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Competitive Edge

Local developments and international trends relevant to Hong Kong and China

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Regional Developments - Competition laws and your business: 10 key areas where decision making may be impacted (Part I)

The Hong Kong government recently published a Consultation Paper outlining details of a proposed new Hong Kong Competition Ordinance, and has invited feedback in relation to those proposals. JSM has previously published a summary of these proposals, which is available at http://www.mayerbrown.com/publications/article.asp?id=4528&nid=11164.

According to the Consultation Paper, the government believes there is widespread support for the introduction of a competition law in Hong Kong. This is not surprising, as competition laws exist in most developed economies, and it is inevitable that there will be broad conceptual support for a law that has as its stated objectives the achievement of economic efficiencies and the benefit of consumers.

However, it is clear that there is limited knowledge about how the proposed Hong Kong Competition Ordinance would operate in practice amongst large sections of the public and business community.

While the Consultation Paper outlines the proposed administration and enforcement structure for the law in some detail, the information provided in relation to the all-important conduct prohibitions is extremely limited.

What we do know is that the law is likely to contain two key broadly worded prohibitions.

Firstly, the law would prohibit undertakings from participating in agreements and concerted practices that have the purpose or effect of substantially lessening competition.

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Key points:

- The Hong Kong government recently published details of a proposed new competition law, and has invited feedback in relation to those proposals.
- The relevant Consultation Paper includes little information about the scope of activity likely to be caught by the proposed key conduct prohibitions, which is unfortunate given that there is limited knowledge about how competition laws operate in practice amongst large sections of the public and business community.
- In this context, the current and next editions of Competitive Edge will outline 10 important examples of how the proposed Competition Ordinance may affect the day-to-day activities and strategic decision making of Hong Kong businesses.

Secondly, where an undertaking has a substantial degree of market power, the law would prohibit the abuse of that power with the purpose or effect of substantially lessening competition.

Conceptually, these prohibitions appear sound and justifiable. At first blush, it seems difficult to argue against prohibitions that forbid relevant anti-competitive conduct or 'abuse' of market power.

However, in order to properly appreciate the potential impact of the proposed law, it is necessary to understand just what kind of conduct the prohibitions may cover, and what kind of activity will be deemed to be 'abusive' and unlawful.

The Consultation Paper is largely silent on these issues. However, some light can be shed on this topic through consideration of previous government statements in relation to the proposed law, relevant recommendations made by the Competition Policy Review Committee (CPRC), and analysis of the enforcement of competition laws in some of the more mature competition law jurisdictions that have influenced developments in Hong Kong.

In this context, the current and next edition of Competitive Edge will outline 10 important examples of how the proposed Competition Ordinance may affect the day-to-day activities and strategic decision making of Hong Kong businesses.

EXAMPLE 1 - DECISIONS ABOUT WHO TO SUPPLY, AND WHO NOT TO SUPPLY

Most businesses take it as a given that they can choose who they supply, and who they do not supply. This seems like a fundamental right of each business.

In most cases, businesses will be keen to supply their goods and services to any customers who wish to purchase them, to maximise their sales turnover and profitability. However, there are clearly some instances where a business may believe it is not in their best interests to supply a prospective customer.

For example, a business may be concerned about whether a prospective customer has sufficient funds, or is sufficiently trustworthy, to pay for supplied goods or services. Alternatively, a business may form part of a corporate group, and that group may believe it is in the group's best interest for each member to protect their affiliates by not supplying competitors of those affiliates.

Most competition laws contain provisions that impact such decisions, and it appears likely that this will be true of Hong Kong's Competition Ordinance. Specifically, based on the recommendations of the CPRC and the example set by the existing sector-specific competition laws in Hong

Kong, it can be expected that the proposed prohibition against abuse of market power will be interpreted as prohibiting businesses with a requisite degree of power from refusing to supply a customer (or discriminating against a customer by, for example, unjustifiably charging them higher prices than other customers), unless relevant exceptions apply.

Such exceptions would be expected to allow for refusals based on credit-issues or similar concerns, but these exceptions are not likely to be of assistance in many cases where the reason for the refusal is that the customer is an affiliate of a competitor of the corporate group.

The proposed Competition Ordinance is also expected to include a prohibition against 'joint boycotts', being where two competitors agree not to purchase from a particular supplier or to supply a particular customer. This prohibition can raise significant issues, as it is not unusual for businesses in particular industries to share information and views on the appropriateness of dealing with relevant customers and suppliers. Such practices will need to be conducted with caution under the proposed Competition Ordinance, to ensure that they fall within relevant exceptions to the extent they may be deemed to constitute implementation of a joint boycott.

EXAMPLE 2 - PRICING DECISIONS

Pricing is another area where businesses that are not in heavily regulated markets (such as essential service utilities) will commonly assume they have complete freedom in their decision making. In accordance with basic free-market principles, such businesses will feel they are constrained only by market forces - if they price too high they will lose customers to competitors who supply at a cheaper rate, and if they price too low they may not derive sufficient margins to survive.

A Hong Kong Competition Ordinance will likely add another regulatory layer to business decisions relating to pricing. That is, not only will businesses be prohibited from agreeing on pricing decisions with their competitors, but they will also be prohibited from selling at a price that is 'too low' in some instances or, potentially, 'too high'.

For example, in most competition law jurisdictions, businesses with a very substantial degree of market power are prohibited from drastically reducing their pricing in some circumstances. Specifically, they are prohibited from engaging in the practice of 'predatory pricing', which is where their prices are dramatically reduced (often to below cost) for a period of time, and this is identified as being for the purpose of driving competitors out of the market so that short term losses from the low pricing are able to be recovered by higher pricing once competitors have been forced out of the market.

The Competition Policy Review Committee has recommended that predatory pricing be prohibited as an unlawful abuse of substantial market power under Hong Kong's Competition Ordinance.

Additionally, selling at a price that is 'too high' can be unlawful under competition laws. Indeed, such a prohibition is included in China's new Anti-Monopoly Law, and applies to businesses that are deemed to have a dominant market position. This kind of prohibition has raised concerns in many jurisdictions, on

the basis that an ability to dictate high pricing can be perceived as a legitimate reward earned by businesses who have successfully carving out a market niche or valued brand. Additionally, many commentators question the justification for competition agencies to turn into virtual 'price regulators', and their capability to properly perform such a function.

It remains to be seen whether 'unfair high pricing' will be considered to be unlawful anti-competitive behaviour under Hong Kong's proposed Competition Ordinance, but it is notable that some of the debate that has surrounded the government's competition laws proposals have related to pricing matters and whether the competition law can be used as an instrument to curb inflationary pressures.

EXAMPLE 3 - DECISIONS ABOUT HOW BUSINESS PEOPLE INTERACT WITH COMPETITORS AND TRADING PARTNERS

Competition laws don't just prohibit contracts and formal arrangements that are deemed to be anti-competitive and unlawful. They also apply to informal and undocumented 'understandings' between a business and its competitors or trading partners.

For example, two businessmen from competing companies may get together for a meeting and jointly agree to raise their prices. Even if the two businessmen do not document this arrangement, or consider that they are each contractually obliged to implement the increase, the 'understanding' they have reached will almost certainly be considered a breach of any prohibition against price-fixing that exists in the jurisdiction in which they offer their goods.

But the impact of competition laws in terms of 'informal arrangements' and 'understandings' can be even wider than this.

It can often be very difficult for competition regulators to identify where an unlawful informal arrangement exists, because of a lack of evidence. Accordingly, it is common for competition regulators to be empowered to raise a presumption that an unlawful arrangement has been instituted where, for example:

- representatives of competitors have gathered at the same place and the conduct of the relevant businesses afterwards indicates that some form of concerted parallel practice has arisen (such as simultaneous increases in pricing, indicating a potential price-fixing arrangement); or
- competitors share information on matters such as pricing or their terms of supply.

In many cases, if the competing businesses who have attended the relevant gathering or who have engaged in the information-sharing cannot demonstrate that their pricing or other supply decisions were made independently, they face a substantial risk of prosecution.

This means that the conduct of business representatives at both formal gatherings such as trade association meetings, as well as informal gatherings such as after-hours networking sessions, can raise substantial issues in a competition law context.

Most businesses with competition law compliance programs will have rigorous policies in relation to such matters, requiring business representatives to:

- avoid any discussions with competitors in relation to such matters as pricing, preferred and un-preferred suppliers or customers, reaching agreement on common supply or purchase terms, or prospective sharing of resources;
- not share data relating to the kinds of matters referenced above with competitors or industry associations, unless such sharing is approved by relevant legal representatives; and
- take notes of trade association meetings and absent themselves from those meetings should 'risk area' discussions arise.

EXAMPLE 4 - DECISIONS ON DISTRIBUTION ARRANGEMENTS

Businesses commonly engage resellers as a means of getting their goods to market, because those resellers may be better placed to undertake this activity economically and efficiently through a network of retail locations and marketing arrangements.

When a reseller is engaged by a manufacturer for this purpose, any distribution agreement that the parties conclude will commonly include terms regulating the price at which the reseller can sell the good to end-consumers. This can, for example, mandate resale at a specific price, or dictate a maximum or minimum resale price (or both).

These kinds of arrangements can raise significant issues under a competition law. For example, it is common for competition laws to include a prohibition against the imposition of significant pricing conditions on the reseller of a good. In Hong Kong, the Competition Policy Review Committee has recommended that the prohibition against abuse of substantial market power be applied to prevent relevant businesses specifying the price at which goods must be resold, or specifying a minimum price below which goods must not be resold (in both cases, unless a relevant exception applies).

This can be a very significant, as often businesses will want their resellers to maintain pricing at or above a 'recommended retail price', to (for example) preserve the high-end image of a brand or to encourage the reseller to provide ongoing customer service to the consumer. Different views have been taken by competition law regulators at different times as to whether these kinds of rationales for resale pricing terms are justifiable and properly afford the concerned businesses the benefit of relevant exceptions to competition law prohibitions.

EXAMPLE 5 - DECISIONS ABOUT MERGERS AND ACQUISITIONS

Most business people are aware that antitrust laws around the world commonly include merger control regimes, under which certain 'M&A' transactions may be deemed unlawful (or, if identified in advance of closing, may be prohibited from

closing) if they are deemed to be anti-competitive. Most advanced economies around the world now apply some form of merger control.

However, there are two key factors that many business people may not appreciate about merger control regimes:

(1) A transaction may fall foul of a merger control regime in one country even where the parties to the transaction are located outside of that country (and even where they do not sell into that country).

A good example of this is China's existing merger control regime. Under this regime, certain transactions must be reported to China authorities (including the Ministry of Commerce) for review where the parties to the transaction meet certain 'notification' thresholds. These thresholds include where the China turnover of just one of the transaction parties *and their affiliates* exceeds RMB 1.5 billion. This means, for example, that even if neither of the transaction parties directly involved in a merger are based in China or sell products into China, the transaction will be notifiable if just one of them is part of a corporate group that includes a business with a China presence significant enough to trigger the stipulated turnover threshold.

(2) Competition law provisions of the type discussed in this section are commonly referred to as constituting a 'merger control regime'. However, they will generally apply to a much broader range of transactions than simply merger transactions or other standard 'M&A' deals.

It is instructive to again consider the example of China's merger control regime. Ministry of Commerce officials currently interpret China's merger control regime very broadly in many instances, regarding the acquisition of any interest in a company (including a small minority shareholding) as a transaction that is notifiable if the relevant notification thresholds are achieved.

Under China's new Anti-Monopoly Law, which commences 1 August 2008, a new merger control regime is likely to be applied in place of the existing regime. Under the Anti-Monopoly Law, transactions may be reportable if they involve the 'acquisition of control' over a target (which is proposed to include becoming the largest holder of shares with voting rights or assets in the target) or the acquisition of decisive influence over a target (which may include where the acquirer, through contractual or other means, obtains the ability to

exercise decision making in relation to key production and operational matters). Joint venture arrangements are also likely to be caught by the new merger control regime in many instances.

JSM has previously published details about China's proposed merger control regime under the Anti-Monopoly Law. See here for details: http://www.mayerbrown.com/publications/article.asp?id=4375&nid=11164.

In Hong Kong, the government is still considering whether or not to introduce a merger control regime. No specific proposal is made in the Consultation Paper in relation to this, although three key options are outlined in the document. Two of these options involve the inclusion of merger control provisions in the law, however one of these two options would see enforcement of the relevant provisions delayed until after a review of the effect of the law.

EXAMPLES 6 TO 10 - *WILL BE OUTLINED IN THE NEXT EDITION OF COMPETITIVE EDGE...*

How Mayer Brown JSM's Antitrust & Competition Team Can Assist:

Mayer Brown JSM's Antitrust & Competition Team is at the forefront of emerging competition law and antitrust issues in China and Hong Kong. The team is experienced in identifying the issues that anti-competitive conduct prohibitions raise for businesses, and is actively involved in the ongoing consultation process with the Hong Kong government regarding the appropriate scope and content of Hong Kong's proposed Competition Ordinance. The Team is also available to conduct appropriate reviews and to roll-out tailored training programs, to ensure compliance with competition laws.

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 prohibitions relating to "limiting production and sales volumes"

When will competition laws regulate conduct that limits production and sales volumes?

In China, Article 13 of the Anti-Monopoly Law (which commences 1 August 2008) dictates that an agreement between competing businesses to 'limit the production volume or sales volume of products' is a prohibited monopoly agreement.

In Hong Kong, the Competition Policy Review Committee has also recommended that the fixing of sales and production quotas by two or more competing businesses be considered to fall within the ambit of a prohibition in the proposed Hong Kong Competition Ordinance against agreements that have the purpose or effect of substantially lessening competition.

What is an example of how this prohibition might apply?

Consider a scenario where suppliers of 'widgets' in China or Hong Kong are finding that their profits are being eroded by oversupply into the market and resulting declining sale prices. To combat this situation, a number of the larger widget producers may get together and strike an agreement that each of them will halve their production totals for the coming year in the hope that this will help stimulate increased prices and profits.

This kind of arrangement would most likely constitute an unlawful output or sales limitation under the Anti-Monopoly Law, and would similarly be prohibited as an unlawful 'fixing of sales and production quotas' under the proposed Hong Kong Competition Ordinance.

Are there any relevant exceptions?

Although there are often a range of exceptions and exclusions to competition law prohibitions, they rarely apply to forms of 'cartel' conduct such as agreement on the limitation of production or sales volumes.

However, it is notable that one of the exceptions to the prohibition against 'monopoly agreements' in China's Anti-Monopoly Law (which covers relevant cartel conduct) is where the businesses involved can prove that the arrangement had the aim of moderating distinct production surpluses during periods of economic depression. This may open the door to allow so-called 'crisis cartels' in situations such as the example described above for widget manufacturers, although the threshold for proving that a sufficiently serious economic depression in the relevant market exists is likely to be set very high.

Additionally, it should be noted that the Hong Kong government has proposed that a 'de minimis' rule apply,

pursuant to which an agreement which might otherwise be considered to be anti-competitive and unlawful will be permitted if, for example, the parties to the agreement have a relatively small aggregate market share (say, 20% or less). However, the government has also indicated in its new Consultation Paper that the de minimis rule is unlikely to be applied to 'hard core' cartel practices, and that such practices may include agreement between competitors on the fixing of sales and production quotas.

So how can a business ensure compliance?

To avoid breaching the relevant prohibitions in China and Hong Kong, it is recommended that business adhere to the following principles (in the absence of legal advice to the contrary for a specific situation):

- Never agree with competitors that you will reduce your output or volume of sales.
- Be wary of agreements to which two or more competitors in a relevant industry are participants, if those agreements contain terms which may be construed as limiting total output by one or more of the parties, restricting the ability of the parties to invest in some element of their production and distribution arms, or introducing barriers to some parties from manufacturing certain products.

How Mayer Brown JSM's Antitrust & Competition Team Can Assist:

Mayer Brown JSM's Antitrust & Competition Team is skilled at identifying business activities and arrangements that may be deemed to breach the existing or proposed competition law provisions in Hong Kong and China, and suggesting appropriate 'workarounds' or alternative lawful ways of achieving business aims. Through the benefit of extensive international experience, and ongoing liaison with key agencies involved in determining and enforcing the competition laws in Hong Kong and China, the team is well placed to assist businesses to ensure compliance with competition laws. Business reviews and training programs can also be arranged to assist compliance activities.

International developments - Private antitrust litigation: New European proposals to be closely monitored in Asia

The European Commission ("**EC**") has proposed a number of changes to EU laws relating to private antitrust damages actions. The proposals are an attempt to institute a 'minimum standard' for private antitrust rights in each member country, and to address criticism that there is currently a lack of effective redress for European businesses and consumers who have suffered loss or damage from anti-competitive conduct.

The proposals will be of interest to businesses and government officials in this region, as the new Anti-Monopoly Law ("**AML**") in China and the proposed new competition law for Hong Kong appear to contemplate relatively broad private action rights for parties who suffer loss or damage as a result of the unlawful anti-competitive actions others.

BACKGROUND TO THE EC PROPOSALS

Historically, the volume of private antitrust actions brought in the EU has lagged far behind the level in the US, where over 90% of antitrust cases are private. It is generally recognised that the prevalence of private antitrust actions in the US has been a factor in encouraging antitrust awareness and compliance in that country, although there are also concerns about excessive and unwarranted litigation in this field.

The EC proposals, set out in a new 'White Paper', are an attempt to strike a balance between the competing goals of improving the mechanisms for seeking private antitrust redress, and preventing the encouragement of speculative and vexatious antitrust claims and resulting excessive litigation.

Key proposals outlined in the While Paper include:

- **Changes to available damages:** In the United States, a 'treble damages' regime applies in relation to private antitrust actions, with private litigants potentially able to recover three times the amount of loss or damage they have suffered from the anti-competitive conduct of others. This has provided a significant incentive for businesses to devote the time and resources required to pursue private antitrust actions.

  Despite calls for a similar regime to be adopted in the EU, the EC has recommended that a uniform system of 'single damages' apply. However, it is proposed that these damages will cover not only actual loss suffered as a result of alleged anticompetitive conduct, but also any loss of profit resulting from it (for example, a reduction in sales). Claimants would also have a right to interest payments.

- **Availability of collective redress:** The EC has proposed a combination of two complementary mechanisms of collective redress. Firstly, it is proposed that opt-in collective actions

be permitted, under which claimants may expressly decide to combine their individual claims for harm they suffered into one single action. Secondly, it is proposed that representative actions be permitted, with qualified entities (such as consumer associations, state bodies or trade associations) able to bring actions on behalf of "identifiable victims" that they are properly constituted to represent.

- **Improved discovery processes:** The White Paper proposes a minimum standard of access to evidence in all Member States. Under the proposals, all alleged victims of antitrust infringements would be able to ask the court to oblige the defendants to "reveal those pieces of evidence in its possession which are essential for the victims to prove their case for damages". However, such disclosure will be subject to strict conditions and under the control of a judge. For example, the claimant must have presented reasonably available facts to show plausible grounds for a case, and the disclosure of the requested evidence must be truly necessary and proportionate.
- **Empowering Courts to derogate from normal cost rules:** The costs involved in bringing antitrust damages actions in the EU have provided a major disincentive for businesses considering whether to bring such actions. To tackle this issue, the White Paper encourages EU Member States to design procedural rules fostering settlements as a way to reduce costs, and to set court fees at a level so that they are not a disproportionate disincentive to antitrust damages claims. Further, the EC has proposed that national courts should be able to issue cost orders deviating, in certain justified cases, from the normal cost rules. Such cost orders would guarantee that the claimant, even if unsuccessful, "would not have to bear all costs incurred by the other party".

NEXT STEPS, AND RELEVANCE TO CHINA AND HONG KONG

A public consultation process is now underway in relation to the EC proposals, which ends mid-July. After that time, the EC will take a definite view and draft a legislative proposal which will be subject to approval by the individual Member States, and also, possibly by the European Parliament.

These developments will no doubt be closely monitored in this part of the world, as the new AML in China and the proposed new competition law for Hong Kong both appear to contemplate relatively broad private action rights.

Specifically, Article 50 of the AML provides that "Undertakings that violate the provisions of this Law and cause damage to others shall bear civil liability", while the Hong Kong government's recently published consultation paper on a new general competition law proposes that private actions could be brought by any person who has suffered loss or damage from a breach of the law.

Both the AML and the proposed Hong Kong law appear to have been heavily influenced by European approaches to competition law matters. This creates an expectation that the latest European developments in the area of private antitrust actions may also guide the drafting of new legislation and implementation rules in this area in China and Hong Kong.

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