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# The World of Competition: Two Years into the Hong Kong Competition Ordinance

More than two years have passed since the implementation of the Competition Ordinance (Cap 619 of the laws of Hong Kong) (the ‘Ordinance’) on 14 December 2015 and the Competition Commission (the ‘Commission’) has made limited but significant steps in upholding the competition regime, in particular, two cases have been brought before the Competition Tribunal (the ‘Tribunal’) and the first block exemption order has been issued for vessel sharing agreements in the liner shipping industry. This article provides an overview of the key developments in the competition regime and the significance of these developments for businesses.



## The Law

As a recap, the Ordinance provides for general prohibitions in three areas of anti-competitive conduct through the First Conduct Rule, the Second Conduct Rule and the Merger Rule.

### First Conduct Rule

#### a. Overview

The First Conduct Rule governs anti-competitive conduct involving more than one party. Undertakings, which include any entity and individual engaging in economic activity (the 'Undertakings'), are prohibited from making or giving effect to agreements or engaging in concerted practices or decisions *with an object or effect to prevent, restrict or distort competition in Hong Kong*. In other words, the First Conduct Rule only applies when undertakings enter into certain arrangements with other market players. The First Conduct Rule also has an extra-territorial effect. Even if the whole agreement or concerted practice or any other arrangement is concluded outside Hong Kong, the undertakings will still be caught under the Competition Ordinance if such arrangement has the effect of preventing, restricting or distorting competition in Hong Kong.

#### b. Categorisation and Exclusion

The following are specifically identified as 'serious anti-competitive conduct':

- (1) Price fixing: Fixing, maintaining, increasing or controlling the price for the supply of goods or services;
- (2) Market sharing: Allocating sales, territories, customers or markets for the production or supply of goods or services;
- (3) Output limitation: Fixing, maintaining, controlling, preventing, limiting or eliminating the production or supply of goods or services (including volume and type); and
- (4) Bid rigging: Agreements between competitors not to compete with each other for tenders without the knowledge of the person requesting a tender.

For 'serious anti-competitive conduct', the Commissioner will have the discretion to issue and even publish an infringement notice (requiring the undertaking to make a commitment to cease or discontinue any contravening

acts) or commence enforcement proceedings in the Tribunal directly without notice.

On the contrary, for other anti-competitive conduct not classified as 'serious anti-competitive conduct', it is mandatory for the Commission to issue warning notices before commencing proceedings in the Tribunal. A warning notice will in general require the contravening undertaking to cease the contravening conduct within a certain timeframe and not to continue/repeat afterwards, failing which the Commission may commence proceedings against the contravening undertaking.

#### c. Leniency Policy for Cartel Conduct

Undertakings that have engaged in cartel conduct (that is, breach of the First Conduct Rule) can report to the Commission and enter into a leniency agreement in which the Commission will undertake not to commence proceedings against the undertaking in exchange for cooperation in the investigation. However, only the first undertaking who reported to the Commission will be offered full immunity, which extends to the current directors, officers and employees of the undertaking. For subsequent reporters, the Commission may consider providing a lower level of enforcement action, including recommendations for a reduced pecuniary penalty to the Tribunal, which has the final decision on the level of penalty to be imposed.

### Second Conduct Rule

#### a. Overview

The Second Conduct Rule governs anti-competitive conduct which may involve only one party. Under the Second Conduct Rule, undertakings that have a 'substantial degree of market power' are prohibited from abusing their power to engage in conduct that has the object or effect of preventing, restricting or distorting competition in Hong Kong. The Second Conduct Rule applies only to undertakings with substantial market power acting on its own. This rule aims at prohibiting huge undertakings from dominating the markets from illegitimate use of their marketing power. The existence of substantial degree of market power per se and the use of it in a non-abusive manner, would not render an Undertaking liable under the Second Conduct Rule.

#### b. The Application of the Second Conduct Rule

Whether an undertaking may be caught by the Second Conduct Rule depends largely on how 'market',

'substantial degree of market power' and 'abuse' are interpreted. For the term 'market', the Commission makes reference to the international practice in defining the relevant market for competition laws, which states that the practice is to analyse the relevant substitutable products and geographical boundary of the demand and supply of the products or services in issue. It is likely the Commission will rely on overseas experience as a reference to determine the relevant market.

In relation to 'substantial degree of market power', there is again no clear definition under the Ordinance. The Government indicated that it would take into account international practices and the actual circumstances of Hong Kong, and at present suggested that a market share of 25% should be adopted as the minimum threshold of 'substantial degree of market power'. It is to be noted that while market share is a determining factor in deciding the degree of market power of an undertaking, other factors, such as the undertaking's power to determine the price and barrier for competitors to enter into the relevant market, would also be relevant.

As to 'abuse', under the laws, the conduct of an undertaking would be considered as 'abusive' if it involves: (1) predatory behavior towards competitors; or (2) limiting production, markets and technical development to the prejudice of consumers. Some of the examples of abusive conducts as suggested by the Commission include:

- (a) cut-throat price war, whereby the Undertaking sets prices below costs in the short run to force out competitors;
- (b) tie in sale, whereby the sale of one product is substantially conditional on the other product, and the Undertaking makes use of this to force out competitors;
- (c) an Undertaking which controls the supply of the upstream market, using its market power and/or forcing other suppliers to increase production costs of other competitors or even refusing to deal with the competitors; or
- (d) an exclusive purchase or supply obligation to squeeze out competitors.

## Merger Rule

The last competition rule is the Merger Rule. For the time being it only regulates telecommunications carrier licensees. The Rule provides that these licensees are prohibited from carrying out a merger that has or is likely to have the effect of substantially lessening competition in Hong Kong. The rationale behind the narrow scope of this Rule is that Hong Kong may not yet be ready for extensive merger control. This Rule is subject to review in a few years' time.

## Upcoming Proceedings at the Tribunal First Enforcement Action

On 23 March 2017, the Commission has, for the first time, commenced proceedings in the Tribunal against five information technology ('IT') companies over alleged contravention of the First Conduct Rule by engaging in bid-rigging conduct. The case concerns a tender issued by the Hong Kong Young Women's Christian Association ('YWCA') in July 2016 for the supply and installation of a new IT server system. In the first round of tenders, only one bid was received. As it was a requirement to receive at least five bids, a second round of tenders was instigated and a total of four bids were received from the other four respondents of this case. Upon review, it was found that the formats and contents of the subsequent four bids were highly similar, from which arose suspicion of bid rigging. The Commission claimed that there were collusions to submit 'dummy' bids in order for the first bidder to secure the contract. Remedies sought include pecuniary penalties and a declaration that each company had contravened the First Conduct Rule. The case has been set down by the Tribunal for hearing in June 2018.

## Second Enforcement Action

Five months after its first enforcement action, the Commission brought its second case to the Tribunal in August 2017 against ten construction and engineering companies for alleged contravention of the First Conduct Rule by making and giving effect to a market sharing agreement and a price fixing agreement in relation to the provision of renovation services at Phase 1 of On Tat Estate, a public rental housing estate in Kwun Tong, Kowloon.

The companies allegedly made a market-sharing agreement whereby the supply of decoration works services to tenants of three residential blocks in the public estate was divided amongst them. Each

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company was allocated four floors of each of the three blocks and agreed to:

- (1) refrain from actively seeking business from tenants on the floors allocated to other companies;
- (2) refrain from accepting business from tenants on the floors allocated to the other companies; and
- (3) refer tenants on the floors allocated to the other companies to their allocated companies.

The ten companies were also alleged to have reached a price fixing agreement by using the same promotional leaflets to advertise their services to tenants of the housing estate. The basic renovation packages advertised in the promotional leaflets were offered at the same price to each tenant and the Commission considered that such arrangement had the effect of maintaining or controlling the price of renovation services since the transaction price was either determined or influenced by the prices on the leaflets, which served as the starting or reference point for negotiations or gave

the impression that all companies charged similar prices. Again, the Commission is seeking remedies including pecuniary penalties and a declaration that each company had contravened the First Conduct Rule. The case has been set down by the Tribunal for hearing in November 2018.

The chairperson of the Commission, Ms Anna Wu, has commented that:

Market sharing and price fixing are serious anti-competitive practices which lead to reduced consumer choices and uncompetitively high prices, hurting consumers, other businesses and the economy as a whole. The Commission accords priority to combating such conduct which are particularly egregious when the people directly affected belong to low income groups such as the residents of the relevant public housing estate in the present case.

The case follows the Commission's 2016 report on the market for residential building renovation and

maintenance, where it is often covered in the media for widespread collusive activity in tenders for renovation and maintenance projects. The Commission expressed concern in the participation of contractors in bid-manipulation practices and calls upon the relevant professional bodies to develop appropriate codes of conduct to ensure compliance with the competition laws. Hence, it was no surprise that the Commission chose this case to be its second case before the Tribunal. It appears that the Commission will place the interests of the public as its top enforcement priority and will exercise the full extent of its powers to combat such actions.

### First Block Exemption Order

Shortly before its second enforcement action, the Commission issued its first block exemption order (the 'Order') on 8 August 2017 for vessel sharing agreements in response to the application by the Hong Kong Liner Shipping Association (the 'HKLSA') for two types of agreements to be exempted:

- Vessel Sharing Agreements ('VSAs'): agreements between carriers in which parties agree on certain operational arrangements relating to the provision of liner shipping services, including the joint operation of vessel services, and the exchange or charter of vessel space, similar to code-sharing or alliance agreements of airlines.
- Voluntary Discussion Agreements ('VDAs'): agreements between carriers in which parties discuss commercial issues relating to a particular trade, including freight rates and surcharges, and may reach agreements on pricing recommendations.

A block exemption order is issued for a category of agreement where it satisfies the criteria for the economic efficiency exclusion under the Ordinance and would therefore be exempted from the First Conduct Rule. These agreements include any agreement that:

- contributes to (1) improving production or distribution or (2) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit;
- does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the above efficiencies; and



The Commission expressed concern in the participation of contractors in bid manipulation practices.

- does not afford the undertaking concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question.

Following an 18-month review, the Commission was satisfied that the economic efficiency exclusion under Schedule 1 of the Ordinance was met in respect of VSAs and granted the Order on the following conditions:

- parties to the VSA do not collectively exceed a market share limit of 40%;
- the VSA does not authorise or require shipping lines to engage in cartel conduct; and
- shipping lines are free to withdraw from the VSA without incurring a penalty on giving a reasonable period of notice.

The Order will be valid for a period of five years until 8 August 2022 and it will be reviewed by the Commission a year before its expiry (that is, on or before 8 August 2021).



However, the application for exemption of VDAs was rejected by the Commission, commenting that the efficiency claims submitted by the HKLSA were not supported by sufficient evidence to address the potential restriction of competition resulting from the VDAs.

Being the first BEO issued by the Commission, it is helpful in shedding light on the Commission's reasoning and approach towards granting block exemption applications, in particular the level of evidence that is required to satisfy the economic efficiency exclusion under the Ordinance. Future applicants for the block exemption order will have to take note of the narrow interpretation adopted by the Commission and any claimed efficiencies will have to be supported by clear evidence that they are shared with direct consumers, which presumably would be a high burden to meet.

### Market Study of the Auto-fuel Market

In May 2017, the Commission completed its study of the Hong Kong auto-fuel market and issued a report on its findings. Hong Kong's high petrol prices have often been under the news spotlight. While the Commission was unable to find evidence of anti-competitive conduct

within the market, it identified a number of structural and behavioural features of the market that hindered competition and which the Commission believed would likely have contributed to high prices. These included high seller concentration and a high degree of vertical integration, high barriers for new market players to enter and expand, similar cost structures among the major retailers and limited variation in retail prices across time or geography.

To address these issues, the Commission made a number of recommendations including (1) the re-introduction of alternative cheaper products to provide greater choices for consumers; (2) increasing the number of petrol-filling stations ('PFS') sites; (3) review of the tendering system for PFS sites; (4) prominent display of pump prices and walk-in discounts at PFS; and (5) exploring potential structural reform options.

### Next Steps

From the effective date of the Ordinance to the end of October 2017, the Commission has received over 2,500 enquiries and complaints from the public, of which 60% related to the First Conduct Rule, with a particular focus on the real estate and property management, machinery and equipment and telecommunications sectors. Supported by additional litigation funding of HK\$200 million (approximately US\$26 million) and led by its new senior management including new Chief Executive Officer, Mr Brent Snyder (former deputy assistant attorney general at the antitrust division of the United States Department of Justice), it is expected that the Commission will be actively taking enforcement actions against violations of the competition rules. The decisions that will be issued by the Tribunal later this year on the two cases will also provide important guidance for businesses on the pecuniary penalties for breach of the Ordinance.



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