

REGULATORY NEWS

Hong Kong Competition Commission Publishes Draft Guidelines - a key step toward bringing the Competition Ordinance into full force

The Hong Kong Competition Commission (the "**Commission**") has published a set of draft guidelines (the "**Guidelines**") on 9 October 2014 for public consultation. These guidelines, upon finalization, will be submitted to the Legislative Council for consultation and adoption. The Commission expects that this process will be completed in the first half of 2015, and then the Hong Kong Competition Ordinance (the "**Ordinance**"), passed in June 2012, will come into full force.

The draft package includes three procedural (items 1-3 below) and three substantive (items 4-6 below) guidelines. The public is invited to submit views and comments on the procedural guidelines before 10 November 2014 and those on the substantive guidelines before 10 December 2014. Following are the Guidelines:

1. Guideline on Complaints
2. Guideline on Investigations
3. Guideline on Applications for a Decision under Section 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders
4. Guideline on the First Conduct Rule
5. Guideline on the Second Conduct Rule
6. Guideline on the Merger Rule

The Guidelines show lots of commonality with competition rules and practices of other jurisdictions with long established competition regimes. The Commission recognizes the benefit resulting from a competition regime that is consistent with the international best practice. Below are a few highlights for those doing business in Hong Kong.

Investigations

The Commission can launch an investigation on its own initiative, upon complaints, upon referrals from the government, the courts or other statutory bodies or authorities. Investigations will be conducted in two phases: (1) the initial assessment phase, during which the Commission determines the sufficiency of the evidence and the worth of further investigation; it will seek

information on a voluntary basis; and (2) the investigation phase, which is triggered when the Commission has reasonable cause to suspect a contravention of competition rules; during this phase, the Commission may exercise its power to compel the production of evidence. To enter and search specific premises, the Commission will first have to obtain a search warrant from a judge of the Court of First Instance. The premises can include those of a supplier or customer of the firm under investigation. Similar on-site inspections and searches are usually referred to as dawn raids in the European Union; note that the Commission undertakes that in Hong Kong such searches will normally start during usual office hours. Detailed rules are provided to specify the scenarios in which the Commission may conduct a dawn raid, how such a raid should be carried out, and protections regarding confidentiality and legal privilege. The Hong Kong procedural guides should help ease concerns in the business community over the future conduct of such raids in the Special Administration Region following a recent storm of raids carried out by competition regulators in the neighboring Mainland China. The Guideline on Investigations provides that commitment can be made at any stage of the investigation to end the investigation.

Complaints

Although anyone can make a complaint to the Commission of a suspected violation of the Ordinance, the Commission will have the discretion to decide which cases to pursue. This will ensure that the Commission's resources focus on protecting the public interest instead of the interest of the complainant. The Guideline on Complaints sets out a range of factors that the Commission will consider when making such a decision.

Exemptions and exclusions

The Guideline on Exemptions and Exclusions sets out criteria and procedures for application of an exemption or exclusion order. However, obtaining a prior decision or (block) exemption order from the Commission is not a precondition for asserting the benefit of an exemption or exclusion provided in the Ordinance. The Commission encourages firms and industries to conduct a self-assessment on the compatibility of their conduct with the Ordinance. The Commission sees a sector-specific block exemption order (exempting certain categories of agreements) as an exceptional measure and will grant one only in limited cases. As the assessment of a block exemption order is often costly in terms of time and resources, the Commission will balance the resource requirement with the expected public benefit of issuing a block exemption order.

Resale price maintenance

In a vertical agreement (typically a distribution agreement), if a supplier imposes a fixed or minimum resale price onto its distributors or retailers ("**resale price maintenance**" or "**RPM**"),

the Commission views the arrangement as having an illegal object. In such cases, whether the arrangement causes any anti-competitive effects in the market is irrelevant. Possible scenarios in which efficiencies may arise include, among others, the introduction of new products, launch of a promotion campaign and prevention of free rides. However, the Commission's assessment will be made on a case-by-case basis. The Commission notes that RPM may in certain cases amount to serious anti-competitive conduct under the Ordinance, with the consequence that (1) the Commission may commence proceedings before the Tribunal without issuing a warning notice to the parties and (2) the *de minimis* threshold (exempting companies whose combined turnover does not exceed HK\$200 million) does not apply.

RPM has been actively enforced in Mainland China for the past two years. Heavy fines have been imposed on liquor producers, baby milk formula companies, optical manufacturers and automakers. However, as China put in place its nascent Anti-Monopoly Law, it did not deliberately prioritize the RPM enforcement; rather, the RPM enforcement was driven by a series of complaints from disgruntled distributors and facilitated by the availability of evidence.

Hong Kong, where retail and consumer business accounts for an important part of the city's economy, seems to plan to prioritize the anti-competitive issues in distribution chains as it commences the enforcement of the new law. In a radio interview in Hong Kong on 17 October 2014, a member of the Commission indicated that the Commission will take an active enforcement approach towards RPM practices in Hong Kong.

Trade associations

The Guideline on First Conduct Rule clarifies that information exchanges at trade associations, or price recommendations by a trade association or professional body – practices which may have been common in Hong Kong for decades – can be seen as having an anti-competitive object or effect. It also discusses such issues as standard contractual terms promoted by the trade association, terms of membership in trade associations and the practice of certifying or awarding quality labels to member companies for meeting certain minimum industry standards. The Commission sets out scenarios in which such activities are unlikely to raise Commission concerns and scenarios in which these activities may have an anti-competitive object or effect.

Substantial market power

The Second Conduct Rule of the Ordinance addresses the abuse of substantial market power by engaging in anti-competitive conduct. Examples of such abusive behavior include predatory pricing, tying and bundling, margin squeezes, refusal to deal, exclusive dealing. During the

Ordinance's legislative process there was a debate over where to set market share thresholds. Ultimately, the Guidelines do not set a market share threshold. The Commission wants to take an economic approach to defining substantial market power, and market share is only one factor in the assessment of market power. The Commission will further consider a set of factors, among them the firm's pricing power and market entry barriers. As the new competition regime begins, this approach is likely prudent for an economy which is dynamic and open to international businesses.

Joint ventures

In many jurisdictions, joint ventures are an usual subject of merger control. As Hong Kong's merger control rules apply only in telecommunication sector, there is no cross sector merger control for joint venture business. However, a joint venture which does not "perform, on a lasting basis, all the function of an autonomous economic entity" (similar to the EU distinction between full-function and non-full-function joint ventures) will have to ensure that the cooperation business complies with both Conduct Rules addressing agreements and dominance under the Ordinance. Such deals include, for example, joint production, joint purchasing, joint commercialization and joint R&D ventures. The Commission provides a few useful criteria for determining the full functionality of a joint venture.

Next steps

The Commission intends to release three further documents in the coming months covering small- and medium-sized enterprises, leniency and enforcement policy. We will provide further updates as they become available. If you would like to discuss any aspect of the Guidelines or evaluate their impact on your business, please feel free to contact us.

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