DRAFT GUIDELINES UNDER THE COMPETITION ORDINANCE

ISSUED BY THE COMPETITION COMMISSION

SUBMISSIONS

The Law Society has considered the six Draft Guidelines under the Competition Ordinance (the "Ordinance") issued by the Competition Commission (the "Commission"). In accordance with the Commission's invitation for comments on the Draft Guidelines, we present below our comments for the Commission's consideration.

GENERAL OBSERVATIONS

1. We are aware that the Ordinance requires the Commission to issue Guidelines on these matters and must before issuing them consult the Legislative Council and any persons it considers appropriate. We note the Commission's aim "to assist businesses operating in the Hong Kong marketplace to become familiar with competition law and its underlying policies" and that other "guidance" will be issued (e.g. to address the concerns of SMEs and with respect to its Leniency Agreement Policy and Enforcement Policy).

2. There may, however, be implications under the Ordinance as between Guidelines issued pursuant to the Ordinance and other guidance. Whilst the Commission correctly points out that "the Tribunal and other courts are ultimately responsible for interpreting the Ordinance and the Commission's interpretation does not bind them", Sections 35(7) and 59(6) of the Ordinance provide that "If in any legal proceedings, the Tribunal or any other court is satisfied that a guideline [issued under the Ordinance] is relevant to determining a matter that is in issue, (a) the guideline is admissible in evidence in the proceedings; and (b) proof that a person contravened or did not contravene the guideline may be relied on by any party to the proceedings as tending to establish or negate the matter".

3. Further, the provisions of Sections 35(6) and 59(5) that a "person does not incur any civil or criminal liability only because the person has contravened any guidelines issued under this section or any amendments made to them" may be noted.

4. This means that the issued Guidelines are more than mere guidance and will have some relevance in proceedings. The Commission should therefore clarify when it issues further guidance whether such is pursuant to any requirement to issue Guidelines under the Ordinance as this will have important implications in any proceedings.

5. As a general observation, we note that the Draft Guidelines relating to procedural aspects of the Ordinance (namely the Draft Guidelines on Complaints, Investigations and Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders) simply recite, at times verbatim, what is stated in the provisions of the Ordinance with little elaboration on their practical application.

6. While we appreciate that references to and citations from the Ordinance are necessary, since it is ultimately the Ordinance that prevails as the governing document, we would expect the public to want to look to the Guidelines to "de-mystify" the provisions of the Ordinance and to provide practical guidance.

7. Overall the Guidelines are not in our view as user friendly as they might be and by expressly deferring to the Ordinance, whilst legally understandable, the Commission gives the impression that it is sticking rigidly to its brief – not the facilitative approach that was promised.

8. In particular, we would hope to see more indications as to the Commission's priorities (at least in the early stages of investigation and enforcement), as well as those areas where the Commission is not intending to concentrate its efforts (for example, if such is the case, in relation to vertical agreements).

9. Bearing in mind the wealth of experience available to the Commission on competition regimes internationally, it is disappointing to note that the Commission is not taking the opportunity to consider issuing (after the relevant sections come into force) Block Exemptions of its own volition (for example in relation to vertical restraints or technology transfer agreements). Placing the onus on businesses to make the very heavy investment (and risk of enforcement) in applying for Block Exemptions is not likely to be well received by those wishing to comply with conduct rules, but lacking sufficient information or knowhow to do so.

10. The interplay between the Commission and the Communications Authority is also not clear even though the Guidelines are being issued jointly, noting also

that dominance is still a factor under the amended Telecommunications Ordinance (added Section 7Q) relating to "exploitative conduct" by a "licensee in a dominant position in a telecommunications market". During the passage of the Bill, the Government suggested that the "dominance" threshold be maintained in this new Section, rather than using the substantial degree of market power threshold, in order to "maintain the status quo" in the telecommunications industry. This suggests that the substantial degree of market power threshold is intended to be different from the dominance threshold previously applied by the CA.

DRAFT GUIDELINE ON COMPLAINTS (THE "COMPLAINT GUIDELINE")

11. Confidentiality

11.1 Paragraph 3.2 requesting that Complainants keep their complaint confidential is not supported by the Ordinance. The same applies to paragraph 6.2 of the Draft Guidelines on Investigations and ought not to be enforceable. It is of particular concern when the disclosure of confidential information carries criminal penalties (under Section 128 of the Ordinance), unless successfully argued that such information was not received from the Commission. Unilaterally providing that a complaint is confidential goes beyond the scope of the Complaint Guideline which (pursuant to Section 38 of the Ordinance) is solely to indicate "the manner and form in which complaints are to be made".

DRAFT GUIDELINE ON INVESTIGATIONS (THE "INVESTIGATION GUIDELINE")

12. Section 48 warrants the right to legal advice and legal professional privilege

12.1 Paragraph 5.31 of the Investigation Guideline states that the Commission "is not required by the Ordinance to wait for a person's legal advisers to attend the premises before commencing its search. However, where parties have requested their legal advisers to be present and there is no in-house lawyer already on the premises, Commission officers may at their sole discretion wait a reasonable time for external legal advisers to arrive" before commencing their search pursuant to a Section 48 warrant (our underlining).

12.2 Under Article 35 of the Basic Law, Hong Kong residents shall have "the right to confidential legal advice" and "choice of lawyers for the timely protection of their lawful rights and interests".

12.3 Bearing in mind issues of privilege, relevancy and liability at the investigation stage and the overriding right of parties to be legally represented, the interests of the party being searched will be seriously affected should their legal adviser not be given an appropriate opportunity to be present during the execution of the Section 48 warrant.

12.4 Further, although it is assumed in Hong Kong that legal professional privilege applies to communications with in-house lawyers, this is only applicable where the in-house lawyer is clearly acting in a professional capacity as a legal adviser within an in-house legal department and not for example carrying out other managerial or administrative duties.

12.5 In the area of competition law, the decision of the European Court in *Akzo Nobel Chemicals Ltd and Akros Chemicals Ltd v European Commission* (Case C-550/07 P) [2010] is of particular concern in holding that communications with in-house lawyers do not benefit from legal professional privilege because, unlike external advisers, they are not economically independent and cannot ignore the commercial strategies of their employees.

12.6 In view of these concerns, we would propose deletion of the words "and there is no in-house lawyer already on the premises" and amending the words "may at their sole discretion" to read "will". The relevant sentence will then read "Commission officers will wait a reasonable time for external legal advisers to arrive."

12.7 We would further wish to see guidance as what will constitute a "reasonable time". For example, in civil proceedings for Mareva Injunctions and Anton Piller Orders the prescribed order in Hong Kong (Practice Direction 11.2) allows the defendant to seek legal advice and to refuse entry for a "short time (not to exceed two hours, unless the plaintiff's solicitors agree to a longer period)" while privileged documents are identified and gathered. "If the defendant wishes to take legal advice and gathers documents as permitted, he shall first inform the plaintiff's solicitors and shall keep him informed of the steps being taken". Some such formula would be appropriate before carrying out a search under Section 48.

12.8 Paragraph 5.38 of the Investigation Guideline provides that the Commission's investigative powers will not affect established rights of legal professional privilege, as is consistent with Section 58 of the Ordinance. The statement that "this does not affect any requirement under the Ordinance to disclose the name and address of a counsel's or solicitor's client", though paraphrased from the wording of Section 58(2), does not provide any greater clarity as to where any such

requirement may be found. Further, the Commission has not provided any guidance on how it intends to handle privileged documents in the context of an investigation. As indicated above, it would be preferable for legal advice to be obtained so that any privileged documents may be identified; otherwise it is unclear whether Commission officers will receive sufficient training to ensure they are capable of identifying potentially privileged documents.

12.9 It should further be indicated whether it will be the practice to remove only those documents that are clearly not covered by privilege, or whether borderline documents may also be removed to further review whether they are privileged. If the Commission follows the latter practice, the review should obviously be conducted by a third party sufficiently removed from the investigation.

12.10 The above concerns are even more pertinent should the Commission maintain its stance that it will not be bound to wait for legal advisers to be present before commencing a search.

12.11 We would accordingly propose that the Investigation Guideline provides further details to address the above concerns.

13. Self-incrimination

13.1 We note that paragraphs 5.40 and 5.41 of the Investigation Guideline are a bare recital of Section 45 of the Ordinance. Paragraph 5.40 states:

"A person is not excused from giving any explanation or further particulars about a document; or from answering any question, from the Commission [under this Division] *on the grounds that to do so might expose the person to proceedings …."*

"This Division" is Division 2 which covers investigations but not complaints under Division 1; search and seizure under Division 3; or warning notices under Division 4. It would be helpful if the Investigation Guideline clarifies the limited circumstances under which the obligation arises and not for example with respect to the execution of Section 48 warrants.

13.2 Paragraph 5.41 states:

"No statement made under compulsion by a person to the Commission in giving any explanation or further particulars about a document, or in answering any question under Part 3,Division 2 of the Ordinance [which we again note only covers investigations] *is admissible against that <u>individual</u>* [note the Ordinance uses *<u>person</u>* here] *in such penalty*

(pecuniary or financial) or criminal proceedings unless, in the proceedings, evidence relating to the statement is adduced, or a question relating to it is asked, by that person or on that person's behalf."

13.3 Considering the opaque drafting of Section 45, the lay person would be no wiser upon reading the Guidelines and would indeed have to refer back to the Ordinance to understand the context in which self-incriminating evidence may be relied upon by the Commission (which in practice should be very limited given the powers of the Tribunal to impose penalties). None of this is explained in the Guidelines.

13.4 Whilst the information given pursuant to this Section may not be admissible in proceedings for a pecuniary/financial penalty or in criminal proceedings against the person being investigated, abrogating the right against self-incrimination may allow the information to be used in other ways (such as providing it to the police or to other authority). The Investigation Guideline could provide assurances that such extended use would not be made.

13.5 Overall, we would expect to see fuller and more explanatory wording as to circumstances, effect and implications of the self-incrimination provisions.

14. Immunity

14.1 Paragraph 5.42 refers the privileges and immunities provided by section 44 of the Ordinance without further explanation. It would be helpful to have these spelt out, particularly in view of the importance of witness immunity from legal proceedings (as noted in *Mahon v Rahn (No.2)* [2000] 1 WLR 2150) and the limitations claimed in the previous paragraph 5.41 in relation to self-incrimination.

15. Confidentiality and collateral use

15.1 Paragraph 6.2 states that the Commission will typically request that Complainants keep their complaint confidential. A similar provision is found in paragraph 3.2 of the Complaint Guideline. No such provision on confidentiality is found in the Ordinance nor is there any such obligation of confidentiality in relation to complaints made to the Communications Authority. It is questionable whether the Commission can impose and enforce such an obligation pursuant to Guidelines. This is of particular concern since the disclosure of confidential information received from the Commission may carry criminal penalties under Section 128 of the Ordinance. Although this

should only be applicable to confidential information received from the Commission, it is clearly not satisfactory for complainants to be in doubt about the confidentiality of a complaint.

15.2 Paragraph 6.11 notes Section 128 of the Ordinance that where the Commission discloses confidential information to third parties, such third parties are also subject to an obligation not to disclose the confidential information An issue may however arise if this third party is foreign and not based in Hong Kong or in some other jurisdiction with effective laws on confidentiality (for example a party based in China) or is a foreign competition authority, as the offence under Section 128(3) does not have extra-territorial effect.

15.3 Paragraph 6.13 states that information obtained by the Commission in one matter may be used by the Commission in another matter. It is not clear on what basis this is asserted and must be subject to the implied undertaking not to use documents for any collateral purpose, applicable in both civil and criminal cases (see *Taylor v Serious Fraud Office* [1999] 2 AC 177). Whilst the Commission may be allowed to disclose confidential information under section 126 of the Ordinance in the performance of its functions under the Ordinance, the collateral use of confidential documents and information should be by consent or subject to obtaining leave from the Tribunal or the court. It should not in any event apply to confidential information obtained outside the terms of lawful disclosure provided under Section 126(1).

DRAFT GUIDELINE ON APPLICATIONS FOR A DECISION (EXCLUSIONS AND EXEMPTIONS) AND BLOCK EXEMPTION ORDERS (THE "EXCLUSIONS GUIDELINE")

16. **Confidentiality and collateral use**

16.1 The same issues as to confidentiality and collateral use raised in paragraph 15 above apply to paragraphs 4.1 of the Exclusions Guideline stating that the Commission can use any information received, with or without notice, for "other purposes" (not specified) under the Ordinance. Those purposes, if applicable, should be spelt out and exclude matters or documents that are subject to the implied undertaking not to use for any collateral purpose or those that are otherwise confidential or privileged, including material that is privileged having been disclosed by an applicant "without prejudice" to any enforcement action.

16.2 Similarly, with respect to Block Exemption applications, the statement in paragraph 5.15 that "the Commission may use information provided by the applicant in the relevant enforcement action" should be further

elaborated and limited as set out in paragraph 16.1 above. Also, the reference to Part 12 of the Guideline is unclear and possibly incorrect.

17. Timeframes

17.1 Although as noted in paragraph 6.1, the Ordinance does not provide any timeframe for reviewing an Application or making a Decision, the Exclusions Guideline could usefully contain illustrative timetables. This would be in line with timeframe the Commission intends to specify under paragraph 6.3. The same applies to Block Exemption Applications (see paragraph 11.8), although it is accepted that such is likely to be a more involved process.

DRAFT GUIDELINE ON THE FIRST CONDUCT RULE (THE "FCR GUIDELINE")

18. Vertical agreements

18.1 As the Commission is aware, certain types of conduct are identified in the Ordinance as "serious anti-competitive conduct", including the allocation of markets and territories. Although this is defined in relation to conduct that is excluded from the exemption for agreements of lesser significance, it implies that such conduct is of itself anti-competitive, which of course will not always be the case. For example, an exclusive licensing agreement restricted to certain products or territories is a very common construct. In the absence of any clear exemption of Block Exemption, it will be a great challenge for businesses (and those advising them) to assess those types of conduct which are potentially, but not clearly, anti-competitive. Guidance is required to ensure that undertakings are in a position to ensure that they comply with best practices and avoid anti-competitive behaviour.

18.2 As noted in paragraph 5.5 of the FCR Guideline, vertical agreements are not precluded from falling within the scope of "serious anti-competitive conduct". Although only a procedural definition (i.e. as regards the issuance of an infringement notice), it may well cause confusion to businesses. Greater clarity in the Guidelines on this issue would be useful.

18.3 Paragraph 6.6 of the FCR Guideline states that vertical agreements will be considered "generally less harmful" compared to horizontal agreements, but will nonetheless in certain cases be anti-competitive. Paragraph 6.8 states that concerns will generally only arise where one party has "some degree of market power". However, it is unclear how the Commission intends this to be understood (presumably as something less than "substantial degree of market power"). It

introduces a further uncertain element into the analysis and as such is unhelpful to rely upon as guidance, especially since the Commission's current approach as to what quantitative degree of market power is relevant is itself unclear (see paragraph 19 below).

18.4 We understand the Commission's desire to preserve flexibility given the early stage of the adoption of competition legislation in Hong Kong. However, it is not desirable for this to be at the expense of sufficient certainty for the business community. Given the size and nature of the Hong Kong market, vertical agreements may not have as significant effect on competition as in other jurisdictions, and in the circumstances, it is appropriate for the Commission to draw a clear line.

18.5 The Commission may feel its hands are tied by the uncertainty inherent in the legislation, and that it is not, as a matter of law, at liberty to introduce new exceptions. However, we see no reason why the Commission could not in the Guideline indicate, as a matter of policy and approach, that vertical agreements will *not* be considered anti-competitive, other than with respect to conduct currently identified (i.e. resale price maintenance, exclusive distribution or customer allocation agreements and recommended and maximum resale price restrictions).

18.6 Even as regards resale price maintenance, it is noted that the Ordinance does not explicitly mention this, yet the Commission appears to have taken a tougher than expected stance in saying in its Overview of the Draft Guidelines that "as a general rule, the Commission will consider that resale price maintenance (RPM) arrangements are by their nature harmful competition." This seems to be an example where the Commission is using the Guidelines to extend its reach, rather than the expected light handed approach.

DRAFT GUIDELINE ON THE SECOND CONDUCT RULE (THE "SCR GUIDELINE")

19. Substantial degree of market power

19.1 We are aware that jurisdictions which adopt the "substantial degree of market power" (as opposed to the "dominance") test do not generally define any market share threshold below which the test will not apply. As a result, the number of undertakings which would come within the ambit of the prohibited conduct is enlarged.

19.2 Nevertheless, it is unfortunate that in promoting the legislation the government suggested a market share threshold of 25% should be adopted as a minimum threshold to establish a substantial degree of market power.

19.3 Section 3 of the SCR Guideline understandably focuses on the non-exhaustive list of factors set out in Section 21(3) of the Ordinance that may be taken into consideration in determining a substantial degree of market power. This will necessarily involve complex gathering and analysis of relevant economic data.

19.4 It would therefore be desirable to have some indicative threshold to enable undertakings to have greater certainty on where they stand, both in terms of their own and others' conduct in a relevant market. Feedback from many quarters indicates that such an indication would be welcomed by the public trying to grasp the implications of a new regulatory regime where there is so little experience. We believe it would be within the Commission's remit to adopt the presumption that an undertaking with a market share below 25% of the relevant market should be presumed not to possess a substantial degree of market power.

20. Predatory pricing

20.1 Paragraphs 5.2 to 5.5 of the SCR Guideline set out predatory pricing as an example of conduct that may constitute an abuse of a substantial degree of market power. We suggest that at this point the Commission should not prioritise the enforcement of predatory pricing behaviour, given the overall disagreement regarding whether predatory pricing should simply be considered a form of rational economic conduct, or whether its anti-competitive effects can be in any event measured and addressed by competition authorities.

20.2 The focus should instead be on conduct that is clearly anti-competitive. In this regard, we note that Section 21(2)(a) of the Competition Ordinance only refers to "predatory behaviour" towards competitors and does not refer specifically to "predatory pricing".

21. Margin Squeeze

21.1 Paragraphs 5.12 to 5.14 of the SCR Guideline concern margin squeeze as a type of abusive behaviour. In particular, paragraph 5.14 states that in considering a case of abusive margin squeeze, the Commission will consider the nature of the upstream input concerned (i.e. whether the upstream product is indispensable) and the level of the margin squeeze.

21.2 In relation to the level of margin squeeze, consideration should also be given as to the efficiency of downstream competitors of a vertically integrated undertaking. A downstream competitor cannot complain of margin squeeze if it is unable to complete simply because it is not

sufficiently efficient to profit from the available margin. In this regard, we recommend that the paragraph 5.14(b) be amended to add the words "who are at least as efficient as the undertaking with substantial market power" after "competitors in the downstream market for the relevant input", such that the sentence reads:

"A margin squeeze can be taken to arise where the difference between the downstream prices charged by the firm with substantial market power and the upstream prices it charges its competitors in the downstream market for the relevant input who are at least as efficient as the undertaking with substantial market power is…"

22. **Rebates**

22.1 Paragraphs 5.28 to 5.30 of SCR Guideline concern conditional rebates which in effect amount to a form of exclusive dealing. These paragraphs focus in particular on the relative anti-competitive effects of retroactive rebates and incremental rebates, as well as individual rebates and standardised rebates. We appreciate that the Commission has avoided taking an overly formalistic approach to rebates, which we agree to be appropriate in the context of Hong Kong.

22.2 Whilst the SCR Guideline casts rebates as a form of exclusionary conduct, we would suggest that the analysis of the exclusionary effects of a rebate program should also involve a cost analysis as consistent with international practice. As suggested in paragraph 5.28 of the SCR Guideline, rebates are usually normal commercial arrangements intended to stimulate demand to the benefit of consumers. An important consideration should therefore be whether the effective price charged for the products subject to the rebate program is below commercial levels.

23. **Intellectual Property**

23.1 We note passing references to intellectual property rights ("IPRs") in paragraphs 3.22 (and footnote 15) and 5.20/21 of the SCR Guideline. The Ordinance does not refer to IPRs and since the issue is complex, any guidelines relating to IPRs at this stage seem premature.

23.2 The short discussion and footnote in paragraph 3.22 raise the issue in the context of legal barriers, but stating that IPRs do not automatically give rise to barriers or necessarily imply substantial market power, as firms might well be able to invent around the relevant IPR, does not really provide guidance. We believe that the interplay between IPRs and competition law should be covered separately from the present Guidelines. Likewise the analysis in paragraph 5.20 sends confusing

messages, on the one hand indicating that a refusal to license would only be violation in exceptional circumstances, but then begs the question as to whether there might be "consumer harm" (which is not really the right test) in limiting a secondary market, new product or technical development.

23.3 As to the note on fair, reasonable and non-discriminatory ("FRAND") commitments in paragraph 5.21, this is currently a sensitive subject, with the developing enforcement of antitrust laws against foreign companies in China, in some cases based solely on royalty demands for licenses for patents that are not subject to FRAND commitments. China's guidelines with respect to the intersection of competition law and IPRs also appear to differ from international norms with consequential dilution of rights for IPR owners.

23.4 It is therefore doubly important for Hong Kong, which prides itself in the strength of its intellectual property regime, to give a clear message to the international community on the continuing scope of IP protection, despite the introduction of competition law. Therefore, we would recommend deleting paragraphs 3.22, footnote 15, 5.20 and 5.21 from the SCR Guideline.

DISCLAIMER AND FURTHER CONSULTATION

24. Finally, by way of disclaimer, we have no doubt that many other related organisations and bar associations will be providing extensive comments. Some Law Society members are already involved in such submissions and although this is the Law Society's preliminary response, different viewpoints may be taken as the law and practice develop. Any views expressed here are not to be taken as the views of any particular member of the Law Society (or its clients).

25. Likewise, any failure to comment on any particular provision in the Draft Guidelines (for example in relation to the Merger Rule, which has not so far been considered in this exercise), or on any other aspect of the process is not to be taken as tacit approval. We would indeed welcome opportunities to be further consulted on any specific procedural/legal issues that might come up.

The Law Society of Hong Kong
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