

Hong Kong Government attempts to shed light on Competition Bill ... but business sector remains in the dark

In recent days, the Legislative Council Bills Committee that is considering Hong Kong's proposed Competition Bill was provided with guidelines that explain how the government believes key aspects of the Bill should be interpreted and applied. However as the *Guidelines on the First Conduct Rule* are a sample only, and are in no way binding on the proposed Competition Commission (which would be established as an independent body under the law and tasked with drafting a 'real' set of guidelines to explain its approach to key matters), they may be considered to be of limited practical use for the business sector in terms of gearing up for compliance or debating the merits of the Bill.

Indeed, for many businesses, the key 'takeout' from publication of the Guidelines will be that it highlights the very broad discretion that would be granted to the Commission in terms of determining the true scope of the proposed law. This is an aspect of the Government's proposals that has already generated concern amongst the business sector, with many representatives of the sector calling for the Bill to be amended to address key uncertainties now (rather than leaving them for later determination by the Commission) so that debate on whether to pass the Bill can be made in full knowledge of its potential impact.

In this legal update we summarise the content of the Guidelines and comment on how their publication impacts the debate in relation to the proposed law.

Scope of the Guidelines

The Guidelines focus on the proposed law's general prohibition on agreements that have the object or effect of preventing, restricting or distorting competition (which prohibition is referred to in the Bill as the 'First Conduct Rule'). No sample guidance is provided in relation to other key aspects of the proposed law, such as how the broadly worded prohibition relating to abuse of substantial market power will be applied. It is not clear whether further sample guidelines may be provided to the Bills Committee in the future.

Examples of potentially unlawful agreements are provided

Several pages of the Guidelines are devoted to providing examples of the types of agreements that may breach the First Conduct Rule. In total, twelve categories of agreement are referenced, covering agreements between competitors to (i) fix prices, (ii) rig bids, (iii) share markets, (iv) limit output, production or investment, (v) fix trading conditions, (vi) engage in joint purchasing or joint selling, (vii) share information, (viii) exchange price information, (ix) exchange non-price information, (x) restrict advertising, (xi) standardise agreements, and (xii) fix terms of membership (i.e. of associations) or certification requirements (i.e. for product quality assurance labels, etc).

Only ‘appreciable’ restrictions or distortions of competition will be actionable

The Guidelines clarify that rather than any level of restriction or distortion of competition being actionable as a breach of the First Conduct Rule, only ‘appreciable’ restrictions or distortions will be actionable (mirroring the approach to enforcement of competition law in Europe). This means that very minor restrictions on competition, such as may often arise from agreements between very small business operators, should not give rise to risks in the context of the First Conduct Rule.

A ‘Single Economic Entity’ defence is outlined

The Guidelines note the First Conduct Rule will not apply to agreements between entities who are considered to be part of a ‘single economic unit’ (that is, the same corporate group). The Guidelines go on to indicate that the issue of whether two entities (i.e. ‘A’ and ‘B’) are part of a single economic unit should be determined by reference to factors such as whether ‘A’ or ‘B’ are under a high degree of operational and financial control by the other (or both are under such control by a parent company).

The concept of an ‘agreement’ is further explained

The Guidelines include explanation of when an ‘agreement’ may be held to exist in the context of the First Conduct Rule, supplementing existing wording in the Bill on this issue. Specifically, the Guidelines note that the term applies to both legally enforceable and non-enforceable agreements, written or oral agreements, and “so-called gentleman’s agreements”. It is also noted that an entity can be considered a party to a relevant agreement even if the entity may have only played a limited role in setting up the agreement, is not fully committed to its implementation, or was pressured into participation in the agreement (however these factors may be

taken into account when any penalty is applied if the relevant agreement violates the First Conduct Rule).

The government has not revealed its hand in relation to vertical agreements

In relation to vertical agreements, the Guidelines state that “it is expected that the first conduct rule will be applied in a much more limited fashion [than it will be applied in respect of horizontal (i.e. cartel agreements)]. The Guidelines note that in the absence of a party to a vertical agreement having strong market power, significant adverse effects on competition will be rare from such agreements, and it may be considered that relevant restrictions placed on parties within such agreements are most commonly for valid or pro-competitive purposes.

However, the Guidelines are carefully worded so as to reflect that ultimately it would be for the proposed Competition Commission to decide whether vertical agreements may still be open to review/challenge under the First Conduct Rule. The Guidelines state “[W]e expect that the Commission would consult the stakeholders and the public on how vertical agreements should be dealt with under the first conduct rule. The Commission could deal with vertical agreements through the guidelines on the first conduct rule. Alternatively, the Commission could issue a block exemption order to exempt vertical agreements from the application of the first conduct rule in light of their pro-competitive effects, and to impose appropriate conditions or limitations....”.

This aspect of the Guidelines may be particularly frustrating for business operators who have called for the Government to make good on strong indications it made in previous consultation documents that vertical agreements would be clearly ‘carved out’ from the possibility of review or challenge under the First Conduct Rule.

Explanation is provided on the concept of ‘concerted practices’

The First Conduct Rule is worded so as to apply both to ‘agreements’ and ‘concerted practices’. The term ‘concerted practice’ is not defined in the Bill, but since publication of the Bill it was generally assumed that the term referred to circumstances where there is informal cooperation between competitors, without any formal agreement or decision. This is confirmed in the Guidelines, which replicate the prevailing European competition law approach to this concept by noting that “[A] concerted practice would be found to exist if parties, even if they did not enter into an agreement, knowingly substituted the risks of competition with co-operation between them”.

The Guidelines note that mere ‘parallel’ (i.e. aligned) behaviour by competitors is not conclusive evidence of collusion between them (as competitors in some industries may be expected to closely follow each others pricing and terms, even if there is no agreement between them to do so), but the presence of other factors in addition to the parallelism may cause the Commission to consider that a concerted practice does exist. In this context, the Guidelines reference several factors that may be taken into account, such as whether the parties knowingly entered into practical co-operation, and whether the structure of the relevant market and the nature of the product involved are favourable to collusion (i.e. oligopoly sectors in which the products competitors produce are relatively homogenous).

Application of the First Conduct Rule to trade associations

The Guidelines briefly touch on the issue of trade associations, noting that they “generally carry out legitimate functions intended to promote the competitiveness of their industry sectors”. However

the Guidelines also note that, in the context of determining whether decisions or conduct of a trade association may violate the First Conduct Rule, “[T]he key consideration is whether the object or effect of [a decision by the association] is to influence the conduct or co-ordinate the activity of members in some commercial matter”. The Guidelines go on to state that such circumstances may even arise from non-binding recommendations of an association.

Ascertaining the “object” of an agreement

The Guidelines note that the term “object” in the context of the First Conduct Rule prohibiting agreements with “the object or effect of preventing, restricting or distorting competition” refers to the objective purpose of the agreement considered in the economic context in which it is to be applied, and does not mean the subjective intention of the parties when entering into the relevant agreement.

It is stated in the Guidelines that the “object” of an agreement will need to be inferred from the surrounding facts, and particular regard may need to be had to such aspects as records of meetings between the relevant parties to the agreement. For example, the Guidelines note that discussions relating to an agreement between competitors that indicate the agreement was intended to prevent “ruinous price competition” or to ensure “an orderly market” may be taken as showing that the object of the agreement was to restrict the level of price competition between them.

Some elaboration is provided on the scope of First Conduct Rule exclusions and exemptions

The Guidelines contain some general commentary on the general exclusions that apply to conduct that may otherwise be deemed to breach the First Conduct Rule.

Of particular interest is the guidance provided in relation to the exclusion for entities entrusted with the provision of services of general economic interest (which exclusion, it should be noted, will only protect the relevant entity to the extent that application of the law would obstruct the performance by that entity of the relevant service provision entrusted to it).

The Guidelines note that the term “entrusted” in the context of the exclusion can apply when the task of providing a particular service is applied to a particular entity “by way of legislative measures such as regulation, or the grant of a licence governed by public law, [and also] through an act of the Government”, however it will not apply in situations where the task of providing the particular services is merely given “approval by the Government”.

The effect of this is that an organisation that is not expressly assigned (under law, or licence, etc) with the task of providing a particularly important service in Hong Kong (such as a utility service), but which is merely ‘recognised’ by the Government as a provider of such a service, will face an uphill battle if it seeks to rely on the exemption. This appears to be the case even if ‘recognition’ of the organisation’s status as a supplier of the relevant service appears in the form of legislation or regulations.

Final comments

The Acting Secretary for Commerce and Economic Development, Mr. Greg So, reportedly advised the Bills Committee during 2010 that ‘sample guidelines’ would be provided to them for review by January 2011. Although it has taken five further months for the Guidelines to now surface, the Bills Committee will have plenty of time to consider and raise questions on the Guidelines - given that their scheduled review of the Bill is expected to continue

until the second calendar quarter of 2012.

The Guidelines are useful in the sense that they explain the Government’s preferred approach to many crucial issues of interpretation and enforcement in relation to the Competition Bill. However, the business sector may continue to question the wisdom of leaving final resolution of these issues to the proposed Competition Commission rather than codifying the position in the text of the Bill. Although it is true that a number of other competition law regimes around the world use ‘flexible’ guidelines to spell out the fine detail on aspects of interpretation and enforcement of their key law, the view may be taken that in a jurisdiction which has not previously had a cross-sector competition law there is a need for more certainty on such aspects during the debate about whether the law is right for Hong Kong, not after.

In particular, while good arguments can be made for ensuring the approach to issues such as application of exclusions and exemptions can evolve and adapt to changing circumstances over time, it can equally be argued that issues such as:

- whether or not vertical agreements can be challenged under the First Conduct Rule; and
- the threshold of restriction or distortion of competition that will be actionable,

are so fundamental and far-reaching that you cannot properly have a debate on the merits of the proposed law without knowing - with certainty, rather than on an indicative basis - the approach that would apply on such issues if the law was to come into effect.

For now, however, the business sector remains ‘in the dark’ on such issues, and many in the business sector will consider that only amendments to the Competition Bill will remove the shadow of uncertainty.

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