach effectively reverses the burden of proof in favour of the HKCC. While the Guidelines seek to emphasise that the possibility of exemption is real (as exemplified by the hypothetical example given), experience from Europe indicates that it is very difficult in practice to justify a restriction on efficiency grounds once it has been categorised as a restriction by object.
Maximum or recommended resale prices are likely to acceptable, unless they soften competition or facilitate coordination between suppliers. Further, if they are combined with measures that make them work in reality as fixed or minimum prices, they will be assessed by the HKCC in the same manner as RPM arrangements.

**Vertical arrangements**

The HKCC has helpfully said that vertical arrangements (excluding RPM) will generally be considered under an “effects based” analysis and will likely only cause competition concerns where there is market power. However, a market share threshold for determining what might be considered market power for this purpose (such as the 30% threshold in the EU) has not been provided, which may make it difficult for businesses to determine whether or not their vertical arrangements are likely to cause concern under the Ordinance.

**Information sharing**

The Guidelines confirm that information sharing between competitors on future pricing intentions will be considered to be an indirect form of price fixing with the object of restricting competition, including when information exchange takes place through a third party, such as a common supplier.

As a general rule, following the precedent set by other jurisdictions, the Guidelines state that the exchange of information between undertakings may harm competition where it results in undertakings becoming aware of the market strategies of their competitors. Other types of information exchange, aside from exchange of future pricing information, may therefore run the risk of infringing the Ordinance based on an analysis of their effects on competition.

**Parallel behaviour**

The HKCC has provided welcome assurance that parallel behaviour by competitors does not necessarily mean that competitors are involved in a “concerted practice” or have made an anti-competitive agreement. The HKCC acknowledges that it is to be expected in a highly competitive market that competitors will respond almost immediately to each other’s pricing and so parallel behaviour may be apparent.

**Trade associations and professional bodies**

Following information received by the HKCC during its engagement process, the HKCC has decided to focus on trade associations in the Guidelines. The Guidelines acknowledge that trade associations and professional bodies have a key role to play in supporting their industries and providing information on developments. However, it is imperative that trade associations do not facilitate coordinated conduct in the market among members. The Guidelines provide some helpful examples to illustrate where trade associations may fall foul of the Ordinance.

**Second Conduct Rule (abuse of substantial market power)**

**Market power**
One of the most notable features of the Guidelines is that they do not provide any indicative market share thresholds for indicating what may constitute substantial market power. This is likely to be of disappointment to businesses, who would have welcomed a “safe harbour” below which a company would be presumed not to have substantial market power for the purpose of the Second Conduct Rule. On the other side of the coin, businesses may of course be relieved that there is no market share “danger zone” above which substantial market power will be presumed.

Instead, the Guidelines provide that market power is the ability to profitably maintain prices above competitive levels, or output below competitive levels, and it is determined based on the features of the market, including market shares, market concentration, barriers to entry or expansion, the competitive advantages of the parties and the existence of any countervailing power on the part of the buyers/suppliers.

A distinction has been made between market power for the purpose of the First Conduct Rule and substantial market power for the purpose of the Second Conduct Rule, although it is not clear how this will apply in practice and it is likely comments during the consultation process will urge the HKCC to provide more clarity in relation to this.

**Conduct that may constitute an abuse**

The Ordinance lists ‘predatory behaviour towards competitors’ and ‘limiting production, markets or technical development to the prejudice of consumers’ as examples of conduct that might constitute an abuse of substantial market power. The Guidelines expand on this by providing a non-exhaustive list of possibly abusive conduct, which includes predatory pricing; tying and bundling; margin squeeze; refusals to deal; and exclusive dealing.

The Guidelines focus entirely on abusive conduct that results in anti-competitive foreclosure. Therefore, whilst not expressly stated in the Ordinance or the Guidelines, it appears that the HKCC intends only to focus on exclusionary abuses of market power and not on purely exploitative abuses, such as excessive or discriminatory pricing. Given the controversial nature of exploitative abuses, this should be welcomed by Hong Kong businesses.

The precise details of when individual conduct may constitute an abuse is subject to considerable complexity and a degree of controversy in many jurisdictions. By limiting its guidance to a relatively high level, the HKCC successfully side steps many of these issues which will remain to be resolved in individual cases.

**Merger Rule**

The Merger Rule only applies to mergers in the telecommunications market which involve holders of carrier licences under the Telecommunications Ordinance and it is a voluntary regime, meaning there is no mandatory obligation on a company to notify a proposed merger to the authorities.
However, it is important that companies note that in the event the Merger Rule is extended in the future to cover other sectors, it is unlikely that the HKCC will issue substantive new guidance on the interpretation of the Merger Rule. Therefore, it is advisable that companies and stakeholders consider and provide comments on the Merger Rule Guideline now, alongside their comments on the other Guidelines.

**Procedural Guidelines**

**Complaints**

The HKCC has advised that it will exercise discretion in deciding which complaints to pursue, taking into account the potential impact of the alleged conduct on competition and consumers; the likelihood of a successful outcome resulting from the investigation; the HKCC’s enforcement priorities; and resources. The HKCC may not pursue a complaint even if it is possible it may result in a contravention of the Ordinance. Where it does not pursue a complaint, it will provide an explanation for its reasoning to the complainant.

**Investigations**

The Guidelines confirm investigations will occur in two phases: an “initial assessment phase” during which the HKCC may request information from companies on a voluntary basis; and, if the HKCC has formed a view that it has reasonable cause to suspect a contravention of the Competition Rules, an “investigation phase”, during which the HKCC can oblige cooperation from undertakings involved.

The HKCC has not provided indicative timeframes for either the initial assessment nor the investigation phase and therefore the investigation process and its potential impact on businesses is still highly uncertain.

**Applications for exemptions**

The Guidelines confirm that the HKCC has no legal basis to commence the process for block exemptions until the Ordinance is fully in force and that sector specific block exemptions will only be granted as an “exceptional measure”. No indicative timeframes for deciding whether to grant individual or block exemptions are provided, meaning the process may take a very long time. Indeed, the HKCC points out that it is not unusual for the block exemption process to take several years in other jurisdictions. The HKCC appears to be very clearly dampening expectation that it will issue any block exemptions in the near future.

However, the Guidelines clearly emphasise that the absence of exemptions should not stop businesses self-assessing and relying on the economic efficiency defence which may be available to them.
**HKCC's next steps**

In addition to the Guidelines, the HKCC will release later in 2014 and early 2015 other documents providing guidance on its proposed interpretation and application of the Ordinance, including small business focused brochures, self-assessment tools and policy statements on leniency and enforcement.

The HKCC has also confirmed that it will launch a comprehensive advocacy and promotion campaign to publicise the implementation of the Ordinance.

The HKCC’s Overview of the Guidelines can be found here.

The HKCC’s press release, including FAQs, can be found here.

The full text of the Guidelines can be found here.

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This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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