How to comply with the Competition Ordinance

Practical Compliance Tools for Small and Medium-sized Enterprises

The graphics on the cover depict the Chinese character for ‘competition’. It features two identical human forms facing each other, denoting the concept of competition on a level-playing field.

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1 SMEs AND COMPETITION LAW

Competition is key to driving efficiency, innovation, and better choices, quality and prices. SMEs are an important driving force in Hong Kong's economic development. The Competition Ordinance (**Ordinance**) is an important measure to protect businesses from anti-competitive practices and to ensure they are able to grow and flourish while competing on a level playing field. While SMEs will benefit from protections offered in the Ordinance, SMEs must also comply with the Ordinance and must ensure that they do not engage in conduct which may harm competition.

This SME Toolkit has been designed to assist you in developing a compliance strategy to best suit your needs. It is intended as a starting point for your compliance efforts. Ultimately, your compliance strategy will be driven by the nature and size of your business - there is no one-size-fits-all solution. Very small businesses may, for example, quickly assess whether they are engaging in high risk conduct (see pages 8 - 9) and immediately address those issues without having to formulate a detailed compliance strategy.

The Competition Commission (**Commission**) has also released a range of other materials to assist SMEs understand the Ordinance, including brochures and Guidelines. These resources are available on our website www.compcomm.hk.

2 OVERVIEW OF THE COMPETITION ORDINANCE

The Ordinance contains three competition rules:

- First Conduct Rule: prohibits anti-competitive conduct involving more than one party;
- Second Conduct Rule: prohibits anti-competitive conduct by a party with substantial market power; and
- Merger Rule: prohibits anti-competitive mergers and acquisitions in the telecommunications sector.

This SME Toolkit focuses on compliance with the First Conduct Rule as it is the rule that is of most relevance to SMEs.

3 WHAT ARE THE KEY COMPETITION LAW RISKS FOR YOUR BUSINESS?

Cartels are the key risk to watch out for in your business. **Cartels** are arrangements (in writing or otherwise) between competitors to agree to cooperate instead of compete. Regardless of the size or nature of your business, there are four arrangements you must never enter with your competitors ("**The Four Don'ts**"):

1. **Don't fix prices**

   including an agreement on a formula to calculate price or elements of price such as discounts, rebates, promotions or credit terms.

2. **Don't restrict output**

   including restricting the volume or type of particular goods or services.

3. **Don't share markets**

   including allocating customers by product or geographic area, agreeing not to compete for each other's customers and agreeing not to enter or expand into a competitor's market.

4. **Don't rig bids**

   including agreeing who should win a bid, supporting the designated winner by refraining from bidding, withdrawing bids or submitting bids with higher prices / unacceptable terms.

SMEs should also watch out for other arrangements between businesses that in some circumstances can harm competition such as:

Information sharing

Businesses often share information, and this is often legitimate commercial behaviour. However, sharing commercial secrets with a competitor such as information concerning future prices, quantities and customers can harm competition.

Joint ventures

Joint ventures, particularly those between SMEs to jointly provide a product or service they could not provide individually, are often good for competition. Competition concerns arise with joint ventures where the joint venture leads to competitors fixing prices, restricting output, sharing markets or exchanging commercial secrets beyond what is strictly required for the specific joint venture.

Agreements with suppliers and customers

Agreements between SMEs and their suppliers or customers – known as vertical arrangements – generally do not harm competition. However, a vertical arrangement which restricts a business' ability to compete (in particular their pricing freedom) can harm competition. Agreements between suppliers and customers are more likely to raise competition concerns where one of the parties to the arrangement has market power.

The Commission's Guideline on the First Conduct Rule provides further detailed guidance on these issues.

Are there exceptions to these rules?

The Ordinance contains exclusions specifically for SMEs ("exclusions for agreements and conduct of lesser significance"):

- the First Conduct Rule will not apply to arrangements between businesses where their **combined turnover is ≤$200 million** so long as that arrangement **is not Serious Anti-competitive Conduct** as defined by the Ordinance; and

- the Second Conduct Rule will not apply to businesses with **turnover ≤$40 million**.

Beyond these exclusions, the Ordinance also contains exclusions and exemptions applicable to all businesses regardless of size. For example, an exclusion applies to agreements that improve economic efficiency but which may otherwise contravene the Ordinance.

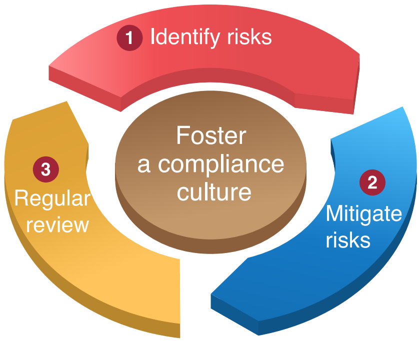
However, SMEs should not assume that a specific exclusion or exemption applies. For example, the Commission considers that **cartels** are examples of Serious Anti-competitive Conduct, so the exclusion for agreements of lesser significance would not apply and businesses will rarely benefit from any of the other exclusions or exemptions when engaging in cartel conduct. As the Commission has consistently said, avoid **The Four Don'ts**, regardless of your business size.

The Commission's Guidelines provide further guidance as to whether businesses can benefit from the exclusions and exemptions contained in the Ordinance. If in doubt, cease engaging in risky conduct and consider whether legal advice may be desirable before relying on any exclusions or exemptions.

4 HOW DO YOU COMPLY?

There are some basic steps to help SMEs ensure compliance. As the diagram below suggests, compliance is an ongoing process.

Figure 1: Compliance cycle



There are 3 key steps to follow:

1 Identify risks

Review your business practices to identify the competition law risks (if any) your business faces. Work out how serious the risks are and classify them as high, medium or low. The checklist on page (8 – 9) provides guidance on this step.

2 Mitigate risks

Develop and adopt appropriate controls (protocols, training etc.) to mitigate and manage the identified risks. Tackle the risks in order of priority (i.e. high to low). A non-exhaustive list of suggestions is set out on page (10 – 11).

3 Regular review

Businesses do not operate in a vacuum. Market conditions change. Compliance is therefore an on-going task. You should be pro-active in reviewing your business practices and compliance strategy.

Step 1: Identify risks

These basic checklists can be used as a starting point to help you and your staff identify and classify potential competition risks.

Table 1: Potential risks in the course of dealing with competitors

Risk Level	Conduct	Risk
High	Do you or your staff discuss or agree on matters of price or any element of price (e.g. discount, rebate or concession) with competitors?	Cartel risk (fix prices)
	Do you or your staff discuss or agree on volume or type of particular goods or services with competitors?	Cartel risk (restrict output)
	Do you or your staff discuss or agree who your customers are, which markets or customers you will or won't compete for with competitors?	Cartel risk (share markets)
	Do you or your staff discuss tenders with competitors?	Cartel risk (rig bids)
	Do you or your staff discuss or share commercial secrets (e.g. future prices, future production plans etc) with competitors?	Cartel risk (fix prices, restrict output)
Other (Low – Medium)	Do you or your staff attend trade association or industry body meetings where representatives of competitors are also present and there is a risk that any of the above high risk conduct may occur?	Other anti-competitive risk
	Does your business enter into joint ventures with competitors?	Other anti-competitive risk
	Does your business have joint purchasing / selling agreements with competitors?	Other anti-competitive risk

Table 2: Potential risks in the course of dealing with suppliers and customers

Risk Level	Conduct	Risk
High	Do you or your staff impose fixed or minimum resale prices on distributors / retailers that sell your product(s)?	Resale price maintenance risk
Other (Low – Medium)	Do you or your staff impose maximum resale prices on distributors / retailers that sell your product(s)?	Other anti-competitive risk
	Do you or your staff recommend resale prices at which your distributors / retailers should sell your product(s)?	Other anti-competitive risk
	Do you or your staff impose restrictions as to where or to which customers a reseller or distributor can resell your product(s)?	Other anti-competitive risk
	Does your business enter into exclusive agreements for long periods (e.g. over several years)?	Other anti-competitive risk

Risks identified in the above tables as “low” or “medium” risks can be escalated to “high” if they involve any of The Four Don’ts (e.g. if trade association meetings provide competitors an opportunity to exchange future pricing information).

The Commission’s Guideline on the First Conduct Rule provides further detailed guidance on other anti-competitive risks.

Step 2: Mitigate risks

Once you have identified and classified the potential risks, take appropriate measures to mitigate and manage them by formulating a compliance strategy to suit your business. There is no one-size-fits-all solution – your business' compliance strategy will be guided by the nature and size of your business and risks identified.

Some measures to consider in formulating your compliance strategy include:

1 Eliminate cartel risk

If your business (or you suspect your business) is engaged in a cartel (that is, **The Four Don'ts**), exit the cartel. You should consider seeking legal advice. In some cases, you may be eligible to approach the Commission to apply for leniency.

The consequences of non-compliance with The Four Don'ts are the most severe – protect your business. Keep a log of the cartel risks identified and how they have been dealt with.

2 Modify business practices

Some business practices do not involve cartel risk but may nonetheless harm competition. Consider if these practices can be modified to achieve a similar outcome in a manner which is not anti-competitive.

3 Appoint a compliance officer

It is useful to appoint a person in your business to be responsible for the compliance strategy. In a larger business, this could be head of legal/compliance, or in a smaller business, a director or senior manager.

4 Develop a competition compliance policy

Competition compliance is the responsibility of all employees. The CEO, senior management or board should lead by example and prepare a written statement setting out their personal commitment to competition compliance.

5 Provide training to staff

Consider organising a simple workshop to ensure staff (especially those who come into contact with competitors, suppliers or customers) have a basic understanding of the Ordinance and the key do's and don'ts. Deliver a strong message that compliance with the Ordinance is everyone's responsibility. Keep a record of employees who attend training.

6 Extra measures for higher risk staff

Consider if targeted training is necessary for "higher risk" staff, e.g. front line sales staff, or staff that participate in "higher risk" events, e.g. annual industry conferences where competitors will be present.

7 Guidelines and protocols

Circulate the Commission's SME brochure to all staff. Ensure your staff read the brochure and understand the key concepts.

Consider if it is appropriate to prepare additional guidelines and protocols to manage risks. Examples include guidelines for staff attending trade association or industry meetings, how to handle commercially sensitive information and how to deal with competition law complaints (internal and external).

8 Other considerations

Businesses with a higher risk profile may consider introducing additional measures to encourage staff to comply with the Ordinance. For example, developing appropriate protections for whistleblowers or sanctions for staff who engage in competition law breaches.

9 Seek advice

If in doubt, seek help. Consider contacting your trade association to ask if they can assist with competition compliance or for more complex issues, contact your legal adviser.

Communicate and explain the compliance strategy to staff for implementation.

Remember, SMEs are potential victims of anti-competitive conduct. If you and your staff devote time to understanding these risks, take the opportunity to consider whether other businesses may be engaging in anti-competitive conduct that is impacting your business. If you identify such conduct, consider reporting it to the Commission.

Step 3: Regular reviews

Compliance is an on-going process which requires strong commitment from staff at all levels. Regularly review your business practices and compliance strategy. Conduct a competition audit on a regular basis to manage existing and detect new risks. The frequency of an audit will depend on your business' risk profile. If necessary, make improvements to your policies and controls following the compliance audit.

Compliance is not necessarily costly and complicated

The complexity of a competition compliance strategy depends on the nature and size of a business. For example, a medium-sized company of 50 staff in the manufacturing industry may spend more resources on setting up a structured compliance program than a small-sized company of 3 staff or an entrepreneur, which may simply run a quick risk assessment and take controlling measures then and there. The key to successful competition compliance is to understand the risks your business is exposed to, manage those risks, and ensure that all staff are mindful of the need for compliance.

You can also save time and worry by focusing on the key risks first. SMEs should first and foremost seek to ensure they avoid The Four Don'ts and do not enter cartel arrangements.

Remember there is no one-size-fits-all solution to formulating a compliance strategy. Develop and implement a strategy suitable to the size and risk profile of your business.

5 TEST YOUR KNOWLEDGE OF COMPETITION LAW

A good understanding of the competition law is fundamental to setting up an effective compliance strategy. This quiz will test how much you know about competition law risks.

1	Q	"Fix prices" only means an agreement in writing between competitors to set a price at which they intend to sell an item in the marketplace.
	A	True / False
	E	Agreement can be verbal or in writing, or even through a forum, e.g. trade association. Agreements need not be formal nor legally binding – it might be an informal arrangement, understanding or undertaking.
2	Q	Using a trade association to share commercial secrets like future prices indirectly with competitors will likely be considered a form of price fixing.
	A	True / False
	E	Both direct and indirect forms of exchange of commercial secrets such as future prices can amount to price fixing.
3	Q	"Restrict output" refers to a restriction of goods only, not services.
	A	True / False
	E	Output includes both goods and services.
4	Q	"Share markets" means competitors do not enter or expand into each other's geographical market only.
	A	True / False
	E	It also captures agreements between competitors not to compete for each other's customers and not to produce each other's goods.

5	Q	“Rig bids” refers to agreeing who should “win” a bid only so it is legal to support the designated winner by refraining from bidding for a project.
	A	True / False
	E	Supporting a designated winner in any manner (e.g. by refraining from bidding or submitting a bid that is not intended to be successful) in a bidding process is prohibited.
6	Q	As an SME, I don’t really have to be concerned about contravening the Second Conduct Rule.
	A	True / False
	E	As explained in the SME Brochure, SME’s acting alone cannot harm competition. SME’s making tactical decisions (e.g. to sell items below cost or refuse to supply someone) risk harming themselves but will not harm competition. In limited circumstances, large businesses (with substantial market power) making the same decisions may harm competition. If you feel a large business has harmed competition through anti-competitive conduct, you should report this to the Commission.
7	Q	I can agree with my competitors to fix the prices of the services we offer as the exclusion for agreements of lesser significance applies.
	A	True / False
	E	The exclusion for agreements of lesser significance does not apply to Serious Anti-Competitive Conduct (i.e. The Four Don’ts). Regardless of the size of your business you should never agree with your competitors to fix prices, restrict output, share markets or rig bids.

6 HYPOTHETICAL EXAMPLES

Example 1

A trade association for junk owners collects from and circulates to its members information on their respective proposed future prices. This includes information as to the proposed prices for specific journeys. The information is not made available to the public and is circulated in advance of a seasonal price review by the association members.

The Commission considers this arrangement harms competition. Members should immediately stop providing the trade association with their future pricing information. Members should consider seeking legal advice. In some cases, they may be eligible to approach the Commission to apply for leniency.

A written record of the action taken should be made. This can help protect member(s) if an allegation is later made about participation in a cartel.

Members should at all times make independent pricing decisions. There should be no agreement between competitors on prices, discounts or any other matters related to price.

Example 2

A tender is announced to construct a mid-rise office building in Wan Chai. Three construction companies intend to submit bids - TungBuild Ltd, ChungConstruct Co and FungFormation Ltd. TungBuild Ltd and ChungConstruct Co separately approach FungFormation Ltd advising that they wish to be seen as tendering for the project but do not want to win the tender and ask FungFormation Ltd for a cover price. In return they suggest FungFormation Ltd let them win an upcoming tender.

The Commission considers this arrangement harms competition. FungFormation Ltd should immediately end all communications with the other two firms. FungFormation should consider seeking legal advice. They may want to consider making a complaint to the Commission.

A written record of this action taken should be made. This can help protect FungFormation Ltd if an allegation is later made about involvement in a cartel.

All bidders should price their bids independently of each other.

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Disclaimer

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