

Hong Kong Competition Law Series: Part 14

2015 - THE YEAR OF COMPETITION IN HONG KONG

Horizontal Cooperation Agreements

Collaborative agreements between businesses are often commercially attractive and can generate significant economic benefit through combining complementary activities, skills or assets. Businesses may save costs, increase investment and pool know-how; consumers benefit from enhanced product quality, variety and innovation.



WHEN ARE COOPERATION AGREEMENTS “HORIZONTAL”?

Agreements between businesses that are actual or potential competitors are “horizontal” cooperation agreements. Businesses active on the same market are actual competitors, and a business is a potential competitor of another business if, despite not being active on the same market, the business can realistically enter the market within a short period of time¹.

On the other hand, horizontal cooperation may, under certain circumstances, especially where one of the parties has market power, lead to competition problems.

WHAT ARE THE USUAL TYPES OF HORIZONTAL COOPERATION AGREEMENTS?

The following are some of the more common types of horizontal cooperation agreements:

Production	Production is carried out by one ² , two, or more parties, or through a jointly controlled separate legal entity.
Bidding	Businesses submit a bid in their joint names, engaging in open, rather than covert, cooperation.
Commercialisation	Sales-related collaboration, such as selling, distribution and marketing.
Research & Development	Businesses may outsource or jointly engage in R&D work. The scope of cooperation may extend to joint production or commercialisation of the fruits of R&D collaboration.
Purchasing	Joint purchasing or buying arrangements consolidate buyer power which allows the cooperating businesses to drive a better bargain than they would otherwise have been able to.
Standardisation	Uniform technical, quality or safety requirements are agreed and set for complex products or services.

¹ The length of time required to enter the market will depend on the legal and economic context of the agreement, the characteristics of the relevant market and whether the potential competitor is a party to the agreement, or a third party. In the European Union, two to three years may be taken as a ballpark for a short period of time.

² Production JVs include specialisation agreements where one party produces and the other purchases from that party, or each party specialises in the production of different goods and purchase from each other.

WHAT ARE THE POTENTIAL HARMS OF HORIZONTAL COOPERATION?

Depending on the market power of the parties, the market structure, the type of agreement and extent of cooperation between the parties to the agreement, horizontal cooperation may raise the following competition law concerns:

The risk of collusion

- The disclosure of strategic information may undermine the parties' decision-making independence.
- The parties' cooperation may lead to a significant commonality of costs, in turn affecting prices and output.
- Exchanges of commercially sensitive information may spill over to areas outside the scope of cooperation.

The risk of reduced competition

- Unrelated competitors may suffer a significant disadvantage to the cooperating businesses and new entry may be foreclosed by the increased strength of incumbent market power.
- The incentives of one business to expand or enter the market of the other may be reduced.
- Competitive constraint to the cooperating parties may decrease, resulting in higher prices, reduced product variety and choice.

Generally, cooperation objectively necessary for businesses (often SMEs) to launch a product or service will not be anti-competitive.

Even where horizontal cooperation may have the effect of harming competition, it may not be prohibited by competition law if the parties are able to demonstrate that they generate sufficient benefit to justify the harmful effects of their cooperation.

CAN YOU DO IT?

Whether a horizontal cooperation agreement may be entered into and how it can be implemented will often depend on what the parties want to do, its potential effects on competition and how the agreement is structured to manage those effects. As horizontal cooperation agreements vary significantly in aim, scope and complexity, there is no one size fits all solution and agreements should be analysed on a case by case basis.

The potential competition law risks of horizontal cooperation can often be managed by putting in appropriate and effective safeguards. When in doubt it may be advisable to seek legal advice at the earliest opportunity to ensure the envisaged cooperation is compliant from the outset.

Next Week

This concludes our discussion on the First Conduct Rule. Next week we will take a look at abuse of substantial market power, i.e., the Second Conduct Rule.

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