**HK Competition Association**
**9 December 2014**

# HONG KONG COMPETITION ASSOCIATION – RESPONSE TO THE PUBLIC CONSULTATION ON THE DRAFT SUBSTANTIVE GUIDELINES

## INTRODUCTION

This submission has been prepared by members of the Hong Kong Competition Association (**HCA**).

The HCA is an informal group of lawyers, researchers, consultants, monitoring trustees, in-house and students based in Hong Kong, who all share a strong interest in the development of fair and efficient competition law in and outside of Hong Kong. A list of all the members involved in the submission can be found in Annex A. The HCA was set up in October 2014 and will soon be registered under the Societies Ordinance. The HCA is thankful to the Competition Commission and the Communications Authority (together, the **Competition Authorities**) to be given the opportunity to participate in the debate on the enforcement of the Competition Ordinance (CAP 619 of the Laws of Hong Kong) (**Ordinance**). Our participation in this debate is based on our members' vast and varied experience in the field of competition law in and outside of Hong Kong. We aim to share some high level and detailed comments with the Competition Authorities and third parties and thereby, contribute constructively to the debate that the Competition Authorities have initiated with HCA.

The HCA intends to organise regular events to promote competition law in Hong Kong. Based on the successful examples of the Competition Law Association (**CLA**) in London and the Association Française pour l'Etude de la Concurrence (**AFEC**) in Paris, we hope to generate more debates about the Ordinance and hope to count on the participation of the Competition Authorities and other competition authorities in its activities to the benefit of the Hong Kong community. We hope that our submission below will pave the way for our engagement with the Competition Authorities in the future.

The HCA wishes to express its deep gratitude to the Competition Authorities for its substantial efforts in preparing the following draft substantive guidelines that are required under the Ordinance:

- the Draft Guideline on the First Conduct Rule;
- the Draft Guideline on the Second Conduct Rule; and
- the Draft Guideline on the Merger Rule,

(together, the **Draft Substantive Guidelines**).

The Draft Substantive Guidelines were clearly drafted in the spirit of the Ordinance and are aligned with international practice and standards. Drafting competition guidelines, both procedural and substantive, is a difficult exercise with deep and lasting consequences. In many places, the Draft Substantive Guidelines provide helpful clarifications and to the Ordinance that businesses, practitioners and scholars need to better understand, apply and respect the Ordinance. These clarifications are essential not only to the enforcement of the Ordinance but also to its overall success.

The HCA hopes to have produced a balanced and comprehensive submission, which aims to show that the Draft Substantive Guidelines must be welcomed but also how it can be improved. The varied examples on which we base our views reflect the variety of backgrounds of the HCA members. In doing so, we have been particularly attentive to the need to remain clear and concise when formulating proposals. We remain available to discuss our submission with the Competition Authorities should the need arise.

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Our submission addresses each of the Draft Substantive Guidelines. It contains our comments on substantive issues raised in and suggested clarifications on the Draft Substantive Guidelines so to ensure they are in line with the meaning and intent of the Ordinance and to ensure clarity.

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## DETAILED COMMENTS

The following comments from the HCA cover the Draft Substantive Guidelines as published by the Competition Authorities on 9 October 2014. The comments are meant to further improve the Draft Substantive Guidelines and the HCA would be pleased to meet the Competition Authorities to discuss or clarify any of their comments below.

Please note that terms and expressions defined in the Draft Substantive Guidelines have the same meanings in the following comments.

### Detailed Comments

### 1. FIRST CONDUCT RULE GUIDELINE

#### *(a) Substantive issues*

- Sections 2.2 and 2.3: the HCA welcomes the definition given by the Competition Authorities to the notion of undertakings and the reference to "economic activity". However, it may be appropriate to stress that an entity that falls within the scope of exclusion of the Ordinance (i.e. an entity not engaged in "economic activity") should not be considered as an undertaking.

- Section 2.6: the notion of "decisive influence" is key but is nowhere defined. The HCA would strongly recommend that a definition be given, for instance by reference to other jurisdictions, in particular, a reference to the European Union where this notion is widely used and recognized. Companies and practitioners need such guidance. The HCA also notes that Section 2.6 refers to "decisive influence over *the commercial policy* of another entity", whereas Section 5 of Schedule 7 refers to decisive influence over "*the activities* of [an] undertaking". It is not clear whether this distinction is involuntary or whether the Competition Authorities intend to define the word "activities" as "commercial policy" (and to utilise these terms interchangeably). In any event, the HCA would strongly recommend that the Competition Authorities clarify this notion and give examples.

- Section 2.6 and Hypothetical Example 1: the HCA understands from Hypothetical Example 1 that the key factors that the Competition Authorities would take into account are the last three risks mentioned in that example. However, this should be mentioned expressly. Furthermore, it appears that the key factor to determine this "agent" is in fact a third independent party is actually not mentioned in Hypothetical Example 1. That is, the "agent" *buys* the products from its principal (first line of Hypothetical Example 1), which means that the property over the products is transferred – at some point in time. This should be made clear in the example.

- Section 2.13: for a non-specialist, it may seem too drastic to conclude that any informal, oral "meeting of minds" may be sufficiently clearly established to constitute an agreement subject to the Ordinance. The Guidelines would benefit from a reminder that there is no need to provide written evidence to prove the existence of an "agreement".

- Section 2.14: in many jurisdictions, it is accepted that a tacit agreement may exist if a person attending a discussion during which an anti-competitive agreement is reached between other

participants has not objected to and distanced itself from the said agreement. Section 2.14 provides, however, that the objection in question must be "sufficient", without explaining what sufficient means. The word "sufficient" could for instance be replaced by "sufficiently clearly" or "sufficiently expressly". Also, there is no explanation as to what "distance itself" means. It could for instance be explained that this means that the person must make clear that it will not follow the proposed agreement. Similarly, the word "publically" may be confusing as it suggests that the person, who attended the meeting, would need to make a public announcement to be exonerated from the application of the Ordinance. The HCA assumes that the Competition Authorities meant that this person only needs to sufficiently clearly object to the agreement and expressly make clear that it does not intend to follow the agreement to the people present at the meeting. Finally, the HCA considers that the Competition Authorities may consider adding a Hypothetical Example to illustrate the content of Section 2.14.

- Sections 2.15-2.18: the definition of "concerted practice" needs to make clear that much will depend on the market conditions and in particular, the level of concentration within the market. Exchanging confidential information may be very pro-competitive, even when this information is detailed, when the market is atomized. In that sense, the definition of "concerted practice" (Section 2.15) should refer to market conditions. The reference to the counter-factual in Section 2.16 seems almost too vague as "normal competitive conditions of the market" is not defined and an exchange of information in a highly competitive market may actually be the source of "normal competitive conditions". Similarly, the first example of Section 2.17 seems to prevent the exchange of confidential information with the aim to "influence" conduct. This influence could be highly competitive (e.g. if it induces participants to decrease their price as a result of price exchanges). Similarly, disclosing future conduct may not on its own lead to restriction of competition. Once again, much will depend on market conditions and in particular, if the level of concentration in the market will be propitious to an increase in, or a stabilization of, price. Only Section 2.18 seems to acknowledge the importance of the level of concentration within the market. Neither Hypothetical Example 2 nor Hypothetical Example 3 mentions this key factor in its analysis.

- Sections 3.8, 3.12 and 3.19: the HCA would recommend that the Competition Authorities take the opportunity in Sections 3.8 and 3.12 to state that the anti-competitive objects or effects of an agreement may in some occasions be severed from the rest of the agreement. The Competition Authorities seem to address this issue by introducing the notion of "ancillary" restrictions in Section 3.19. While the HCA welcomes this specific explanation, the key question remains as to whether an agreement may survive despite the existence of an anti-competitive restriction. The HCA would therefore welcome these three Sections covering the questions of the severance of anti-competitive clauses.

- Section 3.16: the HCA would like the Competition Authorities to clarify whether Section 3.16 also covers a situation where several parties in a given market all adopt agreements, which taken as a whole, may restrict competition because all these parties ***collectively*** have market power in a given market.

- Section 3.22: the HCA has serious doubt on the usefulness of a reference to a mere difficulty in implementing an agreement simply because it would be "***difficult***" to implement it without the ancillary restrictions. This will arguably apply to every clause in any contract. This reference may need to be removed.

- Section 5.6: it is unclear whether resale price maintenance (RPM) is or is not a "Serious Anti-competitive Conduct". RPM seems to be the only conduct that may be serious depending on the facts. The chapter dedicated to RPM (Sections 6.61-6.64) does not clarify the question as it only shows that some influence on resale price does not necessarily amount to an RPM conduct (e.g. "recommended or maximum price") or that efficiencies can be proven ("efficiency justifications for resale price restrictions"). The HCA would welcome the Competition Authorities clarifying whether RPM, defined as a minimum or fixed resale price conduct, is or is not a "Serious Anti-competitive Conduct".

- Section 6.7: if a supplier is vertically integrated, there will usually be no competition concerns under the First Conduct Rule because the Rule does not apply to vertical agreements where there is only one undertaking, including an entity that forms a single economic unit. The Competition Authorities are recommended to clarify that a supplier which chooses not to be vertically integrated should not face a materially higher burden under the law, otherwise this may distort how businesses organise themselves in the market.

- Section 6.8: in the case of vertical agreements, the HCA is of the view that they only restrict competition if both the supplier and reseller have a certain degree of market power in their respective market. This position has been retained by the EU Competition Authorities in its 2010 Block Exemption Regulation on Vertical Agreement, and the HCA strongly believes that no competition concerns may arise if neither the supplier nor the reseller has any market power.

- Section 6.9: the reference to recommended and maximum resale price restrictions in the table may be misleading as these restrictions do not fall within the scope of the Ordinance; it would only be the case if they would indirectly amount to RPM (reference to Section 6.68).

- Section 6.35: it is unclear why the Competition Authorities consider that all information on future prices and quantities would be a breach of the Ordinance by object. Such an exchange of information would arguably breach the Ordinance *per se* only if the market is highly concentrated, if the level of detail of the information exchanged is high, if the information is not made public, etc. The HCA disagrees that a simple exchange of detailed information would constitute an infringement of the Ordinance.

- Section 6.36: the notion of "conduit" must be defined. Businesses all use distributors and customers to try and understand the position taken by their competitors. In that sense, third parties are systematically used as "conduit" for such information. The scenario envisaged by the Competition Authorities seems to address where third parties receive incentives to provide confidential information about an undertaking's competitors or possibly if the two competitors agree with a third party to transfer information between them.

- Sections 6.47-6.60 (Standard Terms, Membership of Associations, Certification): it seems that much of the concerns raised by the conduct described by the Competition Authorities would not arise if the interested undertakings or group of undertakings have no <u>*collective*</u> market power. The importance of market power should be recognized in these Sections.

- Section 6.74: the justification for imposing RPM to avoid "free rider" issues seems to contradict the qualification of RPM conduct as "Serious Anti-competitive Conduct". In the majority of cases, RPM are imposed precisely to avoid free-riders. This reference therefore seems inappropriate, whereas the

second part of this Section (reference to "'experience' or complex products") seems to be a better illustration.

***(b) Suggested clarifications***

- Section 2.18 and Hypothetical Example 3: the HCA questions the choice of Hypothetical Example 3 as this example shows that prices dropped; while it is conceivable that collusion on price decrease may breach the Ordinance, it will arguably not be the priority of the Competition Authorities. It may be preferable to use an example where the broker Competition Authorities increases as a result of the discussions amongst sales directors.

- Section 3.7, Section 5.3 and Section 5.8: the relationship between agreements having the object of harming competition and Serious Anti-competitive Conduct should be made clearer. The HCA understands that according to the Competition Authorities, entering into agreements having the object of harming competition also constitutes Serious Anti-competitive Conduct, but Serious Anti-competitive Conduct may also be entering into agreements having the effect of harming competition.

- Section 5.4: The HCA understands from the text of Section 2(1) of the Ordinance that the list of Serious Anti-competitive Conduct is statutorily defined. Therefore, the Competition Authorities may not be able to further define it as Section 5.4 of the First Conduct Rule Guidelines appears to do.

- Section 5.6: The Guideline emphasises RPM repeatedly under the First Conduct Rule, but has opted not to adopt rule of reason even though it is not explicitly mentioned in the Competition Ordinance. This essentially means that players will have to justify their practice – as some do generate economic efficiencies. We question whether this will not absolve the Competition Authorities from having to prove anti-competitive effect, or whether there is instead a presumption of illegality to be rebutted by businesses. We question whether in that sense the Competition Authorities' choice to make RPM a restriction of competition "by object" is not creating a disproportionate burden for businesses.

- Section 6.14: this Section refers to the "intention of" coordinating pricing. However, non-binding price recommendations or scale fees may indeed restrict competition even if there is no "intention" to have this effect.

- Section 6.20: the notion of bid-rigging is very exhaustively defined in the Ordinance. It seems that the First Conduct Rule Guidelines should refer to this definition although the Competition Authorities may clarify that bid-rigging activities other than those covered by the Ordinance itself may fall within the definition of Serious Anti-competitive Conduct (including market allocation, output control or price fixing).

- Footnote 29: the HCA queries whether Footnote 29 should clarify that it is the Competition Authorities' understanding that the concept of a service of general economic interest corresponds to the concept of a public service, rather than stating that this concept "might be seen as roughly corresponding to the concept of a public service".

## 2. SECOND CONDUCT RULE GUIDELINE

- Sections 1.6-1.8: while these Sections seem to lay down the core criteria for considering whether an undertaking abuses its market power, the Competition Authorities could add further clarity to these Sections by setting out the various criteria on which the Competition Authorities will rely to decide whether an abuse of market power has occurred. For instance, protecting or increasing "position of power and profits", preventing "challenges to [this] position", leveraging substantial market power on a secondary market and profits of market power becoming a "reward for causing harm to economically beneficial outcomes" all seem relevant but the Competition Authorities may want to confirm more clearly that those are the criteria it intends to apply.

- Section 1.8: the notion of "special responsibility" has been imported from the European Union, but the HCA doubts that it fits the Hong Kong economic and legal regime. The Ordinance cannot constitute the legal basis for such a notion neither as this requirement may have far reaching consequences. Therefore, the HCA is of the view that this entire Section should be amended.

- Sections 2.6 and 2.15: Although the HCA understands that the definition of "geographic market" must include the geographic area where customers can go to and acquire interchangeable products/services, the sentence "areas where buyers can find substitutes" seems too vague and far reaching, as it would not be correct to claim that a relevant geographic market includes all areas in the world where a product/service can be found.

- Section 2.7: as is the case in many jurisdictions and with a view to ensure global consistency in applying antitrust regimes, the HCA proposes that Competition Authorities consider cases from either the Communications Authority or foreign competition authorities when defining markets. More importantly, although case definitions may need to be reviewed from time to time, the Section suggests that market definitions can be constantly reviewed, which in practice, is clearly the opposite of what authorities throughout the world try to do – i.e., they will consider previous definitions (including from foreign authorities) and rely on assessment previously made to assess future cases. This would also help undertakings and practitioners in their day-to-day risk assessments and avoid undue uncertainties.

- Section 2.17: the HCA questions the choice in Hypothetical Example 3 of a milk market. It is unclear to us whether retailers in Hong Kong would travel to find alternative milk suppliers, either given the costs involved or for other reasons (including food labelling or food safety).

- Section 2.22: the HCA agrees that buyers may be "locked in" but in the everyday life, buyers would often *feel* "locked in", although from a competition perspective, there may be strong arguments to claim that the buyers have the ability to find alternatives before being "locked in". Furthermore, any exclusivity arrangement would involve a buyer being in a "locked in" situation. The concept of "locked in" should not be the cause for defining a product market too narrowly. With an extreme analysis, this would arguably lead to the absurd situation where all exclusive deals would create separate markets. This Section would therefore benefit from a clearer and more detailed explanation and possibly a hypothetical example to provide further guidance.

- Section 2.25: we welcome the Competition Authorities' explanation regarding two-sided markets, and the indication that the assessment of market power will consider both sides. However the question of two-sided markets, as highlighted by Jean Tirole in his Nobel Prize lecture, is

particularly complex. Therefore businesses would benefit from more details on the way the Competition Authorities will define market, and assess market power.

- Section 2.31: the HCA strongly objects to the position taken by the Competition Authorities that would disregard "supply-side substitutability" as relevant for defining a market. If teachers want red-ink pens, it would be completely absurd to consider that red-ink pen suppliers do not belong to the same market as suppliers of pen of different colours or to consider that the latter are only "potential" competitors. To us, the notions of potential competitors (i.e. companies able to switch production in case of sustainable price increase) and "supply-side substitutability" should not be confused.

- Sections 3.1-3.15: the HCA urges the Competition Authorities to introduce an indicative market share threshold below which there would be no presumption of substantial market power. The HCA understands the Competition Authorities wish to retain flexibility in evaluating market power but stress that an indicative threshold would not tie their hands in finding substantial market power in an appropriate case. If necessary the Competition Authorities may specifically caveat the indicative thresholds with a market concentration element, e.g. the Singapore merger control regime where the Competition Commission of Singapore has indicated competition concerns are unlikely to arise in a merger situation where the merged entity will have a market share of less than 40% or 20-40% where the CR3 or CR4 ratio is 70% or more. The Competition Authorities will appreciate without indicative market share threshold(s) the Guideline is of limited use to businesses as a self-assessment tool, which ultimately defeats the purpose of issuing guidance.

- Sections 4.5-4.8: the HCA suggests the Competition Authorities define what it would consider conduct restricting competition "by object". It would seem unduly broad to categorise as "by object" conduct which have pro-competitive as well as anti-competitive objects, as Section 4.6 suggests. It is unhelpful to state as the sole example that predatory pricing "may" have the object of harming competition. In that regard the Competition Authorities will note that in the United States particularly the threshold for establishing the illegality of predatory pricing conduct is extremely high, as price wars are generally considered beneficial to consumers. The Competition Authorities should also make clear how it will determine conduct is anti-competitive by object and whether and at what stage this determination can be challenged.

- Sections 4.9-4.12: the Competition Authorities should state that efficiency arguments will be considered in the assessment of the effects of conduct under the SCR, and issue appropriate guidance thereon.

- Section 4.12: the HCA suggests that the Competition Authorities clearly defines what constitutes "harm to consumers".

- Section 5.2: the Competition Authorities may want to clarify whether "consumers are worse off if competition is weakened in this way" corresponds to the expression "harm to consumers" as used in Section 4.12.

- Section 5.4: the HCA suggests that the language of this Section is adjusted to reflect a more neutral approach in assessing foreclosure. For instance the expression "will therefore seek to *demonstrate* anti-competitive foreclosure" (emphasis added) denotes a rather biased initial stance. A more neutral wording could be that "the Commission will therefore assess the situation to determine whether a firm has engaged in anti-competitive foreclosure".

Section 5.8 and Hypothetical Example 7: the Competition Authorities may mention expressly that tying may be a way of introduction of a new product in the market to the benefit of the consumers, or a way to enable the supplier to pass on efficiencies to its customers arising from the production or purchase of large quantities of the tied product, and that these will be considered by the Competition Authorities in assessing the anti-competitive effects.

## 3. MERGER RULE GUIDELINE

### *(a) Overall comments:*

- the Merger guideline provides an opportunity to clarify how the Competition Authorities and the Communications Authority would cooperate, exchange information, and decide in case of a disagreement in the context of a merger. We understand, based on public comments made by members of the Competition Authorities, that an MOU between the two authorities is currently being drafted. It may be adequate to refer to this MOU in the Merger guideline, so as to ensure full transparency on the way the Competition Authorities will assess mergers.

### *(b) Suggested clarifications*

- Section 2.5: the notion of decisive influence over activities of undertakings has not been defined. This, however, is a key notion without which companies and practitioners will necessarily hesitate as to how the merger control regime applies in Hong Kong. The HCA, therefore, strongly recommend defining this notion, and in order to preserve coherence with other merger control regimes, the HCA would support the idea of defining the notion of "decisive influence " by reference to the rules and practice adopted in the European Union.

- Section 2.10: at the end of this Section, the Competition Authorities envisage the situation where a joint venture uses its parents' distribution network to distribute its products/services, but only in the limited situation where the parents are the agents of the joint venture. The HCA considers that the joint venture would not lose its status of autonomous economic entity if it uses its parents' distribution network on *an arm's length basis*. In that case, the joint venture remains autonomous and only opts to use its parents' distribution network as it would use any other third party's network. This is only briefly mentioned in Section 2.12, but the HCA would recommend mentioning it in Section 2.10 as well.

- Section 2.12: more clarity is needed as to what proportion of sales from a parent company to a joint venture will be considered sufficient to limit the joint venture's autonomy. The HCA notes that the European Commission consider 50% of the joint venture's turnover as an adequate threshold, below this which a case-by-case analysis would be required and particularly if the joint venture deals with its parents' at arm's length on the basis of normal commercial conditions (EU consolidated jurisdictional notice, C95/2008, paragraph 98).

- Section 2.14: we suggest that the Competition Authorities add to the list of transactions unlikely to qualify as a notifiable merger the operations by which licence carriers acquire securities or control in businesses that are unrelated to the licence carriers' telecom activities.

- Section 2.16: the Competition Authorities helpfully consider that an acquisition of a licence carrier by a bank, an insurance company or an exchange participant is unlikely to give rise to competition concerns. In relation to this, we consider that it would be helpful to clarify what would be the effect of such a presumption. In addition, the cases in which this presumption would be rebutted could be outlined in the guideline. Would for instance the Competition Authorities be concerned in case of an acquisition by an undertaking which already controls a licence career, despite this undertaking been listed in Section 2.16?

- Section 3.9: we suggest replacing the sentence "the main competitive concern is whether the merger *will* result in an increase in prices…" by "the main competitive concern is whether the merger *is likely* result in an increase in prices…"

- Section 3.16: we consider the post-merger HHI indicating an un-concentrated market to be slightly too low. In comparison, the JFTC (Japan) applies a 1,500 threshold, while the KFTC (Korea) applies a 1,200 threshold for markets considered un-concentrated. Considering the relatively highly concentrated nature of the Hong Kong economy, we suggest that the current 1,000 threshold is raised to reflect the East Asian practice and local market conditions. Similarly, the second threshold (Section 3.17) could be raised from 1,800 to 2,500 to reflect the expansion of the "un-concentrated" category of markets.

- Section 5.15:

    - we suggest that the Competition Authorities clarify the process and the principles applied when the parties consider that an information contained in the commitments should be considered confidential and should be omitted from the register of commitments. Such a clarification would be consistent with the wording of Section 64 of the Ordinance.

    - this Section provides an opportunity for the Competition Authorities to clarify the rules for the appointment and the general functioning of corporate monitors (monitoring trustees). Orders made by the Tribunal under Schedule 2 of the Ordinance refer to the appointment of trustees for the purpose of monitoring; however the parties to a merger would benefit from the certainty attached to a clear appointment process at the Competition Authorities level, in particular as the objective of the parties will often be to avoid that a merger is referred to the Tribunal. Such a clarification would be particularly welcome since there is no internationally accepted practice of appointing a monitor. The people and companies who are qualified to act as monitors vary from a jurisdiction to another. Monitors are sometimes proposed by the parties (EC mergers), while in other cases the parties propose a list of monitors, leaving the ultimate choice to the authority (the DoJ in the US, and MOFCOM in the PRC).

- Section 5.23: we suggest that the Competition Authorities clarify what elements will be taken into account when considering rescinding a decision, and in particular what weight will be given to external factors and factors that are outside of the control of the parties.

- Section 5.29: this Section would benefit from a clarification of what effect proposing remedies have on an investigation. In particular, we think the Competition Authorities should be at least bound to consider the commitments, and that it should be clarified whether this would have an effect on the deadline for a decision.

- Section 5.34: it should be clarified what would be the process for determining what elements of a document are confidential when the parties and the Competition Authorities disagree to that effect.

## Annex A

The following people actively participated in this submission:

- François Renard
- Cynthia Chan
- Knut Fournier
- Vivian Tang
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