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Date 10 December 2014
Your ref
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Direct dial

By email (submissions@compcomm.hk) and by fax (+852 2522 4997)

Dear Sirs,

Submission on the Draft Substantive Guidelines

We enclose our submission on the Draft Substantive Guidelines issued by the Competition Commission and the Communications Authority. Please let us know if you would like us to clarify any points.

Your faithfully,

Eversheds

Encl.

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Response to the Competition Commission and Communications Authority's Consultation on Draft Substantive Guidelines

1. The purpose of this Submission is to set out Eversheds' observations on the draft substantive guidelines published jointly by the Hong Kong Competition Commission (the "Commission") and the Hong Kong Communications Authority. In this submission the following guidelines are referred to as the "Substantive Guidelines":

   - Draft Guideline on the First Conduct Rule – 2014;
   - Draft Guideline on the Second Conduct Rule – 2014.

2. Eversheds is an international law firm operating from 57 offices in 31 countries. In Asia it has offices in Hong Kong, Singapore, Shanghai and Beijing. As well as having extensive experience of the application of competition rules in the Hong Kong telecommunications and broadcasting sectors, Eversheds' Competition, EU and Regulatory group is recognised as one of Europe's leading competition practices and has a long track record of advising on the application of EU and national competition laws across multiple jurisdictions. The firm is therefore well placed to comment on the Substantive Guidelines, having seen various approaches adopted by competition regulators around the world.

3. As competition laws are new to Hong Kong businesses (save in relation to the telecoms and broadcasting sectors) and it is not proposed that the Competition Ordinance (the "Ordinance") will have any transitional period, we are concerned to ensure that businesses understand the Conduct Rules and have time to adapt to them. We therefore welcome the joint publication by the Commission and the Communication Authority of the draft Substantive Guidelines and are grateful to the Commission for the opportunity to comment. We also commend the Commission and the Communications Authority on providing clear, concise guidance on the substantive provisions of the Ordinance.

4. Overall we believe that the Substantive Guidelines will assist businesses in assessing whether their practices are likely to infringe either of the Conduct Rules. The Commission has consistently used straight forward, jargon-free and user friendly language. In addition, the use of flow diagrams and hypothetical examples ensures that the difficult concepts of competition law are made as easy as possible for businesses to follow.

5. Our specific comments on the Substantive Guidelines are set out in the remainder of this Submission. Our comments are limited to the guidelines on the First and Second Conduct Rules.

Draft Guideline on the First Conduct Rule – 2014

Definition of undertaking

6. We fully support the Commission's approach to the definition of an "undertaking" for competition law purposes (as set out in paragraph 2.2 to 2.11 of the Draft Guideline on the First Conduct Rule). The guidance is generally in line with the approach adopted in other jurisdictions. We believe it would be helpful to businesses if the Commission could provide additional guidance on the concept of "decisive influence" as, while this concept is known to competition law advisers, it may not be familiar to businesses.

7. Paragraph 2.6 of the Draft Guideline indicates that whether or not separate entities form a single economic unit will depend on the facts of the case. However, the Draft Guideline also indicates if an entity (A) exercises "decisive influence" over the commercial policy of another entity (B) - whether through legal or de facto control - then A and B will be considered a single economic unit and thus the part of the same undertaking. It also provides helpful clarification that agreements between parent companies and subsidiaries will not be subject to the First Conduct Rule.

8. However, it is unclear whether "decisive influence" will be defined solely by reference to legal and de facto control via shareholdings or whether other degrees of influence such as "the right to manage" may be "decisive". Likewise it is not certain whether the mere ability to block strategic decisions would give rise to "decisive influence" (as in the test under the EU Merger Regulation) or if only the ability to pass an ordinary resolution would be sufficient. Nor is there currently any guidance for businesses on what kinds of decisions would be regarded as "strategic" for these purposes.

9. Businesses are likely to have a desire for legal certainty. Therefore, the Commission may wish to consider providing additional guidance on the circumstances in which the degree of influence exerted by (e.g.) A over B would be sufficient to give rise to "decisive influence".

The concept of an "agreement"

10. The Commission's guidance on the concept of an agreement for the purposes of the Ordinance is largely uncontroversial, reflecting the practice of competition authorities elsewhere in the world. We agree that the concept of a "meeting of

minds" between the parties concerned is key to the question of whether or not there has been an agreement and is necessary to prevent avoidance. The Commission's clarification (in paragraph 2.12) that any agreement, arrangement, understanding, promise or undertaking, whether express or implied, written or oral (and whether or not enforceable or intended to be enforceable by legal proceedings) would be caught by the First Conduct Rule will assist businesses in assessing the extent to which their practices may be caught by the First Conduct Rule.

11. The concept of a "concerted practice", which by its nature is fundamentally more nebulous, is more problematic. We accept that a party who has attended a meeting in which an anti-competitive agreement was reached and subsequently implemented, should prima facie be regarded as being party to an anti-competitive agreement. However, the mere fact that a party has attended meetings and failed to sufficiently object to or publicly distance itself from the agreements in question, should not be sufficient to make it party to an anti-competitive agreement, in the absence of evidence that the undertaking in question acquiesced to the suggested cartel.

12. Co-ordination between competitors in the market does not necessarily imply concerted practice and we are grateful for the Commission's clarification in this regard in paragraph 2.16 of the Draft Guideline – namely that undertakings are free to adapt themselves intelligently to the existing or anticipated conduct of competitors.

13. We note the Commission's view (paragraph 2.17 of the Draft Guideline) that undertakings are precluded from direct or indirect contact where such contact influences the conduct on the market of an actual or potential competitor. We agree that such contacts may be problematic. In this regard, however, it is unclear how indirect contact might manifest itself and in what circumstances such indirect contact could amount to an "agreement".

14. We believe that additional guidance would be helpful in defining the types of "indirect contact" with undertakings which would amount to an agreement or concerted practice, as opposed to intelligently adapting to the existing or anticipated conduct of competitors. We would suggest that the key differentiator between indirect contact and intelligent adaptation would be knowledge on the part of each of the competitors involved that the indirect contact in question would enable co-ordination and/or reduce the risks of competition.

The object of harming competition

15. In relation to the concept of agreements which have the ***object*** of restricting competition, this language mirrors that set out in Article 101 of the Treaty on the Functioning of the European Union. As the Commission will be aware, there has been conflicting case law on this concept in Europe. Therefore, we are grateful to the Commission for clarifying that the object of an agreement refers to the ***aims pursued*** [emphasis added] by the agreement in the light of its legal and economic context and the way it is implemented.

The effect of harming competition

16. On the whole, the framework for the assessment of anti-competitive effects is conventional and economically robust. However, as regards the concept of market power, we have some concerns that the definition of market power may not be easily understood by businesses and further guidance is required (see also our comments in relation to the Second Conduct Rule at paragraphs 32 to 34 of this Submission).

Ancillary restrictions

17. Although the concept of ancillary restrictions does not appear in the Ordinance, we believe that there is a clear need to ensure that restrictions directly related to and necessary for mergers, acquisitions and concentrative joint ventures are not caught by the First Conduct Rule. However, we note that paragraph 3.19 of the Draft Guidance appears to indicate that this concept could be extended to other agreements (including distribution agreements).

18. We are unclear as to the necessity for the Commission to develop a doctrine of ancillary restraints other than in the context of mergers and joint ventures. On the basis that the Ordinance contains a general exclusion of restrictions which are efficiency-enhancing and not indispensible to the attainment of the objectives stated in paragraph A of section 1 of Schedule 1 of the Ordinance, we believe there would in reality be few restrictions which would be "directly related to and necessary for" an agreement which were not already "indispensible to the attainment of the objectives".

19. It is also not clear what approach the Commission would be likely to take to determining when restrictions may be regarded as directly related to and necessary for the implementation of the main agreement. To the extent that the Commission is contemplating restrictions directly related to and necessary for implementing the main transaction falling outside the First Conduct Rule, we would suggest that the Commission provides additional guidance.

Exemptions

20. Paragraphs 4.5 and 4.6 of the Draft Guideline sets out guidance on the procedure to be adopted under the Ordinance in relation to the processing of applications for a decision as to whether a particular agreement is excluded from the First Conduct Rule. As noted in our submission on the Procedural Guidelines, because companies operating in Hong Kong may not be familiar with the legal and economic analysis involved in making a self-assessment of an agreement, it may be that a significant number of parties will seek to rely on the guidance of the Commission. This could lead to the Commission being overrun with applications for exclusion, potentially taking up Commission resources which could be more effectively applied elsewhere (for example in the investigation of serious anti-competitive conduct).

21. Alternatively, if the Commission was to find itself overburdened with applications for exclusion and/or were routinely to decline to consider such applications, there is a danger that parties may decide not to enter into agreements which might otherwise qualify for exclusion, due to the difficulty of obtaining legal certainty from the Commission. In these cases, the efficiency benefits that may have flowed from these agreements could be lost.

22. These issues could potentially be addressed by the Commission introducing block exemptions for certain agreements which clearly do not pose competition risks. This would avoid placing potentially unnecessary burdens on the Commission and give businesses greater certainty about the legality of their agreements.

Serious anti-competitive conduct

23. We welcome the approach set out in the Ordinance (and summarised in section 5 of the Draft Guideline) in relation to serious anti-competitive conduct. The focus on serious anti-competitive conduct is in our view proportionate and appropriate to ensure effective prioritisation of the Commission's resources. We also believe that the requirement for the Commission to issue a Warning Notice in relation to conduct which does not amount to serious anti-competitive conduct is equally welcome and proportionate.

24. In relation to retail price maintenance (RPM), we accept that, in certain circumstances, retail price maintenance can adversely affect competition. However, there is a body of economic evidence which suggests that RPM frequently does not have anti-competitive effects: for example where there is strong inter-brand competition, anti-competitive effects may not be expected.

25. In our view, rather than characterising all RPM as serious anti-competitive conduct and making limited exceptions, the preferred approach would be only to

characterise RPM as serious anti-competitive conduct in circumstances where, in the light of the economic and legal context, the practice would be likely to be capable of resulting in anti-competitive effects. We believe that this approach would be consistent with both the definition of "serious anti-competitive conduct" in the Ordinance and economic evidence.

Output limitation

26. In relation to output limitation, we note that in hypothetical example 7, the Commission states that where competitors have agreed to pay certain other competitors to withdraw from the market, this would be regarded as a form of output restriction and an infringement of the First Conduct Rule. We agree that in a situation in which a number of competitors agreed together that they would facilitate the exit of one or more of their competitors, this would amount to an agreement between undertakings which would have either the object or appreciable effect of restricting competition.

27. However, we note that where such an arrangement was entered into only between two firms: whereby firm A agreed with firm B that firm B would exit the market and would assist firm A in transferring B's customers, or the goodwill of the business to A, such a transaction would generally be regarded as amounting to a merger. This would be the case in certain jurisdictions, even where no other assets were transferred from B to A. Accordingly, we believe it would be helpful if the Commission could clarify the circumstances in which an arrangement such as this would amount to a merger and therefore would not be subject to the First Conduct Rule.

Information exchange via customers and suppliers

28. In relation to information exchanges, cases where competitors use a third party to exchange data have been an enforcement priority for many competition authorities in recent years. For example, in the United Kingdom "hub and spoke" agreements have been at the heart of a number of recent investigations undertaken by the Office of Fair Trading.

29. We welcome the guidance provided by the Commission in relation to this area. However, we have two concerns:

- Firstly, such information exchange through third parties should only be of concern to competition authorities in circumstances where, as a result of the exchange, prices would be increased (or other [parameters] of competition similarly eroded). The Commission's views on this would be most welcome.

- Secondly, in circumstances where information is exchanged through third parties, in order for an agreement to be formed, it is necessary that (i) the party disclosing the information to the third party in the first instance discloses it in the knowledge that that information will be passed on to its competitor and (ii) its competitor must receive that information knowing that the business providing it intended that information to be provided to that competitor. Accordingly, additional guidance on the circumstances in which "hub and spoke" exchanges could amount to anti-competitive agreements would be helpful.

Draft Guideline on the Second Conduct Rule

Market definition

30. Although the approach to market definition set out in the Draft Guideline is largely conventional, we do not believe it is appropriate to exclude supply side factors from the assessment of the relevant market. If the party in question's pricing would be constrained by supply side switching (ie the ability of the company manufacturing related products to switch to the production of the product in question in response to a SSNIP), there would be no economic reason to confine this evidence to a consideration of whether the company in question has market power (as opposed to the definition of relevant market).

31. A related point is that the evidential hurdles in relation to likelihood of entry set out in paragraph 3.19 (namely that entry is likely, timely and sufficient) are in practice extremely difficult to clear. We would urge the Commission to take a balanced approach to this evidence and to recognise the role of the threat of entry in constraining the behaviour of firms. Additional guidance as to the nature of the evidence required as well as guidance as to the degree of likelihood, timeliness and sufficiency would be welcomed.

Definition of substantial degree of market power

32. The meaning of "substantial degree of market power" is unlikely to be clear to businesses. While we understand the Commission's desire to adopt an economic approach to the "substantial degree of market power" test, there are a number of ways in which we believe the Commission could potentially assist businesses in identifying whether a substantial degree of market power exists.

33. We understand that market share alone is unlikely to be determinative of whether a firm has a substantial degree of market power. It would be helpful, if possible, to indicate a threshold below which the existence of a substantial degree of market power would be unlikely to arise. This would give businesses

which have market shares which are unlikely to give rise to a substantial degree of market power some comfort that their practices are not abusive.

34. In paragraph 1.4 of the Draft Guideline the Commission has indicated that the most obvious manifestation of market power is the ability of an undertaking profitably to raise prices above the competitive level for a sustained period. The Commission should consider giving additional guidance as to the level of prices which would be regarded as "competitive" and defining a "sustained period". As an alternative, or in addition to the use of the market share guidelines, we believe that the Commission could usefully add additional guidance on when profits would be regarded as being above competitive levels and the period of time over which such profits would need to be sustained in order to indicate a substantial degree of market power.

Countervailing buyer power

35. In paragraphs 3.32 and 3.34 of the Draft Guideline the Commission has indicated that there will be countervailing buyer power where there is a credible threat to bypass the supplier. These are not the only circumstances in which buyer power is likely to arise and therefore it is encouraging that the Commission has acknowledged the relevance of a wider range of factors:

- ability to switch substantial purchases;
- sponsorship of new entry;
- importance of the customer; and
- how competition works (for example competitive tenders).

36. In addition, there are other situations in which buyer power may be asserted. This would include where customers may only need to move a small proportion of their requirements in order to defeat a price increase. Also relevant is the ability of buyers to switch to other providers to satisfy their requirements for ***other*** products purchased from the company in question in order to defeat a price increase in relation to the products in which the entity holds substantial market power. Therefore, we would be grateful if additional clarification could be provided here.

The content of object of uses

37. The concept, introduced by the Ordinance, of conduct which has the object of harming competition in the context of unilateral behaviour is novel. This raises a potential concern about the development of a doctrine of "per se" breaches of

the Second Conduct Rule. In our view, it would be extremely worrying if such a doctrine were to emerge. While the wording is taken from the Ordinance and therefore it will be a matter for the Courts to define what conduct may amount to a breach by "object", it would be helpful if the Commission could spell out what behaviours it believes would amount to an object-based infringement.

38. It is worth noting that the EU equivalent of the Second Conduct Rule has no concept of object-based unilateral conduct. Given that behaviour amounting to an abuse of a substantial degree of market power, when practised by firms without market power, would not be anti-competitive in the least, it is critical that such conduct must be of a type automatically capable of appreciably restricting competition.

39. Care should be exercised in defining particular behaviour which has the object of harming competition. The example given by the Commission in paragraph 4.8 (predatory pricing where the undertaking price is below average variable cost), is behaviour which other competition authorities, such as the European Commission, generally presume to be anti-competitive. However, even the European Commission would not rule out the possibility that such behaviour may not be predatory if, for example, the undertaking could demonstrate that such pricing was required to meet (as opposed to beat) competition. (We note that in paragraph 5.5 of the Draft Guideline the Commission indicates that it will adopt a similar approach. However, paragraph 4.8 appears to be inconsistent with the approach set out in paragraph 5.5).

Abuses

40. In relation to predatory pricing, we welcome the Commission's acknowledgement (set out in paragraph 5.3) that it will be wary of the risk of applying the Second Conduct Rule in its assessment of alleged predatory pricing conduct in a way which harms the competitive dynamic.

41. We support the Commission's approach in paragraph 5.4, which stresses the need to demonstrate likely foreclosure when assessing predatory pricing conduct. Section 5.5 helpfully explains the evidence that the Commission will consider when considering if pricing is "predatory".

42. In relation to tying and bundling, paragraph 5.11 contains a clear explanation of the nature of this abuse. We welcome the Commission's confirmation that it will consider the effects on competitors of such a strategy (5.11). We believe it would be helpful to set out situations in which an objective justification for bundling may arise as these are currently absent. An example of where an

objective justification may arise would be where there are safety or other quality considerations which justify bundling particular products.

43. In relation to refusals to deal, we believe that the text needs to be augmented with examples of situations in which a refusal to deal would amount to an abuse of a dominant position. Although paragraph 5.19 sets out the various factors the Commission will take into account when considering if a refusal to supply is a violation, it is not clear what significance or weight is attached to past history of dealing. The Commission will be aware of case law, in Europe in particular, which suggests that it is only in circumstances where customers are refused supply, having already been supplied in the past, where a finding of an abuse of a dominant position would be made (unless the products or services in question amounted to "essential facilities"). Although 5.20 and 5.21 go some way to answering this question in relation to intellectual property, it is not entirely clear whether the Commission would make such a distinction elsewhere and further clarification is warranted.

44. Paragraph 5.24 states that where exclusive dealing is pursued by an undertaking with a substantial degree of market power, it may amount to an abuse if ***it has the object or effect of harming competition***.

45. In our view (and as noted above), exclusive dealing should not be regarded as being likely to have the object of restricting competition given that, if carried out by a company without market power, this would be entirely rational and legal behaviour. Even where carried out by a dominant firm, exclusive dealing will not inevitably lead to anti-competitive effects.

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(Adam Ferguson/Mark Yeadon/Vishal Melwani)
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