KEY ASPECTS OF HONG KONG'S NEW COMPETITION LAW AND ENSURING THAT YOUR ORGANIZATION IS COMPLIANT

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By: Sacha M. Cheong

BACKGROUND

Until recently, only the broadcasting and telecommunications sectors were subject to competition law in Hong Kong. With the opening up of these markets, consumers in Hong Kong have enjoyed the benefits of effective competition such as lower prices and greater choice in terms of the number of service providers and the range of services offered.

Following a review of Hong Kong's competition policy in 2005 and two rounds of public consultation in 2006 and 2008, a proposal for a broader competition law covering the whole of Hong Kong's economy was introduced into the Legislative Council in 2010. The Competition Ordinance was enacted into law on 14 June 2012, but was not brought into immediate effect so as to allow sufficient time for organizations to understand the requirements and prepare for its implementation.

On 14 December 2015, the Competition Ordinance came into full effect, creating Hong Kong's first cross-sector competition law regime.

The objective of the Competition Ordinance is to provide an open and level playing field for participants in Hong Kong's economy by curbing conduct that prevents, restricts or distorts (i.e. harms) competition and mergers that substantially lessen competition in Hong Kong. The law is both broad in terms of its applicability and far reaching as to its extraterritorial effect.

The Competition Ordinance is currently supplemented by two policy documents and nine guidelines issued by the Competition Commission. These set out, among other things, how the Competition Commission intends to interpret and give effect to the legislation and exercise its investigation and enforcement functions.

WHO DOES THE COMPETITION ORDINANCE APPLY TO?

The law applies to all private and government entities (not being a statutory body), regardless of legal status or the way in which they are financed, and natural persons engaged in economic activity (collectively referred to as "undertaking" in the Competition Ordinance).

In short, any individual or organization who engages in conduct which harms competition in Hong Kong is at risk of contravening the Competition Ordinance and is subject to fines and other restrictions.

THE THREE COMPETITION RULES

The Competition Ordinance sets out three key rules, known respectively as the First Conduct Rule, the Second Conduct Rule and the Merger Rule.

Extraterritorial Effect

Underscoring the extraterritorial reach of the Competition Ordinance, the competition rules apply regardless of whether the conduct occurs, or whether any of the undertakings are located, outside Hong Kong.

First Conduct Rule (FCR)

The FCR prohibits conduct among undertakings that have the object or effect of harming competition in Hong Kong. It also applies to an undertaking that is a member of an association (e.g. a trade association) and that makes or gives effect to a decision of the association.

Both horizontal and vertical arrangements between undertakings are caught by the FCR. Accordingly, a wide array of arrangements such as group boycotts, joint purchasing, joint ventures, exclusive distribution, franchising, resale price maintenance, etc., are subject to the law. It is therefore important for undertakings to scrutinize their business practices and to assess whether or not they are fully compliant.

However, the FCR is most concerned with preventing cartel arrangements among competitors, and the Competition Commission has publicly stated that cartels will be the primary target of its investigations and enforcement efforts. Such cartel arrangements are described in the Competition Ordinance as "serious anti-competitive conduct" and include the following:

> a. price fixing (i.e. fixing, maintaining, increasing or controlling the price for the supply of goods or services). b. Market sharing (i.e. allocating sales, territories, customers or markets for the production or supply of goods or services). c. Output restriction/limitation (i.e. fixing, maintaining, controlling, preventing, limiting or eliminating the production or supply of goods or services). d. Bid-rigging (i.e. collusion between undertakings when bidding for projects or responding to requests for bids and tenders).

Second Conduct Rule (SCR)

The SCR prohibits undertakings that have substantial market power in a market from abusing that power by engaging in conduct that has the object or effect of harming competition in Hong Kong.

There are no limitations on what constitutes "abuse" under the Competition Ordinance, but the examples given in the guideline include:

> a. Predatory pricing: This occurs when an undertaking sets the price of its goods or services so low that it is deliberately foregoing profit in order to force a competitor out of the market or to otherwise discipline the competitor. In this scenario, an undertaking may be willing to incur losses in the short term in the expectation that it will be able to charge higher prices in the longer term, for example, following the exit of the competitor from the market. b. Anti-competitive tying and bundling: Tying occurs when a supplier makes the sale of one product (the tying product) conditional on the purchase of another (the tied product) from the same supplier. Bundling occurs when a package of two or more products is offered at a discount. While tying and bundling are common commercial arrangements that often promote competition and benefit consumers, such practices are sometimes used by undertakings with a substantial degree of market power to harm competition. c. Margin squeeze: Margin squeeze can arise when a vertically integrated undertaking with a substantial degree of market power in the upstream market supplies an important product or service to undertakings operating in a downstream market where it also operates. In this context, the undertaking reduces or squeezes the margin between the price it charges for the product or service to its competitors in the downstream market and the price its downstream operations charges to its own customers, such that the downstream competitor is unable to compete effectively. d. Refusals to deal: This occurs when an undertaking with substantial market power refuses to supply products or services or is only willing to do so on objectively unreasonable terms. The guideline recognizes that, as a general matter, an undertaking is free to decide with whom it will or will not do business. However, competition concerns may arise where the undertaking competes in a downstream market with a competitor with whom it refuses to deal, especially when the refusal relates to a product or service that is indispensable for competitors operating in the downstream market. e. Exclusive dealing: Exclusive dealing is a broad category of conduct that requires a customer to purchase all or a substantial proportion of its requirements of a particular product or service from the undertaking. It can take the form of an exclusive purchasing obligation or an incentive arrangement (i.e. a conditional rebate) with similar effect. While exclusive dealing is a common commercial arrangement and in most cases will not harm competition, the Competition Commission may regard the conduct as anti-competitive if (i) the undertaking has imposed such obligations on many customers, (ii) consumers are unlikely to derive any benefit, and (iii) it has the effect of preventing the entry or expansion of competitors and locks up a significant part of the relevant market.

What is a substantial degree of market power?

In a healthy economy, an undertaking must react to the prevailing trends and market forces to ensure that its products or services remain attractive to consumers. As a result, undertakings will usually be mutually constrained in terms of their pricing, output and related commercial decisions by the activity or anticipated activity of other undertakings that compete in the same market. In contrast, a substantial degree of market power arises where there is an absence of sufficiently effective competitive restraints in the relevant market. Such a situation would enable an undertaking to charge prices above competitive levels or to restrict output or quality below competitive levels for a sustained period of time. In addition, an undertaking may have the ability to weaken existing competition, raise entry barriers or slow innovation, to the overall detriment of consumers.

There is no universal test for determining whether an undertaking has a substantial degree of market power. Rather, the Competition Commission will assess market power based on various factors, including market share, market concentration, countervailing buyer power, barriers to entry or expansion and any characteristics that are specific to the relevant market.

How is the relevant market defined?

The relevant market is assessed by reference to the product market and geographic market. Product market means any products or services that would be considered interchangeable or substitutable by buyers and suppliers. Geographic market means any regions or areas where buyers would be able or willing to find substitutes for the products or services in question.

In theory, the geographic market could be confined to Hong Kong or even an area within Hong Kong. However, given that Hong Kong is small in terms of the size of its territory, it is likely that the geographic market will often be broader than just Hong Kong. In appropriate cases, the geographic market could cover a regional or global area.

While the Competition Commission will have regard to previous cases when defining the relevant market, the guideline states that the definition will depend on the specific facts of the case and the Competition Commission is not bound by previous decisions.

Merger Rule (MR)

The MR prohibits an undertaking from carrying out a merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong.

However, at present, the MR is only of limited application and applies when one of the undertakings participating in the proposed merger holds a carrier licence within the meaning of the Telecommunications Ordinance.

While it is anticipated that the ambit of the MR will be extended across all business sectors, there is no confirmed timeframe as yet for the implementation.

Exclusions and Exemptions

The Competition Ordinance contains a number of exclusions and exemptions. By way of example:

> a. Economic efficiency: The FCR does not apply to agreements that enhance overall economic efficiency. The undertaking will need to show, among other things, that the agreement contributes to improving production or distribution, or promotes technical or economic progress, and that the arrangement benefits consumers or at least causes no prejudice to consumers in the market. Where an undertaking uses identical or substantially similar agreements to conduct business, it may apply to the Competition Commission for a block exemption order. b. Legal requirement: The FCR and the SCR do not apply if the agreement or conduct in question is made or carried out in compliance with a legal requirement. However,

> the fact that anti-competitive behaviour may have been accepted or even encouraged in the past is insufficient. To minimize the risk of non-compliance, an undertaking should carefully assess whether it comes squarely within the exclusion. c. Agreements of lesser significance (which do not involve serious anti-competitive conduct): The FCR does not apply if the combined turnover of the undertakings in relation to the arrangement does not exceed HK$200 million. d. Conduct of lesser significance: The SCR does not apply to conduct engaged in by an undertaking if its turnover during the preceding calendar or financial year does not exceed HK$40 million. e. Statutory bodies: The competition rules do not apply to a statutory body unless it is specifically brought within the scope of the rules by a regulation made by the Hong Kong Chief Executive. This exclusion does not extend to an entity that is owned or controlled by a statutory body unless the entity is also a statutory body.

ENFORCEMENT AND REMEDIES

The Competition Commission is equipped with an array of tools and remedies aimed at encouraging compliance with the competition rules and to punish offenders when necessary.

Enforcement Powers

If the Competition Commission considers that an undertaking has contravened a competition rule, it may:

> a. Issue a warning notice to the undertaking, giving the undertaking a warning period within which to cease the contravening conduct. b. Issue an infringement notice to the undertaking, offering to not bring proceedings in the Competition Tribunal on condition that the undertaking makes a commitment to comply (see below). c. Accept a commitment from the undertaking to take, or refrain from taking, certain actions to address the concerns about a possible contravention. d. Request the Competition Tribunal to impose fines and other orders on the undertaking.

Fines and Other Orders

The Competition Tribunal is empowered to impose fines on any undertaking that contravenes the competition rules. The maximum fine for each breach of the competition rules is 10 percent of the turnover of the undertaking concerned for each year in which the contravention occurred, capped at three years. Turnover is defined as the total gross revenues of an undertaking obtained in Hong Kong.

Additionally, the Competition Tribunal may make any orders that it thinks fit, including:

> e. Disqualifying a person from being a director or otherwise involved in the promotion, formation and management of company for up to five years. f. Issuing mandatory and prohibition orders, as well as

> injunctive relief. g. Requiring the payment of damages to aggrieved parties. h. Declaring an agreement to be void or voidable, requiring the modification or termination of an agreement, and prohibiting a person from giving effect to an agreement.

Leniency Policy

The Competition Commission considers cartel conduct to be a serious and harmful threat. However, because it is usually organized and implemented in secret, the existence of a cartel can be difficult to detect, and the gathering and analysis of evidence is a costly and time-consuming exercise.

In view of these challenges, the Competition Commission intends to use leniency as a tool to encourage an undertaking that is willing to end its involvement in cartel conduct to come forward and cooperate. In essence, provided that it satisfies all of the requirements for leniency, the first member of a cartel to report the cartel conduct will not be subjected to any fines or other orders. Under the leniency agreement, the undertaking will be required to provide its full cooperation to the Competition Commission, for example, by providing all relevant information (which is not legally privileged) and testifying against the other cartel members.

Importantly, a leniency agreement only provides immunity against the imposition of fines and orders by the Competition Tribunal. It will not provide any protection against follow-on private actions brought by aggrieved parties who have suffered damage as a consequence of the cartel's conduct.

ENSURING THAT YOUR ORGANIZATION IS COMPLIANT

The failure to comply with the competition rules could have a devastating impact on your business, not only in terms of the legal consequences discussed here, but also in terms of the damage caused to your organization's reputation and brand, goodwill and share value.   It is vital that your organization critically reviews its business practices and makes the appropriate adjustments.

Below are some indicators as to whether your organization is prepared:

1. Do you understand the Competition Ordinance, policy documents and guidelines?
2. Is your organization committed to a top-down compliance culture that requires ethical conduct and adherence to the law?
3. Does your organization have clear compliance standards and procedures in place, such as measures to detect unlawful conduct, to monitor business practices, to educate employees on competition issues and to take consistent enforcement and disciplinary actions?
4. Has your organization conducted an assessment of its business practices and identified the potential areas of risk? If yes, has your organization taken any corrective actions or made any modifications to its compliance program?

Effective compliance will help you to minimize these risks.

KEY CONTACTS

SACHA M. CHEONG
PARTNER

HONG KONG
+852.2230.3590
SACHA.CHEONG@KLGATES.COM

