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By post and by email: submissions@compcomm.hk

Submissions on Draft Guidelines
Competition Commission
36/F, Room 3601, Wu Chung House
197-213 Queen's Road East
Wanchai
Hong Kong

Dear Sirs

**DRAFT GUIDELINES**

The Hong Kong Association of Banks ("**HKAB**") writes further to the following draft substantive guidelines published by the Competition Commission (the "**Commission**") on 9 October 2014:

- Draft Guideline on the First Conduct Rule – 2014 (the "**Draft FCR Guideline**");
- Draft Guideline on the Second Conduct Rule – 2014 (the "**Draft SCR Guideline**"); and
- Draft Guideline on the Merger Rule (the "**Draft Merger Rule Guideline**"),

(together, the "**Draft Guidelines**").

HKAB welcomes the Commission's Draft Guidelines and is pleased to present this submission in response to the Consultation Paper. We have adopted the definitions used in the Draft Guidelines throughout this submission.

HKAB notes that the Draft Guidelines are an important step towards implementation of the Ordinance and supports the Commission's objective of providing clear and helpful practical guidance for businesses in Hong Kong ahead of full implementation of the Ordinance. In reviewing the Draft Guidelines, we have sought feedback from our business teams, who have limited (if any) experience of competition law and, in our view, are representative of the target audience in Hong Kong once the Draft Guidelines are finalised.

HKAB notes that the merger rule set out in section 3 of Schedule 7 to the Ordinance will apply only to "*carrier licensees*" under the Telecommunications Ordinance (Cap. 106) and is therefore not currently directly applicable to the banking industry. In light of this, we do not have any specific comments on the Draft Merger Rule Guideline at this stage. We set out our general comments and observations on the Draft Guidelines in the first section of this submission, and then our specific comments on the two guidelines in sections 2 and 3. We also enclose a summary of our recommendations as an Annex to this submission.

## 1. General comments

Additional guidance on conduct that is allowed

1.1 While the Draft Guidelines generally contain helpful guidance on the First and Second Conduct Rules, they are generally focused on providing examples of cases that would infringe the Ordinance. This is of course very helpful in identifying conduct that is *not allowed* under the Ordinance, but HKAB considers that the Hong Kong business community would benefit from additional practical guidance in the Draft Guidelines on conduct that *is allowed* under the Ordinance and/or safe harbours that may assist businesses in Hong Kong in ensuring compliance with the Ordinance.

1.2 For undertakings in Hong Kong that are unfamiliar with competition law, it is very difficult to conduct a competition audit or introduce a compliance programme without indicative thresholds or safe harbours. The danger of not providing any such guidance is that businesses wishing to comply with the Ordinance will not be sufficiently equipped to do so, or they will be forced to take an overly conservative and restrictive approach, which will ultimately harm commercial interests in Hong Kong.

1.3 HKAB therefore **recommends that the Draft FCR Guideline and Draft SCR Guideline be amended to include more practical guidance on conduct and activities that are allowed and/or safe harbours under the Ordinance.** We have included in our specific comments below areas where we consider that such additional guidance and safe harbours would be helpful to businesses in Hong Kong.

Reassurance that the Commission will take into account regulatory requirements

1.4 The banking sector is highly regulated in Hong Kong and members of HKAB are required to comply with all applicable codes of practice (such as the Code of Banking Practice, which is endorsed by the Hong Kong Monetary Authority ("**HKMA**")), circulars and regulatory guidance or directives. Failure to comply could have serious consequences on the banks; for example, the HKMA will view breaches of the Code of Banking Practice as failure in the authorized institution's duty to conduct business in the fit and proper manner required of it. A possible consequence of this is that the authorized institution's banking licence could be

revoked. HKAB considers that the potential consequences are therefore sufficiently serious so as to "*eliminate any margin of autonomy on the part of the undertakings concerned*"[1] (which the Commission has described as being the relevant threshold for the legal requirement exclusion in Section 2 of Schedule 1 to the Ordinance to apply) even though such regulatory requirements are not imposed by an enactment in force or national law applying in Hong Kong.

1.5 At the same time, HKAB members fully support the Ordinance and believe it will benefit both Hong Kong consumers and businesses overall. However, to the extent that there is any potential inconsistency between members' regulatory duties and their obligation to comply with the Ordinance, HKAB would like to seek further guidance from the Commission on how such conflicting obligations should be resolved.

1.6 In particular, it would be helpful for the Commission to provide reassurance, either in the Draft Guidelines or through its enforcement priorities when published, that it will take into account whether conduct or agreements are the result of regulatory requirements (including those set out in circulars, guidance and directives), when deciding on which cases to investigate and assessing the effects on competition.

**(i)** In practice, as illustrated above in the context of the banking industry, members of a regulated industry are obliged to adhere to requirements imposed by a regulator as failure to do so may result in penalties or sanctions being applied by the regulator using statutory powers. In the banking industry, a number of these obligations are to implement requirements issued by the HKMA in the exercise of its statutory functions under the Banking Ordinance (including but not limited to sections 7(3) and 82).

**(ii)** Based on EU case law, agreements between undertakings or decisions of associations of undertakings may fall outside the scope of the Article 101 of the Treaty on the Functioning of the European Union ("**TFEU**") where restrictions on competition are necessary for the implementation of a legitimate regulatory objective:

(a) In *Wouters*,[2] the European Court of Justice held that "*not every agreement between undertakings or every decision of an association of undertakings which restricts the freedom of action of the parties or of one of them necessarily falls within the prohibition laid down*

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[1] Paragraph 3.2 of the Annex to the Draft FCR Guideline and paragraph 6.6 of the Draft SCR Guideline.

[2] C-309/99 – *Wouters v Algemene Raad van de Nederlandse*, paragraphs 97.

*in Article 85(1) of the Treaty. For the purposes of application of that provision to a particular case, account must first of all be taken of the overall context in which the decision of the association of undertakings was taken or produces its effects. More particularly, account must be taken of its objectives, which are here connected with the need to make rules relating to organisation, qualifications, professional ethics, supervision and liability, in order to ensure that the ultimate consumers of legal services and the sound administration of justice are provided with the necessary guarantees in relation to integrity and experience...It has then to be considered whether the consequential effects restrictive of competition are inherent in the pursuit of those objectives*". In applying this approach, the court recognised "*the proper practice of the legal profession*" as a legitimate objective.[3]

(b) More recently in 2013, in its preliminary ruling in *Ordem dos Tecnicos Oficiais de Contas v Autoridade de Concorrencia*,[4] the European Court of Justice cited *Wouters* and considered whether the restrictive effects in question were necessary for the implementation of the objective to "*guarantee the quality of the services offered by chartered accountants*" and did not go beyond what was necessary to ensure the pursuit of that objective.[5]

(c) Similarly, in its preliminary ruling in another 2013 case, *Consiglio nazionale dei geologi*, [6] when considering the effects of a requirement prohibiting the application of fee scales which are not "*commensurate with the dignity of the geologist profession*", the European Court of Justice cited the approach taken in *Wouters*, noting that "*account must be taken of its objectives, which in the present case consist in ensuring that the ultimate consumers of the services in question are provided with the necessary guarantees. It has then to be considered whether the consequential effects restrictive of competition are inherent in the pursuit of those objectives.*"[7]

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[3] *Ibid*, paragraph 110.

[4] C-1/12 - *Ordem dos Tecnicos Oficiais de Contas v Autoridade de Concorrencia.*

[5] *Ibid*, paragraph 93 *et seq.*

[6] C-136/12 - *Consiglio nazionale dei geologi.*

[7] *Ibid*, paragraph 53.

1.7 HKAB therefore **recommends that the Commission clarify in the Draft FCR Guideline and Draft SCR Guideline or through enforcement priorities that it will take into account regulatory requirements (including those set out in circulars, guidance and directives) when deciding on which cases to investigate and assessing the effects on competition.**

Burden of proof that exclusions in Schedule 1 to the Ordinance do not apply should rest on the Commission

1.8 Paragraph 4.3 of the Draft FCR Guideline states that the Commission is of the view that the burden of demonstrating that the terms of the general exclusion in Section 1 of Schedule 1 to the Ordinance are met rests with the undertaking(s) seeking to rely on it.

1.9 The Draft SCR Guideline does not refer to the burden of proof or the standard of proof to be applied for exclusions in Schedule 1 to the Ordinance.

1.10 HKAB notes that the Ordinance is silent as regards whether the burden of proof should rest on the Commission (i.e. to prove that the conditions for the exclusion(s) to apply are not met) or the undertaking seeking to rely on the exclusion(s) (i.e. to prove that the conditions for the exclusion to apply are met) in Schedule 1 to the Ordinance.

1.11 However, in the context of the First Conduct Rule, for example, the basic approach set out in the Ordinance is that the efficiencies exclusion in Section 1 of Schedule 1 to the Ordinance will apply automatically where the relevant conditions are satisfied (as noted in paragraph 4.2 of the Draft FCR Guideline). Indeed, HKAB understands that the Commission intends to encourage undertakings to self-assess whether the exclusion applies in most cases.

1.12 The position in Hong Kong may be contrasted to that in other jurisdictions where there is no automatic exclusion and responsibility for the burden of proof in relation to the equivalent general economic efficiencies exclusion is determined by statute.

1.13 In the EU, for example:

**(i)** Article 101(3) TFEU states that "*The provisions of [Article 101(1)] may, however, be declared inapplicable...*" [emphasis added]; and

**(ii)** Article 2 of 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[8] clearly states that:

> "*...the burden of proving an infringement under Article [101(1)] or Article [102] of the Treaty shall rest on the party or authority alleging the infringement. The undertaking or association of undertakings claiming the benefit of Article [101(3)] of the Treaty shall bear the burden of proving that the conditions of that paragraph are fulfilled.*"

1.14 By contrast, Section 30 of the Ordinance states that: "*The conduct rules do not apply in any of the cases in which they are excluded by or as a result of Schedule 1*". Given that the conduct rules do not apply to cases where the conditions in Schedule 1 are met, this would suggest that it is for the Commission to prove that the conduct rules do apply (i.e. that the conditions in Section 1 of Schedule 1 to the Ordinance are not met) in order to find that an infringement has occurred.

1.15 HKAB is therefore of the view that, for both the First and Second Conduct Rule, it should be for the Commission to prove that the conditions in Schedule 1 to the Ordinance are not met such that the exclusion does not apply.

1.16 Separately, HKAB notes that, as a matter of civil law, the standard of proof for any infringement finding by the Competition Tribunal is the balance of probabilities. To avoid any uncertainty, it would be helpful for the Commission to specify that this is the same standard of proof that it will apply to its investigations in the Draft Guidelines.

1.17 HKAB therefore **recommends that:**

**(i)** **the burden of proof be placed on the Commission to prove that the conditions for the exclusions set out in Schedule 1 to the Ordinance (for example, in relation to the general efficiencies exclusion in Section 1 of Schedule 1) do not apply when alleging an infringement of the First Conduct Rule or the Second Conduct Rule; and**

**(ii)** **the Draft FCR Guideline and the Draft SCR Guideline each be amended to confirm that the standard of proof required is on the balance of probabilities.**

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[8] OJ L 1, 4.1.2003.

## 2. Draft FCR Guideline

Clarify that an economic activity must be capable of being carried on for a profit

2.1 Paragraph 2.3 of the Draft FCR Guideline states that the term "*economic activity*" (as used in the Section 2(1) definition of an "*undertaking*" in the Ordinance) is 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 a profit.

2.2 HKAB notes that the concept of an "*economic activity*" in the context of determining whether an entity is an "*undertaking*" is derived from European Union ("**EU**") competition rules. In the EU, as under Section 2(1) of the Ordinance, an undertaking is an entity that is engaged in an economic activity, regardless of its legal status or the way in which it is financed.[9] Case law provides that it is not necessary that an activity is intended to or does in fact earn a profit, but in order to be economic, an activity must be capable of being carried on, at least in principle, by a private undertaking in order to make a profit.[10]

2.3 As noted by Attorney General Jacobs:

> "*In assessing whether an activity is economic in character, the basic test appears to me to be whether it could, at least in principle, be carried on by a private undertaking in order to make profits. If there were no possibility of a private undertaking carrying on a given activity, there would be no purpose in applying the competition rules to it.*"[11] [Emphasis added]

2.4 This is equally true in respect of the competition rules in Hong Kong.

2.5 HKAB therefore **recommends that the Draft FCR Guideline be amended to clarify that, although an activity does not need to be intended to earn a profit in order to be an "*economic activity*", it must be *capable* of being carried on, at least in principle, by a private undertaking in order to make a profit.**

Explain the concept of "*decisive influence*"

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[9] Case C-41/90 *Höfner and Elser v Macrotron GmbH* [191] ECR I-1979, paragraph 21.

[10] See, for example, Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [2000] 4 C.M.L.R. 446, Jacobs AG, paragraph 311; Joined Cases C180–184/98 Pavlov and Others v Stichting Pensioenfonds Medische Specialisten [2001] 4 C.M.L.R. 1.

[11] Joined Cases C-264/01, C-306/01, C-354/01 and C-355/01 AOK Bundesverband v Ichthyol-Gesellschaft Cordes, Hermani & Co [2004] ECR I-2493, Jacobs AG, paragraph 27.

2.6 Paragraph 2.6 of the Draft FCR Guideline states that whether separate entities form a single economic entity will generally depend on whether one entity exercises "*decisive influence*" over the other entity.

2.7 HKAB notes that the Draft FCR Guideline does not, as currently drafted, provide any guidance on the meaning of the term "*decisive influence*" or the factors that will be taken into consideration when determining whether "*decisive influence*" exists, including whether the Commission will seek to apply a presumption of "*decisive influence*", for example where an undertaking holds all or nearly all the shares in a subsidiary. Such a presumption has been developed through case law in the EU in the context of Article 101(1) TFEU.[12]

2.8 The concept of "*decisive influence*" is significant for businesses in Hong Kong, as not only will it determine whether an assessment under the First Conduct Rule needs to be applied in respect of agreements between undertakings that may form part of a single undertaking, it may ultimately also have an important bearing on parental liability in cases where fines are imposed by the Competition Tribunal. It is therefore vital that clear and sufficient guidance is provided for businesses in Hong Kong to develop the correct understanding of when entities will be considered to comprise a single economic entity as a result of the exercise of "*decisive influence*".

2.9 HKAB therefore **recommends that a detailed explanation of the concept of "*decisive influence*", the factors that will be taken into account when determining whether "*decisive influence*" exists and any presumptions that may apply in this context be provided in the Draft FCR Guideline.**

Provide further guidance on the concept of a "*genuine agent*"

2.10 Paragraph 2.10 of the Draft FCR Guideline explains the Commission's approach to considering whether an entity is a "*genuine agent*", and therefore part of the same undertaking as the principal. In particular, it states that the Commission will consider that an entity is a "*genuine agent*" if it does not bear any or bears only insignificant risks in relation to the contract concluded and/or negotiated on behalf of the principal.

2.11 However, the Draft FCR Guideline does not elaborate on the analysis to be applied in assessing whether a "*genuine agent*" relationship exists. HKAB considers that further guidance is needed on how the Commission proposes to interpret this concept in Hong Kong, in particular whether it will adopt the EU approach to the

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[12] See, for example: C-97/08 *Akzo Nobel and Others v Commission* [2009] ECR I-8237, paragraph 60; and T-299/08 *Elf Aquitaine SA v European Commission* [2011] ECR II-2149, paragraph 57 (upheld by the Court of Justice).

concept of a "*genuine agent*" set out in the European Commission Guidelines on Vertical restraints[13] (the "**EU Vertical Restraints Guidelines**"). For example, additional guidance would be helpful in relation to the following issues:

**(i)** The Draft FCR Guideline does not provide an explanation or examples of the types of risk (e.g. contract-specific risks or investments, market-specific risks or investments etc.) that will be relevant to the assessment of a genuine agent and the threshold for determining that a risk is "*insignificant*".

**(ii)** There are circumstances when an agent will bear responsibility for financial or other risk where it acts in breach of a contract or outside the scope of its authority. Such risk should not be taken into account in a genuine agency analysis. The Draft FCR Guideline is silent on the Commission's approach to such cases.

**(iii)** It is also not clear what the Commission's approach is to an agent acting for multiple principals – if, as in the EU, an agent may act for multiple principals and still be a genuine agent then this should be expressed explicitly in the Draft FCR Guideline.[14]

2.12 HKAB therefore **recommends that further guidance be provided on how the genuine agency test will be applied in Hong Kong and that such further guidance includes, as a minimum:**

**(i)** **an explanation of the types of "*risk*" relevant to a genuine agency analysis, including whether risks that will *only* be borne by an agent where it acts in breach of a contract or outside the scope of its authority will be taken into account;**

**(ii)** **an explanation of the threshold for determining that a risk is "*insignificant*"; and**

**(iii)** **whether an agent can act for multiple principals.**

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[13] (OJ C 130, 19.5.2010), paragraphs 12-21.

[14] Paragraph 13 of the EU Vertical Restraints Guidelines states that it is not material for an assessment whether the agent acts for one or several principals.

Clarify and provide examples of steps required for an undertaking to "*sufficiently object to and publically distance itself*" an anticompetitive agreement

2.13 Paragraph 2.14 of the Draft FCR Guideline states that an undertaking that is present at a meeting where an anti-competitive agreement is discussed may be found to be party to that agreement (or to a concerted practice) if it failed to sufficiently object to and publicly distance itself from that agreement. However, HKAB notes that it is not clear from paragraph 2.14 what steps an undertaking would need to take in order to "*sufficiently object to and publically distance itself*" from an anti-competitive agreement (including what, if any, documentary evidence would be required). This information would be very useful to businesses in Hong Kong developing compliance programmes in advance of the full implementation of the Ordinance.

2.14 In the interests of providing legal certainty and allowing Hong Kong businesses to be fully informed on how best to defend against involvement in anti-competitive agreements, HKAB therefore **recommends that paragraph 2.14 be expanded to clarify and provide examples of the steps that an undertaking would need to take in order to "*sufficiently object to and publically distance itself*" from an anti-competitive agreement and what, if any, documentary evidence would be required.**

Further guidance and examples to clarify the concept of a "*concerted practice*"

2.15 Paragraphs 2.15 to 2.18 of the Draft FCR Guideline explain the concept of a "*concerted practice*" and are supported by Hypothetical Examples 2 and 3. Paragraph 2.15 states that a "*concerted practice is a form of cooperation, falling short of an agreement, where undertakings knowingly substitute practical cooperation for the risks of competition*". By contrast paragraph 2.13 states that an agreement will be determined to exist where there is a "*meeting of minds*" between undertakings. The Draft FCR Guideline therefore implies that a "*concerted practice*" cannot be an "*agreement*".

2.16 HKAB notes that the Hypothetical Examples 2 and 3 are described as "*at least*" constituting "*concerted practices*" (in Hypothetical Example 2 this is qualified by the preface "*assuming there is no evidence of an agreement*", without specifying what evidence might tip the conduct into an "*agreement*" rather than a "*concerted practice*"). The logical reading of this is that they might also constitute an "*agreement*". This therefore risks causing confusion for businesses in Hong Kong who are not familiar with such terms.

2.17 Separately, HKAB notes that both Hypothetical Example 2 and Hypothetical Example 3 involve the exchange of commercially sensitive information. This may give the impression to businesses in Hong Kong that a concerted practice can only be found where such anti-competitive exchange of information occurs either indirectly through a trade association or directly between competitors.

2.18 Given that the concept of a "*concerted practice*" is a difficult issue, even in jurisdictions such as the EU where the concept has existed for some time, we would appreciate further guidance and examples to ensure clarity on the circumstances in which a "*concerted practice*", rather than an "*agreement*", will arise.

2.19 HKAB therefore **recommends that additional guidance and Hypothetical Examples be included in the Draft FCR Guideline ensure clarity on the circumstances in which a "*concerted practice*", rather than an "*agreement*", will arise.**

Clarify whether a social event could be construed as an "*association of undertakings*"

2.20 Paragraph 2.19 of the Draft FCR Guideline states that the term "*association of undertakings*" is a broad concept and not confined to entities that hold themselves out as responsible for representing or defending the common interests of a group of undertakings.

2.21 Given that the term is confirmed to apply broadly, HKAB **recommends that paragraph 2.19 be amended to clarify whether a one-off gathering of individuals from the same industry background could be construed as an "*association of undertakings*".**

Clarify implications of an anti-competitive decision of an association for undertakings that do not comply

2.22 Paragraph 2.22 of the Draft FCR Guideline states that a decision of an association may be caught by the First Conduct Rule even where the decision is non-binding and even if the association's members have not complied with the decision. Paragraph 2.23 goes on to say that a non-binding recommendation amounts to a "*decision*" where it reflects an "*objective intention to coordinate the conduct of association members*". This position is reflected in Hypothetical Example 4.

2.23 HKAB notes that it is common for trade associations to issue non-binding recommendations or statements (often at the request of a regulator or other third party) to assist the industry, for example to understand the practical implications of a new regulation. However, in such cases the genuine intention is that members should freely and independently determine their own policies. Consequently, it would be helpful for the Commission to provide further guidance on the relevant factors to consider when assessing whether a non-binding recommendation reflects an "*objective intention to coordinate the conduct of association members*" . Alternatively, a safe harbour in respect of genuinely non-binding recommendations, such as non-binding recommendations that are not monitored and where there are no penalties for not following the recommendation, would be most welcome. These steps would enable trade associations to ensure that recommendations which

are intended merely to assist the industry, and are genuinely non-binding, will not raise competition concerns under the Ordinance.

2.24 Separately, HKAB notes that, where an association has made an anti-competitive decision, it is unclear whether a member undertaking that has chosen not to comply with the decision would still be liable for infringement of the First Conduct Rule and, if so, what steps (if any) such an undertaking could take to protect itself from such liability. HKAB notes that if an undertaking that has chosen not to comply with a decision (and, which may even have voted against the decision) will be held to have participated in an agreement or concerted practice corresponding to that decision and thus liable for infringing the First Conduct Rule, this will likely cause grave concerns for undertakings that participate in trade associations or other associations and potentially discourage participation in such associations. This is clearly undesirable as legitimate trade association activities generally lead to pro-competitive efficiencies to the benefit of consumers. It is thus important that businesses in Hong Kong receive further guidance and reassurance on this issue in order to avoid discouraging participation in trade association activities.

2.25 HKAB **therefore recommends that the Commission clarify and provide further explanation on:**

**(i) the factors that will be taken into account when assessing whether a non-binding recommendation reflects an "*objective intention to coordinate the conduct of association members*" and, if possible, for a safe harbour to be provided, for example for non-binding recommendations that are not monitored and where there are no penalties for not following the recommendation;**

**(ii) whether a member of an association of undertakings will be held to have infringed the First Conduct Rule in relation to an anti-competitive decision by the association, even where the member undertaking did not comply with the decision (and therefore arguably did not participate in any corresponding agreement or concerted practice); and**

**(iii) what steps undertakings can take to protect themselves from liability for infringing the First Conduct Rule in the above situation, for example publically distancing themselves from the decision.**

Clarify what liabilities undertakings may incur as a result of activities carried out through an association that is an exempt statutory body

2.26 Paragraphs 2.19 to 2.25 of the Draft FCR Guideline provide guidance on possible infringements of the First Conduct Rule as a result of a decision by an association

of undertakings. HKAB notes that it is unclear from the First Conduct Rule Guideline what liability members of an association will have under the First Conduct Rule where the association is itself an exempt statutory body. It is, however, important for businesses in Hong Kong to have a clear understanding of this point given that the Government has proposed it will exempt all but six statutory bodies in Hong Kong.

2.27 HKAB therefore **recommends that the Commission include a new paragraph to clarify what liabilities undertakings may incur under the First Conduct Rule as a result of activities carried out through an association of undertakings where that association is an exempt statutory body.**

Clarify if the Commission will investigate only infringements that materially harm competition

2.28 Paragraph 3.11 of the Draft FCR Guideline states that if an agreement does not have an anti-competitive object, it may nevertheless infringe the First Conduct Rule if it has an anti-competitive effect. HKAB notes that in other jurisdictions, such as the EU, it is necessary for the effect on competition to be "*appreciable*" in order for an infringement to be found.[15] This is for example, recognised in the European Commission Guidelines on the applicability of Article 101 of the TFEU to horizontal co-operation agreements (the "**EU Horizontal Guidelines**")[16], which state that:

> "*26. If a horizontal co-operation agreement does not restrict competition by object, it must be examined whether it has appreciable restrictive effects on competition. Account must be taken of both actual and potential effects. In other words, the agreement must at least be likely to have anti-competitive effects.*
>
> *27. For an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation. Agreements can have such effects by appreciably reducing competition*

[15] Case 5/69 *Völk v Vervaecke* [1969] ECR 295 and Case C-226/11 *Expedia Inc v Autorité de la Concurrence* [2013] 4 C.M.L.R. 14.

[16] (OJ C 11, 14.1.2011).

*between the parties to the agreement or between any one of them and third parties*."[17] [Emphasis added]

2.29 The European Commission Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the TFEU (the "**EU De Minimis Notice**")[18] formalises this concept by setting out safe harbours below which agreements, will not be considered to have an appreciable effect on competition for the purposes of Article 101(1) TFEU. These are where each of the parties to a horizontal agreement has a market share of less than 10% or where each of the parties to a vertical agreement has a market share of less than 15%.[19]

2.30 HKAB considers that a similar "*appreciability*" threshold should also be included when applying the First Conduct Rule. HKAB therefore **recommends that the Draft FCR Guideline be modified to clarify that the Commission will adopt a similar approach to the EU in finding that only appreciable effects on competition will be investigated for infringing the First Conduct Rule.**

Clarify the degree of market power at which concerns are likely to arise under the First Conduct Rule and whether market power will be assessed in the same way for horizontal and vertical agreements

2.31 Paragraph 3.13 of the Draft FCR Guideline states generally that whether anti-competitive effects are likely to occur will depend on several factors, including the extent to which the undertakings have market power and the agreement will create, maintain or strengthen that market power. Similarly, paragraph 6.8 states that competition concerns will generally only arise from vertical agreements where there is some degree of market power at either the level of the supplier, the buyer, or both. HKAB notes that it is unclear from the Draft FCR Guideline what degree of market power would be needed for competition concerns to arise as a result of either horizontal or vertical agreements or conduct under the First Conduct Rule, and whether market power will be assessed in the same way in the context of horizontal agreements and vertical agreements.

2.32 By comparison, HKAB notes that, for example in the EU in the context of vertical agreements, a block exemption is generally available for vertical agreements where the market share held by the supplier does not exceed 30% of the relevant market on which it sells the contract goods or services and the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the

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[17] EU Horizontal Guidelines, paragraphs 26 and 27.

[18] (OJ C 291, 30.8.2014).

[19] EU De Minimis Notice, Article 8.

contract goods or services.[20] In any event, as explained in paragraph 2.29 above, safe harbours are available in the EU for agreements with the effect of harming competition where the market shares of the parties involved are below 10% for horizontal agreements or 15% for vertical agreements.

2.33 The inclusion of an indicative threshold provides helpful legal certainty for businesses with market shares below the relevant thresholds. It would therefore be helpful for Hong Kong businesses to have the benefit of similar guidance in relation to both vertical agreements and horizontal agreements from the Commission as regards the level of market shares at which concerns might be likely to arise under the First Conduct Rule or, alternatively, a threshold below which it is unlikely that such concerns would arise.

2.34 In the interests of legal certainty and transparency, HKAB therefore **recommends that paragraphs 3.13 and 6.8 of the Draft FCR Guideline be amended to clarify at what level of market power competition concerns may arise and whether market power will be approached in the same way for horizontal and vertical agreements.**

Clarify that the Commission will always assess the counter-factual

2.35 Paragraph 3.18 of the Draft FCR Guideline states that in assessing whether conduct has the actual or likely effect of harming competition the Commission *may* assess the counter-factual and compare the counter-factual market conditions with the conditions resulting where the conduct is present. HKAB considers that the Commission should, in all cases, analyse the counter-factual and compare this to the conditions resulting where the conduct is present as this is the correct assessment when conducting an effects-based analysis of potential anti-competitive agreements or conduct. It is also consistent with the practice of other competition authorities.

2.36 HKAB therefore **recommends that paragraph 3.18 of the Draft FCR Guideline be amended to state that the Commission "*will*" assess the counter-factual.** If the Commission envisages that there may be circumstances in which it would propose not to conduct an assessment of the counter-factual then the Commission should clearly identify what these circumstances may be and the approach that would be adopted in such cases.

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[20] Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (OJ L 102, 23.4.2010), Article 3(1).

Clarify how the ancillary restraints guidance will apply to mergers and provide examples illustrating how ancillary restraints will be assessed

2.37 Paragraph 3.20 of the Draft FCR Guideline states that if the main parts of an agreement do not have the object or effect of harming competition, restrictions which are "*directly related to and necessary*" for implementing the main transaction will also fall outside the First Conduct Rule. HKAB notes that mergers are excluded from the First Conduct Rule under Section 4 of Schedule 1 to the Ordinance, however it does not necessarily follow that mergers will never have the object or effect of harming competition. It would therefore be helpful for the Commission to clarify how paragraph 3.20 of the Draft FCR Guideline will apply to ancillary restraints in relation to mergers. For example, can it be presumed that merger agreements will be considered by the Commission not to have the object or effect of harming competition for the purposes of any assessment of related ancillary restraints?

2.38 More generally, it would also be helpful for businesses in Hong Kong, in the interests of transparency and legal certainty, for the Commission to provide more detailed guidance on the meaning of "*directly related to*" and "*necessary*", including safe harbours (for example, as provided in other jurisdictions such as the EU)[21], and Hypothetical Examples of ancillary restraints and how they would be analysed by the Commission (including examples of when ancillary restraints will or will not be considered "*directly related to*" and "*necessary*" for the implementation of an agreement) to be included in the Draft FCR Guideline.

2.39 HKAB therefore **recommends that:**

**(i) paragraph 3.20 of the Draft FCR Guideline be amended to clarify how it will apply to mergers;**

**(ii) more detailed guidance on the meaning of "*directly related to*" and "*necessary*", including safe harbours, be included in the Draft FCR Guideline; and**

**(iii) Hypothetical Examples illustrating how ancillary restraints will be analysed under the First Conduct Rule (including examples of when ancillary restraints will or will not be considered "*directly related to*" and "*necessary*" for the implementation of an agreement) be included in the Draft FCR Guideline.**

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[21] See the *European Commission Notice on restrictions directly related and necessary to concentrations* (OJ C 56, 5.3.2004).

Clarify the meaning of "*in certain circumstances*" and provide examples of circumstances in which a non-compete obligation may be ancillary

2.40 Paragraph 3.23 of the Draft FCR Guideline states that a non-compete between parent entities and a joint venture (where the joint venture is subject to the First Conduct Rule but is not itself harmful to competition) might be regarded as ancillary to the joint venture "*in certain circumstances*". In the interests of clarity and legal certainty, HKAB **recommends that the Commission clarify the meaning of "*in certain circumstances*" and provides Hypothetical Examples to illustrate how ancillary restraints will be analysed (including examples of when ancillary restraints will or will not be considered "*directly related to*" and "*necessary*" for the implementation of an agreement).**

Replace "*assuming*" with "*where*" to avoid misunderstandings that the Commission will assume there are no applicable exemptions or exclusions

2.41 Paragraph 5.3 of the Draft FCR Guideline states that once an agreement has been determined to have the object or effect of harming competition and "*assuming there are no applicable exclusions or exemptions*", the Commission will consider whether the conduct amounts to Serious Anti-competitive Conduct. HKAB notes that the use of the word "*assuming*" may introduce scope for misunderstanding that the Commission will assume that there are no applicable exclusions or exemptions.

2.42 HKAB therefore **recommends that, in the interests of clarity, the word "*assuming*" be replaced with "*where*".**

Further guidance on how collaboration between competitors will be assessed

2.43 Part 5 of the Draft FCR Guideline includes sections on various types of agreements that may infringe the First Conduct Rule and provides guidance on how the Commission will approach each of these, including whether there are any potential pro-competitive effects that may arise from each type of agreement. However, the current Draft FCR Guideline does not provide sufficiently comprehensive guidance on collaboration between competitors (such as joint commercialisation agreements or joint research and development agreements – both of which are the subject of detailed guidance in the EU[22] and are likely to be widely used both in the banking industry and other major industries in Hong Kong). There are occasions in which customers may expect and require collaboration between competitors. In such cases, how would the Commission assess such collaboration and what value would it attach to the fact that the customer had consented? It is important that clear guidance is available for businesses on this issue. Examples of occasions in which

[22] EU Horizontal Guidelines, paragraphs 111 *et seq.* and paragraphs 225 *et seq.*

competitors may collaborate in the context of banking include situations where banks act as joint sponsors in the context of an initial public offering and debt restructuring situations where a customer is in financial difficulty.

2.44 In order to enable the banking industry and other businesses in Hong Kong to understand how collaboration between competitors would be assessed by the Commission under the First Conduct Rule, HKAB considers that it would be helpful for the Commission to provide further guidance in the Draft FCR Guideline.

2.45 HKAB therefore **recommends that further guidance be provided in the Draft FCR Guideline to explain how collaboration between competitors (such as joint commercialisation agreements and research and development agreements) will be assessed by the Commission under the First Conduct Rule.**

Recognise the pro-competitive effects of information exchange

2.46 Paragraph 6.32 of the Draft FCR Guideline introduces the section of the guideline on the exchange of information by stating that information exchange may harm competition where it results in undertakings becoming aware of their competitors' market strategies. However, HKAB notes that information exchange is not necessarily anti-competitive and may, in many cases, lead to pro-competitive efficiencies. This is recognised in, for example, the EU Horizontal Guidelines:

> "*Information exchange is a common feature of many competitive markets and may generate various types of efficiency gains. It may solve problems of information asymmetries, thereby making markets more efficient. Moreover, companies may improve their internal efficiency through benchmarking against each other's best practices. Sharing of information may also help companies to save costs by reducing their inventories, enabling quicker delivery of perishable products to consumers, or dealing with unstable demand etc. Furthermore, information exchanges may directly benefit consumers by reducing their search costs and improving choice.*"[23]

2.47 HKAB therefore **recommends that paragraph 6.32 of the Draft FCR Guideline be amended to recognise the potential pro-competitive effects of information exchange.**

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[23] EU Horizontal Guidelines, paragraph 57.

Provide a more precise description of the type of information which, if exchanged by competitors, would have the object of harming competition

2.48 Paragraph 6.35 of the Draft FCR Guideline states that, when competitors share information on their future intentions with respect to price (or elements of price) or quantities, the Commission will consider such information exchange to have the object of restricting competition. Footnote 16 lists example of "*quantities*" in this sentence as, for example, intended future sales, market shares, territories or sales to particular groups of customers.

2.49 HKAB notes that where the exchange of information is used to facilitate a cartel, as suggested in paragraph 6.35, the cartel agreement would constitute an "agreement" for the purposes of the First Conduct Rule. However, the Draft FCR Guideline does not clearly explain how the existence of an "*agreement*" (or "*concerted practice*") will be assessed in the context of standalone information exchange that is not related to a cartel, although Hypothetical Examples 2 and 3 in the Concerted Practice section of the Draft FCR Guideline set out scenarios in which information exchange would be considered "*at least a concerted practice*". Given that the First Conduct Rule is entirely new to Hong Kong businesses and information exchange is a particular area of interest within Hong Kong, it would be helpful for the Commission to expressly explain in the Draft FCR Guideline when it will consider that an "*agreement*" arises in the context of information exchange, including whether an agreement to exchange information could itself be considered by the Commission to constitute an "*agreement*" for the purpose of the First Conduct Rule or whether a separate "*agreement*" to use the information for an anti-competitive purpose would also be required.

2.50 Separately, HKAB notes that the types of information described in the footnote are not all related to quantities (or indeed, price). "*Quantities*" is a broad term, which could arguably include, for example, in the context of discussing best practices, the number of computers to be purchased to resolve a technical issue. This should not constitute information exchange that would infringe the First Conduct Rule.

2.51 HKAB therefore **recommends that paragraph 6.35 of the Draft FCR Guideline be amended to:**

**(i) clarify when the Commission will consider that an "*agreement*" arises in the context of standalone information exchange, including whether an agreement to exchange information could itself be considered by the Commission to constitute an "*agreement*" for the purpose of the First Conduct Rule or whether a separate "*agreement*" to use the information for an anti-competitive purpose would also be required; and**

**(ii) provide a more precise description of the type of information which, if exchanged by competitors, would be considered by the**

**Commission to have the object of infringing the First Conduct Rule.**

Match the wording of Hypothetical Example 10 to paragraph 6.35

2.52 Hypothetical Example 10 of the Draft FCR Guideline sets out an example in which information on pricing is circulated within a trade association, allowing members of the association to adjust their future pricing based on the information exchanges.

2.53 HKAB notes that the final sentence of the Hypothetical Example "*The information exchange arrangement is an indirect form of price fixing*" may create confusion as to whether the example illustrates price fixing or information exchange that has the object of restricting competition. In the interests of clarity and to avoid confusion, HKAB recommends that this example should focus on information exchange. HKAB therefore **recommends that this sentence be amended to match paragraph 6.35 to state that "*The information exchange arrangement has the object of restricting competition*".**

Move examples of commercially sensitive information into main body

2.54 Footnote 17 of the Draft FCR Guideline sets out examples of information that may be commercially sensitive. HKAB notes that these examples are likely to be very helpful to Hong Kong businesses and therefore **recommends that they be moved into the main body of the Draft FCR Guideline.**

Further guidance on how discussions regarding compliance with new laws will be viewed under the First Conduct Rule

2.55 Paragraphs 6.38 to 6.43 of the Draft FCR Guideline address other types of information exchange.

2.56 HKAB notes in this context that some of the most common topics discussed at trade associations are how to comply with new laws and regulations (such as anti-money laundering laws), for example to how to improve controls or manage risks, or common difficulties faces when implementing new laws. Such discussions are generally likely to be pro-competitive and result in efficiencies for consumers. Given the common nature of such discussions, it would be helpful for businesses in Hong Kong if clear guidance were provided to reassure businesses that such discussions would generally not be considered to have the object or effect of harming competition for the purposes of the First Conduct Rule.

2.57 HKAB therefore **recommends that the Commission provide further guidance on how discussions on compliance with new laws and regulations would be viewed under the First Conduct Rule and that a Hypothetical Example addressing this also be included.**

Clarify and provide comfort regarding the approach to price benchmarking exercises that are based on publicly available information

2.58 Paragraphs 6.38 to 6.43 of the Draft FCR Guideline address other types of information exchange. As noted above, information exchange through, for example, benchmarking exercises may in some cases be pro-competitive.

2.59 HKAB notes that where prices are transparent, undertakings may wish to benchmark prices against competitors based on information that is available to the public. For example, a bank may face situations where a customer voluntarily approaches them to request that a competitor's (lower) price is matched and, in doing so, provides information about its competitor's price (which the bank may then wish to verify prior to agreeing to match the lower price). Although both of these scenarios involve pricing information, HKAB notes that the information in such cases is likely to be publicly available and current (rather than future) and may lead to efficiencies, including price reductions for consumers. In the interests of clarity and legal certainty, HKAB considers that it would be helpful for the Commission to clarify its approach to such situations under the First Conduct Rule.

2.60 HKAB therefore **recommends that the Draft FCR Guideline be amended to clarify and provide comfort to undertakings regarding the Commission's approach under the First Conduct Rule to price benchmarking exercises that are based on publicly available information, in particular situations where undertakings receive price information from customers requesting price-matching of lower prices.**

Further guidance on and example of standard terms unlikely to raise competition concerns

2.61 Paragraphs 6.47 to 6.51 of the Draft FCR Guideline explain that the use of standard terms is common in industries such as insurance and banking and that, as a general rule, standard terms are unlikely to raise concerns under the First Conduct Rule if they do not affect price (those that affect prices charged to consumers will be considered to have the object of harming competition). The exceptions to this are where the standard terms define the scope or nature of the product sold or where a trade association prohibits a trade association from accessing its standard terms and the use of those terms is vital for successful entry into the market. However, the Draft FCR Guideline does not list examples of standard terms that are likely to be acceptable under the Draft First Conduct Rule.

2.62 The issue of standardised terms is of particular importance in Hong Kong as there may be certain regulatory expectations or requirements (for example, set out in circulars, guidance and other directives), including in the banking industry, that in practice necessitate the adoption of standardised terms within an industry for the benefit of customers or for the purpose of complying with certain regulations from

time to time. It would therefore benefit businesses in Hong Kong to have clearer guidance on what standard terms will and will not raise competition concerns.

2.63 HKAB therefore **recommends that the Commission provide further guidance and clarification by listing examples of standard terms that are unlikely to raise any competition concerns.**

Clarify the Commission's approach to similar terms that do not arise from any agreement or understanding between competitors

2.64 As noted above, paragraphs 6.47 to 6.51 of the Draft FCR Guideline address the issue of standard terms. The explanation provided in these paragraphs is illustrated by Hypothetical Example 13, which uses an example of a trade association circulating non-binding standard policy terms in the insurance sector.

2.65 HKAB notes that one of the main reasons for standardisation of terms being common in the insurance sector is that many insurers use reinsurers to reduce risks though back-to-back insurance arrangements. Exclusion terms in a policy are primarily dictated by reinsurers' terms when reinsuring the risk. Consequently, as there are only a few reinsurers in the market, the terms used by insurers may become standardised through the requirements of their reinsurer without any agreement or contact between competing insurers.

2.66 As currently drafted, it is unclear from the Draft FCR Guideline whether concerns would arise under the First Conduct Rule in circumstances where the effect of normal market negotiations is that undertakings within the market have similar terms even though there is no agreement or understanding between them regarding those terms.

2.67 HKAB therefore **recommends that the Commission clarify that no competition concerns would arise where undertakings active in a market have similar terms, provided these have arisen in the absence of any agreement or understanding between those undertakings.**

Further practical guidance on what types of exclusive agreements are allowed under the Ordinance

2.68 Paragraphs 6.76 to 6.80 of the Draft FCR Guideline set out the Commission's views that exclusive distribution arrangements will not generally have the object of harming competition and may lead to economic efficiencies of the types required for the purposes of Section 1 of Schedule 1 to the Ordinance. The current drafting discusses in general terms some relevant factors but it does not offer businesses any practical guidance, particularly if they have no experience of competition law, on what types of exclusive agreements are allowed under the Ordinance. For example, how do businesses measure interbrand and intrabrand competition, what

levels of such competition do not raise concerns and whether the duration of the agreement has any bearing on the competitive assessment.

2.69 The use of exclusive distribution arrangements is widespread among businesses in Hong Kong. It is therefore important for the Commission to provide guidance on these issues and, for example, provide safe harbours on areas such as duration so that businesses are able to apply a threshold to identify contracts that may need to be reviewed and, if necessary, amended prior to the Ordinance coming into effect.

2.70 HKAB therefore **recommends that additional practical guidance be included on what types of exclusive agreements are allowed under the Ordinance and, for example, safe harbours in areas such as the duration of such agreements.**

Explain how the proportion of competition accounted for will be assessed and the threshold at which an undertaking will account for a "*substantial proportion*"

2.71 Paragraph 2.9 of the Annex to the Draft FCR Guideline states that particularly strong evidence of substantial efficiency gains will be required where the undertakings involved in an agreement account for "*a substantial proportion of competition in the market*".

2.72 However, the Draft FCR Guideline does not go on to explain what is meant by "*a substantial proportion of competition in the market*". It is therefore unclear whether the proportion of competition that an undertaking accounts for would be determined by reference to that undertaking's market share (and, if so, how much market share would be considered "*a substantial proportion*") or other factors.

2.73 In the interests of clarity and legal certainty, HKAB therefore **recommends that paragraph 2.9 of the Annex to the Draft FCR Guideline be expanded to explain how the proportion of competition accounted for by an undertaking will be assessed and the threshold at which an undertaking will be considered to account for "*a substantial proportion of competition*".**

Clarify the meaning of "*fair share*" and evidence required to demonstrate that consumers receive a fair share

2.74 Paragraphs 2.15 to 2.17 of the Annex to the Draft FCR Guideline explain the term "*fair share*" for the purposes of the second condition to Section 1 of Schedule 1 to the Ordinance.

2.75 Paragraph 2.15 states that "*consumers... means all direct and indirect purchasers*". Although paragraph 2.17 goes on to state that it is not necessary to "*demonstrate that consumers receive a share of every efficiency gain*", HKAB notes it is unclear whether it is necessary to demonstrate that *all* consumers (i.e. all direct and indirect consumers down to the final consumer) receive a fair share of the efficiencies and, if so, how this could be demonstrated in practice. HKAB notes that paragraph 2.17

goes on to state that "*what matters here is the overall impact on consumers of the products within the relevant market as a whole, and not the impact on individual consumers or individual consumer groups within that market*". This implies that, consistent with the position in the EU, it should not be necessary for all consumers to receive a fair share, provided that when looked at as a whole, overall, consumers are receiving a fair share of the benefits. However, further clarification would be helpful to avoid any misunderstanding, particularly given that businesses in Hong Kong are unfamiliar with competition rules.

2.76 Paragraph 2.17 also states that "*fair share*" means that "*the benefits accruing to consumers must at a minimum compensate them for the actual or likely harm to competition associated with the relevant restrictive agreement*". It is also unclear how this will be assessed in practice (e.g. how will it be determined whether the benefits to consumers are sufficient to compensate for the actual or likely harm to competition) and what evidence would be required (e.g. would economic analysis or other quantitative data be needed?) to demonstrate that consumers are receiving a "*fair share*" of the benefit of a restrictive agreement.

2.77 HKAB therefore **recommends that the Annex to the Draft FCR Guideline be amended to clarify that it is not necessary for *all* consumers (i.e. all indirect and direct consumers down to the final consumer) to receive a "*fair share*" of the benefits of a restrictive agreement, how a "*fair share*" will be assessed in practice, and what evidence will be required to demonstrate that consumers are receiving a "*fair share*".**

Clarify the indispensability condition involves a two-step test and that the test is not whether, in the absence of the restriction, the agreement would not have been concluded

2.78 Paragraph 2.18 of the Annex to the Draft FCR Guideline addresses the third condition for an agreement to benefit from the general exclusion from the First Conduct Rule for agreements enhancing overall economic efficiency. In particular, it states that, to satisfy this test, the agreement itself and each of the individual restrictions contained in the agreement must be reasonably necessary to attain the claimed efficiencies. The determinative factor will be whether they "*make it possible to perform the activity in question more efficiently than would likely have been the case in the absence of the agreement or restrictions*". Paragraph 2.19 of the Draft FCR Guideline follows on to state that "*as regards the agreement there be no other economically practicable and less restrictive means of achieving the claimed efficiencies*".

2.79 HKAB notes that the language of paragraphs 2.18 and 2.19 is based on the equivalent EU guidance contained in paragraphs 74 *et seq.* of the Guidelines on the application of Article 101(3) TFEU (the "**EU Article 101(3) Guidelines**").[24]

2.80 Like paragraph 2.18 of the Draft FCR Guideline, the EU Article 101(3) Guidelines provides that the decisive factor in meeting the indispensability criterion is whether the agreement and individual restrictions make it possible to perform the activity more efficiently that would likely otherwise have been the case. The EU Article 101(3) Guideline goes on to expressly explain that the indispensability condition involves a two-fold test:

**(i)** first, the agreement itself must be reasonably necessary in order to achieve the claimed efficiencies – this test requires that "*the efficiencies be specific to the agreement in question in the sense that there are no other economically practicable and less restrictive means of achieving the efficiencies*"; [25] and

**(ii)** second, each of the individual restrictions contained in the agreement must be reasonably necessary in order to achieve the claimed efficiencies – a restriction is only indispensable under this test if "*its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise*".[26]

2.81 Although paragraph 2.19 of the Draft FCR Guideline also sets out these tests in relation to the agreement and individual restrictions, it is unclear that there is a two-step test in the first place. This may potentially cause confusion, particularly when read by businesses in Hong Kong that are unfamiliar with EU competition rules.

2.82 HKAB also notes that the EU guidance clarifies that the question in determining whether the EU indispensability condition for Article 101(3) to apply "*is not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.*"[27] This clarification

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[24] (OJ C 101, 27.4.2004).

[25] EU Article 101(3) Guidelines, paragraph 75.

[26] EU Article 101(3) Guidelines, paragraph 79.

[27] EU Article 101(3) Guidelines, paragraph 74.

is not included in the Draft FCR Guideline but HKAB considers that it would be helpful for businesses in Hong Kong.

2.83 In the interests of clarity, HKAB therefore **recommends that the Annex to Draft FCR Guideline be amended to expressly clarify that:**

**(i) the third condition involves a two-step test and to distinguish between these steps in the test; and**

**(ii) the test is *not* whether, in the absence of the restriction, the agreement would not have been concluded but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.**

Clarify whether compliance with legal requirements includes case law

2.84 Paragraph 3.1 of the Annex to the Draft FCR Guideline states that agreements or conduct are excluded from the First Conduct Rule and Second Conduct Rule to the extent that their purposes is to comply with "*a legal requirement imposed by or under any enactment in force in Hong Kong or imposed by any national law applying in Hong Kong.*" Footnotes 26 and 27 clarify that "enactment" means "any Ordinance, any subsidiary legislation made under any such Ordinance and any provision or provisions of any such Ordinance or subsidiary legislation" and "national law" means "a national law applying in Hong Kong pursuant to the provisions of Article 18 of the Basic Law." However, HKAB notes that there is no reference within paragraph 3.1 or footnotes 26 and 27 to the common law included within Hong Kong's legal framework.

2.85 In the interests of legal certainty, HKAB therefore **recommends that paragraph 3.1 of the Annex to the Draft FCR Guideline be amended to clarify whether compliance with the requirements of case law will be regarded as "*compliance with legal requirements*".**

## 3. Draft SCR Guideline

Relevance of views of concurrent regulators for market definition

3.1 Paragraphs 2.12 and 2.19 of the Draft SCR Guideline outline the relevant tests and evidence that the Commission may consider in defining the relevant product and geographic markets. It only states that the Commission may consider "*evidence from undertakings active in the market and their commercial strategies*".

3.2 HKAB notes that the Commission does not clarify what "*evidence from undertakings*" is likely to be acceptable and credible. HKAB considers that the views of concurrent regulators, which tend to have industry-specific expertise, on the relevant markets should also be taken into account by the Commission.

3.3 HKAB therefore **recommends that the Commission clarify that it may also consider evidence such as views of the concurrent regulators.**

Captive production may be part of the market

3.4 Paragraph 2.24 of the Draft SCR Guideline states that "*generally the Commission will not consider captive production to be within the relevant product market but will assess whether captive production imposes a competitive constraint in terms of potential competition*".

3.5 HKAB considers that, in principle, captive production is part of the production within the relevant market, as such captive production satisfies part of the demand within the market and it is possible for businesses to switch from internal production for captive use to merchant sales and *vice versa*, or even engage in both. In some cases, the captive production may well represent a significant part of the market and exert substantial competitive constraints on the players within the market. It is also common for other competition authorities such as the European Commission to take into account captive production as well as merchant market within the relevant markets.[28] It would therefore be overly restrictive to assume that captive production will "*generally*" not be part of the relevant market.

3.6 HKAB therefore **recommends that the Commission clarify that captive production may be part of the relevant market and impose a competitive constraint on the other players within the market.**

Market participants in bidding markets

3.7 Paragraph 2.27 states that *"[t]o identify the competitive constraints a particular undertaking faces, more weight must be placed on identifying the (potential) market participants, i.e. those suppliers that have the capacity to compete for the contract and participate in future bidding competitions*".

3.8 HKAB agrees that for the purpose of identifying the competitive constraints faced by a particular undertaking in a bidding market, it is important to identify those suppliers that are able to compete for the contract and participate in such tenders.

3.9 HKAB, however, notes that, whatever the market, an important step in market definition is to identify market participants, whether actual or potential, in order to understand the market dynamics and constraints within which undertakings

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[28] See, for example, Case M.7230 - *Bekaert / Pirelli Steel Tyre Cord Business (steel tyre cord)*; COMP / M.6996 - *SECOP / ACC Austria (hermetic reciprocating refrigeration compressors for household appliances).*

compete with each other (e.g. to estimate the overall size of the relevant market and the position of the players). HKAB therefore **recommends that the Commission clarify what "*placing more weight*" means and how the analysis is different in the context of bidding markets.**

Relevance of supply-side substitutability for market definition

3.10 Paragraph 2.31 of the Draft SCR Guideline states that "*the Commission will not generally consider supply-side substitutability or potential competition when defining the relevant market...ultimately, the key issue is whether or not an undertaking has market power. In this context, market definition is only one element of the assessment as undertakings in a market may well be subject to competitive constraints from outside the market no matter how it is defined.*"

3.11 HKAB considers that in principle supply-side substitutability is a relevant consideration for the purpose of defining the relevant market. The concept of substitutability (and the Commission recognises the relevance of the SSNIP test in paragraph 2.12(a)) should be assessed from both a demand- and supply-side perspective. The ability of suppliers to "*switch production to the relevant products and market them in the short term without incurring significant costs or risks in response to small and permanent changes in relative prices*"[29] is an important part of market definition. It is therefore conceptually incorrect to *generally* disregard this issue when defining the relevant market and only consider this issue when assessing market power; otherwise the Commission will not be able to reach a balanced and realistic view about the relevant market with undue emphasis on demand side considerations.

3.12 The Commission has, however, not provided any justification why supply-side substitutability is *generally* not relevant to market definition and why Hong Kong should depart from the international practice in other jurisdictions with well-established competition regimes. For example, the European Commission recognises that supply-side substitutability is a relevant consideration when defining the relevant market and illustrates this point with the example of paper.[30] The Commission does acknowledge that it will not consider supply-side substitutability at the stage of market definition when supply-side substitutability would entail the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays.[31]

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[29] European Commission's Notice on the definition of relevant market (the "**EU Market Definition Notice**"), paragraph 20.

[30] EU Market Definition Notice, paragraphs 21 – 22.

[31] EU Market Definition Notice, paragraph 23.

3.13 HKAB therefore **recommends that the Commission amend paragraph 2.31 to clarify that supply-side substitutability is relevant when defining the relevant market, and it is only where suppliers are not able to switch production promptly or effectively, for reasons such as additional costs or time delays that the Commission should consider the issue of supply-side substitutability at a later stage in the analysis.**

Sustained period for assessing a substantial degree of market power

3.14 Paragraph 3.2 of the Draft SCR Guideline states that "*normally a period of two years can be considered to amount to a sustained period. However, the relevant period may be shorter or longer depending on the facts, in particular with regard to the product and the circumstances of the market in question.*" In paragraph 3.11, the Commission refers to the relevance of evolution of market shares over a period of time, and suggests in bidding markets, the evolution of shares over a period of years might be particularly relevant.

3.15 HKAB notes that the Commission has not provided any explanation why a period of two years would normally be long enough to amount to a sustained period. In contrast, the European Commission does not refer to any indicative time period in its Guidance on the Commission's enforcement priorities in applying Article 82 (now Article 102) of the EC Treaty to abusive exclusionary conduct by dominant undertakings (the "**EC Article 102 Enforcement Priorities**") (see paragraphs 9 to 15 in particular). It is common for the European Commission to have regard to market shares over a much longer period of time than two years; this analysis will depend on the specific circumstances of the market in question.[32] Indeed, HKAB considers that for large corporations and firms with market power, a period of two years is normally a relatively short time horizon for assessing market power. It is therefore not appropriate to draw any general presumption that "*two years*" would normally be long enough to be a sustained period.

3.16 HKAB therefore **recommends that the Commission amend paragraph 3.2 to remove the reference to a period of two years being normally sufficiently long to amount to a "*sustained period*", unless there is a convincing justification.**

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[32] COMP/C-3/37.990 – *Intel* (taking into account market share over time period up to 10 years) (see paragraph 842 *et seq*) COMP/A. 37.507 – *Astra/Zeneca* (taking into account market share over time period up to more than 10 years) (see paragraph 567 *et seq*); COMP/C-3/37.792 *Microsoft* (taking into account market share over time period up to 10 years) (see paragraph 430 *et seq*).

Clarify the concept of "*competitive levels*" and when more than one undertaking is likely to have a substantial degree of market power

3.17 Paragraph 3.2 of the Draft SCR Guideline states "*a substantial degree of market power arises where an undertaking does not face sufficiently effective competitive constraints in the relevant market. Substantial market power can be thought of* as *the ability profitably to price above competitive levels, or to restrict output or quality below competitive levels, for a sustained period of time*". However, for businesses in Hong Kong, "competitive levels" is too abstract a concept. As such, HKAB suggests that further explanation be provided as to what this term means in relation to price, output and quality and how it should be assessed in determining whether an undertaking has a substantial degree of market power.

3.18 Paragraph 3.3 of the Draft SCR Guideline states that "*the above definition of substantial market power does not preclude the possibility of more than one undertaking having substantial market power in a relevant market, particularly if the market is highly concentrated with only a few large market participants*". The Guideline, however, does not provide any reasoning on why it is more likely for two undertakings to have a substantial degree of market power where the market is highly concentrated and there are only a few large players (e.g. an oligopoly). Competition between the few large players may very well be fierce in such highly concentrated markets. It would be helpful if the Commission could clarify how and under what circumstances two undertakings are likely to simultaneously have such economic strength that they do not face sufficiently effective competitive constraints and yet choose not to compete with each other. HKAB considers that such a possibility should be exceptional and limited to circumstances where the parties coordinate with each other (which could raise FCR issues) or where it is economically rational for such undertakings to act in concert due to the market structure.

3.19 HKAB therefore **recommends that the Commission clarify what "*competitive levels*" means in relation to price, output and quality and provide further explanation on the circumstances when more than one undertaking is likely to have a substantial degree of market power.**

Provide indicative market share threshold for a substantial degree of market power

3.20 The Draft SCR Guideline does not refer to any indicative market share threshold that might point to a substantial degree of market power.

3.21 HKAB notes that the absence of any market share threshold at all is liable to give businesses in Hong Kong great uncertainty in relation to this new law. The issue of whether an undertaking may have a substantial degree of market power in a relevant market has significant implications for day-to-day business. Even though HKAB appreciates that market share is not necessarily conclusive evidence of market power, it is generally a useful indicator especially for the purpose of risk

assessment and implementing an effective compliance policy. If the Commission is unwilling to define a threshold of market share that is likely to give rise to market power, the Commission should at least provide an indicative threshold below which an undertaking would be unlikely to have a substantial degree of market power.

3.22 Any indicative threshold should be realistic and not overly conservative. This would enhance certainty for businesses to estimate their market position and yet the Commission will be free to assess market power on the facts of each case. In the absence of any threshold at all, businesses would be left without any guidance and could even resort to the thresholds in other jurisdictions for their internal risk assessment purposes (e.g. 60% threshold in Singapore[33]), which might cause confusion and may be quite different from the Commission's intentions.

3.23 HKAB therefore **recommends that the Commission at least provide an indicative market share threshold below which an undertaking would be unlikely to have a substantial degree of market power.**

Clarify relationship between market concentration and market power

3.24 Paragraph 3.14 of the Draft SCR Guideline states that "*market concentration can provide useful information about the market structure*" and paragraph 3.15 refers to concentration ratios and Herfindahl-Hirschman Index as two common measures of market concentration.

3.25 HKAB notes that the Commission has not provided any explanation on how market concentration will affect the analysis on market power and how the concentration thresholds under these two common measures would work (e.g. what HHI levels would indicate the lack of concentration, a concentrated market or a highly concentrated market). Neither does the Guideline explain whether both measures will be applied in each case, and how any inconsistent results will be reconciled.

3.26 HKAB **therefore recommends that the Commission clarify how market concentration will affect the analysis on market power, provide indicative thresholds on how the measures of market concentration would work as evidence of the level of market concentration in a relevant market, and explain whether both measures will be applied in each case, and how any inconsistent results will be reconciled.**

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[33] http://www.ccs.gov.sg/content/ccs/en/Anti-Competitive-Behaviour/AbuseofDominance/how_do_i_recogniseabuseofdominance.html

Countervailing buyer power to protect the market as a whole

3.27 Paragraph 3.32 of the Draft SCR Guideline states that "*to prevent a substantial degree of market power from arising, countervailing buyer power must be sufficient to protect the market as a whole and not merely certain buyers*".

3.28 HKAB considers that the language of "*to protect the market as a whole*" is vague. It would clearly be an overstatement to require that countervailing buyer power must be sufficient to protect the whole market. It would therefore be helpful to clarify what sufficient countervailing buyer power means with reference to the relevant considerations (e.g. ability to switch to competing suppliers, promote new entry or vertically integrate, or threaten to do so) and to provide some guidance as to the degree at which such power would be sufficient to prevent a substantial degree of market power from arising.

3.29 HKAB therefore **recommends that the Commission amend paragraph 3.32 to set out relevant factors to be considered in assessing countervailing buyer power. The reference to protecting the market "*as a whole*" should be clarified and further guidance provided on what "*sufficient*" means.**

Other relevant factors for assessing a substantial degree of market power

3.30 Paragraphs 3.7 and 3.8 of the Draft SCR Guideline refers to "*any other relevant matters*" (per section 21(3) of the Ordinance) that the Commission may consider in assessing market power in a given case.

3.31 HKAB notes that there is little guidance in the Draft SCR Guideline on what such "*relevant factors*" may be (apart from countervailing buyer power). As the Commission has not provided in this draft any indicative market share threshold (although note our comments in paragraphs 3.20 to 3.23 above), it is even more important for the Commission to provide as much guidance as possible on the relevant considerations for determining market power. For example, other relevant factors could include the following and it would be useful if the Commission could clarify further in the Guideline: degree of product differentiation within the market, the overall size, strength and economic performance of an undertaking (not necessarily the market share within the relevant market) and any previous findings on market power.

3.32 HKAB therefore **recommends that the Commission provide further guidance on the relevant considerations for assessing relevant market power.**

The concept of "*abusive conduct*"

3.33 Paragraph 4.1 of the Draft SCR Guideline states that "*abusive conduct is therefore conduct which has the object or effect of harming competition in Hong Kong*".

3.34 HKAB notes that section 21 of the Competition Ordinance refers to both "*abuse*" and "*engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong*" (which is different from the wording of Article 102 TFEU, which only refers to abuse, but not anti-competitive object or effect). This appears to suggest that the issue of: (i) abuse; and (ii) whether the relevant conduct has the object or effect of harming competition, are in fact two separate issues. As such, conduct that gives rise to SCR issues must be "*abusive*" by nature. However, the Guideline assumes that any type of conduct with an anti-competitive object or effect could constitute an "*abuse*", which is broader than what the Ordinance appears to suggest.

3.35 HKAB therefore **recommends that the Commission clarify whether an infringement of the Second Conduct Rule would require both: (i) abuse by an undertaking of a substantial degree of market power and (ii) conduct that has the object or effect of preventing, restricting or distorting competition in Hong Kong, in addition to what "*abuse*" means.**

Introduce safe harbours conduct that would not be abusive

3.36 HKAB notes that the concept of abusive conduct is complex and difficult for business to understand and predict with certainty. Many of the examples listed in the Draft SCR Guideline are merely *potentially* abusive (e.g. when there is a clear foreclosure effect or exclusionary intent). There may well be instances where such conduct is pro-competitive and beneficial to consumers, for example, short-term discounts (even if below cost) for promotion of a new product or for stock clearing purposes. In particular, the Commission should recognise that any conduct (even if listed as an example in the Draft SCR as abusive) would be unlikely to have negative impact on competition if it is done for a short duration (e.g. less than a few months).

3.37 If businesses do not have sufficient guidance on what is acceptable under competition law, businesses with a substantial degree of market power (and this itself is not currently sufficiently clear, per our comments in paragraphs 3.20 to 3.23 above) may opt to err on the side of caution and terminate all consumer-friendly and pro-competitive offers, for fear that there might be a competition risk because they are listed as examples of "*abusive conduct*". Such regulatory overreach and uncertainty would be undesirable for both businesses and consumers.

3.38 Examples of conduct which may not have an anti-competitive effect (or may even be pro-competitive and beneficial to consumers) include:

(i) discounts and rebates (even if below cost) for short term promotion, e.g. of new products or stock clearance;

(ii) rebates that reflect genuine cost savings (for example, quantity rebates); and

(iii) rebates and exclusivity restrictions for a short duration where commercially justified.

3.39 In the interest of business certainty, HKAB therefore **recommends that the Commission provide safe harbours for conduct that would not be abusive, including an indicative timeframe within which competition concerns are unlikely.**

Foreclosure requires efficient competitors to be unable to compete on equal terms

3.40 Paragraph 4.3 of the Draft SCR Guideline states that "*anti-competitive foreclosure occurs where effective access of actual or potential competitors to sources of supply or buyers is hampered or eliminated as a result of the conduct of the undertakings with substantial market power. Anti-competitive foreclosure can result in the undertaking with substantial market power being able to charge higher prices or in reduced product quality or choice, to the detriment of consumers". However, HKAB notes that the Guideline does not explain the circumstances when "effective access of actual or potential competitors to sources of supply or buyers is hampered or eliminated*".

3.41 HKAB notes that there is some discussion on ability of competitors to compete:

(i) (in the context of exclusive dealing) paragraph 5.27 states that "*in cases where competitors can compete on equal terms of the entirety of each individual customer's demand, exclusive dealing is unlikely to harm competition...*"; and

(ii) (in the context of margin squeeze) footnote 19 also refers to the ability of a downstream competitor to compete in order to make a profit in light of the costs imposed by the upstream undertaking with a substantial degree of market power.

3.42 HKAB considers that, in principle, for the purpose of considering when effective access of competitors is hampered or eliminated by exclusionary conduct, competition concerns should only arise if competitors that are as efficient are not able to compete on equal terms with the undertaking with a substantial degree of market power. Such principle should be discussed in the general section on "Abuse of Substantial Market Power" (e.g. following the description of foreclosure in paragraph 4.3), and elaborated upon in relation to specific types of abuse as appropriate. For example, it would be helpful to clarify in the context of predatory pricing that the concern is whether equally efficient competitors are able to compete above cost, or in the context of rebates that the concern is whether equally efficient competitors are able to compete by compensating the customer for the loss of the rebate as a result of switching away from the undertaking with a substantial degree of market power.

3.43 HKAB therefore **recommends that the Commission clarify that the "*as efficient competitors*" test is applicable in assessing whether conduct is abusive.**

The application of the defence of objective justification

3.44 Paragraph 4.4 of the Draft SCR Guideline states that "*when investigating cases of alleged abuse of substantial market power, the Commission may consider whether the undertaking is able to demonstrate that the concerned conduct is indispensable and proportionate to the pursuit of some legitimate objective unconnected with the tendency of the conduct to harm competition*".

3.45 HKAB considers that this defence of potential justification is of vital importance and merits further detailed discussion both generally and with specific reference to the particular types of abuse. Furthermore, the Commission should further elaborate on what "*legitimate objectives*" may include.

3.46 Examples of objective justification should at least include:

**(i)** short term promotional activities below cost (as defence to allegations of predatory pricing); and

**(ii)** economic efficiencies such as economies of scale, adequate return on investments, incentives to innovate, savings in production or distribution and consumer benefits.

3.47 It is also common for regulators in other jurisdictions to expressly recognise examples of objective justification. The Guidelines issued by the Competition Commission of Singapore on the Section 47 Prohibition refer to the following:

**(i)** (for pricing below average variable cost) "*some possible legitimate commercial reasons for such conduct may include **loss leading**, where a retailer cuts the price of a single product in order to increase sales of other products, **short-run promotions**, which involves selling below AVC for a limited period, especially where a new product is introduced to a market, or **option value**, where in response to an unexpected fall in demand, an undertaking incurs short-run losses so as to maintain a presence in the market, in case demand returns to profitable levels*";[34] and

***(ii)*** (for discounts) "*The CCS will consider whether the dominant undertaking's discount scheme simply reflects competition to secure*

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[34] The Guidelines on the Section 47 Prohibition issued by the Competition Commission of Singapore, paragraph 11.6

*orders from valued buyers or whether it has beneficial effects. For example, the discount scheme may:*

*(a) expand demand and thereby help to cover fixed costs efficiently;*

*(b) lower input costs for downstream undertakings and thereby encourage them to compete more effectively on price;*

*(c) reflect efficiency savings resulting from supplying particular buyers; or*

(d) *provide an appropriate reward for the efforts of downstream undertakings to promote the dominant undertaking's product*".[35]

3.48 HKAB therefore **recommends that the Commission provide further guidance on the defence of objective justification and provide examples on what legitimate objectives may include both generally and with reference to each type of abuse provided in the Guideline.**

Further guidance on discriminatory behaviour

3.49 The Draft SCR Guideline does not provide any guidance on how discriminatory behaviour will be assessed under the Second Conduct Rule. HKAB considers that, in principle, discriminatory behaviour *per se* does not give rise to competition concerns; discrimination may raise concerns only where the conduct leads to anti-competitive foreclosure effects, for example where an undertaking:

**(i)** provides differential discounts to certain customers which would amount to "predatory pricing" to exclude competitors on the same market;

**(ii)** increases prices of inputs for certain customers which would amount to "margin squeeze" of downstream competitors; or

**(iii)** refuses to supply an indispensable input to a downstream competitors or only supplies such input in objectively unreasonable terms.

3.50 It would be helpful for the Guideline to clarify that discrimination between customers with whom the undertaking with a substantial degree of market power does not compete should not give rise to any concerns, because it gains no

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[35] The Guidelines on the Section 47 Prohibition issued by the Competition Commission of Singapore, paragraph 11.12

competitive advantage over rival firms through discrimination (and hence no effect on competition). Indeed, unlike Article 102 TFEU, section 21 of the Ordinance does not refer to "applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage" as an example of abuse.

3.51 HKAB therefore **recommends that the Commission provide further guidance on the assessment of discriminatory behaviour, and in particular clarify that discriminatory conduct *per se* is not a concern under the Ordinance.**

Definitions of cost

3.52 Paragraphs 4.8 and 5.5 of the Draft SCR Guideline refer to concepts such as average variable cost and average total cost. Footnote 16 also refers to long run average incremental cost and average avoidable cost.

3.53 HKAB notes that such concepts on cost are highly technical and are generally not familiar to the general public. It is also difficult for the general public to pick up complex concepts in footnotes with minimal discussion; otherwise, the positioning in the footnotes gives the impression that the concepts on long run average incremental cost and average avoidable cost are of limited practical relevance. If the Commission is minded to rely on these concepts (as the Guideline suggests), the Commission should clarify in the main body what these concepts mean and provide illustrations on how such costs may be calculated. This is, for instance, not addressed in Hypothetical Example 15.

3.54 HKAB therefore **recommends that the Commission provide further guidance on the various concepts on cost such as average variable cost, average total cost, long run average incremental cost and average avoidable cost, with relevant examples and illustrations, and avoid embedding significant concepts in the footnotes.**

Necessity to consider the counterfactual

3.55 Paragraph 4.10 of the Draft SCR Guideline states that "*in assessing whether conduct has the actual or likely effect of harming competition, the Commission may assess what the market conditions would have been in the absence of the conduct (i.e. the counterfactual), and compare these counter-factual market conditions with the conditions resulting where the conduct is present. However, this is not a necessary step. For example, it may not be possible to determine the counterfactual in some cases (such as where an undertaking has held a substantial degree of market power for many years).*"

3.56 HKAB considers that the consideration of the counter-factual should always be a necessary step in assessing actual and potential effects on competition. Even though it may be difficult to predict with certainty or demonstrate with evidence

what the counterfactual would be (which is a question of evidence and the inevitable consequence of any hypothetical question), it is still important to consider what the market conditions would have been absent the alleged abusive market conduct. In many other areas of law (such as contract or tort law especially in the context of causation and remedies), it is common to engage in the hypothetical inquiry about the counterfactual even where there may be evidential challenges. HKAB also notes that the example where an undertaking has held a substantial degree of market power for many years is inappropriate and potentially confusing. This example implies that the counterfactual is what the market conditions would have been had the undertaking not possessed a substantial degree of market power, but the real counterfactual should be the market conditions had such undertaking not engaged in the alleged abusive conduct.

3.57 HKAB therefore **recommends that the Commission clarify that the consideration of the counterfactual should always be a necessary step in assessing effects on competition and remove the reference to the confusing example of an undertaking which has held a substantial degree of market power for many years.**

Predatory pricing – probability of recouping short term losses

3.58 Paragraph 5.6 states that when considering whether below-cost pricing constitutes predatory conduct, the Commission may, at its discretion, consider the extent to which the predator undertaking is in the longer term able to "recoup" its short term losses stemming from the below-cost pricing by subsequently charging supra-competitive prices as a result of increased market power.

3.59 HKAB considers that the whole purpose of predatory pricing should be to recoup losses in the longer term after driving out competitors, and therefore the probability of recouping short term losses should form part of the test for predatory pricing. The United States Supreme Court, in *Brooke Group Ltd v Brown v Williamson Tobacco*,[36] required "*a demonstration that the competitor had a reasonable prospect or... a dangerous probability of recouping its investment in below-cost prices...for the investment to be rational, the predator must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered... Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation. Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers*". Similarly, the

[36] 509 U.S. 209 (1993) at 222 – 224.

Predatory Pricing Enforcement Guidelines published by the Canadian Competition Bureau requires that the predatory pricing behaviour would increase the ability of a firm to exercise market power to the extent that the firm can likely recoup its losses and would consider evidence on the probability of recoupment.[37]

3.60 HKAB therefore **recommends that part of the test for predatory pricing require the probability of recouping the losses resulting from below-cost pricing.**

Clarify when tying and bundling are anti-competitive

3.61 Paragraph 5.11 of the Draft SCR Guideline states that "*the Commission will consider whether the tying and tied products (or products in the bundle) are distinct products and, if so, whether the conduct has an anti-competitive effect*".

3.62 HKAB notes that tying and bundling are very common business practices in Hong Kong and have obvious consumer benefits. However, there is no guidance on the relevant considerations on when tying and bundling "*have an anti-competitive effect*". It is important for businesses in Hong Kong to understand the analysis that needs to be taken in order to allow them to assess whether there is a need to change existing practices.

3.63 HKAB refers to the guidance by the European Commission on this subject in the EC Article 102 Enforcement Priorities to abusive exclusionary conduct by dominant undertakings. The European Commission requires that (i) the tying and tied / bundled products must be distinct; and (ii) the tying / bundling practice must be likely to lead to anti-competitive foreclosure, taking into account a number of relevant considerations including:

**(i)** whether the tying or bundling strategy is a lasting one;

**(ii)** the number of products in the bundle;

**(iii)** whether the competitors may easily replicate the same bundle;

**(iv)** whether there are sufficient customers who will only buy the tied product alone; and

**(v)** whether the tying and tied products are complementary to each other.

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[37] http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02713.html#s20 (See Section 5.1)

3.64 HKAB therefore considers that it is critical for the Commission to provide further guidance to the business community on how to make this assessment and clarify the relevant factors for this assessment. For example, HKAB understands that not all bundling will have an anti-competitive effect, but it is unclear the degree of bundling discount that would give rise to competition concerns. In particular, HKAB would like to seek clarification on whether anti-competitive effect would be less likely when: (i) similar bundles are offered by other competitors in the market; (ii) the discount is not significant (such that it benefits customers but does not foreclose competitors); and (iii) customers are given incentives and rebates for buying a second product.

3.65 HKAB therefore **recommends that the Commission clarify the relevant test and criteria for determining when tying and bundling is anti-competitive and the factors that suggest when tying and bundling is unlikely to lead to anti-competitive foreclosure.**

Clarify third line forcing is not prohibited

3.66 Hypothetical Example 6 of the Draft SCR Guideline states that "*if the medical devices supplier imposed a condition requiring the use of a particular undertaking or firm (including a subsidiary) to provide maintenance and repair services for its devices, this could also raise concerns under the SCR*".

3.67 HKAB notes that the example given relating to the tying of service to the service of a particular undertaking or firm appears to suggest that third line forcing is prohibited in Hong Kong assuming the expression "*a particular undertaking or firm*" includes third parties. In Australia, it is illegal to require the purchase of goods or services or giving of discount on the condition that the purchaser buys goods or services from a particular third party, which is known as third line forcing, a type of exclusive dealing in Australia. However, based on European jurisprudence and the EC Article 102 Enforcement Priorities, exclusive dealing is normally concerned with exclusivity restrictions in favour of the dominant undertaking only, without explicit reference to third line forcing. HKAB therefore **recommends that the Commission clarify whether third line forcing is a type of abusive conduct in Hong Kong and amend Hypothetical Example 6 accordingly**.

Concept of "*margin squeeze*"

3.68 Paragraphs 5.12 to 5.14 of the Draft SCR Guideline provide an explanation on margin squeeze.

3.69 HKAB notes that there is no explanation in the Guideline on what "margin" means, and there are no examples on when margin squeeze is likely to be anti-competitive. It would be useful to clarify what "margin" means as this may be understood differently in different industries and for different products. Given the rather

complex nature of this type of abuse, it would be helpful to provide an illustration of how this works.

3.70 HKAB therefore **recommends that the Commission clarify what "*margin*" means and provide an example on when margin squeeze is likely to be anti-competitive.**

Threshold for exclusivity

3.71 Paragraphs 5.22 and 5.25 of the Draft SCR Guideline describe what exclusive dealing means with reference to criteria such as "*a substantial proportion*" and "to *a large extent*". HKAB notes that these terms are vague and it is difficult to understand how they should be interpreted.

3.72 Apart from being common in Hong Kong, exclusivity restrictions are often commercially justifiable (e.g. where there is requirement for significant upfront investment) and do not necessarily adversely affect competition. It is important for businesses to have reference to a threshold (or some other measure) for the purpose of gauging whether such exclusivity restriction may raise competition concerns.

3.73 In the interests of business certainty, HKAB therefore **recommends that the Commission clarify what "*a substantial proportion*" or "*to a large extent*" means and indicate at least a threshold (or some other measure) below which anti-competitive effect would be unlikely.**

Clarify duration of exclusive dealing that may give rise to a foreclosure effect

3.74 Paragraph 5.27 states that "*in cases where competitors can compete on equal terms for the entirety of each individual customer's demand, exclusive dealing is unlikely to harm competition unless the duration of the exclusivity gives rise to a foreclosure effect*".

3.75 HKAB notes that exclusive arrangements are very common in Hong Kong. It is therefore helpful that the Commission has indicated that competition concerns from exclusive dealing are less likely to arise in these particular circumstances. However, the Commission notes that the duration of the exclusivity could give rise to a foreclosure effect (and thus raise concerns). In the interests of enhancing business certainty, HKAB **recommends that the Commission clarify the duration of exclusivity restrictions below which foreclosure effect would be unlikely.**

Rebates

3.76 Paragraph 5.28 of the Draft SCR Guideline states that "*typically, a loyalty rebate scheme involves offering a financial incentive to encourage the buyer to commit to purchasing more from the supplier. As a general matter, rebates of this kind are*

*normal commercial arrangements intended to stimulate demand to the benefit of consumers. However, rebates which are granted by an undertaking with a substantial degree of market power can have foreclosure effects similar in nature to those caused by exclusive purchasing obligations*".

3.77 In a business environment such as Hong Kong where rebates are very common, it is important to provide clear guidance on the test and relevant considerations for determining when rebates will give rise to competition concerns. The reference to "*similar foreclosure effects to exclusive purchasing obligations*" implies that the same tests set out in paragraphs 5.25 and 5.26 of the Guideline will apply equally to rebates and it would be helpful if the Commission can clarify whether that is indeed the case.

3.78 In the interests of business certainty, the Commission should provide further guidance on:

**(i)** the test for determining when rebates will give rise to competition concerns (e.g. when equally efficient competitors are unable to compensate the customer for the loss of the demand) and whether the Commission will follow a similar approach to the European Commission on calculating the "effective price" which the competitor will need to match)[38];

**(ii)** the relevant factors for determining when rebates will give rise to competition concerns (e.g. the higher the rebate as a percentage of the total price, the greater the foreclosure effect) and to provide indicative safe harbours to the extent appropriate;

**(iii)** whether incremental rebates are unlikely to give rise to competition concerns similar to quantity rebates (unless they are predatory in nature) and the analysis to be conducted by businesses to ensure that their rebates do not infringe the Ordinance;

3.79 Given the common practice of giving rebates in Hong Kong, HKAB **recommends that the Commission provide further guidance on the tests and relevant considerations for determining when rebates will give rise to competition concerns.**

HKAB trusts that the Commission will give due consideration to the issues and recommendations set out in this submission. In view of the importance of the Ordinance to the business community in Hong Kong, it would be helpful if the Commission could

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[38] See EC Article 102 Enforcement Priorities, paragraphs 41-42

publish its consultation conclusions and provide feedback to HKAB on the above recommendations. HKAB remains available to discuss the specific matters mentioned in this submission, and issues relevant to banking practices generally, and will seek to set up a meeting with the Commission at a convenient time.

Yours faithfully

Eva Wong
Secretary

Encl. – Summary of HKAB's recommendations

## Annex
## Summary of HKAB's recommendations

HKAB respectfully suggests that the following changes to be made to Draft Guideline on the First Conduct Rule – 2014 (the "**Draft FCR Guideline**") and the Draft Guideline on the Second Conduct Rule – 2014 (the "**Draft SCR Guideline**") published by the Competition Commission (the "**Commission**") on 9 October 2014. HKAB has adopted the definitions used in the draft guidelines herein.

### General

1. The **Draft FCR Guideline** and **Draft SCR Guideline** be amended to include more practical guidance on conduct and activities that are allowed and/or safe harbours under the Ordinance.

2. The Commission clarify in the **Draft FCR Guideline** and **Draft SCR Guideline** or through enforcement priorities that it will take into account regulatory requirements (including those set out in circulars, guidance and directives) when deciding on which cases to investigate and assessing the effects on competition.

3. The **Draft FCR Guideline** and the **Draft SCR Guideline**:

   (i) The burden of proof be placed on the Commission to prove that the conditions for the exclusions set out in Schedule 1 to the Ordinance (for example, in relation to the general efficiencies exclusion in Section 1 of Schedule 1) do not apply when alleging an infringement of the First Conduct Rule or the Second Conduct Rule.

   (ii) The Draft FCR Guideline and the Draft SCR Guideline each be amended to confirm that the standard of proof required is on the balance of probabilities.

### The Draft FCR Guideline

4. **Paragraph 2.3** be amended to clarify that, although an activity does not need to be intended to earn a profit in order to be an "*economic activity*", it must be *capable* of being carried on, at least in principle, by a private undertaking in order to make a profit.

5. **Paragraph 2.6**: A detailed explanation of the concept of "*decisive influence*", the factors that will be taken into account when determining whether "*decisive influence*" exists and any presumptions that may apply in this context be provided in the Draft FCR Guideline.

6. **Paragraph 2.10**: Further guidance be provided on how the genuine agency test will be applied in Hong Kong and that such further guidance includes, as a minimum:

(i) an explanation of the types of "*risk*" relevant to a genuine agency analysis, including whether risks that will *only* be borne by an agent where it acts in breach of a contract or outside the scope of its authority will be taken into account;

(ii) an explanation of the threshold for determining that a risk is "*insignificant*"; and

(iii) whether an agent can act for multiple principals.

7. **Paragraph 2.14** be expanded to clarify and provide examples of the steps that an undertaking would need to take in order to "*sufficiently object to and publically distance itself*" from an anti-competitive agreement and what, if any, documentary evidence would be required.

8. **Paragraphs 2.15 to 2.18**: Additional guidance and Hypothetical Examples be included in the Draft FCR Guideline ensure clarity on the circumstances in which a "*concerted practice*" rather than an "*agreement*", will arise.

9. **Paragraph 2.19** be amended to clarify whether a one-off gathering of individuals from the same industry background could be construed as an "*association of undertakings*".

10. **Paragraph 2.22**: The Commission clarify and provide further explanation on:

(i) the factors that will be taken into account when assessing whether a non-binding recommendation reflects an "*objective intention to coordinate the conduct of association members*" and, if possible, for a safe harbour to be provided, for example for non-binding recommendations that are not monitored and where there are no penalties for not following the recommendation;

(ii) whether a member of an association of undertakings will be held to have infringed the First Conduct Rule in relation to an anti-competitive decision by the association, even where the member undertaking did not comply with the decision (and therefore arguably did not participate in any corresponding agreement or concerted practice); and

(iii) what steps undertakings can take to protect themselves from liability for infringing the First Conduct Rule in the above situation, for example publically distancing themselves from the decision.

11. **Paragraphs 2.19 to 2.25**: The Commission include a new paragraph to clarify what liabilities undertakings may incur under the First Conduct Rule as a result of activities carried out through an association of undertakings where that association is an exempt statutory body.

12. **Paragraph 3.11**: The Draft FCR Guideline be modified to clarify that the Commission will adopt a similar approach to the EU in finding that only appreciable effects on competition will be investigated for infringing the First Conduct Rule.

13. **Paragraphs 3.13** and **6.8** be amended to clarify at what level of market power competition concerns may arise and whether market power will be approached in the same way for horizontal and vertical agreements.

14. **Paragraph 3.18** be amended to state that the Commission "*will*" assess the counter-factual.

15. **Paragraphs 3.19 to 3.23**:

    (i) **Paragraph 3.20** be amended to clarify how it will apply to mergers; and

    (ii) more detailed guidance on the meaning of "*directly related to*" and "*necessary*", including safe harbours, be included in the Draft FCR Guideline; and

    (iii) Hypothetical Examples illustrating how ancillary restraints will be analysed under the First Conduct Rule (including examples of when ancillary restraints will or will not be considered "*directly related to*" and "*necessary*" for the implementation of an agreement) be included in the Draft FCR Guideline.

16. **Paragraph 3.23**: The Commission clarify the meaning of "*in certain circumstances*" and provides Hypothetical Examples to illustrate how ancillary restraints will be analysed (including examples of when ancillary restraints will or will not be considered "*directly related to*" and "*necessary*" for the implementation of an agreement).

17. **Paragraph 5.3**: The word "*assuming*" be replaced with "*where*".

18. **Section 5**: Further guidance be provided in the Draft FCR Guideline to explain how collaboration between competitors (such as joint commercialisation agreements and research and development agreements) will be assessed by the Commission under the First Conduct Rule.

19. **Paragraph 6.32** be amended to recognise the potential pro-competitive effects of information exchange.

20. **Paragraph 6.35** be amended to:

    (i) clarify when the Commission will consider that an "*agreement*" arises in the context of standalone information exchange, including whether an agreement to exchange information could itself be considered by the Commission to constitute an "*agreement*" for the purpose of the First Conduct Rule or

whether a separate "*agreement*" to use the information for an anti-competitive purpose would also be required; and

(ii) provide a more precise description of the type of information which, if exchanged by competitors, would be considered by the Commission to have the object of infringing the First Conduct Rule.

21. **Hypothetical Example 10**: The final sentence be amended to match paragraph 6.35 to state that "*The information exchange arrangement has the object of restricting competition*".

22. **Footnote 17**: The examples of information that may be commercially sensitive be moved into the main body of the Draft FCR Guideline.

23. **Paragraphs 6.38 to 6.43**: The Commission provide further guidance on how discussions on compliance with new laws and regulations would be viewed under the First Conduct Rule and that a Hypothetical Example addressing this also be included.

24. **Paragraphs 6.38 to 6.43**: The Draft FCR Guideline be amended to clarify and provide comfort to undertakings regarding the Commission's approach under the First Conduct Rule to price benchmarking exercises that are based on publicly available information, in particular situations where undertakings receive price information from customers requesting price-matching of lower prices.

25. **Paragraphs 6.47 to 6.51**: The Commission provide further guidance and clarification by listing examples of standard terms that are unlikely to raise any competition concerns.

26. **Paragraphs 6.47 to 6.51**: The Commission clarify that no competition concerns would arise where undertakings active in a market have similar terms, provided these have arisen in the absence of any agreement or understanding between those undertakings.

27. **Paragraphs 6.76 to 6.80**: Additional practical guidance be included on what types of exclusive agreements are allowed under the Ordinance and, for example, safe harbours in areas such as the duration of such agreements.

28. **Paragraph 2.9 of the Annex to the Draft FCR Guideline** be expanded to explain how the proportion of competition accounted for by an undertaking will be assessed and the threshold at which an undertaking will be considered to account for "*a substantial proportion of competition*".

29. **Paragraphs 2.15 to 2.17 of the Annex to the Draft FCR Guideline**: The Annex to the Draft FCR Guideline be amended to clarify that it is not necessary for *all* consumers (i.e. all indirect and direct consumers down to the final consumer) to receive a "*fair share*" of the benefits of a restrictive agreement, how a "*fair share*"

will be assessed in practice, and what evidence will be required to demonstrate that consumers are receiving a "*fair share*".

30. **Paragraphs 2.18 to 2.19 of the Annex to the Draft FCR Guideline**: The Annex to Draft FCR Guideline be amended to expressly clarify that:

    (i) the third condition involves a two-step test and to distinguish between these steps in the test; and

    (ii) the test is not whether, in the absence of the restriction, the agreement would not have been concluded but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.

31. **Paragraph 3.1 of the Annex to the Draft FCR Guideline** be amended to clarify whether compliance with the requirements of case law will be regarded as "*compliance with legal requirements*".

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32. **Paragraph 2.12** and **2.19**: The Commission clarify that it may also consider evidence such as views of the concurrent regulators.

33. **Paragraph 2.24** be amended to clarify that captive production may be part of the relevant market and impose a competitive constraint on the other players within the market.

34. **Paragraph 2.27** be amended to clarify what "*placing more weight*" means and how the analysis is different in the context of bidding markets.

35. **Paragraph 2.31** be amended to clarify that supply-side substitutability is relevant when defining the relevant market, and it is only where suppliers are not able to switch production promptly or effectively, for reasons such as additional costs or time delays that the Commission should only consider the issue of supply-side substitutability at a later stage in the analysis.

36. **Paragraph 3.2** be amended to remove the reference to a period of two years being normally sufficiently long to amount to a "*sustained period*", unless there is a convincing justification.

37. **Paragraph 3.2** and **3.3**: The Commission clarify what "*competitive levels*" means in relation to price, output and quality and provide further explanation on the circumstances when more than one undertaking is likely to have a substantial degree of market power.

38. **Paragraph 3.10** be amended to at least provide an indicative market share threshold below which an undertaking would be unlikely to have a substantial degree of market power.

39. **Paragraph 3.14** be amended to clarify how market concentration will affect the analysis on market power, provide indicative thresholds on how the measures of market concentration would work as evidence of the level of market concentration in a relevant market, and explain whether both measures will be applied in each case, and how any inconsistent results will be reconciled.

40. **Paragraph 3.32** be amended to set out relevant factors to be considered in assessing countervailing buyer power. The reference to protecting the market "*as a whole*" should be clarified and further guidance provided on what "*sufficient*" means.

41. **Paragraphs 3.7 and 3.8** be amended to provide further guidance on the relevant considerations for assessing relevant market power.

42. **Paragraph 4.1** be amended to clarify whether an infringement of the SCR would require both: (i) abuse by an undertaking of a substantial degree of market power and (ii) conduct that has the object or effect of preventing, restricting or distorting competition in Hong Kong, in addition to what "*abuse*" means.

43. **Section 4** be amended to provide safe harbours for conduct that would not be abusive, including an indicative timeframe within which competition concerns are unlikely.

44. **Paragraph 4.3** be amended to clarify that the "*as efficient competitors*" test is applicable in assessing whether conduct is abusive.

45. **Paragraph 4.4**: The Commission provide further guidance on the defence of objective justification and provide examples on what legitimate objectives may include both generally and with reference to each type of abuse provided in the Guideline.

46. **Section 4**: The Commission provide further guidance on the assessment of discriminatory behaviour, and in particular clarify that discriminatory conduct *per se* is not a concern under the Ordinance.

47. **Paragraphs 4.8 and 5.5**: The Commission provide further guidance on the various concepts on cost such as average variable cost, average total cost, long run average incremental cost and average avoidable cost, with relevant examples and illustrations, and avoid embedding significant concepts in the footnotes.

48. **Paragraph 4.10**: The Commission clarify that the consideration of the counterfactual should always be a necessary step in assessing effects on competition and remove the reference to the confusing example of an undertaking which has held a substantial degree of market power for many years.

49. **Paragraph 5.6**: Part of the test for predatory pricing require the probability of recouping the losses resulting from below-cost pricing.

50. **Paragraph 5.11**: The Commission clarify the relevant test and criteria for determining when tying and bundling is anti-competitive and the factors that suggest when tying and bundling is unlikely to lead to anti-competitive foreclosure.

51. **Hypothetical Example 6**: The Commission clarify whether third line forcing is a type of abusive conduct in Hong Kong and amend Hypothetical Example 6 accordingly.

52. **Paragraphs 5.12 to 5.14**: The Commission clarify what "*margin*" means and provide an example on when margin squeeze is likely to be anti-competitive.

53. **Paragraphs 5.22 and 5.25**: The Commission clarify what "*a substantial proportion*" or "*to a large extent*" means and indicate at least a threshold (or some other measure) below which anti-competitive effect would be unlikely.

54. **Paragraph 5.27**: The Commission clarify the duration of exclusivity restrictions below which foreclosure effect would be unlikely.

55. **Paragraph 5.29**: The Commission provide further guidance on the test and relevant considerations for determining when rebates will give rise to competition concerns.