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By Email

24 December 2014

Submissions on Draft Guidelines
Competition Commission
36/F, Room 3601
Wu Chung House
197-213 Queen's Road East
Wanchai, Hong Kong

Your reference 貴行檔案編號

Our reference 本行檔案編號
NZY
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Dear Sirs,

Consultation on Draft Guidelines: Response of Slaughter and May

This letter sets out the views of the Slaughter and May Competition Group on the following draft guidelines published by the Competition Commission (the "**Commission**") on 9 October 2014:

- the draft Guideline on The First Conduct Rule ("**FCR Guideline**");
- the draft Guideline on The Second Conduct Rule ("**SCR Guideline**"); and
- the draft Guideline on The Merger Rule ("**Merger Guideline**"),

(together, the "**Draft Guidelines**"). Terms defined in the Draft Guidelines shall have the same meaning when used in this letter.

We welcome the opportunity to comment on the Draft Guidelines and fully support the Commission's aim of providing clear guidance to businesses in Hong Kong as to how it will interpret and give effect to the Competition Ordinance (the "**Ordinance**").

Our views on specific issues raised in the Draft Guidelines are set out below.

1. FCR Guideline

Paragraph 2.6 – Definition of "decisive influence"

1.1 Paragraph 2.6 states that separate entities will generally form a single economic unit when one entity exercises "*decisive influence*" over the other.

1.2 No further guidance is provided on the meaning of "*decisive influence*". It is therefore not clear what factors the Commission intends to take into account in making this assessment. We suggest such

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further guidance be provided as this is of particular importance to businesses in Hong Kong, given that:

(A) it determines whether or not an agreement is subject to the First Conduct Rule;

(B) it may also be instructive in determining whether or not liability can be imputed to a parent company, which is of particular importance in situations where a fine is imposed by the Competition Tribunal; and

(C) the Merger Guideline also makes reference to "*decisive influence*".[1] It is therefore important that the Commission clarify whether decisive influence has the same meaning in the FCR Guideline and the Merger Guideline.

1.3 Further, it is not clear from the FCR Guideline if the Commission will presume "*decisive influence*" is exercised in certain instances (for example where an entity is almost wholly owned),[2] and if the entity is required not only to have decisive influence but also to actually exercise it.[3]

1.4 We therefore suggest that the Commission provide further information on what is meant by "*decisive influence*" in the context of the FCR Guideline and also the factors which it will take into account when determining if it exists.

Paragraphs 2.9 - 2.10 – Definition of "genuine agency agreement"

1.5 Paragraph 2.9 states that the determining factor in identifying a genuine agency agreement "*is the level of financial or commercial risk borne by the agent.*" Paragraph 2.10 explains that an entity is only a genuine agent "*if it does not bear any or bears only insignificant risks in relation to the contract concluded and/or negotiated on behalf of the principal.*"

1.6 Whilst Hypothetical Example 1 provides some examples of the risks which the Commission will consider, no further guidance is provided on how the Commission will assess such agreements. Given the prevalence of agency agreements, we suggest that the following further guidance be included in the FCR Guideline:

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[1] Paragraph 2.5 states that 'control' is acquired when decisive influence is capable of being exercised over the activities of the target undertaking "*and, in particular by: (a) ownership of, or right to use all or part of, the assets of an undertaking; or (b) rights or contracts which enable decisive influence to be exercised with regard to the composition, voting or decisions of any governing body of an undertaking.*"

[2] Such a presumption is applied in the EU. For example, see C-97/08 *Akzo Nobel and Others v Commission.*

[3] As is the case in the EU. For example, see C-172/12 *El du Pont de Nemours and Others v Commission.*

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(A) an explanation of the types of risks which are referred to in paragraphs 2.9 and 2.10 (e.g. contract-specific risks or investments, market-specific risks or investments etc.);

(B) an exhaustive list of risks the Commission will and will not take into account (e.g. responsibility for financial or other risks where the agent acts in breach of a contract or outside the scope of its authority) in its assessment;

(C) an indication of the threshold for determining that the risks borne by an agent are "*insignificant*";[4]

(D) whether an agent can act for multiple principals at the same time;[5] and

(E) whether exclusive agency agreements or single branding agreements are also exempt from the FCR.

1.7 We therefore suggest that paragraph 2.10 of the FCR Guideline be amended to provide further guidance on how the genuine agency test will be applied by the Commission to address the points raised above in paragraph 1.6.

Paragraph 2.14 – Clarify what is meant by "sufficiently object to, and publically distance itself from"

1.8 Paragraph 2.14 states that an undertaking may be found to be party to an agreement if it attends a meeting where an anti-competitive agreement is reached and it fails *"to sufficiently object to, and publically distance itself from, that agreement or the discussions leading to the agreement."*

1.9 No guidance is provided as to the meaning of "*sufficient*" objection or how an undertaking is expected to "*distance itself from*" the agreement or discussions. Further, the inclusion of the word "*publically*" could be misinterpreted by companies as requiring them to make a public announcement rather than an announcement at the meeting.

1.10 In order to provide legal certainty to businesses in Hong Kong, we suggest the Commission clarify what the minimum steps are that an undertaking must take if they are not to be deemed part of the agreement. Given the importance of this section, it may be appropriate for a Hypothetical Example to be added to illustrate this point.

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[4] In the EU, it is enough for the agent to bear one of the risks provided in the European Commission Guidelines on Vertical Restraints (OJ C 130/1, 19.5.2010) ("**EU Vertical Restraints Guidelines**").

[5] Paragraph 13 of the EU Vertical Restraints Guidelines states that it is not material for an assessment whether the agent acts for one or several principals.

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Paragraphs 2.15 - 2.18 – Definition of "concerted practice"

1.11 We note that the definition of concerted practice in the FCR Guideline has been adopted from the EU and, in particular, is based on the wording of the European Court of Justice's decision in *Suiker Unie v Commission*.[6] Whilst we do not have substantive comments on the definition provided, we have two suggestions in relation to the Hypothetical Examples in these paragraphs.

(A) First, Hypothetical Examples 2 and 3 are both said to "*at least*" amount to a concerted practice. Further, Hypothetical Example 2 is qualified with the wording "[a]*ssuming there is no evidence of an agreement*". Neither example therefore provides clear guidance on what is meant by a "*concerted practice*" alone – we would recommend amending the wording (and/or the examples) accordingly so that they focus on "*concerted practices*".

(B) Second, Hypothetical Examples 2 and 3 both concern exchanges of commercially sensitive information. We would recommend that the Commission include further Hypothetical Examples that do not concern information exchange so that businesses have a full understanding of the potential scope of the term "*concerted practices*".

Paragraph 3.11 – Include an "appreciable effects" test

1.12 Paragraph 3.11 states that an agreement that does not have an anti-competitive object "*may nevertheless infringe the First Conduct Rule if it has an anti-competitive effect.*"

1.13 We note that it is a common feature of competition regimes to provide a safe harbour whereby only agreements which have an appreciable effect on competition in the market in question are subject to investigation. Such safe harbours are very useful for risk assessment purposes and provide those businesses with a limited presence on the relevant market with legal certainty on whether their conduct falls within the scope of competition law. For example:

(A) the European Commission expressly provides in its guidance that horizontal agreements will not have an appreciable effect on competition where the parties' aggregate market share is less than 10%. Vertical agreements do not appreciably affect competition where each party has a market share of less than 15%;[7] and

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[6] C-40/73 *Coöperatieve Vereniging "Suiker Unie" UA and others v Commission.*

[7] The European Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the TFEU (OJ 2014 291/1, 30.8.2014), paragraph 8.

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(B) the Competition Commission of Singapore ("**CCS**") expressly provides in its guidance that horizontal agreements will not have an appreciable effect on competition where the parties' aggregate market share is less than 20%. Vertical agreements do not appreciably affect competition where each party has a market share of less than 25%.[8]

1.14 While we note that the Ordinance contains an exclusion for agreements or conduct of lesser significance at Sections 5 and 6 of Schedule 1, these are based on turnover and, in practice, would likely apply only to small- and medium-sized enterprises. As such, these exclusions would not apply to large companies which have only a small presence on a particular market (or markets). This approach does not appear to be justified. Unlike other areas of law, competition law cannot be viewed only by reference to an undertaking's total group turnover when assessing its likely impact on competition, because an undertaking could generate a high turnover from its activities in a number of different markets without being capable of having an appreciable effect on competition in any of these markets. Just as the Commission would not consider using turnover to measure whether an undertaking has a substantial degree of market power for the purposes of the Second Conduct Rule, we would suggest that a turnover-based exclusion is insufficient in itself to ensure that only agreements with an appreciable effect on competition are caught by the First Conduct Rule.

1.15 We therefore suggest that an appreciability test by reference to market share thresholds also be included in the FCR Guideline. This will not only provide legal certainty to businesses with a small market presence in Hong Kong but will also reduce the administrative burden on the Commission.

Paragraph 3.13 – Definition of "market power"

1.16 Paragraph 3.13 states that whether an agreement has anti-competitive effects will depend on various factors including "*the extent to which the parties individually or jointly have or obtain some degree of market power; and the extent to which the agreement contributes to the creation, maintenance or strengthening of market power*".[9]

1.17 The FCR Guideline, however, provides no guidance on either the level of market power required for competition concerns to arise as a result of horizontal or vertical agreements, or whether market power will be assessed in the same way in the context of horizontal and vertical agreements. Paragraph 3.16 simply states that "*market power is … a matter of degree.*" What is meant by "market power" therefore is not sufficiently clear. We suggest that further guidance be provided by the Commission so that businesses who are unfamiliar with competition law are able to assess this.

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[8] CCS Guideline on the Section 34 prohibition, paragraph 2.19.

[9] Similarly, paragraph 6.8 states that competition concerns will generally only arise from vertical agreements where there is some degree of market power at either the level of the supplier, the buyer, or both.

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1.18 As noted above, it is common for jurisdictions either to: (i) enact safe harbours for horizontal and vertical agreements below which anti-competitive effects are deemed not to arise; or (ii) issue block exemptions which apply to certain types of horizontal (e.g. research & development agreements, specialisation agreements etc.) and vertical agreements with market share thresholds below which competition concerns are assumed not to arise (provided there are no "hard-core" restrictions).

1.19 We therefore suggest that similar indicative thresholds be included in the FCR Guideline. This will, in turn, provide businesses with clarity and legal certainty regarding any existing arrangements and their ability to enter into future agreements which may have limited effects on competition.

Paragraph 3.18 – Clarify why "the Commission may assess what the market conditions would have been in the absence of the conduct (known as the "counterfactual")"

1.20 Paragraph 3.18 states that the Commission <u>may</u> assess the counterfactual and compare these counterfactual market conditions with the conditions resulting where the conduct is present when it considers if the conduct in question has the actual or likely effect of harming competition.

1.21 We consider that the Commission should always carry out this analysis in cases where it conducts an effects based analysis. As noted by the European General Court in the case of *O2 v. Commission*:

> "*where it is accepted that the agreement does not have as its object a restriction of competition, the effects of the agreement should be considered and for it to be caught by the prohibition it is necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent. The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute.*"[10]

1.22 We therefore suggest that paragraph 3.18 be amended to state that the Commission "*will*" always assess the counterfactual.

Paragraphs 3.20 - 3.23 – Definition of "ancillary restrictions"

1.23 Paragraph 3.20 states that where the main parts of an agreement do not have the object or effect of harming competition, restrictions which are "*directly related to and necessary*" for implementing the main transaction will also fall outside the First Conduct Rule.

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[10] T-328/03 *O2 (Germany) GmbH & Co. OHG v Commission*, paragraph 68.

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1.24 Paragraph 3.22 states that a restriction is "*necessary*" where it would otherwise be "*difficult*" to implement the main non-restrictive agreement. We would recommend clarifying what is meant by "*difficult*" given that it is a broad term that can be interpreted in different ways, especially by those who may not be familiar with competition law and have only the company's commercial interests in mind.

1.25 Second, paragraph 3.23 states that a non-compete between parent entities and a joint venture might be regarded as being ancillary to the joint venture "*in certain circumstances*". No guidance however is provided on what these circumstances are; we therefore suggest that some further guidance and/or a Hypothetical Example be provided to clarify both the scope and duration of permitted non-competes.

Paragraphs 5.2 - 5.5 – Definition of Serious Anti-competitive Conduct

1.26 Paragraphs 5.2 - 5.5 set out the definition of Serious Anti-competitive Conduct ("**SAC**"). We agree with the Commission's decision to separate this assessment from the object analysis (paragraph 5.2), as well as its statement that vertical agreements are less harmful to competition than horizontal agreements and will generally not amount to SAC (paragraph 5.5).

1.27 Upon a literal reading, however, the definition of SAC in Section 2(1) of the Ordinance is rather broad and potentially captures both horizontal and vertical agreements, regardless of whether the agreement has an anti-competitive object or effect. Rather confusingly, in paragraph 5.6 of the FCR Guideline, the Commission suggests that it will take a "*literal reading*" of the definition of SAC in relation to RPM, but it suggests in other places (e.g. paragraph 5.5 in relation to vertical agreements) that it will take a less literal approach.

1.28 We therefore suggest that the Commission clarify its approach to the interpretation of SAC. As this is a concept that is unique to Hong Kong, we would urge the Commission to reassure businesses that SAC would be reserved only for the most serious of infringements. In addition to clarifying the position on RPM (see paragraph 1.29 below), it would be useful if the Commission could provide further examples of conduct, other than vertical agreements, that are unlikely to amount to SAC.

Paragraph 5.6 – Clarify when RPM is Serious Anti-competitive Conduct

1.29 Paragraph 5.6 states that RPM is "*conduct falling within the literal meaning of Serious Anti-competitive Conduct*" but will only amount to SAC in certain cases. No further guidance is provided either in paragraph 5.6 or in paragraphs 6.61 - 6.75 where RPM is covered in more detail. Whilst we acknowledge that the Commission considers the definition of SAC is largely of procedural relevance, this is still an important distinction for businesses in Hong Kong. We therefore suggest that some further guidance be provided to clarify the instances in which the Commission considers RPM will (or will not) amount to SAC.

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Paragraph 6.4 – Further guidance requested on horizontal agreements which lead to economically beneficial outcomes

1.30 Part 6 provides some guidance on how the Commission will approach certain types of horizontal agreements, including their potential pro-competitive effects. There is, however, little guidance on the various types of collaboration agreements which competitors commonly enter into which can benefit from the efficiencies exclusion as set out in Section 1 of Schedule 1 to the Ordinance (e.g. commercialisation agreements, research and development agreements and standardisation agreements[11]). We note that such agreements are the subject of detailed guidance in the EU[12] and are likely to be widely used in major industries in Hong Kong.

1.31 In order for businesses in Hong Kong to understand how collaboration between competitors will be assessed by the Commission, we suggest that the Commission amend Part 6 accordingly to include further information on these agreements. As noted above in paragraph 1.18, such guidance would also benefit from the inclusion of market share based safe harbours.

Paragraph 6.32 – Further guidance on the pro-competitive effects of information exchange

1.32 Paragraph 6.32 states that an information exchange may harm competition where it results in undertakings becoming aware of their competitors' market strategies. The guidance does not, however, explain that information exchanges are common in competitive markets and can be pro-competitive, a point which is specifically addressed in the EU Horizontal Co-operation Guidelines:

> "*Information exchange is a common feature of many competitive markets and may generate various types of efficiency gains. It may solve problems of information asymmetries, thereby making markets more efficient. Moreover, companies may improve their internal efficiency through benchmarking against each other's best practices. Sharing of information may also help companies to save costs by reducing their inventories, enabling quicker delivery of perishable products to consumers, or dealing with unstable demand etc. Furthermore, information exchanges may directly benefit consumers by reducing their search costs and improving choice.*"[13]

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[11] We acknowledge that standardisation agreements are dealt with in paragraphs 6.52 - 6.53. Further information however is requested in relation to the pro- and anti-competitive effects which such agreements can have.

[12] See the EU Horizontal Co-operation Guidelines.

[13] EU Horizontal Co-operation Guidelines, paragraph 57.

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1.33 We suggest that paragraph 6.32 be amended to recognize the pro-competitive effects of information exchange.

Paragraph 6.35 – Clarify when an information exchange is an object infringement

1.34 Paragraph 6.35 states that the Commission will consider the exchange of information by competitors concerning their future intentions with respect to price or quantities as having an anti-competitive object.

1.35 As currently drafted, all exchanges of such information are to be regarded as object infringements of the Ordinance. We note however that this is not necessarily the case. For example, an exchange of information concerning future prices and quantities should only be regarded as an object infringement if the disclosed information is both individualised (i.e. company specific) and not public. As noted in the EU Horizontal Co-operation Guidelines, the public announcement of such information will not amount to an object restriction in certain instances:

> "*In specific situations where companies are fully committed to sell in the future at the prices that they have previously announced to the public (that is to say, they can not revise them), such public announcements of future individualised prices or quantities would not be considered as intentions, and hence would normally not be found to restrict competition by object.*"[14]

1.36 We therefore suggest that paragraph 6.35 in relation to exchange of future information be further clarified accordingly to take into account instances when this may not have an anti-competitive object.

Paragraph 6.36 – Clarify when an information exchange via customers and suppliers is an agreement or concerted practice

1.37 Paragraph 6.36 states that the exchange of competitively sensitive information can occur indirectly via a trade association or a conduit. Given that "*competitively sensitive information*" is not defined until paragraph 6.40, we suggest that this section be moved below Hypothetical Example 11. This will put the discussion in context and should help businesses understand that sharing aggregated, historic, public etc. data is unlikely to give rise to competition concerns. This is particularly important given that businesses frequently receive market information from their suppliers (and *vice versa*).

1.38 Second, paragraph 6.36 states that using a conduit to share commercially sensitive information raises competition concerns when this is the result of either an agreement or concerted practice. Given the

[14] EU Horizontal Co-operation Guidelines, footnote 4.

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complexities of the terms "*agreement*" and "*concerted practice*" and the frequency with which businesses share information with their suppliers and vice versa, further guidance should be provided to clarify when an indirect information exchange gives rise to either.

1.39 We note that in the UK, indirect information exchanges are considered only to give rise to a concerted practice where the competing parties have the requisite state of mind when they share the information. By way of example, it must be evidenced that:

(A) Company A disclosed commercially sensitive information to Supplier B and intended or foresaw that B would make use of the information to influence market conditions by passing it to Company C (a competitor of A);

(B) Supplier B passed the information to Company C; and

(C) Company C knew the circumstances in which the information had been disclosed by A to B and used or took into account the information in determining its market behaviour.[15]

1.40 We therefore suggest that further clarity be provided by the Commission as to when an agreement or a concerted practice will arise in this context.

Paragraphs 6.76 - 6.80 – Clarify the proposed analysis of agreements concerning "Exclusive Distribution or Exclusive Customer Allocation"

1.41 Paragraphs 6.76 - 6.80 set out the Commission's view that exclusive distribution and customer allocation arrangements will not generally have the object of harming competition and may lead to economic efficiencies. While we agree with the overall substance of these paragraphs, we suggest that it would benefit from the following amendments in order to make it clearer to businesses in Hong Kong:

(A) paragraph 6.76 would benefit from further guidance on how inter-brand and intra-brand competition will be measured by the Commission, the levels of such competition which do not raise concerns, and whether the duration of the agreement has any bearing on the competitive assessment (and, if so, what is an acceptable duration);

(B) paragraph 6.78 would benefit from a few examples of the types of products which are likely to result in economic efficiencies (e.g. new products, complex products and products with

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[15] See, for example, UK Office of Fair Trading's decision concerning Dairy retail price initiatives (CA98/03/2011); *Tesco v Office of Fair Trading*.

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qualities which are difficult to judge before or after consumption (i.e. experience and credence products respectively));

(C) paragraph 6.79 currently focuses on the intra-brand issues of such arrangements at the wholesale level. For completeness, this paragraph would benefit from an example concerning the retail level as intra-brand competition is likely to be important here; and

(D) given that Hypothetical Example 17 discusses non-compete clauses (i.e. single branding), this section should discuss the potential pro- and anti-competitive effects of combining exclusive distribution agreements with either single branding or exclusive sourcing requirements, and how such an assessment would be carried out by the Commission.

Paragraph 6.84 – Definition of "functions of an autonomous economic entity"

1.42 Paragraph 6.84 sets out the factors which the Commission will take into account when considering if a joint venture is within the scope of the First Conduct Rule. As these factors are discussed in greater detail in the Merger Guideline, our comments are set out below in section 3 (paragraphs 3.3 - 3.7).

Paragraph 2.4 of the Annex – Clarify who has the burden of proof under Section 1 of Schedule 1 to the Ordinance

1.43 Paragraph 2.4 of the Annex states that the Commission considers the burden of demonstrating that each of the cumulative conditions of Section 1 of Schedule 1 to the Ordinance are met rests with the undertaking(s) seeking to rely on it.

1.44 We note, however, that the Ordinance is silent on this point and merely states, at Section 30, that "*The conduct rules <u>do not apply</u> in any of the cases in which they are excluded by or as a result of Schedule 1*" (emphasis added). This differs to Section 8 of Schedule 7 which specifies that the burden of proving that the economic efficiencies of a merger outweigh its adverse effects lies with the undertaking seeking to rely on it.[16]

1.45 Given that: (i) the Ordinance does not expressly state that the burden of demonstrating that each of the cumulative conditions of Section 1 of Schedule 1 rests with the undertaking; and (ii) Section 30 implies that the exclusion applies automatically, there is an argument that it is for the Commission to prove that the conditions in Schedule 1 are not met in order to find that an infringement has occurred.

[16] It is also different to other jurisdictions such as the EU where the burden of proof is set out in statue. In the EU, Article 2 of Council Regulation (EC) No 1/2003 states that "*The undertaking or association of undertakings claiming the benefit of Article [101(3)] of the Treaty shall bear the burden of proving that the conditions of that paragraph are fulfilled.*"

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1.46 Second, we note that the FCR Guideline does not set out the relevant standard of proof. Given that a decision of the Commission may be subject to litigation before the Competition Tribunal, the standard of proof should be the balance of probabilities. This should be expressly stated in the FCR Guideline in order to avoid any confusion.

Paragraph 2.17 of the Annex – Clarify when consumers receive a fair share of efficiencies

1.47 Paragraph 2.17 of the Annex defines "*fair share*" as "*the benefits accruing to consumers must at a minimum compensate them for the actual or likely harm to competition associated with the relevant restrictive agreement.*"

1.48 It is unclear, however, how the Commission intends to assess in practice whether the benefits to consumers are sufficient to compensate for the actual or likely harm to competition and what evidence undertakings are required to produce in order to substantiate any such claims. Further, we note that it is common for an agreement's efficiencies to materialise either after a certain period of time has passed or, in certain instances, faster than would be the case absent the agreement. The FCR Guideline provides no clarity on how the Commission will consider whether or not consumers have received a fair share of such efficiencies.

1.49 We note that in the EU, detailed guidance is provided in the Guidelines on the application of Article [101](3) of the Treaty ("**Article 101(3) Guidelines**")[17] on the factors which will be taken consideration by the European Commission,[18] the evidence which undertakings are required to provide,[19] and also that the exclusion can apply in instances where the efficiencies occur after a delay (or faster than would otherwise be the case) provided that they are sufficient to compensate consumers accordingly.

1.50 We therefore suggest that the Commission provide further clarity on these points to provide certainty to businesses on the factors which the Commission will consider, as well as the evidence which they will be required to provide to substantiate their claims.

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[17] OJ 2004 C101/97, 27.4.2004.

[18] For example, in relation to cost efficiencies the characteristics and structure of the market, the nature and magnitude of the efficiency gains, the elasticity of demand, and the magnitude of the restriction of competition are all taken into account.

[19] Paragraph 94 of the Article 101(3) Guidelines states that in light of the fact that it is difficult to calculate the consumer pass-on rate and other types of consumer pass-on, "*Undertakings are only required to substantiate their claims by providing estimates and other data to the extent reasonably possible, taking account of the circumstances of the individual case.*"

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Paragraph 2.18 of the Annex – Clarify when restrictions are not indispensible

1.51 Paragraph 2.18 of the Annex states that the agreement and each of the individual restrictions contained within it must be reasonably necessary to attain the claimed efficiencies. In particular, paragraph 2.18 states that the determinative factor is whether they "*make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement or restrictions.*" Paragraph 2.19 then states that "*as regards the agreement there be no other economically practicable and less restrictive means of achieving the claimed efficiencies.*"

1.52 We note that the language used in these paragraphs is based on the Article 101(3) Guidelines which explain that this condition is in fact a two part, cumulative, test:

(A) the first part "*requires that the efficiencies be specific to the agreement in question in the sense that there are no other economically practicable and less restrictive means of achieving the efficiencies*";[20] and

(B) the second part requires "*the indispensability of each restriction of competition flowing from the agreement*" to be assessed – a restriction is indispensable if "*its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise.*"[21]

1.53 However, although paragraph 2.19 of the FCR Guideline sets out a similar test, it is not clear that there are two parts to this and, as such, the current wording may lead to some confusion because the tests in paragraphs 2.18 and 2.19 appear to be slightly different.

1.54 Further, we note that the Article 101(3) Guidelines also explain that the key factor in establishing whether the indispensability condition applies is "*not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.*" This point is not included in the FCR Guideline and would be of assistance to businesses in Hong Kong.

Paragraph 3.1 of the Annex – Definition of "legal requirement"

1.55 Paragraph 3.1 of the Annex states that agreements or conduct are excluded from the First and Second Conduct Rule if their purpose is to comply with "*a legal requirement imposed by or under any*

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[20] Article 101(3) Guidelines, paragraph 75.

[21] Article 101(3) Guidelines, paragraph 79.

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enactment in force in Hong Kong or imposed by any national law applying in Hong Kong." We note that the definitions of "*enactment*" and "*national law*" provided in the FCR Guideline do not refer to the common law which is part of the legal framework of Hong Kong. We therefore suggest that the Commission clarify if compliance with the requirements of case law would also fall within the exclusion.

2. SCR Guideline

Paragraph 2.31 – Supply-side substitutability for market definition

2.1 Paragraph 2.31 provides that the Commission "*will not generally consider supply-side substitutability or potential competition when defining the relevant market…ultimately, the key issue is whether or not an undertaking has market power.*"

2.2 We note that supply-side substitutability is relevant to market definition. Where a supplier is able to switch production readily to substitutes without incurring significant costs in response to a small but significant non-transitory increase in price (e.g. where the same machinery may be readily used for production of alternative products), conceptually such alternatives should be considered part of the same market for the purpose of defining the relevant market.

2.3 This approach is consistent with international practice in jurisdictions such as the EU.[22] We suggest clarifying that supply-side substitutability is in principle a relevant consideration when defining the market, and that for these purposes supply-side substitutability is not established (rather than irrelevant) where suppliers are not able to switch production promptly in response to price increase.

Paragraphs 3.1 - 3.2 – Definition of "substantial degree of market power"

2.4 Paragraph 3.2 provides that "*a substantial degree of market power arises where an undertaking does not face sufficiently effective competitive constraints in the relevant market. Substantial market power can be thought of as the ability profitably to charge prices above competitive levels, or to restrict output or quality below competitive levels, for a sustained period of time. Normally a period of two years can be considered to amount to a sustained period. However, the relevant period may be shorter or longer depending on the facts, in particular with regard to the product and the circumstances of the market in question.*"

[22] For example, see the European Commission Notice on the definition of relevant market for the purposes of Community competition law (OJ 1997 C372/5, 09.12.1997), paragraphs 21 - 23.

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2.5 Since the concept of a substantial degree of market power is key to the application of the Second Conduct Rule, it is important that this concept is clear to the business community in Hong Kong in practical terms. As stated in paragraph 1.8 of the SCR Guideline, "*undertakings with a substantial degree of market power have a special responsibility not to engage in conduct which harms competition*". Given that such undertakings are subject to additional obligations that their competitors (without a substantial degree of market power) are not subject to, and such obligations will have a significant impact on their business, it is crucial that clear and practical guidance is provided to assess whether or not the Second Conduct may be relevant to a particular undertaking. Businesses in Hong Kong must be offered some guidance as to whether or not they are likely to be subject to this special responsibility and additional obligations. This is necessary to ensure effective compliance and to facilitate competition audit exercises in preparation for the implementation of the Ordinance.

2.6 The definition of "*a substantial degree of market power*" refers to "*competitive levels*", but does not provide any guidance on what this term means and how "*competitive levels*" will be determined in practice. For example, in other jurisdictions such as the EU, more detailed explanation is given for the equivalent test. The European Commission explains the concept of dominance in terms of enjoying "*a position of economic strength… which enables [the dominant undertaking] to prevent effective competition being maintained on a relevant market, by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers… and that the undertaking's decisions are largely insensitive to the actions and reactions of competitors, customers and, ultimately, consumers.*" [23] It would be helpful if the Commission could similarly provide further explanation of the test to help businesses understand in practical terms when an undertaking will be regarded as having a substantial degree of market power.

2.7 In our experience, it is helpful to point to an indicative market share threshold as a starting point for identifying the areas of a business for which the Second Conduct Rule would apply. This is useful for risk assessment, and for relevant businesses to focus their compliance efforts on those areas where they may be regarded as having a substantial degree of market power. However, the SCR Guideline does not provide any market share threshold that points to a substantial degree of market power, which is out of line with most international practice. Many other jurisdictions provide at least an indicative threshold for establishing when undertakings will be subject to the "special responsibility" not to abuse their market power:

[23] See the Guidance on the European Commission's enforcement priorities in applying Article [102] to abusive exclusionary conduct by dominant undertakings (OJ C 45, 24.2.2009) ("**EC Enforcement Priorities**").

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(A) the European Commission expressly provides in its guidance that dominance is not likely if the undertaking's market share is below 40% in the relevant market;[24]

(B) the CCS expressly provides in its guidance that "*generally, as a starting point, the CCS will consider a market share above 60% as likely to indicate that an undertaking is dominant in the relevant market. Other factors mentioned earlier, where relevant, may then be considered in determining if an undertaking is dominant. Similarly, dominance could potentially be established at a lower market share, if other relevant factors provided strong evidence of dominance*";[25]

(C) in China, Article 19 of the Anti-Monopoly Law provides that an undertaking is presumed to be dominant if it has a market share of more than 50% in a relevant market[26] (a similar presumption exists in Korea);

(D) In Canada, the Competition Bureau of Canada indicates that a market share of less than 35% will generally not prompt further examination, and a share between 35% and 50% will generally only prompt further examination if it appears the firm is likely to increase its market share through the alleged anti-competitive conduct within a reasonable time;[27] and

(E) In the United States, the US Federal Trade Commission provides that where the concept of "monopoly power" is used, the courts typically do not find monopoly power if the firm (or a group of firms acting in concert) has less than 50% of the sales of a particular product or service within a certain geographic area.[28]

2.8 The Commission separately provides in paragraph 3.12 of the Merger Guideline an indicative safe harbour (for "*screening*" purposes) that "*for a horizontal merger where the post-merger combined market share of the parties to the transaction is 40% or more, it is likely that the merger will raise competition concerns and the Commission is likely to make a detailed investigation of the transaction.*" This suggests that the Commission agrees with the principle of providing indicative

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[24] EC Enforcement Priorities, paragraph 14.

[25] CCS Guidelines on the Section 47 Prohibition, paragraph 3.8.

[26] Article 19 of the Anti-Monopoly Law also provides that where collective dominance is presumed where the joint market share is 66% or more for two undertakings or 75% or more for three undertakings.

[27] Enforcement Guidelines of the Competition Bureau of Canada. Available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03497.html#s2_3_1

[28] http://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/monopolization-defined

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thresholds as guidance for prospective merging parties; the same should be the case for Hong Kong businesses in general to understand whether they are likely to have a substantial degree of market power. We therefore suggest that the Commission similarly provide indicative thresholds for when market power will be regarded as "*substantial*".

2.9 We suggest that the Commission:

(A) clarify what "*competitive levels*" means and how this will be determined in practice;

(B) provide further explanation on the test for "*a substantial degree of market power*"; and

(C) provide at least an indicative threshold below which "*a substantial degree of market power*" would be unlikely.

Paragraphs 3.14 - 3.15 – Clarify relationship between market concentration and market power

2.10 Paragraph 3.14 does not provide any guidance on how market concentration will affect the analysis on market power. Nor does paragraph 3.15 provide any guidance in the form of indicative thresholds on how market concentration is assessed using the concentration thresholds under the measures of concentration ratios and Herfindahl-Hirschman Index. Without such guidance, there is no clear basis for assessing when a market is concentrated or how such a market will affect the Commission's assessment. We recognise that the Commission separately provides in paragraphs 3.14 and 3.16 of the Merger Guideline some indicative thresholds for market concentration in the context of assessing mergers under the Merger Rule. We therefore suggest that the Commission clarify in the context of applying the Second Conduct Rule how market concentration affects the analysis on market power and indicate how both measures will be applied, for example, whether the Commission will adopt the same thresholds for consistency with the Merger Guideline, and how different levels of concentration (e.g. moderately concentrated markets vs. concentrated markets) will affect the analysis of market power under the Second Conduct Rule.

Foreclosure – Clarify if an economic and effects-based approach will be used

2.11 The SCR Guideline refers to an adverse effect on competition in the context of discussing various types of abuse (see paragraphs 5.4, 5.11 and 5.26 of the SCR Guideline), which suggests an effects-based approach will be taken. We agree with this approach and suggest that the Commission expressly clarify whether it will take an effects-based approach, with the use of economic analysis, to the application of the Second Conduct Rule. The Economic Advisory Group for Competition Policy, which is a forum within the European Commission on competition policy matters between academics with a recognised reputation in the field of industrial organisation, advocates this approach:

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> "*An economics-based approach makes it more difficult for companies to circumvent competition policy constraints by way of attempting to achieve the same end results through the use of different commercial practices; and (ii) this approach provides a more consistent treatment of practices, since any specific practice is assessed in terms of its outcome and two practices leading to the same result will therefore be subject to a comparable treatment.*"[29]

Paragraph 4.3 – Foreclosure should require exclusion of "equally efficient" competitors

2.12 Paragraph 4.3 provides no guidance on when "*effective access of actual or potential competitors to sources of supply or buyers is hampered or eliminated.*" As a general comment, competition concerns should only arise if competitors that are as efficient are not able to compete on equal terms with the undertaking with a substantial degree of market power. This principle is indeed recognised for certain types of abuse in paragraph 5.27 (relating to exclusive dealing)[30] and footnote 19 (relating to margin squeeze).[31] However, we are of the view that this principle should be applied more generally when looking at all types of abuse. This is particularly important as the goal of competition law is to protect an effective competitive process, rather than simply competitors, and undertakings with a substantial degree of market power should not be prevented from competing on the merits of the products or services they provide.

2.13 We suggest clarifying that, as part of the analysis on breach of the Second Conduct Rule, it is necessary to establish that equally efficient competitors are excluded from the market as a result of conduct by an undertaking with a substantial degree of market power. For illustration purposes, below cost pricing is predatory only where equally efficient competitors are not able to compete above cost, and rebates give rise to concerns only where equally efficient competitors cannot compete for the customer's demand by compensating the customer for the loss of the rebates as a result of switching away from the undertaking with a substantial degree of market power.

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[29] "*An economic approach to Article 82*", Report by the Economic Advisory Group for Competition Policy. Available at http://ec.europa.eu/dgs/competition/economist/eagcp_july_21_05.pdf.

[30] Paragraph 5.27 states that "*in cases where competitors can compete on equal terms of the entirety of each individual customer's demand, exclusive dealing is unlikely to harm competition.*"

[31] Footnote 19 also refers to the ability of a downstream competitor to compete in order to make a profit in light of the costs imposed by the upstream undertaking with a substantial degree of market power.

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Paragraph 4.4 – Clarify the application of the objective justification "defence"

2.14 Paragraph 4.4 recognises the availability of the "*defence*" of objective justification. However, it does not provide any guidance on what objectives are legitimate and what the tests for indispensability and proportionality are.

2.15 Based on international experience, the grounds for objective justification should at least include:

(A) efficiencies: cost savings,[32] short-term promotional offers to promote new products,[33] loss-leading practice to promote demand for complementary products,[34] protecting customer-specific investments etc.;[35]

(B) reasonable steps taken to protect its commercial interest: in *United Brands*, the European Court of Justice recognised that a dominant undertaking may take "*reasonable steps*" as it deems appropriate to protect its commercial interests if it was attacked.[36] In *Glaxo Greece*, the European Court of Justice held that a dominant undertaking may refuse to meet an order from an existing customer that was "*out of the ordinary*", which requires an appraisal of both the "*previous business relations*" between the pharmaceutical company and the wholesalers, and the "*size of the orders in relation to the requirements of the markets concerned*";[37] and

(C) objective necessity: as the Commission already recognises in the SCR Guideline, the conduct must be indispensable and proportionate to the goal pursued (e.g. protection of health and safety, capacity concerns).

2.16 We therefore suggest elaborating further on the grounds for objective justification, including practical examples, and the tests for determining when the justification may apply.

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[32] EC Enforcement Priorities, paragraph 46.

[33] CCS Guideline on the Section 47 Prohibition, paragraph 11.6.

[34] CCS Guideline on the Section 47 Prohibition, paragraph 11.6; *Enforcement Guidelines: The Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act) as Applied to Retail Grocery Industry*, Canadian Competition Bureau (Draft 17 December, 2001) suggest that pricing below cost on less than fifty items is not likely to raise competition concerns.

[35] EC Enforcement Priorities, paragraph 46.

[36] C-27/76 *United Brands Company and United brands Continental BV v Commission*, paragraphs 189 - 191.

[37] C-468/06 to C-478/06 *Sot. Lelos kai Sia EE v GlaxoSmithKline*, paragraphs 49 and 73.

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Paragraph 4.8 – Clarify the approach to "object" infringements

2.17 Further to the arguments above in favour of an effects-based approach, it is important to have clear guidance on what conduct may be regarded as an "object" infringement under the Second Conduct Rule. Paragraph 4.8 only provides one example of "*conduct which may have the object of harming competition*", namely, pricing below average variable cost. If the Commission considers that other types of abuse may be found to be an "object" infringement, we suggest that the Commission make this clear in the SCR Guideline, or otherwise clarify that it would be reasonable to expect that it is necessary to establish the effect of anti-competitive foreclosure in order to substantiate an infringement of the Second Conduct Rule in most other cases.

Section 5 – Clarify the relevant tests and criteria for assessing when conduct is anti-competitive

2.18 The SCR Guideline provides little practical guidance on the tests and criteria for determining when certain types of conduct leads to anti-competitive foreclosure. For instance, it would be helpful to clarify whether the considerations below are relevant to determining whether tying and bundling and rebates would be anti-competitive.

For tying and bundling:

(A) whether the tying or bundling strategy is a lasting one;

(B) the number of products in the bundle;

(C) whether the competitors may easily replicate the same bundle;

(D) whether there are sufficient customers who will buy the tied product alone (i.e. if there are insufficient customers who will buy the tied product alone to sustain competitors of the undertaking with a substantial degree of market power in the tied market, the tying can lead to those customers facing higher prices); and

(E) whether the tying and tied products are complementary to each other (i.e. if the tied product is an important complementary product for customers of the tying product, a reduction of alternative suppliers of the tied product and hence a reduced availability of that product can make entry to the tying market alone more difficult).[38]

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[38] EC Enforcement Priorities, paragraphs 52 - 58.

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For rebates:

(F) the test for determining when rebates are anti-competitive (e.g. when equally efficient competitors are unable to compensate the customer for the loss of the demand) and whether the Commission will calculate the "*effective price*" which the competitor will need to match;[39]

(G) the relevant factors for determining when rebates are anti-competitive (e.g. the higher the rebate as a percentage of the total price, the greater the foreclosure effect); and

(H) whether incremental rebates are unlikely to give rise to competition concerns similar to quantity rebates (unless they are predatory in nature).

3. Merger Guideline

Paragraph 2.5 – Definition of "decisive influence"

3.1 Paragraph 2.5 states that a merger takes place when an undertaking acquires direct or indirect control of the whole or part of one or more undertakings. Control is said to exist if, by reason of rights, contract or any other means, or any combination of rights, contracts or other means, *"decisive influence is capable of being exercised with regard to the activities of the undertaking".* This phrase, which is commonly used in merger regimes of other jurisdictions,[40] however, is not defined in the Merger Guideline. For example, the EC Jurisdictional Notice provides substantial guidance on the various ways in which *de jure* and *de facto* control can be exerted by one or more undertaking.

3.2 In order for carrier licensees and other relevant parties to have certainty as to when a merger occurs, we strongly suggest that the Commission provide a full and complete definition for "*decisive influence*" in the Merger Guideline.

Paragraphs 2.8 - 2.12 – Definition of "functions of an autonomous economic entity"

3.3 Paragraph 2.8 of the Merger Guideline states that a joint venture ("**JV**") is a merger when it performs "*all the functions of an autonomous economic entity*". As noted in paragraph 6.82 of the FCR Guideline, a joint venture which amounts to a merger is excluded from the scope of both the First and Second Conduct Rules by virtue of Section 4 of Schedule 1. It is therefore of particular importance to

[39] EC Enforcement Priorities, paragraphs 41 - 42.

[40] See, for example, the European Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (OJ 2008 C 95/1, 16.42008) ("**EC Jurisdictional Notice**"), paragraph 54 *et seq.*; and CCS Guidelines on the Substantive Assessment of Mergers, paragraphs 3.7 *et seq.*

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all businesses in Hong Kong that a clear and exhaustive definition of what is meant by the "*functions of an autonomous economic entity*" is provided, as this will determine whether or not the First and Second Conduct Rules will apply to the relevant transaction.

3.4 Although the definition provided in paragraphs 2.9 to 2.12 broadly corresponds with that used by the European Commission to assess full functionality, three points in particular could be further clarified.

3.5 First, paragraph 2.9 states that in order to operate on a market and perform the functions normally carried out by an undertaking operating on the market, the JV must have a "*management dedicated*" to its day-to-day operations. No guidance however is provided on what factors the Commission will take into account when considering if the JV has such management. For example, we note that it is common for staff to be: (i) provided under an operational agreement or via an employment agency; or (ii) seconded by the parent companies either for a start-up period or longer term. We therefore suggest that the Commission clarify when it will regard staff as "*dedicated*".

3.6 Second, paragraph 2.11 states that the JV must be intended to operate for a "*sufficiently long period*" which is normally demonstrated by the parent companies committing all of the resources necessary for it to carry out all the functions of an autonomous economic entity. There is no guidance on what other factors the Commission could take into account as part of its analysis. For example, we note that it is common for JV agreements either to expressly include mechanisms by which the JV is to be dissolved (or one or both parents to exit), and/or to specify the duration of the JV. We suggest that the Commission provide some further guidance on how it will interpret "*sufficiently long period*" including whether the above points will affect the Commission's assessment.

3.7 Third, paragraph 2.12 states that where a "*substantial proportion*" of sales or purchases between the parents and the JV are "*likely for a lengthy period and are not on an arm's length basis*" the JV is not likely to be viewed as a merger. Given that it is not uncommon for JVs to be initially dependent on their parents or to make sales to, or purchases from, their parent on a lasting basis, we suggest that the Commission clarify the meaning of "*substantial proportion*" and "*for a lengthy period*". We note that it is common for this to be included – for example the EC Jurisdictional Notice states that: (i) JVs are able to be reliant on the their parents for an initial period which "*will normally not exceed a period of three years, depending on the specific conditions of the market in question*"; and (ii) where such sales and purchases are intended to be made on a lasting basis they will not be considered significant "*if the joint venture achieves more than 50% of its turnover with third parties.*"[41] This will provide some practical guidance to relevant parties to assess whether or not their JV is a merger and thus excluded from the Ordinance.

[41] EC Jurisdictional Notice, paragraphs 97 - 98.

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Paragraph 2.17 – Clarify the rules on "lasting nature" and interdependent and successive transactions

3.8 Paragraph 2.17 states that "*the Commission will not be concerned about changes in the control of undertakings which are not of a lasting nature.*" There is however no guidance on what is meant by "*lasting nature*".

3.9 Furthermore, the Commission is silent on how it will consider either interdependent or successive transactions. For example, will they be viewed as part of the same single transaction and, if so, within what timeframe? For the sake of clarity, we suggest that the Commission provide further guidance on both these points.

Paragraphs 5.1 and 5.30 – Clarify when interim orders will be sought by the Commission

3.10 We note that the Ordinance has changed how mergers will be reviewed in a number of important ways, including: (i) the Commission and the Communications Authority are able to review anticipated mergers even when no application has been made by the parties; and (ii) as set out in paragraphs 5.1 and 5.30 of the Merger Guideline, the Tribunal can issue a hold separate order to prevent anticipated mergers from completing. The Tribunal therefore has the power to block anticipated mergers.

3.11 In light of these fundamental changes to the way in which anticipated mergers can be investigated and reviewed, we believe it is important that the Commission provide extensive guidance on both the instances in which it (or the Communications Authority) will investigate anticipated mergers of their own accord and also the instances when it might consider seeking interim orders from the Tribunal.

Paragraph 5.10 – Clarify when commitments can be offered and accepted by the parties and the Commission respectively

3.12 Paragraph 5.10 notes that Section 60 of the Ordinance provides the parties to a merger with an opportunity to offer remedies to address the competition concerns identified by the Commission. Neither Section 60 nor the Merger Guideline, however, explicitly states when such remedies can be offered by the parties. This differs to other jurisdictions such as the EU and UK where this is expressly stated in both statute and the competition authority's supporting guidelines.[42] We therefore suggest that the Commission clarify the process and the proposed timetable for the submission of commitments to address any potential competition concerns in the context of a merger.

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[42] In the UK, for example, the merger guidelines state that commitments can be proposed at any time during the investigation or during pre-notification discussions whilst Section 73A of the Enterprise Act 2002 states that commitments can be offered until 5 working days after the CMA has made its decision. See CMA paper *Mergers: Guidance on the CMA's jurisdiction and procedure* (2014), paragraph 8.7. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/384055/CMA2__Mergers__Guidance.pdf

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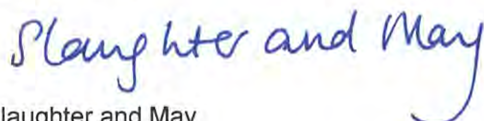
Paragraphs 5.13 - 5.15 – Clarify structural and behavioural remedies

3.13 Paragraph 5.13 states that structural remedies typically involve the disposal of an overlapping business and that the "*Commission would require the disposal to be made within a specified time limit.*" Little guidance however is provided on the criteria which the commitments must satisfy in order to be accepted to the Commission. We therefore suggest that the Commission expand this paragraph and explain what the structural remedy must amount to, such as, for example, whether the divestment has to be of a viable business or can include assets, and whether the Commission will generally allow the main transaction to close provided the divestment occurs with a specified time period.

3.14 Paragraph 5.14 notes that the Commission may accept behavioural remedies in "*appropriate cases*". Given that no examples of behavioural remedies are provided in the Merger Guideline, we suggest that that Commission clarifies what is an "*appropriate case*" and the types of behavioural remedies that may be acceptable to the Commission.

We appreciate the opportunity to participate in this important milestone in the development of Hong Kong's competition law. We are available to discuss our views further if this would be useful to the Commission.

Yours faithfully,



Slaughter and May