



THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG

SUBMISSION ON HONG KONG COMPETITION ORDINANCE DRAFT GUIDELINES

August 28, 2014

I. INTRODUCTION

AmCham has followed closely, on behalf of its members, the public and legislative debate leading to the adoption in June 2012 of the Hong Kong Competition Ordinance (“Ordinance”). We are therefore grateful for the opportunity to offer our observations and suggestions to the Hong Kong Competition Commission (“HKCC”) as part of its engagement initiative, noted in the consultation paper “Getting Ready for the Full Implementation of the Competition Ordinance”.

AmCham understands that in September 2014 the HKCC will publish draft guidelines pursuant to the Ordinance (“Guidelines”) and we expect to provide further comments on these Guidelines in due course.

This submission therefore articulates a few fundamental principles, which we hope will be of assistance to the HKCC when finalising the draft Guidelines.

II. GENERAL COMMENTS

In our February 10, 2012 submission to the Legislative Council Bills Committee on Competition Bill copying the Commerce and Economic Development Bureau (“Administration”) regarding the proposed competition law, AmCham stressed the strong concerns of the business community over the cost of doing business in Hong Kong. We highlighted the need to minimise that burden by way of limiting the amount of regulations to the strict minimum and simplifying existing rules to facilitate their implementation.

Since this is Hong Kong’s first broad experience with a competition law regime, AmCham advocates that the HKCC’s priorities should be (i) to *educate* the public about the meaning of the Ordinance, and (ii) to focus enforcement on *serious* (hard-core) anti-competitive conduct, meaning mainly price fixing, market sharing, output restriction and bid rigging.

The Guidelines being an important educational tool and the public having long anticipated the increased legal certainty they would bring about, the HKCC should therefore carefully manage these high expectations. This can be achieved by maximizing both the clarifications the Guidelines will provide and the HKCC’s transparency over the enforcement priorities it will set out for itself.

A. Clarity

The Guidelines should be comprehensive, detailed and clear.

Substantive Rules. Regarding substantive rules, multiple examples should be included to demonstrate what is likely to be lawful and unlawful. Extensive background information should help in the Guidelines’ interpretation; and this is all the more necessary since a general competition law is new to Hong Kong and the Guidelines will be valid in two operative languages – English and Chinese – leading to potential uncertainties.

Procedural Rules. Regarding process, the Guidelines should also be as detailed as possible, particularly regarding how complaints should be made; how the HKCC will decide to launch, and how it will conduct, investigations; and how it expects to receive applications for, and exercise its power to grant, individual or block exemptions (absent which the HKCC may be flooded with demands and lose control over its own enforcement agenda). Wherever possible and relevant, the Guidelines should set out the procedural safeguards available to undertakings when under investigation – including the right to confidentiality, to be heard and to be informed. Where no Guideline is scheduled under the Ordinance (e.g., for warning notices or leniency applications), relevant issues and clarifications should be provided by way of policy statements.

B. Transparency

Priorities. The HKCC should, to the extent possible, be transparent about its enforcement priorities. At a minimum, a policy statement confirming that the HKCC will in the first instance dedicate its resources primarily to combat hard-core conduct would be beneficial. It would also be helpful for the HKCC to set out if/how it may give consideration to Hong Kong’s specificities; and if/how it may rely (or not) on international precedents (and if so, which ones: e.g., Australia, US, EU, UK, Singapore, Canada). The more the rationale behind enforcement priorities is articulated, the better the business community will be able to understand and adapt to the new law.

Timeline. While public statements have indicated a tentative, non-binding timeline for the entry into force of the Ordinance, a clear timetable for the adoption of the Guidelines, the subsequent coming into force of the substantive provisions of the Ordinance and any step in-between, should be set out as soon as possible. Businesses are eager to be compliant as soon as possible and at the latest by the time the Ordinance becomes effective, but some of the commercial and/or operational changes that may be required in some cases could take time to design and implement. Having a clear and reliable timetable to conduct such changes is necessary to ensure compliance.

III. FIRST CONDUCT RULE

A. Horizontal Agreements

1. Hard-core infringements

As a new authority, the HKCC should focus its enforcement efforts exclusively for the first few years on hard-core conduct, namely the “serious anti-competitive conduct” (price fixing, market sharing, output restriction and bid rigging). This is because (i) the HKCC will have limited resources; (ii) serious anti-competitive conduct has been identified as the primary policy concern; and (iii) it may take time for businesses to fully appreciate, understand, and therefore comply with, various complex and more nuanced concepts set out in the Ordinance.

We suggest that this be made clear by way of a policy statement and a timeframe (e.g., 2 or 3 years). This would significantly increase legal certainty, while giving time to the business community to comply with the areas of the Ordinance which are more subject to interpretation and controversy.

For the sake of clarity, we also suggest that the HKCC confirm that “serious anti-competitive conduct” is not automatically an infringement “by object”. There is a gap between these two concepts in the Ordinance – the former one being procedural and determining the availability (or not) of warning

notices, and the latter one being substantive and referring to the HKCC's burden to prove anti-competitive effects. Indeed, there may be circumstances, given the market structure in Hong Kong, where a "serious anti-competitive conduct" may overall have pro-competitive effects (e.g., small businesses coordinating their prices to remain competitive and indeed, survive, against larger businesses).

2. Other conduct

Since enforcement would at first focus on hard-core conduct as suggested above, the HKCC should also clarify that it does not intend to pursue cases based on conduct which can be linked to hard-core violations, but whose anti-competitive effects are controversial or at least unclear. This is the case for instance for information exchange, joint negotiating and ancillary restraints relating to joint ventures.

Any other approach may have a chilling effect on businesses conducting commercial activities in Hong Kong. This would run counter to Hong Kong's long standing efforts to promote free enterprise and innovation.

B. Vertical Agreements

1. General Approach to Vertical Agreements

AmCham strongly supports that vertical agreements should be exempted from the First Conduct Rules. The exemption should cover all undertakings, or at a minimum, undertakings, which either do not reach a certain market share threshold, or do not have "substantial market power" (resulting in a review of vertical agreements only under the Second Conduct Rule). AmCham supports such a block exemption for the following reasons.

- (i) There is broad economic evidence that where there is sufficient inter-brand competition, vertical restrictions have pro-competitive rather than anti-competitive effects and that, given competition, the interests of suppliers, retailers and end-customers are aligned. Any prescriptive rules in a context where effective competition exists will naturally lead to sub-optimal outcomes. AmCham believes that the First Conduct Rule is therefore not the appropriate enforcement tool in the context of vertical agreements.
- (ii) It was not the Administration's intention to enforce the First Conduct Rule strongly against vertical agreements. We refer to the draft guidelines issued by the Administration during the Bills Committee stage in which it was stated that "[i]n respect of "vertical agreements", it is expected that the first conduct rule will be applied in a much more limited fashion."¹ AmCham considers this evinces a clear intention that a block exemption would be applied to vertical agreements, and AmCham believes that such a block exemption should cover all vertical agreements, or at a minimum those between undertakings that do not reach a certain market share threshold, or do not have "substantial market power".
- (iii) It is notoriously difficult to enforce the law against vertical restraints because, depending on the circumstances, these actions can often be pro-competitive. This is an area of the law where legal certainty is the most difficult to establish and thus not appropriate for a new, resource-constrained authority.
- (iv) In a new regime where the local business community is not particularly competition law literate, it is particularly important to provide a reliable and workable framework so as to avoid chilling pro-competitive behaviour.

¹ Bills Committee on Competition Bill – Guidelines on First Conduct Rule (CB(1)2336/10-11(01)), at p.5.

- (v) Since Hong Kong has a “substantial market power” test for the Second Conduct Rule (a test which is markedly lower than dominance tests in other systems), there will be ample opportunity to review vertical agreements under the Second Conduct Rule, making it even more appropriate to exempt vertical agreements under the First Conduct Rule.
- (vi) The HKCC should identify what it considers as being the best fit for Hong Kong. This is not necessarily the same as other jurisdictions, which have different characteristics and different policy considerations (e.g., the EU, which is heavily influenced by its single EU economic market policy).

Prior to any exemption being brought into force, the HKCC should make it clear that there will be no enforcement against vertical agreements, pending the vertical block exemption consultation and implementation of any form of block exemption that is decided in that process.

2. Resale Price Maintenance (RPM)

First, to reduce the legal uncertainty created by the broad language of the Ordinance, it should be made clear that Retail Price Maintenance (RPM) is not a form of “serious anti-competitive conduct” in the way that horizontal price fixing is. The same should apply to any other vertical agreement, unless of course the vertical agreement is in effect designed and implemented as a tool to operate a horizontal anti-competitive agreement.

Secondly, there is no justification to treat RPM differently from other vertical restraints. There is robust inter-brand competition in Hong Kong and prohibiting RPM regardless of the undertaking’s strength in the relevant market would be disproportionate; it could have chilling effects, when businesses need time to adapt to the Ordinance.

Hong Kong remains to date one of the most competitive and successful economies in the world. Its retail sector is particularly buoyant. If the HKCC sees significant issues that would require a shift away from the liberalised status quo, AmCham would be happy to support a move by the HKCC to deal with the concern. However, in the absence of any particular and well-identified concern, there is a risk associated with intervention. Absent any specific issue that the HKCC has identified that is not related to the special characteristics of the Hong Kong market, AmCham would suggest that the HKCC does not follow unnecessarily tedious RPM rules, which may be inspired by other jurisdictions, and instead maintains a liberalised approach in relation to RPM where competition exists.

AmCham submits, therefore, that RPM should only be prohibited (subject to efficiency defences) if the undertakings are not capable of benefiting from the block exemption (i.e. their market share is higher than the threshold provided for in the block exemption), or they have “substantial market power” and the Second Conduct Rule applies.

IV. SECOND CONDUCT RULE

A. Market Definition

1. Definition

Market definition is a critical step in the application of the Ordinance and should be used as the starting point for any investigation by the HKCC, under either the First or the Second Conduct Rule. It is therefore necessary to provide as much legal certainty as possible regarding the process and analysis used to define the relevant market under the Ordinance.

Clarification should therefore include a description of the tests the HKCC plans to rely upon (whether SSNIP or other tests), as well as the extent to which economics will be used in defining the market.

2. Special issues in Hong Kong

Hong Kong is a small jurisdiction but an open economy. This raises particular challenges regarding market definition. In offering guidance on market definition, consideration should be given to Hong Kong's specificities – including consumer habits, customary trading terms, but also the significance of imports and exports in Hong Kong (Hong Kong being a major trading platform with significant transit arrangements).

This means it is possible that, given the size of Hong Kong, the geographic market definition could often be as large as the whole territory or, depending on the competitive constraints exercised by businesses outside of Hong Kong, could be larger than Hong Kong. The latter is of particular significance in relation to businesses having limited activities in Hong Kong, but which leverage their strong market power outside of Hong Kong to gain market share in Hong Kong.

B. Substantial Market Power

1. Market Share Test

AmCham recognises the need for increased legal certainty in relation to the Ordinance's interpretation and implementation. In this sense, the setting of a specific market share percentage to flag the level below which no undertaking may be deemed to have "substantial market power" would be a welcome clarification, particularly for SMEs.

At the same time, figures can be powerful and identifying a specific market share for indicating substantial market power may polarise views and undermine the importance of other, more qualitative elements of the definition of "substantial market power". The concept of market power is complex. Attempts to define market power should take into consideration Hong Kong's specificities and the identification of market power should be based on a rigorous economic analysis. The concern regarding a specific figure is all the more serious that very low numbers have been suggested recently (sometimes as low as 25%), in stark contrast with most, if not all, other competition regimes.

There is no reason why Hong Kong's market share test for market power should be any different from most other jurisdictions, such as the EU (40-50%), the PRC (50%) and tellingly, other small but open economies such as Singapore (60%) and Israel (50%).

On balance, therefore, AmCham is of the view that a definition of "substantial market power" *without* reference to a market share level is preferable. This approach would require each case to be individually considered with a full analysis and without short cuts. However, if a market share is to be set out, the figure should not be markedly different from most other jurisdictions. And, if a low figure is to be adopted, it should be made very clear that it is a safe harbour and does not create a presumption of "substantial market power" for undertakings whose market share is above the threshold.

2. Regulated Markets

The HKCC should consider how the regulation of certain markets in Hong Kong may have an impact on competition and how the Ordinance may not necessarily be the best tool to address potential defects. As the UK's Competition and Markets Authority (CMA) recently stated in its Market Investigation Guidelines:²

"24. Prohibitions on using market power to exploit customers or exclude rivals, or on coordinating with the few rivals that remain, may not be sufficient to address issues in a

² "Guidelines for market investigations: Their role, procedures, assessment and remedies", Competition Commission, April 2013, adopted by the CMA Board in March 2014.

market whose characteristics and structure limit the ability or incentive of firms to compete effectively. There are markets, for example, in which the root cause of a problem lies within the regulatory framework; or it may lie within the way the market operates, with weak competition resulting, for example, from network effects, Public interest issues, customer inertia or imperfect information flows between market participants.”

“224. Regulations may be beneficial for a variety of reasons ranging from ensuring the stability of the financial system to protecting the environment, but they may inhibit the extent to which competition can flourish in certain circumstances. [Certain types of regulations] may limit the number of competitors in the market directly, for example by requiring that only firms with a licence or permit may operate within it.”

“379. The CC can decide to make recommendations to other bodies, rather than taking action itself. Such recommendations can [include] the removal or reform of regulatory requirements that have been found to constitute a barrier to entry.” [Emphasis added]

C. Abuse

At a minimum, it would appear necessary to set out in detail how competition rules and enforcement are expected to interplay with other sector regulations and authorities. The Ordinance is explicit on the telecommunications sector, but is silent regarding other regulated industries, such as the financial sector. However, there may be direct conflicts or overlaps between the two sets of rules (e.g., prohibition against collusion under financial sector rules). AmCham would therefore welcome clarification from the HKCC on how it intends to address this issue.

1. No abuse by object

AmCham is concerned that certain conduct may be an infringement *by object* of the Second Conduct Rule. Across jurisdictions, the concept of abuse of market power is notoriously difficult to identify and to establish. It is also a highly controversial notion. Although most commentators (including AmCham) call for more legal certainty under the Ordinance, we believe that the HKCC should clarify that it intends to review potential abuses using an effects-based analysis only.

2. Unilateral v. bilateral conduct

It would also be helpful to clarify whether certain bilateral conduct may be considered under the Second Conduct Rule (as suggested above regarding vertical agreements); and whether certain conduct typically captured under the abuse category (such as bundling/tying) may also be reviewed under the First Conduct Rule (and if so, whether as a by object or by effect infringement).

V. OTHER ISSUES

A. Single Economic Entity/Group

Conglomerates in Hong Kong represent a large part of the economy. Similarly, many businesses choose (or are required) to conduct their activities in Asia via joint ventures – particularly in the PRC where local partners must have a majority of the capital, but do not in fact manage the business of the JV. Whether the JV is located in or outside Hong Kong (e.g., in the PRC), its activities may have an impact on the Hong Kong market therefore may have the potential of infringing the Ordinance.

Consequently, the notion of “undertaking” and the issue of “control” when evaluating a single economic entity are particularly important and should be addressed by the HKCC. AmCham believes that the notion of single economic entity should consider the degree of strategic, operational and

financial control by an entity over another one, and the latter's lack of economic independence from the former.

Consequently, businesses should gain assurance that all intra-group arrangements will fall outside the scope of the First Conduct Rule. At the same time, the HKCC should strike a fine balance and seize the opportunity presented by the Guidelines to avoid following the mistaken development in the EU, where the wide concept of "undertaking" has made it possible to fine parent companies without any proof of involvement in the conduct of subsidiaries. The EU is clearly motivated by a resolve to use monetary penalties as deterrence; an approach which AmCham believes is at odds with what the Hong Kong model should be – at least in its early years.

B. Market Studies

While the Ordinance enables the HKCC to conduct market studies, AmCham considers that the HKCC would make a better use of its limited resources by focusing on well-identified hard-core infringements first. The HKCC has very limited investigative powers in relation to market studies, so the results of such studies may be far from conclusive. Meanwhile, market studies may create the impression of a "fishing expedition" and also will generate massive compliance costs for businesses active in the relevant sectors.

We recognise the value of market studies as an educational tool regarding certain sectors, but we believe their use should be spared for a later stage, and the Guidelines should make this clear.

C. Effect of decisions from PRC antitrust regulators.

AmCham closely follows all developments pertaining to the Anti-Monopoly Law in the PRC. Given the proximity and the ties of Hong Kong with the Mainland, the question arises of whether the HKCC would defer to decisions adopted by the PRC competition authorities (particularly NDRC/SAIC decisions relating to same markets) and treat them as binding. For instance, in the case of exemption decisions (e.g., a cooperation agreement between two airline companies pertaining to Hong Kong-Mainland routes and approved by NDRC), would such decisions be the basis of an exemption under the Ordinance on the basis of the need to avoid a conflict with Hong Kong's international obligations as per Section 32?

D. Statutory Bodies

AmCham would welcome clarification from the HKCC on its position towards Statutory Bodies. In particular, confirmation of the final list of Statutory Bodies which are exempt from the Ordinance is necessary.

Given that Statutory Bodies are exempt from the Ordinance but parties that contract with them are not, AmCham also welcomes clarification from the HKCC on how this will apply in practice under the First Conduct Rule. For example, if an agreement between a Statutory Body and a non-Statutory Body is restrictive of competition, would the non-Statutory Body be potentially liable whereas the Statutory Body would escape liability? What would be the position as regards two Statutory Bodies that collude with each other in an anti-competitive manner? AmCham would welcome guidance on these issues.

The American Chamber of Commerce in Hong Kong is the largest international chamber in Hong Kong and represents a broad and diverse membership.