RESPONSE TO THE HONG KONG COMPETITION COMMISSION'S CONSULTATION ON DRAFT GUIDELINES:

(1) ON THE FIRST CONDUCT RULE

(2) ON THE SECOND CONDUCT RULE

(3) ON THE MERGER RULE

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Freshfields Bruckhaus Deringer

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I. Introduction

1. Freshfields Bruckhaus Deringer LLP welcomes the opportunity to respond to the public consultation on the three draft Guidelines on the First Conduct Rule, the Second Conduct Rule, and the Merger Rule (together, the ***draft Guidelines***).

2. The draft Guidelines have been published by the Hong Kong Competition Commission and the Communications Authority (together, the ***Commission***) as required by the Competition Ordinance (Cap. 619) (the ***Ordinance***). We set out below our general comments, and then address each of the draft Guidelines under consultation in turn. Our comments are based on our significant experience and expertise in advising on competition law proceedings in numerous jurisdictions around the world.

3. The comments contained in this paper reflect the views of many in Freshfields Bruckhaus Deringer LLP. They do not necessarily represent the views of every partner in the firm, nor do they represent the views of our individual clients.

II. Executive Summary

- The draft Guidelines are a welcome guide for companies and a useful insight into how the Commission will approach some important issues.
- We would encourage the Commission to elaborate further in the Guidelines its policy on certain key issues.
- In relation to the draft Guideline on the First Conduct Rule:
    - further clarity would be welcome on the Commission's approach to resale price maintenance;
    - we would suggest an indicative safe harbour for vertical agreements be established in order to reduce compliance costs for businesses; and

- further detailed guidance would be welcome on key areas to enable companies to effectively self-assess and to increase legal certainty.

- In relation to the draft Guideline on the Second Conduct Rule:
  - an indicative market share threshold should be introduced in relation to the assessment of whether an undertaking has a substantial degree of market power; and
  - the guidance on the abuse of a refusal to deal should be amplified.
- In relation to the draft Guideline on the Merger Rule:
  - a public informal "clearance" route should be made available for parties willing to seek the Commission's approval in relation to a reviewable merger; and
  - an indicative timeframe should be introduced for the Commission's merger review.

III. General Comments

4. By the standards of guidance published by new competition authorities, the draft Guidelines are extensive. They provide helpful guidance on the new regime particularly to small and medium size enterprises and companies that have not previously been exposed to competition law.

5. The Commission does not have, by definition, decades of decisions and case-law upon which to draw when elaborating the draft Guidelines, and it is understandable that it has reserved its position or adopted a high level approach in many areas. In many ways, this approach will enable the Commission to develop the Hong Kong competition regime and specifically the guidance relating to the regime, in a manner that is most tailored to Hong Kong. This leads us to make the following overarching observations:

   (a) we would encourage the Commission to treat its statutory obligation to issue guidance as a continuing one, so that the Guidelines are refreshed and re-issued as practice, decisions and case-law develop;

   (b) we would encourage the Commission to elaborate further in the draft Guidelines its policy on certain key issues, drawing – in the Commission's own phrase – on "*international best practices*". Many companies will have a sophisticated understanding of competition law concepts, and necessarily seek far more detailed and precise guidance on substantive and procedural issues. The incorporation of more detail, drawing inspiration from the

reams of guidance published by other authorities, would provide greater legal certainty to businesses; and

(c) we would encourage the Commission to clarify in the draft Guidelines how the overlap between provisions in Ordinance and the Telecommunications Ordinance will be managed by the Competition Commission and the Communications Authority.

IV. Draft Guideline on the First Conduct Rule

6. Our experience of applying guidelines in other jurisdictions in relation to equivalents of the First Conduct Rule has informed our view that it is important that businesses have legal certainty over key issues. In a number of areas, we consider that legal certainty may be compromised by the absence of certain key details. Though the resulting revised guideline on the First Conduct Rule would then be a lengthier document, we think this would be justified in the light of the varying levels of experience and expertise in competition law between undertakings in Hong Kong who will look to such guidance when making decisions in specific instances. It is vitally important that undertakings therefore be given as much assistance as possible. With that in mind, we discuss the various areas in respect of which greater clarity would be most desirable.

The principal / agent relationship

7. The draft Guideline on the First Conduct Rule provides that "*[w]hether an 'agent' is considered a separate undertaking depends upon the economic reality of the 'agency' agreement.*"[1] The draft Guideline then states that the determining factor in identifying whether there is a principal-agent relationship is "*the level of financial or commercial risk borne by the agent in relation to the activities for which it has been appointed as an agent by the principal*".[2]

8. It is generally accepted that the greater the commercial risk taken by an "agent", the more likely it is that the relationship will not be viewed as an agency relationship. However, the wording of paragraph 2.11 of the draft Guideline on the First Conduct Rule - "*agreements between principals and their agents may or may not fall within the First Conduct Rule depending on the facts of the case*"[3] – leaves room for doubt as to the precise consequences of a finding of a principal / agent relationship. For the avoidance of any doubt, we would recommend that the

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[1] See, draft Guideline on the First Conduct Rule, at para 2.9.

[2] *Ibid.*

[3] See, draft Guideline on the First Conduct Rule, at para 2.11.

Commission include a statement that where there is a "*genuine*" agency relationship, the terms of the relationship between principal and agent do not fall within the scope of the First Conduct Rule.

9. It is then important to be certain as to what constitutes a "*genuine*" principal / agent relationship. We would therefore consider it helpful if the Commission were to include further guidance on what factors may be taken into account in determining whether there is, in fact, a principal / agent relationship. Those factors may include whether the agent:

   (a) takes title in the goods bought or sold;

   (b) contributes to the costs relating to the supply or purchase of goods or services;

   (c) contributes to the costs of unsold goods; and / or

   (d) takes responsibility for customers' non-performance (except for losing its commission in relation to that customer).

Franchisor – Franchisee relationship

10. It would be helpful if the Commission were to include a section in the draft Guideline on the First Conduct Rule on another common form of agreement in Hong Kong, franchise agreements. At present, franchise agreements receive only a passing reference in the draft Guideline on the First Conduct Rule.[4]

11. Franchise systems work effectively when each franchisee conforms with the uniform commercial methods laid down by the franchisor. From the consumer's perspective, it is important that all franchised outlets achieve the same standard and the franchisor should therefore be able to impose certain common standards and practices on the franchisee.

12. There currently appears to be no *sui generis* treatment of franchise agreements (as distinct from general distribution agreements) in the draft Guideline on the First Conduct Rule and there may be a risk that this silence will create business uncertainty for franchisors and franchisees which may, in turn, reduce the effectiveness of such distribution channels.

Resale price maintenance

13. The Commission's guidance in the draft Guideline on the First Conduct Rule in respect of resale price maintenance (***RPM***) is welcomed given this area has been

[4] See, draft Guideline on the First Conduct Rule, at para 6.73 in which franchise agreements are discussed in relation to possible efficiencies that would serve to justify resale price maintenance.

the subject of considerable debate and commentary.[5] These debates may serve to explain, in part, the different approaches taken in established competition law regimes such as the United States and the European Union.

14. On a preliminary review, it would appear from the draft Guidelines that the Commission's approach to RPM (i.e. characterisation of RPM as object restriction together with the efficiencies rule) closely resembles that of the European Commission (the ***EC***). It is therefore instructive that, in practice, the EC is generally understood to regard RPM as more or less absolutely prohibited. This may suggest that the Commission is looking to take a "*strict*" approach to RPM (i.e. that it is *per se* illegal).

15. However, the Commission's proposed treatment of RPM needs greater clarification in the draft Guideline on the First Conduct Rule. On the one hand, RPM is considered by the Commission to have the "*object*" of harming competition such that there is no need to examine the effects of the conduct.[6] On the other hand, the listing of three efficiencies in the draft Guideline that could be advanced to justify RPM is likely to create the impression in the Hong Kong business community that RPM is justifiable (perhaps readily so) based on an effects analysis. That impression is likely to be given support by Hypothetical Example 16 which provides an example in which RPM appears to be justified with relative ease.[7]

16. Given the Competition Ordinance will be new for Hong Kong businesses, the draft Guideline on the First Conduct Rule is likely to give rise to some legal uncertainty at the outset. If the Commission is looking to adopt a strict approach in relation to RPM, it should make that clear. That clarity could be achieved, in part, by emphasising in Hypothetical Example 16 the considerable level of evidence and detail required to satisfy an efficiencies justification under Section 1 of Schedule 1 of the Ordinance above and beyond the two reasons provided in the current draft (i.e. low "share of supply" and the short duration of the promotion). If, however, the Commission is considering the adoption of an effects-based approach, the guidance would be very much more useful if it went on to indicate specifically how, in practice, RPM efficiencies might be established. The draft Guideline on the First Conduct Rule provides little guidance on how undertakings may provide evidence of efficiencies and such guidance would be necessary here.

Information exchange – a clearer recognition of the efficiencies

17. In accordance with international best practice, the Commission's draft Guideline on the First Conduct Rule examines the potential anti-competitive effects of

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[5] See, for a helpful summary of the debates, the OECD's Policy Roundtables, *Resale Price Maintenance (2008)*.

[6] See, draft Guideline on the First Conduct Rule, at para 3.4, 3.7, and 6.9 (Figure 1).

[7] See, draft Guideline on the First Conduct Rule, at para 6.75.

information exchange in the market. The section begins with a broad statement that, "*the exchange of information between undertakings may harm competition where it results in undertakings becoming aware of the market strategies of their competitors*."

18. However, we have some concerns that this section of the draft Guideline on the First Conduct Rule is overly broad and appears out of step with best international practice. In particular, it would be helpful to reflect the position that exchanges of information is a common feature in many markets and may give rise to a broad range of efficiencies.[8] The Commission helpfully provides Hypothetical Example 11 which hints at some of these efficiencies but we consider it would be helpful if the benefits of information exchange were drawn out more clearly outside of a Hypothetical Example.

Information exchange – information exchange between customer and supplier ("hub & spoke")

19. Paragraph 6.36 of the draft Guideline on the First Conduct Rule states that competitors may seek to use a third party supplier or distributor as a "*conduit*" for the exchange of information. Paragraph 6.37 then provides that if undertakings exchange information on proposed future pricing intentions with respect to price through a third party such as a common supplier, this will be price fixing.

20. We acknowledge that the indirect exchange of information through a third party, such as a common supplier, can be a breach of competition law. However, a short reference to information exchange through a third party is in our view insufficient. This is a highly complex and controversial area of competition law as it is well-recognised that there is considerable difficulty in distinguishing legitimate commercial conduct from conduct which may be deemed to be anti-competitive.[9]

21. Suppliers and distributors need to exchange commercially sensitive information as part of their standard commercial negotiations. That reality is not currently reflected in the draft Guideline on the First Conduct Rule and there is a clear risk that the draft Guideline may capture and inhibit perfectly legitimate commercial negotiations between a supplier and a distributor. We would recommend that the Commission include a statement in the draft Guideline to the effect that there are

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[8] See, for example, European Commission, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal cooperation agreements* (2011/C 11/01), at para. 57; See also the OECD's Policy Roundtables, *Information Exchanges Between Competitors under Competition Law* (2010).

[9] See, for example, Okeoghene Odudu, *Indirect information exchange: the constituent elements of hub & spoke collusion*, European Competition Journal (Vol 7, No.2), 205 – 242 (at p. 209); see also, European Competition Lawyers Forum (ECLF), *Comments on the Draft Guidelines on the Applicability of Article 101 of the Treaty on the Functioning of the European Union to Horizontal Co-operation Agreements*, 25 June 2010, at para 19.

legitimate commercial reasons why firms at different levels of the supply chain need to pass commercially sensitive information to each other as part of their legitimate day-to-day operations.

22. Moreover, in light of the above considerations, there should also be certain additional factors that would need to be present for "*hub and spoke*" behaviour to amount to an infringement of the First Conduct Rule. A number of those factors have been set out in the relevant UK case law [10] which considers that to demonstrate an infringement of competition rules in the "hub & spoke" context, it is necessary to show that:

    (a) retailer A *must intend* that the information provided to the supplier (the hub) be passed on to retailer B;

    (b) the supplier does *in fact* pass the information on to retailer B; and

    (c) retailer B does *in fact use* the information it receives from the supplier to determine its own pricing.[11]

23. We would recommend that the Commission include these factors in the draft Guideline on the First Conduct Rule. Absent these factors, there will be a real risk of legitimate supplier / customer negotiations falling within the scope of the First Conduct Rule.

Vertical agreements: the need for an indicative safe harbour

24. We welcome the statement by the Commission that while vertical agreements may include provisions which have the object or effect of harming competition, "*vertical agreements are generally less harmful to competition [than horizontal agreements] while offering greater scope for efficiencies*".[12]

25. This position is in line with other competition law regimes where it has widely been acknowledged that in relation to vertical restraints, competition concerns can only arise if there is insufficient competition at one or more levels of trade. There is a general acceptance that some degree of market power is required at the level of the supplier or the buyer (or at both levels) for competition concerns to arise in relation to vertical agreement. [13] In light of that view, certain competition authorities have adopted what are referred to as "*safe harbours*" within which vertical agreements may be presumed to be compatible with the equivalents of the

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[10] See, *Argos, Littlewoods v OFT and JJB v OFT* [2006] EWCA Civ 1318.

[11] *Ibid*, at para 141.

[12] See, draft Guideline on the First Conduct Rule, at para 6.8.

[13] See, for example, the European Commission Guidelines on Vertical Restraints (2010/C 130/01), at para 6.

First Conduct Rule.[14] The "*safe harbours*" typically operate by reference to both the market share of the supplier on the market on which it sells the goods / services and the market share of the buyer on the market on which it buys the goods / services.

26. In a regime in which the Commission is strongly pushing for companies to self-assess their agreements for compatibility with the Ordinance from the outset, we would recommend that the Commission consider including a clear "*safe harbour*" for companies in the draft Guideline on the First Conduct Rule. That safe harbour would serve, in practice, to create a rebuttable presumption that a vertical agreement does not infringe the First Conduct Rule if the supplier and / or buyer fall below certain market share thresholds and there are no restrictions amounting to Serious Anti-Competitive Conduct.[15]

27. The absence of at least an indicative safe harbour will likely increase compliance costs considerably for a great many businesses entering regularly into such agreements. Moreover, in the absence of a clear and meaningful "*safe harbour*", there must be a risk that the Commission will receive a large number of requests for guidance from companies who are unsure as to how the Commission will assess their agreements. A clear and meaningful indicative "*safe harbour*" in relation to the First Conduct Rule would therefore also free up resources at the Commission, because it would then be likely to be less frequently called upon in respect of arrangements that would not typically be expected to raise competition concerns.

28. We therefore consider a meaningful safe harbour would be in all parties' interests and should be introduced.

Detailed guidance required for self-assessment of vertical agreements

29. It is helpful that the Commission has considered and provided guidance in relation to two common vertical agreements: exclusive distribution and exclusive customer allocation. The Commission also makes clear that each such agreement entered into will require the companies to carry out an analysis of its effects or likely effects on competition. Companies will effectively need to self-assess.

30. The Commission rightly states that any evidence that the agreements in question entail economic efficiencies will "*require careful consideration*".[16] However, there is little precise guidance provided to companies as to what factors they need to take into account when conducting such a self-assessment. The absence of detailed guidance and decisional practice of the Commission is likely to have *at least* two implications:

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[14] See, for example, the European Commission Guidelines on Vertical Restraints (2010/C 130/01).

[15] As defined in Section 2(1) of the Ordinance.

[16] See, draft Guideline on the First Conduct Rule, at para 6.80.

(a) it will increase compliance costs considerably for a great many businesses entering regularly into such agreements; and

(b) it does not provide businesses with sufficient legal certainty as businesses will not have a real benchmark against which to measure the competitive effects of the relevant agreement(s).

31. To provide further details on how companies may wish to self-assess such vertical agreements, the Commission could discuss in further detail, among other things:

(a) whether the presence of strong competitors may mean that a reduction in intra-brand competition may be outweighed by inter-brand competition;

(b) how exclusive distribution coupled with single branding may be assessed by the Commission;

(c) whether intra-brand and inter-brand competition may be less relevant in dynamic and fast-evolving markets; and

(d) how the Commission will assess exclusive distribution at different levels of the supply chain (wholesale / retail level).

32. In addition, we note that the draft Guideline on the First Conduct Rule is silent on how the Commission might treat specific types of vertical restraints / agreements including, for example, non-competes, selective distribution agreements and territorial restrictions. As the Commission has made clear that it intends for companies to self-assess the majority of their agreements, it would be helpful if the Commission were to give companies some guidance as to how a broader range of vertical agreements / restraints might be treated under the First Conduct Rule.

V. Draft Guideline on the Second Conduct Rule

33. Our experience of applying guidelines in other jurisdictions in relation to equivalents of the Second Conduct Rule has informed our view that it is important certain key issues are set out as clearly as possible. In that sense, we welcome the draft Guideline on the Second Conduct Rule which presents a clear framework for the analysis of the conduct which may be held to infringe the Second Conduct Rule. However, we have observations on a number of key issues.

Market definition

34. Paragraph 2.4 of the draft Guideline on the Second Conduct Rule states that, "*it should be noted that it will not generally be necessary to define precisely the boundaries of the relevant market in a given case*". Upon review of the draft Guideline on the Second Conduct Rule as a whole, we consider that the

Commission may only leave market definition open in investigations where it concludes that no contravention of the Second Conduct Rule has occurred (for whatever reason). If that is indeed the case, then we would suggest simply amending the opening sentence of paragraph 2.4 to make that clear.

35. If the Commission were, however, to leave market definition open in a case in which it seeks to commence proceedings before the Competition Tribunal or it seeks commitments from the relevant party, we would have serious reservations for the following reasons:

    (a) a substantial degree of market power cannot be assessed in a vacuum, it must be assessed within the relevant product and geographic market;

    (b) assessing the degree of market power enjoyed by the undertaking on the relevant market requires the examination of a number of factors including market share, market concentration, and barriers to entry. These factors would need to be assessed in the context of a clearly defined market;

    (c) it would compromise the rights of the undertaking to defend itself in proceedings before the Commission; and

    (d) such a position would not be in line with international best practice.[17]

Substantial degree of market power – the absence of an indicative market share threshold is likely to create considerable uncertainty

36. As the Commission has commented, it has decided to adopt an "*economic approach*".[18] However, we express reservations that the Commission has decided, on the basis that it is adopting an economic approach to the analysis, not to identify an indicative market share threshold above which a firm will be presumed to have substantial market power or below which an undertaking would clearly fall outside the scope of the Second Conduct Rule. The silence reduces legal certainty.

37. The concerns expressed at the absence of an indicative market share threshold are compounded by debates during the legislative passage of the Ordinance in which a threshold of 25 per cent was debated and gained some traction. The ensuing

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[17] See, for example, Case 6/72, *Europemballage Corp and Continental Can Co Inc v. Commission* [1973] ECR 215, [1973] CMLR 199, at para 32. In this case the European Court identified that it is necessary to define the relevant market before a breach of Article 82 of the EC Treaty (now Article 102 of the Treaty on the Functioning of the European Union) can be established; see also, Case 27/76, *United Brands Company and United Brands Continentaal BV v Commission of the European Communities* [1978] ECR 207, [1978] 1 CMLR 429.

[18] See, Hong Kong Competition Commission, *Overview of Draft Guidelines under the Competition Ordinance – 2014*.

silence in the draft Guideline on the Second Conduct Rule will lead to concerns that the Commission might treat the 25 per cent figure as a focal point.

38. The vacuum created by the absence of an indicative threshold risks materially compromising legal certainty and places the Commission at odds with established antitrust regimes on two counts:

    (a) the absence of an indicative market share threshold; and

    (b) the risk that a figure as low as 25 per cent may become the focal point for establishing a substantial degree of market power. [19]

39. It is understandable that the Commission wishes to retain as much discretion as possible. However, a reasonable indicative market share threshold would serve as a useful screening device for companies to determine whether or not they are more or less likely to be subject to the "*special responsibilities*" imposed by the Second Conduct Rule on companies that hold such a position. Those special responsibilities weigh heavily on undertakings that are subject to the Second Conduct Rule, and the risks for breach are potentially material. The Commission could retain its margin of discretion and yet provide some important assurance to businesses in assessing their responsibilities by including an indicative market share threshold which would serve as some form of "safe harbour" below which an undertaking would clearly fall outside the scope of the Second Conduct Rule.

Refusals to deal

40. We welcome the clarity of the statement from the Commission that a "*refusal to deal by an undertaking with a substantial degree of market power is likely to be abusive in very limited or exceptional circumstances.*" [20] The Commission confirms that undertakings have the right to choose their trading partners and that there may be legitimate commercial reasons for not wishing to engage with a particular counter-party.

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[19] See, for example, European Commission, *Guidance on the enforcement priorities in applying Article 102 on the Treaty on the Functioning of the European Union to abusive exclusionary conduct by dominant undertakings* (2009/C 45/02), at para 14. In the US, many federal courts have taken the position that a 50 per cent market share is a prerequisite for a finding of monopoly, see for example, *Bailey v. Allgas, Inc.*, 284 F.3d 1237, 1250 (11th Cir. 2002), and *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1411 (7th Cir. 1995) (Posner, C.J.); in the UK, The Office of Fair Trading (now the Competition and Markets Authority) has indicated that it is unlikely that dominance will be established below a 40 per cent market share (see para 4.18 of the *Guideline on the Abuse of a Dominant Position* (Office of Fair Trading)); in Japan, a majority (i.e, over 50 per cent) market share is considered by the Japan Fair Trade Commission (the ***JFTC***) in setting its enforcement priorities (see Part 2, para 1 of the *Exclusionary Private Monopolisation Guidelines*).

[20] See, the draft Guideline on the Second Conduct Rule, at para 5.15.

41. However, the draft Guideline on the Second Conduct Rule could usefully provide a little more guidance on when a refusal to deal may amount to an infringement of the Second Conduct Rule. In particular, it would be helpful if more details were provided on the nature of the input which is the subject of any alleged refusal to supply. Specifically, we consider that the Commission should include a statement to the effect that the relevant input is objectively necessary for downstream undertakings to operate in the market. That threshold would involve, among other things, an assessment as to whether there are actual or potential substitutes for the relevant input on which the downstream undertaking could rely.

The need for an efficiencies defence?

42. Under the First Conduct Rule, undertakings can raise efficiencies arguments for conduct that would otherwise infringe the First Conduct Rule. However, there currently appears to be no equivalent efficiency justification under the Second Conduct Rule. It is not immediately obvious as to why there should be a difference of approach between the First and Second Conduct Rules in this sense.

43. Faced with a similar legislative landscape, the European Commission and the European courts have developed a defence which allows defendants to assert that there is an objective justification or other efficiency argument for conduct which would otherwise amount to an abuse of the equivalent of the Second Conduct Rule.[21]

44. We consider that the Second Conduct Rule and the draft Guideline on this rule would benefit from the inclusion of a such defence. If the Commission were to develop such a defence, it may want to consider the conditions that would need to be fulfilled to satisfy the defence. Those conditions may include:

    (a) a finding that the stated efficiencies have been, or are likely, to be achieved;

    (b) the conduct is necessary to the achievement of those efficiencies; and

    (c) the stated efficiencies outweigh any lessening of competition brought about by the particular conduct.

[21] See, for example, Case 27/76, *United Brands Company and United Brands Continentaal BV v Commission of the European Communities* ECR 207 [1978] 1 CMLR 429; see also Case T-30/89, *Hilti v Commission* [1991] 4 CMLR 16; see also, European Commission, *Guidance on the Commission's enforcement priorities in applying Article 102 on the Treaty of the Functioning of the European Union* (2009/C 45/02).

VI. Draft Guideline on the Merger Rule

45. We understand that the draft Guideline on the Merger Rule has been adapted from the existing merger regime which was previously subject to the exclusive jurisdiction of the Communications Authority under the Telecommunication Ordinance (Cap. 106). We note that the Competition Commission and the Communications Authority will publish a memorandum of understanding setting out how the authorities will coordinate their respective functions. That memorandum, once published, will hopefully clarify some of the procedural questions that may arise in the merger context.

46. In the meantime, we would suggest careful consideration be given to the draft Guideline on the Merger Rule to ensure the merger review regime in Hong Kong is effective. In particular, consideration should be given to clarifying certain points in the draft Guideline on the Merger Rule, in a manner consistent with the best practices of other competition authorities. With that in mind, we set out below some suggestions for the Commission's consideration.

Definition of "decisive influence"

47. We note the Commission's adoption of the concept of "*decisive influence*" in assessing whether an undertaking has acquired control over another undertaking, and hence whether the transaction may be subject to the review of the Competition Commission or the Communications Authority (as the case may be).

48. Paragraph 2.5 of the draft Guideline on the Merger Rule defines decisive influence as, "*(i) the ownership of, or the right to use all or part of, the assets of an undertaking; (ii) rights or contracts which enable decisive influence to be exercised with regard to the composition, voting or decisions of any governing body of an undertaking.*"

49. While the definition has set out factors to be considered in assessing whether an undertaking has "*decisive influence*" over another undertaking, we note that the current definition gives rise to a certain circularity. We understand the need for the Commission to retain a certain amount of discretion but it would be helpful if further guidance were provided as to what may amount to "*decisive influence*".

50. There are many international precedents that the Commission could refer to including the European Commission's *Consolidated Jurisdictional Notice on the control of concentrations between undertakings*[22] which also refers to the concept of "*decisive influence*" to determine whether there is a reviewable transaction for merger control purposes.

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[22] See, European Commission, *Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings* (2008/C 95/01).

51. In the Consolidated Jurisdictional Notice, "*decisive influence*" includes situations where one party acquires the right to veto decisions which are essential for the strategic commercial behaviour of the merged entity, such as appointment of senior management and determination of budget, business plan and key investment decisions. We would recommend that the Commission refine the definition of "*decisive influence*" along such lines so as to provide greater clarity to market players.

Incentivising parties to seek merger approval

52. The draft Guideline sets out two possible routes (other than waiting for an investigation) by which undertakings may seek merger approval pursuant to the Merger Rule:

    (a) voluntary notification of a proposed merger for informal advice (the ***informal advice route***); and

    (b) voluntary application for a decision that a merger is excluded from the application of the Merger Rule (the ***decision route***).

53. The informal advice route would be available before the merger is in the public domain and the process would remain confidential.[23] In that context, given the absence of market-testing, it is understandable that the Commission's advice under the informal advice route will be "*non-binding and confidential*".[24]

54. However, it is unclear why the Commission is limiting itself to giving informal views on mergers which are not yet in the public domain. There would be merit in allowing merger parties to notify a merger to seek an informal view from the Commission even if the merger is in the public domain or comes into the public domain (for whatever reason). Such an approach would be akin to the informal procedure adopted by the Australian Competition and Consumer Commission in its merger reviews. The Commission would then, at its discretion, be able to conduct market testing and the Commission's informal view could be made public. Such an approach would seem to be achievable in the existing statutory framework.

55. To not expand the existing informal advice route would risk giving rise to odd outcomes given there is no practical formal route by which merger parties can proactively seek a decision / view from the Commission in relation to a reviewable merger. This may create situations where the competition risk is left unresolved for extended periods of time: should a transaction be closed or not? What should the sale and purchase agreement provide by way of competition conditions precedent? We consider that it would be unrealistic, and in certain cases not possible, to expect parties to wait until the end of the Commission's statutory review period where the

[23] See, the draft Guideline on the Merger Rule, at para 5.4.

[24] See, the draft Guideline on the Merger Rule, at para 5.8.

parties have not been given the opportunity to proactively seek the Commission's views.

56. Certainly the "*decision route*" is not likely to be relied upon by merger parties as it can only be used if one of the following apply, (i) the economic efficiencies of the merger outweigh the adverse effects caused by any lessening of competition, (ii) the statutory bodies exemption applies, or (iii) the person is engaged in specified activities.[25] Therefore, unless the undertaking is an exempted statutory undertaking or a person engaged in specified activities - both of which are narrow exemptions - it can only apply for a decision if it concedes upfront that the merger gives rise to "*lessening of competition*" but that efficiencies outweigh the lessening of competition. The need to concede a lessening of competition upfront coupled with the strong aversion of competition authorities to rely exclusively on efficiencies to approve a merger, is likely to discourage undertakings from seeking a merger clearance on this route.[26] Accordingly, we consider that while in theory this provides a route by which increased certainty might be provided to merging parties, in practice this provision may seldom be used.

A timeframe for clearance

57. In relation to the informal advice route and the decision route, the Commission has provided no timelines for its review of the merger.[27] In relation to the application for a decision that a merger is excluded, the Commission explains that, the time taken to review a merger, "*will depend very much on the nature and complexity of the transaction in question (including the volume of data required to be processed and the timeliness of their availability), and the resources available to the Commission at that point in time.*"[28]

58. We note that the Merger Rule retains a merger control regime which is voluntary and non-suspensory so that in theory (but not in practice) the timelines for the review of a merger are likely to have less significance than under mandatory and suspensory regimes.

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[25] See, the draft Guideline on the Merger Rule, at para. 5.16.

[26] Moreover, according to paragraph 5.19 of the draft Guideline on the Merger Rule, the Commission is not obligated to review every application, but only an application that "*poses novel or unresolved questions of wider importance or public interest*" and "*raises a question of an exclusion under the Ordinance for which there is no clarification in existing case law or decisions of the Commission*". This effectively allows the Commission to disregard certain applications, and again, creates uncertainties for merger parties.

[27] With regards to the informal advice route, paragraph 5.5 of the draft Guideline on the Merger Rule states that, "*There is no timetable for providing informal advice, but the Commission will try to deal with requests within the parties' requested time frame, where that is possible*".

[28] See, the draft Guideline on the Merger Rule, at para 5.21.

59. However, we consider that the merger control regime described in the draft Guideline on the Merger Rule would benefit from, at a minimum, indicative timelines for merger reviews. In particular, we would like to point out that this is not only a departure from international practice, given that most established international regimes provide an indicative time frame for clearance (notwithstanding the complexity of any transaction), but it is also out of line with the existing Hong Kong merger regime under the Telecommunications Ordinance.

60. We would therefore suggest that the Commission provide an indicative time frame for its merger reviews (i.e. informal advice route, decision route and any eventual informal clearance route).

VII. Conclusion

61. We would like to emphasise again that we strongly welcome the Commission's draft Guidelines which provide guidance to businesses on some key points. In providing comments in this response, we are endeavouring to suggest ways in which the Commission could further clarify certain specific issues.

62. We would be happy to provide any further explanation of the points raised in this response, either in a meeting or otherwise. If such further discussion would be helpful, please contact:

Jenny Connolly

Ninette Dodoo

Nicholas French

William Robinson

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