Competition Commission's Consultation on Draft Guidelines under the Competition Ordinance (Cap 619)

Submission of the Hong Kong Bar Association

A. Overview

1. The Hong Kong Bar Association ("**HKBA**") makes its submission on the Draft Guidelines under the Competition Ordinance 2014 issued by the Competition Commission (the **"Commission"**) and the Communications Authority (the **"Authority"**) for public comment. There are altogether six Draft Guidelines. The HKBA submits comments on each of them under the sections that follow. The Guidelines in their final form will be jointly issued by the Commission and the Authority under section 35(1) of the Competition Ordinance (Cap 619) (the **"Ordinance"**).

2. The Commission is empowered under the Ordinance as the principal competition authority responsible for its enforcement. Three of the Draft Guidelines set out how the Commission intends to interpret and give effect to the First Conduct Rule, the Second Conduct Rule and the Merger Rule under the Ordinance. The other three of the Draft Guidelines set out how the Commission intends to receive complaints, conduct investigations and consider applications for decisions on exclusions and exemptions and for block exemption orders.

3. It may be noted that under section 35(8) of the Ordinance, the Guidelines issued by the Commission do not have the status of subsidiary legislation. However, in

line with the prevalent view under the EU regime, it is suggested that the Guideline should be recognized as "soft law", and the adoption and the publication of which would produce the legitimate expectation that the Commission will apply them in the cases that it deals with. In light of this, the HKBA suggested that the *Draft Guidelines* should clarify the precise legal effect of the Guideline upon adoption and publication. Reference in this connection can probably be made to the "overarching approach" and "key consequences" discussed in pages 3 to 5 of the *Overview of Draft Guidelines under the Competition Ordinance – 2014*, which was issued at the same time as the Draft Guidelines.

4. The HKBA also finds it useful to refer to the opinion of Professor Richard Whish of 29 April 2004 to the Telecommunications Authority concerning guidelines: "*guidelines must strike the correct balance between providing practical advice to the business, investment and legal communities as to what might be expected of a system of … control on the one hand and avoiding too much hypothesis and speculation, which can lead to a loss of clarity, on the other hand. It is impossible to address every possible issue of 'what might happen' in advance; it is inevitable that there will be something of a learning process for all stakeholders as a new system of … control is introduced, and it is important therefore to review from time to time any guidelines that have been written in the light of relevant experience of the legislation in practice*".

B. Draft Guideline on the First Conduct Rule (*Draft Guideline 1CR)*

5. The First Conduct Rule as provided under section 6(1) of the Ordinance is introduced under *Draft Guideline 1CR §1.4*. This section is in similar terms as

the prohibition under Article 101 of the Treaty on the Functioning of the European Union (**"TFEU"**), and the Chapter I Prohibition under the UK Competition Act 1998. This Submission will also make references to the corresponding EU position where applicable. However some caution must be exercised when reference is made to the EU position, especially with regards to areas in which the Hong Kong position may be relevantly different to that of EU regime. By way of example, it is suggested that any reasoning of the European Commission and/or the European Courts based on EU's single market imperative (*e.g.* absolute territorial protection under Article 101(1) TFEU) should have no applicability in Hong Kong.

"Undertaking"

6. *Draft Guideline 1CR §§2.2 to 2.11* discuss the notion of "undertaking" under the First Conduct Rule. It is stated under *Draft Guideline 1CR §2.2* that "*[t]he key question is whether the relevant entity is engaged in an economic activity*", and under *Draft Guideline 1CR §2.3* an "economic activity" is said to be "*generally understood to refer to any activity consisting in offering goods or services in a market regardless of whether the activity is intended to earn of profit*". This position is in line with that adopted in the European Cases of Case C-41/90 Höfner and Elser v Macrotron [1991] ECR I-1979 and Case C-67/96 Albany Internatioal BV v Stichting Bedriifspensioenfounds Textielindustrie [1999] ECR I-5751.

7. It is suggested that further elaboration can be made to *Draft Guideline 1CR §§2.2 and 2.3*, in particular as to the "functional approach" which should be applied to the concept of "undertaking". This should be understood as a relative concept, and one which focuses on the substance of the activity rather than the

form of the entity. Hence an entity may be considered an undertaking when it engages in some activities but not when it engages in others: Case C-364/92 SAT Fluggesellshaft mbH v Eurocontrol [1994] ECR I-43.

8. Moreover, it should be noted that activities provided on the basis of "solidarity" (*e.g.* provision of social protection such as social security or health care) are not "economic": *cf.* Case T-319/99 FENIN v Commission [2003] ECR II-357, §37 (upheld on appeal Case C-205/03P, [2006] ECR I-6295). The European Court of Justice ("**ECJ**") in FENIN upheld a decision of the European General Court that public bodies through the provision of free health care at the point of delivery were acting on the basis of "solidarity", and hence they would not be acting as "undertakings". However, a different conclusion on similar facts was found by the UK Competition Appeal Tribunal (the **"CAT"**) in BetterCare v The Director General of Fair Trading (Case No 1006/2/1/01, [2002] Competition Appeal Reports 299), in which the decisive factor was held to be whether the entity in question was in a position to generate effects which the competition rules seek to prevent.

9. The *Draft Guideline 1CR* does not give any guidance as to the notion of "solidarity" in this context, or whether the Commission would prefer the approach taken by the ECH in FENIN or the CAT in BetterCare. It would be helpful for the *Draft Guideline* to provide further analysis on this aspect.

10. Furthermore, the *Draft Guideline 1CR* does not indicate whether activities connected with the exercise of the powers of a public authority could be considered "economic". The settled EU and UK position is that such activities are not "economic": see Case C-309/99 Wouters v Algemene Raad van de Nederlandsche Orde van Advocaten [2002] ECR I-1577, §57. It is suggested

that the position of the Commission on this point should be clarified in the *Draft Guideline*.

11. *Draft Guideline 1CR §§2.4 to 2.7* address the notion of "single economic unit". It is suggested that more elaboration may be provided under *Draft Guideline 1CR §2.6*, which primarily relies on the consideration of "decisive influence". On the question of "single economic unit", a crucial question is whether an entity enjoys "real autonomy" from another in determining its course of action in the market: Case C-73/95 P Viho v Commission [1996] ECR I-5457, §16. In the typical scenario involving parent and subsidiary companies, the relevant factors may include (a) the shareholding that a parent company has in its subsidiary; (b) the composition of the board of directors; and (c) the extent to which the parent influences the policy of or issues instructions to the subsidiary: see Case 107/82 AEG-Telefunken v Commission [1983] ECR 3151, §§47-53.

12. As to *Draft Guideline 1CR §§2.8 to 2.11* which deal with "agents and distributors", it is noted that the Commission will consider the criterion of *risk*, and that the inquiry looks to the economic reality rather than the legal form. In this respect, it would be helpful for the Commission to set out examples as to when the First Conduct Rule would be inapplicable in an "agency" setting. By way of example, in the European Commission's *Guidelines on Vertical Restraints 2010* (OJ 2010, No. C130/01) (the **"Vertical Guidelines"**), it provided a non-exhaustive list for which an agreement would not generally be considered an agency agreement, and such include where "*property in the contract goods bought or sold does not vest in the agent*" (§16). A similar list could be set out under the *Draft Guideline* as an aid to understanding the Commission's approach to agency agreements.

"Agreement", "Concerted Practice" and "Decision by an Association of Undertakings"

13. *Draft Guideline 1CR §§2.12 to 2.14* deal with the notion of an "agreement" under section 2(1) of the Ordinance. In addition to the analysis provided, it may be helpful to clarify whether the Commission would in appropriate cases adopt a "joint classification" of an agreement *"and/or"* a concerted practice, as was held in Cases T-305-7 etc Limburgse Vinyl Maatschapij NV and Or. v Commission [1999] ECR II-931. The Commission should also clarify the applicability and/or scope of the notion of a "single, overall agreement", for which undertakings may bear responsibility even though they may not be involved in every aspect of the decision-making: see Case T-1/89 Rhône Poulenc v Commission [1991] ECR II-867, §126.

14. As to *Draft Guideline 1CR §2.14*, it should be clarified as to what steps an undertaking must or should take in order to "publically distance" itself from the agreement, and whether such means of excluding liability would be interpreted narrowly, as in Case T-302/02 Westfalen Gassen Nederland BV [2006] ECR II-4567.

15. *Draft Guideline 1CR §§2.15 to 2.18* address the concept of "concerted practice", and in the opinion of the HKBA, it was correct to state the distinction between parallel behavior on the one hand, and concerted practice on the other. However, it may be clarified that the existence of parallel behavior may constitute *circumstantial evidence* of a concerted practice, although it is not conclusive of such where there are other plausible explanations for such parallel behavior: *cf.* Case 48/69 Imperial Chemicals Industries (ICI) v Commission (the

"Dyestuffs" case) [1972] ECR 619; Cases 40/73 *etc* Suiker Unie and Ors. v Commission [1975] ECR 1663.

16. *Draft Guideline 1CR §§2.19-2.24* address "decisions" by an "association of undertakings". This notion is designed to encompass cartel activity between individual undertakings achieved through the medium of an "association of undertakings", most notably in practice through a trade association. Under *Draft Guideline 1CR §2.20*, it is suggested that the Commission should clarify whether an association of undertakings may be subject to the First Conduct Rule, even though it does have to have a commercial or economic activity of its own: *cf.* Cases T-25/95 *etc* Cimenteries CBR SA v Commission [2000] ECR II-491, §1320.

The "Object" and "Effect" of Harming Competition

17. *Draft Guideline 1CR §3* deal with the *object* or *effect* of an agreement to harm competition in Hong Kong. Under the wording of section 6 of the Ordinance, it is clear that the phrase "object or effect" is to be read disjunctively. It is first necessary to consider the *object* of an agreement; and it is only where it cannot be shown that the agreement has an anti-competitive object, would it be necessary to consider whether it would have an anti-competitive *effect*.

18. *Draft Guideline 1CR §§3.4 to 3.10* deal primarily with the *object* of harming competition. One aspect which may require clearer elaboration is that where an agreement is found to be an infringement by *object*, a party to such an agreement *cannot argue* that such agreement does not have the effect of harming competition: *cf.* Cases 56 and 58/64 Consten and Grundig v Commission [1966] ECR 299. In such a situation, a party can only assert that

the agreement has efficiency-enhancing effects under the criteria of Schedule 1, section 1 of the Ordinance.

19. *Draft Guideline 1CR §3.9* introduces section 7(2) of the Ordinance, which provides that an anti-competitive object may be ascertained by inference. The *Draft Guideline* states that an inference may be necessary from the underlying facts and the specific circumstances, but it does not give any further elaboration or guidance on how such inferences are drawn. It is suggested that further clarification (and possibly examples) in this respect would be helpful.

20. The *effect* of harming competition is dealt with under *Draft Guideline 1CR §§3.11-3.18*. *Draft Guideline 1CR §3.12* discusses that for an agreement to have an anti-competitive effect on competition, it must have (or be likely to have) an adverse effect on one or more of the parameters of competition in the market. However, the *Draft Guideline* gives no indication as to whether the relevance or otherwise of the *extent* of adverse impact on competition, namely whether a minimum threshold must be passed before there would be a finding as to an infringement by *effect*. By way of comparison, under the EU and the UK competition regimes, negative effects on competition which are not appreciable or insignificant would not amount to an *effect* infringement: see Case 5/69 Völk v Vervaecke [1969] ECR 295. Similarly, further clarification would be helpful in relation to the Commission's approach in cases where the anticompetitive effect may merely be transient or temporary.

21. It is suggested that the Commission's approach to section 7(3) of the Ordinance (see *Draft Guideline 1CR §3.12*) also requires further elaboration. The section provides that if an agreement has more than one effect, it is considered to have an anti-competitive effect if one of its effects is anti-competitive. It is suggested

that this may potentially cause difficulties in practice, as it is conceivable that an agreement may have other *pro*-competitive effects which far outweigh any *anti*-competitive effects. In such circumstances, it should be clarified whether the Commission would view the agreement as having an anti-competitive effect, and/or whether the party to such an agreement should then find recourse under Schedule 1, section 1 of the Ordinance.

22. As to "ancillary restrictions" under *Draft Guideline 1CR §§3.19-3.23*, it is suggested that the Commission may give further guidance on the notions of "commercial ancillarity" and "regulatory ancillarity", which have been recognized under the EU and UK regimes. For example, it may be stated clearly that "*commercial ancillarity*" cover restrictions which are necessary to enable the parties to an agreement to achieve a legitimate commercial purpose, *e.g.* the penetration of a new market, the sale of a business, *etc*: see Case 42/84 Remia BV and Nv Verenigde Bedrijven Nutricia v Commission [1985] ECR 2545; Bookmakers' Afternoon Greyhound Services Ltd v Amalgamated Racing Ltd [2008] EWHC 1978 (Ch) (upheld on appeal [2009] EWCA Civ 750).

23. More controversially, the notion of "*regulatory ancillarity*" has been recognized in the ECJ judgment in Case C-309/99 Wouters v Algemene Raad van de Nedelandsche Orde van Advocaten [2002] ECR I-1544, in which it was held a restriction ancillary to a regulatory function for *non-competition* objectives could also fall outside Article 101(1) TFEU (the EU equivalent of the First Conduct Rule). In light of *Wouters*, the Commission should clarify whether (or the extent to which) it is permissible to balance non-competition objections against a restriction of competition, or whether "public interest arguments" could be heard under the First Conduct Rule.

24. The broader point which may require further elaboration is whether, or the extent to which, a variant of the "rule of reason" approach under US law may be applicable under the First Conduct Rule, which call for a case-by-case assessment that involves balancing the agreement's pro- and anti-competitive effect: see *e.g.* Continental TV Inc v GTE Sylvania 433 US 36, 49 (1977). The "rule of reason" approach has been expressly rejected by the European General Court in Case T-112/99 Métropole Télévision v Commission [2001] ECR II-2459 (see in particular §72). This EU position appears to be adopted by the Commission under *Draft Guideline 1CR §4.1*, which states that "*[t]he assessment of efficiencies therefore takes place under section 1 of Schedule 1 of the Ordinance and not under the First Conduct Rule as such*". Further consideration (and clarification) may be necessary as to whether all evidence or analysis of pro-competitive effects should be excluded under the *effects* analysis, or whether the Commission should instead adopt the "rule of reason" approach which may be more in line with the economic realities in individual cases.

Exclusion under Section 1 of Schedule 1 of the Ordinance

25. *Draft Guideline 1CR §§4.1 to 4.4* introduces the exclusion for agreements enhancing overall economic efficiency under Schedule 1, section 1 of the Ordinance, with further elaboration set out under *Draft Guideline 1CR, Annex §2*. In this respect, the *Draft Guideline 1CR* appears to be influenced by the European Commission's *Guidelines on the application of Article 81(3) of the* Treaty (OJ 2004, No. C 101/08) (the **"Article [101(3)] Guidelines"**). At the outset, I have addressed the question as to whether the pro-competitive effects of an agreement should solely be considered at the Schedule 1, section 1 stage (see §24 above), and this will not be repeated here.

26. Under the discussion of the "First Conclusion" of the exemption in *Draft Guideline 1CR, Annex §2.10*, it was stated that "the types of efficiencies mentioned in Schedule 1, section 1 ("*improving production or distribution*" and "*promoting technical or economic progress*") are broad categories covering all objective economic efficiencies". Under *Draft Guideline 1CR, Annex §2.9*, it is clearly stated that the likelihood and magnitude of each claimed efficiency must be demonstrated. This appears to adopt a narrow view to economic efficiency for the purposes of the exempion under Schedule 1, section 1 of the Ordinance.

27. In this light, it should be clarified whether the Commission's interpretation of Schedule 1, section 1 necessarily excludes broader considerations of public interest or policy. It is noteworthy that in Case T-528/93 Métropole Télévision SA v Commission [1996] ECR II-649, §18, the General Court observed that "in the context of an overall assessment, the Commission is entitled to base itself on considerations *connected with the pursuit of the public interest* in order to grant exemption under Article 85(3) of the Treaty [*i.e.* the EU equivalent of Schedule 1, section 1]" (at §118, *emphasis* added).

28. *Draft Guideline 1CR, Annex §§2.15 to 2.17* deal with the "Second Condition" of the exemption, namely that the consumers must receive a fair share of the efficiencies. The section of the *Draft Guideline* appears to lack detailed discussion as to how this "fair share" requirement may be shown by a party to an agreement. For instance, under the EC's *Article [101(3)] Guidelines*, the analytical framework assessing consumer "pass-on" of efficiency gains is firstly balanced against the cost efficiencies (see §§95 to 101), and secondly against other types of qualitative efficiencies (see §§102 to 104). It is suggested that the

Commission should likewise give further guidance as to its approach in this respect.

29. The "Third Condition" relates to the indispensability of the restrictions, and this is addressed under *Draft Guideline 1CR, Annex §§2.18 to 2.19*. The language of indispensability appears to import a very high threshold to be met, and requires that there be "*no other economically practicable and less restrictive means of achieving the claimed efficiencies*" (see *Draft Guideline 1CR, Annex §2.19*). In view of this, it would be helpful for the *Draft Guideline 1CR* to give examples as to the types of restrictions which may be considered "indispensable" by the Commission.

30. *Draft Guideline 1CR, Annex §§2.20 to 2.23* address the "Fourth Condition" of the exemption, namely that in relation to "no elimination of competition". Under *Draft Guideline 1CR, Annex §2.22*, it is stated that sources of potential competition should also be considered. However, the *Draft Guideline* merely note that "*the parties will need to do more than merely assert that barriers to entry are low*", without providing any guidance as to what the parties would need to demonstrate in the context. Under EC'S *Article [101(3)] Guidelines* (at §115), a series of relevant factors are listed in relation to the assessment of entry barriers and the real possibility for new entry on a significant scale, including *e.g.* the regulatory framework, the costs of entry including sunk costs, the minimum efficient scale with the industry, *etc*. It is suggested that the Commission should likewise provide more concrete guidelines in the respect.

<u>*Serious Anti-competitive Conduct*</u>

31. *Draft Guideline 1CR §5* address "serious anti-competitive conduct" under section 2(1) of the Ordinance. Under *Draft Guideline 1CR §5.7*, the view is that the category of Serious Anti-competitive Conduct is an open one. However, the non-exhaustive nature of this list is not apparent from the plain reading of the Section under the Ordinance. Given the significant consequences which may arise if a party is found the have engaged in "serious anti-competitive conduct", it is suggested that the Commission should further elaborate on the non-exhaustive nature of the section 2(1) list, and to give some guidelines as to the circumstances under which certain anti-competitive conduct would be considered "serious" within the meaning of section 2(1).

Agreements that May Infringe the First Conduct Rule

Price Fixing

32. *Draft Guideline 1CR §§6.10 to 6.14* address "price fixing", which will be considered an *object* infringement of the First Conduct rule. Under *Draft Guideline 1CR §6.12*, it is suggested that the discussion on indirect price fixing may be expanded to include more illustrations as to the types of behavior which may be caught under the First Conduct Rule, including for instance restrictions upon advertising, agreements on terms on conditions which limit competition, and agreements on recommended prices, *etc*.: see Whish and Bailey, *Competition Law* (7th Ed.), p.524.

33. It is suggested that reference should also be made to section 2(1)(a) of the Ordinance, which expressly provides that the "fixing, maintaining, increasing or controlling the price for the supply of goods or services" would constitute "serious anti-competitive conduct".

Market Sharing

34. *Draft Guideline 1CR §§6.15 to 6.16* address "market sharing", which will be considered an infringement by *object*. Market sharing is generally viewed as particularly objectionable as it can eliminate competition within a geographic area, and diminish the choice of the consumers. We suggest that the Guideline should clearly state that "market sharing" can constitute "serious anti-competitive conduct" under section 2(1)(b) and/or (c) of the Ordinance.

Output Limitation

35. *Draft Guideline 1CR §§6.17 to 6.19* provide an outline as to "output limitation", which is an *object* infringement under the First Conduct Rule. Agreements to limit output are commonly found as part of wider cartel agreements to fix prices or share markets: see e.g. Cartonboard, OJ 1994 L243/1, [1994] 5 CMLR 877. It is suggested that reference should be made to section 2(1)(c) of the Ordinance, which stipulate that such conduct would constitute "serious anti-competitive conduct".

Bid-Rigging

36. *Draft Guideline 1CR §§6.20 to 6.23* deal with "bid rigging", which is an *object* infringement under the First Conduct Rule. Such conduct will be considered to be "serious anti-competitive conduct" under section 2(1)(d) of the Ordinance. In this respect, the Commission may clarify the position in relation to whether joint bids would infringe the First Conduct Rule in circumstances where cooperation may be carried out openly and made known to the tenderee.

Joint Buying

37. *Draft Guideline 1CR §§6.24 to 6.31* deal with "joint buying", which is not generally an infringement by object unless it serves as a disguised cartel. It may be noted that a two-step analysis for such agreements is set out under EC's *Guidelines on Horizontal Cooperation Agreements* (OJ 2011, C 11/1) (the **"Horizontal Cooperation Guidelines"**), namely that the horizontal agreements (*i.e.* the agreement between the purchasers to buy jointly) would firstly be considered, and if the conclusion is that the cooperation is acceptable, then a further assessment will be necessary to examine the vertical agreements concluded with suppliers or individual sellers (see §195).

38. It should be noted that joint buying agreements may bring about economic benefits such as economies of scale in ordering or transportation which may outweigh restrictive effectives (see §217 of the Horizontal Cooperation Guidelines). Hence, in such cases, an exemption under Schedule 1, section 1 of the Ordinance may be applicable in an appropriate case.

Exchange of Information

39. *Draft Guideline 1CR §§6.32 to 6.43* deal with the "exchange of information", which is an *object* infringement under the First Conduct Rule. We suggest the Draft Guideline should clearly spell out that such conduct will be considered "serious anti-competitive conduct" under section 2(1)(d) of the Ordinance.

40. As to *Draft Guideline 1CR §§6.36 and 6.37* in relation to "Information exchanged *via* customers and suppliers", it may be further clarified whether a supplier may lawfully ask a distributor for price information, provided that he does not pass the information on the other distributors: see Hasselblad v Commission [1984] ECR 883.

Standard Terms and Standardisation Agreements

41. *Draft Guideline 1CR §§6.49 and 6.53* address "standard terms and standardisation agreements". Under *Draft Guideline 1CR §6.33*, it is suggested that further guidance should be given in relation to the effect-based analysis of standardization agreements.

42. The *Draft Guideline 1CR* may address the point that whether standardisation agreements may give rise to anti-competitive effects may depend on whether the members of a standard-setting organisation remain *free to develop alternative* standards or products that do not comply with the agreed standard (see §293 of EC's *Horizontal Cooperation Guideline*). It is further suggested that where (1) participation in standard-setting is *unrestricted* and (2) the procedure for adopting the standard in question is *transparent*, standardisation agreements which (3) contain no obligation to comply with the standard and (4) provide access to the standard on fair, reasonable and non-discriminatory terms should not be considered as restrictive of competition under the First Conduct Rule (see §280 of the *Horizontal Cooperation Guideline*).

Resale Price Restrictions

43. *Draft Guideline 1CR §§6.61 to 6.75* deal with "resale price restrictions", which include resale price maintenance (**"RPM"**) and recommended or maximum prices. Under the *Draft Guideline 1CR*, RPM is considered as an *object* infringement of the First Conduct Rule. *Draft Guideline 1CR §§6.71 to 6.75* address the efficiency justifications for resale price restrictions (including RPM), and it is suggested that this at least brings into question whether RPM should be treated as an *object* infringement in Hong Kong. For instance, the United States position in relation to RPM is different from that of the EU and

the UK, in that a "rule of reason" approach is adopted which looks to the pro-competitive justifications of the use of RPM: Leegin Creative Leather Products, Inc v PSKS, Inc, 551 US 877 (2007)[1]. Hence, the Commission may further consider whether it would be appropriate to treat RPM as an infringement by object as opposed to effect under the First Conduct Rule.

Exclusive Distribution or Exclusive Customer Allocation

44. *Draft Guideline 1CR §§6.61 to 6.75* address exclusive distribution or exclusive customer allocation. As to exclusive distribution agreements, it is suggested that the factors which would be taken into account in the First Conduct Rule analysis should be identified. It should be made clear in the *Draft Guideline* that the *market position* of the supplier and its competitor is of major importance, because the loss of intra-brand competition can only be problematic if inter-brand competition is limited. The stronger the position of the supplier, the more serious is the loss of intra-brand completion (see §153 of the *Vertical Guidelines*). Other relevant factors which the Commission should take into account include the maturity of the market (§158 of the *Vertical Guidelines*) and the level of trade affected (see §159 *Vertical Guidelines*).

45. In relation to the application of Schedule 1, section 1 to exclusive distribution agreements (*Draft Guideline 1CR §6.80*), it is suggested that the case of efficacies is strongest for products which are new, complex or have qualities that are difficult to assess prior to consumption (see §164 *Vertical Guidelines*).

[1] For a recent study of the empirical effects of minimum RPM in the United States, see MacKay, Alexander and Smith, David Aron, The Empirical Effects of Minimum Resale Price Maintenance (June 16, 2014). available at http://ssrn.com/abstract=2513533

Moreover, exclusive distribution may lead to savings in logistic costs due to economies of scale in transport and distribution (see §164 *Vertical Guidelines*).

46. It is suggested that exclusive customer allocation agreements should be treated in a similar way to exclusive distribution agreements. Whereas exclusive allocation agreements may lead to efficacies for the purposes of Schedule 1, section 1, it is suggested that the exemption would not likely apply in cases of allocation of final consumers (see §172 *Vertical Guidelines*).

47. Moreover, it is suggested that the Commission should give guidelines for *selective distribution agreements*, which mandate that products can be brought and resold only by authorized distributors and retailers: see §§174-188 *Vertical Guidelines*; Case 26/16 Metro v Commission [1977] ECR 1875. These agreements may restrict intra-brand competition, foreclose access to the market, soften competition and/or facilitate collusion between suppliers or buyers (§175 *Vertical Guidelines*).

Joint Ventures

48. *Draft Guideline 1CR §§6.81 to 6.92* deal with "joint ventures", and it states that only joint ventures which do not amount to a "merger" under Schedule 7, section 3(4) of the Ordinance would potentially fall within the ambit of the First Conduct Rule. *Draft Guideline 1CR §§6.87 to 6.92* specifically deal with "production joint ventures". For such production agreements, it may be made clear by the Commission that anti-competitive effects are not likely to occur if the parties to the agreement do not have market power in the market in which the competition concerns are assessed (§165 *Guidelines on Horizontal Cooperation Agreements*). Moreover, it is suggested that production agreements which also involve commercialization functions (such as joint

distribution or marketing), in general carry a higher risk of restrictive effects on competition than pure joint production agreements (§167 *Guidelines on Horizontal Cooperation Agreements*).

Services of General Economic Interest

49. *Draft Guideline 1CR, Annex §4* deal with "services of general economic interest" under Section 3, Schedule 1 of the Ordinance. As to the meaning of "general economic interest", the ECJ have recognized that the scope of equivalent TFEU provision could extend beyond conventional utilities, *i.e.* to pension schemes, ambulance services, the treatment of waste material, and the provision of private medical insurance: see Whish and Bailey p.237. Hence, it would be helpful if the Commission could provide further illustrations as to what would constitute "general economic interest" under *Draft Guideline 1CR, Annex §§4.6-4.8*.

50. As to the requirement that the application of the Conduct Rules would obstruct the performance of the particular tasks assigned under *Draft Guideline 1CR, Annex §§4.6-4.8*, the burden on the undertaking seeking the benefit of the exclusion is a heavy one. However, the ECJ has observed that it is not necessary to show that the survival of the undertaking itself be threatened, or that there is no other conceivable measure which would enable those tasks to be performed under the same conditions: *cf.* Cases 157/94 *etc* Commission v Netherlands [1997] ECR I-5699, §§43 and 58. In light of this, it may be helpful for the Guideline to further provide examples as to when an undertaking will be considered to have met this requirement under the Section 3, Schedule 1 exemption.

C. Draft Guideline on the Second Conduct Rule (*Draft Guideline 2CR*)

51. *Draft Guideline 2CR, §1.7* discusses examples in which an undertaking with substantial degree of market power may abuse that power. The Commission may wish to use the four examples set out in Article 102 of the TFEU instead.

Market Definition

52. *Draft Guideline 2CR, Part 2* is concerned with defining the relevant market. The HKBA notes that market definition is not only relevant to the Second Conduct Rule. It is also relevant to the First Conduct Rule and the Merger Rule. Hence the Draft Guidelines on the First Conduct Rule and the Merger Rule make reference to the Draft Guideline on the Second Conduct Rule in relation to market definition. Defining the market is often a very important starting point of competition analysis. Indeed, if the market is properly defined, it would help the Commission to screen out those obvious frivolous and/or vexatious complaints. It is therefore necessary to have a more in-depth guideline on market definition.

53. *Draft Guideline 2CR, Part 2* in its current form appears to have missed out some matters that the HKBA considers to be of importance. For example, the Commission has not explained how it would deal with Cellophane fallacy, which is a particularly acute problem when the Commission defines the market for the purpose of applying the Second Conduct Rule. The Commission has not explained how it would deal with the situation in which there is a chain of substitution either.

54. *Draft Guideline 2CR, §2,31* states that "the Commission will not generally consider *supply-side substitutability* or potential competition *when defining the relevant market*" (emphasis added). In Case 6/72, Europemballage Corp & Continental Can Co Inc v Commission [1973] ECR 215, the ECJ held that the market must be defined by reference both to demand-side and supply-side substitutability. Accordingly, the HKBA considers that *Draft Guideline 2CR, §2,31* is not appropriate. Further reference can be found in §§20-23 of the *European Commission Notice on the Definition of the Relevant market for the Purposes of Community Competition Law* ([1997] OJ C372/5) and its application by the General Court in Case T-446/05 P, Amann & Söhne GmbH & Co KG v Commission [2010] ECR II-1255, §§73-88.

Assessment of Substantial Market Power

55. *Draft Guideline 2CR, Part 3* is concerned with the way of assessing substantial market power. The HKBA notes that the US authority has been using another method called "Upward Pricing Pressure Test" to measure market power in analyzing horizontal mergers.[2] It appears that if such a method is adopted, even the step of defining the market can be dispensed with. The Commission may wish to consider whether it would follow or take account of the approach used by the US authority in this regard either in the Guideline on the Second Conduct Rule or the Guideline on the Merger Rule.

56. The Commission should consider whether there would be a presumption of having a substantial market power if an undertaking's market share exceeds a certain threshold. In particular, the HKBA considers that it is desirable for the

[2] See the revised US Horizontal Merger Guidelines published by the DOJ in 2010. See also OECD Policy Roundtable on market definition DAF/COMP(2012)19 at section 5 of the Background Note.

Commission to clarify if it would follow the approach of the ECJ in Case C-62/86, AKZO v Commission [1991] ECR I-3359, [1993] 5 CMLR 215 to the effect that an undertaking with a market share of 50% or more would be presumed dominant. Such an undertaking would bear the burden of establishing that it is not dominant. As this is a matter that goes to the issue of burden of proof, it is desirable for the Commission to clear this uncertainty in the Guideline.

Examples of Conduct that May Constitute an Abuse

57. *Draft Guideline 2CR, Part 5* is concerned with illustrating conduct that may constitute an abuse of market power. The Commission however has not dealt with some exploitative pricing practices such as excessive pricing and price discrimination in this part. While the HKBA appreciates that the examples provided in the Draft Guideline are non-exhaustive, it is highly desirable to see whether the Commission is going to adopt the ECJ's approach to excessive pricing[3] and price discrimination[4], which are not uncommon in Hong Kong. The Commission may wish to expound also its view on excessive pricing and price discrimination in this part of the Guideline.

D. Draft Guideline on the Merger Rule (*Draft Guideline MR*)

58. Schedule 7 of the Competition Ordinance sets out the Merger Rule and the statutory regime for implementing the Merger Rule. Schedule 7, section 4 provides that the Merger Rule applies only where an undertaking involved in the merger or acquisition is a carrier licensee within the meaning of the

[3] For example, see Case 27/76, *United Brands v Commission* [1978] ECR 207, [1978] 1 CMLR 429 .
[4] For example, see Case C-95/04 P, *British Airways plc v Commission* [2007] ECR I-2331, [2007] 4 CMLR 982.

Telecommunications Ordinance (Cap 106). Section 7P of the Telecommunications Ordinance currently empowers the Authority to regulate changes in relation to carrier licensees. Accordingly, the Merger Rule at present applies to the telecommunications sector and the Commission's jurisdiction under the Competition Ordinance operates concurrently with the Authority's jurisdiction under the Telecommunications Ordinance.

59. The HKBA notes that the *Draft Guideline MR* is substantially similar with the current applicable guidelines of the Authority on *Mergers and Acquisitions in Hong Kong Telecommunications Markets*, which were issued in May 2004. The HKBA commends this approach since this would allow those who are at present subject to the concurrent jurisdictions of the Commission and the Authority to meet regulatory demands by reference to substantially similar methodologies. Particularly, the HKBA notes the same provision for indicative safe harbours in *Draft Guideline MR, §§3.12-3.19*.

60. On the other hand, there are some apparent differences between the *Draft Guideline MR* and the *Mergers and Acquisitions in Hong Kong Telecommunications Markets* (May 2004) that the Commission may give further consideration.

61. *Draft Guideline MR, §2.16* sets out the transactions that the Commission considers are not likely to raise competition concerns under the Merger Rule. The list in this paragraph reproduces the corresponding list in the *Mergers and Acquisitions in Hong Kong Telecommunications Markets* (May 2004) but omits item 1.20(e), namely "bona fide corporate reorganization exercise". The Commission may give further consideration to incorporation of this item.

62. *Draft Guideline MR, Part 4* provides guidance on exclusions from the Merger Rule under Schedule 7, section 8 of the Competition Ordinance, with the assessment criteria based on economic efficiencies. Exclusions from the Merger Rule under the Competition Ordinance might have a substantial similarity with the Authority's public benefit assessment under section 7P(2) of the Telecommunications Ordinance after forming the opinion that a merger or acquisition has or is likely to have the effect of substantially lessening competition. This appears to be reinforced by the Authority's view in *Mergers and Acquisitions in Hong Kong Telecommunications Markets* (May 2004), §5.4 that while "benefit to the public" is not defined in the Telecommunications Ordinance,[5] it "*is more likely to be persuaded by economic reasoning since a merger or acquisition is essentially an economic transaction*". This is a reasonable view, focusing therefore on the maintenance of competitive market structures. It is therefore likely that the two assessments will have a significant degree of overlap, albeit that the Authority may be more likely to consider non-economic benefits to the public. However, it may be useful for the Commission to highlight the regulatory approach under the Competition Ordinance in the *Draft Guideline MR* since whereas the Authority will conduct public benefit assessment on a case by case basis under section 7P of the Telecommunications Ordinance, the Commission acts only upon an application for Decision that meets the criteria of Schedule 7, section 11 of the Competition Ordinance.

E. Draft Guideline on Complaints (*Draft Guideline C*)

[5] Professor Richard Whish remarked in his Opinion of 29 April 2004 to the Telecommunications Authority that the "public benefit" test seems to be specific to Hong Kong law as other jurisdictions took account of differently phrased matters, such as "relevant customer benefits" in the case of the United Kingdom then.

63. *Draft Guideline C, §3.1* concerns disclosure. Under section 127 of the Ordinance, the Commission is required to give prior notice of the proposed disclosure to the complainant if the disclosure of confidential information is to be made lawful by virtue of section 126(1)(a). For the purpose of clarity, it would be useful if the Guideline could state whether, when the Commission is relying on other grounds of disclosure under section 126(1)(b) to (h), prior notice of such proposed disclosure would nonetheless be provided to the complainant.

F. Draft Guideline on Investigations (*Draft Guideline I*)

64. *Draft Guideline I, §3.3* has not been clear when it indicates that "the Commission may seek information using voluntary means". If it means that a person may decide to provide or refuse to provide the information sought, then this ought to be made clear.

65. *Draft Guideline I, §5.1(a)* states that "reasonable cause to suspect…requires a suspicion based on relevant facts and any other information". It is unclear what "any other information" is contemplated in this provision. The HKBA considers that any reasonable suspicion must be based on "relevant facts" and the reference to "any other information" seems otiose and may cause confusion unnecessarily.

66. *Draft Guideline I, §5.4* provides that during the investigation phase, "[the] Commission may continue to seek evidence on a voluntary basis". The HKBA considers that, in order to facilitate the arrival at an agreement (such as by way of a section 60 commitment) between the Commission and the undertaking

being investigated, it is desirable for the Guideline to indicate the Commission's approach regarding the use of "without prejudice" communications. The HKBA notes that such form of communication is often employed in SFC investigations with considerable success. This is particularly important given the Commission's indication in *Draft Guideline I, §6.13* that "information obtained by the Commission in one matter may be used by the Commission in another matter."

67. *Draft Guideline I, §5.15* provides that time extension for compliance with a section 41 and 42 notice will be given "in limited circumstances". However, the sentence that follows contain general considerations which are applicable to all cases and does not suggest any "special circumstances". Given the criminal sanction that may be imposed for a failure to comply with a section 41 and 42 notice, it is desirable that more guidance is given.

68. *Draft Guideline I, §5.32* provides that officers of the Commission will "search, copy and/or *confiscate* relevant documents and equipment" (emphasis supplied). However, under section 50 of the Ordinance, officers of the Commission are empowered to "take possession" of items, and no power to "confiscate" is given. It is suggested that the word "confiscate" should be replaced by the words "to take possession of".

69. Further, *Draft Guideline I, §5.32* provides that officers of the Commission will "seek explanations from individuals present at the premises about any documents which may appear to be relevant". The Guideline, however, does not make clear whether there is an obligation (as opposed to voluntary provision) to provide such explanations in the absence of a section 41 notice and, if so, what authority is being relied upon to support the existence of such a

power to "seek explanations". On the other hand, it is clear that the Guideline itself is not authority for requiring provision of explanations.

70. *Draft Guideline I, §5.38* is concerned with the handling of documents in the possession of the Commission. The HKBA considers that the Guideline should provide for procedures to be followed in case of disagreement regarding the existence or otherwise of legal professional privilege over the subject documents. For instance, the Guideline should provide that documents claimed by a person to be covered by legal professional privilege should be sealed up and should not be read unless and until the existence or otherwise of legal professional privilege is ruled upon by a Court of competent jurisdiction.

G. Draft Guideline on Applications for Exclusion, Exemption and Block Exemption (*Draft Guideline Ex*)

71. The HKBA welcomes the provision in *Draft Guideline Ex, §§1.5-1.6* of the default, automatic attachment of exclusion/exemption under the Ordinance. This may avert the risk of the Commission being inundated with applications for a decision in the early stages of the implementation of the Ordinance.

72. *Draft Guideline Ex, §§5.1-5.3* are concerned with applications for block exemption. The HKBA observes that under the Ordinance, both individual undertakings as well as an association of undertakings may apply to the Commission for the issue of a block exemption order. Yet, *Draft Guideline Ex, §5.3* provides that "[i]n relation to a Block Exemption Applications, the Commission expects the applicant to be representative of a wider industry interest and the applicant must demonstrate that this is the case". It is unclear if

this suggests effectively that the Commission would more readily accede to an application by an association of undertakings which can better show its representativeness than another which is less able to do so.

73. The HKBA also welcomes the emphasis in *Draft Guideline Ex, §§5.4-5.6* of self-assessment among the undertakings themselves before making an application to the Commission. This is one of the underlying themes of the reform brought by the Modernisation Regulation (i.e. *Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty* (OJ L1, 4.1.03)) in the European context. The Commission should better utilise its resources by focusing more on investigating serious non-compliance with competition laws and less on examining individual agreements. The same point is made in respect of *Draft Guideline Ex, §11.4*.

74. *Draft Guideline Ex, §5.15* makes clear that the making of an application does not confer any immunity on the applicant undertaking. The Commission may take enforcement action at its discretion. Yet, the HKBA suggests that as a matter of fairness and good administration, notice should be given before taking any enforcement action should the Commission decline to consider an application to make a decision, or issue a block exemption order.

75. The HKBA further welcomes *Draft Guideline Ex, §§6.11-6.12* of requiring applications not to be of a hypothetical question or agreement. Although this criterion is not found in section 9(2) of the Ordinance, it is an important gateway in the UK OFT Guidelines.

76. *Draft Guideline Ex, §7.3* deals with the stage when the Commission declines an application and states: ""If the Commission declines the Application, it will inform the applicant that it will not consider the Application. Such an outcome does not constitute a Decision. It also does not indicate the Commission's position …" The HKBA considers that this provision would leave an applicant as perplexed as he first approached the Commission and is very undesirable. Where practical, it would be better for the Commission to inform an applicant of the *reasons* for declining his application instead of simply informing him that his application will not be considered. This would parallel a similar requirement to give reasons in the event a Decision is being made: section 11(3) of the Ordinance. Additionally, what then is the *effect* of such a "decline" should also be clarified.

77. *Draft Guideline Ex, §§8.3-8.5* is concerned with engagement with parties likely to be affected, where the Ordinance has specified a period for making representations. The HKBA considers that this part of the Guidelines should address how the Commission would generally deal with representations made or received outside the specified period.

78. *Draft Guideline Ex, §10.9* deals with compliance with the Decision. It is useful to set out here the statutory consequence of resumption of compliance under section 13(2) of the Ordinance.

79. *Draft Guideline Ex, Part 13* is concerned with the issuing of a block exemption. This is a more far-reaching measure than an individualized exemption. Hence the group of persons who should be regarded as "likely to be affected" under section 16(1) of the Ordinance should in this context be subject to a more generous interpretation than the similar expression in section 10(1). Further, this

part of the Guidelines should address how the Commission would generally deal with representations made or received outside the specified period.

80. *Draft Guideline Ex, Part 14* is concerned with acts subsequent to the issuing of a block exemption, including the review of a block exemption. This part of the Guidelines should clarify whether the Commission would generally consider representations made or received outside the publicized period of time.

Dated 12 December 2014.

HONG KONG BAR ASSOCIATION