

## Proposals on HKCC’s Revised Draft Guidelines on the first conduct rule (FCR) and the second conduct rule (SCR)

| Current issue   | Proposal   |
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| 1. Only Merger Guidelines define the concept of “decisive influence”. FCR and SCR Guidelines silent on concept.   | Include the definition of “decisive influence” in Merger Guidelines in the FCR and the SCR Guidelines.   |
| 2. Non-binding decisions of trade associations may amount to a decision even in the absence of an objective intention to coordinate the conduct of association members. | Clarify when genuinely non-binding recommendations (i.e. those which are not monitored or subject to sanctions) will be an issue even in absence of objective intention to coordinate behaviour and when genuinely non-binding recommendations will not be caught by the FCR.  |
| 3. No clarity on interactions between competition law and other regulatory regimes.   | Clarity that HKCC would take other regulatory regimes and/or the views of concurrent regulators into account in (A) assessing whether certain conduct constitutes an infringement of the conduct rules – either when assessing its object or effect; (B) defining the relevant market; and (C) deciding which cases to investigate and exercising its discretion in deciding which complaints or matters warrant further investigation |
|   | Express the HKCC’s policy towards resolving conflicts between the policy objectives of other regulators (i.e. an undertaking’s regulatory duties under a different regime) and HKCC’s policy objectives (i.e. the undertaking’s obligation to comply with the Ordinance), in the guidelines and/or the HKCC’s enforcement policy. Establish a regular dialogue with other regulators.  |
| 4. Exclusive dealing as an “object” infringement.   | Provide guidance on when exclusive dealings will be considered to have the <u>object</u> of harming competition OR amend so that exclusive dealings will usually be considered by effects analysis.  |

## Detailed explanation

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| <b>1</b> | <p><b>Defining the concept of “decisive influence” for FCR and SCR</b><br/> <i>FCR Guidelines: Paragraph 2.9;</i><br/> <i>Merger Guidelines: Paragraph 2.7</i></p>   |
|          | <p><b>Current Proposal</b></p>   |
|          | <p><b>Background:</b> Group entities very often share information and collaborate in respect of different aspects of the business. The FCR applies to collaboration and information exchanges between undertakings. The question is whether the FCR applies to interactions between group entities. The FCR Guidelines already state (i) that the FCR does not apply to conduct involving two entities if they are part of the same undertaking and (ii) that if entity A exercises “decisive influence” over the commercial policy of entity B, then A and B form a single economic entity/the same undertaking. However it is silent on what amounts to “decisive influence”.</p> <p>For the SCR, the market power of entities that form part of the same “undertaking” will be aggregated when assessing whether the undertaking has substantial degree of market power and whether SCR applies to it. The SCR Guidelines refer to the FCR Guidelines as to what “undertaking” means and the FCR Guidelines, as said above, is silent on what amount to “decisive influence”.</p> <p><b>HKCC:</b> The revised guidelines on Mergers (para.2.7) now defines decisive influence to be “the power to determine decisions (including the making or vetoing of such decisions) relating to the strategic commercial behavior of an undertaking such as the budget, the business plan, major investments or the appointment of senior management”. This is consistent with the equivalent EU law. However the FCR and SCR guideline are silent on whether the same definition applies to the conduct rules.</p> |
|          | <p><b>Implication of current proposal</b></p>  |
|          | <p>If the FCR Guidelines remain silent on the idea of decisive influence, this will create uncertainty on how group entities should or should not behave in relation to each other. It means that group entities cannot take any comfort in their conduct being exempt from the operation of FCR. To avoid infringement, they may avoid sharing certain information or stopping certain collaborating etc which may paralyse the proper operation of a group. Similarly, for SCR, group entities will be unsure whether or not they should aggregate the market power of entities within the group having similar businesses and that will significantly affect group businesses’ ability to self-assess whether they have substantial market power.</p>   |
|          | <p><b>Proposed amendment</b></p>   |
|          | <p>We propose the insertion of the following wording at the end of paragraph 2.9 of the FCR Guideline:</p> <p>“The concept of “decisive influence” to be applied in the context of assessing whether the relevant entities constitute a single economic unit is consistent with that discussed at paragraph 2.7 of the Guideline on the Merger Rule.”</p>  |

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| <b>2</b> | <b>Non-binding decisions of trade associations</b><br><i>FCR Guidelines: Paragraph 2.36</i>  |
|          | <b>Current Proposal</b>  |
|          | <p><b>Background:</b> Businesses in HK often participate in trade associations. It is not unusual for trade associations to issue non-binding recommendations or statements (often at the request of a regulator) to assist the industry (for example, explaining and assisting with the application of a new regulation etc.). These are often best practices suggestions which are very often more advanced as they are results of a collaborative thought process. Very often these are suggested after the association engages an external consultant to advise on how to deal with a common issue in the industry. As the industry engages consultant together, the cost associated is lower than those incurred if each individual firm engages a consultant separately. Trade association members are free to defer from the retain a choice on how to respond to non-binding recommendations proposed by a trade association.</p> <p><b>HKCC:</b> Para.2.23 of the first version of the FCR Guideline (dated October 2014) provides that a non-binding recommendation of trade association amounts to a decision of the association where it reflects an “objective intention to coordinate the conduct of association members”.</p> <p>It seems that the view of the HKCC on trade associations appears to have tightened. “Objective intention” was deleted in its second version of the guideline (dated March 2015). It also says that recommended fee scales and reference prices are now said to be decisions of associations “which the HKCC would likely consider as having either the object or effect of harming competition.” The Guide further explains that recommendations, whether binding or not, can constitute a decision. (para 2.36 of FCR Guidelines)</p> |
|          | <b>Implication of current proposal</b>   |
|          | <p>It is common for trade associations to issue guidance on regulations, best practices, recommendations on how to deal with common issues. And it is unclear under what circumstances such guidance would constitute a non-binding decision caught by the FCR.</p> <p>Non-binding recommendations often offer a collaborated/ more in-depth view on an issue (based on specialized data and understanding of the impact on the relevant industry). It is those small and medium sized businesses that benefit the most from non-binding decisions as the trade association is able to devote its resources into better understanding the issue at hand before making a recommendation. Lack of clarity surrounding this issue will hinder and restrict the effectiveness and purpose of such advice.</p>  |
|          | <b>Proposed amendment</b>  |
|          | <p>The following clarification should be added to Paragraph 2.36 of the FCR Guideline:</p> <p>(A) clarify whether a non-binding recommendation may amount to a decision even in the absence of such objective intention to coordinate conduct;</p> <p>(B) provide further guidance on when non-binding recommendations (which are, as previously stated, common in many industries) will be permissible; and</p> <p>(C) confirm that genuinely non-binding recommendations (i.e. those which are not monitored or subject to sanctions) will generally not</p>   |

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|   | be caught under the FCR.  |
| 3 | <p><b>Interaction between competition law and other regulatory regimes</b><br/> <i>FCR Guidelines: Paragraphs 3.5 and 3.25, Paragraphs 3.2 and 3.3 of Annex 1;</i><br/> <i>SCR Guidelines: Paragraphs 2.14, 2.21, 4.8 and 4.18;</i><br/> <i>Investigation Guidelines Paragraph 3.3(b) and 3.6;</i><br/> <i>HKCC Guide on the Revised Guidelines: Paragraph 60</i></p>   |
|   | <b>Current Proposal</b>   |
|   | <p><b>Background:</b> There is no guidance on how the HKCC will interact with regulators in Hong Kong in relation to enforcement of their respective regulations and laws, and how entities are to respond to conflicting laws or directions from such bodies. For example, a regulator may ask industry players to agree not to deal with certain audience (CONFIDENTIAL CONFIDENTIAL).</p> <p><b>HKCC:</b> The Competition Ordinance provides that agreements are excluded from the conduct rules if the agreement is made for the purposes of complying with a legal requirement imposed by or under any enactment in force in HK or imposed by any national law applying in HK. (Note: this is part of the Ordinance and therefore would be difficult to amend).</p> <p>The HKCC has interpreted in its draft guidelines, that for the exemption to apply, the relevant legal requirement must eliminate any margin of autonomy on the part of the undertakings concerned compelling them to enter into or engage in the agreement or conduct in question. If the relevant agreement or conduct merely facilitated or encouraged enactment in force in HK or national law applying in HK, the exclusion will not apply. Equally, approval or encouragement on the part of the public authorities will not suffice for this general exclusion to apply. (para.3.2 and 3.3 of Annex 1 of FCR Guidelines)</p> <p>The Investigations Guideline only states that, in the Initial Assessment Phase, the Commission “may” seek information by (amongst other means) “meeting and interviewing persons who may have knowledge of the conduct”, which, without express reference to other regulators.</p> <p>In the Guide, the HKCC says that it cannot, in the abstract, bind itself to the views of public or regulatory authorities, who may pursue different policy objectives to those of the Ordinance. However, the HKCC’s investigations will include gathering information from third parties, which could include public or regulatory authorities, who may have knowledge of the conduct in question.</p> |
|   | <b>Implication of current proposal</b>  |

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|          | <p>The implication is grave for sectors and industries which are subject to more than one regulator. Without adding further clarity as to how the regulators will interact going forward, it is unclear whether entities which seek to meet the requirements of certain regulators will in fact be in breach of their competition obligations (and vice-versa). This not only creates tension between regulators and difficulties internally within an organization seeking to comply and do the right thing, seeking approvals/reconciliation between regulators on an ad hoc basis every time this conflict arises is impractical in terms of time and cost.</p>   |
|          | <p><b>Proposed amendment</b></p>   |
|          | <p>(1) Inclusion of <i>“The Commission may also, for example, take into account the existence of other regulatory regimes or the views of any concurrent regulators in Hong Kong in assessing whether the agreement has the object of harming competition.”</i> at the end of paragraph 3.5 of the FCR Guideline, and at the end of paragraph 4.8 of the SCR Guideline.</p> <p>(2) Inclusion of <i>“The Commission may also, for example, take into account the existence of other regulatory regimes or the views of any concurrent regulators in Hong Kong in assessing whether the agreement has an anti-competitive effect.”</i> at the end of paragraph 3.25 of the FCR Guideline, and at the end of paragraph 4.18 of the SCR Guideline.</p> <p>(3) Inclusion of <i>“consider the views of any concurrent regulators in Hong Kong”</i> as an analytical step the HKCC may take in defining the relevant product market, in paragraph 2.14 of the SCR Guideline.</p> <p>(4) Inclusion of <i>“The views of any concurrent regulators in Hong Kong”</i> as a factor the HKCC may consider in defining the relevant geographic market, in paragraph 2.21 of the SCR Guideline.</p> <p>(5) Inclusion of <i>“the existence of other regulatory regimes and the views of any concurrent regulators in Hong Kong”</i> as a factor to be taken into consideration by the Commission in exercising its discretion whether to pursue a particular matter, in paragraph 3.6 of the Investigations Guideline (and/or in the HKCC’s forthcoming enforcement policy).</p> |
| <b>4</b> | <p><b>Exclusive dealing may be considered by object</b><br/> <b>SCR Guidelines: Paragraph 4.15 and 5.26</b></p>  |
|          | <p><b>Current Proposal</b></p>   |
|          | <p><b>Background:</b> Infringements of competition law are often distinguished into (i) object infringement; and (ii) effects infringements. When certain conduct is classified as an object infringement, it means that the conduct, by its very nature, is so harmful to the proper function of normal competition in the market that there is no need to examine their effects. For effects infringements, the HKCC cannot just say that the conduct is very harmful by nature and need to consider its effect on the market. The revised draft guidelines provide that</p>   |

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|  | <p>“certain” exclusive dealing arrangements by an undertaking with a substantial degree of market power might also be considered to have <u>the object</u> of harming competition. (para 4.15 and 5.1 SCR Guidelines) This classification of exclusive dealings as a potential “object” infringement is inconsistent with the practices of most overseas jurisdictions (which tend to involve an assessment of the effect of the exclusive dealing).</p> <p><b>HKCC:</b> Although the revised draft guideline explains that certain exclusive dealings will have the object of harming competition, the HKCC also recognises that exclusive dealing is “commonly used in commercial arrangements and in most cases will not harm competition”. The SCR Guideline then discusses the circumstances when exclusive dealing may be a concern, focusing on the effects of such arrangements (see paragraphs 5.24 to 5.28 of the SCR Guideline).</p> |
|  | <p><b>Implication</b></p>   |
|  | <p>Simply providing that exclusive dealing “may” be considered by “object” in itself creates uncertainties. As acknowledged by the HKCC, exclusive dealings clauses are commonly used in commercial arrangements and in most cases will not harm competition. Therefore, by failing to explain what arrangements would be considered by object and by leaving the guideline vague, further difficulties will arise in relation to an internal self-assessment of whether these clauses should be used in the future. In the end, if borderline cases are wrongly assessed internally based on the lack of clarity in the guideline, this will have a chilling effect on businesses leading them to stop entering into exclusive agreement which could have brought incentives for distributors/suppliers and benefits to customers.</p>   |
|  | <p><b>Proposed amendment</b></p>  |
|  | <p>The following clarifications should be added to SCR Guideline:</p> <p>(A) We recommend that the HKCC provide further explanation of when exclusive dealing arrangements will be considered to have the object of harming competition in paragraph 4.15 of the SCR Guideline.</p> <p>(B) We also recommend that this explanation is coupled with the addition of examples of when exclusive dealing arrangements will be considered to have the object of harming competition in paragraph 5.26 of the SCR Guideline.</p>   |