Johnson Stokes & Master

Competitive Edge

Local developments and international trends relevant to Hong Kong and China

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REGIONAL DEVELOPMENTS

China's new Anti-Monopoly Law

On 30 August 2007, China introduced the Anti-Monopoly Law, which is China's first comprehensive competition law. The Anti-Monopoly Law prohibits companies (and industry associations) from engaging in certain anti-competitive practices and market concentration activity, and also prohibits government departments and authorised organisations from abusing their administrative powers to curb competition.

The Anti-Monopoly Law is scheduled to commence on 1 August 2008, and regulates conduct within China as well as conduct outside of China that has 'eliminative or restrictive effects on competition' in a domestic market in China.

Under the Anti-Monopoly Law, companies are prohibited from entering into 'monopoly agreements' that have the effect (or likely effect) of eliminating or restricting competition. 'Monopoly agreements' are divided into horizontal monopoly agreements and vertical monopoly agreements in the Anti-Monopoly Law. Horizontal monopoly agreements include agreements between competitors to fix prices, limit production or sales volumes, share markets, restrict technology development, or boycott competitors or customers. Vertical monopoly agreements include agreements that fix resale prices or restrict minimum resale prices to third parties.

Under the Anti-Monopoly Law, these agreements are deemed to unlawfully restrict competition unless any of the exceptions set out in the Law apply, which include agreements that can improve technology, raise quality of product and production efficiency, or enhance the competitiveness of small or medium-sized companies.

Abuse of a 'dominant market position' is also prohibited under the Anti-Monopoly Law. The law specifies particular forms of conduct which may constitute an unlawful abuse of a companies' dominant market position, including the sale of products at unfair high prices, and (where it cannot be justified) the act of selling below cost, refusing to trade with partners, or imposing unreasonable trading conditions or 'tie-ins' to sales.

The Anti-Monopoly Law denotes that a company has a 'dominant market position' where it is able to control the price or quantity of products or other trading conditions or to engage in conduct restricting or affecting entry of other companies into a relevant market. A number of other factors relevant to an assessment on 'dominance' are set out in the Anti-Monopoly Law.

The Anti-Monopoly Law also contains provisions prohibiting mergers and acquisition activity that has the effect or likely effect of eliminating or restricting competition, and outlines a regime for companies to notify the regulator of relevant transactions meeting relevant thresholds (which are still to be published). Additionally, the Anti-Monopoly Law requires a national security review to be carried out before foreign companies are allowed to purchase or invest in Chinese operations where such activity could affect 'national security'.

According to the Anti-Monopoly Law, a new Anti-Monopoly Commission will be established in China, and significant penalties will be imposed for breach conduct and hindrance or failure to cooperate with an investigation.

REGIONAL DEVELOPMENTS

Review of Hong Kong Consumer Protection Laws

The Hong Kong Consumer Council has established a working group to review Hong Kong's consumer protection laws, with a view to determining what changes are required to tackle a range of unfair business practices.

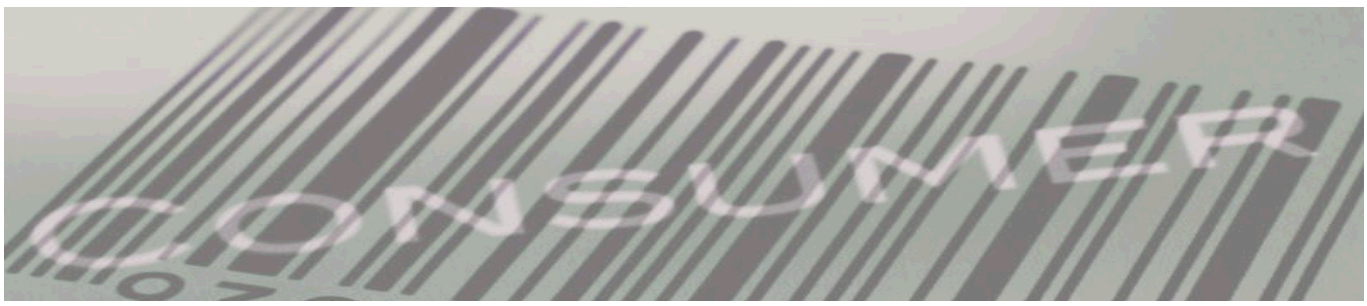
The working group is examining how to ensure consumers are adequately protected against 'unfair' business practices such as misleading and deceptive conduct, aggressive sales practices, poor after-sales service, and 'bait advertising'. Bait advertising occurs where a business advertises a product as a special offer without actually having it in stock, or having only a token stock of the product.

The working group's brief includes examining how unfair sales practices are regulated in Australia, Britain and Singapore, in order that they may advise on an appropriate legal and regulatory framework for the protection of Hong Kong consumers.

In each of those countries, prohibitions in relation to unfair business practices exist either in the country's general competition law, such as the Trade Practices Act in Australia, or in separate laws such as in 'Unfair Terms' laws in the UK, and in the Consumer Protection (Fair Trading) Act in Singapore.

At present, regulations for the protection of consumer interests are contained in various pieces of legislation in Hong Kong, such as the Sale of Goods Ordinance, the Supply of Services Ordinance, and the Trades Description Ordinance.

The Hong Kong government is proposing to introduce a general competition law in 2008. The establishment of the new Consumer Council working group is further evidence that Hong Kong is moving towards greater regulation of trading activities in the business sector, and the implementation of competition and consumer protection laws more akin to those found in other developed economies.



HONG KONG & CHINA - COMPETITION LAW FUNDAMENTALS

Each issue JSM will consider one element of China and Hong Kong's existing or proposed Competition Laws.

This month we examine "Price-fixing"

What is Price-fixing and why is it relevant to Hong Kong and China?

Price-fixing occurs where competitors agree on the price at which one or more of them will make supplies. An agreement involving price-fixing is a prohibited "monopoly agreement" under Article 13 of China's Anti-Monopoly Law, while the Hong Kong government's Competition Policy Review Committee (CPRC) has recommended that 'price-fixing' be made unlawful under the proposed Hong Kong cross-sector competition law.

What does Price-fixing involve?

In most developed competition law jurisdictions, unlawful price-fixing involves the following elements:

- *competitive parties:* price-fixing occurs between two or more parties that are in competition with one another (whether directly, or through related companies);
- *an agreement or arrangements between these parties:* price-fixing arrangements can be in writing or oral, or evidenced as 'understood' by the parties as a result of circumstances such as the circulation of price lists or the presence of company representatives at a meeting where price-fixing proposals are discussed;
- *an agreed restriction on the freedom of one or more of the parties in relation to their pricing decisions:* price-fixing arrangements commonly takes the form of a fixing (at a low, high or existing level), temporarily or otherwise, of the price or price range of goods or services that are supplied by one or more of the parties (or a discount, allowance, rebate or similar supplied by one or more of the parties); and
- *an intention, or result, of the conduct restricting competition in a market*: although in some jurisdictions this intention will be deemed to exist merely by virtue of the existence of price fixing conduct, so the conduct will be illegal per se (unless relevant exemptions apply).

It is likely that these will also be the core elements of price-fixing under the Anti-Monopoly Law in China, and the proposed general competition law in Hong Kong - although the detail of how the law may be applied in both jurisdictions remains to be seen. There have been suggestions that price fixing will be applied as a 'per se' offence in China, based on statements by government officials. However, this has not yet been definitively communicated.

Where Price-fixing is illegal, are there 'workarounds'?

In a number of countries with developed competition laws, companies can seek to have certain conduct exempted from the price fixing prohibition on net public-benefit grounds. A general exemption of this nature has been proposed for inclusion in Hong Kong's competition law, and under China's Anti-Monopoly Law, price-fixing and other "monopoly agreements" will not be prohibited if it can be proved that they benefit "social public interests" (with 'energy saving, environmental protection, and disaster rescue and remedy' stated as examples).

However, a net public-benefit is often extremely difficult to prove in relation to price-fixing conduct. Accordingly, the most commonly utilised 'workaround' to avoid unlawful price-fixing is for parties to combine to supply customers through one entity, be it a merged company, joint venture or similar. It is important to note, however, that such arrangements may be tested under separate provisions prohibiting merger and acquisition (or similar) activity that lessens competition in a market. Merger-control provisions applying equally to domestic PRC entities and to international companies in relevant situations are included in China's Anti-Monopoly Law, and may be included in the proposed Hong Kong competition law.

It should also be noted that "recommended" price arrangements are generally also lawful so long as there is no express or implied compulsion on a party to adhere to the recommended prices.

INTERNATIONAL SPOTLIGHT

The European Union's 'Microsoft' decision:

Important lessons for Hong Kong and China businesses

On 17 September 2007 the European Union ("EU") Court of First Instance handed down a significant decision that evidences how competition laws can erode the general right of businesses to decide for themselves with whom they wish to deal.

The court upheld a 2004 decision by the European Commission that Microsoft had abused its dominant position in the personal computer desktop market, which resulted in Microsoft being fined €497m. The case stemmed from complaints that Microsoft had bundled a media player into its market-dominant 'Windows' operating system, and then refused to supply competitors with technical information about Windows (at a reasonable price) that would allow the competitors to develop competing media players compatible with Windows.

A key aspect of the decision is the finding that Microsoft, as the dominant provider of operating systems for personal computers, effectively has a duty to make information about those systems available to competitors at a reasonable price so that competition in relevant 'add on' software markets can be encouraged.

Microsoft appealed the 2004 decision on the grounds that protection of the intellectual property ("IP") associated with its operating systems was central to the company's ability to innovate, as it ensured reward for research and development investment. However, the court ruled that Microsoft had failed to show that disclosure of the relevant information would have a significant effect on its incentive to innovate.

This is the latest in a string of EU decisions evidencing that competition law principles can override a companies right to decide who it will deal with and how it will exercise its IP rights.

These decisions are based on a broad interpretation of a general prohibition in EU competition laws against a party 'abusing' a 'dominant position' in a market. An equivalent prohibition is found in China's Anti-Monopoly Law, and is also proposed for inclusion in the anticipated Hong Kong general competition law.

Article 17 of the Anti-Monopoly Law prohibits a business with a "dominant market position" from abusing that dominance. The law contains examples of such conduct, including "refusing to trade with trading partners" and "imposing unreasonable trading conditions", that could potentially be applied to situations akin to the scenario that led to the EU Microsoft decision. In addition, the law contains a 'catch-all' provision that will allow the relevant enforcement authority to find that a business has unlawfully abused its dominance in the market in other situations.

It is interesting to note that the Anti-Monopoly Law also prohibits competing businesses from entering into agreements that limit the development of new technology or new products. It is conceivable that this prohibition could also be applied to block some restrictions in licence agreements between the owner of significant IP (such as operating system software coding) and licensees of that IP (such as software developers) who may also be competitors in a relevant market.

In Hong Kong, the Competition Policy Review Committee has recommended that a prohibition against abuse of dominance be included in the proposed Hong Kong cross-sector competition law. Although discussion documents in relation to the proposed law have not touched on the issue of whether a party who 'refuses to supply' another party in Hong Kong might be acting in an unlawful anti-competitive manner (unless the refusal stems from a 'cartel' agreement), it seems likely that Hong Kong will follow the lead of other jurisdictions and enact a broad prohibition against abuse of dominance which could potentially be applied to scenarios akin to the Microsoft case.

Accordingly, it can be seen that the introduction of a prohibition against abuse of market dominance, has the potential to impact not only software licensing and information-sharing arrangements involving dominant market players in China and Hong Kong, but also other industry sectors where there are dominant suppliers of resources other than intellectual property rights, and access to those resources may be considered essential to the ability of market participants to compete in other markets. Accordingly, companies in a position or market that may fit this description should seek advice on how the new Anti-Monopoly Law in China, and the proposed Hong Kong competition law, may impact on their activities.

INTERNATIONAL SPOTLIGHT

US Supreme Court decision on Resale Price Maintenance:

To what extent will Hong Kong and China adopt the new U.S. approach to this area of conduct?

In the United States, and most other countries with developed competition laws, the practice of 'resale price maintenance' (RPM) is prohibited. RPM involves a supplier (such as a manufacturer) dictating to a purchaser who acquires goods for the purposes of resale (such as a retailer) that the purchaser cannot resell the goods below a stipulated price, or refusing to supply goods to a purchaser who will not agree to such resale conditions.

In the recent U.S. Supreme Court decision of *Leegin Creative Leather Products vs PSKS*, the court held that a leather goods manufacturer did not breach the RPM prohibition by withholding supply to a retailer who sold below stipulated minimum resale prices. In handing down its decision, the court overruled previous judgments which made RPM illegal 'per se' (i.e. regardless of whether the conduct results in anti-competitive outcomes). The court instead adopted the 'rule of reason' test, under which RPM will only be illegal where the anti-competitive detriments of the conduct outweigh its pro-competitive benefits.

The court observed that RPM may, in certain circumstances, encourage retailers to invest more in promoting products and providing after-sales support, prevent customers 'free riding' (i.e. going to high-end retailers for advice but ultimately buying from discount stores), and protect the image of luxury products.

Resale price maintenance in the form of agreements to "fix prices of products re-sold to third persons" is prohibited under Article 14 of China's Anti-Monopoly Law. However, the prohibition may be avoided where it can be proved that the agreement aims to achieve a relevant objective, including the realisation of "social public interests". It remains to be seen whether any of the possible 'benefits' of RPM conduct identified by the U.S. Supreme Court will be legitimate 'social public interest' aims that may take RPM conduct outside of the realm of the RPM prohibition in China's Anti-Monopoly Law.

In Hong Kong, the Competition Policy Review Committee has recommended that a prohibition against RPM be included in the proposed Hong Kong cross-sector competition law, but that it only apply to companies who are 'dominant' suppliers in their relevant market. It remains to be seen whether RPM conduct by such Hong Kong suppliers will be made illegal 'per se', or whether a 'rule of reason' test will be applied.

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