

For discussion

Legislative Council Panel on Economic Development
Guidelines and other documents prepared by the Competition
Commission as required under the Competition Ordinance

Purpose

The Competition Commission (Commission) is required to consult the Legislative Council and any persons it considers appropriate before issuing any guidelines that it is required to issue under the Competition Ordinance (Ordinance). Before signing the Memorandum of Understanding (MOU) required by the Ordinance between the Commission and the Communications Authority (CA) for the purpose of co-ordinating the performance of their functions under the concurrent legislation, the two agencies must consult the Legislative Council. This paper also outlines the proposed recommendation by the Commission to the Government for fees payable under the Ordinance in respect of applications.

Guidelines required by the Competition Ordinance

2. The Ordinance provides that the Commission, together with the CA which has concurrent jurisdiction with the Commission to enforce the Ordinance in relation to the anti-competitive conduct of certain businesses operating in the broadcasting and telecommunications sector,¹ must issue guidelines on:

- the manner in which the Commission² expects to interpret and give effect to:
 - the First Conduct Rule (Guideline on the First Conduct Rule)
 - the Second Conduct Rule (Guideline on the Second Conduct Rule)

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (“TO”) or the Broadcasting Ordinance (Cap 562) (“BO”), other persons whose activities required them to be licensed under the TO or the BO or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the Ordinance.

² References to the Commission in this paper includes the CA so far as the Guidelines are concerned.

- the Merger Rule (Guideline on the Merger Rule);
- the manner and form in which complaints are to be made (Guideline on Complaints);
- the procedures it will follow in deciding whether or not to conduct an investigation and the procedures it will follow in conducting an investigation (Guideline on Investigations); and
- the manner and form in which it will receive applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders (Applications Guideline).

3. In November 2014 the Commission informed the Panel that it had published six Draft Guidelines on 9 October 2014. The Commission also published an Overview summarising the Commission’s approach to preparing the Draft Guidelines and the process for providing comments on the drafts. A media release and a series of responses to Frequently Asked Questions were also published. The Draft Guidelines and additional materials were published on the Commission’s website and also emailed to over 1,000 interested parties.

4. The Draft Guidelines reflected an extensive engagement program undertaken by the Commission following publication of “Getting Prepared for the Full Implementation of the Ordinance” in May 2014.

5. The guidelines set out how the Commission intends to interpret and give effect to the Competition Rules and the procedural provisions of the Ordinance. The guidelines are not, however, a substitute for the Ordinance and do not have binding legal effect. The Competition Tribunal and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them.

Public Consultation on Draft Guidelines

6. During the public consultation between October and December 2014 the Commission received 64 submissions on the Draft Guidelines covering a total of 640 pages. Submissions were made by 49 separate parties including parties representing thousands of businesses in Hong Kong. A range of organisations provided comments including trade associations, chambers of commerce, political parties, public bodies, businesses, law firms and other professional advisory bodies, as well as private individuals.

7. The Commission made all the submissions about the Draft Guidelines available on its website. Overall the Draft Guidelines were received positively. Many submissions welcomed the clear drafting and comprehensive nature of the Draft Guidelines, while raising specific issues for further consideration. The input received through these submissions greatly assisted the Commission in identifying areas where amendments, clarification and further guidance in the Draft Guidelines were merited.

8. In addition, the Commission held meetings with a range of parties and presented at a number of seminars about the Draft Guidelines. Information and feedback from these events was also taken into account in reviewing the Draft Guidelines. Further information about the Commission's education and outreach activities is provided at paragraphs 29 to 32 below.

9. The Commission is particularly aware that the Guidelines are by their nature technical and detailed. With this in mind, the Commission has provided alternative guidance particularly targeted at small and medium sized enterprises (SMEs) including the publication in December 2014 of a brochure entitled "The Competition Ordinance and SMEs".

Publication of Revised Draft Guidelines

10. Following careful consideration of the feedback provided, the Commission published six Revised Draft Guidelines on 30 March 2015. These Revised Draft Guidelines are attached for consultation as required by the Ordinance (see Annex).

11. In addition to publishing the Revised Draft Guidelines, the Commission also published a Guide (also attached, see Annex) summarising the Commission's approach to preparing the Revised Draft Guidelines and how it addressed the key issues raised in the submissions received. A media release and series of answers to Frequently Asked Questions were also published. All of this material is available on the Commission's website.

12. Members of the public were invited to provide any further comments on the Revised Draft Guidelines by 20 April 2015. The representatives of the Commission will be able to update Panel members on these comments at the meeting on 27 April 2015.

13. In the Revised Draft Guidelines the Commission:
- increased the number of hypothetical examples and included examples on topics for which request for further detail were made;
 - provided further guidance and detailed analysis on a range of specific topics that submissions had sought further detail on including joint selling, distribution and marketing agreements and joint tendering arrangements and new sections on collective bargaining, franchising and selective distribution agreements.
 - clarified a number of procedural topics on the Commission's approach to the handling and processing of complaints and applications for decisions and block exemption orders.

Memorandum of Understanding between the Competition Commission and the Communications Authority

14. Section 161(1) of the Ordinance provides that as soon as is reasonably practicable after the coming into operation of the section, the Commission and the CA (Authorities) must prepare and sign a MOU for the purpose of co-ordinating the performance of their functions under the Ordinance. A list of matters that must be provided for in the MOU is contained in Schedule 6 to the Ordinance.

15. Before signing any MOU under section 161, or any amendment to it, the Authorities must consult the Legislative Council. The Authorities therefore provide the following information to Legislative Council members on the proposed MOU.

16. The Authorities have engaged in detailed discussions on the content of the MOU. Subject to further discussion and finalisation of the text, the salient principles and features that are proposed to be adopted in the MOU are set out in paragraphs 17 to 21 below.

17. The MOU will state as an objective that the functions which can be performed under the Ordinance concurrently will be exercised by the Authorities in such a manner as to ensure a consistent interpretation and application of the provisions of the Ordinance. The MOU will provide a framework to promote co-operation and coordination between the

Authorities in dealing with matters that are subject to concurrent jurisdiction and to facilitate the efficient and effective handling of such matters while avoiding duplication where possible.

18. The MOU will provide that wherever a matter which falls within the concurrent jurisdiction comes before either of the Authorities, the receiving Authority will inform the other and discuss the matter with each other with a view to agreeing which Authority will take the lead in dealing with the matter. Where a matter falls fully within the concurrent jurisdiction the CA would ordinarily take the lead role given its sectoral expertise in the telecommunications and broadcasting industries. The Authorities will continue to liaise during the course of a matter and provide each other assistance and support. The MOU will also provide for the timely and efficient transfer of matters from one Authority to the other should the Authorities consider this to be appropriate in particular circumstances.

19. The proposed framework under the MOU will be designed to ensure the efficient and effective allocation and conduct of all matters which fall within the concurrent jurisdiction. The close liaison between the Authorities will mitigate any attempts by parties to “forum shop” between the Authorities.

20. The MOU will provide for the exchange of information between the Authorities, including confidential information as provided for by section 126(h) of the Ordinance. There will be arrangements for general co-operation and support for the activities of the Authorities, such as the joint publication of Guidelines and other educational material and the provision of enforcement and technical support to each other.

21. The MOU will make arrangements for regular liaison meetings between the executive teams of the Authorities and the appointment of liaison officers for day to day contact. As required by Schedule 6 of the Ordinance, the MOU will provide for the manner in which the Authorities will resolve any disputes over any issues relating to or covered by the MOU and/or concurrent matters.

22. Following this consultation with the Legislative Council, the Authorities will finalise the text of the MOU. Once the text has been agreed, each of the Authorities will then proceed to formally approve and sign the

MOU. It is anticipated this process will be completed upon the commencement of the substantive provisions of the Ordinance.

Proposed recommendation to Government for fees payable

23. Section 164 of the Ordinance provides that the Commission may charge a fee for the making of an application to the Commission under the Ordinance. Parties may make applications for the following under the Ordinance:

- (1) Decisions under Section 9 or Section 24 confirming whether an agreement or conduct is covered by an exclusion or exemption from the conduct rules (Applications for a Decision);
- (2) Decisions under Section 11 of Schedule 7 confirming whether a merger or proposed merger is covered by an exclusion from the merger rule (Merger Decision Applications); and
- (3) Block exemption orders for certain categories of agreement under Section 15 (Block Exemption Applications).

24. The Commission has carefully considered fees payable to other authorities in Hong Kong, fees charged by competition authorities in other jurisdictions in respect of similar applications to those described at points (1) to (3) of paragraph 23 and has conducted preliminary discussions with various parties on the possibility of prescribing fees under the Ordinance. The Commission has also taken account of the likely resources involved in dealing with applications under the Ordinance, having regard to the Government's policy that fees and charges payable to the public authorities should generally uphold the "user pays" principle.

25. The Commission proposes to recommend the following level of fees to Government for inclusion in regulations made under Section 164 of the Ordinance:

- (1) In respect of Applications for a Decision, the Commission proposes to recommend a two tier system of fees:
 - (a) For applications in respect of all exclusions and exemptions except the exclusion in Section 1 of Schedule 1 of

the Ordinance, the fee would be \$50,000;

(b) For applications in respect of the exclusion in Section 1 of Schedule 1 of the Ordinance (exclusion for agreements enhancing overall economic efficiency) the fee would be \$100,000.

This two tier arrangement recognises that applications in respect of Section 1 of Schedule 1 of the Ordinance are likely to be more complex and require more Commission resources than for other Applications for a Decision. Where parties make an application in respect of the exclusion in Section 1 of Schedule 1 of the Ordinance and other exclusions or exemptions under the Ordinance, the fee payable would be a combination of the two fees referenced above.

(2) In respect of Merger Decision Applications, the Commission proposes to recommend a fee of not more than \$500,000.

(3) In respect of Block Exemptions Applications, the Commission proposes to recommend a fee of not more than \$500,000.

26. Section 164(4)(d) of the Ordinance states that regulations made under Section 164 may provide for the reduction, waiver or refund, in whole or in part, of any fee, either upon the happening of a certain event or in the discretion of the Commission. The Commission proposes to recommend that the Government provides for a discretion on the part of the Commission to reduce, waive or refund fees in the regulations the Government makes under Section 164.

27 The Commission proposes to publish guidance outlining the criteria it would take into account in exercising this discretion. Relevant factors likely to be considered by the Commission would be the actual costs incurred by the Commission, appropriateness of waivers or reductions for SMEs and not-for-profit entities and the extent of general public interest arising from the application.

28. The Commission has posted information about its proposed recommendations on fees on its website and also sent letters inviting comments to chambers of commerce and business associations. The Commission will be able to update Members at the meeting on 27 April on the comments that the Commission has received.

Education and Assistance Activities of the Commission

29. Since May 2014 the Commission has been actively engaging with businesses and the Hong Kong community to inform them about the Ordinance and to prepare for its full implementation.

30. Up to March 2015 the Commission has conducted over 130 briefings and meetings with the major chambers, a large range of industry associations, representatives of SMEs and a wide variety of professional bodies. Five seminars for SMEs were organised and well attended. As noted above a brochure “The Competition Ordinance and SMEs” was published in December 2014 to assist SMEs in understanding their rights and obligations under the Ordinance.

31. In addition, the Commission has commissioned a series of TV / radio Announcement of Public Interests (API) and an educational video which were broadcasted in conventional media, public transport and online platforms. The educational video on cartels which was uploaded to YouTube has attracted over 81,000 views. In addition, the Commission’s website has received over 2.5 million hits since its launch in 2014.

32. Since the start of this publicity work, the Commission has seen increased public awareness and strong interest from businesses. The Commission has received and addressed enquiries from businesses and trade associations on various competition-related issues. The Commission has also been working with trade/industry associations so that they can assist their members to comply with the new law.

Next steps

33. Following this consultation with the Legislative Council, the Commission will adopt and issue a finalised set of Guidelines.

34. The Commission recognises that in addition to the guidelines prescribed by the Ordinance, there are a number of other publications that advisers and specific sectors may find helpful. The Commission will continue to prepare and release policies (such as a Leniency Agreement Policy and an Enforcement Policy), publications (such as easy to follow

leaflets and booklets for SMEs and trade associations) and self-assessment tools to assist businesses and their advisers in understanding how to comply with the Ordinance.

35. The Commission is completing its internal preparations including finalising the recruitment of staff and establishing operational policies and processes. It is anticipated that both the external publication program and the internal preparations will be completed by the middle of 2015. The Commission will continue to engage actively with the business sector and the general public to ensure they are ready for the full implementation of the Ordinance.

Competition Commission

April 2015

Annex: Guide to the Revised Draft Guidelines Issued under the Competition Ordinance and the Revised Draft Guidelines on

- The First Conduct Rule
- The Second Conduct Rule
- The Merger Rule
- Complaints
- Investigations
- Applications for a Decision under Section 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders

Guide to the Revised Draft Guidelines Issued under the Competition Ordinance

Introduction

1. On 9 October 2014, the Competition Commission (the “**Commission**”), together with the Communications Authority (the “**CA**”), published six draft guidelines (the “**draft Guidelines**”) pursuant to the Competition Ordinance (Cap 619) (the “**Ordinance**”) for public comment. Issued at the same time, the *Overview of Draft Guidelines under the Competition Ordinance – 2014* (the “**Overview**”) provided details of the Commission’s approach to preparing, and the process for submitting feedback on, the draft Guidelines. These followed the release of the Commission’s publication, *Getting prepared for the full implementation of the Competition Ordinance*, in May 2014 and an engagement process with a large number of Hong Kong businesses and other stakeholders between May and August 2014.
2. The Commission is pleased to report extensive submissions from a wide spectrum of stakeholders in Hong Kong and overseas during the consultation:
 - 64 submissions were received on the draft Guidelines, covering a total of 640 pages.
 - Submissions were made by 49 separate parties, including parties representing thousands of businesses in Hong Kong.
 - A range of organisations provided comments, including trade associations, chambers of commerce, political parties, public bodies, businesses and law firms and other professional advisory bodies, as well as private individuals.
3. These submissions are available on the Commission’s website. In addition, the Commission held meetings with many individuals and organisations both before and during the consultation period to provide information about the Ordinance and give context to the development of the draft Guidelines.
4. The Commission would like to thank all those who participated in the Commission’s engagement exercise and consultation. The input received through submissions and meetings has greatly assisted the Commission in identifying areas where amendments, clarifications and further guidance in the draft Guidelines were merited.

5. Following careful consideration of the feedback provided, the Commission has released revised versions of each of the draft Guidelines. These revised draft Guidelines, published on 30 March 2015, are referred to as the “**revised Guidelines**” in this document. The revised Guidelines will be put before the Legislative Council and other appropriate persons for consultation as required by the Ordinance.
6. This guide to the revised Guidelines (the “**Guide**”) summarises the Commission’s approach to preparing the revised Guidelines and, in particular, how it has addressed key issues raised in the submissions received. The Guide is not intended to give an account of every comment received during the consultation. Amendments to the draft Guidelines which are clear on their face or purely stylistic are not discussed in the Guide.

Overarching approach to preparing the revised Guidelines

7. In the Overview, the Commission set out a number of principles underlying its approach to preparing the draft Guidelines. These principles apply equally to the revised Guidelines.
8. The submissions raised a number of additional points regarding the Commission’s general approach to the Guidelines, which are addressed in the paragraphs below.

Status of the Guidelines

9. Certain parties sought clarification as to the legal status of the Guidelines, including the extent to which the Commission would follow the Guidelines.
10. As noted in the Overview, the Guidelines reflect the Commission’s interpretation of the Ordinance. Ultimately, it is the Competition Tribunal (the “**Tribunal**”) and other Hong Kong courts that will decide the meaning and application of the Ordinance.
11. The Commission will follow the general approach set out in the Guidelines, which will be adapted to the facts and circumstances of a particular matter as may be appropriate. However, there may be circumstances where it modifies the application of the Guidelines, for example where the Tribunal has issued a decision which is inconsistent with the Guidelines. The introductory text in each of the revised Guidelines reflects this position.

Industry and sector neutral

12. Certain submissions requested guidance in relation to a specific industry or sector in the revised Guidelines. As mentioned in the Overview, the legal and economic tests to assess competition concerns have proven around the world to be flexible enough to be applied to a range of economies and industries. As such, the Guidelines are designed to be applicable across sectors. The revised Guidelines therefore do not distinguish between particular sectors, business types or industries.
13. The Commission is aware that there may be sector-specific concerns where guidance would be useful and will endeavour to assist with such concerns to the extent possible. As indicated in the Complaints Guideline, the Commission welcomes queries from the public regarding matters which may be within the scope of the Ordinance, including in relation to sector-specific concerns. In addition, although the examples in the Guidelines are based on a purely hypothetical scenario in a particular industry, they may be applied by analogy to other industries. In the coming months, the Commission intends to issue a range of further guidance (see paragraphs 17 and 18 below) and will continue to engage with specific sector groups as well as Hong Kong businesses generally.

Relevance of overseas precedents

14. Some parties requested clarification regarding the extent to which overseas precedents would be referred to by the Commission, or could be relied on by parties, in the application of the Conduct Rules.
15. The Commission recognises that the Ordinance was drafted having regard to the competition laws of a number of countries. It may well be informative to consider the analytical approach taken by other jurisdictions to assessing particular competition issues. However, the Commission is tasked with assessing potential competition concerns in markets in Hong Kong under the framework of the Ordinance. The legal frameworks underlying overseas precedents are not identical to, and may differ in certain important respects from, the Ordinance. Additionally, the structure and operation of the markets examined in overseas precedents may vary considerably from those in Hong Kong. This means that foreign precedents or analysis will rarely be an exact 'fit' for the purposes of applying the relevant legal tests under the Ordinance.
16. As such, the Commission has not simply adopted the position taken by overseas jurisdictions to particular competition issues but has tailored the Guidelines to suit the Hong Kong context.

Other publications

17. As indicated in the Overview, the Guidelines required by the Ordinance will not be the only guidance the Commission provides. The Commission will continue to prepare policies and publications to assist businesses and their advisers in understanding how to comply with the Ordinance, including with respect to sector-specific concerns. The Commission has already published a brochure, *The Competition Ordinance and SMEs*, on 30 December 2014.
18. Forthcoming publications include the Commission's Leniency Agreement Policy and its Enforcement Policy. The Commission will also publish its Memorandum of Understanding with the CA for the purpose of coordinating the performance of their respective functions, as required under section 161 of the Ordinance. To the extent that matters raised in submissions would be more appropriately dealt with in these publications, the Commission did not include them in the revised Guidelines.

Guideline on the First Conduct Rule

19. The draft Guideline on the First Conduct Rule (“**FCR**”) attracted the majority of comments. This reflects the impact of the FCR on businesses across Hong Kong. The Commission noted a number of recurring themes in the submissions:

- **Creation of presumptions and new ‘tests’.** A range of submissions pressed the Commission to introduce specific ‘tests’, ‘safe harbours’, ‘presumptions’ or ‘indicators’ into the Guideline which are not provided for in the Ordinance. The Commission does not propose to introduce such tests through Guidelines where the Tribunal and other courts are ultimately responsible for interpreting the Ordinance.
- **Requests for further guidance and detailed analysis.** Many submissions requested further detail on a range of specific topics relating to the FCR. The revised Guideline provides additional guidance on a number of areas. In some cases, however, parties sought the level of detail that is available in more established competition law jurisdictions. The Commission is mindful that detailed guidance from overseas agencies is a result of decades of enforcement practice and case-law by their courts. This is not yet available in Hong Kong.
- **Use of hypothetical examples.** The inclusion of hypothetical examples in the Guideline was welcomed as a helpful way to demonstrate the practical application of the Ordinance. By their very nature, such examples apply the Commission’s analysis to simplified and purely hypothetical facts. To enhance the use of examples in the revised Guideline, the Commission has:
 - refined certain of the existing examples and increased the number of hypothetical examples to 25. Additional examples are now provided on topics for which requests for further detail were made, namely the exchange of information, resale price maintenance (“**RPM**”) and common types of joint ventures;
 - where possible, provided additional detail in examples to give a clearer indication of when conduct is permitted and would not give rise to concerns under the FCR; and
 - indicated in the relevant examples where the Commission would likely consider the conduct to amount to Serious Anti-competitive Conduct (“**SAC**”).

Terms Used in the First Conduct Rule

Undertaking: Groups of employees, their trade unions and self-employed persons

20. A small number of submissions questioned whether under the FCR, groups of employees could engage in collective negotiation activities with their employers in relation to matters such as salaries and conditions of work. The draft Guideline was silent on this topic.
21. The FCR prohibits undertakings from engaging in anti-competitive behaviour. What constitutes an undertaking is therefore a relevant consideration, particularly in considering whether groups of employees and/or trade unions are undertakings.
22. The Commission recognises the importance of this issue for a number of industries. The revised Guideline at paragraphs 2.18 and 2.19 clarifies what amounts to an undertaking. In general, an employee is an integral part of his/her employer undertaking. As a result, an agreement between a group of employees and their employer (for example in relation to matters such as salaries and conditions of work) is outside the scope of the FCR. Where a trade union acts as an 'agent' representing a number of employees in collective negotiations with an employer, such arrangements would also fall outside the FCR.
23. The revised Guideline also provides guidance on the interpretation of 'undertaking' with respect to self-employed persons (see paragraphs 2.20 and 2.21).

Undertaking: Decisive influence

24. A range of submissions requested further detail on the concept of 'decisive influence' over commercial policy, which is relevant in considering whether two or more entities may form a single undertaking. The assessment of decisive influence is highly dependent on the specific facts of the matter, with both legal and factual elements relevant to the determination. As such, the Commission has not provided an exhaustive list of the factors that it may take into account in a particular matter.

Single economic unit: Independent distributors and agents

25. Some submissions noted that it is common in Hong Kong to use independent distributors or agents. The comments received sought further detail on when such agents/distributors may form part of a single economic unit and therefore be part of the same undertaking as the supplier.

26. The revised Guideline contains additional detail on the key factors the Commission considers to be relevant in this regard.

Concerted practices: Failing to object to or distance from anti-competitive conduct

27. The draft Guideline indicated that an undertaking may be considered by the Commission to be a party to a concerted practice by merely attending a meeting at which an anti-competitive arrangement is reached and having failed to object to and publicly distance itself from such conduct. A number of submissions sought guidance on how parties who have attended such meetings can publicly distance themselves from anti-competitive arrangements. The Commission has provided more detail at paragraph 2.24 of the revised Guideline on the steps an undertaking should take to distance itself from the arrangement sufficiently to mitigate the risk of contravening the FCR.

Decision by an association of undertakings: Recommendations/fee scales

28. A small number of submissions questioned the scope of a 'decision of an association of undertakings' in relation to recommendations by a trade association or fee scales by a professional body. The draft Guideline has been amended to clarify the Commission's position that recommendations, whether binding or not, can constitute a decision of an association of undertakings. This may include recommended fee scales and 'reference' prices (see paragraph 2.36 of the revised Guideline).

Object or Effect of Harming Competition

The object of harming competition

29. Under the FCR, establishing an anti-competitive object is an alternative to establishing whether conduct has the effect of harming competition. Where conduct has the object of harming competition, the Commission is not required to examine its actual or likely effects.
30. A range of submissions queried the Commission's interpretation of object of harming competition and how this relates to the definition of SAC under the Ordinance. The revised Guideline clarifies a number of points to address these concerns:

- **Agreements having the object of harming competition.** The revised Guideline provides further guidance on when an agreement will be considered to have the object of harming competition. As detailed in paragraphs 3.3 to 3.15 of the revised Guideline, the Commission will assess the specific facts of the case and view the conduct in its context. An assessment of the aims of the arrangement viewed in its context does not require an analysis of the effects on the market of the arrangement. As highlighted in the revised Guideline, the Commission considers that, in particular, cartels that seek to price fix, share markets, restrict output or rig bids have the object of harming competition. Other forms of agreement which may have the object of harming competition include RPM, group boycotts and the exchange of future pricing or quantity information.
- **No ‘automatic’ contraventions of the FCR.** Unlike competition laws in a number of other jurisdictions, the Ordinance does not provide for ‘automatic’ or ‘*per se*’ contraventions of the Conduct Rules. Some submissions had suggested that this was the Commission’s approach to dealing with restrictions having the object of harming competition. The Commission does not equate restrictions having the object of harming competition to *per se* contraventions of the Ordinance.
- **Conduct which harms competition distinguished from SAC.** The Ordinance makes a distinction between two different concepts:
 - The analysis of a potential restriction of competition. The substantive assessment of whether conduct contravenes the FCR requires only that the Commission establish that conduct has the object or effect of harming competition (subject to any applicable exclusions or exemptions).
 - The determination of SAC. The question as to whether conduct amounts to SAC needs to be considered only when a restriction of competition having the object or effect of harming competition has been found.

The revised Guideline has added guidance to make this distinction clearer:

- **Commission’s classification of agreements having the object of harming competition.** A number of submissions suggested that the Commission should always assess conduct based on ‘effects’. The Ordinance provides that conduct may either have the object or the effect of preventing, restricting or distorting competition in Hong Kong. As such, the Commission cannot adopt an interpretation of the FCR whereby all conduct is assessed by reference to its effects on competition. The revised Guideline therefore maintains the approach taken in the draft Guideline.

The effect of harming competition: Appreciability and requests for market share safe harbours

31. A range of submissions requested that the Commission apply a concept of 'appreciability' or 'materiality' as a pre-requisite for finding an anti-competitive effect. Unlike some overseas jurisdictions, the Ordinance does not contain such an explicit test.
32. Some submissions indicated that the Commission should only consider a contravention of the FCR has occurred when an anti-competitive effect crosses a pre-defined threshold. Submissions suggested that the Commission could imply 'substantial effect' into section 6 of the Ordinance or create a market share 'safe harbour'. The underlying concern appeared to be that any effect, no matter how minimal, could potentially be found to be a contravention of the Ordinance.
33. The revised Guideline does not adopt a threshold for intervention based on market share. However, additional wording is provided to clarify that for conduct to have the effect of harming competition, the effect must be more than minimal and cannot be insignificant. The Investigations Guideline also states that at any stage of its consideration of a matter, the Commission will take into account the potential impact of the alleged conduct on competition and consumers.

The effect of harming competition: Market power

34. A number of submissions requested that the Guideline include market share 'safe harbours' to indicate when the Commission would consider that certain levels of market share would not give rise to concerns under the FCR, while one party agreed that such safe harbours should not be included in the Guideline.
35. The Commission considers that market share thresholds are not an appropriate screen for anti-competitive effects in Hong Kong due to the disparate range of existing market structures. The Commission also notes that the Tribunal and other courts are ultimately responsible for interpreting the Ordinance. The Commission has not yet taken cases under the Ordinance and therefore does not have sufficient information to determine the appropriate level (if there is one) for a threshold with cross-sector application.
36. The Commission also notes a divergence in views as to the level of the safe harbours requested in submissions, which ranged from between 20% and 50%.

37. A small number of submissions considered that an arrangement could only have an anti-competitive effect when an undertaking holds a substantial degree of market power, as is the case under the Second Conduct Rule (“**SCR**”). The Commission considers it inappropriate to blur the distinction between the two Conduct Rules. The Ordinance specifically refers to ‘substantial’ market power in the SCR, and it is widely accepted that competition concerns can arise with a degree of market power below the level required under the SCR.
38. Market share thresholds were also requested in the context of the SCR and the Commission’s reasons against introducing such thresholds are set out in further detail in paragraph 79 below.

Serious Anti-competitive Conduct (SAC)

39. Various submissions requested that the Commission more precisely define the circumstances in which SAC would arise. In particular, some parties submitted that the Commission should indicate that vertical agreements and/or RPM fall outside the scope of SAC, even though the definition of SAC under the Ordinance makes no distinction between horizontal and vertical agreements.
40. As indicated above at paragraph 30, the Ordinance makes a distinction between:
- SAC, as used in sections 67 and 82, and section 5 of Schedule 1 of the Ordinance; and
 - the object or effect of harming competition, as used in the FCR.
41. That distinction was blurred in many of the submissions on this topic. This may have led to a general view that certain categories of conduct should not be enforced as SAC, even though they could arguably fall within the definition of SAC in the Ordinance. Some adjustments to the text in the revised Guideline provide further clarity on the Commission’s interpretation of these provisions. The Commission has also indicated in the relevant hypothetical examples where it would consider the conduct to amount to SAC.

Agreements that May Contravene the First Conduct Rule

Exchange of information

42. A range of submissions sought further detail on the exchange of information. Specifically, parties sought further guidance on the indirect exchange by competitors of commercially sensitive information, such as through a customer or supplier. The revised Guideline at paragraphs 6.41 to 6.43 provides more detail on this issue and amendments have been made to clarify the Commission’s approach to information exchange generally.

Vertical price restrictions: Resale price maintenance (RPM)

43. A number of submissions asked the Commission to reconsider its approach to fixed or minimum RPM.
44. The Commission maintains its view that RPM arrangements have an inherent potential to harm competition in Hong Kong. The Commission does not accept the proposition that RPM warrants a 'light touch' because it may be a pervasive practice in Hong Kong. Anti-competitive conduct may indeed be currently a common business practice, but this is more likely to have been the result of the absence of a sector-wide competition law in Hong Kong.
45. The revised Guideline continues to take the view that RPM may have the object of harming competition and that there may be circumstances when it amounts to SAC. The revised Guideline includes specific examples of RPM which will be considered to have the object of harming competition (such as where the arrangement is instigated by a distributor who seeks to persuade its supplier to impose RPM on the distributor's competitors). A new hypothetical example has also been provided to give practical assistance in identifying when RPM arrangements have the object of harming competition.
46. However, in certain cases RPM arrangements may be made for a pro-competitive purpose and so do not have the aim of harming competition in the market. The Commission also notes that RPM does not 'automatically' contravene the FCR. RPM arrangements having the object (or effect) of harming competition might still be excluded from the FCR by reference to efficiencies.
47. The revised Guideline also states that a specific RPM arrangement may not have the object of harming competition when viewed in its context (see paragraphs 6.74 and 6.75 of the revised Guideline on when an agreement will be considered to have the object of harming competition). In those circumstances, the Commission would assess whether the RPM causes harm to competition by way of its effects on the market.

Additional guidance provided on joint ventures and other types of vertical agreements

48. In response to a number of submissions, the revised Guideline provides additional guidance on several specific topics that had not been addressed in detail in the draft Guideline. These enhancements provide additional clarity on common commercial practices to enable self-assessment by businesses.

49. More detailed guidance, including additional hypothetical examples, has now been provided on certain types of joint ventures, namely, joint selling, distribution and marketing agreements and joint tendering arrangements. The revised Guideline at paragraphs 6.90 to 6.114 illustrates when such arrangements are and are not likely to give rise to concerns under the FCR.
50. Some submissions noted the prevalence of franchising and selective distribution agreements in Hong Kong, particularly in the retail sector. The revised Guideline includes new sections to address these topics.

Exclusions and Exemptions from the First Conduct Rule

Agreements enhancing overall economic efficiency

51. Certain parties sought further detail on how the Commission intends to interpret the exclusion for agreements enhancing overall economic efficiency in section 1 of Schedule 1 to the Ordinance. The Commission considers the level of description already provided in the draft Guideline to be a sufficient basis for self-assessment. However, with a view to ensuring a closer alignment with the wording of the test in section 1 of Schedule 1, certain revisions have been made to clarify the Commission's interpretation.

Burden of proof under section 1, Schedule 1

52. A number of submissions questioned whether it was correct that the burden of proving the conditions of section 1 of Schedule 1 rests with the undertaking seeking the benefit of the general exclusion.
53. The Commission remains of the view that in relation to each of the general exclusions in Schedule 1, it is for the party asserting the availability of the exclusion to provide the evidence that the conditions of the exclusion are met. This view is consistent with the scheme of the Applications process, where applicants must provide sufficient information to the Commission for it to be able to make a Decision or issue a Block Exemption Order under the Ordinance.

Request to exempt vertical agreements from the FCR

54. The Commission's approach to vertical agreements received many comments. Many parties welcomed the acknowledgement in the draft Guideline that, in general, most vertical agreements do not impact competition. However, some submissions argued that even those vertical agreements which do have anti-competitive effects should be exempted from the Ordinance. These parties requested that the Commission issue a block exemption order relating to all vertical agreements. Alternatively, they suggested the Commission pursue vertical agreements only under the SCR.

55. In the revised Guideline, the Commission has maintained its position that in most cases vertical agreements do not give rise to concerns under the FCR and, where they do, they will generally be assessed on the basis of their effects on competition in Hong Kong. It must, however, be recognised that some vertical arrangements may be just as harmful to competition as horizontal cartel conduct.
56. Vertical agreements clearly fall within the terms of the FCR and the Commission cannot confine analysis of such arrangements to the SCR. The revised Guideline also maintains the Commission's approach in the draft Guideline that some vertical arrangements may be considered SAC within the meaning of section 2 of the Ordinance.
57. The Commission notes that it can only make a block exemption order under section 15 of the Ordinance on the basis of reliable evidence showing that a category of agreements satisfies the exclusion in section 1 of Schedule 1 for agreements enhancing overall economic efficiency.

Compliance with legal requirements

58. A small number of submissions questioned the scope of the general exclusion in section 2 of Schedule 1 to the Ordinance. Some considered that the Commission was adopting too strict an interpretation. The Commission, however, is bound by the terms of the Ordinance which defines 'legal requirement' to mean a requirement "imposed by or under any enactment in force in Hong Kong" or "imposed by any national law applying in Hong Kong". The principles of statutory interpretation also suggest that, as an exclusion to the FCR, the provision should be construed narrowly. Therefore, outside of the circumstances indicated in section 2 of Schedule 1, the Commission considers that this exclusion would not be available.
59. The Commission was asked to formally acknowledge 'regulatory requirements' when conducting an analysis of potentially anti-competitive conduct under the FCR. It was submitted that 'circulars', 'guidance' or similar publications from public or regulatory authorities in a specific sector should be taken into account when the Commission assesses conduct under the FCR.
60. The Commission cannot, in the abstract, bind itself to the views of public or regulatory authorities, who may pursue different policy objectives to those of the Ordinance. However, for businesses who consider themselves subject to such requests by public or regulatory authorities, the Commission notes that the revised Investigations Guideline already indicates that the Commission's investigations will include gathering information from third parties, which could include public or regulatory authorities, who may have knowledge of the conduct in question.

Guideline on the Second Conduct Rule

61. The Guideline on the SCR generally attracted fewer comments than the Guideline on the FCR.
62. A number of submissions commented on the market definition section in Part 2 of the Guideline and some amendments have been made in the revised Guideline to reflect these submissions (see paragraphs 64 to 70 below). The principles of market definition also apply to the FCR and the Merger Rule, and the amendments to the market definition section will therefore also be relevant in the application of these rules.
63. In addition, as with the Guideline on the FCR, a number of submissions sought more detailed guidance on specific topics. The revised Guideline provides additional detail in certain areas, such as the circumstances in which an abuse may have the object of harming competition. With respect to other areas, particularly in relation to the examples of abusive conduct in Part 5 of the Guideline, the level of guidance requested by parties often reflected the detail provided in more established competition regimes. As indicated in paragraph 19 above, detailed guidance from overseas agencies is a result of decades of enforcement practice and case-law by their courts. In the absence of relevant precedents in Hong Kong, the Commission has not provided additional guidance on these matters.

Defining the Relevant Market

Relevance of market definition precedents

64. Certain parties argued that the Commission should indicate that it would be bound by its position in previous cases as to how a particular market is defined.
65. The Commission considers that every case must be assessed on its own facts, including with respect to the definition of the relevant market. Over time, markets change such that the market definition which was considered in a previous case may no longer reflect the current state of the market. As stated in paragraph 2.9 of the revised Guideline, a defined relevant market in one case will therefore not bind the Commission in another.
66. However, as a matter of practice, the relevant markets previously considered may serve as a guide for parties as to the Commission's likely approach in future cases, and will be taken into account by the Commission when assessing market definition in another case.
67. To clarify the Commission's position, amendments have been made to the draft Guideline, including the deletion of the statement that "market definition has no precedential value".

Relevance of supply-side substitutability for market definition

68. Certain submissions argued in favour of including supply-side substitutability as a relevant factor at the market definition stage, among other things on the basis of the approach taken in some overseas jurisdictions. The Commission has not amended the Guideline in this respect and would note in any event that international practice is not consistent on this point.
69. As indicated in paragraphs 2.10 and 2.17 of the revised Guideline, demand side substitution is a central factor for the purposes of market definition. Where an assessment of demand side substitution leads to a particular conclusion as to the scope of the relevant market, the Commission is of the view that an assessment of supply-side substitution will very rarely alter that conclusion.
70. As such, paragraph 2.34 of the revised Guideline indicates that the Commission generally will not consider supply-side substitutability when defining the relevant market. As stated in paragraph 2.35 of the revised Guideline, all competitive constraints, including supply-side considerations, will in any event be considered in the assessment of market power.

Assessment of Substantial Market Power

Relationship between a substantial degree of market power, market power and section 7Q of the Telecommunications Ordinance (Cap 106) (“TO”)

71. A number of submissions requested clarification as to the relationship between ‘a substantial degree of market power’ under the SCR and market power, which may be relevant under the FCR (see paragraphs 3.22 and 3.23 of the revised Guideline on the FCR). The relationship between a substantial degree of market power and market power was also raised in submissions on the Guideline on the FCR (see paragraph 37 above).
72. The Commission notes, as was already indicated in paragraph 3.6 of the draft Guideline, that market power is a matter of degree. The degree of market power which is relevant for the application of the SCR is a ‘substantial degree’. The degree of market power at which concerns may arise under the FCR is not the same and is typically less.
73. Other submissions provided comments and/or requested clarification regarding the relationship between ‘a substantial degree of market power’ under the SCR and ‘dominant position’ under the new section 7Q of the TO.

74. The Commission notes that the Guidelines are issued pursuant to the Ordinance and are required to provide guidance on the matters specified in the Ordinance. The Commission has therefore not included guidance on section 7Q of the TO in the Guidelines.

Determining ‘competitive levels’ of pricing, output or quality

75. Paragraph 3.2 of the Guideline explains that substantial market power can be thought of as the ability profitably to charge prices above competitive levels, or to restrict output or quality below competitive levels, for a sustained period of time. Some submissions requested details as to how the Commission will assess ‘competitive levels’ in this context.

76. The extent to which the competitive level will need to be assessed, and the methodologies used for assessment, will differ depending on the case in question. As such, the Commission has not provided further detail on how the competitive level should be assessed in the revised Guideline. The key factors for the assessment of substantial degree of market power are already discussed in considerable detail in paragraphs 3.9 to 3.32 of the revised Guideline.

Market share threshold for a substantial degree of market power

77. A large number of submissions requested the inclusion of some form of market share-based threshold, including a specific percentage to assess whether an undertaking has a substantial degree of market power. The market share thresholds requested included a ‘safe harbour’ threshold below which an undertaking would be considered not or unlikely to have substantial market power and, in a more limited number of cases, a threshold above which an undertaking would be presumed to have a substantial degree of market power. Other submissions were of the view that a market share threshold should not be included in the Guideline.

78. After careful consideration of these submissions, the Commission has not amended the Guideline to include a market share-based threshold.

79. This is for a number of reasons:

- Market share is but one factor in determining whether an undertaking has substantial market power. Factors such as ease of entry and expansion, availability of supply-side substitution and buyer power have the capacity to prevent a firm with a high market share from having a substantial degree of market power.
- The Commission has not yet taken cases under the Ordinance and as such the Tribunal has not yet issued any decisions as to the interpretation of the ‘substantial degree of market power’ standard.

- In addition, market structures in Hong Kong vary widely. There is a risk that applying a particular market share threshold across sectors would become the focal point of analysis of substantial market power, even though it may not accurately reflect the competitive structure in a particular sector. Such an approach could lead to an incomplete and potentially incorrect assessment as to the existence or absence of substantial market power in that sector.
- By contrast, it has been possible to provide an indicative market share threshold appropriate for the substantive assessment of mergers in the Merger Rule Guideline, based on the experience of the CA in a specific and narrowly defined sector (the telecommunications sector).
- The submissions received in favour of the inclusion of a market share threshold do not themselves provide a consistent view as to the appropriate level of a threshold. In this respect, the 'safe harbour' thresholds suggested by parties ranged from 25% to 50%, while one party also suggested that a threshold of 80% should be presumptive of a substantial degree of market power.

Relevance of market concentration

80. The Commission received a request for clarifications regarding the relevance of market concentration in the analysis of market power and the methods of measuring market concentration.
81. As mentioned in the draft Guideline, measuring the level of concentration in a market may provide useful information about market structure. The Commission expects that in practice it will not be necessary to measure market concentration in many cases. Where other factors relevant to the assessment of substantial market power lead to a particular conclusion as to the existence or absence of substantial market power, the Commission believes that measuring market concentration is unlikely alter that conclusion.
82. To clarify the Commission's position, the revised Guideline refers to the fact that the level of concentration in the market may be measured 'in some cases' and does not discuss methods for measuring market concentration.

Abuse of Substantial Market Power

Availability of economic efficiency and other justifications

83. A number of submissions requested clarification as to the extent to which economic efficiency and other justifications would be taken into account in the assessment of conduct under the SCR and/or further detail on the justifications which may apply.
84. Unlike the FCR, the Ordinance does not provide for an exclusion for conduct enhancing overall economic efficiency with respect to the SCR (i.e. section 1 of Schedule 1 to the Ordinance applies only to the FCR). The Commission clarifies in the revised Guideline that the exclusion under section 1, Schedule 1 does not apply to the SCR.
85. However, additional text in paragraph 4.5 of the revised Guideline recognises that, despite the absence of an explicit exclusion in the Ordinance, parties may wish to refer to efficiencies associated with particular conduct which mean that no net harm to consumers arises. Where such efficiencies apply, the conduct may not be considered to contravene the SCR. The Commission considers, however, that this will likely only be the case in exceptional circumstances where the claimed efficiencies are in fact passed on to consumers and no net harm to consumers can be demonstrated.
86. In addition, as was already stated in paragraph 4.4 of the draft Guideline, the Commission may examine “legitimate objective[s] unconnected with the tendency of the conduct to harm competition” put forward by the parties when investigating alleged abuses of substantial market power. To provide further clarity, the Commission has included an example of such a possible legitimate objective in paragraph 4.4 of the revised Guideline.

Conduct which may have the object of harming competition

87. A number of parties requested that the Commission clarify the basis on which conduct will be considered to have the object of harming competition and/or to specify explicitly which types of conduct may have such an object.
88. Paragraph 4.8 of the revised Guideline notes that the ‘object’ of conduct refers to the purpose or aim of the conduct engaged in by the undertaking considered in its context. The category of conduct which may have the object of harming competition is therefore an open one which cannot be reduced to any exhaustive list (though the concept of an anti-competitive object can only be applied to conduct which is by its very nature harmful to competition). Determining the nature of particular conduct requires an objective assessment of its aims.

89. The draft Guideline already provided one example of such conduct, namely where an undertaking with substantial market power sets prices below its average variable cost (“**AVC**”). For further clarity, paragraph 4.15 of the revised Guideline provides additional examples of conduct which may have the object of harming competition.
90. Some submissions also argued that all abusive conduct should be assessed on the basis of its effects on competition, while others favoured at least limiting the extent to which such conduct would be assessed as having the object of restricting competition.
91. The SCR explicitly envisages that conduct may have the object, as well as effect, of preventing, restricting or distorting competition in Hong Kong. The Commission considers it would be inappropriate to adopt an interpretation of the SCR whereby all conduct would be assessed by reference to its effects on competition.
92. The Commission expects, however, that it will in practice assess most conduct within the scope of the SCR by reference to its actual or likely effects on competition. An amendment has been made in paragraph 4.13 of the revised Guideline to reflect this position.

Examples of Conduct that May Constitute Abuse

Treatment of ‘exploitative’ conduct

93. Several parties requested explicit confirmation as to whether ‘exploitative’ conduct, such as the imposition of unfair prices or other unfair trading conditions, falls within the scope of the SCR.
94. The Commission notes that international practice has sometimes categorised abusive conduct under headings such as ‘exploitative’, ‘exclusionary’ and/or ‘discriminatory’. The Guideline explains that the category of conduct capable of amounting to an abuse is an open one and that potentially any conduct which has the object or effect of harming competition might be an abuse. The Commission has, however, focused in the Guideline on exclusionary conduct which may harm the *process of competition* in the market. Such conduct will be the main enforcement focus under the SCR.

Predatory pricing

95. A number of submissions favoured a more lenient approach towards predatory pricing, with several arguing against the treatment of pricing below AVC as having the object of harming competition.

96. The Commission has not amended the treatment of predatory pricing in the Guideline.
97. Paragraph 5.3 of the revised Guideline recognises that offering low prices to consumers is the epitome of competitive conduct. The Commission is therefore conscious of the need for caution when applying the SCR to alleged predatory pricing. For this reason, it will generally consider whether there is a prospect of anti-competitive foreclosure when assessing predatory pricing conduct, to the extent that reliable data is available (see paragraph 5.5 of the revised Guideline).
98. However, where an undertaking with substantial market power prices below its AVC, the undertaking is making losses on each unit of output it produces even with respect to the variable costs for each unit. Such conduct is thus unlikely to have any economic rationale but rather to be aimed at the anti-competitive foreclosure of competitors. For this reason, as stated in paragraph 5.6 of the revised Guideline, the Commission is likely to infer that the conduct has the object of harming competition, such that it does not need to demonstrate actual or likely anti-competitive foreclosure.
99. A smaller number of parties argued that 'recoupment' of losses stemming from below-cost pricing should be a necessary pre-condition for the establishment of predation.
100. The Guideline recognises that the possibility of recoupment may provide significant evidence of likely harm to competition. However, it is not the only factor which may demonstrate such harm. The revised Guideline therefore maintains the position that recoupment may be considered at the Commission's discretion.

Guideline on the Merger Rule

101. Amongst the total of 64 submissions received, a smaller number made comments on the draft Guideline on the Merger Rule compared to other draft Guidelines. This may be because the Merger Rule has only restricted application in cases where an undertaking that directly or indirectly holds a carrier licence issued under the Telecommunications Ordinance (TO) is involved in a merger.

Interpretation and application of the Merger Rule

Meaning of 'control'

102. Some submissions sought more guidance on what would constitute a 'merger' within the meaning of the Merger Rule. Whilst guidance was already given in Part 2 of the draft Guideline, some respondents submitted that the Commission should provide more specific detail. In particular, guidance was sought on what would constitute acquisition of 'control' of another undertaking, in terms of exercising 'decisive influence' on another undertaking and holding various forms of control (sole, joint control, negative sole control, legal and *de facto* control etc.), and what would constitute a full-function joint venture.

103. The Commission is aware of some extensive guidance provided by some jurisdictions on the meaning of 'merger' and it would appear that the respondents had such guidance in mind when making these comments. Whilst guidance issued by other jurisdictions may be informative, the Commission considers that a direct adoption of such guidance is not appropriate, as such guidance was developed on the basis of different merger control regimes, precedents, corporate practices and market environment. Hong Kong has its own new Merger Rule, and the corporate practices and market environment in Hong Kong may not be the same.

104. The starting point for the Commission in interpreting the Merger Rule will be the Merger Rule provisions of the Ordinance. The Commission has considered the appropriate level of guidance that should be given on the scope of the Merger Rule, and considered that any guidance should be given on a 'general principle' basis, such that the Commission would be able to apply the Merger Rule provisions to the specific circumstances of each case.

105. The Commission does not consider it appropriate to provide guidance on what would constitute a 'merger' in various scenarios as requested. However, principles-based further guidance is added in paragraph 2.7 of the revised Guideline on the meaning of 'decisive influence', which refers to the power to make decisions relating to the strategic commercial behaviour of an undertaking.

Indicative safe harbours

106. Part 3 of the draft Guideline provided two indicative safe harbour measures, i.e. the four-firm concentration ratio and Herfindahl-Hirschman Index (commonly referred to as 'CR4' and 'HHI' respectively). Some respondents suggested variations or alternatives to the two indicative safe harbour measures. One submitted that the safe harbours should not only be 'indicative in nature' in order to be meaningful.
107. It should be noted that these safe harbours are merely intended to provide a screening device to identify merger transactions that are more likely to warrant further examination, such that the parties concerned are able to conduct their own assessment. They do not replace a case-by-case analysis by the Commission in light of the prevailing market conditions in each case.
108. Further, the two safe harbours have been well-tested in Hong Kong's telecommunications sector for over a decade in the context of the enforcement of section 7P of the TO. As the Merger Rule is only applicable to a merger that directly or indirectly involves a carrier licensee, the Commission does not consider it necessary to revise the two safe harbour measures.

Procedural Matters

Indicative timelines

109. Comments were made that indicative timelines should be provided for various processes under the Merger Rule, including processing a request for informal advice, processing an application for a decision that a merger is excluded, and considering a commitment proposal.
110. Whilst the Commission will endeavour to process such requests or applications in an efficient and timely manner, the time required for completing these processes will depend on a number of factors, including the complexity of the matter in question, whether and how soon the data and information required for conducting the analysis is available, and the resources available to the Commission at the time. The Commission does not consider it appropriate to introduce any indicative timelines for processes relating to the Merger Rule.

Informal advice

111. One respondent asked why the process of informal advice would only be available for a proposed merger not in the public domain.
112. The revised Guideline clarifies that the informal advice process will in fact be available to proposed mergers irrespective of whether or not they are in the public domain.

Procedural Guidelines

113. The majority of submissions received during the consultation process provided comments on the three draft Procedural Guidelines. Many submissions asked for greater clarity and consistency generally across the three Guidelines on issues that arise across the various Commission processes, such as confidentiality. These comments have been taken into account across the revised Procedural Guidelines, which are discussed in turn below.

Guideline on Complaints

Should a complainant have a 'legitimate interest' in the complaint?

114. A number of submissions suggested the Commission require complainants to demonstrate a sufficient level of interest, such as a 'legitimate interest' as applies under EU competition law, to bring a complaint to the Commission. The Commission notes that there is no such requirement under the Ordinance and considers it would be inappropriate to impose such a requirement in the Hong Kong context.

115. Complaints are a source of information for detecting non-compliance with the Ordinance. The Commission's position is that if a person suspects anticompetitive conduct, they are encouraged to report it. Whether it has directly impacted the complainant or not is irrelevant. The public interest is served by reporting the possible contravention. In a broad sense, everyone in Hong Kong has a legitimate interest in ensuring compliance with the Ordinance.

Anonymous complaints

116. Certain submissions suggested that the Commission should limit its discretion to consider anonymous complaints to protect the interests of the subject of those complaints and avoid the Commission's resources being overwhelmed by complaints lacking merit. The Commission does not intend to introduce such a limitation on how complaints are dealt with on the basis that:

- it does not intend to reduce the possible sources of information about possible anticompetitive conduct; and
- under section 37(2) of the Ordinance, the Commission may, in particular, not investigate complaints that are frivolous, vexatious or otherwise unfounded.

117. Amendments have been made in the revised Complaints Guideline to clarify the matters the Commission will take into account in considering whether a complaint is misconceived or lacking in substance under section 37(2)(b) of the Ordinance.

Acknowledging the complaint

118. Some submissions suggested that the Commission should always acknowledge receipt of complaints in writing.
119. Acknowledgment of a complaint in writing will follow where the complaint is made in writing and contact details have been provided. However, it may be unnecessary and burdensome to acknowledge complaints in writing in certain circumstances, for example where the complaint is made over the telephone or in person, and receipt of the complaint is acknowledged in that context. It will also not be possible to acknowledge anonymous complaints.

Evidence provided by the complainant

120. A small number of submissions queried why the Commission did not include a 'checklist' of information that must be provided in support of a complaint.
121. Complainants are not often in a position to provide all material relevant to the Commission's consideration of whether the Ordinance may have been contravened. For example, a complainant alleging predatory pricing could hardly be expected to know whether the alleged contravener was pricing below its relevant cost. Moreover, what information is relevant depends on the circumstances of individual cases. To exclude consideration of complaints in the first instance because not all relevant information is provided would unduly limit the class of people able to make complaints to the Commission.
122. However, the Commission expects complainants to furnish all relevant information in their possession either when making the complaint or when asked by the Commission to do so. The draft Complaints Guideline has been amended to more clearly reflect this position (see paragraph 2.4 of the revised Complaints Guideline).

Complainant's 'obligation' to keep complaints confidential

123. Certain submissions queried the apparent suggestion in the draft Complaints Guideline that the Commission would require complainants to keep their complaints confidential, while others submitted that the Commission should indeed force complainants to do so.
124. The Ordinance does not oblige complainants to keep their complaint confidential. Paragraph 3.2 of the draft Complaints Guideline was merely intended to state the Commission's preference that complainants keep their complaint confidential with a view to protecting the integrity of the investigation. Amendments have been made in the revised Complaints Guideline to clarify the Commission's intent and to request that complainants inform the Commission prior to disclosing their complaint.

Assessing whether to consider a complaint further

125. The Commission set out a number of factors in paragraph 4.3 of the draft Complaints Guideline (repeated in paragraph 3.4 of the draft Investigations Guideline in respect of the Initial Assessment Phase) which it would take into account in deciding whether or not to pursue a complaint further. The factors in paragraph 4.3 have been deleted in the revised Complaints Guideline and expanded upon in the draft Investigations Guideline (see paragraphs 130 to 134 below for further discussion).

Engagement with the complainant and other parties

126. A number of submissions suggested that the complainant should be informed of the progress of an investigation and one requested that further guidance be provided on a complainant's procedural rights and obligations, including access to information (see also discussion at paragraph 135 of this Guide).

127. As stated at paragraph 1.4 of the draft Complaints Guideline, the Commission does not act on behalf of complainants. The Commission will exercise its enforcement discretion and choose matters to investigate having regard to the public interest in having competitive markets, rather than complainants' interests. In balancing this public interest and transparency considerations, the Commission will seek to develop practices that are suited to the Hong Kong environment.

128. With respect to paragraph 5.4 of the draft Complaints Guideline, the Commission intended to convey the position that, as advancing a matter to an Initial Assessment was an internal procedural step for the Commission, it would not generally advise the complainant that this internal step had been taken. It will however keep complainants up to date as regards the general progress of the Commission's consideration of issues relevant to their complaint when it is appropriate to do so. Paragraph 5.4 has been amended in the revised Complaints Guideline to reflect this position.

129. The draft Guideline already made it clear that, whenever the Commission decides to take no further action, it will advise the complainant of this decision and provide an explanation of its decision.

Guideline on Investigations

Enforcement discretion and assessing whether to investigate a matter further

130. The Commission set out a number of factors in paragraph 3.4 of the draft Investigations Guideline which it would take into account in deciding whether or not to pursue a matter further during the Initial Assessment Phase (these were also in paragraph 4.3 of the draft Complaints Guideline). The Commission received a large number of submissions in relation to these factors. The revised Investigations Guideline provides further guidance.

131. Amendments have been made to more clearly express the Commission's intended exercise of its enforcement discretion. Paragraph 3.6 of the revised Investigations Guideline clarifies that the Commission may discontinue its consideration of a matter at any time, including during the Initial Assessment and Investigation Phases.
132. Certain parties asked the Commission to clarify the meaning of 'successful outcome'. For example, there were concerns that this factor may be read to indicate that the Commission will avoid 'hard' cases. This is not the Commission's intention. The measure of a successful outcome will differ depending on the particular case. It includes consideration of factors such as:
- whether the Commission is likely to be able to uncover sufficient evidence to prove whether or not the Ordinance has been contravened; and
 - the remedies available.
133. The fact that a case will likely be hard fought or involve respondents with substantial means is not a relevant consideration as to whether the Commission will investigate a potential contravention of the Ordinance.
134. A small number of submissions also requested guidance on the factors the Commission will take into account when deciding on an enforcement response in a particular matter. Such matters are more appropriately addressed in the Commission's enforcement policy which will be published in the coming months (see paragraph 18 of this Guide).

Access to Commission's information

135. A few submissions sought guidance on whether persons would have access to the Commission's file. The Tribunal, rather than the Commission, is the decision maker. Under the Ordinance, the Commission is required to build a case which it will bring before the Tribunal. In these circumstances it will be for the Tribunal to issue rules of procedure under section 158 of the Ordinance, setting out guidance on the relevant practice and procedures for proceedings before the Tribunal, including in relation to access to the Commission's information.

Commission's use of Investigation Powers generally

136. Some submissions sought further guidance on the circumstances in which the Commission would rely on its Investigation Powers, as defined in the draft Investigations Guideline, to gather information. Several submissions proposed that there should be restrictions on the Commission's discretion to exercise these powers (some submissions requested, for example, that these powers be used only in 'exceptional circumstances').

137. The Ordinance clearly sets out the relevant thresholds for the Commission to satisfy before these Investigation Powers may be exercised. Once the relevant legal test is satisfied, there is no further requirement that the Commission apply particular criteria before it may elect to exercise its compulsory powers, or that it provide advance notice of its decision to exercise these powers to relevant persons. To clarify that that the Commission did not intend to depart from the processes and powers prescribed by the Ordinance, a number of paragraphs in the draft Investigations Guideline (such as paragraphs 5.8, 5.22 and 5.29) have been revised to follow more closely the wording of the relevant provisions of the Ordinance.

Confidential information and disclosure

138. Many submissions sought further clarification of the treatment of confidential information generally.

139. The Ordinance provides a detailed regime for the classification and handling of confidential information by the Commission. The Ordinance provides that parties providing information to the Commission may claim confidentiality providing written reasons as to why in their view the information is confidential. However, the Commission has the power under section 126(1)(b) of the Ordinance to disclose confidential information in certain circumstances.

140. The Commission will always endeavour to ensure, as provided by the Ordinance, that confidential information is only disclosed under section 126(1)(b) in the performance of its functions, and then only to the extent that it satisfies the considerations and necessity criteria in section 126(3). The revised Investigations Guideline clarifies that the Commission considers it to be in parties' interests to clearly specify the reasons for claiming confidentiality, due to the operation of the Ordinance.

141. Amendments have been made in the revised Investigations Guideline (see also paragraphs 153 to 155 of this Guide below in relation to the treatment of information provided in the Applications context) to:

- explain the Commission's understanding of how the Ordinance operates in relation to confidential information and its disclosure; and
- emphasise that it will be in parties' interests to make specific and justified claims for confidentiality.

Subsequent use of information provided to the Commission voluntarily

142. A large number of submissions sought to address the extent to which the Commission could use information voluntarily provided for purposes other than that for which it was provided or acquired.
143. The Commission may use information provided to it voluntarily for any purpose under the Ordinance, unless prohibited by law. This position is expressly set out at paragraph 6.17 of the revised Investigations Guideline (as well as at paragraph 4.1 of the revised Applications Guideline). Paragraph 6.17 of the revised Investigations Guideline also states that the Commission will not normally accept information or documents with any restrictions on the use of the information. This means that parties who voluntarily provide information to the Commission cannot rely on an implied undertaking that it will not be used in connection with other Commission matters, or that the information has been accepted on a 'without prejudice' or limited waiver basis, unless the Commission has expressly agreed to do so. The Commission is unlikely to expressly agree to accept information on a 'without prejudice' or limited waiver basis except in limited circumstances.
144. The Investigations Guideline sets out the specific requirements of the Ordinance regarding the privilege against self-incrimination and legal professional privilege. The Commission has not attempted to summarise the position at common law, which does not fall within the scope of the Guidelines and which may change over time.

Requests for information

145. Certain submissions sought further clarity on the criteria the Commission would apply in choosing whether to seek information under section 41 of the Ordinance or on a voluntary basis. It should be noted that the Commission generally expects requests for information to be written, whether made under a section 41 notice or by letter, and that a section 41 notice should not impose higher burden on recipients.
146. In response to submissions that the Commission must have regard to the burden imposed on recipients of section 41 notices, the draft Investigations Guideline had already indicated that the Commission would endeavour to provide reasonable timeframes for persons to comply with a section 41 notice, having regard to the nature and volume of information and documents requested. The Commission notes that this already goes beyond the requirements of the Ordinance.

Attendance by legal advisers at premises that are the subject of a section 48 warrant

147. A small number of submissions addressed the extent to which the Commission is required to wait for legal advisers before commencing a search under section 48 of the Ordinance. The Ordinance does not require the Commission to wait any period for a person's legal advisers to attend the premises before commencing a search. As already indicated at paragraph 5.31 of the draft Investigations Guideline, Commission officers will allow for a reasonable time in the relevant circumstances for external legal advisers to attend where there are none already at the premises. However, preserving the integrity of the search and evidence will be the paramount consideration in the exercise of Commission officers' discretion.

Information obtained in an investigation which is subject to legal professional privilege

148. Some submissions sought guidance on how the Commission intends to treat privileged materials obtained in an investigation. Drafting has been added to the revised Investigations Guideline at paragraph 5.40 to indicate that the Commission intends to establish and publish a procedure for dealing with disputes with respect to claims to legal professional privilege in the context of the Commission exercising its Investigation Powers and notably powers conferred by warrant under section 48 of the Ordinance.

Consent orders as a possible outcome of Investigation Phase

149. A few submissions requested guidance on a consent order process. As with the other possible outcomes of the Investigation Phase, the circumstances in which a consent order may be appropriate will vary from matter to matter. Paragraph 7.23 of the revised Investigations Guidelines provides more detail on the possible terms of a consent order in this context.

Indicative timeframes for the Commission's investigative processes

150. A very large number of submissions requested that the Commission place timeframes on its processes for assessing complaints and other investigative processes.

151. The Commission considers the length of investigations will differ markedly depending on issues such as:

- the complexity of the investigation;
- the availability of evidence such as key data; and
- the cooperation (or lack thereof) of the parties under investigation.

152. The Commission will endeavour in all matters to conduct these processes in an efficient and timely manner, in the performance of its functions under the Ordinance.

Guideline on Applications

Confidentiality claims made in relation to an Application for a Decision or Block Exemption Application

153. A number of submissions queried whether applicants needed to justify claims for confidentiality to the Commission and also sought clarification of the treatment and disclosure of confidential information in the context of the Applications process.

154. The Commission has added further guidance to emphasise that it will be in applicants' interests to avoid making overly broad claims for confidentiality, due to the operation of the Ordinance.

155. Consistent with the amendments made to the revised Investigations Guideline (see paragraphs 138 to 141 of this Guide), drafting changes have also been made to the revised Applications Guideline to explain how the provisions relating to confidential information generally operate under the Ordinance.

Initial Consultation before applying for a Decision or Block Exemption Order

156. A large number of submissions argued that the process for applying for a Decision or a Block Exemption Order should somehow be separated from other Commission processes, in particular enabling parties to consult the Commission about their conduct without risk of alerting the Commission to a likely contravention of the Ordinance.

157. The Commission's view is that it would not be an appropriate use of the Applications process for parties to be able to 'test the water' about conduct that has already occurred and may have contravened the Ordinance without risk of subsequent action, especially in the longer term.

158. As the draft Applications Guideline makes clear, parties are able to approach the Commission before they enter commercial arrangements which might, but for a relevant exemption or exclusion, contravene the Ordinance. Similarly, parties should self-assess their circumstances and approach the Commission only where they wish to seek greater legal certainty, as there is no need for a Commission decision for exemptions or exclusions to take effect.

159. However, the Commission's intention in this process is that parties have an open dialogue with the Commission about their intended Application without unnecessary public disclosure of commercially sensitive information. To reflect this, the draft Applications Guideline has been amended to confirm that the consultation meetings will take place on a confidential basis, and that confidential information provided to the Commission during an Initial Consultation will be treated in accordance with Part 8 of the Ordinance and the revised Application Guideline.
160. The Commission received a number of requests for it to begin considering applications for a Decision or Block Exemption Order or commence work on Commission initiated Block Exemption Orders prior to, or immediately after, commencement of the Ordinance. The Commission acknowledges these requests and is considering whether any preparatory work can be done before the Competition Rules are in effect.

Subsequent use of information provided to the Commission in the Applications process

161. A large number of submissions sought to address the extent to which the Commission could use information voluntarily provided for purposes other than that for which it was provided or acquired.
162. As already discussed at paragraph 143 above, paragraph 4.1 of the revised Applications Guideline is consistent with the approach followed in the Commission's investigative processes. Parties who voluntarily provide information to the Commission cannot rely on an implied undertaking that it will not be used in connection with other Commission matters, or that the information has been accepted on a 'without prejudice' or limited waiver basis.

Consideration of exemption or exclusion decisions in other jurisdictions

163. A small number of submissions suggested that the Commission take into account, or inquired whether the Commission would take into account, decisions of other competition authorities when considering Applications for Decisions or Block Exemption Orders.
164. While it can be informative to consider the analytical approach taken by other jurisdictions to assessing competition issues, the impact of conduct on markets in Hong Kong will rarely be identical to the impact of the same general conduct on markets in other jurisdictions. The Commission will assess the relevant conduct under the framework of the Ordinance and by reference to the specific markets concerned in Hong Kong.

Categories of agreements in Block Exemption Applications to be of wider industry use or adopted sector-wide

165. A large number of submissions on the draft Applications Guideline related to whether or not it was appropriate to require a Block Exemption Order to be representative of wider industry interest. The Commission's intention is to make it clear that it is not satisfactory to suggest that, on the basis of one or more agreements used by one company, these agreements are used more widely in an economy. If similar agreements or issues within agreements are not in wider use, an Application for Decision may be the more appropriate process.
166. The draft Applications Guideline has been amended to make clear that it is the category of agreements which are the subject of a Block Exemption Order that should be representative of the category of agreements in wider use across an industry or industries (see paragraph 5.3 of the revised Applications Guideline).
167. The Commission has also made some amendments to clarify when it may be appropriate to make a sector-specific Block Exemption Application. New text in the revised Applications Guideline is provided to clarify that applicants seeking a sector specific Block Exemption Order are expected to show evidence of a greater need for cooperation between undertakings in the relevant sector as compared with other sectors in the economy.
168. Any parties in doubt about the appropriate path are encouraged to seek an initial consultation meeting as described in the draft Applications Guideline.

Forms relating to Applications for Decisions and Block Exemption Orders

169. A small number of parties requested that the Commission consult on any forms referred to in its draft Applications Guideline. The Guideline already contains the substantive checklist of information that will be required and the process by which the Commission will liaise with parties and seek further information if required. The Commission will not be rejecting applications on the basis of technicalities, but will work with parties who make a genuine effort to complete the Application to ensure it is complete. The forms will simply structure the key information to be provided, how it should be provided and the relevant fee payable for the specific application.
170. The Commission has decided not to use a form for Applications for Block Exemption Orders and has accordingly removed references to Form BE in the revised Applications Guideline.

Consulting on a draft Decision

171. Certain submissions queried the Commission's position that it would not automatically consult on a draft Decision, in contrast to a draft Block Exemption Order. The consultation with respect to the latter is required by the Ordinance and reflects the likely broader impact of issuing a Block Exemption Order. However, there are some cases where the Commission may well benefit from consulting third parties on a draft proposed Decision. The Commission has amended the draft Applications Guideline to reflect when it is likely to consult on a draft proposed Decision (see paragraph 8.10 of the revised Applications Guideline).

Indicative timeframes for the Commission's Applications processes

172. A very large number of submissions requested that the Commission place timeframes on its processes for making Decisions or issuing Block Exemption Orders. The Commission has not done so.

173. While the Commission will endeavour to work efficiently and keep parties up to date on the progress of its assessment, the timeframe for making a Decision or Block Exemption Order will vary markedly depending on factors such as the complexity of the issues raised, the number of parties who have an interest in the decision and who also need to be consulted, and the resources available to be devoted to the review.

174. The Commission will monitor on the time taken to review Applications and always seek to streamline its processes to ensure they are efficient.

Providing reasons

175. A number of submissions requested that the Commission provide reasons for its decisions or Block Exemption Orders. The Commission intends to do so and has made minor amendments to the Guideline to expressly state that the communication of these outcomes will incorporate the Commission's reasons.



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Revised Draft Guideline on **The First Conduct Rule**

30 March 2015

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Guideline on the First Conduct Rule

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under section 35(1)(a) of the Competition Ordinance (Cap 619) (the “**Ordinance**”).*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*The Guideline sets out how the Commission intends to interpret and give effect to the First Conduct Rule in the Ordinance. The Guideline is not, however, a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

The Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I The First Conduct Rule

- 1.1 This Guideline provides a framework for the Commission's analysis of conduct under the First Conduct Rule. The Guideline will also help undertakings to determine whether their conduct complies with the First Conduct Rule.
- 1.2 Consumers (including businesses acting as customers)² benefit from competitive rivalry in the marketplace. Hong Kong's free market economy depends on a healthy competitive environment which incentivises businesses to offer a wider variety of better quality products³ at lower prices.
- 1.3 Most agreements and arrangements between market participants benefit consumers and the Hong Kong economy. Cooperation between businesses can often stimulate more efficient, cost-effective and innovative business practices. However, the benefits of a competitive market are undermined when market participants collude with their competitors⁴ on key parameters of competition such as price, output, product quality, product variety and innovation.
- 1.4 The proposition that competitors should make decisions on competitive parameters independently is embodied in the First Conduct Rule set out in section 6(1) of the Ordinance: "*An undertaking must not (a) make or give effect to an agreement; (b) engage in a concerted practice; or (c) as a member of an association of undertakings, make or give effect to a decision of the association, if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong.*"
- 1.5 The First Conduct Rule applies, however, not only to agreements and arrangements involving businesses which compete with one another. The rule also applies to any agreement or arrangement between parties who are not competitors if the agreement or arrangement has the object or effect of harming competition⁵ in Hong Kong.

² References to consumers in this Guideline includes businesses acting as customers unless the context otherwise dictates.

³ References to products in this Guideline includes services unless the context otherwise dictates.

⁴ References to a competitor or competitors in this Guideline includes a potential competitor or potential competitors unless the context otherwise requires.

⁵ This Guideline uses the shorthand "harm competition" in place of "prevent, restrict or distort competition".

- 1.6 The First Conduct Rule applies where there is an agreement or concerted practice. These terms are explained in Part 2 of this Guideline. As a general proposition, there must be some form of conduct involving two or more parties for the First Conduct Rule to apply. The First Conduct Rule applies to contractual conduct but a contract is not a prerequisite. The rule may also apply where cooperation is non-binding or not legally enforceable.
- 1.7 The First Conduct Rule applies to undertakings. The term undertaking is defined in section 2(1) of the Ordinance. An undertaking means any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity. The term undertaking is a broader concept than the term company although a company may be an undertaking. The term undertaking is explained in detail in Part 2 of this Guideline.
- 1.8 The First Conduct Rule also applies to decisions of an association of undertakings which have the object or effect of harming competition in Hong Kong. A trade association is an example of an association of undertakings. Members of trade associations are prohibited from making or giving effect to trade association decisions which harm competition.
- 1.9 Conduct which is in principle subject to the First Conduct Rule may be excluded or exempt from its application by virtue of:⁶
- (a) the general exclusions provided for in Schedule 1 to the Ordinance;
 - (b) the exemptions provided for in section 31 (public policy) and section 32 (international obligations) of the Ordinance; or
 - (c) the disapplication of certain provisions of the Ordinance to statutory bodies, specified persons and persons engaged in specified activities as provided for in sections 3 and 4 of the Ordinance.
- 1.10 In particular, Schedule 1 to the Ordinance recognises that agreements⁷ between undertakings, even where they harm competition, might sometimes generate efficiencies which compensate for the harm to competition. In this context, section 1 of Schedule 1 provides that the First Conduct Rule does not apply to an agreement which enhances overall economic efficiency. The exclusion for agreements enhancing overall economic efficiency is discussed in Part 4 of this Guideline and in the Annex.

⁶ These various exclusions and exemptions are discussed in detail in the Annex to this Guideline.

⁷ Generally, the term "agreement" when used in this Guideline is to be read as also encompassing a concerted practice and a decision of an association of undertakings.

- 1.11 Schedule 1 to the Ordinance also excludes certain conduct engaged in by small and medium-sized enterprises (“**SMEs**”) from the application of the First Conduct Rule. In that respect, section 5 of Schedule 1 contains a general exclusion for agreements of lesser significance. The exclusion for agreements of lesser significance is discussed in the Annex.
- 1.12 The application of the First Conduct Rule as described in this Guideline does not preclude the parallel application of the Second Conduct Rule to the same conduct. Conduct in the form of an agreement that harms competition and therefore contravenes the First Conduct Rule might also contravene the Second Conduct Rule where the agreement involves an abuse of a substantial degree of market power:⁸
- 1.13 The First Conduct Rule applies to conduct which causes harm to competition in Hong Kong. Section 8 of the Ordinance provides that the rule applies even if the impugned conduct occurs outside of Hong Kong or any party to the conduct is outside of Hong Kong.

2 Terms Used in the First Conduct Rule

- 2.1 This part of the Guideline provides an overview of how the Commission intends to interpret and apply certain key terms used in the First Conduct Rule and in the Ordinance generally.

Undertaking

- 2.2 The First Conduct Rule applies to undertakings. The term undertaking is defined in section 2(1) of the Ordinance and refers to any entity (including a natural person), regardless of its legal status or the way in which it is financed, which is engaged in an economic activity. Examples of undertakings include individual companies, groups of companies, partnerships, individuals operating as sole traders or subcontractors, co-operatives, societies, business chambers, trade associations and non-profit organisations. The key question is whether the relevant entity is engaged in an economic activity.

⁸ See the *Guideline on the Second Conduct Rule* for guidance on how the Commission intends to interpret and give effect to the Second Conduct Rule set out in section 21(1) of the Ordinance.

- 2.3 The term economic activity, while not defined in the Ordinance, is generally understood to refer to any activity consisting of offering products in a market regardless of whether the activity is intended to earn a profit.
- 2.4 The Commission considers that an entity may be an undertaking for certain of its activities but may not be an undertaking for other activities. Where the relevant activities are economic, the entity is an undertaking with respect to those activities for the purposes of the Ordinance.
- 2.5 An individual acting as a final consumer is not an undertaking under the Ordinance.

Single economic unit

- 2.6 The First Conduct Rule does not apply to conduct involving two or more entities if the relevant entities are part of the same undertaking. To determine whether two (or more) entities are a single undertaking for the purposes of the First Conduct Rule, the Commission will assess whether the relevant entities constitute a single economic unit.
- 2.7 When determining whether two or more entities should be considered a single economic unit, the Commission is not limited to the notion of a corporate or a company group within the meaning of the Companies Ordinance (Cap 622) or other laws.
- 2.8 Whether or not separate entities form a single economic unit depends on the facts of the case. Generally, if entity A exercises decisive influence over the commercial policy of entity B, whether through legal or *de facto* control, then the Commission will consider A and B a single economic unit and part of the same undertaking.
- 2.9 An agreement between a parent company and its subsidiary, or between two companies under the control of a third, will not be subject to the First Conduct Rule if the relevant controlling companies exercise decisive influence over their respective subsidiaries notwithstanding that these various entities might have separate legal personalities.

- 2.10 Whether a joint venture entity forms a single undertaking with any one of its parents depends on the facts of the case. Generally, if two or more parent entities have power to block actions which determine the strategic commercial behaviour of the joint venture (i.e. if there is joint control – including *de facto* control), the joint venture is not part of the same economic unit as any of its parents.

Independent distributors and distribution agents

- 2.11 Suppliers commonly use third parties to distribute their products. Whether the First Conduct Rule applies to the relationship with such third parties depends on whether or not the third party is a separate undertaking from the supplier i.e. whether or not the supplier and the third party are part of the same single economic unit.
- 2.12 Where a supplier enters into a distribution agreement with an independent third party distributor the agreement will in principle be subject to the First Conduct Rule as the supplier and distributor are separate undertakings.
- 2.13 In certain cases, however, a supplier may appoint a third party to negotiate and/or conclude contracts on behalf of the supplier for the sale of the supplier's products. Here the third party acts as a distribution agent for the supplier.
- 2.14 Whether a third party acts as a true distribution agent does not depend on whether that party is labelled an "agent" or the agreement appointing the third party is labelled an "agency agreement". Rather, the relevant factors are the level of control which the supplier exercises over the third party and the level of financial or commercial risk borne by the third party in relation to the activities for which it has been appointed as a distribution agent by the supplier.

2.15 In particular, the Commission may consider that a distributor acts as a true distribution agent of the supplier if it does not bear any, or bears only insignificant, risks in relation to the contracts concluded on behalf of the supplier. This might be the case where (i) title to the contract products is not transferred to the distributor⁹ and (ii) the distributor does not bear any or bears only an insignificant portion, of the following non-exhaustive types of risks and costs:

- (a) costs linked to the distribution of the contract products including transport costs;
- (b) costs or risks associated with the maintenance of stocks of the contract products (e.g. costs relating to loss of stocks or where the distributor must bear the costs of unsold stock);
- (c) responsibility for damage caused by contract products sold to third parties (product warranty);
- (d) costs or risks associated with non-performance by customers (e.g. late or non-payment by the customer);
- (e) costs associated with advertising or sales promotion for the contract products;
- (f) costs associated with market-specific investments in equipment, premises or the training of personnel; and
- (g) costs associated with other activities in the same product market as the contract products where these activities are required by the supplier.

2.16 Where a supplier appoints a distributor for the purposes of distributing its products and that distributor is a true distribution agent of the supplier pursuant to the principles explained above, the Commission considers that the selling function of the distributor with respect to the contract products forms part of the same undertaking as the supplier. The First Conduct Rule, therefore, does not apply to restrictions imposed in the distribution agreement on the distributor in so far as they relate to the contracts concluded on behalf of the supplier. This includes restrictions imposed on the distributor which limit the customers with whom the distributor can deal, the territories where the distributor can sell or the prices and conditions at which the distributor can sell the contract products.

⁹ Or, in the case of services, the third party does not itself supply the contract services.

- 2.17 The First Conduct Rule may, however, continue to apply to other aspects of the relationship with the distributor which do not relate to the sale of the contract products but govern the relationship between the distributor and the supplier more generally (such as an exclusive agency provision).

Hypothetical Example I

A manufacturer of hi-fi equipment sells its products to Hong Kong consumers directly through its website and through a number of retail stores. The retail stores are owned by independent third parties who are party to a contract with the manufacturer entitled "Agency Agreement". The retail store owners are referred to throughout the Agency Agreement as the manufacturer's "agents".

The Agency Agreement provides that the retailers must sell the products at a specified price not less than the manufacturer's current online price. While property in the contract products does not vest in the retailers at the time when the contract products are delivered by the manufacturer to the retailers, the Agency Agreement nonetheless provides that each retailer must bear a number of risks in relation to selling the contract products including the cost of certain advertising, delivery and installation services, responsibility for product warranty risks toward customers, and the risk of unsold stock.

The level of risk assumed by the retailers under the Agency Agreement would tend to suggest that they are separate undertakings from the manufacturer conducting business on their own account. This is irrespective of the title of the agreement. The resale pricing provision of the Agency Agreement would therefore be subject to the First Conduct Rule.¹⁰

Employees and trade unions

- 2.18 The Commission does not consider an employee to be an undertaking. Discussions or arrangements in relation to salary or other working conditions between one or more employees and their employer take place within the framework of a single economic unit and are outside of scope of the First Conduct Rule.

¹⁰ The resale pricing clause in the hypothetical example is a form of resale price maintenance. Resale price maintenance is discussed in Part 6 of this Guideline.

2.19 Where a trade union acts as on behalf of its members in collective bargaining with an employer on terms and conditions of work, the trade union is not engaged in economic activity and is not an undertaking.¹¹ Arrangements with respect to employees' salaries and conditions of work agreed with the relevant employer during the collective bargaining fall outside of scope of the First Conduct Rule.

Self-employed persons

2.20 In general, self-employed persons who offer services in the market, whether or not they are incorporated, are considered to be undertakings for the purposes of the Ordinance.

2.21 In some limited circumstances a self-employed person may not be considered an undertaking. This may be the case where the relationship between the self-employed person and an undertaking hiring the self-employed person is similar to that which exists between an employee and an employer. In other words for the purposes of the Ordinance, the self-employed person may be regarded in these circumstances as a *de facto* employee.

Agreement

2.22 The term agreement is a broad concept which is defined in section 2(1) of the Ordinance to include any agreement, arrangement, understanding, promise or undertaking, whether express or implied, written or oral, and whether or not enforceable or intended to be enforceable by legal proceedings.

2.23 In determining whether there is an agreement, the Commission will generally seek to determine whether there is a "meeting of minds" between the parties concerned. Thus, an agreement under the First Conduct Rule may exist whether or not there has been a physical meeting of the parties. An agreement may be formed through, for example, an exchange of letters, emails, SMS, instant messages or telephone calls.

2.24 An undertaking may be found to be party to an agreement or, in the alternative a concerted practice, if it attended a meeting at which an anti-competitive agreement is reached and it failed to sufficiently object to, and publicly distance itself from, the agreement or the discussions leading to the agreement. This may be the case regardless of whether it played an active part in the meeting or intended subsequently to implement the agreement.¹²

¹¹ A trade union may, however, act as an undertaking where it carries on an economic activity in its own right, such as by operating a supermarket, a travel agency or other business. In this circumstance, the First Conduct Rule would apply to these activities of the trade union.

¹² To effectively distance itself from the anti-competitive agreement in such a case, the undertaking must demonstrate that it had clearly indicated to its competitors that it participated in the relevant meeting without any anti-competitive intention. This may entail the undertaking evidencing that it had in fact withdrawn from the meeting once the anti-competitive nature of the meeting had become apparent.

- 2.25 An anti-competitive arrangement might comprise a series of sub-agreements concluded as part of a series of activities by the undertakings in pursuit of a common objective of harming competition. Where this is the case, the Commission may consider that the various sub-agreements form part of a single overarching agreement for the purposes of the First Conduct Rule.
- 2.26 The Commission considers that it is not necessary to show that an undertaking participated in or agreed to each and every aspect of an anti-competitive agreement for the undertaking to be held responsible for the agreement as a whole. For example, it is not necessary to show that an undertaking attended every meeting of a cartel arrangement. An undertaking may be found to be a party to and responsible for an overall cartel agreement even though it participated only in certain of its constituent elements if it can be shown that the undertaking knew, or should have known, that the collusion in which it participated was part of an overall plan intended to harm competition.

Concerted practice

- 2.27 The First Conduct Rule also applies to cooperation between undertakings which constitutes a concerted practice. A concerted practice is a form of cooperation, falling short of an agreement, where undertakings knowingly substitute practical cooperation for the risks of competition. Inherent in the concept of a concerted practice is the notion that undertakings should determine independently the strategy which they adopt in the market and in particular their policies as regards price, product quality and other competitive parameters.
- 2.28 A concerted practice typically involves an exchange of competitively sensitive information between competitors. Whether the exchange of such information is made as part of a concerted practice depends, however, on the circumstances of the case. The Commission will likely conclude that there exists a concerted practice with the object of harming competition where competitively sensitive information such as an undertaking's planned prices or planned pricing strategy is exchanged between competitors in circumstances where:
- (a) the information is given with the expectation or intention that the recipient will act on the information when determining its conduct in the market; and
 - (b) the recipient does act or intends to act on the information.

- 2.29 Without a legitimate business reason for an information exchange of this kind, the Commission will likely infer from the information exchange that the party providing the relevant information had the requisite expectation or intention to influence a competitor's conduct in the market.
- 2.30 Similarly, absent a legitimate business reason for taking receipt of the information exchanged or other evidence showing that the recipient did not act or intend to act on the information when determining its conduct in the market, the Commission will likely infer that the recipient undertaking acted on or intended to act on the information exchanged.

Hypothetical Example 2

Each calendar quarter, a number of private language schools in Hong Kong complete a survey, organised by one of the schools, which requests the schools to provide detailed information on their intended fee increases for the following quarter. The results of the survey are then distributed to each school that participated in the survey in advance of the schools finalising their respective fee arrangements for the next quarter. The results of the survey show the proposed future fees for all participating schools by name.

Assuming there is no evidence of an agreement, the Commission would consider the language schools' behaviour as evidence of a concerted practice. In a competitive market, each language school would make its fee decisions independently. This would result in a range of fee levels at the different schools, and a variety of options for students in terms of price. The concerted practice has the effect of removing all uncertainty between the schools as to their respective fee-setting policies. This conduct harms competition and leads to higher prices.

Hypothetical Example 3

A highly specialised insurance product was launched into the market with only three providers in Hong Kong. The product is sold to consumers via independent brokers. The sales directors of the three insurance providers recently attended a corporate golf tournament. During the tournament, the directors mentioned the commission rate that they currently offer brokers and one director commented that he was planning to lower his company's commission rate to a particular level. The information exchanged by the directors is confidential in nature. In the month following the golf tournament, each of the three insurers dropped the level of broker commission offered by their respective companies to identical levels.

The Commission would view the information exchange on intended commission levels as evidence of a concerted practice between the three insurance providers. The Commission would likely infer that the insurers took account of the information when determining their future commission levels. The fact that the parties exchanged information on only one occasion, and even assuming there was no agreement to lower commission as such, would not affect the analysis.

- 2.31 Parallel behaviour by competitors in the market (for example where their prices are similar) does not mean that the competitors are involved in a concerted practice or have made an agreement. If a market is highly competitive, it is to be expected that competitors will respond almost immediately to each other's pricing in the market. For example, if one competitor lowers its price, others are likely to respond to avoid losing customers. This behaviour is the very essence of competition and is not a concerted practice.

Decision of an association of undertakings

- 2.32 In addition to agreements between undertakings and concerted practices, the First Conduct Rule applies to decisions of an association of undertakings that have the object or effect of harming competition.
- 2.33 The Commission considers that the prohibition in the First Conduct Rule of a decision of an association of undertakings which has the object or effect of harming competition is intended to prohibit indirect anti-competitive cooperation between undertakings through an association.
- 2.34 The reference to association of undertakings in the First Conduct Rule is not limited to any particular kind of association. Examples of associations of undertakings include trade associations, cooperatives, professional associations or bodies, societies, associations without legal personality, associations of associations etc. The mere fact that a professional association has statutory or regulatory functions does not mean that it is not an association of undertakings or that its decisions do not have the object or effect of harming competition.
- 2.35 The Commission considers a decision of an association of undertakings to include, without limitation, the constitution of the association, rules of the association, resolutions, rulings, decisions, guidelines or recommendations of the association, whether made by the board, members, a committee or an employee of the association.
- 2.36 A decision of an association may fall within the First Conduct Rule even if it is non-binding. For example, recommended fee scales and 'reference' prices of trade and professional associations are decisions of associations of undertakings which the Commission would likely consider as having either the object or effect of harming competition.
- 2.37 Where a decision of an association has the object or effect of harming competition, the decision contravenes the First Conduct Rule and the Commission may commence proceedings against the association or its members.

Hypothetical Example 4

At the annual meeting of an association representing mooncake bakers, the association's executive proposed a non-binding resolution that encouraged members to introduce a price increase of HK\$10 on all mooncakes in time for the Mid-Autumn Festival. The resolution was passed unanimously. The stated aim of the resolution was to support the association members' position in the market as manufacturers of a "premium" product and to protect members' profit margins. Association members generally implemented the price increase.

Although the resolution is non-binding and some members do not comply with it, the Commission would consider the resolution as a decision of the association having the object of harming competition.

The Commission would also consider the conduct in the example to be Serious Anti-competitive Conduct under the Ordinance.

3 Object or Effect of Harming Competition

Introduction

- 3.1 The First Conduct Rule applies where the object or effect of an agreement is to harm competition in Hong Kong. Most agreements between undertakings are unlikely to be anti-competitive and will not raise concerns under the First Conduct Rule.
- 3.2 The Commission interprets the First Conduct Rule to require that the Commission must demonstrate that an agreement has either an anti-competitive object or an anti-competitive effect. These are therefore two alternative ways of showing that the agreement harms competition. Where an agreement has an anti-competitive object, it is not necessary for the Commission to also demonstrate that the agreement has an anti-competitive effect.

The object of harming competition

- 3.3 Certain types of agreement between undertakings can be regarded, by their very nature, to be so harmful to the proper functioning of normal competition in the market that there is no need to examine their effects. These agreements are considered to have the object of harming competition.
- 3.4 In order to determine whether an agreement has the object of harming competition, regard must be had to the content of the agreement, the way it is implemented and its context (including both the economic and legal context).
- 3.5 Determining the object of an agreement requires an objective assessment of its aims. That is, the object of an agreement refers to the purpose or aim of the agreement viewed in its context and in light of the way it is implemented, and not merely the subjective intentions of the parties. Nonetheless, there is nothing to prevent the Commission from taking the parties' intention into account when determining whether or not an agreement has the object of harming competition.¹³
- 3.6 Although the category of agreements which have the object of harming competition cannot be reduced to an exhaustive list, the concept of an anti-competitive object can only be applied to conduct which is by its very nature harmful to competition in a market.
- 3.7 Agreements between competitors to fix prices, to share markets, to restrict output or to rig bids are agreements which the Commission considers to have the object of harming competition. Agreements of this kind, often called "cartel" agreements, are inherently harmful to competition and are universally condemned.
- 3.8 In the case of agreements between parties at different levels of the supply chain (vertical agreements), resale price maintenance agreements may also be considered by the Commission as having the object of harming competition.

¹³ This is not to say that a subjective intention to harm competition can suffice to show an anti-competitive object. Evidence of subjective intent is merely a factor the Commission can have regard to in its objective assessment of the aims of the conduct.

- 3.9 An examination of the context of an agreement for the purposes of determining whether it has the object of harming competition does not require or involve an analysis of the effects of the agreement in the market. As noted at paragraph 3.2, where it is shown that an agreement has the object of harming competition, the Commission does not need to demonstrate that the agreement has anti-competitive effects. It is sufficient for the Commission to show that the agreement has the potential to harm or is *capable* of harming competition in the relevant context.
- 3.10 Where it is established that an agreement has the object of harming competition, the agreement cannot be defended by the parties showing that the agreement does not in fact have any anti-competitive effects or that such effects are not likely to flow from the agreement.
- 3.11 In examining the relevant context for an agreement, the following factors may show that an agreement does not have the object of harming competition:
- (a) in the case of an agreement between parties at the same level of the supply chain, an examination of the relevant context reveals that the parties are neither competitors nor potential competitors;
 - (b) an examination of the relevant context reveals that at the relevant time there is in fact no competition in the market to be harmed; and/or
 - (c) if the primary objective pursued by an agreement does not contravene the First Conduct Rule, any restrictions which are necessary and proportionate to achieving that primary objective do not have the object of harming competition. Such restrictions will also not contravene the First Conduct Rule.¹⁴
- 3.12 Section 7(1) of the Ordinance provides that if an agreement has more than one object, it will be capable of contravening the First Conduct Rule if any one of its objects is to harm competition.

¹⁴ See paragraphs 3.28 to 3.33 of this Guideline for a more detailed discussion of the relevant principles in this context.

- 3.13 The efficiencies listed in section 1 of Schedule 1 to the Ordinance (improvements in production or distribution, factors tending to promote technical or economic progress) are not relevant for determining whether an agreement has the object of harming competition. It is only after it has been established that an agreement has the object (or effect) of harming competition that a consideration of the efficiencies listed in section 1 of Schedule 1 to the Ordinance becomes relevant.
- 3.14 Section 7(2) of the Ordinance provides that an anti-competitive object may be ascertained by inference. In practice, it will often be necessary to infer an anti-competitive object from the facts underlying the agreement and the specific circumstances in which it operates or will operate.
- 3.15 An agreement may be considered to have an anti-competitive object, even if it is not implemented by the undertakings who are party to the agreement.

The effect of harming competition

- 3.16 If an agreement does not have an anti-competitive object, it may nevertheless contravene the First Conduct Rule if it has an anti-competitive effect.
- 3.17 When demonstrating that an agreement has an anti-competitive effect, the Commission will consider not only any actual effects but also effects that are likely to flow from the agreement.
- 3.18 For an agreement to have an anti-competitive effect on competition, it must have, or be likely to have, an adverse impact on one or more of the parameters of competition in the market, such as price, output, product quality, product variety or innovation. Agreements can have such an effect by reducing competition between the parties to the agreement, or by reducing competition between any one of them and third parties.
- 3.19 Section 7(3) of the Ordinance provides that if an agreement has more than one effect, it is considered to have an anti-competitive effect if one of its effects is anti-competitive.

- 3.20 Anti-competitive effects on competition within a relevant market are likely to occur where it can be expected that, due to the agreement, one or more of the parties would be able profitably to raise prices or reduce output, product quality and variety or innovation. This will depend on several factors such as the nature and content of the agreement, the extent to which the parties individually or jointly have or obtain some degree of market power, and the extent to which the agreement contributes to the creation, maintenance or strengthening of that market power or allows the parties to exploit market power.
- 3.21 When assessing the actual or likely anti-competitive effects of an agreement, the Commission will consider the extent to which the undertakings concerned have market power in a relevant market. The exercise of defining the relevant market assists in identifying in a systematic way the competitive constraints that undertakings face when operating in a market. The Commission's *Guideline on the Second Conduct Rule* sets out the Commission's approach to market definition.¹⁵
- 3.22 Market power can be thought of as the ability to profitably maintain prices above competitive levels for a period of time or to profitably maintain output in terms of product quantity, quality and variety or innovation below competitive levels for a period of time.
- 3.23 Market power is, however, a matter of degree. The degree of market power for concerns to arise under the First Conduct Rule is not the same as the degree of market power required for concerns to arise under the Second Conduct Rule and is typically less.
- 3.24 The assessment of market power of the parties to an agreement does not rely solely on any single factor and includes, for example, an assessment of the (combined) market shares of the parties, market concentration, barriers to entry or expansion in the market, the competitive advantages of the parties, and the existence of any countervailing power on the part of buyers/suppliers.¹⁶

¹⁵ See Part 2 of the Commission's *Guideline on the Second Conduct Rule*.

¹⁶ A detailed discussion of these various factors is contained in Part 3 of the Commission's *Guideline on the Second Conduct Rule*.

- 3.25 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 (known as the counter-factual), and compare these counter-factual market conditions with the conditions resulting where the conduct is present. In general, the Commission will consider the effects of specified conduct on a case-by-case basis in the light of available evidence.
- 3.26 Where the effect of an agreement on the competitive process is insignificant, the Commission considers that the agreement does not contravene the First Conduct Rule on the basis of its effects. For an agreement to have the effect of harming competition, the relevant effect must be more than minimal.¹⁷
- 3.27 When considering whether an agreement has an effect on competition that is more than minimal, the Commission may take into account the cumulative effect on competition of similar agreements in the relevant market and the contribution which the particular agreement under examination makes to the cumulative effect.

Restrictions necessary for a legitimate commercial purpose

- 3.28 Where the main arrangement covered by an agreement is not in itself harmful to competition, the Commission considers that restrictions contained in the agreement which are necessary for the agreement to be workable (sometimes termed ancillary restrictions) fall outside the prohibition in the First Conduct Rule.
- 3.29 Accordingly, if the main purpose of an agreement is not harmful to competition, it becomes necessary to assess whether particular individual restrictions contained in the agreement do not contravene the First Conduct Rule because they are ancillary to the main purpose of the agreement. This principle may be particularly relevant, for example, in the context of an assessment of a distribution agreement or a joint venture under the First Conduct Rule.

¹⁷ This proposition does not apply in the case of an agreement having the object of harming competition. Parties to an agreement with the object of harming competition may not argue that their agreement does not contravene the First Conduct Rule merely, for example, because they happen to have a very small share of the relevant market.

- 3.30 A restriction of competition will be ancillary when it is directly related to and necessary for the implementation of a separate, main (non-restrictive) agreement and proportionate to it. If the main parts of an agreement do not have the effect of harming competition, restrictions which are directly related to and necessary for implementing the main arrangement will also fall outside the First Conduct Rule.
- 3.31 For a restriction to be considered directly related to a main agreement, the restriction must be subordinate to the implementation of the main agreement and be inseparably linked to it.
- 3.32 For the restriction to be truly ancillary it must also be objectively necessary for the implementation of the main arrangement and proportionate to it. If, without the restriction, the main non-restrictive agreement would be difficult or impossible to implement, the restriction might be regarded as objectively necessary and proportionate.
- 3.33 For example, in the case of a joint venture subject to the First Conduct Rule but which is not itself harmful to competition, a non-compete clause between the parent entities and the joint venture might be regarded as ancillary to the joint venture or necessary for the joint venture agreement to be workable for the lifetime of the joint venture.

4 Exclusion for Agreements Enhancing Overall Economic Efficiency

- 4.1 Agreements that have the object or effect of harming competition may generate pro-competitive benefits in the form of economic efficiencies. If an agreement is found to harm competition, the parties may therefore wish to provide evidence that the agreement entails such pro-competitive benefits. The Commission will consider this evidence and whether the alleged pro-competitive benefits compensate for the harmful impact of the agreement under section 1 of Schedule 1 to the Ordinance – the general exclusion for agreements enhancing overall economic efficiency. The assessment of efficiencies therefore takes place under section 1 of Schedule 1 of the Ordinance and not under the First Conduct Rule as such.

- 4.2 The general exclusion for agreements enhancing overall economic efficiency applies automatically, and without any prior decision of the Commission or Tribunal, to any agreement that fulfils the cumulative conditions of the exclusion.
- 4.3 The Commission interprets section 1 of Schedule 1 to the Ordinance as a “defence” that can be invoked by an undertaking in response to an allegation that the First Conduct Rule has been contravened. The Commission is of the view that the burden of demonstrating that the terms of the general exclusion are met rests with the undertaking seeking to rely on it.
- 4.4 Parties are free to argue that any restrictive agreement generates efficiencies, including agreements which have the object of harming competition. However, as a practical matter, cartel conduct involving an agreement between competitors to fix prices, to share markets, to restrict output or to rig bids is unlikely to be justifiable on the basis of the general exclusion for agreements enhancing overall economic efficiency.
- 4.5 A more detailed discussion of the general exclusion for agreements enhancing overall economic efficiency is contained in the Annex to this Guideline. The Annex also includes discussion of other exclusions and exemptions from the First Conduct Rule.

5 Serious Anti-competitive Conduct

- 5.1 Where the Commission has reasonable cause to believe that a contravention of the First Conduct Rule has occurred and the contravention does not involve Serious Anti-competitive Conduct, the Commission must, before bringing proceedings in the Tribunal against the undertaking whose conduct is alleged to constitute the contravention, issue a Warning Notice under section 82 of the Ordinance to the undertaking concerned. The Warning Notice procedure affords an undertaking an opportunity to cease or alter the investigated conduct within a specified warning period.

5.2 In cases of Serious Anti-competitive Conduct:

- (a) the Commission may institute proceedings before the Tribunal without following the Warning Notice procedure; and
- (b) the general exclusion for agreements of lesser significance contained in section 5, Schedule 1 to the Ordinance does not apply.¹⁸

5.3 Serious Anti-competitive Conduct is a defined term in the Ordinance. Section 2(1) of the Ordinance defines Serious Anti-competitive Conduct to mean:

“any conduct that consists of any of the following or any combination of the following –

- (a) fixing, maintaining, increasing or controlling the price for the supply of goods or services;*
- (b) allocating sales, territories, customers or markets for the production or supply of goods or services;*
- (c) fixing, maintaining, controlling, preventing, limiting or eliminating the production or supply of goods or services;*
- (d) bid-rigging.”*

5.4 The Commission takes the view that cartel arrangements between competitors (horizontal arrangements) that seek to fix prices, share markets, restrict output or rig bids are forms of Serious Anti-competitive Conduct.

5.5 Vertical arrangements are, as a general matter, unlikely to be considered Serious Anti-competitive Conduct although the definition of Serious Anti-competitive Conduct does not preclude the possibility (there is no reference in the definition to “competitors”).

5.6 The Commission considers, however, that vertical arrangements may amount to Serious Anti-competitive Conduct in certain cases. For example, in certain circumstances, resale price maintenance may be Serious Anti-competitive Conduct.¹⁹

¹⁸ See the Annex to this Guideline for a more detailed discussion of the exclusion for agreements of lesser significance.

¹⁹ Paragraph (a) of the definition of Serious Anti-competitive Conduct in section 2(1) of the Ordinance provides that conduct which consists of “fixing, maintaining, increasing or controlling the price for the supply of goods or services” is Serious Anti-competitive Conduct. Resale price maintenance involves the supplier fixing, maintaining or controlling the resale price for its products. Further discussion of resale price maintenance is contained in Part 6 of this Guideline.

- 5.7 Whether conduct is considered Serious Anti-competitive Conduct is not part of the determination of whether the conduct contravenes the First Conduct Rule because it has the object or effect of harming competition. The issue of whether the conduct is considered Serious Anti-competitive Conduct only arises after the Commission forms the view that the conduct contravenes the First Conduct Rule. Conduct that is Serious Anti-competitive Conduct may contravene the First Conduct Rule where it has either the object or effect of harming competition.

6 Agreements that May Contravene the First Conduct Rule

- 6.1 The First Conduct Rule applies to agreements if they have the object or effect of harming competition in Hong Kong. The First Conduct Rule applies to both horizontal agreements and vertical agreements.
- 6.2 A horizontal agreement is an agreement made by two (or more) actual or potential competitors, each operating at the same level of the production or distribution chain.
- 6.3 Horizontal agreements may be particularly liable to harm competition because they involve cooperation between competitors. By way of example, cartel arrangements negatively impact the market giving rise to higher prices, reduced output, reduced product quality and variety and innovation. The First Conduct Rule prohibits these practices.
- 6.4 However, horizontal agreements can also lead to economically beneficial outcomes, in particular, if they combine complementary activities, skills, or assets. Horizontal agreements of this kind allow parties to share risk, save costs, increase investments, pool know-how, enhance product quality and variety and stimulate innovation. The Ordinance does not prohibit agreements which either do not harm competition or which, even if they do harm competition to an extent, have sufficient pro-competitive efficiencies and otherwise satisfy the terms of section 1 of Schedule 1 to the Ordinance.

- 6.5 A vertical agreement is an agreement between undertakings that operate, for the purposes of the agreement, at a different level of the production or distribution chain. For example, where undertaking A produces a raw material, and undertaking B uses the raw material acquired from A as an input in making B's own product, A and B are said to be in a vertical relationship.
- 6.6 While vertical agreements as compared with horizontal agreements are generally less harmful to competition, some vertical agreements may, nonetheless, cause harm to competition.
- 6.7 This may be the case where vertical agreements include restrictions which foreclose existing competition or limit the scope for market entry or expansion. In certain cases, vertical restrictions of competition may also serve to facilitate horizontal coordination between competing suppliers and/or downstream distributors.
- 6.8 However, vertical agreements also frequently improve economic efficiency within a chain of production or distribution by facilitating better cooperation between the participating undertakings. In particular, vertical agreements can lead to a reduction in transaction and distribution costs and/or an optimisation of the parties' sales and investment levels.
- 6.9 The fact that vertical agreements are generally less harmful to competition while offering greater scope for efficiencies will be reflected in the Commission's approach to these arrangements under the Ordinance. As a general matter, competition concerns will only arise where there is some degree of market power at the level of the supplier, the buyer or at the level of both. Vertical agreements between SMEs will rarely be capable of harming competition.

Price Fixing

- 6.10 Agreements between competitors with the aim of fixing, maintaining, increasing or otherwise controlling prices (generally termed price fixing agreements) are examples of agreements with the object of harming competition.²⁰

²⁰ In certain cases, an examination of the relevant context for the agreement (pursuant to the principles elaborated in paragraphs 3.3 to 3.15 of this Guideline) may, however, show that the object of the agreement is not to harm competition. For example, where the agreement with respect to price is part of some wider pro-competitive integration of the parties' operations. See further paragraph 6.16 of this Guideline.

- 6.11 Horizontal price fixing may take a number of forms. It may, for example, involve directly agreeing upon a specified price, the amount or percentage by which prices are to be increased or a price range. Price in this context includes any element of price and, in particular, includes any discount, rebate, allowance, price concession or other advantage in relation to the supply of products. An agreement with respect to an element of price amounts to price fixing.
- 6.12 Price fixing can be achieved by indirect means. This includes where, for example, undertakings agree not to quote a price without consulting competitors, or not to charge less than any other price in the market. Similarly, the exchange of information on future price intentions may be assessed as price fixing.²¹
- 6.13 An agreement concerning price may still amount to price fixing even if it does not entirely eliminate all price competition. Competition may, for example, be harmed despite the ability to grant discounts up to a certain agreed level on a published list price or notwithstanding that parties only fix one price component while competing on others.
- 6.14 Price fixing might arise through the activities of a trade association or professional body. For example, the association might issue a recommendation to members on prices and/or publish (possibly non-binding) fee scales for members. The non-binding price recommendations or fees scales of a trade association will likely be assessed as having the object of harming competition, as ultimately these arrangements may not differ in substance to a direct agreement or concerted practice between the members of the association.
- 6.15 The Commission considers that horizontal price fixing agreements are Serious Anti-competitive Conduct under the Ordinance.
- 6.16 The Commission notes that certain legitimate commercial arrangements may involve parties agreeing on pricing within the context of the relevant arrangements. For example, the parties to a production joint venture might agree that the joint venture will sell its jointly produced products at a particular price. In this respect, the Commission takes the view that the joint setting of the price of such products will not be considered as having the object of harming competition if, for example, the joint sales are necessary for the joint production to be implemented.²²

²¹ See paragraphs 6.38 to 6.49 of this Guideline for a discussion of when exchanges of information may give rise to competition concerns.

²² See also paragraphs 3.28 to 3.33 of this Guideline which concern restrictions necessary for a legitimate commercial purpose.

Hypothetical Example 5

A number of new car dealers in Hong Kong meet to discuss how to avoid supposed consumer confusion on the range of car-financing options available in the market. The dealers agree to minimum interest rates on car finance packages. They also note that many dealers regularly offer heavy discounts from the list price prior to Chinese New Year. To prevent “too much” undercutting in the market, they agree to a discount of no more than 5% off the list price.

These agreements relating to the elements of price would be viewed by the Commission as having the object of harming competition. By collectively setting a minimum interest rate and fixing the maximum discount, particular elements of price competition have been agreed by the competitors when these matters should be determined independently.

As the conduct has the object of harming competition, it is not necessary for the Commission to consider whether the conduct has or is likely to cause harmful effects on competition in the relevant market.

The Commission would also consider the conduct in the example to be Serious Anti-competitive Conduct under the Ordinance.

Market Sharing

6.17 Market sharing agreements are agreements between competitors that seek to allocate sales, territories, customers or markets for the production or supply of particular products. Market sharing entails competing undertakings agreeing to divide up a market so that the undertakings are “sheltered” from competition in their allotted portion of the market. For example, competitors might agree not to:

- (a) compete in the production of certain products (undertaking A agrees it will only produce product X, while undertaking B agrees it will only produce product Y);
- (b) sell in each other’s agreed territories;
- (c) sell to each other’s customers (non-poaching agreements); or
- (d) expand into a market where another party to the agreement is already active – for example an agreement not to enter a particular geographical area or an agreement not to begin selling certain products.

- 6.18 Agreements between competitors with the aim of sharing markets have the object of harming competition. Even a mere understanding that parties will not supply a competitor's existing customers, and/or will encourage such customers to stay with their existing supplier should the customer seek to switch supplier, can be considered a market sharing agreement with the object of harming competition.
- 6.19 The Commission considers that horizontal market sharing agreements are Serious Anti-competitive Conduct under the Ordinance.
- 6.20 The Commission notes, however, that certain legitimate commercial arrangements may involve parties agreeing to "share markets". For example, competitors might agree to cease production of certain products so that they can specialise in the production of other products which they then supply to each other on a reciprocal basis. An objective assessment of the nature of such an arrangement viewed in its context may lead to the conclusion that the arrangement does not have the object of harming competition.

Hypothetical Example 6

A group of coach companies supplying services to residents at particular residential buildings meet to discuss how they operate their services across Hong Kong. To enable them all to make what they consider to be a reasonable profit, they decide to allocate between themselves a number of buildings based on the total projected number of passengers. They agree not to provide services or to pursue customers which have been allocated to another company. They also agree not to launch new services without consulting each other.

This agreement not to compete with one another defined customer's has the object of harming competition. The agreement removes a choice of supplier with the likely result of higher prices for the services concerned.

Having concluded that the agreement has the object of harming competition, the Commission is not required to show that the conduct has or is likely to have harmful effects in the market.

The agreement is unlikely to satisfy the conditions of section 1 of Schedule 1 to the Ordinance. While it might be argued that the agreement can be defended on the grounds that it rationalises and avoids overlapping services, the arrangement entails the elimination of all competition between the parties concerned and on this basis the terms of section 1 of Schedule 1 are unlikely to be satisfied.

The Commission would also consider the conduct in the example to be Serious Anti-competitive Conduct under the Ordinance.

Output Limitation

- 6.21 Agreements between competitors which fix, maintain, control, prevent, limit or eliminate the production or supply of products are often referred to as output limitation agreements. Output limitation agreements can take the form of production or sales quota arrangements involving undertakings limiting the volume or type of products available in the market. Such agreements also include agreements that limit or coordinate investment plans or control capacity.
- 6.22 Output limitation agreements between competitors have the object of harming competition. Agreements which reduce or control the level of output of a product by their very nature result in price increases. Such arrangements may also have other anti-competitive effects, for example, by aligning product quality and/or facilitating collusion between suppliers on price.
- 6.23 The fact that an industry might be perceived to be in “crisis” by industry participants as a result of structural over-capacity, is not a defence to an agreement on output limitation. So-called “crisis cartels” receive no special treatment under the Ordinance. They will be considered as having the object of harming competition.
- 6.24 The Commission considers that horizontal output limitation agreements are Serious Anti-competitive Conduct under the Ordinance.
- 6.25 The Commission notes, however, that certain legitimate commercial arrangements may involve parties agreeing on output. For example, the parties to a joint venture might agree to a particular level of output for the joint venture. Viewed in its context, the Commission may not consider this sort of arrangement as having the object of harming competition.

Hypothetical Example 7

Local salted fish producers have faced financial difficulty for a number of years as supply in Hong Kong has increasingly outstripped demand. Given this “crisis” affecting the industry, the main producers meet to discuss how to restructure the sector with a view to rationalising what they consider to be a situation of “over-capacity”. A scheme is agreed which encourages certain producers to withdraw from the production of salted fish for a period and to refocus their commercial activities on other areas of business. Those producers who continue to operate their salted fish businesses make certain compensation payments to the producers leaving the market and, as a further expression of solidarity, agree to cover the costs of decommissioning relevant production lines.

The Commission would view this scheme as having the object of harming competition. In a competitive market, the producers would be expected to make production and capacity decisions independently. It is not for the market participants in a particular market collectively to agree what the market outcome should be.

The Commission would also regard the conduct as Serious Anti-competitive Conduct within the meaning of the Ordinance.

Bid-Rigging

- 6.26 Bid-rigging generally involves two or more undertakings agreeing that they will not compete with one another for particular projects. For example, they might agree among themselves which bidder will be the winner – the outcome of an ostensibly competitive process is “rigged”.
- 6.27 Bid-rigging is defined in section 2(2) of the Ordinance for the purposes of determining whether the conduct is Serious Anti-competitive Conduct in the form of bid-rigging. Bid-rigging which contravenes the First Conduct Rule is not, however, necessarily limited to the conduct defined in section 2(2). For example, as stated in section 2(2) of the Ordinance, if the bid-rigging is “*made known to the person calling for or requesting bids at or before the time when a bid is submitted or withdrawn by a party*”, the conduct does not fall within the definition of bid-rigging in section 2(2) and is, therefore, not Serious Anti-competitive Conduct in the form of bid-rigging. The bid-rigging conduct may, however, still contravene the First Conduct Rule if it has the object or effect of harming competition.

6.28 Bid-rigging can take a number of forms, including undertakings agreeing:

- (a) that certain parties will not submit a bid or will withdraw a bid submitted previously (“bid suppression”);
- (b) to take turns at being the winning bidder (“bid rotation”);
- (c) that certain bidders will submit higher bid prices or less attractive terms than the supplier “chosen” to win the tender (“cover bidding”); or
- (d) to take other actions that reduce the competitive tension in the bidding process, such as by agreeing minimum bidding prices or agreeing that the winning bidder will reimburse other bidders’ bid costs.

6.29 Bid-rigging is inherently anti-competitive and has the object of harming competition in contravention of the First Conduct Rule.

Hypothetical Example 8

A large company with a number of offices across Hong Kong decides to outsource its catering services. The company invites four major competing caterers to bid for the new contract. The sales representatives of the four caterers meet, by chance, at a charity football match and discuss the tender. The sales representatives agree as follows: the first caterer will decline to submit a bid while the second will withdraw a previously-submitted bid; the third caterer will submit a higher priced “cover bid”. The company calling for the bids was not aware of these arrangements and proceeded to award the contract to the fourth caterer which, on the face of it, submitted the most “competitive” bid.

The Commission will consider this arrangement as having the object of harming competition. The caterers have sought to artificially pre-determine the outcome of the tender. In addition to reducing customer choice, the bid-rigging results in inflated prices for the outsourced catering services.

The Commission would also regard the conduct in the example to be Serious Anti-competitive Conduct under the Ordinance.

6.30 Bid-rigging practices should be distinguished from legitimate forms of joint tendering. While bid-rigging will be considered as having the object of harming competition, joint tendering will generally be assessed by reference to its actual or likely effects on competition. Joint tendering is discussed further in paragraphs 6.101 to 6.106 of this Guideline.

Joint Buying

- 6.31 A joint or group buying agreement arises when undertakings agree to jointly purchase products including inputs used for the production of other products.
- 6.32 Joint buying can be carried out in a number of ways, for example through a jointly controlled legal entity, through an association, by a contractual arrangement between undertakings, or some looser form of cooperation.
- 6.33 Joint buying frequently allows SME undertakings to achieve purchasing efficiencies similar to their larger competitors. This may result in lower prices in the market where the joint buying takes place, lower transaction costs, and/or distribution efficiencies for the SMEs. Joint buying of this kind seldom gives rise to competition concerns.
- 6.34 A joint buying arrangement would typically not be considered by the Commission to have the object of harming competition unless it is a disguised buyers' cartel.²³ Joint buying arrangements, including any agreement by members of the buying group of the prices to pay suppliers, will be analysed as to whether the effects, actual or likely, of the arrangements are harmful to competition.
- 6.35 An analysis of the effects on competition of joint buying will consider the effects of the arrangement on both the upstream buying and the downstream selling markets, i.e. the relevant markets where the undertakings engage in the joint buying and the relevant markets where the jointly purchased products are subsequently sold or where other products produced using jointly purchased inputs are sold.
- 6.36 Harmful effects on competition in the downstream market may occur if, for example, the joint buying results in competitors in the downstream market achieving a high degree of commonality of costs²⁴ or where there is some sharing of competitively sensitive information²⁵ beyond what is necessary for the purposes of the buying arrangement. As regards the upstream buying market, concerns may arise if, for example, the joint buying results in the buying market being foreclosed to competing purchasers.
- 6.37 In general, joint buying is unlikely to give rise to concerns under the First Conduct Rule if the parties do not have market power in the relevant downstream markets.

²³ Buyers' cartels while uncommon are considered to have the object of harming competition. An example of a buyers' cartel would be where the buyers collude in secret on the prices they will pay for purchases made individually.

²⁴ Joint buying and other horizontal co-operation agreements may result in the parties achieving significant commonality of variable costs such that they can more easily coordinate on retail prices and/or output.

²⁵ See paragraphs 6.38 to 6.49 of this Guideline for a discussion of information exchange under the Ordinance. Competitively sensitive information is explained in paragraph 6.39.

Hypothetical Example 9

With a view to achieving savings in their input costs, 100 small snack food retailers and market stall holders from across Hong Kong form a joint buying group. The buying group members must buy at least half of their snack food products through the buying group. Together, the small retailers account for a small portion of the relevant buying and selling markets in Hong Kong and there are a number of strong competitors in both buying and selling markets (including large wholesalers and supermarket chains).

The arrangement does not have the object of harming competition and the Commission would be unlikely to find that the arrangement has any anti-competitive effects.

Even if the formation of the buying group enhances the commonality of input costs across the small retailers to an extent, their market position on both the buying and selling markets and the presence of large competitors suggests harm to competition is unlikely.

If the joint buying agreement did give rise to harmful effects on competition, it would still be likely to generate economic efficiencies in the form of economies of scale. As the buying group members face strong competitive pressures in the downstream selling market(s) from supermarket chains, it is likely that the cost savings achieved by the joint buying will be passed on to consumers. The general exclusion for agreements enhancing overall economic efficiency may therefore apply.

Exchange of Information

6.38 In the normal course of business, undertakings exchange information on a variety of matters with no risk to the competitive process. Indeed, competition is often enhanced through the sharing of information, for example, in relation to best practices or exchanges of information which allow firms to better predict how demand is likely to evolve. Similarly, information exchanges may facilitate price comparisons by consumers or reduce consumer search costs. As a general proposition, the more informed consumers are, the more effective competition is likely to be.

6.39 However, concerns may arise where undertakings which are competitors exchange information. In particular, this will be the case where competitors exchange information which is competitively sensitive information. Competitively sensitive information includes information relating to price, elements of price or price strategies, customers, production costs, quantities, turnover, sales, capacity, product quality, marketing plans, risks, investments, technologies and innovations. Generally, information relating to price and quantities (information concerning sales, market shares, sales to particular customer groups or territories) is the most competitively sensitive.

Agreements to exchange information which may have the object of harming competition

6.40 If competitors share information in private on their future individual intentions or plans with respect to price,²⁶ the Commission will likely consider that the agreement to exchange such information, has the object of harming competition. Similarly, as explained at paragraphs 2.28 to 2.30 of this Guideline, where an exchange of such information arises as part of a concerted practice, the Commission would likely assess the conduct as having the object of harming competition.

Hypothetical Example 10

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 to members in advance of a seasonal price review by the association members.

Absent a decision of the association giving rise to the information exchange or evidence of an agreement between members to engage in the information exchange, the Commission would infer that this arrangement is implemented as part of a concerted practice with the object of harming competition. The conduct allows the junk owners to adjust their future pricing to reflect the proposed pricing of competitors and thus reduces price competition in the market. The information exchange arrangement is an indirect form of price fixing.

The Commission would also regard the conduct to be Serious Anti-competitive Conduct under the Ordinance.

²⁶ The reference to price in this context is shorthand for price and quantities information. See paragraph 6.39 of the Guideline.

Information exchanged through a third party

- 6.41 The exchange of competitively sensitive information may not only occur directly between competitors or indirectly through a trade association. Instead, competitors may seek to use a third party supplier or distributor as a “conduit” for the indirect exchange of, for example, future pricing information.
- 6.42 If undertakings agree with each other to exchange information on their proposed future intentions with respect to price indirectly through a third party conduit such as a common supplier, this will likely be considered a form of price fixing with the object of harming competition.
- 6.43 Equally such an information exchange might occur as part of a concerted practice, for example, if (i) an undertaking exchanges information via a third party functioning as a conduit intending that the third party will make use of the information to influence market conditions by passing it to a competitor of the undertaking, (ii) the third party in fact transmits the information to the competitor and (iii) the competitor uses the information to determine its conduct in the market.²⁷

Hypothetical Example I I

Connaught, Queens and DVo are the main retailers in Hong Kong for a particular type of cosmetic product. CentralCosmetics currently provides its cosmetic products to each of the competing retailers.

Connaught emails Central indicating it plans to raise the retail price of Central's products next month by HK\$5 “if Queens and DVo do the same”. Connaught asks Central to ensure “this message is understood”. Central immediately forwards the email to the sales personnel at Queens and DVo. Both reply to Central indicating “seems like a good idea”. Central contacts Connaught and informs them that their email was “well received”. Connaught proceeds with a price hike the following month. Queens and DVo follow within a couple of days.

The scenario is likely to be viewed as an agreement or at least a concerted practice involving all four undertakings with the object of harming competition. The Commission would also consider the arrangement to be Serious Anti-competitive Conduct under the Ordinance.

²⁷ See generally paragraphs 2.28 to 2.30 of this Guideline for further information on when an exchange of information might give rise to or take place as part of a concerted practice.

Central is provided with the confidential information by Connaught on the express basis that it should be disseminated to Connaught's competitors and acted upon accordingly. Central clearly understands the intention behind Connaught's email and thus actively participates as the conduit for the sharing of future pricing intentions. Central's role and the various confirmations received from the other retailers has removed the inherent uncertainty in competitive markets. Connaught feels confident that its price rise will be matched and therefore proceeds with the price rise.

Agreements to exchange information which may have the effect of harming competition

- 6.44 Where an agreement to exchange information does not have the object of harming competition, the Commission will consider whether it might have anti-competitive effects.
- 6.45 Whether or not the exchange of information gives rise to concerns under the First Conduct Rule depends on the circumstances of the case including the characteristics of the market, the type of information exchanged (whether it is competitively sensitive and how competitively sensitive it is) and other relevant factors.
- 6.46 As a general matter, the smaller the number of undertakings operating in the market (i.e. the more concentrated the market), the more frequent the exchange of information between the undertakings concerned, the more competitively sensitive the information, the more current it is, the more detailed the information exchanged, the more individualised or company specific the information, the more access to the information is limited to the undertakings participating in the information exchange (so that other competitors and consumers do not have access to it), the more likely it is that the agreement to exchange the information will give rise to concerns under the First Conduct Rule.
- 6.47 The type of information exchanged and the structure of the market in which the information exchange occurs are important factors in the analysis. For example, the exchange of historical,²⁸ aggregated and anonymised data is less likely to harm competition, since the exchange of such information is unlikely to reduce independent decision-making by undertakings with regard to their actions in the market.

²⁸ Whether data is historic (in the sense that it is old enough not to pose any risk of harm to competition) depends on the specific characteristics of the market in question. There is no predetermined threshold in this respect.

- 6.48 In general, the exchange of publicly available information is unlikely to involve a contravention of the First Conduct Rule. Publicly available information in this sense is information that is equally accessible in terms of the cost of access to all competitors and customers. Information which is more costly to obtain for parties not affiliated with the information exchange because they would need to gather and collate the information is unlikely to be considered truly public. The fact that information could have been gathered from a customer does not mean that the information is publicly available.
- 6.49 Where information is exchanged in public so that all parties have access to the information (including consumers), harmful effects are less likely. Exchanges which take place in public are also more likely to generate efficiencies.

Hypothetical Example 12

There are five suppliers of pre-packaged fresh fruit to small grocery retailers in Hong Kong. Demand is unstable, varying with the season and the location of the grocery retailers. The suppliers frequently have significant volumes of unsold waste products. To address the problem, the suppliers agree to hire an independent market research company to collate information on unsold fruit on a daily basis. Each week, the research company publishes on its website statistics for unsold fruit in an aggregated form broken down by district or location. The data allows the suppliers to better predict demand and assess their performance against that of the sector as a whole. The individual suppliers are unable to disaggregate the data to identify competitively sensitive information pertaining to any specific competitor.

The Commission is unlikely to consider that this agreement has the object or effect of harming competition. The aggregated and arguably historic nature of the information exchanged, and the fact that the information is exchanged in public makes it less likely that harmful effects will arise. In any case, the agreement to exchange the information appears to give rise to efficiencies sufficient to satisfy the terms of section 1 of Schedule 1 to the Ordinance. In particular, the high levels of waste products suggest that the market is not working effectively. The information exchange seeks to correct this and does not in any event eliminate competition between the suppliers.

Group Boycotts

- 6.50 In most circumstances, an undertaking is free to choose with whom it will or will not do business.²⁹ However, an agreement or concerted practice amongst competitors not to do business with targeted individuals or undertakings may be an anti-competitive group boycott.
- 6.51 The Commission will consider that an agreement to engage in a group boycott has the object of harming competition when, in particular, a group of competitors agrees to exclude an actual or potential competitor.
- 6.52 Where a boycott is intended to facilitate a wider cartel agreement, the boycott is simply part of the cartel. For example, the members of a price fixing cartel might agree to take actions intended to prevent market entry by new competitors or they might agree to take retaliatory measures against undertakings refusing to comply with the cartel agreement. Evidence of a boycott of this kind is evidence of the implementation of the cartel or evidence, possibly together with other evidence, from which the Commission might infer a cartel agreement.

Hypothetical Example 13

Companies active in a particular manufacturing industry in Hong Kong rely on a variety of specialist recruitment agencies to source staff from overseas. HireMe Ltd recently entered the market with a new and innovative business model. HireMe acts as an intermediary consolidating the services of the different specialist agencies active in the supply of candidates to industrial clients. The HireMe business model aims at giving its clients the option of a “one stop shop” so that they can avoid dealing directly with the different specialist agencies. HireMe aims to cater for the totality of its clients’ hiring needs.

After HireMe entered the market, the major recruitment agencies in Hong Kong arrange a conference call to discuss the impact of HireMe and their shared concern that HireMe is causing instability in the market. During the call, the agencies agree to immediately terminate all existing contracts with HireMe and to refrain from entering into further contracts with the company. They undertake to ensure that their overseas branches do likewise. This agreement limits HireMe’s ability to function as a “middle man” between the agencies and its customers.

²⁹ Where an undertaking has a substantial degree of market power, a refusal to deal may, however, contravene the Second Conduct Rule. See the Commission’s *Guideline on the Second Conduct Rule* for further detail in this respect.

The recruitment agencies' conduct amounts to an agreement to boycott a competitor with a view to excluding that competitor from the market. The Commission would consider the agreement as having the object of harming competition. The agreement is unlikely to satisfy the terms of the general exclusion for agreements of overall economic efficiency in section 1 of Schedule 1 to the Ordinance.

The Commission would also consider the conduct in the example to be Serious Anti-competitive Conduct within the meaning of point (c) of the definition of Serious Anti-competitive Conduct in the Ordinance.³⁰

Activities of Trade Associations and Industry Bodies

- 6.53 Trade associations and similar bodies play a valuable role in the economy in terms of furthering the collective interests of members. Such organisations may represent industry players in dealings with Government or help promote the members' interests in the media. They can assist with collecting and disseminating statistical information of interest to members or serve as a forum for agreeing industry standards or standard terms. They may offer a range of advisory services for members or training. Many of these activities have a positive impact in the economy and they often would not give cause for concern under the Ordinance.
- 6.54 As discussed at paragraphs 2.32 to 2.37 of this Guideline, some activities of a trade association may, however, raise concerns under the First Conduct Rule. The association may contravene the rule if an activity is considered to be a decision of an association of undertakings which has the object or effect of harming competition. An undertaking may contravene the First Conduct Rule if its activities are pursuant to an anti-competitive agreement or concerted practice to which it is a party or if, where the activity is pursuant to a decision of an association of which the undertaking is a member, the undertaking made or has given effect to the decision.
- 6.55 While much of the guidance in this Guideline will be of general relevance for trade associations and industry bodies, the discussion below groups together a number of issues of specific relevance to such organisations.

³⁰ Namely, conduct consisting of "controlling, preventing, limiting or eliminating the production or supply of goods or services".

Terms of membership of associations which may give rise to competition concerns

- 6.56 Membership of an association can, in some cases, be an essential pre-condition for competing in a market. In such circumstances, exclusion from membership can significantly impact an undertaking's effectiveness as a competitor and might be equivalent in terms of effect to an anti-competitive boycott.
- 6.57 To minimise competition concerns of this kind, the rules of admission to membership of the relevant association should be transparent, proportionate, non-discriminatory, based on objective standards and provide for an appeal procedure in the event of a refusal to admit a party to membership. Rules of admission to membership which do not satisfy these requirements may be viewed by the Commission as having either the object or effect of harming competition.
- 6.58 Procedures for members wishing to leave an association (and/or join a competing association) or expelling the members of an association may harm competition, where they are not based on reasonable and objective standards or where there is no proper appeals procedure in the event of expulsion from membership. In this context, the effect of a restriction on leaving an association may prevent undertakings from developing alternative business opportunities thus harming the competitive process.

Certification practices having the object or effect of harming competition

- 6.59 A trade association sometimes certifies or awards quality labels to members to recognise that they have met certain minimum industry standards. Such practices are often valuable to consumers, for example, where they offer quality assurance or promote interoperability between products.
- 6.60 Where certification is available to all suppliers that meet objective and reasonable quality requirements, it is unlikely to raise concerns under the First Conduct Rule.
- 6.61 The Commission may, however, consider certification practices as having the object or effect of harming competition when additional obligations are imposed on members as regards the products they can buy or sell (for example, an obligation only to sell the certified products) or where restrictions are imposed on members' pricing or marketing conduct.

Hypothetical Example 14

For many years a local professional body organised a certification scheme such that members were able to advertise themselves as “endorsed” by the professional body. Consumers consider the existence (or absence) of such an endorsement as a key consideration in their choice of service provider. The professional body recently decided to change its membership requirements to include a minimum turnover threshold for members to remain eligible for membership. The new requirements were discussed at a meeting at which only a few (larger) members attended, and where concerns were expressed that certain smaller members were offering “low quality” services and engaging in “low pricing” conduct. As a result of the new requirements, a number of smaller members were no longer eligible for membership and began to lose a significant proportion of their existing customers as they could no longer claim to be “endorsed”.

This scenario raises concerns under the First Conduct Rule. The change to the rules is on its face discriminatory and seems intended to exclude smaller market participants from membership of the professional body with the result that they are placed at a competitive disadvantage. The rule change may force some of the smaller companies to cease trading altogether potentially allowing the larger competitors to raise their prices. The Commission will be likely to consider the rule change as having the object of harming competition. Thus, the professional body and/or members who made or gave effect to the decision may contravene the First Conduct Rule.

The Commission would also consider the conduct in the example to be Serious Anti-competitive Conduct under the Ordinance.

Standard terms which may raise a concern under the First Conduct Rule

- 6.62 In certain industries market participants may agree on standard terms relating to the supply of products. The use of such terms is common, for example, in the insurance and banking sectors.

- 6.63 Often, the use of standard terms makes it easier for consumers to compare conditions offered and may therefore facilitate switching between alternative suppliers. Standard terms might also result in reduced transaction costs, facilitate market entry in certain cases, and increase legal certainty.
- 6.64 However, where standard terms define the nature of, or relate to the scope of the product, their use may limit product variety and innovation. Similarly, standard terms relating to price can harm price competition. If a standard term becomes an accepted industry standard, restricting access to the standard term makes market entry more difficult.
- 6.65 If a trade association prohibits new entrants from accessing its standard terms and the use of those terms is vital for successful entry into the market, the Commission will likely consider such conduct as having the object of harming competition. Standard terms affecting prices charged to consumers (including terms which recommend particular prices) will also be considered as having the object of harming competition.
- 6.66 As a general proposition, standard terms which do not affect price are unlikely to raise concerns under the First Conduct Rule if participation in the process for adopting the terms is open and the standard terms are non-binding and accessible to all market participants. However, this may not apply in all cases including where the standard terms define the scope or nature of the product sold (for instance, standard terms concerning risks to be covered by a particular category of insurance policy) as the use of such terms may entail a risk of reduced innovation and product variety. In this circumstance, an assessment of the effects of the standard terms will be required.

Hypothetical Example 15

A trade association in the insurance sector circulates non-binding standard policy terms for pleasure boat insurance to members. The terms do not relate to the maximum extent of cover offered and do not concern premiums or other price elements. While a large number of insurers use the standard terms, contracts are nonetheless varied and tailored to individual client needs. The standard terms have the advantage, however, of allowing consumers to compare the various policies on offer in the market. The standard terms are accessible to all insurers on equal terms including potential new entrants.

These standard terms relate to the scope of the product sold to consumers and may therefore raise a concern under the First Conduct Rule. That said, harm to product variety, if any, appears limited as the affected insurance policies are still tailored to individual customer needs. The standard terms entail efficiencies as they allow consumers to compare the various products on offer, facilitate switching between insurers and facilitate market entry. Competition is therefore enhanced by the standard terms. Overall, even if the adoption of the standard terms has a harmful effect on competition, there appears to be a plausible efficiency justification under section 1 of Schedule 1 to the Ordinance.

Standardisation agreements under the First Conduct Rule

- 6.67 In some markets, businesses may make agreements on the definition of technical or quality requirements with which, for example, current or future products must comply. Such agreements often increase competition and lower production and sales costs, benefiting consumers and the economy as a whole. Standardisation generally promotes interoperability and enhances product quality.
- 6.68 However, agreements that use a standard as part of a broader restrictive agreement aimed at excluding actual or potential competitors will likely be considered by the Commission as having the object of restricting competition. Other forms of standardisation agreement generally require an analysis of their actual or likely effects on competition.

Vertical Price Restrictions

- 6.69 Vertical price restrictions are restrictions imposed or recommended by an undertaking which affect the prices at which another undertaking operating at a different level of the production or distribution chain sells products.
- 6.70 The most common example of a vertical price restriction is the situation where a supplier imposes or recommends prices at which another undertaking sells the products it purchases from the supplier – so-called resale price restrictions. Vertical price restrictions are not limited to resale prices, however. While reference is made to resale price restrictions throughout this section, the principles should be understood to apply to vertical price restrictions generally and nothing turns on whether there is or is not a 'resale' as such. The key consideration is whether the vertical price is fixed, whether there is a minimum or maximum price level or whether the price level is merely recommended.

Resale price maintenance

6.71 Resale price maintenance (“**RPM**”) occurs whenever a supplier establishes a fixed or minimum resale price to be observed by the distributor when it resells the product affected by the RPM obligation.

6.72 RPM can restrict competition in a number of ways:

- (a) RPM facilitates coordination between competing suppliers through enhanced price transparency in the market. In this context, the Commission may have a particular concern where RPM is employed by multiple suppliers in the market or RPM is otherwise common in the market;
- (b) RPM undermines suppliers’ incentives to lower prices to distributors³¹ and distributors’ incentives to negotiate lower wholesale prices;
- (c) RPM limits “intra-brand” price competition by restricting the ability of distributors to offer lower sales prices for the affected brand as compared with prices offered by competing distributors of the same brand.³² This will be a particular concern where there are strong or well organised distributors operating in a market. RPM facilitates coordination between distributors on the downstream market affected by the RPM. In this context, the Commission will have concern particularly where there is evidence that the RPM conduct is distributor driven;
- (d) RPM prevents the emergence of new market participants at the distributor level and will generally hinder the expansion of distribution models based on low prices (for example, the emergence of discounter distributors); and
- (e) where RPM is implemented by a supplier with market power, this may have the effect of excluding smaller suppliers from the market. Distributors are incentivised to only promote the product affected by the RPM causing harm to consumers.

³¹ While reference is made to distributors throughout the discussion of resale price restrictions, vertical price restrictions can also be imposed on retailers selling to end-consumers. The principles discussed in paragraphs 6.71 to 6.84 apply equally in the case vertical price restrictions imposed on retailers.

³² The Commission interprets the First Conduct Rule as prohibiting not only restrictions on inter-brand competition but also restrictions on intra-brand competition. Intra-brand competition is competition between products of the same brand. Inter-brand competition is competition between products of differing brands.

- 6.73 RPM can be achieved indirectly by, for instance, fixing the distributor's margin or the maximum level of discount the distributor can grant from a prescribed price level. The supplier might also make the grant of rebates or the reimbursement of promotional costs subject to the observance of a given price level by the distributor, or link the prescribed resale price to the resale price of competitors. The supplier might equally use threats, intimidation, warnings, penalties, delays in, or the outright suspension of, deliveries to achieve RPM.
- 6.74 For the reasons set out in paragraph 6.72 of this Guideline, where an agreement involves direct or indirect RPM, the Commission takes the view that the arrangement may have the object of harming competition. However, whether this is in fact the case turns on a consideration of the content of the agreement establishing the RPM, the way the arrangement is implemented by the parties and the relevant context.
- 6.75 For example, RPM will be considered as having the object of harming competition if there is evidence that the RPM was implemented by a supplier in response to pressure from a distributor seeking to limit competition from competitors of the distributor at the resale level. Similarly, if the RPM is implemented by a supplier solely to foreclose competing suppliers, the Commission may consider that the RPM has the object of harming competition.

Hypothetical Example 16

HomeStore is the owner of a wide number of household goods shops across Hong Kong. HomeStore is a significant customer of CleanUpCo for a number of daily use products which are widely available in supermarkets, convenience stores, specialist stores and smaller shops.

HomeStore is concerned that its competitors, including other large chain stores and smaller independent stores, are offering CleanUpCo's products at a lower price than HomeStore. HomeStore is concerned that its competitors' pricing decisions will impact on the profitability of a number of important business lines in its stores. HomeStore therefore pressures CleanUpCo to require its customers to sell CleanUpCo products across Hong Kong at a fixed retail price determined by CleanUpCo. As HomeStore is a significant customer of CleanUpCo, CleanUpCo implements the RPM policy.

The Commission would view this arrangement as having the object of harming competition. HomeStore's insistence on CleanUpCo introducing a fixed retail price across Hong Kong has an inherent ability to harm competition. In this scenario, the purpose of the arrangement is merely to protect HomeStore from the competitive pricing of its competitors. In addition, there would be unlikely to be sufficient justifications for the RPM practice to satisfy the terms of the general exclusion for agreements enhancing overall economic efficiency in section 1 of Schedule 1 to the Ordinance.

The Commission would also consider the RPM in the example to be Serious Anti-Competitive Conduct under the Ordinance.

Hypothetical Example 17

NailCo, a leading manufacturer of nails and screws for DIY and construction purposes sells its products in Hong Kong through independent retail stores. NailCo requires each of the stores to sell its products at a price stipulated by NailCo. NailCo justifies its pricing policy as a means of ensuring an orderly market and to avoid customer confusion as a result of differing prices for NailCo products across Hong Kong. NailCo also claims the arrangement affords retailers a healthy profit margin.

The Commission would view this arrangement as having the object of harming competition.

NailCo's justifications for the RPM practice will not be likely to satisfy the terms of the general exclusion for agreements enhancing overall economic efficiency in section 1 of Schedule 1 to the Ordinance. These justifications appear merely to suggest that RPM is a good way of keeping prices high. The argument that RPM avoids confusing customers amounts to an assertion that price competition is harmful for consumers. Price is the key parameter of competition and price competition is central to the regime established by the Ordinance.

- 6.76 If RPM does not have the object of harming competition, the Commission will assess whether the RPM causes harm to competition by way of its effects.

6.77 For example, where a supplier introduces a new product, a RPM arrangement may serve to induce distributors to better take into account the supplier's interest in promoting the product during the introductory period of expanding demand. In this context, the RPM might incentivise increased sales or promotional efforts on the part of the distributors. Similarly, RPM may be of assistance in a franchise distribution system for the purposes of organising a coordinated price campaign of limited duration. In both of these scenarios the Commission would consider that the RPM does not have the object of harming competition and would therefore assess whether the arrangement had any harmful effects on competition.

Hypothetical Example 18

A well-known producer of confectionary products wishes to introduce a range of "K-Pop" candy products into Hong Kong which have been successful elsewhere in Asia. The producer's existing share of supply in Hong Kong is less than 5% and it is hoped the new product range will be its 'break' in terms of reaching Hong Kong consumers. The producer requires its retailers in Hong Kong to sell its product at a fixed resale price of HK\$5 – which the producer understands to be a lower price than those of the leading competing brands (which retail between HK\$6 and HK\$8). To make a splash, the producer proposes to market the product across Hong Kong as "\$5 a POP".

Such an agreement on fixing the resale price may raise concerns of having the object of harming competition in so far as the agreement reduces the ability of independent retailers to set the price of the new products as they see fit.

However, the RPM when viewed in its context does not have the object of harming competition. Rather, the arrangement is intended objectively to assist a particular supplier break into the Hong Kong market. Accordingly the Commission would proceed to an analysis of the effects of the arrangement. On the facts, including the small market presence of the relevant supplier, the Commission might be able to conclude that the RPM does not give rise to concerns under the First Conduct Rule on the basis of its effects.

Even assuming that the RPM in this case might be assessed as having either the object or effect of harming competition, the parties may be able to bring forward evidence of economic efficiencies under section 1 of Schedule 1 to the Ordinance. In particular, given that the fixed resale price is for a short introductory period, it may be considered important to allow a new product to establish itself in the market. From this perspective, the fixed price encourages retailers to stock the product, increase sales through promotional activities and thus expands overall demand thereby improving distribution in the market with consumers likely to be afforded a fair share of these benefits. The absence of market power on the part of the supplier suggests that the practice is unlikely to eliminate competition in the relevant market. Consequently, the general exclusion for agreements enhancing overall economic efficiency appears likely to apply on the facts.

Recommended or maximum prices

- 6.78 Where a supplier merely recommends a resale price to a distributor or requires a reseller to respect a maximum resale price, the agreement will not be considered by the Commission to have the object of harming competition.
- 6.79 Instead, an agreement which entails recommended or maximum resale prices will be subject to an analysis of its competitive effects.
- 6.80 Recommended or maximum resale price agreements may give rise to a concern where they serve to establish a “focal point” for distributor pricing (that is, where the distributors generally follow the recommended or maximum price), and/or where they soften competition between suppliers or otherwise facilitate coordination between suppliers. An important factor in the analysis is the market position of the supplier. The more the supplier has market power, the more likely it is that the conduct will have the effect of harming competition.
- 6.81 Recommended or maximum resale price arrangements, when they are combined with measures that make them work in reality as fixed or minimum prices, will be assessed in the same manner as RPM.

- 6.82 This could include, for example, the use of a price monitoring system, or an obligation on distributors to report other members of a distribution network that deviate from the recommended or maximum price level or other measures which reduce the distributor's incentive to lower the resale price. While the presence of these practices or similar mechanisms may support a conclusion that ostensibly recommended or maximum resale price arrangements function in reality as RPM, this is not inevitably the case and the position must be assessed in light of all available facts.
- 6.83 Where a firm retaliates or threatens to retaliate when its "recommended" resale price is not followed, the Commission will consider the price is not truly recommended and assess the conduct as a form of RPM.

Efficiency justifications for vertical price restrictions

- 6.84 Vertical price restrictions, including RPM, may sometimes lead to efficiencies of the type detailed in section I of Schedule I to the Ordinance. While efficiencies must be assessed on a case by case basis, examples of possible efficiency arguments which may have relevance for vertical price restrictions are given below:³³
- (a) RPM may help address so-called free rider problems at the distribution level where the extra margin guaranteed by the RPM structure encourages parties to provide certain sales services for the benefit of consumers. This efficiency may have some relevance in the case of "experience" or complex products but the Commission would expect to see compelling evidence of an actual free rider problem; or
 - (b) in the case of maximum resale prices, the resale price restriction may help to ensure that the brand in question competes more effectively with other brands notably when it avoids "double marginalisation".³⁴

³³ The discussion here in respect of efficiencies is subject to the more detailed discussion in the Annex. Undertakings will be required to substantiate efficiencies and may not simply assert them. Undertakings seeking the benefit of the general exclusion for agreements enhancing overall economic efficiency will be required to demonstrate that all the conditions for the application of that exclusion have been met.

³⁴ Double-marginalisation occurs where the supplier and buyer both have market power and both apply a high margin when selling the product with the result that the end price is higher than the price that would have been charged by a vertically integrated monopolist. A maximum resale price may therefore have the effect of reducing the end price and increasing output.

Exclusive Distribution and Exclusive Customer Allocation

- 6.85 In an exclusive distribution agreement, a supplier assigns exclusivity for the resale of its products in a particular territory to a single distributor (or reseller). In an exclusive customer allocation agreement, the supplier assigns exclusivity to a single distributor for resale to a particular group of customers. The possible risks to competition from such agreements are reduced competition between distributors for the same products/brands, potential market sharing, and a reduction in competition through limiting market access to potentially competing distributors.
- 6.86 Exclusive distribution and exclusive customer allocation agreements will not generally be considered by the Commission to have the object of harming competition. For the purposes of the First Conduct Rule, these types of agreement will generally require an analysis of their effects or likely effects on competition in the relevant market, including an assessment of how intra-brand and inter-brand competition³⁵ is affected, the extent of the territorial and/or customer sales limitations, and whether exclusive distributorships are common generally in the markets impacted by the agreements under consideration.
- 6.87 If an exclusive distribution or exclusive customer allocation agreement is considered to have anti-competitive effects, the agreement may nonetheless benefit from the general exclusion for agreements enhancing overall economic efficiency set out in section 1 of Schedule 1 to the Ordinance. If the agreement meets the cumulative conditions of this exclusion, the First Conduct Rule does not apply to the agreement. This may be the case, for example, where investments by distributors are required to protect or build up the brand image of a product or where specific equipment, skills or experience are required for a particular group of customers. Exclusivity provisions may incentivise distributors to invest in marketing and customer service – thereby making the concerned product more competitive as against other branded products in the market. This in turn ensures a wider range of product choices for final consumers. Exclusive distribution agreements may also lead to savings in logistics costs due to economies of scale in transport and distribution.
- 6.88 The level of trade affected by the exclusivity might also be relevant in this context. For example, a manufacturer might choose a particular wholesaler to be its exclusive distributor for the whole of Hong Kong. Assuming there are no resale restrictions on the wholesaler, the loss of intra-brand competition at the wholesale level might be justified by reference to efficiencies in terms of logistics considerations.

³⁵ As explained in footnote 32 of this Guideline, intra-brand competition is competition between products of the same brand. Inter-brand competition is competition between products of differing brands.

- 6.89 Generally, in the case of exclusive distribution and exclusive customer allocation, arguments raised and supported by evidence that the agreements in question entail economic efficiencies within the meaning of section 1 of Schedule 1 to the Ordinance will require careful consideration.

Hypothetical Example 19

SportCo, a global brand, is a medium-sized player in the Hong Kong market for sports equipment. SportCo's practice is to appoint an exclusive wholesale distributor for each country where its products are marketed and it has one such distributor for Hong Kong. To become a SportCo exclusive wholesaler, a distributor is obliged only to sell SportCo products and not to sell products from SportCo's competitors. Distributors are responsible for all promotional activities in their allotted territory.

While the combination of an exclusivity territory arrangement with a "non-compete" clause might give rise concerns under the First Conduct Rule in some cases in terms of foreclosing competing suppliers, there is no evidence on the facts that this would be a concern here. The restrictions placed on the distributor serve to incentivise the promotion of the SportCo brand and are likely justifiable under the general exclusion for agreements enhancing overall economic efficiency in section 1 of Schedule 1 to the Ordinance.

Joint Ventures

- 6.90 The term "joint venture" can be used to describe various types of cooperative arrangement between undertakings including, for example, joint production arrangements, joint buying arrangements, joint selling, distribution and marketing arrangements, and joint R&D ventures. The activities of a joint venture may be carried out through a legal entity separate from the parties to the joint venture or by some or all parties to the joint venture.

- 6.91 Where a joint venture amounts to a “merger” as defined in section 2(1) of the Ordinance, the joint venture is excluded from scope of the First Conduct Rule and the Second Conduct Rule (collectively the “**Conduct Rules**”) as a result of section 4 of Schedule 1 to the Ordinance. In this context, section 2(1) provides that a merger has the meaning given by section 3 of Schedule 7 to the Ordinance read together with section 5 of Schedule 7. Specifically, in the context of a joint venture, section 3(4) of Schedule 7 provides that the creation of a joint venture “*to perform, on a lasting basis, all the functions of an autonomous economic entity*” constitutes a merger.
- 6.92 The Commission considers the following non-exhaustive factors as providing an indication that a joint venture does not perform, on a lasting basis, all the functions of an autonomous economic entity and is therefore within scope of the Conduct Rules. Not all of these factors need be present in a given case:
- (a) the joint venture does not have a management dedicated to its day-to-day operations or access to sufficient resources including finance, staff, and assets, in order to conduct on a lasting basis its business activities;
 - (b) the joint venture merely takes over a specific function within the parent companies’ business activities. This would be the case with joint ventures limited to production or R&D or where the joint venture effectively acts as a distribution arm for the parent entities;
 - (c) the joint venture sells a significant proportion of its output to its parents; and/or
 - (d) the joint venture is created for a short period of time. For example, where a joint venture is established to construct a particular project such as a power plant but will not be involved in the operation of the plant beyond the construction phase.
- 6.93 Where a joint venture falls within scope of First Conduct Rule, the Commission will consider whether the venture has the object or effect of harming competition in Hong Kong.
- 6.94 As explained at paragraphs 3.28 to 3.33 of this Guideline, if the joint venture agreement viewed as a whole does not have the object or effect of harming competition, restrictions which are directly related to and necessary for implementing the joint venture will also fall outside the First Conduct Rule. For example, a non-compete clause between the parent entities and their joint venture might be regarded as directly related to and necessary for implementing the joint venture for the lifetime of the joint venture.

Production joint ventures

- 6.95 A common form of joint venture that may fall within scope of the First Conduct Rule is a production joint venture. Joint production agreements take a number of forms. They may provide that production is carried out by one party or by two or more parties or the parties may establish a separate legal entity for the purposes of the joint production.
- 6.96 Generally, agreements which involve price-fixing or output limitation have the object of harming competition. In the case of joint production, the parties might well agree to a particular level of output for the joint venture. The Commission will not consider this sort of arrangement as having the object of harming competition but will consider more generally whether the production joint venture as a whole has the effect of harming competition.
- 6.97 Similarly, if the parties to a production joint venture agree that the joint venture will sell the jointly produced products, the joint setting of the price of those products will not be considered as having the object of harming competition where joint sales are necessary for the joint production to be implemented in the first place (i.e. if absent the joint selling, the parents would not otherwise enter into the joint production). Again, in this circumstance the Commission will consider the actual or likely effects of the joint venture as a whole on competition.
- 6.98 Where a joint production agreement allows parties to produce a product that they would not, objectively, be able to produce alone, the agreement will not likely have the object or effect of harming competition.
- 6.99 Joint production agreements may sometimes have the effect of harming competition, for example, where:
- (a) producing jointly leads to reduced product variety in the markets where the joint venture partners competed prior to forming the joint venture;
 - (b) producing jointly results in higher prices for customers;
 - (c) producing jointly results in an increase in the parties' commonality of costs with the result that the parties can more easily coordinate market prices; or
 - (d) the agreement leads to an exchange of competitively sensitive information beyond that which is strictly necessary for producing jointly.

Hypothetical Example 20

Two leading suppliers of an industrial chemical product in Hong Kong, Company A and Company B, decide to close their existing independent production facilities, and open a more efficient joint plant solely for use by A and B. Company A and B do not agree on any terms beyond those strictly limited to the running of the new facility. There are only two other competitors, C and D in the market who are running their plants at full capacity. Company B already has an existing joint venture with C. Costs of production are a significant proportion of the variable costs of the companies active in the market. The market has not seen any recent entry.

In assessing whether the creation of the joint production facility would give rise to concerns under the First Conduct Rule, the Commission would consider:

- the existing market structure and the state of competition in the market;
- whether the agreement enhances the commonality of costs of Companies A and B; and
- whether competition (on price) would likely be softened in the market as a result of the joint venture.

6.100 Even where they have the effect of harming competition, the Commission recognises that many production joint ventures are likely to entail economic efficiencies sufficient to satisfy the terms of the exclusion for agreements enhancing overall economic efficiency set out in section 1 of Schedule 1 to the Ordinance. This might particularly be the case where the joint production results in significant cost savings and synergies and/or economies of scale or scope, or improvements in product range or quality.

Joint tendering

6.101 Joint tendering generally involves undertakings cooperating openly with a view to making a joint bid. Such conduct can be contrasted with bid-rigging which more often involves collusion by competing bidders which nonetheless submit separate bids. Bid-rigging is discussed at paragraphs 6.26 to 6.30 of this Guideline.

6.102 Where the joint tendering activity is carried out in the open and the arrangement is known to the party organising the tender, competition concerns may not arise at all as the arrangement may be pro-competitive.

- 6.103 In particular, the submission of a joint tender can be of benefit to competition where it allows participation by companies which would not have been able to make a stand-alone bid (i.e. the arrangement results in additional bids being made), or if it enables companies to submit more competitive bids, e.g. through a consortia arrangement.
- 6.104 For the purposes of the First Conduct Rule, joint tendering is less likely to give rise to competition concerns where the undertakings involved pool their complementary skills or different specialities. For example, the undertakings may have access to different and complementary technologies and/or the cooperation may facilitate access to raw materials, the workforce necessary for a particular project or finance.
- 6.105 Where, however, the parties could have made independent bids, the conduct may raise a concern under the First Conduct Rule. Joint tendering which leads to a reduction in the number of potential bidders is more likely to have harmful effects if there is already a limited number of potential bidders in a concentrated market.
- 6.106 Joint tendering will not generally be considered by the Commission to have the object of harming competition, rather such arrangements will be assessed for their actual or likely effects on competition in the relevant market.

Hypothetical Example 21

A tender is announced for the renovation of a high-rise office building in Mong Kok. The tender requires bidders to have significant manpower to be able to complete the project in the given timeframe and also sets out a minimum financial resource threshold for the bidder – to ensure the chosen construction company has sufficient liquidity throughout the project.

Two small construction companies with a limited market share in Hong Kong, TungBuild and ChungConstruct, considered independently bidding for the tender. However, neither company had sufficient manpower resources or financial capital to satisfy the tender specifications and would thus individually be excluded from bidding.

Tung and Chung therefore submitted a joint-bid which allowed them to combine their resources to deliver the required project. The bid makes it clear they are submitting a joint tender, which transpires to be one of the lower prices submitted. Six other bids were submitted by larger construction companies who in the past five years have won the vast majority of the tenders for similar sized projects.

Assuming the creation of the TungBuild/ChungConstruct joint venture does not amount to a merger the arrangement may be assessed under the First Conduct Rule. In that regard, the joint venture does not have the object of harming competition and appears unlikely to give rise to anti-competitive effects. The fact that Tung and Chung could not individually bid for the project is particularly relevant here – they are not in fact competitors *for the project* in issue. The collaboration results in enhanced choice for the party organising the tender and a more competitive bidding process overall.

Nonetheless, Tung and Chung would need to be careful that any competitively sensitive information they share in submitting the bid and in carrying out the joint venture is used strictly for the purposes of the joint venture and that the joint venture is not used as a vehicle for exchanging commercial information on their usual prices and costs.

Joint selling, distribution and marketing

- 6.107 There exists a wide range of possible joint ventures between undertakings where they agree to jointly sell, distribute or market particular products (collectively “sales-related joint ventures”). Such arrangements range from collaboration in respect of advertising only or the joint provision of after-sales service, through to joint selling involving the joint determination of key commercial parameters including price.
- 6.108 Sales-related joint ventures can be an effective way of facilitating market entry for a new product, particularly where SMEs collaborate with a view to selling a new product they could not market individually. A sales-related joint venture does not give rise to competition concerns where the joint venture is objectively necessary for a party to enter a market it could not have entered on its own or with a smaller number of parties than those actually involved in the collaboration.

- 6.109 However, sales-related joint ventures can give rise to concerns under the First Conduct Rule where they lead to price fixing, output restriction, market sharing or the exchange of competitively sensitive information.
- 6.110 For example, agreements between competitors which are limited to the joint selling of products can serve as a vehicle for price fixing and may also entail restricting the output of the parties concerned. Where they do so, the agreements are likely to have the object of harming competition and may also be considered Serious Anti-competitive Conduct.
- 6.111 Equally, where competing undertakings enter into a reciprocal distribution arrangement with a view to limiting competition between them by allocating markets, the arrangement can be assessed as having the object of harming competition and may be considered Serious Anti-competitive Conduct.

Hypothetical Example 22

Various leading European flower producers have previously sold their products to Hong Kong through individual contracts with distributors. To rationalise their resources and reduce air freight costs, they form Bloomport JV, a joint venture arrangement under which each party agrees to make all its export sales to Hong Kong through the Bloomport brand. Bloomport will also decide on the products and volumes to be sold, the choice of customers and the prices to be charged.

The Commission would consider that this type of arrangement has the object of harming competition. By coordinating key commercial decisions, the parties risk contravening the First Conduct Rule by engaging in price fixing and output restriction.

The Commission may also consider the arrangement to be Serious Anti-competitive Conduct under the Ordinance.

- 6.112 Where sales-related joint ventures between competitors do not have the object of harming competition, they might, nonetheless, give rise to concerns under the First Conduct Rule where the relevant arrangements result in anti-competitive effects.

6.113 For example, anti-competitive effects might arise if:

- (a) the relevant arrangements increase the parties' commonality of variable costs;³⁶
- (b) the arrangements involve the exchange of competitively sensitive information which goes beyond what might be necessary for the purposes of implementing the collaboration; and/or
- (c) in the case of reciprocal and non-reciprocal distribution agreements between competitors, the arrangement serves to undermine the incentive of one party to enter the market of another.

6.114 Even where sales-related joint ventures have the effect of harming competition, such arrangements can entail efficiencies sufficient to satisfy the terms of the exclusion for agreements enhancing overall economic efficiency in section 1 of Schedule 1 to the Ordinance. For example, this might be the case where the joint venture results in significant cost savings and synergies and/or economies of scale or scope, or improvements in product range or quality.

Hypothetical Example 23

In order to reduce distribution costs and enhance access to a wider range of customers, a group of local microbreweries agree to set up a single distribution and delivery centre. Each of the breweries contributes their existing delivery staff and vehicles to the centre.

An arrangement of this kind would be unlikely to give rise to concerns under the First Conduct Rule. The scope of the cooperation is limited to one discrete aspect of the commercial activities of the parties and seems unlikely to require the parties to share competitively sensitive information, beyond the identity of customers which in any event is necessary for the purposes of implementing the collaboration. In particular, the parties remain free to set their own prices. Furthermore, although the parties transport costs might be harmonised by the arrangement, other significant input costs (e.g. ingredients, brand investment, marketing, and production) will continue to vary across the breweries and there remains ample room for competition on product quality.

³⁶ See footnote 28 above.

Franchise Arrangements

- 6.115 Franchise arrangements are a common business model for the production and distribution of products in Hong Kong.
- 6.116 With limited investment and risk, franchise agreements permit franchisors to quickly establish a network of entities with a uniform brand image and consistent product offering. Franchise agreements also allow franchisees with limited resources to benefit from the reputation and support services of a more widely known brand.
- 6.117 Measures necessary for maintaining the identity and reputation of a franchise network and/or provisions of a franchise agreement which are essential to protect the franchisor's branding, trademarks and know-how do not raise concerns under the First Conduct Rule. Other restrictions in a franchise agreement may contravene the First Conduct Rule where they have the object or effect of harming competition.

Maintaining the identity and reputation of the franchise network

- 6.118 A franchise agreement may contain restrictions with the objective of maintaining the identity and reputation of the franchise network. These may include the following obligations on the franchisee:
- (a) to apply the business method developed by the franchisor;
 - (b) not to use the franchisor's trademarks, trade names or other marks anywhere other than at the agreed franchise location;
 - (c) to exploit the franchise from the agreed location and not to change location without consent of the franchisor;
 - (d) in certain circumstances, not to sell competing goods apart from those supplied by or selected by the franchisor;
 - (e) to only sell products in a manner consistent with instructions of the franchisor (e.g. following a particular recipe, using particular technology, sales methods/promotional material); or
 - (f) to decorate the franchise premises in a manner specified by the franchisor.
- 6.119 Although restrictions of the above kind limit a franchisee's commercial freedom, they will not give rise to concerns under the First Conduct Rule where they relate directly to and are necessary for the implementation of the franchise arrangement.³⁷

³⁷ Restrictions which are necessary for some other commercial arrangement (ancillary restrictions) are discussed at paragraphs 3.28 to 3.33 of this Guideline.

Protecting the franchisor's branding and know-how

6.120 A franchise agreement may contain provisions that legitimately protect the franchisor's know-how and expertise. These may include, for example, a restriction on the transfer of the franchise, requirements on the use of the franchisor's intellectual property or obligations in relation to protecting confidential information and know-how, a prohibition during the term of the franchising contract on opening the same kind of shop in an area where it might compete with another franchisee or on carrying on any kind of competing business, and/or a prohibition for a reasonable period after the termination of the franchise on opening the same kind of shop in an area where it might compete with another franchisee. Such aspects of a franchise agreement are inherent in the nature of franchising (i.e. the relevant restrictions are ancillary to a legitimate commercial purpose) and, as such, typically raise no concerns under the First Conduct Rule.

Selective Distribution

6.121 Some businesses sell their products to end consumers through a network of authorised retailers chosen on the basis of particular criteria. Generally, the suppliers will prevent the authorised retailers from reselling the products concerned to non-authorised retailers.

6.122 Selective distribution systems are a common feature of the market in Hong Kong, particularly as regards the sale of branded final products. Selective distribution is very often economically beneficial and an effective way of furthering inter-brand competition. In particular, selective distribution may assist in establishing a quality reputation for a new product, can incentivise retailers to increase marketing efforts and might serve to maintain brand image and quality standards.

Qualitative criteria for establishing a selective distribution system

6.123 Generally, where a supplier selects retailers on the basis of purely qualitative criteria³⁸, the arrangement will not give rise to concerns under the First Conduct Rule where the following conditions apply:

- (a) the nature of the product is such as to require a selective distribution network in order to preserve its quality and ensure its proper use;

³⁸ The following criteria might be regarded as examples of qualitative criteria: criteria relating to the training or qualifications required of staff; criteria relating to the type of equipment available on the premises of the retail outlet; a stipulation that the products be sold in a specialist shop or that there be a separate display for the products; criteria requiring sales outlets to have a certain appearance; stipulating particular opening hours; or requiring the provision of after sales services.

- (b) members of the network (the authorised retailers) are selected on the basis of non-discriminatory qualitative criteria relating to their technical ability to handle the product or the suitability of their premises to protect the brand image of the product; and
- (c) the relevant criteria do not go beyond what is necessary for the particular product concerned.

6.124 Where the selective distribution system does not have the above characteristics, the Commission may need to assess the effects of the arrangement on competition. In this context, the Commission may consider, for example, whether the arrangement:

- (a) leads to anti-competitive foreclosure at the distributor/retailer level; and/or
- (b) serves to facilitate collusion between suppliers or distributors/retailers.

6.125 Risks to competition may be more likely when the supplier has market power, where the number of authorised retailers is small and/or all major competing suppliers in the market have similar selective distribution methods.

Other conditions in a selective distribution system

6.126 Some selective distribution systems select retailers on quantitative criteria e.g. sales targets or a pre-defined number of retailers in a particular locality. In addition, selective distribution systems may contain restrictions that do not relate to the qualitative needs of the supplier. For example, retailers may be prevented from making cross-sales to other members of the system, or selling to customers outside a prescribed class of customers. Such arrangements may give rise to concerns under the First Conduct Rule on the basis of their effects on competition.

6.127 In assessing the effects of such arrangements, the Commission will consider the market power of the supplier. Selective distribution systems are more likely to cause concern where inter-brand competition is limited and the supplier's market position is particularly strong. In addition, where there is widescale use of selective distribution in the relevant market, the risks of foreclosing certain types of retailer (e.g. more efficient retailers or "price discounters") and collusion between the major suppliers (i.e. competing brands) are more likely to arise.

Annex

Exclusions and Exemptions from the First Conduct Rule

I Introduction

- 1.1 The Ordinance provides for a number of exclusions and exemptions from the First Conduct Rule.
- 1.2 Undertakings to whom an exclusion or exemption applies will not contravene the First Conduct Rule even where their conduct has the object or effect of harming competition. There is no requirement for undertakings to apply to the Commission in order to secure the benefit of a particular exclusion or exemption. Undertakings can assess for themselves whether their conduct falls within the terms of a particular exclusion or exemption. Equally, undertakings may assert the benefit of an exclusion or exemption as a defence in any proceedings before the Tribunal or other courts.
- 1.3 However, the Ordinance provides that undertakings may elect to apply to the Commission under section 9 of the Ordinance for a decision pursuant to section 11 of the Ordinance as to whether or not their conduct is excluded or exempt from the First Conduct Rule. If an undertaking wishes to seek greater legal certainty, it may therefore apply to the Commission for a decision under section 11 of the Ordinance.
- 1.4 The Commission's *Guideline on Applications for a Decision under sections 9 and 24 (Exclusions and Exemptions) and section 15 Block Exemption Orders* provides information on how undertakings can apply to the Commission for a decision on whether a statutory exclusion or exemption applies.
- 1.5 The First Conduct Rule does not apply where it is excluded by or as a result of the application of an exclusion in Schedule 1 to the Ordinance.

- 1.6 Schedule I to the Ordinance provides for the following general exclusions in respect of the First Conduct Rule:
- (a) agreements enhancing overall economic efficiency;
 - (b) compliance with legal requirements;
 - (c) services of general economic interest;
 - (d) mergers; and
 - (e) agreements of lesser significance.
- 1.7 Discussion on each of these general exclusions and other statutory exclusions and exemptions is provided in the sections which follow.

2 Agreements Enhancing Overall Economic Efficiency

- 2.1 Section I of Schedule I provides for a general exclusion on the ground that an agreement enhances overall economic efficiency (the “**efficiency exclusion**”).
- 2.2 Section I of Schedule I only applies where certain cumulative conditions are met, namely where the relevant agreement:
- “(a) contributes to—*
 - (i) improving production or distribution; or*
 - (ii) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit;*
 - (b) does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the objectives stated in paragraph (a); and*
 - (c) does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question.”*
- 2.3 The efficiency exclusion is available whether the agreement has the object or the effect of harming competition.

- 2.4 Where an agreement has the object or effect of harming competition contrary to the First Conduct Rule, the parties to the agreement may rely on the efficiency exclusion as a defence. The Commission is of the view that the burden of proving that each of the cumulative conditions of section 1 of Schedule 1 is satisfied rests with the undertaking seeking the benefit of the exclusion.
- 2.5 The efficiency exclusion applies when four separate conditions are met.

First condition

The agreement contributes to improving production or distribution or promoting technical or economic progress

- 2.6 The application of the efficiency exclusion requires an assessment of the claimed contribution of the agreement to “improving production or distribution” or “promoting technical or economic progress”. The term “efficiencies” as used in this Guideline refers to the claimed contributions to improving production or distribution or promoting technical or economic progress.
- 2.7 An undertaking relying on the efficiency exclusion must provide convincing evidence of each of the following:
- (a) the efficiencies, which must be objective in nature;
 - (b) a direct causal link between the efficiencies and the agreement;
 - (c) the likelihood and magnitude of each efficiency;
 - (d) how each efficiency will be achieved; and
 - (e) when the efficiencies will be achieved.
- 2.8 The efficiencies referred to in the efficiency exclusion cover all objective economic efficiencies, including cost efficiencies and qualitative efficiencies.
- 2.9 Cost efficiencies (i.e. cost savings) can originate from a number of sources. The development of new production technologies, for example, may give rise to cost savings; so too may the synergies brought about by an integration of particular assets. Cost efficiencies may also result from economies of scale or scope (for example, where producers of different products improve distribution by sharing distribution costs).

- 2.10 Qualitative efficiencies arise when agreements between undertakings generate efficiencies in the form of quality improvements, innovation, or similar product improvements. This type of efficiency can include the technical and technological advances brought about when undertakings cooperate on research and development leading to improved or new products.
- 2.11 Examples of improvements in production or distribution that the parties may wish to provide evidence for include lower costs from longer production or delivery runs, or from changes in methods of production or distribution; improvements in product quality; or increases in the range of products produced.
- 2.12 Efficiencies resulting from the promotion of technical progress may include efficiency gains from economies of scale and increased effectiveness in research and development. These efficiencies may be categorised as cost efficiencies or qualitative efficiencies depending on the facts of the case.

Second condition

Consumers receive a fair share of the efficiencies

- 2.13 Section 1 of Schedule 1 to the Ordinance requires that consumers receive a fair share of the efficiencies claimed by the parties and generated by the agreement. Consumers in this context means all direct and indirect purchasers of the relevant products including businesses acting as purchasers (e.g. manufacturers purchasing inputs, retailers etc.) and final consumers.
- 2.14 Undertakings seeking to invoke the efficiencies exclusion in respect of a particular agreement must demonstrate that consumers receive or will receive a fair share of the efficiencies generated by the agreement.
- 2.15 The Commission considers that the notion of a “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. While the parties need not demonstrate that consumers receive a share of every efficiency gain, the overall impact for consumers must at least be neutral and parties must demonstrate that this is the case. The key consideration 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.

Third condition

The agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the relevant efficiencies

- 2.16 The third condition requires that the agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the relevant efficiencies. For the purposes of satisfying this test, the parties must demonstrate that the agreement itself, and each of the individual restrictions contained in the agreement, are reasonably necessary to attain the efficiencies. The determinative factor in this context will be whether the restrictive agreement and the individual restrictions in it 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 the restrictions.
- 2.17 This third condition implies that as regards the agreement there be no other economically practicable and less restrictive means of achieving the efficiencies.³⁹ If the parties can show that the agreement is reasonably necessary to achieve the efficiencies in this sense, they must then demonstrate that the individual restrictions in the agreement are also reasonably necessary in order to produce the efficiencies. An individual restriction can be considered indispensable or reasonably necessary if its absence would eliminate or significantly reduce the relevant efficiencies or make it significantly less likely that they will materialise.

Hypothetical Example 24

DrinkCo is a producer of carbonated soft drinks, holding 60% of the market. The nearest competitor holds a 20% share. DrinkCo concludes supply agreements with customers accounting for 50% of demand in Hong Kong, whereby they undertake to purchase exclusively from DrinkCo for 7 years.

DrinkCo claims that the agreements allow it to predict demand more accurately and thus to better plan production, reducing raw material storage and warehousing costs and avoiding supply shortages.

³⁹ The market conditions and business realities facing the parties should be taken into account in this context.

Given the market position of DrinkCo and the coverage of the restrictive arrangements, the exclusive purchasing agreement seems unlikely to be considered indispensable. The exclusive purchasing obligation exceeds what is reasonably necessary to plan production and/or achieve the other claimed efficiencies. The 7 year term is also not likely to be indispensable and/or the efficiencies generated are unlikely to compensate for the foreclosure effects of an exclusive purchase arrangement of that duration.

Fourth condition

The agreement does not afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the goods or services in question

- 2.18 The fourth condition requires that the undertakings that are party to the relevant agreement demonstrate that their agreement does not afford them the possibility of eliminating competition in respect of a substantial part of the goods or services in question. This condition recognises that protecting the competitive process takes priority over the potential efficiency gains which might result from a particular agreement – ultimately the competitive process is the best guarantor of efficiency in the longer term.
- 2.19 Whether there is a possibility of competition being eliminated depends on the reduction in competition that the agreement brings about and the state of competition in the market. The weaker the state of existing competition in the market, the smaller any further reduction in competition would need to be for competition to be eliminated. Similarly, the more the relevant agreement causes harm to competition, the greater the likelihood that the undertakings concerned are afforded the possibility of eliminating competition.
- 2.20 An evaluation of whether there is a possibility of competition being eliminated will therefore require consideration of the various sources of competition in the relevant market and the impact of the agreement on these various sources of competitive constraint. While sources of actual competition will generally be more important, potential competition must be considered. In this context, the parties will need to do more than merely assert that barriers to entry are low.

2.21 The possibility of eliminating competition within the meaning of the fourth condition means the possibility of eliminating effective competition in respect of a substantial part of the goods or services in question. If effective competition is at risk of elimination in respect of one of its most important expressions, that will suffice for the purposes of showing that the parties have been afforded the possibility of eliminating competition within the meaning of the fourth condition. This will be particularly the case if the agreement affords the undertakings concerned the possibility of eliminating effective price competition in respect of a substantial part of the goods or services in question.

Hypothetical Example 25

Airlines A and B, have together more than 70% of the passenger traffic on the route between destination X and Hong Kong. A and B agree to coordinate their schedules and certain of their tariffs on the route in the context of a codeshare arrangement. Following the agreement, prices rise by between 30% and 50% for the various fares on the route. There are three other airlines operating on the same route, the largest, a low cost carrier, has about 15% of the passenger traffic on the route. The other two carriers are niche operators. There has been no new entry in recent years and the parties to the agreement did not lose significant sales following the price increases. The existing competitors brought no significant new capacity to the route and no new entry occurred.

In light of the market position of the parties and the absence of competitive response to their joint conduct, it might reasonably be concluded that the parties to the agreement are not subject to any significant competitive pressures. It is more likely that in such a market where competition is already weak, the relevant agreement may afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the services in question and therefore reliance on the efficiency exclusion is misplaced.

3 Compliance with Legal Requirements

- 3.1 Section 2 of Schedule 1 to the Ordinance provides that agreements or conduct are excluded from the First Conduct Rule and Second Conduct Rule to the extent that the relevant agreement or conduct is made or engaged in for the purposes of complying with a legal requirement imposed by or under any enactment in force in Hong Kong⁴⁰ or imposed by any national law⁴¹ applying in Hong Kong.
- 3.2 The Commission considers that for this general exclusion to apply, the relevant legal requirement must eliminate any margin of autonomy on the part of the undertakings concerned compelling them to enter into or engage in the agreement or conduct in question.
- 3.3 Where an undertaking has some scope to exercise its independent judgment on whether it will enter into an agreement or engage in the relevant conduct, the general exclusion for complying with legal requirements will not be available. Accordingly, if the relevant agreement or conduct is merely facilitated or encouraged by an enactment in force in Hong Kong or national law applying in Hong Kong, the exclusion will not apply. Equally, approval or encouragement on the part of the public authorities will not suffice for this general exclusion to apply.

4 Services of General Economic Interest

- 4.1 Section 3 of Schedule 1 to the Ordinance provides that neither the First Conduct Rule nor the Second Conduct Rule applies to an undertaking entrusted by the Government⁴² with the operation of services of general economic interest in so far as the Conduct Rules would obstruct the performance, in law or in fact, of the particular tasks assigned to the undertaking.

⁴⁰ Section 2, Schedule 1 to the Ordinance. An “enactment” is defined in section 3 of the Interpretation and General Clauses Ordinance (Cap 1) (the “**Interpretation Ordinance**”) to mean any Ordinance, any subsidiary legislation made under any such Ordinance and any provision or provisions of any such Ordinance or subsidiary legislation.

⁴¹ Section 3 of the Interpretation Ordinance provides that the term “national law applying in Hong Kong” means a national law applied in Hong Kong pursuant to the provisions of Article 18 of the Basic Law.

⁴² Section 3 of the Interpretation Ordinance provides that the term “Government” means the Government of the Hong Kong Special Administrative Region. Section 2 of the Ordinance indicates, however, that Government does not include a company that is wholly or partly owned by the Government.

- 4.2 The Commission intends to interpret this general exclusion strictly. The onus will be on the undertaking seeking the benefit of the exclusion to demonstrate that all the conditions for application of the exclusion have been met. In other words, the Ordinance in this exclusion allows for the non-application of the Conduct Rules only under strict terms. These are discussed below.

Entrusted

- 4.3 The undertaking will need to demonstrate that it has been expressly entrusted by the Government with the service in question. The Commission considers that an act of entrustment may be made by way of some legislative measure or regulation, through the grant of a concession or license governed by public law or through some other act of the Government. Mere approval by the Government of the activities carried out by the relevant undertaking will not suffice.
- 4.4 The exclusion applies only to the particular entrusted tasks and not to the undertaking or its activities generally.
- 4.5 For obligations imposed on an undertaking entrusted with the operation of a service of general economic interest to fall within the particular tasks entrusted to it, they must be linked to the subject matter of the service of general economic interest in question and contribute directly to achieving that interest.

Services of general economic interest

- 4.6 The Commission considers that the reference to “services” in this context includes the distribution of products and not only the provision of services.
- 4.7 Services of general economic interest are services that the public authorities believe should be provided to the public whether or not the private sector would supply the relevant services.⁴³ The reference to “economic” refers to the economic nature of the service provided. For example, services of an economic nature may include activities in the cultural, social, and public health fields where their aim is to make a profit.

⁴³ The concept of a service of general economic interest might be seen as loosely corresponding to the concept of a public service.

- 4.8 To be considered a service of general economic interest, the service must typically be widely available and not restricted to a certain class, or classes, of buyers. That said, services aimed at a particular group or a particular locality, for example a disadvantaged group or a remote locality, could still qualify in so far as such services are in the general interest.

Obstruct the performance, in law or in fact, of the particular tasks assigned

- 4.9 To benefit from the services of general economic interest exclusion, it will not be sufficient for an undertaking merely to provide evidence that it has been entrusted with the performance of a particular service of general economic interest. Rather, the undertaking must also demonstrate that the application of the Conduct Rules would obstruct the performance of the relevant entrusted tasks.
- 4.10 An undertaking seeking to demonstrate that the application of the Conduct Rules would obstruct the performance of the entrusted tasks must show with supporting evidence that the application of those rules would require it to perform the entrusted tasks under economically unacceptable conditions. The undertaking must also show that the entrusted tasks could not be discharged in other ways, which would cause less harm to competition.

5 Mergers

- 5.1 Section 3 of Schedule 7 to the Ordinance provides that agreements or conduct, which result in, or if engaged in would result in, a “merger” are excluded from the Conduct Rules. A merger, as defined in the Ordinance, takes place where:
- (a) two or more undertakings previously independent of each other cease to be independent of each other;
 - (b) one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings;

- (c) there is an acquisition by one undertaking (the “acquiring undertaking”) of the whole or part of the assets (including goodwill) of another undertaking (the “acquired undertaking”) which results in the acquiring undertaking being in a position to replace, or to substantially replace, the acquired undertaking, in the business or in part of the business concerned (as the case requires) in which the acquired undertaking was engaged immediately before the acquisition; or
- (d) a joint venture is created to perform, on a lasting basis, all the functions of an autonomous economic entity.

5.2 The application of the exclusion for mergers is further discussed in Part 6 of this Guideline.

6 Agreements of Lesser Significance

6.1 Section 5 of Schedule 1 to the Ordinance contains a general exclusion for agreements of lesser significance. Pursuant to that provision (but subject to paragraph 6.3 below), the First Conduct Rule does not apply to:

- (a) an agreement between undertakings in any calendar year if the combined turnover of the undertakings for the turnover period⁴⁴ does not exceed HK\$200 million;
- (b) a concerted practice engaged in by undertakings in any calendar year if the combined turnover of the undertakings for the turnover period does not exceed HK\$200 million; or
- (c) a decision of an association of undertakings in any calendar year if the turnover of the association for the turnover period does not exceed HK\$200 million.

6.2 As stated at section 5(5) of Schedule 1 to the Ordinance, turnover for the purposes of the above exclusion for agreements of lesser significance means the total gross revenues of an undertaking whether obtained in Hong Kong or outside Hong Kong. In the case of an association of undertakings, turnover means the total gross revenues of all the members of the association whether obtained in Hong Kong or outside Hong Kong.

⁴⁴ Pursuant to section 5(3) of Schedule 1 to the Ordinance, the turnover period of an undertaking is (a) if the undertaking has a financial year; the financial year of the undertaking that ends in the preceding calendar year; or (b) if the undertaking does not have a financial year; the preceding calendar year. Additional rules concerning the appropriate turnover period are contained in regulations made by the Secretary for Commerce and Economic Development under section 163(2) of the Ordinance. The relevant regulations are available on the Commission's website.

- 6.3 The general exclusion for agreements of lesser significance is not available if the agreement is considered Serious Anti-competitive Conduct under the Ordinance.
- 6.4 Additional rules in respect of the calculation of relevant turnover of an undertaking for the purposes of this particular general exclusion are contained in regulations made by the Secretary for Commerce and Economic Development under section 163(2) of the Ordinance.⁴⁵

7 Block Exemption Orders

- 7.1 Section 15 of the Ordinance provides that if the Commission is satisfied that a particular category of agreement is excluded from the application of the First Conduct Rule by or as a result of section 1 of Schedule 1 to the Ordinance, the Commission may issue a Block Exemption Order in respect of that category of agreement. Block Exemption Orders that have been made by the Commission, if any, will be available on the Commission's website.⁴⁶
- 7.2 Where an agreement falls within scope of a Block Exemption Order issued by the Commission, the agreement is exempt from application of the First Conduct Rule under section 17 of the Ordinance.

8 Public Policy and International Obligations Exemptions

- 8.1 Sections 31 and 32 of the Ordinance provide for exemptions on public policy grounds ("**Public Policy Exemption**") and to avoid a conflict with international obligations that directly or indirectly relate to Hong Kong ("**International Obligations Exemption**").⁴⁷

⁴⁵ The relevant regulations are available on the Commission's website.

⁴⁶ Further information on the Commission's approach to making Block Exemption Orders is available in the Commission's *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and section 15 Block Exemption Orders*.

⁴⁷ Under section 32 of the Ordinance an international obligation "includes an obligation under – (a) an air service agreement or a provisional arrangement referred to in Article 133 of the Basic Law; (b) an international arrangement relating to civil aviation; and (c) any agreement, provisional arrangement or international arrangement designated as an international agreement, international provisional arrangement or international arrangement by the Chief Executive in Council by order published in the Gazette".

- 8.2 Unlike the Schedule 1 exclusions which are listed in the Ordinance, these two exemptions require that the Chief Executive in Council make an order specifying that a particular agreement or conduct or a particular class of agreement or conduct is exempt from the Conduct Rules.
- 8.3 Sole responsibility for making Public Policy Exemption and International Obligations Exemption orders rests with the Chief Executive in Council. In so far as the First Conduct Rule is concerned, the Commission's role in respect of these exemptions, if any, is confined to determining whether they apply in a particular case following an application for a decision under section 11 of the Ordinance.
- 8.4 Public Policy Exemption and International Obligation Exemption orders that have been made by the Chief Executive in Council, if any, will be made available on the Commission's website.

9 Statutory Bodies, Specified Persons and Activities

- 9.1 Section 3 of the Ordinance provides that the First Conduct Rule does not apply to statutory bodies.⁴⁸ Under section 3, statutory bodies are excluded from the competition rules (including the First Conduct Rule) unless they are specifically brought within the scope of those rules by a regulation made by the Chief Executive in Council under section 5.
- 9.2 The reference to a statutory body in section 3 of the Ordinance includes an employee or agent of the statutory body acting in that capacity. The section 3 exclusion does not, however, extend to legal entities owned or controlled by a statutory body unless those entities are also statutory bodies.⁴⁹ The section 3 exclusion does not extend to undertakings that might enter into anti-competitive arrangements with an excluded statutory body. These undertakings remain subject to the Ordinance.

⁴⁸ As defined in section 2 of the Ordinance, "statutory body" means "a body of persons, corporate or unincorporate, established or constituted by or under an Ordinance or appointed under an Ordinance, but does not include (a) a company; (b) a corporation of trustees incorporated under the Registered Trustees Incorporation Ordinance (Cap 306); (c) a society registered under the Societies Ordinance (Cap 151); (d) a co-operative society registered under the Co-operative Societies Ordinance (Cap 33); or (e) a trade union registered under the Trade Unions Ordinance (Cap 332)".

⁴⁹ In any event, the definition of statutory body does not include a "company" as defined in the Ordinance (including a company within the meaning of section 2(1) of the Companies Ordinance).

- 9.3 Section 4 of the Ordinance provides that the competition rules (including the First Conduct Rule) do not apply to persons specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance or to persons engaged in activities specified in such a regulation. The reference to a person in section 4 of the Ordinance includes an employee or agent of the person acting in that capacity.
- 9.4 All regulations that might be made by the Chief Executive in Council under section 5 of the Ordinance will be available on the Commission's website.

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Revised Draft Guideline on **The Second Conduct Rule**

30 March 2015

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Guideline on the Second Conduct Rule

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under section 35(1)(a) of the Competition Ordinance (Cap 619) (the “**Ordinance**”).*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*The Guideline sets out how the Commission intends to interpret and give effect to the Second Conduct Rule in the Ordinance. The Guideline is not, however, a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

The Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I The Second Conduct Rule

1.1 This Guideline provides a framework for the Commission's analysis of conduct under the Second Conduct Rule. The Guideline will also help undertakings to determine whether their conduct complies with the Second Conduct Rule.

1.2 Section 21(1) of the Ordinance sets out the Second Conduct Rule:

"An undertaking that has a substantial degree of market power in a market must not abuse that power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong."

1.3 The Second Conduct Rule therefore applies where the following elements are present:

- (a) the entity engaged in the relevant conduct is an undertaking;
- (b) this undertaking has a substantial degree of market power in a market; and
- (c) the undertaking abuses its substantial degree of market power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong.

1.4 The term undertaking is defined in section 2(1) of the Ordinance. An undertaking means any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity. The term is therefore a broader concept than the term company although a company may be an undertaking. The term undertaking is explained in detail in Part 2 of the Commission's *Guideline on the First Conduct Rule*.

1.5 The Second Conduct Rule only applies where an undertaking has a *substantial degree of market power* in a market. Smaller undertakings are unlikely to have a substantial degree of market power. Thus, the commercial conduct of small and medium-sized undertakings would be unlikely to contravene the Second Conduct Rule. Small and medium-sized undertakings may, however, be victims of abusive conduct under the Second Conduct Rule.

1.6 The commercial conduct of smaller undertakings might also fall within the exclusion for conduct of lesser significance in section 6(1) of Schedule 1 to the Ordinance. This exclusion provides that the Second Conduct Rule does not apply to conduct engaged in by an undertaking with an annual turnover of not more than HK\$40 million.² Section 6(1) should not, however, be interpreted to mean that undertakings with an annual turnover above the threshold would automatically be considered to have a substantial degree of market power or be more likely to contravene the Second Conduct Rule.

1.7 The most obvious manifestation of market power is the ability of an undertaking profitably to raise prices above the competitive level for a sustained period. Market power can, however, be manifested in other ways. For example, an undertaking with market power may be able to:

- (a) reduce the quality of its products³ below competitive levels for a sustained period without offering any compensatory reduction in price;
- (b) reduce the range or variety of its products below competitive levels for a sustained period;
- (c) lower customer service standards below competitive levels for a sustained period; and/or
- (d) impair, relative to competitive levels and for a sustained period, innovation or any other parameter of competition in the market.

1.8 The Second Conduct Rule only applies where an undertaking with a substantial degree of market power in a market *abuses* that power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong. The Commission considers that potentially any conduct which has the object or effect of preventing, restricting or distorting competition in Hong Kong may constitute abusive conduct where the conduct is attributable to an undertaking with a substantial degree of market power. What is abusive conduct under the Second Conduct Rule includes but is not limited to the types of conduct discussed in this Guideline. Abusive conduct is an open category.

² Turnover in this context is to be assessed for the relevant turnover period, which is defined as either the financial year of the undertaking or, if the undertaking does not have a financial year, the preceding calendar year. Additional rules on the applicable turnover period are provided in regulations made by the Secretary for Commerce and Economic Development under section 163 of the Ordinance. These regulations are available on the Commission's website.

³ References to products in this Guideline include services unless the context dictates otherwise.

- 1.9 The Second Conduct Rule is not concerned with preventing firms from gaining market power or being able to exercise it to increase their profits for a time. The pursuit of market power and higher profits through innovation and competition is key to a prosperous free market economy. To remove this profit motive would risk dampening rather than invigorating competition.
- 1.10 Nonetheless, the pursuit of profit may lead some undertakings with a substantial degree of market power to abuse that power with a view to protecting or increasing their position of power and profits. For example, a powerful undertaking may:
- (a) seek to maintain its substantial degree of market power by abusing it to prevent challenges to its position by existing or new competitors; or
 - (b) leverage its substantial degree of market power in one market to harm competition⁴ in a second market instead of competing on the merits for customers in that second market.
- 1.11 When undertakings with a substantial degree of market power abuse it in this way, the negative effects of that power for the economy and consumers (including businesses acting as customers)⁵ become entrenched. Instead of the profits of market power rewarding competition and innovation, they become a reward for causing harm to economically beneficial outcomes.
- 1.12 Section 21(2) of the Ordinance offers guidance on the types of conduct that might constitute an abuse of a substantial degree of market power. Conduct may, in particular, constitute an abuse if it involves:
- (a) *Predatory behaviour towards competitors.* Predatory behaviour includes “predatory pricing” which occurs when an undertaking with a substantial degree of market power lowers its price below an appropriate measure of cost, deliberately incurring losses in the short run so as to eliminate or reduce the competitive effectiveness of one or more of its rivals or to prevent entry into the market by potential rivals.

⁴ This Guideline uses the shorthand “harm competition” in place of “prevent, restrict or distort competition”.

⁵ References to consumers in this Guideline includes businesses acting as customers unless the context otherwise dictates.

(b) *Limiting production, markets or technical development to the prejudice of consumers.* This category of conduct includes practices such as anti-competitive tying and bundling, refusals to deal and exclusive dealing, which harm the competitive process and consumers.

- I.13 As the Second Conduct Rule only applies to undertakings with a substantial degree of market power, undertakings within scope of the rule are prohibited from engaging in conduct which, objectively, undertakings without a substantial degree of market power are free to engage in. Thus, the Ordinance places limits on the commercial conduct of undertakings with a substantial degree of market power that are not imposed on other undertakings.
- I.14 In addition to the exclusion in section 6(1) of Schedule 1 to the Ordinance mentioned in paragraph 1.6 above, the Ordinance provides for other exclusions and exemptions with respect to the application of the Second Conduct Rule. Further details of these exclusions and exemptions are set out in the Annex to this Guideline.
- I.15 The application of the Second Conduct Rule as described in this Guideline does not preclude the parallel application of the First Conduct Rule to the same conduct. Abusive conduct which takes the form of an agreement might also contravene the First Conduct Rule depending on the facts of the case.⁶
- I.16 The Second Conduct Rule applies to conduct that harms competition in Hong Kong. Section 23 of the Ordinance provides that this is the case notwithstanding that the abusive conduct takes place outside Hong Kong or the undertaking that engages in the abusive conduct is located outside Hong Kong.

⁶ See generally the Commission's *Guideline on the First Conduct Rule*.

2 Defining the Relevant Market

Introduction

- 2.1 When conducting a competition assessment under the Ordinance, the Commission will use an analytical framework which involves defining the relevant market. The exercise of defining the relevant market is, however, no more than an analytical tool and not an end in itself. The purpose of defining the relevant market is to assist with identifying in a systematic way the competitive constraints that undertakings face when operating in a market.
- 2.2 While market definition is discussed in this Guideline in the context of explaining the Commission's proposed approach to the Second Conduct Rule, the principles of market definition apply also to the First Conduct Rule and the Merger Rule. This is the case in particular for determining if undertakings are competitors or potential competitors and when assessing the anti-competitive effects of conduct in a market.
- 2.3 When defining the relevant market the Commission will look at evidence that is available and relevant to the case at hand. The Commission will follow the general analytical framework explained in this Guideline but would not expect to follow mechanically each and every step in each and every case.
- 2.4 The Commission will define the boundaries of the relevant market as precisely as required by the circumstances of the case. Where appropriate, the Commission may conduct its competition assessment on the basis of alternative market definitions. Where it is apparent that investigated conduct is unlikely to have an adverse effect on competition or that the undertaking under investigation does not possess a substantial degree of market power on the basis of any reasonable market definition, the question of the most appropriate market definition can be left open.
- 2.5 A market might be commonly understood to mean an area or place where products are bought and sold. However, the term "relevant market" has a more technical meaning in competition analysis and the manner in which the Commission defines the market may differ from how businesses typically think of a market.

- 2.6 The relevant market within which to analyse market power or assess a given competition concern has both a product dimension and a geographic dimension. In this context, the relevant product market comprises all those products which are considered interchangeable or substitutable by buyers because of the products' characteristics, prices and intended use. The relevant geographic market comprises all those regions or areas where buyers would be able or willing to find substitutes for the products in question.
- 2.7 The relevant product and geographic market for a particular product may vary depending on the nature of the buyers and suppliers concerned by the conduct under examination and their position in the supply chain. For example, if conduct at the wholesale level is concerned, the relevant market is defined from the perspective of the wholesale buyers. If the concern is conduct at the retail level, the relevant market is defined from the perspective of buyers of retail products.⁷
- 2.8 When defining the relevant market, the Commission will generally have regard to its previous cases. Undertakings may, therefore, wish to use relevant markets defined in past cases as a guide to the Commission's likely approach when assessing the impact of their conduct on competition and/or when assessing whether they might have a substantial degree of market power.
- 2.9 That said, the way in which the relevant market for a particular product is defined depends on the specific facts of the case, and may vary from one case to the next based on the structure of the market, the preferences of buyers at the point in time under consideration and the particular competition concern for which the analysis is undertaken. For this reason, a defined relevant market in one case will not bind the Commission in another.

Product market

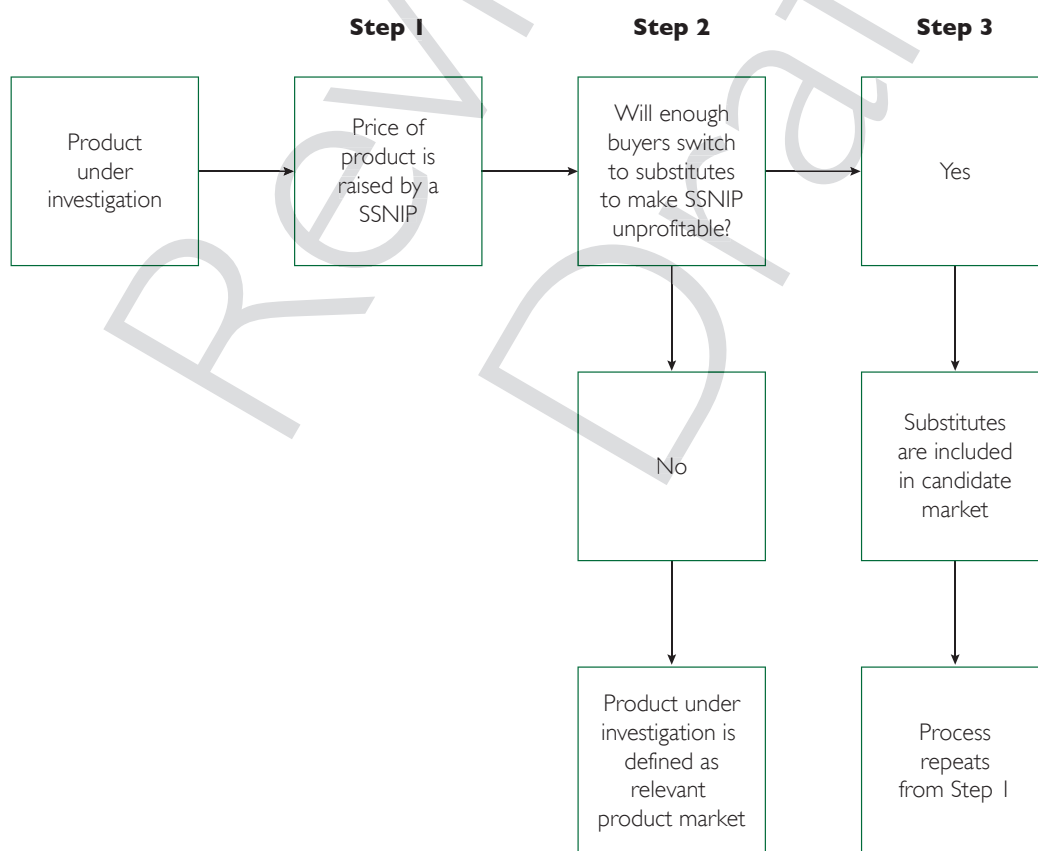
- 2.10 Substitutability from the perspective of the buyer (demand-side substitution) is a central factor for the purposes of market definition. The process of defining the relevant product market will often start by looking at a relatively narrow potential product market definition. This would normally be one (or more) of the products which are the subject of an investigation or, in the case of a merger, offered by the merging parties. The potential product market is then expanded to include those substitute products to which buyers would turn in the face of a price increase above the competitive price.⁸

⁷ See Hypothetical Example 3 below for an illustration of this point.

⁸ Generally, for the purposes of the analysis, prevailing prices will be considered and this is particularly so in the case of a merger. In Second Conduct Rule cases, however, the fact that the prevailing price might be above competitive levels due to the exercise of existing market power will need to be taken into account.

- 2.11 In this regard, a frequently used method of assessment involves postulating a candidate product market and considering whether a hypothetical firm with a monopoly in that market (a “hypothetical monopolist”) would be able profitably to impose an increase in price that is small but significant (typically between 5% and 10%) and non-transitory. Such a price increase, a small but significant non-transitory increase in price, is referred to as a “SSNIP”. If enough buyers would switch to substitute products in the face of a SSNIP to make the attempted price increase unprofitable, the candidate product market is too narrow. The candidate market is then expanded to include the substitute products to which buyers would turn, and the same analysis is performed on this broader candidate product market. The relevant product market will be that group of products over which a hypothetical monopolist can profitably impose a SSNIP.
- 2.12 The approach described in the preceding paragraph is shown below in Figure 1 and in hypothetical example 1.

Figure 1



Hypothetical Example 1

CoffeeCo, the manufacturer of a popular brand of ready-to-drink coffee-based beverages, decides to increase the price of its product by 5% above the competitive level. As a result, a substantial percentage of CoffeeCo's customers switch to a ready-to-drink tea-based beverage produced by TeaCo. CoffeeCo loses enough sales to TeaCo that the price increase is unprofitable and it is forced to lower its price to the original level. The relevant product market in this scenario would include at least both the CoffeeCo and TeaCo products.

- 2.13 When applying the hypothetical monopolist test in the context of a given case, the Commission would consider both quantitative and qualitative evidence of demand-side substitution using appropriate analytical techniques.
- 2.14 In particular, the Commission may:
- (a) undertake an analysis of whether a SSNIP would be profitable;
 - (b) consider evidence of patterns in price changes;⁹
 - (c) consider the characteristics of the product in question and the product's intended use;¹⁰
 - (d) consider evidence from undertakings active in the market and their commercial strategies; and/or
 - (e) consider evidence regarding the past behaviour of buyers (relating to, for example, their tendency to switch between products in response to a price increase).

Geographic market

- 2.15 The relevant geographic market can be defined using the same general process as that used to define the relevant product market.
- 2.16 The geographic market may cover a global or regional area, or be limited to Hong Kong or a part of Hong Kong. For example, depending on the market in question, there may be cases where parts of Mainland China (such as the Pearl River Delta area) could be included in the relevant geographic market. A number of factors will determine the extent of the relevant geographic market. These factors are discussed below.

⁹ If two products show the same pattern of price changes, for reasons not connected to costs or general price inflation, this may be consistent with the two products being substitutes.

¹⁰ Where the intended uses of products are sufficiently similar, this would tend to support a conclusion that the products are close substitutes and therefore within the same product market.

- 2.17 As in the case of product market definition, buyers' views of reasonably available substitutes will drive the Commission's analysis of the relevant geographic market. The objective of this analysis will therefore be to identify all those areas where buyers would be able or willing to find substitutes for the products under examination. To determine the relevant geographic market, the Commission will typically begin by looking at a relatively narrow geographic area (the candidate geographic market). The hypothetical monopolist test may then be applied to this area with a view to establishing whether a hypothetical monopolist of the product at issue in the area could profitably sustain a price increase above the competitive level. If not, the test is repeated over wider geographic areas as appropriate until the hypothetical monopolist would find it profitable to sustain a price increase.
- 2.18 Accordingly, when defining the relevant geographic market, the Commission may employ a SSNIP analysis to assess the extent to which customers of a product would switch to suppliers located in other areas in response to a hypothetical SSNIP of the relevant product. If, in response to a SSNIP, enough buyers would switch to substitutes in other areas to make the attempted price increase unprofitable, the candidate geographic market is too narrow. The candidate geographic market is then expanded to include the other areas to which buyers would turn, and the same analysis is performed on this broader potential geographic market. Hypothetical example 2 illustrates this approach.

Hypothetical Example 2

The only shop selling a particular type of specialty paint in Lantau decides to increase the price it charges for the specialty paint by 5%. After this price increase, a number of customers of the shop decide to purchase a substitute product from specialty paint shops on Hong Kong Island. Enough customers of the Lantau shop switch to shops on Hong Kong Island that the Lantau shop is not able profitably to maintain its price increase. On these facts, the Commission would conclude that the geographic market in which the Lantau shop competes comprises at least Lantau and Hong Kong Island.

2.19 The extent to which buyers are willing and able to purchase the product from different areas may vary with the circumstances and the nature of the buyer. For example, in the case of consumer products, geographic markets may be quite narrow if a significant number of buyers are unlikely to purchase products sold in neighbouring areas. For wholesale or manufacturing markets in which transport costs are low, buyers may be in a better position to switch between suppliers in different regions. Thus, the scope of the geographic market for a particular product might vary depending on whether the buyer is at the end consumer level (in which case the geographic market may be relatively narrow) or the wholesale level (in which case the geographic market may be relatively broad). Hypothetical example 3 illustrates this approach.

Hypothetical Example 3

A milk producer based in Hong Kong increases the price at which it sells a litre of milk by 5%. The retail outlets which buy the milk have sufficient transport capability to source milk easily from a number of different areas around Hong Kong. They decide to obtain milk from an alternative producer with a lower price, which is located 10 kilometres away from the first producer. From the perspective of the retailers, the geographic market includes both areas in which the milk producers are located. If considered from the perspective of the end consumer, however, the same conclusion might not apply. If a retail outlet increased the price of a litre of milk by 5%, an end consumer might be unwilling to travel to a retail outlet 10 kilometres away in order to purchase milk at a lower price.

This hypothetical example shows that the scope of the geographic market may differ depending on the nature of the buyers of the product under consideration.

2.20 When applying the hypothetical monopolist test in the context of defining the relevant geographic market, the Commission will consider both quantitative and qualitative evidence using appropriate analytical techniques.

2.21 In particular, the Commission may consider evidence of the switching of orders to other areas, prices in the different areas, the geographic pattern of purchases for buyers, trade flows, barriers to switching and switching costs that might be associated with diverting to suppliers in other areas, transport costs relative to the value of the products concerned and cultural factors.

Particular issues in market definition

2.22 Some markets have specific characteristics which may give rise to particular issues in market definition. The relevance of these specific characteristics will, however, depend on the issue being considered.

Price discrimination markets

2.23 Where suppliers are able to differentiate between types of buyers in terms of price, it may be appropriate to assess these types of buyers as being in separate markets. Undertakings might be able to discriminate between buyers for a variety of reasons including, for example, because buyers meet different user profiles (e.g. business users might be charged a different price for a software product than individual users) or because some buyers face such high switching costs that they are “locked in” to purchasing a particular product.

Aftermarkets

2.24 An aftermarket is a market for a secondary product, namely a product which is purchased only as a result of buying a primary product. The primary product and the secondary product can be considered to be complementary. For example, a customer might purchase spare parts (the secondary products) for use with a particular machine (the primary product). The appropriate market definition in the case of aftermarkets will depend on the facts of the case. It might be appropriate to define, for example:

- (a) *a single system market* comprising both the primary product and the secondary product (i.e. machine A and its spare parts (system A) competes with machine B and its spare parts (system B)); or
- (b) *dual or multiple markets* where there is a market for the primary product and either (i) a separate market comprising all secondary products or (ii) separate secondary markets for each primary product (i.e. there is one market for all primary products but as many secondary markets as there are individual primary products).

Captive production

2.25 Where a particular market includes vertically integrated firms, the question sometimes arises as to whether: (a) production of a product consumed internally by a vertically integrated firm (“captive production”) should be considered in the product market; or (b) only production sold externally to the “merchant market” should be included. 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. Potential competition is discussed further below in paragraphs 2.33 to 2.35, and in Part 3 of this Guideline in the context of potential entry or expansion.

Two-sided markets

2.26 A two-sided market is a market where undertakings compete simultaneously for two groups of customers whose demands are inter-related. In this context the undertakings use a two-sided platform to sell to the two different groups of buyer. An example of a two-sided market is an online auction platform, where the platform provider must attract both parties wishing to sell products through the platform and parties wishing to buy those products. In this circumstance, an increase in the fees charged to the sellers could result in a loss of customers on both sides of the market (if fewer sellers use the platform, a smaller range of products will be available on the platform, making it less attractive to buyers). Other examples include video game markets, where the video game manufacturer must attract demand from both video game developers and video game buyers, or newspapers which must attract both readers and advertisers.

2.27 Because of the two sides of the market and the interaction between the two different groups of buyers, market definition can be more complex than in most traditional one-sided markets. When assessing market power in a two-sided market, competitive constraints on both sides of the market must be considered.

Bidding markets

2.28 A bidding market is one in which firms typically compete by submitting bids in response to tenders organised by buyers. To 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. In bidding markets, the relevant market will include all undertakings that can be viewed as credible bidders for the product at issue in the geographic area where they can place a credible bid.

Temporal markets

2.29 A factor that may be relevant in some markets is time. Examples of how time might be relevant for market definition purposes include:

- (a) *Peak and off-peak services.* Some buyers may not view peak and off-peak services as substitutable. For example, train tickets for early morning weekday services may not be in the same market as train tickets for weekend services. Conceptually, this time dimension might be regarded as an aspect of product market definition.
- (b) *Seasonal markets.* It may be appropriate to refer to time as a factor in market definition for certain seasonal products.

Markets characterised by frequent innovation

2.30 Some industries are characterised by rapid technological change. For example, new products may be developed, formerly separate functionalities may be integrated in a new product and process innovations may lead to the entry of undertakings into the market increasing the competitive pressure on incumbent undertakings. These developments are often unpredictable, leading to the emergence of new markets or the convergence of formerly separate markets. As a result, market boundaries may shift rapidly and this can pose particular challenges when defining the relevant market in the context of a particular investigation. Equally, market shares at a given point in time might be less indicative of market power depending on the facts of the case.

Supply-side substitution and potential competition

2.31 Products might be regarded as being subject to three main sources of competitive constraint: (i) substitutability from the perspective of the buyer (demand-side substitutability); (ii) supply-side substitutability; and (iii) potential competition. The assessment of demand-side substitutability involves a consideration of:

- (a) the range of products viewed as substitutes by buyers; and
- (b) the areas where buyers would be able and willing to find substitutes for the products concerned.

As explained in paragraphs 2.10 and 2.17 above, buyers' views on substitutability will be central for the purposes of market definition in the Commission's practice.

- 2.32 Supply-side substitutability refers to the ability of undertakings to switch production to the product under consideration or to begin supplying the product to the geographic area under consideration, in the event of an increase in the price of the product concerned.
- 2.33 Potential competition refers to the competitive constraint imposed in the market from the potential entry of new undertakings and the potential expansion of existing ones. Where suppliers cannot switch production in the short term with ease, they are considered as a source of potential competition rather than supply-side substitution.
- 2.34 The Commission will not generally consider supply-side substitutability or potential competition when defining the relevant market. Rather, they will be considered at a later stage in the Commission's analysis.¹¹
- 2.35 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. The important point is that all sources of competitive constraint are taken into consideration in the assessment of market power.

3 Assessment of Substantial Market Power

Introduction

- 3.1 An undertaking does not operate in a vacuum. There is generally an ongoing rivalry between undertakings in a relevant market in terms of price, service, innovation and quality to which each undertaking must react if its products are to remain attractive to consumers. As a result, undertakings in a relevant market, both big and small, will usually be mutually constrained in their pricing, output and related commercial decisions by the activity or anticipated activity of other undertakings that compete in, or may compete in, that market.

¹¹ Potential competition is discussed in Part 3 of this Guideline in the context of potential entry or expansion. The Commission will treat supply-side substitution as a sub-category of potential competition.

- 3.2 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 profitably¹² to charge prices above competitive levels, or to restrict output or quality¹³ below competitive levels, for a sustained period of time. Following generally accepted international practice, the Commission would normally consider a sustained period to be two years. 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.
- 3.3 The above definition of a substantial degree of market power does not preclude the possibility of more than one undertaking having a substantial degree of market power in a relevant market, particularly if the market is highly concentrated with only a few large market participants.
- 3.4 An undertaking in a competitive market may be able temporarily to raise its price above the competitive level, but it will be unable to sustain such a price increase because customers will switch to cheaper suppliers or additional suppliers will enter the market. Hence, if an undertaking can profitably charge prices above competitive levels over a sustained period, it can be considered to have a substantial degree of market power. An undertaking with a substantial degree of market power might also have the ability and incentive to harm the process of competition by, for example, weakening existing competition, raising entry barriers or slowing innovation.
- 3.5 Although this Part of the Guideline mainly deals with market power in terms of the ability to raise prices on the supplier side, market power might equally arise on the buyer side of the market (known as monopsony power). In the latter case, a substantial degree of market power may exist where the *buyer* has the ability to obtain purchase prices below the competitive level for a sustained period of time.

¹² The reference to “profitably” means that the undertaking’s conduct is profitable relative to the competitive level. This does not, however, imply that the undertaking with a substantial degree of market power is making a profit in absolute terms or in an accounting sense, which would depend on factors other than the conduct concerned.

¹³ The references to price, output and quality (or references to price alone elsewhere in this Guideline as the context requires) are to be understood as shorthand for the various ways in which the parameters of competition might be influenced to the advantage of the undertaking with a substantial degree of market power and to the detriment of consumers.

- 3.6 Market power is a matter of degree. The degree of market power possessed by an undertaking will be assessed based on the circumstances of the case. An undertaking does not need to be a monopolist to have a substantial degree of market power. When assessing whether an undertaking has a substantial degree of market power, the Commission will consider the extent to which that undertaking faces constraints on its ability profitably to sustain prices above competitive levels.
- 3.7 Section 21(3) of the Ordinance sets out the following non-exhaustive list of the matters that may be taken into consideration in determining whether an undertaking has a substantial degree of market power:
- (a) the market share of the undertaking;
 - (b) the undertaking's power to make pricing and other decisions;
 - (c) any barriers to entry to competitors into the relevant market; and
 - (d) any other relevant matters.
- 3.8 An assessment of market power thus comprises an analysis of several factors including market share, countervailing buyer power, barriers to entry or expansion, and market-specific characteristics. These various factors are examined in more detail below. The points discussed are however not exhaustive and there may be other considerations that the Commission will take into account in its assessment of market power in a given case.

Market share and market concentration

- 3.9 In general, an analysis of market shares may be useful as an initial screening device in the assessment of substantial market power.
- 3.10 Undertakings are more likely to have a substantial degree of market power where they have high market shares. However, a high market share does not always imply a substantial degree of market power. For example, where undertakings compete to improve the quality of their products, a persistently high market share might indicate persistently successful innovation and so would not necessarily mean that competition is ineffective. A determination of the presence or absence of a substantial degree of market power will be made on the facts of the particular case, taking into account all relevant factors, in particular the characteristics of the industry involved, and not merely the market shares of the relevant market participants.

- 3.11 It is important to consider the evolution of the market shares of the undertakings in the relevant market, as this will often be more informative than a snapshot picture of market shares at a single point in time. This will be particularly relevant, for example, where the market under consideration is dynamic, characterised by frequent innovation or highly competitive, in which case market shares might be volatile. Frequent changes in market shares may also indicate that barriers to entry or expansion in a market are low and this would tend to suggest an absence of market power. In contrast, an undertaking is more likely to have a substantial degree of market power if it has a high market share which it has either maintained or grown over time, while its competitors have relatively weak positions. Relative market share can therefore be an important factor in the analysis. The evolution of shares over a period of years might be particularly relevant for bidding markets, where demand may be lumpy and market share may vary dramatically from one year to the next.
- 3.12 How market shares are calculated depends on the case at hand. The following data may be used:
- (a) *Turnover or sales value data.* Market share is often determined by measuring the value of an undertaking's sales to customers in the relevant market.
 - (b) *Sales volume data.* In some cases, such as when products are homogenous in nature, it may be more helpful to measure market share in terms of the volume of sales to customers in the relevant market.
 - (c) *Capacity.* Market shares may be determined by measuring an undertaking's capacity to supply the relevant market. This measure of market share may be of interest where capacity is an important feature of an undertaking's ability to compete, such as in an industry operating at, or close to, full capacity.
 - (d) *Other indicators.* Market share might also be calculated by reference to, for example, product reserves held, customer base or share of new customers.
- 3.13 In some cases, the indications provided by measuring market shares may be supplemented by measuring the level of concentration in the market. Market concentration in this context refers to the number and size of undertakings in the market. A concentrated market is one with a small number of leading undertakings with a large combined market share.
- 3.14 Market concentration can provide useful information about the market structure and can be used to assess the relative positions of the undertakings in the market as part of an assessment of market power.

Potential entry or expansion

- 3.15 Barriers to entry are factors that prevent or hinder a prospective new entrant from entering the market or otherwise place it at a significant competitive disadvantage relative to incumbents. Barriers to entry may arise from a variety of sources, including regulatory or legal restrictions, economic or structural factors or the conduct of the undertaking under assessment (so-called strategic barriers).
- 3.16 When evaluating whether an undertaking has a substantial degree of market power, the Commission will consider whether entry by potential competitors or expansion by existing market participants (or the threat of entry or expansion) would deter or defeat the exercise of such market power. The relevant question is whether entry or expansion, or the threat of it, pose a credible competitive constraint on the undertaking concerned. Where that is the case, the undertaking under examination will likely not have a substantial degree of market power.
- 3.17 The lower the barriers to entry or expansion, the more likely it will be that potential competition will prevent an undertaking from profitably sustaining prices above competitive levels. Persistently high market shares may be an indicator of the presence of barriers to entry or expansion. Moreover, an undertaking with a large market share in a market protected by significant entry barriers is likely to have a substantial degree of market power. By contrast, even an undertaking with a very large market share would be unlikely to have a substantial degree of market power in a market where there are very low entry barriers.

Hypothetical Example 4

A butcher shop has a 70% market share for the supply of meat in a particular locality. This locality amounts to a distinct geographic market because customers are not willing to travel to other localities to purchase their meat. An assessment of the butcher's market share alone might be taken to suggest the butcher enjoyed a substantial degree of market power. However, if barriers to entering the market are low (as one would typically expect for an activity such as the retail sale of meat), another butcher shop could easily begin to operate in the area, preventing the first butcher shop from profitably sustaining prices above competitive levels. As such, the butcher shop would not have a substantial degree of market power whatever its actual market share might suggest.

3.18 For entry or expansion (or the threat thereof) to be considered an effective competitive constraint, the entry or expansion must be likely, timely and sufficient. “Timely” means that entry or expansion will occur within such period as will serve to deter or defeat the exercise of market power. “Likely” refers to the expectation that entry will occur and be profitable. “Sufficient” means that entry will occur on an adequate scale to prevent or deter undertakings from exercising market power.

3.19 Examples of barriers to entry or expansion include:

- (a) regulatory and legal barriers (such as licensing requirements);
- (b) structural barriers (such as significant economies of scale and/or scope, or network effects); and
- (c) strategic barriers intentionally created or enhanced by incumbent undertakings in the market.

Regulatory and legal barriers

3.20 Regulation by a government or an industry sector regulator may give rise to barriers to entry or expansion. For example, regulation may limit the number of undertakings which can operate in a market through a requirement that parties obtain a licence. In this case the licence can be thought of as a necessary input before production can take place. Similarly, planning and licensing laws that impose limits on the number of retail outlets limit expansion and entry possibilities at the retail level, and in turn may make it more difficult for suppliers to gain access to efficient distribution.

3.21 Intellectual property rights (“**IPRs**”) may also amount to legal barriers when they prevent or make more difficult entry or expansion by (potential) competitors. In principle, IPRs are indicative of a substantial degree of market power only when the product or technology protected by the IPR corresponds to a relevant product or technology market. IPRs do not automatically give rise to barriers and do not necessarily imply substantial market power as firms might well be able to invent around the relevant IPR.¹⁴

¹⁴ See Part 2 of this Guideline for an explanation of the principles of market definition. While an IPR might confer a legal monopoly, it does not follow that this legal monopoly confers market power in an economic sense or a substantial degree of market power under the Ordinance.

Structural barriers

- 3.22 Sunk costs of entry or expansion are an example of structural barriers. Sunk costs are costs that are incurred on entering or remaining active in a market, cannot be economically recouped within a short period of time, and are not recoverable on exit.
- 3.23 Sunk costs create entry risks which may in turn create barriers to entry. Examples of sunk costs include investments in product research and development, the construction of a specialised production facility, start-up marketing and on-going advertising expenditures. When considering whether sunk costs give rise to entry barriers, it may be useful to consider the extent to which sunk costs give an incumbent an advantage over potential new entrants. The mere existence of sunk costs in a particular industry is not, however, proof of the existence of a barrier to entry or expansion. The relevant question is whether an undertaking seeking to enter or expand must incur the sunk costs to be an effective competitor.
- 3.24 Structural entry barriers may also arise where important inputs or distribution channels are scarce. If an incumbent undertaking has privileged access to these inputs or channels, they may obtain an advantage over a potential entrant, making entry more difficult.
- 3.25 Economies of scale may give rise to barriers to entry or expansion. Such economies exist where average cost falls as output increases. Where a market is characterised by large economies of scale, a potential entrant may need to enter the market on a large scale (in relation to the size of the market) in order to compete effectively. A barrier to entry could arise where such entry or expansion requires relatively large sunk costs to be incurred. Similarly, where a potential entrant would be able to reach a viable scale of production only after a significant period of time, this may deter entry or expansion. Even where entry or expansion is not deterred by economies of scale, the incumbent may retain a substantial degree of market power for a significant period of time if new entrants would take time to establish a sufficient operation to be able to compete effectively.
- 3.26 The costs of entry or expansion may also be affected by economies of scope. Such economies arise where the production or distribution of multiple products leads to a reduction in long-run average costs. If economies of scope are significant, an undertaking intending to produce only one product may be at a cost disadvantage relative to the incumbent and therefore a less effective competitor. The existence of scope economies raises the cost of successful entry or expansion as a result.

3.27 Closely related to economies of scale are network effects. Network effects arise when the value a consumer places on connecting to a network (such as payment card schemes or online classifieds) depends on the number of others already connected to the network. Network effects may act as a barrier to entry or expansion because an incumbent may have the advantage of significant network effects, which an entrant would lack unless it can displace the incumbent's network.

Strategic barriers

3.28 Strategic barriers are barriers which are created or enhanced by incumbents in a particular market, possibly with a view to deterring potential entry or expansion. Strategic barriers can be distinguished from structural barriers, which arise from the characteristics of the market itself. An example of a strategic barrier is "strategic brand proliferation" practices engaged in by the incumbent which may crowd out product space and result in only limited opportunities to enter or expand. Other examples include long term contracts concluded by incumbents, or where an incumbent decides to build excess capacity to send a signal to potential new entrants that it could push prices down to levels which, while still profitable for the incumbent, would not permit new entrants to earn sufficient revenue to cover their sunk costs.

Countervailing buyer power

3.29 The strength of buyers and the structure of the buyers' side of the market may prevent a supplier from having a substantial degree of market power. Buyer power is not so much a matter of the size of the buyer but more a matter of bargaining strength and whether buyers have a choice between alternative suppliers. Generally speaking, buyer power implies the existence of a credible threat to bypass the supplier if no acceptable deal can be reached. A buyer will be more likely to have this kind of buyer power where one or more of the following factors apply:

- (a) the buyer is well informed about alternative sources of supply and could readily, at little cost to itself, and within a reasonable period, switch substantial purchases (although not necessarily all of its purchases) from a given supplier (i.e. any threat to switch must be credible);
- (b) the buyer could commence production itself (e.g. by vertically integrating) or "sponsor" new entry or expansion by another supplier relatively quickly and without substantial sunk costs;
- (c) the buyer is an important customer for the supplier (so that the supplier is willing to offer better terms to keep the buyer as a customer); and/or
- (d) the buyer can intensify competition among suppliers by purchasing through a competitive tender.

- 3.30 To prevent a substantial degree of market power from arising, buyer power must be 'countervailing', such that it is a sufficiently effective competitive constraint which operates to protect the market as a whole. Buyer power will not be considered a sufficiently effective competitive constraint if it only ensures that a particular or limited segment of customers is shielded from the exercise of market power. For example, an undertaking may still be able to exercise a substantial degree of market power even though certain of its larger customers can secure preferable terms.
- 3.31 Countervailing buyer power should be reasonably foreseeable for some future period, and not merely temporary or transient.
- 3.32 A buyer who has a substantial degree of market power in the market where it purchases particular products is subject to the Second Conduct Rule. Should such a buyer in its capacity as buyer engage in conduct which has the object or effect of harming competition, the buyer may be found to have contravened the Second Conduct Rule.

Particular issues in the assessment of substantial market power

- 3.33 Some markets have specific characteristics which may give rise to particular issues in any assessment of substantial market power.

Bidding markets

- 3.34 Sometimes buyers choose their suppliers through procurement auctions or tenders. The main feature of bidding markets is that there is "competition for the market" as opposed to competition in the market. In these circumstances, even if there are only a few suppliers, competition might be intense. This is more likely to be the case where tenders are infrequent (so that suppliers are more likely to bid), and where suppliers are not subject to capacity constraints (so that all suppliers are in a position to place competitive bids). If competition at the bidding stage is effective, a high market share at a given point in time would not necessarily reflect long-term market power. For this reason, it may be more appropriate to assess market power over an extended period.

Vertical integration

- 3.35 Vertically integrated firms may be able to prevent an undertaking from having a substantial degree of market power. For example, suppose a supplier produces an input A which is a necessary input for the manufacture of a product B. Suppose also that a vertically integrated supplier that does not supply a substitute for input A on the merchant market supplies a product C which is a substitute for B. The ability of customers to substitute product C for product B may constrain the ability of the non-vertically integrated producer of input A to raise the price of input A. This might therefore preclude the supplier of input A from having a substantial degree of market power in the relevant market for input A.

Capacity constraints

- 3.36 Sometimes an undertaking's competitors will not be in a position to respond to the exercise of market power by increasing output in response to higher prices in the relevant market. For example, an undertaking operating in an industry with limited capacity would be in a stronger position to increase prices above competitive levels than an undertaking with a similar market share operating in an industry with substantial excess capacity. Moreover, even existing excess capacity may be so expensive to employ that it will not in practice constitute a competitive constraint. For example, the costs of introducing another shift in a factory with excess capacity might be so high as to hinder a competitor from responding to the exercise of market power.

4 Abuse of Substantial Market Power

Introduction

- 4.1 To contravene the Second Conduct Rule, an undertaking must abuse its substantial market power by engaging in conduct that has the object or effect of harming competition in Hong Kong. Abusive conduct is potentially any conduct which has the object or effect of harming competition in Hong Kong. As noted in paragraph 1.8 above, the category of abusive conduct is an open one.
- 4.2 It is possible for an undertaking with a substantial degree of market power in one market to commit an abuse in a different market. In this regard, the relevant undertaking might leverage its market power in the first market to harm competition in the second. For example, it may be an abuse to tie two products together with a view to harming competition in the tied market. This type of abuse is discussed further in Part 5 of this Guideline.

- 4.3 Abusive conduct may in particular result in harm to competition through anti-competitive foreclosure. Anti-competitive foreclosure occurs when competitors, actual or potential, are denied access to buyers of their products or to suppliers as a result of the conduct of the undertaking with a substantial degree of market power.¹⁵ Anti-competitive foreclosure can result in the undertaking with a substantial degree of market power being able to charge higher prices or in reduced product quality or choice, to the detriment of consumers.
- 4.4 When investigating cases of alleged abuse of a substantial degree of market power, the Commission may consider whether the undertaking is able to demonstrate that the conduct concerned is indispensable and proportionate to the pursuit of some legitimate objective unconnected with the tendency of the conduct to harm competition. For example, a refusal to deal may not be abusive under the Second Conduct Rule where an undertaking with a substantial degree of market power refuses to supply a particular input to a customer because the customer is, as an objective matter, insufficiently creditworthy.
- 4.5 While the Ordinance makes provision for a general exclusion from the application of the First Conduct Rule for agreements enhancing overall economic efficiency in section 1 of Schedule 1, there is no comparable efficiency-based exclusion for conduct within scope of the Second Conduct Rule. Undertakings may, however, wish to argue that conduct does not in fact contravene the Second Conduct Rule because it entails efficiencies sufficient to guarantee no net harm to consumers. A key consideration will be whether the claimed efficiencies are in fact passed on to consumers – notwithstanding the market power of the undertaking concerned – and whether the undertaking with a substantial degree of market power can demonstrate in fact no net harm to consumers.

¹⁵ It should be clarified that where competitors are foreclosed from access to buyers or sources of supply simply as a result of the business efficacy of, and/or the provision of better products or services by, the undertaking with a substantial degree of market power, this will not be regarded as anti-competitive foreclosure. Additionally, for anti-competitive foreclosure to occur access to buyers or suppliers does not need to be entirely eliminated. Degraded or diminished access can be sufficient.

The object of harming competition

- 4.6 Certain types of conduct by undertakings with a substantial degree of market power can be regarded, by their very nature, to be so harmful to the proper functioning of normal competition in the market that there is no need to examine their effects. Such conduct is considered to have the “object” of harming competition.
- 4.7 In order to determine whether conduct has the object of harming competition, regard must be had to the nature of the conduct (including, if the conduct is contained in an agreement, the content of the agreement and the way it is implemented) and its context (including both the economic and legal context).
- 4.8 Determining the object of particular conduct requires an objective assessment of its aims. That is, the object of conduct refers to the purpose or aim of the conduct viewed in its context and in light of the way it is implemented, and not merely the subjective intentions of the undertaking concerned. Nonetheless, there is nothing to prevent the Commission from taking the relevant undertaking’s subjective intention into account when determining whether or not particular conduct has the object of harming competition.¹⁶
- 4.9 An examination of the context of particular conduct for the purposes of determining whether it has the object of harming competition does not require or involve an analysis of the effects of the conduct in the market. Where it is shown that conduct has the object of harming competition, the Commission does not need to demonstrate that the conduct has anti-competitive effects or is likely to have such effects – for example, a foreclosure effect. It is sufficient for the Commission to show that the conduct has the potential to harm or is capable of harming competition in the relevant context.
- 4.10 Where it is established that particular conduct has the object of harming competition, the conduct cannot be defended by the relevant undertaking showing that the conduct does not in fact have any anti-competitive effects or that such effects are not likely to flow from the conduct.

¹⁶ This is not to say that a subjective intention to harm competition can suffice to show an anti-competitive object. Evidence of subjective intent is merely a factor the Commission can have regard to in its objective assessment of the aims of the conduct.

- 4.11 Section 22(1) of the Ordinance provides that if conduct has more than one object, it will be capable of contravening the Second Conduct Rule if any one of its objects is to harm competition. Moreover, section 22(2) of the Ordinance provides that an anti-competitive object may be ascertained by inference. In practice, it will often be necessary to infer an anti-competitive object from the facts underlying the conduct and the surrounding circumstances.
- 4.12 Although the category of conduct which has the object of harming competition cannot be reduced to an exhaustive list, the concept of an anti-competitive object can only be applied to conduct which is by its very nature harmful to competition in a market.
- 4.13 Consequently, the Commission is of the view that most conduct falling within scope of the Second Conduct Rule will be assessed by reference to the conduct's actual or likely anti-competitive effects in the market.
- 4.14 An example of conduct which may have the object of harming competition is where an undertaking with a substantial degree of market power sets prices below its average variable costs. This type of conduct, known as predatory pricing, is discussed further in Part 5 of this Guideline.
- 4.15 Certain exclusive dealing arrangements by an undertaking with a substantial degree of market power might also be considered to have the object of harming competition when viewed in their context. Similarly, should it be established that an undertaking with a substantial degree of market power paid a distributor or customer to delay the introduction of a competitor's product, such conduct might be assessed as having the object of harming competition.

The effect of harming competition

- 4.16 If conduct does not have the object of harming competition, it will contravene the Second Conduct Rule if it nevertheless has the effect of harming competition.

- 4.17 When demonstrating that conduct has an anti-competitive effect, the Commission will consider not only any actual effects but also effects that are likely to flow from the conduct.
- 4.18 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 counter-factual), 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 counter-factual in some cases (such as where an undertaking has held a substantial degree of market power for many years).
- 4.19 Conduct might have the actual or likely effect of harming competition where it results in or is likely to result in:
- (a) higher prices;
 - (b) a restriction in output;
 - (c) a reduction in product quality or variety; and/or
 - (d) anti-competitive foreclosure.
- 4.20 For conduct to have the actual or likely effect of harming competition, it must harm the process of competition causing harm to consumers, and not simply harm an individual competitor. Consumers benefit when competitors have strong incentives to win the competitive battle against one another. In a highly competitive market some competitors will leave the market over time while new ones will enter. The Ordinance is concerned with protecting competition in the market and not the commercial interests of particular market participants.
- 4.21 Section 22(3) of the Ordinance provides that if conduct has more than one effect, it will be capable of contravening the Second Conduct Rule if any one of its effects is to harm competition.

5 Examples of Conduct that May Constitute an Abuse

- 5.1 The following are non-exhaustive examples of types of conduct that the Commission may, in appropriate circumstances, consider an abuse of a substantial degree of market power:
- (a) predatory pricing;
 - (b) tying and bundling;
 - (c) margin squeeze conduct;
 - (d) refusals to deal; and
 - (e) exclusive dealing.
- 5.2 The specific conduct under examination in a given case may involve more than one type of abuse.

Predatory pricing

- 5.3 Offering low prices to consumers is the epitome of competitive conduct. The Commission is alive to the need to distinguish lower prices resulting from competition on the merits from alleged predatory pricing conduct.
- 5.4 An undertaking with a substantial degree of market power may be engaging in predatory pricing where it sets prices so low that it deliberately foregoes profits in an attempt to force one or more other undertakings out of the market and/or in an attempt to otherwise “discipline” competitors. In this context, the undertaking may incur losses in the short run in the expectation that it will be able to charge higher prices in the longer term (for example, following the exit of relevant competitors from the market). Consumers will ultimately be worse off if competition is weakened in this way, leading to higher prices and reduced product quality and choice.
- 5.5 Generally speaking, an adverse effect on competition will arise where there is or is likely to be anti-competitive foreclosure of existing competitors or new entrants. Where reliable data is available, the Commission will seek to demonstrate anti-competitive foreclosure when assessing predatory pricing conduct. It will not, however, be necessary for the Commission to demonstrate that competitors have actually exited the market in order to show a foreclosure effect. The undertaking with a substantial degree of market power may prefer merely to undermine the ability of competitors to compete effectively rather than to force them from the market. Such conduct may also amount to anti-competitive foreclosure.

5.6 When assessing whether predation is taking (or has taken) place, the Commission will typically consider whether the undertaking is pricing below an appropriate measure of cost. Although different cost benchmarks may be used to identify predatory behaviour depending on the facts of the case, the following general remarks can be made:

- (a) *Pricing below average variable cost.* Pricing below average variable cost ("**AVC**") is unlikely to be economically rational, because an undertaking that does so is making losses on each unit of output it produces even with respect only to the costs that it must immediately and unavoidably incur in producing those units of output (i.e. its variable costs). For this reason, where an undertaking with a substantial degree of market power sets prices below AVC, the Commission may consider that this is undertaken for a predatory purpose. Moreover, in the absence of evidence to the contrary, the Commission is likely to infer that the conduct has the object of harming competition. In such a scenario, the Commission need not demonstrate actual or likely anti-competitive foreclosure.¹⁷
- (b) *Pricing below average total cost.* Where an undertaking prices above its AVC (or a comparable measure¹⁸) but below its average total cost, the conduct may be entirely rational commercial behaviour because the immediately unavoidable costs of production (the variable costs) are more than met, even if not all costs in the longer term (i.e. fixed costs) are covered. When analysing this type of conduct, evidence of actual or likely anti-competitive effects may be considered or there may be documentary evidence of a predatory strategy. Equally, the Commission may investigate whether the allegedly predatory conduct resulted in losses that could have been avoided or whether the undertaking's pricing strategy makes commercial sense only because of its tendency to harm competition.

5.7 When considering whether below-cost pricing constitutes predatory conduct, the Commission may, at its discretion, consider the extent to which the predating 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.

¹⁷ Long run average incremental cost ("**LRAIC**") is another benchmark that may be used as an alternative to AVC. LRAIC is sometimes considered a more appropriate cost measure than AVC when the alleged predatory conduct involves products that have large fixed costs and low marginal costs of production. Pricing below average avoidable cost ("**AAC**") is a further benchmark that can be used as an alternative to AVC depending on the facts of the case. AAC is sometimes considered a more appropriate cost measure than AVC when analysing profit sacrificed and avoidable losses. AAC focuses on the costs incurred to generate increased output weighed against the revenues received.

¹⁸ See footnote 17 above.

Hypothetical Example 5

KowloonVend Ltd and New Vending Co are the only two companies that sell vending machines in Hong Kong. KowloonVend has the majority of vending machine sales, while New Vending, a recent entrant in the market, has a much smaller share. KowloonVend was selling its machines at a highly profitable price. When it entered the market, New Vending began selling its machines at a much lower price and KowloonVend's market share began to decline. New Vending gained these lost sales from KowloonVend. In response, KowloonVend cut its prices in half. This low price is not enough to cover any measure of KowloonVend's costs and KowloonVend loses money with each vending machine sold. New Vending cannot compete with these low prices and eventually goes out of business.

Assuming it can be established that KowloonVend has a substantial degree of market power, the Commission may assess KowloonVend's conduct as predatory and a contravention of the Second Conduct Rule. The conduct might also be considered as having the object of harming competition.

Anti-competitive tying and bundling

- 5.8 Tying occurs when a supplier makes the sale of one product (the tying product) conditional upon the purchase of another (the tied product) from the supplier (i.e. the tying product is not sold separately).¹⁹ Bundling refers to situations where a package of two or more products is offered at a discount.
- 5.9 Tying and bundling are common commercial arrangements that generally do not harm competition and often promote competition. Many undertakings, whether or not they have a substantial degree of market power, engage in tying and bundling and such arrangements often result in lower production costs, reduced transaction and information costs, and increased convenience and variety for consumers.
- 5.10 However, an undertaking with a substantial degree of market power in the tying market can use tying to harm competitors in the tied market. In this circumstance, the undertaking leverages its substantial degree of market power from the tying market into

¹⁹ There are many types of tying. For example, technical tying occurs when the tying product is designed in such a way that it only works properly with the tied product, and not with alternatives offered by competitors. Contractual tying occurs when the customer who purchases the tying product undertakes also to purchase the tied product.

the tied market. By tying, it may be able to reduce the number of potential buyers that are available for its competitors in the tied market – that is, the tied market is foreclosed. This may in turn cause those competitors to be less effective as competitors or to exit the tied market, with the result that the undertaking with a substantial degree of market power can raise prices to the detriment of consumers.

- 5.11 Similarly, in the context of bundling, an undertaking with a substantial degree of market power in the market for one of the products that forms part of the bundle may use bundling to harm competitors in the markets for the other products that are part of the same bundle. This may give rise to foreclosure in the latter markets, leading potentially to higher prices for consumers.
- 5.12 When assessing tying and bundling conduct, 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. An anti-competitive effect may arise in particular when the conduct results in anti-competitive foreclosure.

Hypothetical Example 6

The leading supplier of medical devices to Hong Kong hospitals and clinics stipulates in its sales contracts that the consumable medical products used with the devices must be purchased exclusively from it. These contractual requirements significantly limit the customer base available to competing manufacturers of consumables. If the medical devices supplier has a substantial degree of market power in the relevant medical devices markets, the contractual arrangements (which cause harm to competition in the market for consumable medical products) may amount to an abusive tie in contravention of the Second Conduct Rule.

The analysis might be similar with respect to the tying of a service. For example, if the medical devices supplier imposed a condition requiring the use of a particular undertaking or firm (including a subsidiary) for the purposes of providing maintenance and repair services for its devices, this could raise concerns under the Second Conduct Rule.

Hypothetical Example 7

The manufacturer of a popular brand of toothbrush, CleenTeeth, decides to implement a special offer in Hong Kong stores. Customers buying CleenTeeth toothbrushes can receive a tube of its new toothpaste product, SparkL Advance, at a discounted price. The offer is only for a 3 month period, and is intended to help CleenTeeth raise the profile of SparkL Advance in the market.

Even assuming CleenTeeth has a substantial degree of market power in the relevant market for toothbrushes, this bundling arrangement would be unlikely to amount to a contravention of the Second Conduct Rule. The discount offered on SparkL Advance is unlikely to have the object or effect of limiting CleenTeeth's competitors' ability to compete in the toothpaste market. The discount is of limited duration and arguably supported by a pro-competitive efficiency (relating to the introduction of a new product in the market).

Margin squeeze

- 5.13 A margin squeeze may arise where a vertically integrated undertaking with a substantial degree of market power supplies an important input to undertakings operating on a downstream market where it also operates.
- 5.14 A margin squeeze occurs where the undertaking with a substantial degree of market power reduces or "squeezes" the margin between the price it charges for the input to its competitors on the downstream market and the price its downstream operations charge to its own customers, such that the downstream competitor is unable to compete effectively. A margin squeeze requires that the undertaking supplying the relevant input has a substantial degree of market power in the market where it sells the input – that is, the upstream market.
- 5.15 When assessing whether conduct amounts to an abusive margin squeeze, the Commission will consider the following factors:
- (a) *The nature of the upstream input concerned.* An anti-competitive effect is more likely if the upstream product is an indispensable input from the perspective of the participants in the downstream market. Nonetheless, an abusive margin squeeze cannot be excluded even if there are alternatives available for the upstream input.

- (b) *The level of the margin squeeze.* A margin squeeze arises 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 is (i) negative (that is, if the upstream price is higher than the downstream price charged by the undertaking with a substantial degree of market power), or (ii) at least insufficient to cover the downstream product-specific costs of the firm with substantial market power.²⁰

Refusals to deal

- 5.16 As a general matter, an undertaking, whether or not it has a substantial degree of market power, is free to decide with whom it will or will not do business. An undertaking might not wish to enter into a trading relationship with another party for a variety of legitimate commercial reasons, for example because it has objectively justified concerns about the creditworthiness of the other party. A refusal to deal by an undertaking with a substantial degree of market power is likely to be abusive in very limited or exceptional circumstances.
- 5.17 The term “refusal to deal” describes a situation where an undertaking with a substantial degree of market power refuses to supply an input to another undertaking, or is willing to supply that input only on objectively unreasonable terms – known as a constructive refusal to deal. Constructive refusal could, for example, consist of unduly delaying or otherwise degrading the supply of the relevant input or imposing a price for the input that is excessive.
- 5.18 A refusal to deal may harm competition in the downstream market by preventing the undertaking seeking access to the relevant input from: (a) operating in that market; or (b) operating in that market as an effective competitive constraint.
- 5.19 Competition concerns are more likely to arise when the undertaking with a substantial degree of market power competes in the downstream market with the party with whom it refuses to deal (that is, where the undertaking with a substantial degree of market power is vertically integrated). Concerns may arise in particular when the refusal relates to an input that is indispensable for undertakings operating in the downstream market. In this context, the Commission will consider whether the undertakings operating in the

²⁰ The Commission will consider whether a downstream competitor with the same product-specific costs as the downstream operations of the vertically integrated undertaking with a substantial degree of market power would be profitable in light of the upstream and downstream prices levied by the undertaking with a substantial degree of market power.

downstream market are able to duplicate the relevant input or whether they would be able to duplicate it only at unreasonable cost (i.e. where the cost is so high that it would not make commercial sense to incur it).

5.20 In assessing whether a refusal to deal is a contravention of the Second Conduct Rule, the Commission may consider as appropriate:

- (a) whether or not it is technically and economically feasible for the undertaking with a substantial degree of market power to provide the input in question;
- (b) the past history of dealing between the undertakings (the termination of an existing supply arrangement might more readily be characterised as abusive); and/or
- (c) the terms and conditions at which the products in question are generally supplied or are supplied in other contexts.

5.21 Given the importance of IPRs in encouraging innovation, the Commission will consider an undertaking's refusal to license an IPR as a contravention of the Second Conduct Rule only in exceptional circumstances. In addition to the factors that the Commission would have regard to in any case of a refusal to deal, the Commission may also assess, for example, whether a refusal to licence prevents the development of a secondary market or new product or otherwise limits technical development resulting in consumer harm.

5.22 Where an undertaking with a substantial degree of market power holds an IPR which is essential to an industry standard, and the undertaking gave a commitment at the time when the standard was adopted by the industry that it would license the IPR on fair, reasonable and non-discriminatory ("**FRAND**") terms, a subsequent refusal to honour the FRAND commitment may be an abuse. Equally, it may also be an abuse for the holder of a standard essential patent with a FRAND commitment to seek injunctive relief against a willing licensee in certain circumstances.²¹

Exclusive dealing

5.23 Exclusive dealing is commonly used in commercial arrangements and in most cases will not harm competition.

²¹ Whether or not a refusal to honour a FRAND commitment amounts to an abuse in the form of a refusal to deal will depend on the facts of the case. A failure to honour a FRAND commitment might equally raise issues of excessive pricing or discriminatory pricing. Where the holder of a FRAND obligated standard essential patent seeks injunctive relief against a willing licensee, that may be assessed as a refusal to deal but equally it might be appropriate to assess such conduct as an abusive use of litigation.

- 5.24 An undertaking with substantial market power may, however, seek to foreclose competitors by preventing them from selling to customers through exclusive dealing arrangements. Exclusive dealing in this context includes arrangements requiring a customer to purchase, directly or indirectly, all or a substantial proportion of its requirements of a particular product from a particular undertaking. This may take the form of either an exclusive purchasing obligation or a conditional rebate. These two types or arrangement are discussed further below.
- 5.25 Exclusive dealing is a broad category of conduct which also covers exclusive supply obligations or incentive arrangements with a similar effect. Where an undertaking with a substantial degree of market power uses such arrangements to foreclose competitors by preventing them from accessing particular inputs, this may amount to an abuse if the exclusive supply or relevant incentive arrangement locks up most of the efficient input suppliers in the market and competitors of the undertaking with a substantial degree of market power are unable to secure the inputs concerned from alternative suppliers.²²
- 5.26 Where exclusive dealing is pursued by an undertaking with a substantial degree of market power, the exclusive dealing conduct may amount to an abuse if it has the object or effect of harming competition.²³
- 5.27 An exclusive purchasing obligation requires a customer to purchase its requirements of a particular product exclusively or to a large extent only from the undertaking with a substantial degree of market power. Other obligations, such as stocking requirements, may have the same effect as exclusive purchasing even though they do not, strictly speaking, entail exclusivity.
- 5.28 The Commission will have particular concerns where:
- (a) the undertaking with a substantial degree of market power has imposed exclusive purchasing obligations on many customers;
 - (b) it is likely that consumers as a whole will not derive a benefit; and
 - (c) the relevant obligations, as a whole, have the effect of preventing the entry or expansion of competing undertakings because, for example, the exclusive purchasing locks up a significant part of the relevant market²⁴ – that is, where there is anti-competitive foreclosure.

²² Other exclusive dealing practices or similar structures which may give rise to concern under the Second Conduct Rule, depending on the facts of the case, include arrangements in supply agreements to match more favourable terms offered by competing suppliers (known as 'English clauses'), slotting allowances paid by suppliers to retailers, incentives in the form of storage or other equipment provided free of charge in return for an exclusive stocking commitment or, in certain limited circumstances, category management arrangements.

²³ Where neither of the parties to the exclusive dealing arrangement has a substantial degree of market power, the exclusive dealing may still fall to be assessed as a vertical agreement under the First Conduct Rule.

²⁴ The undertaking with a substantial degree of market power might of course simply choose to target customers who are particularly important for competitors in terms of possibilities to enter or expand, thereby increasing the risk of anti-competitive foreclosure. Such conduct could equally amount to an abuse.

- 5.29 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 or is likely to give rise to a foreclosure effect. In the case of bidding markets for example, where there is competition for the market, exclusivity might merely be the result of a highly competitive market.
- 5.30 Conditional rebates, in particular loyalty or fidelity rebates, involve the grant of a rebate to customers as a reward for particular purchasing behaviour. 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.
- 5.31 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. Usually a loyalty rebate involves the customer being awarded the rebate if the customer's purchases over a defined period exceed a defined threshold. Loyalty rebates may be granted either on all purchases from the undertaking with a substantial degree of market power (retroactive rebates) or only on purchases above the relevant threshold (incremental rebates). Retroactive rebates have the potential to foreclose the market significantly since buyers switching portions of their demand to an alternative supplier would lose the rebate in respect of all products purchased and not only the incremental amount for which the buyer is considering alternative suppliers.
- 5.32 Rebates may be individualised in nature (where the relevant thresholds are tailored to each customer according to its particular requirements) or standardised (where the same thresholds apply for all customers). Generally, an individualised threshold allows the undertaking with a substantial degree of market power to set the threshold at such a level as will maximise its foreclosure effect, while a standardised rebate may be too high for some buyers and/or too low for others to have a sufficient loyalty enhancing effect. Standardised rebates are therefore less likely to raise competition concerns. General quantity rebates, conditional on the size of a particular order, are also unlikely to raise competition concerns unless they are predatory in nature.

Hypothetical Example 8

A large and popular rice noodle producer, LargeNoodle Co, offers significant rebates to local grocery stores in Hong Kong that agree to purchase a certain volume of rice noodles from LargeNoodle Co. LargeNoodle Co sets volume targets for each customer individually and these correspond roughly to the volume of noodles which the customer usually purchases. The targets are calculated over a period of one year and increase in size, year on year, for a period of 5 years. No rebates are received unless the grocery store hits the volume target, and after that point, the rebate is received in respect of all volumes purchased from LargeNoodle Co that year.

The effect of the rebate scheme is that customers, in practice purchase all of their rice noodle requirements from LargeNoodle Co, as to do otherwise would lead to them losing the entire rebate for a particular year. Other rice noodle producers are effectively 'locked out' from supplying a large portion of the grocery market and can no longer compete effectively with LargeNoodle Co. If LargeNoodle Co has a substantial degree of market power, this rebate scheme may amount to an abuse under the Second Conduct Rule.

Hypothetical Example 9

A Hong Kong glass manufacturer supplies glass for windows to several construction companies in Hong Kong. Where the volume of glass supplied to these companies increases, the manufacturer's cost per unit decreases. This is as a result, among other things, of lower average transport costs. In light of these cost savings and in order to drive sales, the manufacturer offers discounts to customers on reaching certain volume targets. The discounts are granted only on those purchases above the target volume. The same targets and discounts apply to all customers. The glass manufacturer separately offers a small discount in return for early payments.

Even assuming that the glass manufacturer has a substantial degree of market power, these discounts would be unlikely to contravene the Second Conduct Rule. The early payment discount would be unlikely to have the object or effect of restricting competition. As for the other discounts, the standardised and incremental nature of the discounts means that they would be less likely to foreclose competitors than, for example, individualised and/or retroactive rebates. The fact that the discounts are linked solely to the volume of the purchases and based on cost savings also suggests they are unlikely to raise concerns under the Second Conduct Rule.

Annex

Exclusions and Exemptions from the Second Conduct Rule

I Introduction

1.1 The Second Conduct Rule does not apply where it is excluded by or as a result of the application of an exclusion in Schedule 1 to the Ordinance. In this respect, Schedule 1 to the Ordinance provides for the following general exclusions in respect of the Second Conduct Rule:

- (a) compliance with legal requirements;
- (b) services of general economic interest;
- (c) mergers; and
- (d) conduct of lesser significance.

Discussion on each of these general exclusions and other statutory exclusions and exemptions is provided in the paragraphs which follow.

1.2 Undertakings to whom exclusions and exemptions apply will not contravene the Second Conduct Rule. There is no requirement for undertakings to apply to the Commission in order to secure the benefit of a particular exclusion or exemption. Undertakings can assess for themselves whether their conduct falls within the terms of a particular exclusion or exemption. Equally, undertakings may assert the benefit of any exclusion or exemption as a defence in any proceedings before the Tribunal or other courts.

1.3 However, the Ordinance provides that undertakings may elect to apply to the Commission under section 24 of the Ordinance for a decision pursuant to section 26 of the Ordinance as to whether or not the conduct in question is excluded or exempt from the Second Conduct Rule. If an undertaking wishes to seek greater legal certainty, it may wish to apply to the Commission for a decision under section 26 of the Ordinance. However, the Commission is only required to consider applications for such a decision in certain circumstances.

- 1.4 The Commission's *Guideline on Applications for a Decision under sections 9 and 24 (Exclusions and Exemptions) and section 15 Block Exemption Orders* provides information on how undertakings can apply to the Commission for a decision on whether a statutory exclusion or exemption applies.

2 Compliance with Legal Requirements

- 2.1 Section 2, Schedule 1 to the Ordinance provides that agreements or conduct are excluded from the First Conduct Rule and Second Conduct Rule to the extent that the relevant agreement or conduct is made or engaged in for the purposes of complying with a legal requirement imposed by or under any enactment²⁵ in force in Hong Kong or imposed by any national law²⁶ applying in Hong Kong.
- 2.2 The Commission considers that for this general exclusion to apply, the relevant legal requirement must eliminate any margin of autonomy on the part of the undertakings concerned compelling them to enter into or engage in the agreement or conduct in question.
- 2.3 Where an undertaking has some scope to exercise its independent judgment on whether it will enter into an agreement or engage in the relevant conduct, the general exclusion for complying with legal requirements will not be available. Accordingly, if the relevant agreement or conduct is merely facilitated or encouraged by an enactment in force in Hong Kong or national law applying in Hong Kong, the exclusion will not apply. Equally, approval or encouragement on the part of the public authorities will not suffice for this general exclusion to apply.

²⁵ An "enactment" is defined in section 3 of the Interpretation and General Clauses Ordinance (Cap 1) (the "**Interpretation Ordinance**") to mean any Ordinance, any subsidiary legislation made under any such Ordinance and any provision or provisions of any such Ordinance or subsidiary legislation.

²⁶ Section 3 of the Interpretation Ordinance provides that the term "national law applying in Hong Kong" means a national law applied in Hong Kong pursuant to the provisions of Article 18 of the Basic Law.

3 Services of General Economic Interest

- 3.1 Section 3, Schedule 1 to the Ordinance provides that neither the First Conduct Rule nor the Second Conduct Rule applies to an undertaking entrusted by the Government²⁷ with the operation of services of general economic interest in so far as the Conduct Rules would obstruct the performance, in law or in fact, of the particular tasks assigned to the undertaking.
- 3.2 The Commission intends to interpret this general exclusion strictly. The onus will be on the undertaking seeking the benefit of the exclusion to demonstrate that all the conditions for application of the exclusion have been met. These are discussed below.

Entrusted

- 3.3 The undertaking will need to demonstrate that it has been expressly entrusted by the Government with the service in question. The Commission considers that an act of entrustment may be made by way of some legislative measure or regulation, through the grant of a concession or licence governed by public law or through some other act of the Government. Mere approval by the Government of the activities carried out by the relevant undertaking will not suffice.
- 3.4 The exclusion applies only to the particular entrusted tasks and not to the undertaking or its activities generally.
- 3.5 For obligations imposed on an undertaking entrusted with the operation of a service of general economic interest to fall within the particular tasks entrusted to it, they must be linked to the subject matter of the service of general economic interest in question and contribute directly to achieving that interest.

Services of general economic interest

- 3.6 The Commission considers that the reference to “services” in this context includes the distribution of goods and not only the provision of services as such.

²⁷ Section 3 of the Interpretation Ordinance provides that the term “Government” means the Government of the Hong Kong Special Administrative Region. Section 2 of the Ordinance indicates, however, that Government does not include a company that is wholly or partly owned by the Government.

- 3.7 Services of general economic interest are services that the public authorities believe should be provided to the public whether or not the private sector would supply the relevant services.²⁸ The reference to “economic” refers to the economic nature of the service provided. For example, services of an economic nature may include activities in the cultural, social, and public health fields where their aim is to make a profit.
- 3.8 To be considered a service of general economic interest, the service must typically be widely available and not restricted to a certain class, or classes, of buyers. That said, services aimed at a particular group or a particular locality, for example a disadvantaged group or a remote locality, could still qualify in so far as such services are in the general interest.

Obstruct the performance, in law or in fact, of the particular tasks assigned

- 3.9 To benefit from the services of general economic interest exclusion, it will not be sufficient for an undertaking merely to provide evidence that it has been entrusted with the performance of a particular service of general economic interest. Rather, the undertaking must demonstrate that the application of the Conduct Rules would obstruct the performance of the relevant entrusted tasks.
- 3.10 An undertaking seeking to demonstrate that the application of the Conduct Rules would obstruct the performance of the entrusted tasks must show with supporting evidence that the application of those rules would require it to perform the entrusted tasks under economically unacceptable conditions. The undertaking will also generally need to show that the entrusted tasks could not be discharged in other ways, which would cause less harm to competition.

4 Mergers

- 4.1 Section 4(2) of Schedule 1 to the Ordinance provides that, to the extent that conduct results in, or if engaged in would result in, a merger as defined in the Ordinance, the Second Conduct Rule does not apply to the conduct. The Commission’s *Guideline on the First Conduct Rule* provides additional information on the general exclusion for mergers and guidance on the Commission’s interpretation of the scope of that exclusion.

²⁸ The concept of a service of general economic interest might be seen as loosely corresponding to the concept of a public service.

5 Conduct of Lesser Significance

- 5.1 Schedule 1 to the Ordinance contains a general exclusion for conduct of lesser significance. Pursuant to section 6 of Schedule 1, the Second Conduct Rule does not apply to conduct engaged in by an undertaking the turnover of which does not exceed HK\$40 million for the turnover period.²⁹ As stated in section 6(4) of Schedule 1 to the Ordinance, turnover for the purposes of this general exclusion means the total gross revenues of an undertaking whether obtained in Hong Kong or outside Hong Kong.
- 5.2 Additional rules in respect of the general exclusion for conduct of lesser significance are contained in regulations made by the Secretary for Commerce and Economic Development under section 163(2) of the Ordinance.

6 Public Policy and International Obligations Exemptions

- 6.1 Sections 31 and 32 of the Ordinance provide for exemptions on public policy grounds (a “**Public Policy Exemption**”) and to avoid a conflict with international obligations³⁰ that directly or indirectly relate to Hong Kong (an “**International Obligations Exemption**”).
- 6.2 Unlike the Schedule 1 exclusions which are listed in the Ordinance, these two exemptions require that the Chief Executive in Council make an order specifying that a particular agreement or conduct or a particular class of agreement or conduct is exempt from the Conduct Rules.
- 6.3 Sole responsibility for making Public Policy Exemption and International Obligations Exemption orders rests with the Chief Executive in Council. In so far as the Second Conduct Rule is concerned, the Commission’s role in respect of these exemptions, if any, is confined to determining whether they apply in a particular case following an application for a decision under section 24 of the Ordinance.

²⁹ Pursuant to section 6(2) of Schedule 1 to the Ordinance, the turnover period of an undertaking is (a) if the undertaking has a financial year, the financial year of the undertaking that ends in the preceding calendar year; or (b) if the undertaking does not have a financial year, the preceding calendar year.

³⁰ Under section 32 of the Ordinance an international obligation “includes an obligation under – (a) an air service agreement or a provisional arrangement referred to in Article 133 of the Basic Law; (b) an international arrangement relating to civil aviation; and (c) any agreement, provisional arrangement or international arrangement designated as an international agreement, international provisional arrangement or international arrangement by the Chief Executive in Council by order published in the Gazette”.

- 6.4 Public Policy Exemption and International Obligations Exemption orders that have been made by the Chief Executive in Council, if any, will be made available on the Commission's website.

7 Statutory Bodies, Specified Persons and Activities

- 7.1 Section 3 of the Ordinance provides that the competition rules (including the Second Conduct Rule) do not apply to statutory bodies.³¹ Under section 3, statutory bodies are excluded from the competition rules unless they are specifically brought within the scope of those rules by a regulation made by the Chief Executive in Council under section 5.
- 7.2 The reference to a statutory body in section 3 includes an employee or agent of the statutory body acting in that capacity. The section 3 exclusion does not, however, extend to legal entities owned or controlled by a statutory body unless those entities are also statutory bodies.³²
- 7.3 Section 4 of the Ordinance provides that the competition rules (including the Second Conduct Rule) do not apply to persons specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance or to persons engaged in activities specified in such a regulation. The reference to a person in section 4 of the Ordinance includes an employee or agent of the person acting in that capacity.
- 7.4 All regulations as might be made by the Chief Executive in Council under section 5 of the Ordinance will be available on the Commission's website.

³¹ As defined in section 2 of the Ordinance, "statutory body" means "a body of persons, corporate or unincorporate, established or constituted by or under an Ordinance or appointed under an Ordinance, but does not include (a) a company; (b) a corporation of trustees incorporated under the Registered Trustees Incorporation Ordinance (Cap 306); (c) a society registered under the Societies Ordinance (Cap 151); (d) a co-operative society registered under the Co-operative Societies Ordinance (Cap 33); or (e) a trade union registered under the Trade Unions Ordinance (Cap 332)".

³² In any event, the definition of statutory body does not include a "company" as defined in the Ordinance (including a company within the meaning of section 2(1) of the Companies Ordinance).



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Revised Draft Guideline on The Merger Rule

30 March 2015

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Guideline on the Merger Rule

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under section 17 of Schedule 7 to the Competition Ordinance (Cap 619) (the “**Ordinance**”).*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*This Guideline sets out how the Commission intends to interpret and give effect to the Merger Rule in the Ordinance. This Guideline is not however a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

This Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I Introduction

- 1.1 Section 3 of Schedule 7 to the Ordinance provides that an undertaking² must not, directly or indirectly, carry out a merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong (the “**Merger Rule**”). Section 4 of Schedule 7 to the Ordinance provides that, *at present, the Merger Rule only applies where an undertaking that directly or indirectly holds a “carrier licence” within the meaning of the Telecommunications Ordinance (Cap. 106) (“TO”) is involved in a merger.*³ Given the restricted application of the Merger Rule to mergers involving at least one carrier licensee, examples given in this Guideline are generally related to telecommunications.
- 1.2 In accordance with section 17 of Schedule 7 to the Ordinance, this Guideline indicates the manner in which the Commission expects to interpret and give effect to the provisions under the Ordinance relating to the Merger Rule, including, in particular:
- (a) the manner in which the Commission will determine whether or not a merger has, or would be likely to have, the effect of substantially lessening competition in Hong Kong;
 - (b) the manner in which the Commission will determine whether or not a merger would fall within the exclusion referred to in section 8(1) of Schedule 7 to the Ordinance; and
 - (c) the manner and form in which the Commission should be notified of any merger.
- 1.3 There is no requirement to notify the Commission of a merger or a proposed merger under the Ordinance. However, the Commission may use its powers to investigate a merger and take the necessary action to ensure compliance with the Merger Rule. As such, it may be in the interest of the parties to a proposed merger that would fall within the scope of the Merger Rule to approach the Commission to discuss the transaction and seek informal advice (which would not be binding on the Commission) on the

² Section 2(1) of the Ordinance provides that undertaking means “any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity, and includes a natural person engaged in economic activity”. For a discussion of the concept of undertaking, see the *Guideline on the First Conduct Rule*.

³ “Carrier licence” is defined in section 2(1) of the TO as “a licence issued for the establishment or maintenance of a telecommunications network for carrying communications to or from the public between fixed locations, between moving locations or between fixed locations and moving locations, within Hong Kong, or between Hong Kong and places outside Hong Kong, on a point-to-point, point-to-multipoint or broadcasting basis, such locations within Hong Kong being separated by unleased Government land, but does not include the licences listed in Schedule 1 [of the TO]”. See also Part 2 of this Guideline for details.

transaction on a confidential basis. Pursuant to section 60 of the Ordinance, parties to a merger or proposed merger may propose Commitments to the Commission to address its concerns about a possible contravention of the Merger Rule. Where applicable, parties to a merger or proposed merger may under section 11 of Schedule 7 to the Ordinance also apply to the Commission for a decision whether the merger or proposed merger is excluded from the application of the Merger Rule.

2 Scope of the Merger Rule

What constitutes a merger?

- 2.1 This part of the Guideline explains the types of transactions that would constitute a merger under the Ordinance. In general, transactions that involve the merging of two or more undertakings into one, the acquisition of one (or part of an) undertaking by another, the forming of a joint venture and the acquisition of assets by one undertaking from another may potentially be a merger which needs to be examined under the Merger Rule. Section 4 of Schedule 1 to the Ordinance indicates that where an agreement or conduct amounts to a merger under the Ordinance, the First and Second Conduct Rules do not apply.
- 2.2 Section 3(1) of Schedule 7 to the Ordinance sets out the Merger Rule: *“An undertaking must not, directly or indirectly, carry out a merger that has, or is likely to have, the effect of substantially lessening competition in Hong Kong.”*
- 2.3 A merger takes place if:
- (a) two or more undertakings previously independent of each other cease to be independent of each other (section 3(2)(a) of Schedule 7 to the Ordinance);
 - (b) one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings. The creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity also constitutes a merger within this category (sections 3(2)(b) and 3(4) of Schedule 7 to the Ordinance); or
 - (c) an acquisition by one undertaking (the **“acquiring undertaking”**) of the whole or part of the assets, including goodwill, of another undertaking (the **“acquired undertaking”**) results in the acquiring undertaking being in a position to replace the acquired undertaking, or to substantially replace the acquired undertaking, in

the business or in part of the business concerned in which the acquired undertaking was engaged immediately before the acquisition (sections 3(2)(c) and 3(3) of Schedule 7 to the Ordinance).

Mergers between previously independent undertakings

- 2.4 A merger takes place when, for example, two or more previously independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities. A merger may also occur where, in the absence of a legal merger, there is a *de facto* amalgamation of the undertakings concerned into a single economic unit, by establishing a permanent, single economic management. Other relevant factors for the determination of a *de facto* merger may include internal profit and loss compensation or a revenue distribution between the various entities within the group, and their joint liability or external risk sharing. The *de facto* amalgamation may be solely based on contractual arrangements, but it can also be reinforced by cross-shareholdings between the undertakings forming the economic unit.

Acquisition of control

- 2.5 A merger may also take place when one or more persons or other undertakings acquire direct or indirect control of the whole or part of one or more other undertakings. Under section 5(1) of Schedule 7 to the Ordinance, control, whether solely or jointly, in relation to an undertaking, is to be regarded as existing if, by reason of rights, contracts or any other means, or any combination of rights, contracts or other means, decisive influence is capable of being exercised with regard to the activities of the undertaking and, in particular, by:
- (a) ownership of, or the right to use all or part of, the assets of an undertaking; or
 - (b) rights or contracts which enable decisive influence to be exercised with regard to the composition, voting or decisions of any governing body of an undertaking.
- 2.6 Section 5(2) of Schedule 7 to the Ordinance indicates that control is acquired by any person or other undertaking if the person or undertaking:
- (a) becomes a holder of the rights or contracts, or entitled to use the other means, referred to in paragraph 2.5 above; or
 - (b) although not becoming such a holder or entitled to use those other means, acquires the power to exercise the rights derived from them.

- 2.7 “Decisive influence” in paragraph 2.5 refers to the power to determine decisions (including the making or vetoing of such decisions) relating to the strategic commercial behaviour of an undertaking, such as the budget, the business plan, major investments or the appointment of senior management. In determining whether decisive influence is capable of being exercised, section 5(3) of Schedule 7 to the Ordinance states that regard must be had to all the circumstances of the case and not solely to the legal effect of any instrument, deed, transfer, assignment or other act done or made. Control may therefore occur on a legal or *de facto* basis.

Joint ventures

- 2.8 The creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity constitutes a merger for the purposes of the Ordinance. Joint ventures which satisfy these requirements bring about a lasting change in the structure of the undertakings concerned and the relevant market.
- 2.9 Performing all the functions of an autonomous economic entity means that a joint venture must operate on a market and perform the functions normally carried out by an undertaking operating on that market. In order to do so, the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources, including finance, staff and assets (tangible and intangible), in order to conduct on a lasting basis its business activities within the area provided for in the joint venture agreement.
- 2.10 A joint venture does not perform all the functions of an autonomous economic entity if it only takes over one specific function within the parent companies’ business activities without access to or presence on the market. This is the case, for example, for joint ventures limited to research and development or production. Such joint ventures are auxiliary to their parent companies’ business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies’ products and, therefore, acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it from being considered as performing all the functions of an autonomous economic entity, as long as the parent companies are acting only as agents of the joint venture.
- 2.11 The joint venture must be intended to operate for a sufficiently long period to bring about a lasting change in the structure of the undertakings concerned. The fact that the parent companies commit to the joint venture the resources to carry out all the functions of an autonomous economic entity normally demonstrates that this is the case. However, joint ventures for a short finite duration are unlikely to be considered as creating such a

lasting change. For example, a joint venture established for a specific project which does not include ongoing operational activities is unlikely to be viewed as a merger under the Ordinance. In addition, where a joint venture's core activities depend on a third party's decision which at the time of establishment remains outstanding (e.g. a tender award, the grant of a licence, etc.), it remains unclear whether the joint venture would become operational at all. Thus, at that stage the joint venture cannot be considered to perform autonomous economic functions on a lasting basis.

- 2.12 The Commission will also take into account the presence of the joint venture's parent companies in upstream or downstream markets. Where a substantial proportion of sales or purchases between the parents and the joint venture are likely for a lengthy period and are not on an arm's length basis, the joint venture is likely to be viewed as lacking sufficient economic autonomy in its operational activities.

Acquisition of assets

- 2.13 A merger may also take place by way of acquisition of the whole or part of the assets (as opposed to control) of an undertaking, provided that such acquisition results in the acquiring undertaking being in a position to replace, or substantially replace, the acquired undertaking in the business or in part of the business concerned, i.e. the business which the acquired undertaking was engaged in immediately before the acquisition. The assets which are being acquired in a merger may include both tangible assets (such as network, equipment, customer base, etc) and intangible assets (such as licences, rights, permissions, etc).

Merger Rule applies only to a merger involving a carrier licensee

- 2.14 The Merger Rule does not apply to every merger that meets the requirements of section 3 of Schedule 7 to the Ordinance. Section 4 of Schedule 7 specifically limits the application of the Merger Rule to the following:
- (a) in a case involving amalgamation of undertakings, one or more of the undertakings participating in the merger holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence;
 - (b) in a case involving acquisition of control of undertakings, the undertaking or the person or persons acquiring control or the undertaking in which control is acquired holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence; or

- (c) in a case involving acquisition of assets, the acquiring undertaking or the acquired undertaking holds a carrier licence or, directly or indirectly, controls an undertaking that holds a carrier licence, and the relevant business conducted by the acquired undertaking immediately before the acquisition was conducted under a carrier licence.

2.15 In short, under section 4 of Schedule 7 to the Ordinance, the Merger Rule only applies where an undertaking that directly or indirectly holds a carrier licence is involved in a merger:

Transactions which are unlikely to raise competition concerns under the Merger Rule

2.16 Subject to the specific facts of the case, the Commission will normally take the view that the following transactions are unlikely to give rise to competition concerns:

- (a) the acquisition of securities in a carrier licensee or in an undertaking which directly or indirectly controls a carrier licensee on a temporary basis by:
 - (i) an authorized institution within the meaning of the Banking Ordinance (Cap. 155);
 - (ii) an insurer who is authorized within the meaning of the Insurance Companies Ordinance (Cap. 41); or
 - (iii) an exchange participant within the meaning of the Securities and Futures Ordinance (Cap. 571), or a person licensed or exempt to carry on a business in dealing in securities or securities margin financing under Part V of that Ordinance,
if:
 - (iv) the securities are acquired with a view to reselling them; and
 - (v) the authorized institution, insurer, or exchange participant, registered institution or licensed corporation (as the case may be):
 - (A) does not exercise voting rights in the securities; or
 - (B) exercises the voting rights in the securities only with a view to preparing the disposal of all or part of the securities of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be), or of the assets of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be), and the disposal takes place:
 - (l) within one year of the date of the acquisition; or

- (II) where the Commission is satisfied that the disposal is not reasonably possible within one year of the date of the acquisition, within such further period as the Commission considers appropriate;
- (b) the acquisition of control of a carrier licensee or an undertaking which directly or indirectly controls a carrier licensee by the liquidators and receivers of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be) by virtue of their offices;
- (c) the acquisition of holdings in a carrier licensee or in an undertaking which directly or indirectly controls a carrier licensee by a financial holding company. In this context, the notion of a “financial holding company” means a company whose sole object is to acquire and manage holdings in other undertakings and to turn them into profit without involving itself directly or indirectly in the management of those undertakings;
- (d) a charge⁴ over securities⁵ in a carrier licensee or an undertaking which directly or indirectly controls a carrier licensee to:
- (i) an authorized institution within the meaning of the Banking Ordinance (Cap. 155);
- if:
- (ii) the securities are charged pursuant to a deed or instrument with a view to securing a loan to the chargor, the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee or otherwise, and
 - (iii) the authorized institution,
 - (A) does not exercise voting rights in the securities or has not given notice in writing to the chargor under the charge of an intention to exercise the right to vote attaching to such voting shares; or
 - (B) having given notice in writing to the chargor under the charge of an intention to exercise the right to vote attaching to such voting shares, exercise the right to vote only to maintain the full value of the security and without directly or indirectly affecting or influencing the competitive conduct of the carrier licensee or the undertaking which directly or indirectly controls a carrier licensee (as the case may be).

⁴ “Charge” means (i) a debenture within the meaning of the Companies Ordinance (Cap. 622); (ii) a mortgage; (iii) a bill of sale; (iv) a lien; or (v) any document, under or pursuant to which a business or any assets thereof are charged as security by the chargor for the payment of money or the performance of an obligation, and includes an equitable charge.

⁵ “Securities” has the meaning assigned to it by section 1 of Part 1 in Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

2.17 In general, the Commission will not be concerned about changes in the control of undertakings which are not of a lasting nature. Changes in control of undertakings which are purely transitory in nature, for example, a transaction that is short-term and is only an intermediary step among several operations occurring in succession are unlikely to have any effect on competition in the relevant market.

Ancillary restrictions

2.18 A merger transaction can involve the acceptance of restrictions which go beyond the merger agreement itself. Such restrictions could include non-compete covenants, licences for intellectual property or purchase and supply agreements.

2.19 Where the restrictions are directly related and necessary to the implementation of the merger agreement, they will be treated as ancillary restrictions and will be assessed as part of the merger transaction under the Merger Rule. On the other hand, where the restrictions are not directly related and necessary in this sense, they will fall to be assessed under the First and/or Second Conduct Rules.

3 Competition Assessment

General overview

3.1 Merger and acquisition activities do not necessarily raise competition concerns under the Merger Rule. Indeed, mergers can be normal business activities without competition consequences that perform an important function in the efficient operation of the economy. They may allow firms to achieve efficiencies such as economies of scale or scope, synergies and risk spreading. Although some mergers may lessen competition to an extent, concerns under the Merger Rule are unlikely to arise where there are sufficient competitive constraints on the merged entity that will discipline its post-merger commercial behaviour.

3.2 However, some mergers may have the effect of changing the structure of the market in such a way that it diminishes market participants' incentives to compete. Where such an effect is likely to substantially lessen competition, the transaction will contravene the Merger Rule.

3.3 The promotion of competition in the context of the Ordinance has an economic objective to increase economic efficiencies and, ultimately, consumer welfare (typically in the form of lower prices, higher output, wider choice, better quality or more innovation). Given the economic objective, a meaningful economic framework of analysis for the assessment of a merger is needed.

3.4 It follows that an assessment of the competitive effects of a merger requires:

- (a) an identification of the relevant market(s); and
- (b) an assessment of whether the transaction has, or is likely to have, the effect of substantially lessening competition in the identified market(s).

3.5 However, the two issues identified above are not distinct and separate aspects of the analysis since many of the factors affecting the identification of the relevant market(s) will also be relevant to the assessment of the state of competition within the identified market(s).

Market definition

3.6 Proper examination of the competitive effects of a merger rests on a sound understanding of the competitive constraints under which the merged entity will operate. The scope of those constraints, if any, is identified through a market definition analysis since it offers an insight into the sources of competition to the merging parties and the alternatives available to customers. It is important to emphasise that market definition is not an end in itself. It is a framework for analysing the direct competitive pressures faced by the merged entity.

3.7 The Commission will focus its assessment on whether a merger has, or will likely to have, the effect of substantially lessening competition in the relevant market(s). The definition of a relevant market for the practical enforcement of the Merger Rule involves the same basic approach employed in defining relevant markets in other contexts.

3.8 The delimitation of relevant market(s) has two basic dimensions: product (or service) scope and geographic scope. Please refer to the *Guideline on the Second Conduct Rule* for an explanation of the Commission's methodology for identifying the scope of the relevant product and geographic markets for all purposes under the Ordinance.

3.9 In general, when assessing the potential competitive impact of a merger, the main competitive concern is whether the merger has resulted or is likely to result in an increase in prices above the prevailing level after the merger⁶.

⁶ The reference to "increase in prices" is used as a short hand reference that includes also references to adverse impact on other parameters of competition in the market such as output, product quality, product variety, and innovation.

- 3.10 For the purpose of merger analysis, market definition focuses attention on the areas of overlap in the merging parties' activities. This is particularly the case in differentiated product markets, where the merging parties' products or services may not be identical, but may still be substitutes for each other. In this context, the analytical discipline of market definition is helpful in identifying the extent of the immediate competitive interaction between the parties' products. Once the overlap in the merging parties' products or services has been identified, along with the "market" in which those products or services compete, the Commission can focus attention on the competitive assessment.
- 3.11 The approach to market definition set out in the *Guideline on the Second Conduct Rule* is a conceptual framework and is not intended to be applied mechanically. The Commission will look at the evidence which is relevant to the case in question (and, to an extent, will be constrained by the evidence available and the time reasonably available during the merger process to review the evidence). In particular it may be clear in certain cases that, although there is potentially more than one market definition, the merger would not give rise to a substantial lessening of competition based on any sensible market definition. In such cases, it will not normally be necessary to establish a final position on which of the potential market definitions is correct. It may for example be possible to conclude that even on the narrowest plausible market definition no substantial lessening of competition would result from the merger.
- 3.12 In relation to telecommunications markets specifically, they may be characterised by dynamic and rapid technological changes. In such circumstances, market boundaries are not likely to remain constant.

Indicative safe harbours

- 3.13 The objective of specifying "safe harbours" is to give guidance as to which mergers are unlikely to substantially lessen competition. They provide a screening device and are not intended as a replacement for a case-by-case analysis. If a merger falls outside the safe harbour thresholds, it is not necessarily an indication that the transaction would substantially lessen competition in a market for the purposes of the Merger Rule. It merely indicates that further inquiry may be made by the Commission to assess the extent of any potential anti-competitive effects. The Commission may conclude after further investigation that the transaction would not be likely to substantially lessen competition. In general, for a horizontal merger where the post-merger combined market share of the parties to the transaction is 40% or more, it is likely that the merger will raise competition concerns and the Commission is likely to make a detailed investigation of the transaction.

- 3.14 The Commission has identified two safe harbour measures that it intends to apply concurrently, thereby expanding the effective coverage of the indicative safe harbour mechanism beyond a single measure. A merger that meets either one of the safe harbour measures will fall within the safe harbour. The application of these safe harbour measures requires identification of the relevant market and the respective market shares of the players in the relevant market.
- 3.15 The first safe harbour measure is based on concentration ratios. These ratios measure aggregate market shares of the leading firms in the relevant market. The Commission intends to apply a test based on a four-firm concentration ratio. If the post-merger combined market share of the four (or fewer) largest firms ("**CR4**") in the relevant market is less than 75%, and the merged firm has a market share of less than 40%, the Commission takes the view that it is unlikely that there will be a need to carry out a detailed investigation or to intervene. Where the CR4 is 75% or more, the Commission is unlikely to investigate the transaction if the combined market share of the merged entity is less than 15% of the relevant market.
- 3.16 The second safe harbour measure is based on the Herfindahl-Hirschman Index ("**HHI**"). The HHI measures market concentration. It is calculated by adding together the squares of the market shares of all the firms operating in the market. The increase in the HHI resulting from the merger is calculated by subtracting the pre-merger index from the expected value of the HHI following the merger, the difference being known as the "delta." Both the absolute level of the HHI and the expected change resulting from the merger can provide an indication of whether a merger is likely to raise competition concerns.
- 3.17 In respect of the application of HHI, any market with a post-merger HHI of less than 1,000 will be regarded as unconcentrated. Mergers resulting in unconcentrated markets are unlikely to result in a substantial lessening of competition and normally require no further investigation.

- 3.18 Markets with a post-merger HHI of between 1,000 and 1,800 will be regarded as moderately concentrated. Mergers producing an increase in the HHI of less than 100 in these markets are unlikely to result in a substantial lessening of competition and normally require no further investigation. However, mergers producing an increase in the HHI of more than 100 potentially raise competition concerns and will normally require further investigation.
- 3.19 Markets with a post-merger HHI of more than 1,800 will be regarded as highly concentrated. Mergers producing an increase in the HHI of less than 50 are unlikely to substantially lessen competition, even in a highly concentrated market. Mergers producing an increase of more than 50 in the HHI will potentially raise competitive concerns and will normally require further investigation.
- 3.20 These two safe harbours are indicative in nature. While the Commission is unlikely to further assess any mergers which fall below these thresholds, it does not categorically rule out intervention. Occasionally, such mergers may still raise competition concerns, for example where it involves a vertically integrated firm with market power in a related upstream or downstream market.

Assessment of the level of competition after a merger

- 3.21 Where the safe harbour thresholds are not satisfied, or the Commission otherwise considers that a detailed investigation into the merger is necessary, the next issue is to assess the level of competition following the merger.
- 3.22 Market structure comprises those factors that influence the level of competition in a market. Competition in a market is influenced by the structural features of the market such as market shares, market concentration, barriers to entry, vertical integration, buying power and import competition. A merger, by its nature, will change the market structure.
- 3.23 For non-structural factors, one that may be particularly relevant is the “strategic behaviour” of firms. Such strategic behaviour is directed at altering the market structure itself (for example, by raising barriers to entry) and in this sense goes beyond the normal competitive rivalry between firms.

3.24 Accordingly, the Commission will take into account structural factors and non-structural factors such as strategic behaviour, when assessing the level of competition in a market and the likely effect the merger would have on that level of competition. In this way, the Merger Rule ensures that market structures which are likely to harm competition are not created.

Relevant analytical issues

3.25 Before entering into a discussion of the particular factors that the Commission will generally take into account in analysing the competitive effects of a merger, several analytical issues that are considered relevant to any merger analysis are discussed below.

Protection of the process, not the competitor

3.26 Competition in a market is essentially a dynamic process rather than a static situation where particular conduct may competitively disadvantage a particular competitor at a particular time. Competition by its very nature is a deliberate and at times ruthless process as competitors jockey for position. This is as true for mergers as it is for any other forms of market conduct.

3.27 That a particular competitor may be injured or competitively disadvantaged at a particular time does not necessarily lessen competition in a market, let alone substantially (the test of substantiality is discussed below). Indeed, it may be the epitome of the competitive process. As part of the process, disadvantaged competitors would be expected to respond to any competitive initiatives in the market. It is only when they are unable to respond as a direct consequence of the merger in question that concerns arise about the effects on the competitive process in a market.

Substantiality test – creation or enhancement of market power

3.28 The relevant test to be applied for the Merger Rule is whether the merger has, or is likely to have, the effect of substantially lessening competition in Hong Kong. The focus of the Commission's assessment is the likely competitive effects the merger has on the relevant market(s) in Hong Kong.

3.29 The term “substantial” is useful in avoiding application of the regime to situations where there are limited effects on the competitive process, such as may occur when there is day-to-day injury to individual competitors but the competitive process within the relevant market remains strong.

3.30 The Commission will generally interpret a substantial lessening of competition by reference to the creation or enhancement of market power. A merger creates or enhances market power if it is likely to encourage one or more firms to raise price, reduce output, limit innovation, or otherwise harm consumers as a result of diminished competitive constraints or incentives.

3.31 In assessing a merger, the Commission will consider whether a merger creates or enhances market power. If there is a reasonable likelihood that prices in the relevant market will be maintained at a significantly greater level than would be the case in the absence of the merger, or where competitive outcomes would be otherwise distorted such as reduction in consumer choice, product quality or innovation in a relevant market, the Commission will consider that the merger substantially lessens competition in contravention of the Merger Rule.

Exercise of market power: unilateral and coordinated effects

3.32 A horizontal merger may lessen competition in two ways, in terms of creating unilateral effects and coordinated effects. A single merger may raise both types of effects.

3.33 *Unilateral effects* may arise in a merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to reduce output or otherwise exercise market power it has gained, even given the expected responses of other market participants to the resulting change in market conditions.

3.34 *Coordinated effects* take place where the merger increases, enables or encourages post-merger coordinated interaction among the firms in the market. Coordinated interaction involves conduct by multiple firms that is profitable for each of them only as a result of the accommodating reactions of others. These reactions can blunt a firm's incentive to offer customers better deals by undercutting the extent to which such a move would win business away from rivals. They also can enhance a firm's incentive to raise prices, by assuaging the fear that such a move would lose customers to rivals. Coordinated interaction can involve the explicit negotiation of a common understanding of how firms will compete or refrain from competing – such conduct typically would also contravene the First Conduct Rule. Coordinated interaction alternatively can involve parallel accommodating conduct not pursuant to any prior understanding, which can still have the effect of dampening competition. Conditions conducive to coordination typically include concentrated markets, product homogeneity and transparent pricing.

3.35 Coordinated effects can be disrupted by the presence of a “maverick” firm, a firm which has the economic incentive not to follow coordinated action. A firm is more likely to be a “maverick” if it has excess capacity (a feature of some telecommunications markets) and low incremental costs (thus making it profitable to charge low prices). It is a feature of network industries, including telecommunications, that services which are provided over networks tend to have low incremental costs. However, excess capacity amongst the remaining coordinated firms may be used as an effective weapon to “punish” a “maverick” firm.

With-and-without test

- 3.36 In assessing whether competition is likely to be substantially lessened by a merger, the Commission will usually employ an analytical tool called the “with-and-without” test. That is, the level of competition that is likely to exist in a market with the merger will be assessed and compared with the level of competition that is likely to exist in the market without the merger. The competitive situation without the merger is referred to as “the counterfactual”. This analysis will be applied prospectively, that is, future competition will be assessed with and without the merger.
- 3.37 In most cases, the best guide to the appropriate counterfactual will be prevailing conditions of competition, as this may provide a reliable indicator of future competition without the merger. However, the Commission may need to take into account likely and imminent changes in the structure of competition in order to reflect as accurately as possible the nature of rivalry without the merger. For example, in cases where one of the parties is failing, pre-merger conditions of competition might not prevail even if the merger were prohibited. The Commission will not, however, apply the “with-and-without” test relying on agreements or conduct that would contravene the Ordinance: only lawful prospective options are relevant.

Market share and market concentration

- 3.38 Market share refers to the share of a market that a particular firm has. It is usually measured in terms of sales volume or revenue. The latter is a particularly useful indicator of market shares in markets characterised by product differentiation and brand loyalty. In telecommunications markets, the number of subscribers, call minutes, data volume, etc. are obvious measures of sales volume. Transmission capacity or bandwidth may be a relevant form of volume measurement when the transmission service is largely commoditised or undifferentiated. Capacity or reserves may also be useful as a measure of market share in markets where there is volatility in market shares measured in terms of sales volume or revenue.
- 3.39 Market concentration refers to the degree to which a market is composed of a small number of large firms or made up of many small firms. In general, an unconcentrated market may be more competitive than a concentrated market. A merger which results in the merged entity holding large market share and increases the level of market concentration may lessen the level of competition.
- 3.40 High market shares and concentration levels as a result of a merger are generally necessary but not sufficient conditions for the creation or enhancement of market power that may lead to a contravention of the Merger Rule. On the other hand, a merged firm with only small market share in a relatively unconcentrated market would not normally be able to exercise market power and thus is less likely to contravene the Merger Rule.
- 3.41 As information on market shares and concentration levels is more readily obtainable for a pre-merger situation, thresholds on market shares and concentration levels are simple means of screening-out mergers that are not likely to lessen competition (see paragraphs 3.13 to 3.20). Post-merger information by its nature is prospective and may be based on a number of assumptions on future market structure. As a starting point, post-merger market shares and concentration ratios will be estimated on the basis of historic sales patterns and trends. This is likely to be more informative than considering market shares at a single point in time (which might hide the dynamic nature of the market). The Commission will then consider any submissions as to how these trends may vary, such as through the introduction of new, innovative services or technology.

3.42 The actual volume or revenue measure used for market share calculation will depend on the characteristics of the product in question. The choice of measure may also be constrained by the availability of reliable data. For example, in telecommunications, retail revenues, call minutes or numbers of subscribers are possible measures for measuring market share of telecommunications operators.⁷

Prices and profit margins

3.43 The Commission will consider the likelihood of a merger resulting in the merged firm being able to significantly and sustainably increase prices or profit margins.

3.44 Sustained price increases above competitive levels are the most visible sign that the merged firm has increased its market power and there is a substantial lessening of competition in the market. The price increase may be used to protect inefficient operations rather than to accumulate excess profits. Another possibility is that a merger, instead of increasing prices, may prevent prices from falling to the competitive level by forestalling entry such that profit margins are preserved or even increased.

3.45 Cost reductions which are claimed to result from the merger may not result in lower prices to consumers because the savings may accrue as increased profits.

Relevant matters that may be considered in determining whether competition is substantially lessened

3.46 Section 6 of Schedule 7 to the Ordinance provides a non-exhaustive list of the relevant matters that may be taken into account in determining whether a merger has, or is likely to have, the effect of substantially lessening competition in Hong Kong:

“(a) the extent of competition from competitors outside Hong Kong;

(b) whether the acquired undertaking, or part of the acquired undertaking, has failed or is likely to fail in the near future;

⁷ Reference may be made to the Final Decision of the Communications Authority in April 2014, on the Application for Prior Consent under Section 7P of the Telecommunications Ordinance in respect of the Proposed Acquisition of CSL New World Mobility Limited by HKT Limited (http://www.coms-auth.hk/filemanager/statement/en/upload/270/decision_20140502_e.pdf), where the CA looked at market shares in the retail mobile telecommunications services market from different perspectives, including market share by subscribers (which was further subdivided into market share of all subscribers and market share of 3G/4G subscribers), and market share by revenue (which was further subdivided into voice revenue, non-voice revenue, total revenue minus handsets, and total retail revenue). In that Decision, assessing market shares from different perspectives enabled the CA to have a more all rounded view of the competitive position of the mobile network operators in the market identified.

- (c) *the extent to which substitutes are available or are likely to be available in the market;*
- (d) *the existence and height of any barriers to entry into the market;*
- (e) *whether the merger would result in the removal of an effective and vigorous competitor;*
- (f) *the degree of countervailing power in the market; and*
- (g) *the nature and extent of change and innovation in the market.”*

Extent of competition from competitors outside Hong Kong

- 3.47 In an open economy such as Hong Kong, competition from competitors outside Hong Kong, so called “import competition”, can play an important role in restraining the exercise of market power. An example of import competition in the telecommunications industry is the provision of international telephone services to Hong Kong users by service providers operating outside Hong Kong. In considering the effectiveness of import competition as a restraint to the exercise of market power, the capacity of supply of overseas suppliers and speed of entry into the domestic market have to be considered.
- 3.48 In most segments of the telecommunications industry where physical presence in Hong Kong is necessary for the supply of services, the threat of import competition may not be relevant.

Failing firms

- 3.49 At first glance, one would expect that the acquisition of a failing or failed firm would not substantially lessen competition. In some instances this may be the case. However, there may be circumstances where the acquisition of a failing firm may substantially lessen competition.
- 3.50 It is considered that the acquisition of a failing or failed firm would be unlikely to substantially lessen competition in cases where:
- (a) the firm is likely to experience commercial failure, if the firm has not already failed;
 - (b) without the acquisition, the assets of the firm will exit the market; and
 - (c) the firm has made unsuccessful, good-faith efforts to elicit reasonable alternative offers to acquire its assets that would keep those assets in the market and would pose a less severe danger to competition.

- 3.51 If all three conditions are satisfied, then subject to the considerations in the following paragraph, the competitive effects of the firm being acquired by the acquirer are likely to be no worse than if the assets were allowed to exit the market, consistent with the “with-and-without” test discussed in paragraph 3.36. A competitive influence that would otherwise have been removed by failure is to be removed by acquisition. Thus, in the absence of other considerations, the acquisition would be unlikely to cause concerns under the Merger Rule.
- 3.52 One issue that may arise in this scenario, however, is the distribution of the failing firm’s customer base if this base is significant in terms of market share. If the assets exited the market, the distribution of the failing firm’s customer base among the remaining market participants would be determined by market forces, whereas an acquisition would tend to deliver those customers to the acquiring firm thus increasing its market share.

Extent to which substitutes are available

- 3.53 In considering the extent to which substitutes are available in the market, both existing and potential substitutes from the supply side and the demand side will be included. In considering the extent to which substitutes are available, the Commission may also consider the price elasticity of supply of the firms in the market post-merger. Unless the producers of the substitutes are able to increase supply to meet the demand of customers of the merged firm who intend to switch suppliers in response to a material price increase of the merged firm, the existence of substitutes in the market would not be an effective restraint to the exercise of market power by the merged firm. It may therefore be necessary to consider the relative supply capacity of the firms in the market after the merger, as well as the costs of capacity expansion. If the merged firm ends up controlling a majority of the capacity in the market, other firms in the market may not be able to provide much competitive restraint.

Barriers to entry or expansion

- 3.54 An important factor influencing the level of competition in a market is the height of barriers to entry/expansion of rivals, for the threat of entry/expansion of rivals is often viewed as the ultimate regulator of competitive conduct even if the merged firm currently has a high market share.

3.55 Barriers to entry/expansion of rivals are essentially any market features that prevent an efficient prospective new entrant from entering the market or an existing player in the market from expanding in the market, or otherwise place them at a significant competitive disadvantage to incumbents. They may arise from a variety of sources, from regulatory restrictions to economic factors or from the conduct of the merging parties to the behaviour of third parties. Barriers to entry/expansion of rivals can reduce the prospects of competitive entry by new entrants or expansion of rivals, with the consequence that incumbents are less constrained by the threat of new entry or expansion of rivals to behaving competitively.

3.56 Recognised barriers to entry for the purposes of the Merger Rule include sunk costs, economies of scale and scope, network effects, strategic behaviour, product differentiation and brand loyalty, essential facilities and regulatory or legal barriers. Sunk costs and economies of scale and scope are particular features of telecommunications markets and other network-based markets. These structural barriers to entry can be contrasted with strategic behaviour as a barrier to entry, which will be discussed separately. Paragraphs 3.57 to 3.70 set out the Commission's approach to barriers to entry in the context of the Merger Rule with particular relevance to the telecommunications sector. Additional guidance on barriers to entry is provided in the *Guideline on the Second Conduct Rule* in the context of assessing substantial market power.

Barriers to entry – structural

3.57 Market entry in certain markets such as telecommunications typically involves significant sunk costs. Sunk costs are the costs of acquiring capital and other assets that:

- (a) are uniquely incurred in entering the market and supplying the services in question;
- (b) cannot be economically recouped within a short period of time; and
- (c) once incurred, cannot easily be physically recovered and redeployed in another market.

3.58 Because of their nature, sunk costs create entry risks which increase with the significance of the costs. In turn, significant risks can create significant barriers to entry. The extent of sunk costs depends on a number of factors such as the proportion of capital involved, the requirements for advertising and promotion to create brand awareness, etc.

- 3.59 An example of significant sunk costs typically incurred in telecommunications is the cost of network roll-out (e.g. installing radio base stations, core network equipment, antennae, etc), a cost which cannot be recovered or easily recouped if the new entrant decides to exit the market within a short period. Accordingly, firms considering entry into the market with significant sunk costs must assess the profitability of entry on the basis of long-term participation in the market until the sunk capital and assets are economically depreciated. In certain circumstances, the cost of providing a new service may also involve costs which cannot be recovered or easily recouped.
- 3.60 With economies of scale and scope, average costs fall as the supply of services or range of services supplied increases respectively. Falling costs are likely to increase barriers to entry where there are minimum efficient scales for entry.
- 3.61 When combined with sunk costs and excess capacity, the effect of economies of scale in particular can create significant barriers to entry. Having sunk the infrastructure costs, there are incentives for incumbents in situations of excess capacity to reap the economies of scale to drop prices and gain necessary revenue flows. Even without any strategic purpose, such action can significantly deter new entrants (as discussed below, such action may indeed be accompanied with that strategy in mind).
- 3.62 Closely related to economies of scale are network effects. By its nature, telecommunications is essentially a network industry and a feature of networks is that they generate network effects (or externalities). Network effects arise when the value a consumer places on connecting to a network (as measured by the price one is willing to pay) depends on the number of others already connected to it. They are a form of economies of scale, but on the demand side.
- 3.63 Network effects generate “positive feedback” or advantages for incumbents whereby the bigger networks get bigger (and, on the negative side, the weak get weaker). Unrestrained positive feedback can result in the market “tipping” in favour of one competitor and a “winner-takes-all” market outcome. Particularly when combined with economies of scale on the supply side, network effects can create significant barriers to entry.

- 3.64 Reputational barriers established by brand loyalty to incumbents (which may in themselves be a strategic barrier to entry) may add to the sunk costs faced by a new entrant in the form of advertising and promotion costs. The ongoing investment in advertising and promotion that is required to maintain a differentiated product will accentuate sunk costs. The nature and extent of the barriers created by brand loyalty and product differentiation can be conceptualised as an investment in sunk costs that is required to shift demand to an unknown brand and create a new differentiated market niche.
- 3.65 In some cases, entry to a market might require the use of an essential facility, an asset or infrastructure where: (1) access to it is indispensable in order to compete in the market; and (2) duplication of the facility is impossible or extremely difficult owing to physical, economic or legal constraints, or is highly undesirable for reasons of public policy.
- 3.66 Denial of access to essential facilities is thus capable of constituting a significant barrier to entry, particularly in the telecommunications industry where access to customers in certain situations has to go through a “bottleneck” or “essential facility”. However, the potential for essential facilities to act as a barrier to entry can be alleviated by effective regulatory regimes for the interconnection and sharing of bottleneck facilities.⁸

Barriers to entry – strategic behaviour

- 3.67 The most important non-structural factor, when assessing barriers to entry, is what is generally referred to as strategic behaviour. This is broadly defined as any actions by a firm to alter the market structure, and so alter the conditions and levels of competition (for example, by raising barriers to entry). As such, it goes beyond the normal competitive rivalry between firms.
- 3.68 Strategic advantages can arise where incumbent firms have advantages over new entrants because of their established position. This is known as the first-mover advantage. Strategic (first mover) advantages are available to incumbent firms because they are already established in the market and therefore might enjoy advantages over recent or potential new entrants. These advantages could be used by incumbents to raise the barriers to entry, and can involve strategic behaviour designed to deter entry to the market.

⁸ The regulation of such telecommunications facilities is separately overseen by the CA as a sector regulator under the TO.

- 3.69 An example of strategic behaviour which would raise the barriers to entry is where an incumbent firm decides to build excess capacity so as to send credible signals to potential entrants that it could profitably (with economies of scale and low marginal costs) push prices down to levels such that new entrants would not earn sufficient revenue to cover their sunk costs.
- 3.70 An incumbent firm can act strategically to create barriers to entry which can be as effective as any traditional structural barriers to entry described in the previous section. These are sometimes described as strategically erected barriers to entry.

Removal of a close competitor

- 3.71 By its nature, a horizontal merger will usually remove a competitor from the market. However, the resulting higher market shares of the merged entity and increased concentration levels are generally necessary, but not sufficient, conditions for the creation or enhancement of market power that may lead to a contravention of the Merger Rule. A factor which may provide guidance on whether market power is created or enhanced is whether the merger results in the removal of a close competitor. The higher the degree of substitutability between the merging firms' products, the higher the degree of closeness of competition between them, and the more likely it is that the merging firms will raise prices significantly. For example, a merger between two undertakings offering products which a substantial number of customers regard as their first and second choices could generate a significant price increase.
- 3.72 Beyond removing a close competitor, the merger may create a market structure which is conducive to coordinated action or tacit collusion. Effective and vigorous competitors, otherwise known in this context as "maverick" firms, serve to undermine attempts to coordinate conduct in a market. The role of mavericks has been discussed above in respect of the unilateral and coordinated exercise of market power:

Buying power or countervailing power

- 3.73 Market power can be exercised on the demand-side by monopsonists or groups of buyers acting together to depress prices below their competitive levels. The effects are comparable to those associated with the exercise of market power on the supply-side. Additional guidance on countervailing buyer power is provided in the *Guideline on the Second Conduct Rule* in the context of assessing substantial market power:

3.74 Market power on the buying side is relevant in two principal ways under the Merger Rule. First, it may make a finding of substantial lessening of competition less likely if customers can use their negotiating strength to limit price rises. Second, the existence of buyer power may contribute to a finding of a substantial lessening of competition where the merging firms purchase similar products and the merger would create or strengthen post-merger buyer power.

3.75 Generally, the market power (sometimes referred to as buying or bargaining power) must be supported by a credible threat to bypass the supplier if no acceptable deal can be bargained. This may not always be the case in telecommunications when the existence of alternative suppliers may be constrained by the presence of bottleneck or essential facilities, particularly the network to which the originating or terminating customers are directly connected. While it may not be common in telecommunications, should it occur, the Commission will assess the effects of any demand-side market power in an analogous fashion to assessing supply-side market power.

Nature and extent of change and innovation in the market

3.76 The Ordinance indicates that the nature and extent of change and innovation in the market may be a relevant factor when determining whether a merger is or likely to have the effect of substantially lessening competition. While price competition is a central concern of merger control, non-price competition, and in particular reductions in innovation levels, may also be a source of legitimate concern. In general, the analysis of innovation issues involves the application of the “with-and-without test” described at paragraph 3.36, that is to compare pre and post-merger innovation levels and, if there is any material change, to assess the effect on competition of the posited reduction in innovation.

Additional relevant matters for vertical mergers

3.77 A vertical merger is the integration of two functional levels in the supply chain. Vertical mergers can often be pro-competitive as it allows firms to generate efficiencies, particularly through savings on transaction costs and the achievement of economies of scale.

- 3.78 In industries with high sunk costs such as telecommunications, vertical mergers can also help reduce the risk of investment. For example, a provider of telecommunications services carried over someone else's network may wish to integrate with upstream network operation in order to reduce the risk of being held captive by the network owner.
- 3.79 More fundamentally, a vertical merger is less likely to be anti-competitive than a horizontal merger because in a vertical merger, the two merging firms will generally supply complementary products whereas in a horizontal merger the parties will supply substitute products in the same market.
- 3.80 There are two main possible theories of harm for unilateral effects under a vertical merger. Competitors at a downstream functional level (e.g. retail telecommunications service providers) may have to rely on the supply of an input at an upstream level (e.g. reliance on an upstream network provider to carry their downstream services). Where a vertical merger takes place, the merged entity may have the ability and incentive to foreclose downstream non-integrated rivals' access to the supply of such an input. This is known as input foreclosure theory of harm. The other theory of harm, known as customer foreclosure, may result from a vertical merger when a supplier integrates with an important customer in the downstream market. Such downstream presence of the merged entity may enable it to foreclose access to a sufficient customer base by its actual or potential rivals in the upstream market (the input market) thereby reducing their ability or incentive to compete.
- 3.81 Where there is market power at one functional level, there may be incentives to leverage that market power into the vertically-related market for anti-competitive purposes.
- 3.82 The leverage, for example, may take the form of refusing access to an essential facility that the merged firm has recently acquired control of through the merger so as to foreclose competition in a downstream market where it faces competition. Alternatively, access may be supplied only on discriminatory or competitively disadvantageous terms (either actual discrimination or concealed discrimination), thus raising its downstream rivals' costs.

3.83 To profitably engage in a foreclosure strategy, one must have market power in the relevant market from which to leverage the strategy. Otherwise downstream competitors relying on the upstream facilities firms would simply bypass the facilities and seek better terms elsewhere in the upstream market (unless the market power is exercised through coordinated action). It may also be relevant to ask in this connection whether the input in question represents a material proportion of the total costs of the final product and whether cost increases are likely to be passed on in whole or in part to purchasers of the final product. Anti-competitive foreclosure concerns are more likely to arise if the answer to one or both of these questions is affirmative.

3.84 Accordingly, in assessing a vertical merger for its likely anti-competitive effects, the Commission will particularly inquire as to whether:

- (a) there is market power at one or more of the functional levels involved in the merger;
- (b) there are incentives to leverage that market power into the upstream or downstream market with the purpose of lessening or foreclosing competition in that market (i.e. where the merged firm operates in a competitive upstream or downstream market);
- (c) the market power is likely to be leveraged (for example, where raising rivals costs in downstream markets through discriminatory access pricing would be profitable and would lessen competition); and
- (d) the effect is likely to substantially lessen competition in that market.

3.85 A vertical merger may also bring about coordinated effects. For example, a vertical merger may increase the degree of symmetry between firms active in the market. This may enhance the likelihood of coordination by making it easier for the firms in the market to achieve a common understanding on the terms of coordination.

4 Exclusions and Exemptions

4.1 The Ordinance provides for certain exclusions and exemptions from the Merger Rule, which are explained in this part of the Guideline.

Exclusion – outweighing economic efficiencies

- 4.2 Section 8(1) of Schedule 7 to the Ordinance provides that the Merger Rule does not apply to a merger if the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition in Hong Kong. Section 8(2) of Schedule 7 to the Ordinance indicates that the undertaking(s) claiming the benefit of this exclusion has/have the burden of proving the claim.
- 4.3 Analysing whether the economic efficiencies that arise or may arise from the merger outweigh the adverse effects involves a net economic benefit analysis. The aim of the analysis is to isolate and ascertain the objective benefits created by the merger and the economic importance of such efficiencies. The efficiencies are not assessed from the subjective viewpoint of the parties.
- 4.4 There are generally three types of economic efficiencies:
- (a) productive efficiency, which is achieved where a firm produces the goods and services that it offers to consumers at the lowest cost;
 - (b) allocative efficiency, which is achieved where resources in the economy are allocated to their highest valued uses (i.e. those that provide the greatest benefit relative to costs); and
 - (c) dynamic efficiency, which is achieved through an ongoing process of introducing new technologies and products in response to changes in consumer preferences and production techniques.
- 4.5 In relation to productive and dynamic efficiencies, competition seeks to achieve these efficiencies organically or internally within a firm. However, mergers also have a potential to generate significant efficiencies by permitting a better utilisation of existing assets and the realisation of economies of scale and scope which would not have been available (or available to the same extent) to either firm without the merger.
- 4.6 Efficiencies generated through a merger can enhance the merged firm's ability and incentive to compete. For example, merger generated efficiencies may enhance competition by permitting two ineffective high-cost competitors to become one effective low-cost competitor. If the efficiency gains attributable to a merger would transform the merged entity into a more vigorous competitor, competition in the market as a whole would be increased rather than lessened by the merger.

- 4.7 Furthermore, in markets with conditions conducive to coordinated conduct, an efficiency-enhancing merger can undermine those conditions by increasing the incentive for a “maverick” to break from the pack or, indeed, by creating a new “maverick” firm.
- 4.8 Any undertaking claiming the benefit of the outweighing economic efficiency exclusion must show that the efficiency gains occur as a direct result of the merger. Further, the efficiencies must be clearly identified and verified. It must also be demonstrated that the efficiencies will be achieved (or achieved to a similar extent) by the merger and would be unlikely to have been achieved (or achieved to a similar extent) without the merger (for example, internal re-organisation) or by another means having less significant anti-competitive effects. But the less restrictive alternative must be something that is likely to be practical for firms in the market and not merely a theoretical possibility.
- 4.9 Efficiencies are often difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realised. Therefore, undertakings must do more than assert the claimed efficiencies. They must be able to demonstrate that the efficiencies are timely, likely and sufficient to outweigh the adverse effects caused by any lessening of competition. Efficiency claims must be substantiated by the merging parties so that the Commission can verify by reasonable means:
- (a) the likelihood and magnitude of each claimed efficiency;
 - (b) how and when each efficiency would be achieved;
 - (c) how each efficiency would enhance the merged firm’s ability and incentive to compete;
 - (d) why each efficiency would be merger-specific; and
 - (e) how the efficiencies would outweigh the adverse effects caused by any lessening of competition.
- 4.10 Certain types of efficiencies are more likely to be identifiable and more substantial than others. In general, cost reductions ought to be capable of verification without excessive difficulty. For example, efficiencies resulting from the shifting of telecommunications traffic from formerly separately owned networks onto the one network may result in a reduction in marginal costs which are merger-specific, identifiable and quantifiably substantial. Other efficiencies, such as those relating to research and development, are

potentially substantial but are generally less verifiable. Others, such as those relating to procurement, management, or capital cost, are less likely to be merger-specific or substantial, or may not be as identifiable.

- 4.11 The Ordinance provides for a mechanism for parties to a merger to apply for a decision of the Commission as to whether the merger is excluded from the Merger Rule on the basis that the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition. The procedures for making such an application are explained in paragraphs 5.16 to 5.24.

Public Policy Exemption

- 4.12 Pursuant to section 9 of Schedule 7 to the Ordinance, the Chief Executive in Council may, by order published in the Gazette, exempt a specified merger or proposed merger from the application of the Merger Rule if he or she is satisfied that there are exceptional and compelling reasons of public policy for doing so. Such an exemption may be subject to any conditions or limitations that the Chief Executive in Council considers appropriate.

Exclusion from the merger rule for statutory bodies or specified persons and persons engaged in specified activities

- 4.13 The Merger Rule does not apply to a statutory body as defined in section 2(1) of the Ordinance, unless it is specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance that, *inter alia*, the Merger Rule applies to the statutory body, or to the statutory body to the extent that it is engaged in an activity specified in the regulation under section 3 of the Ordinance.
- 4.14 The Merger Rule also does not apply to a person specified in a regulation made by the Chief Executive in Council under section 5 of the Ordinance, which provides that, *inter alia*, the Merger Rule disapplies to such specified person, or to such specified person to the extent that the person is engaged in an activity specified in the regulation pursuant to section 4 of the Ordinance.

5 Procedures and Enforcement

No requirement to notify a merger

- 5.1 There is no requirement to notify the Commission of a merger falling within the Merger Rule. The Commission will keep itself informed about merger activities for example by monitoring the media and/or through information or complaints from third parties, such as competitors, to bring transactions to its attention. Under section 7(1) of Schedule 7 to the Ordinance, the Commission may commence an investigation of a merger within 30 days after the day on which the Commission first became aware, or ought to have become aware, that the merger has taken place. As detailed in sections 99 and 100 and in Schedule 4 to the Ordinance, if the Commission, after carrying out an investigation, has reasonable cause to believe that a merger contravenes the Merger Rule, it may, within six months after the day on which the merger was completed or the Commission became aware of the merger (whichever is the later), bring proceedings in the Tribunal seeking orders to unwind the merger in relation to a completed merger. In relation to an anticipated merger, the Commission under section 97 to the Ordinance may also bring proceedings in the Tribunal seeking to stop the merger process.
- 5.2 As a merger may be subject to investigation by the Commission, and proceedings in the Tribunal (which has the power to effectively unwind a completed merger or stop the merger process in case of an anticipated merger), it may be in the interest of the parties to a merger to contact the Commission at an early stage to understand whether the Commission has any concerns about a proposed transaction. Such contacts in advance may enable the parties to identify any potential competition concerns and to address the issues in good time, as well as to minimise the risk that proceedings are brought by the Commission before the Tribunal.
- 5.3 Parties are therefore encouraged to contact the Commission at the earliest opportunity to discuss a proposed merger that falls within the Merger Rule, where they may seek the Commission's informal advice on the transaction. Parties will proceed at their own risks where they choose not to notify the Commission of a proposed merger in advance. Details of the procedures for seeking the informal advice from the Commission are provided at paragraphs 5.4 to 5.8 below.

Voluntary notification of a proposed merger for informal advice

- 5.4 To assist merging parties and their advisers when planning mergers, the Commission is willing to provide informal advice on a proposed merger on a confidential basis. Since the advice would be given without the benefit of any third party views being made known to the Commission, the advice would not be binding on the Commission in any way. It would simply be a preliminary view of the Commission as to whether the proposed merger is likely to raise competition concerns. The advice would be confidential to the party requesting it and the Commission requests the party concerned (and its advisers) to agree not to publish the advice or to disclose it in any other way without the Commission's prior consent, whether or not the proposed merger has been made public or is completed.
- 5.5 There is no timetable for providing informal advice, but the Commission will try to deal with requests in an efficient and timely manner and within the parties' requested time frame, where that is possible.
- 5.6 Before deciding whether to submit a notification of a proposed merger for informal advice from the Commission, parties to a merger may apply the safe harbours set out in paragraphs 3.13 to 3.20 to self-assess whether the merger transaction in contemplation may potentially raise competition concerns. It should however be emphasised that meeting one or both of the safe harbour thresholds does not necessarily mean that the proposed transaction does not give rise to competition concerns. The Commission may still commence an investigation in appropriate circumstances. Parties considering application for informal advice are encouraged to contact the Commission at an early opportunity to discuss the content, timing and scope of information that they may be required to provide.
- 5.7 While the Commission does not wish to be entirely prescriptive as to what information it would require in this regard, it would expect parties to provide some evidence that either the heads of agreement, term sheet, or sale and purchase agreement are in place. Parties may make reference to the type of information listed in Form M⁹, to the extent where it is applicable, when submitting their notification. The Commission may require the parties to provide additional information as necessary to enable it to conduct a review of the proposed merger.

⁹ Form M is available at the CA's website (www.coms-auth.hk).

5.8 After reviewing the information provided, the Commission will advise the parties requesting the advice whether the proposed merger is likely to give rise to concerns under the Merger Rule, on a non-binding and confidential basis. In the event that the Commission is of the view that the proposed merger may likely give rise to concerns under the Merger Rule, the Commission may commence an investigation if the parties intend to proceed with the merger nonetheless (see paragraphs 5.25 to 5.28). The parties concerned may wish to explore possibilities of offering Commitments to the Commission in return for the Commission not taking enforcement actions (see paragraphs 5.9 to 5.15), or assess whether there are justifiable circumstances for them to apply for a decision from the Commission that the merger is excluded from the Merger Rule (see paragraphs 5.16 to 5.24).

Acceptance of Commitments

5.9 Section 60 of the Ordinance provides that the Commission may accept from a person a Commitment to take any action or refrain from taking action that the Commission considers appropriate to address its concerns about a possible contravention of, *inter alia*, the Merger Rule, in return for the Commission's agreement not to commence an investigation or bring proceedings in the Tribunal, or to terminate any investigation or proceedings that has been commenced.

5.10 Section 60 thus provides for an opportunity to the parties to a merger to offer remedies to address the competition concerns that the Commission may identify in relation to a merger or proposed merger; in return for the Commission not taking, or ceasing, enforcement actions against them. Such circumstances may arise, for example, where parties to a proposed merger have notified the transaction to the Commission for an informal advice, and the Commission is of the view that the proposed merger raises certain competition concerns and intends to take further action were the proposed merger to proceed.

- 5.11 In order for the Commission not to take, or to cease, enforcement actions, the remedies offered by the parties to a merger or proposed merger as Commitments should be able to eliminate or avoid the effect of substantially lessening competition in a relevant market that is, or is likely to be, brought about by the merger or proposed merger. The Commission will consider accepting both structural and/or behavioural remedies.
- 5.12 In general, structural remedies will be preferred by the Commission as they are more able to deal with the competition concerns identified at source, by re-establishing the structure of the market expected in the absence of the merger to restore the process of rivalry, and do not generally require ongoing monitoring activity. Behavioural remedies, on the other hand, are less likely to address competition concerns arising from a merger or a proposed merger as comprehensively as structural remedies, may result in distortions compared with a competitive market outcome, and are generally subject to the disadvantage of requiring ongoing monitoring and compliance activity.
- 5.13 Structural remedies could include divestment of part of the merged business through the disposal of assets or shares. Typically this might involve an overlapping business. The Commission would require the disposal to be made within a specified time limit.
- 5.14 In appropriate cases, behavioural remedies may be accepted where the Commission wishes to ensure that the merged entity does not behave in an anti-competitive way after the merger. For example, the parties may be required not to undertake a particular course of conduct made possible by the merger.
- 5.15 Under Schedule 2 to the Ordinance, before accepting a Commitment, the Commission must give notice of the proposed Commitment in any manner it considers appropriate to those that are considered likely to be affected by the merger and the proposed Commitment, allow at least a period of 15 days for representations to be submitted, and consider any representations that are made to the Commission. As required by section 64 of the Ordinance, any Commitment accepted by the Commission will be made public in the register of Commitments required to be established and maintained by the Commission. The Commission may also under sections 61 and 62 of the Ordinance, subject to a similar publication requirement, withdraw its acceptance of a Commitment in specified circumstances, accept a variation of the Commitment or a new Commitment in substitution for it, or release any person from a Commitment. The procedural requirements for the acceptance, withdrawal of acceptance, variation and release of Commitments are provided in Schedule 2 to the Ordinance.

Decision that a merger is excluded

5.16 Pursuant to Part 5 of Schedule 7 to the Ordinance, parties to a merger or proposed merger may apply to the Commission for a decision as to whether or not the merger is, or the proposed merger would if completed be:

- (a) excluded from the application of the Merger Rule by or as a result of section 8 of Schedule 7, i.e. if the economic efficiencies that arise or may arise from the merger outweigh the adverse effects caused by any lessening of competition (see paragraphs 4.2 to 4.11); or
- (b) excluded from the application of Schedule 7 by virtue of section 3 (application to statutory bodies) or section 4 (application to specified persons and persons engaged in specified activities) of the Ordinance (see paragraphs 4.13 and 4.14) ("**Decision**").

Under section 164 of the Ordinance, a fee will be payable for making an application for Decision.¹⁰

5.17 If the Commission makes a Decision, the Commission may not take any action under the Ordinance unless the Decision is rescinded (section 15 of Schedule 7 to the Ordinance), or the merger as implemented is materially different from the proposed merger to which the Decision relates (section 14 of Schedule 7 to the Ordinance). The Decision by the Commission may include conditions or limitations subject to which it is to have effect including, in the case of a proposed merger, specifying a date by which the proposed merger must be completed. Pursuant to section 13 of Schedule 7 to the Ordinance, after the Commission has made a Decision, it must inform the applicant in writing of the Decision, the date of the Decision and the reasons for it. The Commission will in line with section 16 of Schedule 7 to the Ordinance, maintain a register of Decisions and notices of rescissions of Decisions made under Part 5 of Schedule 7 to the Ordinance.¹¹

¹⁰ The amount of fees chargeable is prescribed by a regulation made by the Chief Executive in Council.

¹¹ The Commission may omit confidential information from any entry made in the register; and where confidential information has been omitted, that fact must be disclosed on the register. The Commission must make the register available for inspection by any person (a) at the offices of the Commission during ordinary business hours; (b) through the Internet or a similar electronic network; and (c) in any other manner the Commission considers appropriate.

- 5.18 Before deciding on an application for a Decision, section 12(1)(a) of Schedule 7 to the Ordinance requires that the Commission publish a notice of the application through the Internet or a similar electronic network and in any other manner the Commission considers appropriate. Under section 12 of Schedule 7 to the Ordinance, in order to bring the application to the attention of those the Commission considers likely to be affected by the Decision, the Commission must allow at least a period of 30 days for representations to be submitted, and consider any representations about the application that are made to the Commission.
- 5.19 According to section 11(3) of Schedule 7 to the Ordinance, the Commission is only required to consider an application for a Decision if:
- (a) the application poses novel or unresolved questions of wider importance or public interest;
 - (b) the application raises a question of an exclusion under the Ordinance for which there is no clarification in existing case law or decisions of the Commission; and
 - (c) it is possible to make a Decision on the basis of the information provided.

Further, the Commission is not required to consider an application for a Decision if the application concerns hypothetical questions or conduct (section 11(4) of Schedule 7 of the Ordinance).

- 5.20 Any party who would like to apply for a Decision should complete Form M. Parties who have submitted information to the Commission when notifying a proposed merger for informal advice need only to provide such further information as required by the Form M¹² which has not already been provided. Where the application involves a proposed merger which is not yet in the public domain, the applicant must give consent to the Commission to publicise the proposed merger for inviting representations from the relevant parties pursuant to the statutory requirements (see paragraph 5.18 above), otherwise the application will not be processed.

¹² Please refer to paragraph 5.7 above.

5.21 The time taken by the Commission to make a Decision on the application (where the application is accepted for meeting the requirements set out in paragraph 5.19) will depend very much on the nature and complexity of the transaction in question (including the volume of data required to be processed and the timeliness of their availability), and the resources available to the Commission at that point in time. The Commission will, however, endeavour to process applications in an efficient and timely manner with due regard being paid to the circumstances of the case.

5.22 The Commission may rescind a Decision if it has reason to believe:

- (a) if the merger has not been carried into effect, that there has been a material change of circumstances since the Decision was made; or
- (b) whether or not the merger has been carried into effect:
 - (i) that the information provided by a person involved in the merger, on which it based its Decision was incomplete, false or misleading in a material particular; or
 - (ii) that an undertaking has failed to observe any condition or limitation subject to which the Decision has effect.

5.23 Before rescinding a Decision, the Commission is required under section 15(3) of Schedule 7 to the Ordinance to publish a notice of the proposed rescission through the Internet or a similar electronic network and in any other manner the Commission considers appropriate in order to bring the proposed rescission to the attention of those the Commission considers likely to be affected by the proposed rescission, allow at least a period of 30 days for representations to be submitted, and consider any representations about the proposed rescission that are made to the Commission. If a Decision is rescinded, a notice of rescission will be issued to each undertaking specified in the Decision, informing them of the rescission and the reasons for it, the date on which the determination to rescind the Decision was made, and the date from which the rescission takes effect. Pursuant to section 15 of Schedule 7 to the Ordinance, each undertaking specified in the notice of rescission loses its immunity from action under the Ordinance, as from the date the rescission takes effect, with regard to anything done after that date.

5.24 Subject to the above, in considering and processing an application for a Decision for exclusion from the Merger Rule, the Commission will in general follow the procedures for processing an application for a Decision set out in *the Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders*, to the extent where they are applicable.

Investigation

- 5.25 As indicated in paragraph 5.1 above, under section 39 of the Ordinance, the Commission may conduct an investigation into a merger or an anticipated merger if it has reasonable cause to suspect that a contravention of the Merger Rule has taken place, is taking place or is about to take place. In relation to a completed merger, section 7 of Schedule 7 to the Ordinance states that an investigation may only be commenced within 30 days after the day on which the Commission first became aware, or ought to have become aware, that the merger has taken place. Under section 7(2) of Schedule 7 to the Ordinance, the Commission is to be taken to have become aware that a merger has taken place if it has been notified of the merger pursuant to this Guideline.
- 5.26 During an investigation, the Commission may in appropriate circumstances make use of the investigation powers conferred under the Ordinance to obtain evidence from the relevant parties. The Commission may also seek representations from the parties to a merger or an anticipated merger, and/or from relevant third parties, conduct market inquiries which could include consulting competitors of the merging parties, suppliers, customers, industry associations and consumer groups and consider their views in so far as they are relevant, and carry out independent research, for example to help assess the degree of competition in the relevant market.
- 5.27 If, after investigation, the Commission considers that there is no reasonable cause to believe that the merger or anticipated merger contravenes or is likely to contravene the Merger Rule (as the case may be), no proceedings will be brought and the Commission will take no further action.
- 5.28 The Commission will in general follow the *Guideline on Investigations*, to the extent where it is applicable, in conducting investigations.

Proceedings before the Tribunal

- 5.29 If the Commission, after carrying out an investigation, has reasonable cause to believe that a merger or an anticipated merger contravenes, or is likely to contravene the Merger Rule (as the case may be), it may under sections 97 or 99 of the Ordinance bring proceedings before the Tribunal seeking orders to stop the contravention (which may, effectively, unwind a completed merger, or stop the process in relation to an anticipated merger). As required under section 99(2) of the Ordinance, for a completed merger, proceedings must be brought within the period of six months after the day on which the merger was completed or the Commission became aware of the merger, whichever is the later. This six month period may be extended by the Tribunal under section 99(3) of the Ordinance on the application of the Commission if the Tribunal considers it reasonable to do so.
- 5.30 Where proceedings are brought in relation to an anticipated merger under section 97 of the Ordinance, and before the Tribunal has finally determined on the matter, the Tribunal may, either of its own motion or on application by the Commission, make interim orders under section 98 of the Ordinance for the purpose of preventing pre-emptive action that might prejudice the hearing under section 97 or any final order that the Tribunal might make on the hearing of the application.¹³

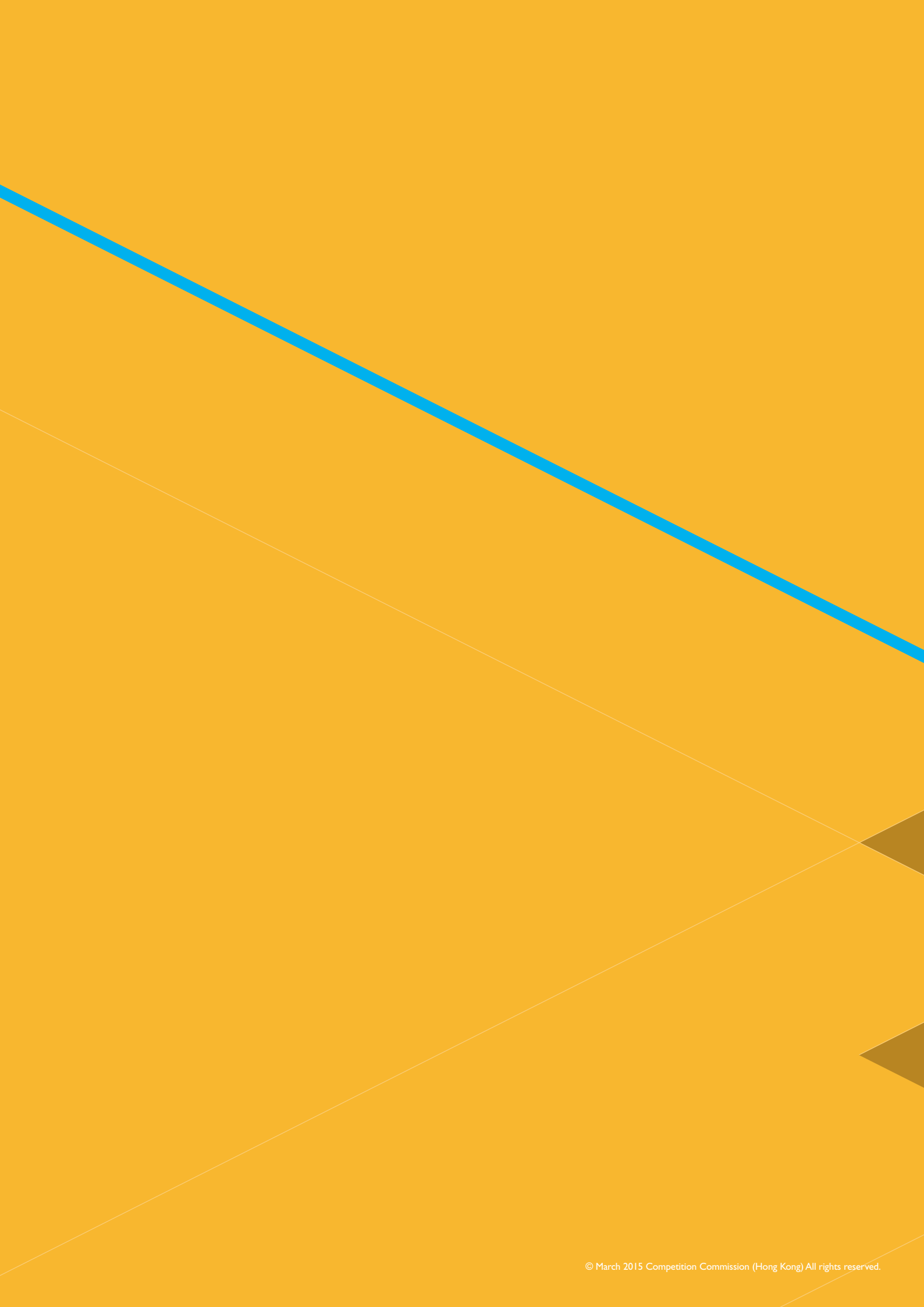
Confidentiality and disclosure

- 5.31 Section 125 of the Ordinance imposes a general obligation on the Commission to preserve the confidentiality of any confidential information provided to or obtained by the Commission. Reference is made to the *Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders* and *Guideline on Investigations* issued by the Commission, to the extent where they are applicable, for the Commission's approach in handling confidential information and its disclosure under the Merger Rule.

¹³ Interim orders may include orders (a) prohibiting or restricting the doing of things that the Tribunal considers would constitute pre-emptive action; (b) imposing on any person concerned obligations as to the carrying on of any activities or the safeguarding of any assets; (c) providing for the carrying on of any activities or the safeguarding of any assets either by the appointment of a person to conduct or supervise the conduct of any activities (on any terms and with any powers that may be specified or described in the order) or in any other manner.

Other Commission Procedures

- 5.32 Information provided voluntarily to the Commission by parties seeking an informal advice on a proposed merger or approaching the Commission for other purposes (such as for exploring possibilities of Commitments or applying for a Decision from the Commission that the merger is excluded from the Merger Rule), including information protected by legal professional privilege, will not be accepted on a “without prejudice” basis or otherwise on terms that its use is limited for the sole purpose of seeking an informal advice (or such other purposes as specified by the parties). The Commission can use any information so received, with or without notice to interested parties, for other purposes under the Ordinance. This includes for the purposes of considering whether a contravention under the Ordinance has occurred and/or with a view to enforcement where there has been a contravention.
- 5.33 As a general matter, parties to a merger are encouraged to seek legal advice before approaching the Commission seeking an informal advice on a proposed merger or for other purposes.



Revised Draft Guideline on **Complaints**

30 March 2015

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Guideline on Complaints

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under section 38 of the Competition Ordinance (Cap 619) (the “**Ordinance**”) to indicate the manner and form in which complaints are to be made in respect of alleged contraventions of the Ordinance.*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*The Guideline is not, however, a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

This Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I Introduction

- 1.1 The Ordinance applies to all sectors of the economy. It prohibits conduct which has the object or effect of preventing, restricting or distorting competition in Hong Kong. Such conduct includes anti-competitive arrangements and abuses of a substantial degree of market power. The Ordinance also prohibits mergers which may substantially lessen competition. Further guidance on these prohibitions can be found in the Commission's *Guideline on the First Conduct Rule*, *Guideline on the Second Conduct Rule* and *Guideline on the Merger Rule*.
- 1.2 The Ordinance is applied and enforced by the Commission. In the exercise of its enforcement functions under the Ordinance, the Commission encourages input from the public. In particular, the Commission values any input drawing its attention to suspected contraventions of the Ordinance, such as the submission of well-informed complaints.
- 1.3 Section 37(1) of the Ordinance provides that any person who suspects that a competitor, supplier, customer or any other party has contravened, is contravening, or is about to contravene a competition rule may contact the Commission to express their concerns and to make a complaint ("**Complainant**"). The Commission also welcomes queries from the public regarding matters which may be within scope of the Ordinance.
- 1.4 Section 37(2) of the Ordinance provides the Commission with the discretion to decide which complaints may warrant investigation. The Commission does not act on behalf of Complainants, and will consider what matters to pursue having regard to the public interest in having a competitive market place, rather than the Complainant's interest.
- 1.5 This Guideline describes the manner and form in which complaints may be made to the Commission. The Guideline also incorporates information on the processes the Commission will use for determining what action to take in relation to a complaint or query.

2 Making a Complaint to the Commission

- 2.1 The Commission relies on complaints and queries from the public as an important means of identifying possible contraventions of the Ordinance. The Commission will accept complaints and queries in any form, including those provided to the Commission:
- (a) directly;
 - (b) anonymously; and
 - (c) through an intermediary (such as a legal adviser).
- 2.2 A complaint or query may be made by telephone, e-mail, post, by completing an online form on the Commission's website or in person at the Commission's offices (by appointment only). The relevant contact details are listed in Part 6 of this Guideline. A complaint may be submitted on behalf of more than one person or party.
- 2.3 Where the Complainant has provided relevant contact details, the Commission will usually acknowledge promptly receipt of any complaint or query.
- 2.4 At the time of making a complaint, it is not necessary to provide all details of the relevant conduct. However, to assist the Commission in assessing the matter, a Complainant should submit any information that it has or has access to and is encouraged to provide as much of the following information as possible:
- (a) a description of the relevant facts regarding the conduct the Complainant is concerned about;
 - (b) information on any documents that relate to the conduct including copies of those documents where possible;
 - (c) information about the party or parties involved in that conduct, including their contact information where known;
 - (d) information about other parties affected by the conduct, including contact information where known; and
 - (e) information about the Complainant, including their name, job title, address, telephone and email address.
- 2.5 The Commission expects Complainants to respond in a timely manner to any particular requests for information that the Commission may make.
- 2.6 Further guidance on information the Commission will routinely seek from Complainants may be published on the Commission's website from time to time.

3 Confidentiality

Confidentiality of complaints

- 3.1 The Commission will not normally comment on what matters it is considering or investigating.
- 3.2 The Commission's ability to effectively investigate a complaint may be impeded where the complaint is publicised or otherwise widely known. To support the Commission's ability to conduct effective investigations, the Commission requests that Complainants keep their complaints confidential. If a Complainant elects to disclose their complaint publicly, the Commission asks that the Complainant inform the Commission in advance of any such disclosure.

Disclosure of a Complainant's identity

- 3.3 Section 125 of the Ordinance imposes a general obligation on the Commission to preserve the confidentiality of any confidential information provided to or obtained by the Commission, including information that relates to the identity of any person who has given information to the Commission. Section 125(2) of the Ordinance permits the disclosure of confidential information by the Commission in certain circumstances.²
- 3.4 The Commission will not normally disclose the details of a Complainant, and in particular their identity, without the Complainant's consent. In some exceptional cases however, it may be necessary to disclose the Complainant's identity without their consent. This includes where disclosure is ordered by the courts³ or under section 126(1)(b) of the Ordinance where the Commission considers it necessary to make a disclosure in the performance of its functions or in carrying into effect or doing anything authorised by the Ordinance.
- 3.5 When deciding whether or not to disclose confidential information under section 126(1)(b), section 126(3) of the Ordinance provides that the Commission must consider the extent to which the disclosure is necessary for the purpose sought to be achieved by the disclosure and the need to exclude, as far as is practical, specific categories of information from such disclosure as specified in section 126(3)(a) of the Ordinance.

² The Commission's *Guideline on Investigations* provides further detail on the use of confidential information by the Commission under the Ordinance.

³ A reference to the 'courts' in this Guideline means the Tribunal, the Court of First Instance, the Court of Appeal and the Court of Final Appeal.

- 3.6 Where confidential information is disclosed, the party receiving the confidential information from the Commission must, under section 128 of the Ordinance, maintain the confidentiality of that information. This includes keeping the identity of a Complainant confidential if it is included in such a disclosure.

Cooperation between competition authorities⁴

- 3.7 For matters falling within the Commission's concurrent jurisdiction with the CA, section 126(1)(h) of the Ordinance enables the routine exchange of confidential information, including the Complainant's identity, between the Commission and the CA.

4 Assessment of Complaints and Queries

- 4.1 The Commission will consider any complaint or query it receives regarding anti-competitive behaviour. However, it will not pursue all such complaints and queries. Section 37(2) of the Ordinance provides the Commission with the discretion to decide which complaints may warrant investigation. This includes the discretion not to investigate a complaint further where the Commission does not consider it reasonable to do so, and the discretion to investigate a complaint even where the Complainant no longer wishes to cooperate with the Commission.
- 4.2 Without limiting what is considered reasonable under section 37(2), the Ordinance provides that the Commission may, in particular, not investigate a complaint if it is
- (a) trivial, frivolous or vexatious; or
 - (b) misconceived or lacking in substance.
- 4.3 When considering whether a complaint is misconceived or lacking in substance, the Commission will have regard to factors including:
- (a) the subject matter of the complaint and the scope of the Ordinance;
 - (b) any applicable exclusions and exemptions under the Ordinance; and
 - (c) the likely veracity of the complaint, including any supporting information provided with it.

⁴ Section 2 of the Ordinance defines 'competition authority' to mean the Commission or the CA. The phrase 'competition authority' when used in this Guideline is used in this narrow sense.

5 Next Steps

- 5.1 After a preliminary review of a complaint, the Commission will do one of the following:
- (a) take no further action;
 - (b) recommend the Complainant refer the complaint to another agency; or
 - (c) review the matter further by conducting an Initial Assessment.⁵
- 5.2 If the Commission proposes to take no further action or recommends the Complainant refer their concerns to another agency, it will provide an explanation of this outcome to the Complainant in writing.
- 5.3 Even where it initially decides to take no further action, the Commission may later reconsider the issues raised in a complaint or query. This may occur where additional evidence has been obtained, where a pattern of conduct arises which warrants further consideration or where the Commission has increased capacity to investigate an issue.
- 5.4 If the Commission reviews a complaint further, it will endeavour to keep the Complainant generally informed as the matter progresses. This will always be subject to any overriding considerations, including the Commission's ability to conduct effective investigations and the need to preserve confidentiality. The Commission is therefore unlikely to advise a Complainant of internal procedural steps taken, such as whether a matter is in the Initial Assessment Phase or Investigation Phase.

6 Further Materials and Contact Details

Further materials

- 6.1 As set out in paragraph 2.6 of this Guideline, the Commission and the CA may publish additional guidance and other materials for the benefit of Complainants from time to time. These may be found on the respective websites of the Commission and the CA at www.compcomm.hk and www.coms-auth.hk.

⁵ Initial Assessments are addressed in detail in the Commission's *Guideline on Investigations*.

Contact Details

Commission contact details

You can make a complaint or an inquiry to the Commission about anti-competitive behaviour and conduct that may affect Hong Kong in the following ways:

- Website www.compcomm.hk
- Telephone [to be confirmed in the final version]
- Email [to be confirmed in the final version]
- Post/In person 36/F, Wu Chung House, 197-213 Queen's Road East, Wanchai, Hong Kong

Please see the Commission's website for the most up to date contact details for making a complaint.

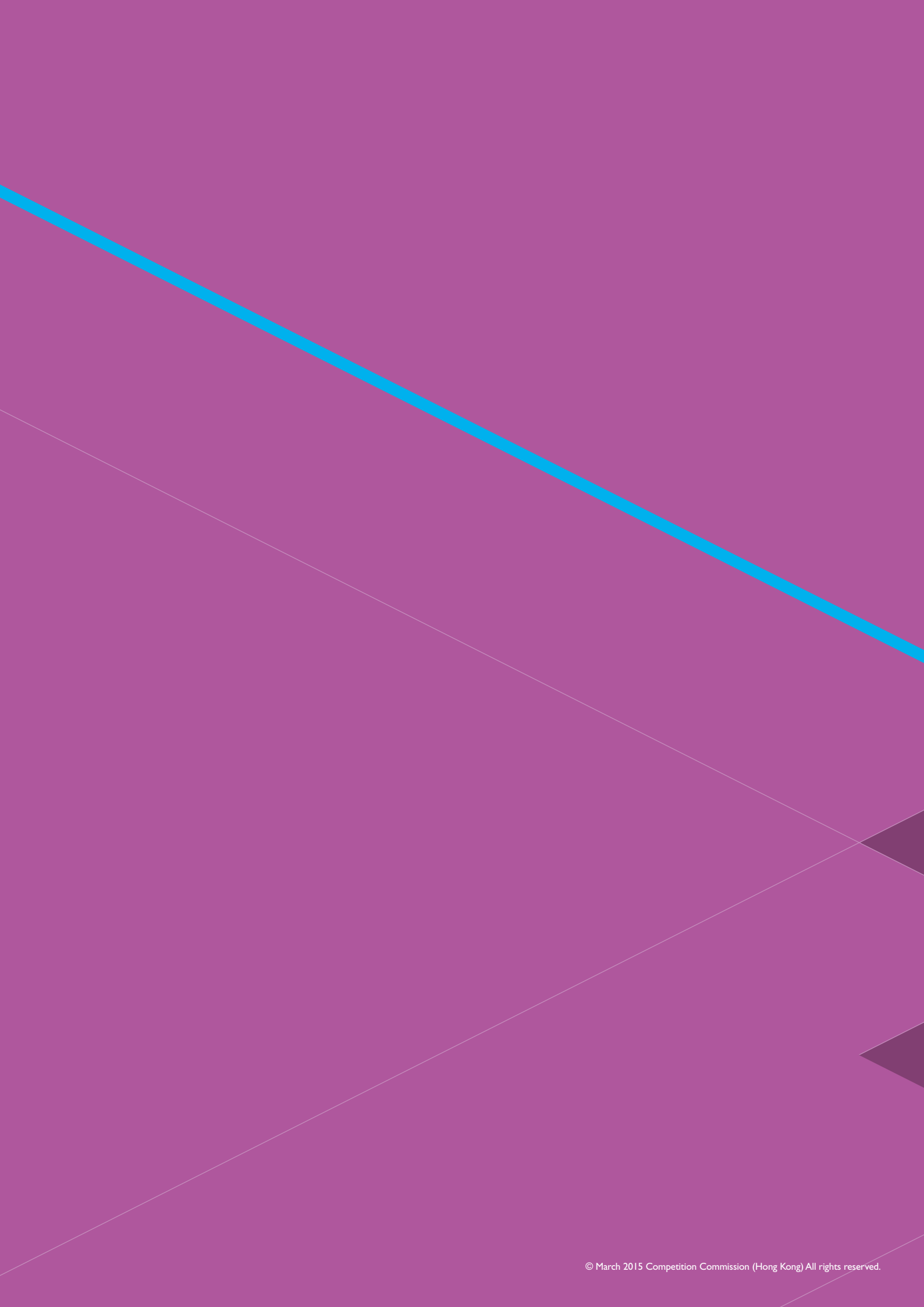
Complaints or inquiries about the anti-competitive behaviour and conduct of licensees and other persons operating in the telecommunications and broadcasting sectors in Hong Kong can also be made to the CA.

CA contact details

You can make a complaint or an inquiry to the CA about the anti-competitive behaviour and conduct of licensees and other persons operating in the telecommunications and broadcasting sectors in Hong Kong in the following ways:

- Website www.coms-auth.hk
- Telephone [to be confirmed in the final version]
- Email [to be confirmed in the final version]
- Post/In person 29/F, Wu Chung House, 197-213 Queen's Road East, Wanchai, Hong Kong

Please see the CA's website for the most up to date contact details for making a complaint.



Revised Draft Guideline on **Investigations**

30 March 2015

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Guideline on Investigations

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under section 40 of the Competition Ordinance (Cap 619) (the “**Ordinance**”) to indicate the procedures they will follow in deciding whether to conduct an investigation and in conducting an investigation under Part 3 of the Ordinance, including the use of their powers of investigation. Separately, the Commission and the CA have issued the Guideline on Complaints which sets out the manner and form in which complaints in relation to contraventions of the Ordinance are to be made.*

In addition to these Guidelines, the Commission and CA will be releasing other policy documents, including on Leniency Agreements. These documents will also be of relevance to the various stakeholders of an investigation under Part 3 of the Ordinance.

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*The Guideline is not, however, a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

This Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified in section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I Introduction

- 1.1 The Ordinance applies to all sectors of the economy. It prohibits certain conduct which has the object or effect of preventing, restricting or distorting competition in Hong Kong. This conduct includes anti-competitive arrangements and abuses of a substantial degree of market power. The Ordinance also prohibits mergers which may substantially lessen competition. These prohibitions are collectively referred to as the “**Competition Rules**”. Detailed guidance on the Competition Rules can be found in the Commission’s *Guideline on the First Conduct Rule*, *Guideline on the Second Conduct Rule* and *Guideline on the Merger Rule*.
- 1.2 The Ordinance is applied and enforced by the Commission. The Commission may become aware of potential contraventions of the Ordinance in various ways, including via complaints received from the public (see the Commission’s *Guideline on Complaints*). Under sections 37 and 39 of the Ordinance, the Commission has discretion whether to investigate a matter. Under section 39(2) of the Ordinance, the Commission may only conduct an investigation using compulsory powers under Part 3 of the Ordinance where it has reasonable cause to suspect that a contravention of a Competition Rule has occurred.²
- 1.3 Where the Commission exercises its discretion to investigate an alleged contravention of a Competition Rule, whether initiated by a complaint or otherwise, it will do so in two phases:

Initial Assessment Phase

During this phase, the Commission has not formed a view on whether it has reasonable cause to suspect that a contravention of the Competition Rules has occurred. Any information it requires will be sought on a voluntary basis.

Investigation Phase

During this phase, the Commission has formed a view that it has reasonable cause to suspect a contravention of the Competition Rules under section 39. The Investigation Phase may involve the use of the Commission’s compulsory document and information gathering powers under sections 41, 42 and 48 of the Ordinance (“**Investigation Powers**”).

- 1.4 An overview of the Commission’s investigative process is set out in this Guideline.

² In this Guideline, a reference to a contravention of a Competition Rule having occurred or having taken place includes a contravention which has taken place, is taking place or is about to take place.

2 Sources of Commission Investigations

- 2.1 The Commission may launch an investigation into conduct that constitutes or may constitute a contravention of a Competition Rule on its own initiative or where information about a possible contravention is provided to the Commission by another party.
- 2.2 The Commission may become aware of possible contraventions of the Ordinance from sources such as:
 - (a) a complaint or query made by the public;
 - (b) the Commission's own research and market intelligence gathering;
 - (c) other Commission processes and investigations; or
 - (d) referrals by the Government, the courts³ or other statutory bodies or authorities of potentially anti-competitive conduct for investigation.

3 Initial Assessment Phase

- 3.1 The Initial Assessment Phase is used by the Commission to identify whether:
 - (a) there is sufficient evidence to establish a reasonable cause to suspect that a contravention of a Competition Rule has occurred; and
 - (b) the matter warrants further investigation.
- 3.2 The timeframe for the Initial Assessment Phase will vary depending on the nature and complexity of each matter, as well as the resources available to the Commission at the time. Where the Commission already has sufficient evidence to form a view on the matters referred to in paragraph 3.1 of this Guideline, the timeframe for the Initial Assessment Phase may be very short.

³ A reference to the 'courts' means the Competition Tribunal, the Court of First Instance, the Court of Appeal and the Court of Final Appeal.

- 3.3 In the Initial Assessment Phase, the Commission may seek information using voluntary means, such as:
- (a) contacting parties by telephone or in writing;
 - (b) meeting and interviewing persons who may have knowledge of the conduct;
 - (c) reviewing publicly available information including market surveys and industry reports; and
 - (d) conducting surveys.
- 3.4 Depending on the circumstances, the Commission may contact undertakings who are the subject of an Initial Assessment to request information relevant to the Commission's consideration of the matter.
- 3.5 Once undertakings are aware that they are the subject of a Commission investigation, the Commission will endeavour to keep those undertakings informed of the progress of the Commission's investigation subject to overriding operational or confidentiality considerations.
- 3.6 At any stage of the Commission's consideration of a matter, the Commission may reassess its priorities to make the best use of its limited public resources. In this context, when exercising its discretion whether or not to pursue or continue pursuing a particular matter, the Commission will take a range of factors into account including:
- (a) whether the available evidence indicates that the Ordinance may have been contravened;
 - (b) the potential impact of the alleged conduct on competition and consumers;
 - (c) the Commission's current enforcement strategy, priorities and objectives;
 - (d) other matters currently under consideration by the Commission and the courts;
 - (e) the likelihood of a successful outcome resulting from further investigation; and
 - (f) whether the resource requirements of further investigation are proportionate to the expected public benefit.
- 3.7 When deciding whether or not to investigate a matter beyond the Initial Assessment Phase, a consideration of the factors in paragraph 3.6 of this Guideline may mean that the Commission exercises its discretion not pursue a matter further even if it is possible that further investigation would uncover some evidence that there may be a contravention of the Ordinance.

4 Possible Outcomes of Initial Assessment Phase

- 4.1 There are four possible outcomes of the Initial Assessment Phase:
- (a) the Commission takes no further action;
 - (b) the Commission commences the Investigation Phase;
 - (c) the Commission uses alternative means of addressing the issue, such as:
 - (i) referring the matter to another agency; or
 - (ii) conducting a market study; or
 - (d) the Commission accepts a voluntary resolution of the matter; such as a commitment under section 60 of the Ordinance where the Commission has concerns about a possible contravention of a Competition Rule ("**Commitment**").
- 4.2 If the Commission proposes to take no further action in relation to a complaint from a member of the public ("**Complainant**"), it will provide an explanation of this outcome to the Complainant in writing.
- 4.3 Further guidance on the outcomes at paragraphs 4.1(a), (c) and (d) above is set out in Part 7 of this Guideline.
- 4.4 If the Commission proceeds to the Investigation Phase in respect of conduct referred to it by a Complainant, it will endeavour to keep the Complainant generally informed as the matter progresses. This will always be subject to any overriding considerations, including the Commission's ability to conduct effective investigations and the need to preserve confidentiality. The Commission is therefore unlikely to advise a Complainant of internal procedural steps taken, such as whether a matter is in the Initial Assessment Phase or Investigation Phase.

5 Investigation Phase

- 5.1 The Ordinance requires the Commission to have reasonable cause to suspect a contravention of a Competition Rule before it may use its information gathering powers under Part 3 of the Ordinance. The Commission considers that this test:
- (a) requires a suspicion based on relevant facts and any other information; and
 - (b) only requires that the Commission is satisfied, at least beyond mere speculation, that there may have been a contravention of a Competition Rule.
- 5.2 This test does not require evidence to a standard that, on balance, tends to suggest that a contravention has occurred.
- 5.3 The Commission will proceed to the Investigation Phase only when it is satisfied that:
- (a) it has reasonable cause to suspect a contravention of a Competition Rule; and
 - (b) the matter warrants further investigation in view of the factors listed at paragraph 3.6 of this Guideline.
- 5.4 The Commission may seek evidence without relying on its Investigation Powers during the Investigation Phase. This may include inviting parties to make voluntary submissions relevant to the investigation, such as providing relevant facts and legal and economic arguments, with evidence in support of those arguments.
- 5.5 In addition or in place of gathering evidence through voluntary means, the Commission may use its Investigation Powers during the Investigation Phase to compel the production of evidence or to enter and search premises.

The Commission's Investigation Powers

- 5.6 The Commission has powers under sections 41, 42 and 43 of the Ordinance to issue notices requiring a person to provide documents, information and/or to give evidence before the Commission. It also has the capacity to seek a search warrant from a judge of the Court of First Instance to enter and search specific premises for evidence under section 48 of the Ordinance.

5.7 Under section 167 of the Ordinance, the Commission may serve section 41 or 42 notices by email, post, fax or personal service.

Written requests for documents and information (section 41 notices)

5.8 Under section 41 of the Ordinance, where the Commission has reasonable cause to suspect that a person has or may have possession or control of relevant documents or information or may otherwise be able to assist the Commission in its investigation, the Commission may issue written notices (“**section 41 notices**”) to that person. The Commission may use section 41 notices to obtain documents or specified information which relate to any matter it reasonably believes to be relevant to an investigation from any person, such as the person under investigation, their competitors, suppliers and customers or any other parties.

5.9 Pursuant to sections 41(3) and (4) of the Ordinance, a section 41 notice will, amongst other matters:

- (a) indicate the subject matter and purpose of the investigation;
- (b) specify or describe the documents and/or information that the Commission requires;
- (c) provide details of where, when and how documents and/or information must be produced; and
- (d) set out the offences and/or sanctions that may apply if the recipient of the notice does not comply.

5.10 Pursuant to section 2 of the Ordinance, the documents that might be sought under section 41 notices include information recorded in any form. For example, the Commission may request material such as:

- (a) draft documents;
- (b) original documents;
- (c) records in electronic format (and their metadata);
- (d) correspondence; and
- (e) databases and the means of accessing the information contained in those databases.

- 5.11 Section 41 notices will often include questions or other requests to provide the Commission with information in a particular format. This may involve the creation of new documents, such as:
- (a) written responses to Commission questions set out in the section 41 notice;
 - (b) lists of customers and suppliers;
 - (c) contact details of relevant persons;
 - (d) organisational diagrams and charts; and
 - (e) data extracted in various formats.
- 5.12 Section 41 notices may be used at any stage of the Investigation Phase and may be issued to the same person more than once. For example, the Commission may decide to seek further information from the same person to clarify information or documents submitted under an earlier section 41 notice.
- 5.13 Under section 41(5) of the Ordinance, the Commission can make copies of or take extracts from documents, require an explanation of the document, or question where a particular document can be found if it is not produced to the Commission.
- 5.14 The deadline specified in the notice for the production of documents and/or provision of information will depend on the nature and volume of information requested. Other factors the Commission may consider in setting the deadline include the resources available to the recipient and the urgency of the matter.
- 5.15 The Commission will endeavour to provide reasonable timeframes for persons to comply with a section 41 notice having regard to the nature and volume of information and documents requested. In limited circumstances, the Commission will consider requests to extend the deadline for responding to a section 41 notice. In considering such requests, the Commission will have particular regard to evidence of efforts already made by the recipient to comply with the section 41 notice and whether providing an extension will impede the Commission's investigation.
- 5.16 The Commission will also consider any representations made by the recipient in a timely manner regarding the scope of section 41 notices.

***Request for attendance before the Commission to answer questions
(section 42 notices)***

- 5.17 Under section 42(1) of the Ordinance, the Commission may require any person to appear before it, at a specified time and place, to answer questions relating to any matter the Commission reasonably believes to be relevant to an investigation (“**section 42 notices**”). By way of example, persons with relevant evidence may include, without limitation:
- (a) current or former employees, competitors, customers, distributors or suppliers of the parties under investigation;
 - (b) representatives of relevant trade associations; or
 - (c) Complainants.
- 5.18 Section 42 notices may be used at any stage of the Investigation Phase and may be issued to the same person more than once. For example, the Commission may require a person to appear before it after considering responses provided in a previous appearance before the Commission or to ask about information obtained from other sources.
- 5.19 When setting the time and place for appearance before it, the Commission may consider a range of factors including the resources available to the person and the urgency of the matter.
- 5.20 Any person required by the Commission to appear may be accompanied and represented by a legal adviser admitted to practice law in Hong Kong and, to the extent required by relevant professional regulations or rules of conduct, holding a current Hong Kong practising certificate.
- 5.21 If necessary, an appearance before the Commission may be adjourned after commencement to be continued at a later date.
- 5.22 Recordings and any transcripts made of the interview will be provided to the person interviewed upon request when practicable. These recordings and transcripts will be subject to the person’s confidentiality obligations under the Ordinance (discussed further at Part 6 of this Guideline).

Enter and search premises under warrant (section 48 warrant)

- 5.23 Under section 48 of the Ordinance, the Commission may apply to a judge of the Court of First Instance for permission to enter and search any premises to obtain documents, information and other items relevant to its investigation (“**section 48 warrant**”).
- 5.24 A section 48 warrant may be issued where a judge of the Court of First Instance is satisfied, on the basis of an application made on oath by an authorised officer of the Commission, that there are reasonable grounds to suspect that there are or are likely to be, on the premises in question, documents that may be relevant to an investigation by the Commission.
- 5.25 The premises specified in the section 48 warrant need not relate to the party under investigation. For example, the premises may belong to the investigated party’s supplier or customer.
- 5.26 The Commission expects the types of situations where it may seek a section 48 warrant to include, without limitation, matters which involve:
- (a) secretive conduct;
 - (b) instances where it considers that documents or information relevant to its investigation may be destroyed or interfered with should the Commission seek them through other means; and/or
 - (c) circumstances where the Commission has been unsuccessful in obtaining specific or categories of documents or information (the existence of which the Commission may already be aware of through other sources) or suspects non-compliance with an earlier request for such documents and information, whether the request was voluntary or pursuant to a section 41 notice.
- 5.27 The Ordinance does not require the Commission to have first used one of its other Investigation Powers before applying for a section 48 warrant.
- 5.28 A section 48 warrant provides authorised Commission officers with broad powers to enter specified premises, without providing any prior notice to the occupier. However Commission officers will normally, subject to operational considerations, arrive at the specified premises during usual office hours.

5.29 On arrival, the Commission officer executing the section 48 warrant will produce, upon request, evidence of their identity, the section 47 authorisation and the warrant.

5.30 If there is no one at the premises when authorised Commission officers arrive, the authorised officers will take reasonable steps to inform the occupier of the intended entry and afford the occupier, or the occupier's representative, a reasonable opportunity to be present when the warrant is executed.

5.31 Section 50 of the Ordinance authorises the Commission to, among other matters:

- (a) use reasonable force to gain entry and/or access evidence on the premises;
- (b) remove any obstructions to the execution of the warrant (including individuals who are obstructing the execution of the warrant); and
- (c) take such action and steps as necessary for the preservation of any relevant documents or the prevention of any interference with them (including the alteration or removal of such documents from the premises), such as by taking possession of any computer or other device found on the premises that Commission officers believe will, on examination, afford evidence of a contravention.

5.32 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 that their legal advisers be present during a search, 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. During such time, Commission officers may take necessary measures to prevent tampering with evidence, such as instructing employees and other persons at the premises to move away from their workspaces, requesting that computer/IT system access or email accounts be blocked, stopping external communications and sealing offices and/or filing cabinets. Where compliance with such directions cannot be assured or legal advisers are unable to commit to a timely arrival at the premises, the Commission will immediately commence its search of the premises.

5.33 During the search of the premises, Commission officers will:

- (a) search, copy and/or confiscate relevant documents and equipment (such as a computer or other device) that might reasonably provide evidence of a contravention of a Competition Rule; and

(b) seek explanations from individuals present at the premises about any documents which may appear to be relevant.

5.34 To facilitate an efficient execution of the section 48 warrant, Commission officers will request that the person in charge at the premises designate an appropriate person to be a point of contact for Commission officers during the search.

5.35 Commission officers may search any part of the specified premises for relevant documents and other evidence including desks, bookshelves and cabinets, and take away anything which might be or contain relevant evidence (including electronic equipment and devices such as hard drives, servers and mobile phones). Following a review of the collected evidence, the Commission will return documents and/or equipment if it considers that these are outside the scope of the investigation, or clearly duplicate other relevant documents.

5.36 Evidence found during the search will be retained by the Commission for as long as necessary for the purposes of the investigation and/or any ensuing legal proceedings. Section 56 of the Ordinance provides that parties may request from the Commission copies of documents retained by or in the possession of the Commission certified by a member of the Commission to be a true copy of the original.

Other issues relating to the use of the Commission's Investigation Powers

Statutory declarations regarding evidence

5.37 Section 43 provides that, when the Commission uses its Investigation Powers to compel a person to provide any explanation, further particulars, answer or statement to the Commission, the Commission may require that person to verify the truth of the information provided by statutory declaration.

5.38 In normal circumstances, the Commission will require persons to provide such a verification.

Legal professional privileged communications

5.39 None of the Commission's Investigative Powers affect any claims, rights or entitlements that would, but for these powers, arise on the ground of legal professional privilege under the laws of Hong Kong. However, section 58 of the Ordinance provides that this does not affect any requirement under the Ordinance to disclose the name and address of a counsel's or solicitor's client.

5.40 The Commission will establish and publish a procedure for dealing with disputes with respect to claims to legal professional privilege in the context of the Commission exercising its Investigation Powers, including powers conferred by warrant under section 48 of the Ordinance.

Obligations of confidence

5.41 Section 46 of the Ordinance provides that a person is not excused from providing any information or document to the Commission under its Investigation Powers where an obligation of confidence is owed to any other person. Section 46 also provides that such a person will not be personally liable for a disclosure required under the Ordinance.

Self-incrimination

5.42 Section 45 of the Ordinance provides that a person is not excused from giving any explanation or further particulars about a document, or from answering any question from the Commission, on the grounds that to do so might expose the individual to proceedings in which the Commission seeks a pecuniary or financial penalty⁴ or criminal proceedings.⁵

5.43 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 pursuant to Part 3 of the Ordinance, including the Commission's Investigation Powers, is admissible against that individual 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.

Immunity

5.44 Section 44 of the Ordinance provides that a person who provides evidence to the Commission, and any counsel, solicitor or other person who appears before the Commission, has the same privileges and immunities as the person would have if the investigation were a civil proceeding in the Court of First Instance.

⁴ Pursuant to sections 93 and 169 of the Ordinance respectively.

⁵ Section 45 applies to all criminal proceedings, other than an offence under section 55 of the Ordinance, an offence under Part V (Perjury) of the Crimes Ordinance (Cap 200) or an offence of perjury.

Sanctions for non-compliance with the Commission's Investigation Powers

5.45 Section 52 of the Ordinance provides that failure to comply without reasonable excuse with any requirement (or prohibition) imposed under the Commission's Investigation Powers is a criminal offence punishable by fines of up to HK\$200,000 and imprisonment for 1 year.

5.46 The Ordinance creates criminal offences punishable by fines of up to HK\$1 million and imprisonment for 2 years in respect of providing false or misleading information,⁶ destroying, falsifying or concealing documents,⁷ obstructing a search under a section 48 warrant,⁸ or disclosing confidential information received from the Commission.⁹

Duration of Investigation Phase

5.47 The duration of an Investigation Phase will largely depend on the nature and complexity of each matter and the level of cooperation, if any, by the parties under investigation.

6 Confidentiality and Disclosure

The Commission will conduct investigations in confidence

- 6.1 The Commission will generally investigate in private to protect the interests of all persons involved and will not make disclosures except where appropriate. To this end, the Commission will not normally comment on matters it is considering or investigating.
- 6.2 The Commission's ability to investigate a matter may be impeded where the investigation is publicised or otherwise widely known. In appropriate cases, such as where an investigation is made public by another party, the Commission may acknowledge that it is reviewing a matter. To support the Commission's ability to conduct effective investigations, the Commission will typically ask that Complainants keep their complaint confidential.

⁶ Section 55 of the Ordinance.

⁷ Section 53 of the Ordinance.

⁸ Section 54 of the Ordinance.

⁹ Section 128(3) of the Ordinance.

Handling confidential information

- 6.3 Section 125 of the Ordinance imposes a general obligation on the Commission to preserve the confidentiality of any confidential information provided to or obtained by the Commission. The following categories of information are defined as confidential under section 123 of the Ordinance:
- (a) information that has been provided to or obtained by the Commission in the course of, or in connection with, the performance of its functions under the Ordinance, that relates to
 - i. the private affairs of a natural person;
 - ii. the commercial activities of any person that are of a confidential nature; or
 - iii. the identity of any person who has given information to the Commission;
 - (b) information that has been given to the Commission on terms or in circumstances that require it to be held in confidence; or
 - (c) information given to the Commission that has been identified as confidential information in accordance with section 123(2) of the Ordinance.
- 6.4 Section 126(1) of the Ordinance permits the disclosure of confidential information by the Commission in certain circumstances, including disclosures made by the Commission in the performance of any of its functions, or in carrying into effect or doing anything authorised by the Ordinance. Section 126(1) disclosures are therefore not limited to where the Ordinance expressly requires the Commission to publish information and, subject to the provisions of the Ordinance, the Commission may in certain circumstances disclose confidential information without the consent of relevant parties.

Claiming confidentiality and making confidential information available to the Commission

- 6.5 Section 123(1)(c) of the Ordinance provides that a person may identify information given to the Commission as confidential information. Pursuant to section 123(2), claims to confidentiality under section 123(1)(c) should be in writing setting out the reasons why the identified information is, in the relevant person's opinion, confidential.
- 6.6 Where a document contains a mix of non-confidential and confidential information (as defined under the Ordinance), persons submitting information to the Commission should identify within the document which parts of the document are confidential.

- 6.7 As set out in paragraph 6.13 of this Guideline, the Commission considers it is in parties' interests to clearly specify the reasons for claiming confidentiality.

Disclosure of information and documents obtained during the Initial Assessment and Investigation Phases

- 6.8 Section 126(1) of the Ordinance permits the Commission to disclose confidential information in a number of circumstances.

Disclosures made in the performance of the Commission's functions

- 6.9 As discussed at paragraph 6.5 of this Guideline, section 126(1)(b) of the Ordinance permits the disclosure of information by the Commission in the performance of any of its functions, or in carrying into effect or doing anything authorised by the Ordinance.
- 6.10 During the Initial Assessment Phase or Investigation Phase, the Commission may need to disclose confidential information to other persons to the extent that is necessary to seek clarifications on existing evidence or to seek relevant evidence. For example, in the Investigation Phase the Commission may need to question a person under section 42 of the Ordinance about a confidential meeting minute obtained from another party.
- 6.11 In deciding whether or not to disclose confidential information pursuant to section 126(1)(b), the Ordinance requires the Commission to consider and have regard to the matters set out at section 126(3). These factors include the extent to which the disclosure is necessary for the purpose sought to be achieved by the disclosure and the need to exclude, as far as is practicable, from such disclosure, information the disclosure of which, in the opinion of the Commission:
- (a) would be contrary to public interest;
 - (b) would or might be likely to significantly harm the legitimate business interests of the person to whom it relates; or
 - (c) might significantly harm the interest of a natural person where the information relates to the private affairs of that person.
- 6.12 In conducting this assessment, the Commission will usually be in a better position to evaluate the interests of the person to whom the confidential information relates where the person providing the information has, in its reasons, clearly articulated the basis for identifying the relevant information as confidential.

Disclosures made in accordance with a court order or by law

- 6.13 In some circumstances, the Commission may be required to produce confidential information in accordance with a court order, law or legal requirement. Section 126(1)(c) of the Ordinance provides that a disclosure of confidential information made by the Commission in accordance with any court order, law or legal requirement is to be regarded as a disclosure made with lawful authority. The Commission will endeavour to notify and consult the person who provided the confidential information prior to making such a disclosure.

Cooperation between competition authorities¹⁰

- 6.14 For matters falling within the Commission's concurrent jurisdiction with the CA, information may be exchanged between the Commission and the CA under section 126(1)(h) of the Ordinance.

Obligation of other parties to maintain confidentiality

- 6.15 Where a disclosure of confidential information is made by the Commission to a person, that person has an obligation under section 128(1) of the Ordinance to maintain the confidentiality of that information. That person must not disclose the information to any other person or permit any other person to have access to the information. Failure to maintain such confidentiality is an offence under section 128(3) of the Ordinance.
- 6.16 Under section 128(2) of the Ordinance, there are certain exceptions to the obligation imposed by section 128(1), including where:
- (a) the Commission has consented to a disclosure;
 - (b) the information has already been lawfully disclosed to the public;
 - (c) disclosure is for the purpose of obtaining professional advice in connection with a matter arising under the Ordinance;
 - (d) disclosure is made in connection with any judicial proceedings arising under the Ordinance; or
 - (e) disclosure is required by, or in accordance with, any law or court order.

¹⁰ Section 2 of the Ordinance defines 'competition authority' to mean the Commission or the CA. The phrase 'competition authority' when used in this Guideline is used in this narrow sense.

Use of information by the Commission

6.17 Subject to legal requirements to the contrary, information obtained by the Commission in one matter may be used by the Commission in another matter. In particular, the Commission will not normally accept information or documents provided voluntarily on any condition that seeks to limit the Commission's use of the information. Accordingly, the Commission will not accept any such information or documents on a 'without prejudice' or limited waiver basis¹¹ unless it expressly agrees to do so in a specific circumstance.

7 Possible Outcomes of Investigation Phase

- 7.1 Where the Commission considers it unlikely that a contravention of a Competition Rule has occurred, it will take no further action regarding the matter. Where a Complainant is involved, the Commission will notify the Complainant of this outcome.
- 7.2 Where the Commission considers that a contravention of a Competition Rule has occurred or may occur, the Ordinance provides it with a range of options to resolve its concerns. These include express powers to accept Commitments under section 60 and, where the Commission has reasonable cause to believe that a contravention of a Competition Rule has taken place, to commence proceedings before the Tribunal. The Commission might also seek to resolve its concerns by way of a consent order.
- 7.3 At any stage the Commission may approach parties under investigation to discuss the matter and outline any concerns the Commission may have. Similarly, parties under investigation may approach the Commission at any stage to propose a way to resolve the Commission's concerns.
- 7.4 Possible outcomes of Commission investigations are outlined further below.

No further action

7.5 The Commission may, having regard to its resources and priorities, determine at any point of the Initial Assessment or Investigation Phase that no further action by the Commission is warranted. Where parties swiftly alter any conduct of concern in response to the Commission's enquiries, this will increase the likelihood of the Commission taking no further action.

¹¹ For example, in circumstances where privilege might be waived only for the purpose of one particular matter or Commission procedure.

- 7.6 If the Commission proposes to take no further action in relation to a matter commenced following a complaint, it will provide an explanation of this outcome to the Complainant in writing. When the Commission's decision to take no further action is influenced by parties changing their conduct in response to the Commission's enquiries, the Commission will inform the Complainant of this outcome.
- 7.7 A decision to take no further action at a point in time does not prevent the Commission from revisiting the issue at a later date. For example, additional evidence or a pattern of conduct may arise warranting further investigation.

Accept a section 60 Commitment

- 7.8 Under section 60 of the Ordinance, at any stage the Commission may accept a Commitment to take any action or refrain from taking any action from parties under investigation. The Commitment process¹² may be initiated by the Commission or parties subject to a Commission investigation at any time.
- 7.9 If the Commission accepts a Commitment, it may agree to terminate its investigation and not to bring proceedings in the Tribunal (or terminate them if it has already brought proceedings).
- 7.10 Section 61(1) of the Ordinance provides that the Commission may withdraw its acceptance of a Commitment in the event of a material change of circumstances or where the Commission has reasonable grounds to suspect either:
- (a) failure to comply with the Commitment; or
 - (b) the Commitment was based on information that was incomplete, false or misleading in a material particular.
- 7.11 Where a Commitment has been withdrawn pursuant to section 61 of the Ordinance, the Commission may conduct a new investigation or begin proceedings in the Tribunal.
- 7.12 Under section 60(6) of the Ordinance, as soon as practicable after accepting a Commitment, the Commission must notify the person who made the Commitment and publish the Commitment in a register under section 64 of the Ordinance.

¹² Schedule 2 to the Ordinance sets down the procedural requirements for acceptance and variation of Commitments.

- 7.13 If a person fails to comply with a section 60 Commitment accepted by the Commission, the Commission may seek to enforce the Commitment in the Tribunal under section 63 of the Ordinance.

Issue Warning Notice

- 7.14 Where the Commission has reasonable cause to believe that there has been a contravention of the First Conduct Rule, and this suspected contravention does not involve Serious Anti-competitive Conduct, section 82(1) of the Ordinance provides that the Commission must issue a Warning Notice before commencing proceedings in the Tribunal. The Warning Notice provides parties under investigation with an opportunity to cease the conduct within a specified period.
- 7.15 Section 82(2) of the Ordinance requires that a Warning Notice must set out the alleged contravening conduct, the undertaking(s) involved, the evidence relied upon by the Commission and indicate the manner in which the contravening undertaking may cease the contravening conduct. Section 82(4) provides that if parties continue to engage or repeat the contravening conduct after the expiry of the warning period, the Commission may without further notice commence proceedings in the Tribunal.
- 7.16 Warning Notices will be published on the Commission's website.

Issue Infringement Notice

- 7.17 Section 67 of the Ordinance provides that the Commission may issue an Infringement Notice where it has reasonable cause to believe that there has been a contravention of the First Conduct Rule involving Serious Anti-competitive Conduct and/or the Second Conduct Rule. In the Infringement Notice, the Commission will offer not to bring proceedings in the Tribunal on condition that the undertaking(s) under investigation makes a commitment to comply with the requirements of the notice within a specified compliance period ("**Infringement Notice Commitment**").

7.18 Section 75 of the Ordinance provides that where an Infringement Notice Commitment is made by the undertaking(s) within the compliance period, the Commission may not bring proceedings in the Tribunal in respect of the alleged contravention specified in the Infringement Notice. However, section 76 of the Ordinance provides that section 75 does not prevent the Commission from beginning proceedings in the Tribunal where the Commission has reasonable grounds for suspecting that a person who made an Infringement Notice Commitment has failed to comply with one or more of the requirements of the Infringement Notice.

7.19 The Commission is not required, however, to issue an Infringement Notice before commencing proceedings in the Tribunal or accepting a Commitment under section 60 of the Ordinance.

Commence proceedings in the Tribunal

7.20 Where the Commission has reasonable cause to believe that a person has contravened a Competition Rule, or been involved in such a contravention, the Commission may initiate proceedings before the Tribunal under sections 92, 94, 99 and/or 101 of the Ordinance to seek appropriate orders and sanctions¹³ including, where relevant, interim orders under sections 95 and 98 of the Ordinance. This includes initiating proceedings against persons involved in a contravention of a Competition Rule as defined in section 91 of the Ordinance. Persons in this context includes individuals who aided and abetted, counselled or procured any other person to contravene a Competition Rule, induced or attempted to induce another person to contravene a Competition Rule, was in any way knowingly concerned in or party to a contravention or conspired with another to contravene a Competition Rule.

7.21 For a suspected contravention of the First Conduct Rule that does not involve Serious Anti-competitive Conduct, the Commission must issue a Warning Notice (see paragraphs 7.14 to 7.16 of this Guideline) before the Commission can apply to the Tribunal. In all other cases prior to commencing proceedings in the Tribunal, the Commission will usually contact parties:

- (a) to advise parties of its concerns; and/or
- (b) to provide parties with an opportunity to address those concerns.

¹³ Schedules 3 and 4 to the Ordinance, and sections 93, 96 and 101 of the Ordinance, set down the orders that may be made by the Tribunal in relation to contraventions of the Competition Rules.

7.22 If proceedings are commenced in the Tribunal, the Commission will issue a press release as soon as practicable after commencing proceedings.

Apply for a consent order

7.23 Even where parties wish to resolve the Commission's concerns, these may in some cases only be satisfactorily addressed by an order made by the Tribunal upon the consent of the Commission and the parties. Subject to the Tribunal's determination, a consent order may provide for a declaration that a person has contravened a Competition Rule, the imposition of a pecuniary penalty, a disqualification order or any other order that may be made by the Tribunal under the Ordinance.

Referral to a Government agency

7.24 At any stage, the Commission may consider it appropriate to refer a complaint to a Government agency. In such cases, it will provide an explanation of this outcome to the Complainant in writing.

Conduct a market study

7.25 In addition to investigating suspected contraventions of the Competition Rules, section 130(3) of the Ordinance provides that the Commission may conduct market studies into cases that affect competition in markets in Hong Kong. Although an investigation is not a necessary precursor for the Commission to conduct a market study, evidence gathered by the Commission during the Initial Assessment or Investigation Phase into particular conduct may lead to a market study being conducted into particular practices or certain industries.



競爭事務委員會
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通訊事務管理局
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AUTHORITY

**Revised Draft Guideline on
Applications for a Decision
under Sections 9 and 24
(Exclusions and Exemptions)
and Section 15
Block Exemption Orders**

30 March 2015

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Guideline on Applications for a Decision under Sections 9 and 24 (Exclusions and Exemptions) and Section 15 Block Exemption Orders

*This Guideline is jointly issued by the Competition Commission (the “**Commission**”) and the Communications Authority (the “**CA**”) under sections 35(1)(b) and (c) of the Competition Ordinance (Cap 619) (the “**Ordinance**”). The Guideline sets out:*

- *the manner and form in which the Commission will receive applications for a decision or block exemption order; and*
- *how the Commission expects to exercise its power to make a decision or issue block exemption orders.*

While the Commission is the principal competition authority responsible for enforcing the Ordinance, it has concurrent jurisdiction with the CA in respect of the anti-competitive conduct of certain undertakings operating in the telecommunications and broadcasting sectors.¹ Unless stated otherwise, where a matter relates to conduct falling within this concurrent jurisdiction, references in this Guideline to the Commission also apply to the CA.

*The Guideline is not, however, a substitute for the Ordinance and does not have binding legal effect. The Competition Tribunal (the “**Tribunal**”) and other courts are responsible ultimately for interpreting the Ordinance. The Commission’s interpretation of the Ordinance does not bind them. The application of this Guideline may, therefore, need to be modified in light of the case law of the courts.*

This Guideline describes the general approach which the Commission intends to apply to the topics covered in the Guideline. The approach described will be adapted, as appropriate, to the facts and circumstances of the matter.

¹ The relevant undertakings are specified under section 159(1) of the Ordinance. These are licensees under the Telecommunications Ordinance (Cap 106) (the “**TO**”) or the Broadcasting Ordinance (Cap 562) (the “**BO**”), other persons whose activities require them to be licensed under the TO or the BO, or persons who have been exempted from the TO or from specified provisions of the TO pursuant to section 39 of the TO.

I Introduction

- 1.1 The Ordinance applies to all sectors of the economy. It prohibits certain conduct which has the object or effect of preventing, restricting or distorting competition in Hong Kong. This conduct includes anti-competitive arrangements and abuses of a substantial degree of market power. The Ordinance also prohibits mergers which may substantially lessen competition. These prohibitions are collectively referred to as the “**Competition Rules**”. Detailed guidance on the Competition Rules can be found in the Commission’s *Guideline on the First Conduct Rule*, *Guideline on the Second Conduct Rule* and *Guideline on the Merger Rule*.
- 1.2 The Competition Rules recognise that free and competitive markets benefit consumers, businesses and the economy. Businesses and consumers benefit from the process of rivalry in the marketplace. The Competition Rules seek to preserve that rivalry.
- 1.3 In limited circumstances, conduct which might otherwise be anti-competitive may produce benefits which should be considered in assessing the detriment caused by that conduct.
- 1.4 The Ordinance allows for a limited regime of exclusions and exemptions which, if applicable, means the First Conduct Rule and/or the Second Conduct Rule (collectively, the “**Conduct Rules**”) do not apply. These exclusions and exemptions are discussed in Part 2 of this Guideline and in the Commission’s *Guideline on the First Conduct Rule* and *Guideline on the Second Conduct Rule*. Specific guidance on exemptions and exclusions from the Merger Rule are provided in the *Guideline on the Merger Rule*.
- 1.5 Undertakings to whom an exclusion or exemption applies will not contravene the Ordinance. There is no requirement for undertakings to apply to the Commission in order to secure the benefit of a particular exclusion or exemption. Equally, undertakings may assert the benefit of any exclusion or exemption as a “defence” to any proceedings before the Tribunal or other courts.

- 1.6 However, the Ordinance provides that undertakings may elect to apply to the Commission under section 9 and/or section 24 for a decision under section 11 and/or section 26 ("**Decision**") as to whether or not an agreement² or conduct³ is excluded or exempt from the Conduct Rules ("**Application for a Decision**"). The Commission is only required to consider Applications for a Decision under certain circumstances.
- 1.7 Pursuant to section 15 of the Ordinance, the Commission may also issue block exemption orders ("**Block Exemption Orders**") exempting categories of agreements that enhance overall economic efficiency ("**Excluded Agreements**"). As defined by section 15(5) of the Ordinance, Excluded Agreements are particular categories of agreements excluded from the First Conduct Rule under section 1, Schedule 1 of the Ordinance. The Commission may issue a Block Exemption Order in response to an application ("**Block Exemption Application**") or on its own initiative.
- 1.8 This Guideline provides undertakings which are considering whether to make an Application for a Decision or a Block Exemption Application with general guidance on the:
- (a) procedure to follow in applying for a Decision or a Block Exemption Order; and
 - (b) process that the Commission will follow in making Decisions and issuing Block Exemption Orders.

2 Exclusions and Exemptions

- 2.1 The Ordinance provides for the following exclusions and exemptions:
- (a) general exclusions from the Conduct Rules listed under Schedule 1:
 - i. agreements enhancing overall economic efficiency;
 - ii. compliance with legal requirements;
 - iii. services of general economic interest;
 - iv. mergers;
 - v. agreements of lesser significance; and
 - vi. conduct of lesser significance(collectively, the "**General Exclusions**");

² A reference to "agreements" in this Guideline in the context of sections 9 and 11 of the Ordinance (Applications and Decisions regarding the First Conduct Rule) includes agreements to which an undertaking has made or given effect, is giving effect or is proposing to make or give effect.

³ A reference to "conduct" in this Guideline in the context of sections 24 and 26 of the Ordinance (Applications and Decisions regarding the Second Conduct Rule) includes conduct which an undertaking has engaged, is engaging in or is proposing to engage in.

- (b) section 3 provides that the Competition Rules and the enforcement provisions in Parts 4 and 6 of the Ordinance do not apply to statutory bodies (“**Statutory Body Exclusion**”), unless the Chief Executive in Council specifies otherwise under regulations; and
- (c) the Chief Executive in Council may:
 - i. under sections 4 and 5, provide for exclusions under regulations from the Competition Rules in respect of specified persons and persons engaged in specified activities (“**Specified Person or Activities Exclusion**”);
 - ii. under section 31, publish an order in the Gazette specifying that a particular agreement or conduct or a particular class of agreement or conduct is exempt from the Conduct Rules on public policy grounds (“**Public Policy Exemption**”); and
 - iii. under section 32, publish an order in the Gazette specifying that a particular agreement or conduct or a particular class of agreement or conduct is exempt from the Conduct Rules to avoid a conflict with international obligations that directly or indirectly relate to Hong Kong (“**International Obligations Exemption**”).

2.2 The Ordinance also provides that an undertaking may make an Application for a Decision to confirm whether an existing Block Exemption Order applies to its agreement(s).

2.3 Figure 1 below summarises which exclusions and exemptions apply in respect of each Conduct Rule.

Figure 1. Exclusions and exemptions from the Conduct Rules

Relevant exclusion or exemption		Exclusion or exemption from First Conduct Rule	Exclusion or exemption from Second Conduct Rule
General Exclusions	Agreements enhancing overall economic efficiency	✓	
	Compliance with legal requirements	✓	✓
	Services of general economic interest	✓	✓
	Mergers	✓	✓
	Agreements of lesser significance	✓	
	Conduct of lesser significance		✓
Block Exemption Orders		✓	
Public Policy Exemption		✓	✓
International Obligations Exemption		✓	✓
Statutory Body and Specified Person or Activities Exclusions		✓	✓

General Exclusions

2.4 The *Guideline on the First Conduct Rule* and the *Guideline on the Second Conduct Rule* set out the Commission's approach to assessing whether the General Exclusions apply.

Scope of Statutory Body Exclusion

2.5 Statutory bodies, as defined in section 2(1) of the Ordinance, are excluded from the Competition Rules unless they are specifically brought within the scope of those rules by a regulation made by the Chief Executive in Council under section 5 of the Ordinance.

- 2.6 The reference to a statutory body in section 3 of the Ordinance includes an employee or agent of the statutory body acting in that capacity. The Statutory Body Exclusion does not, however, extend to legal entities owned or controlled by a statutory body unless those entities are also statutory bodies.⁴ Moreover, the Statutory Body Exclusion does not extend to undertakings that might engage in anti-competitive arrangements with an excluded statutory body. Those undertakings remain subject to the Ordinance.

Exclusions and exemptions made by the Chief Executive in Council

- 2.7 Any regulations and orders made by the Chief Executive in Council in respect of exclusions and exemptions from the Conduct Rules can be found on the Commission's website.

3 Confidentiality and Disclosure

- 3.1 Section 125 of the Ordinance imposes a general obligation on the Commission to preserve the confidentiality of any confidential information provided to or obtained by the Commission. The following categories of information are defined as confidential under section 123 of the Ordinance:
- (a) Information that has been provided to or obtained by the Commission in the course of, or in connection with, the performance of its functions under the Ordinance, that relates to
 - i. the private affairs of a natural person;
 - ii. the commercial activities of any person that are of a confidential nature; or
 - iii. the identity of any person who has given information to the Commission;
 - (b) Information that has been given to the Commission on terms that or in circumstances that require it to be held in confidence; or
 - (c) Information given to the Commission that has been identified as confidential information in accordance with section 123(2) of the Ordinance.

⁴ In any event, the definition of statutory body does not include a "company" as defined in the Ordinance (including a company within the meaning of section 2(1) of the Companies Ordinance (Cap 622)).

- 3.2 Section 126(1) of the Ordinance permits the disclosure of confidential information by the Commission in certain circumstances, including disclosures made by the Commission in the performance of any of its functions, or in carrying into effect or doing anything authorised by the Ordinance. Section 126(1) disclosures are therefore not limited to where the Ordinance expressly requires the Commission to publish information and, subject to the provisions of the Ordinance, the Commission may in certain circumstances disclose confidential information without the consent of relevant parties.
- 3.3 Parties submitting information to the Commission in the context of the Commission's consideration of an Application for a Decision or Block Exemption Application should also refer to Part 6 of the *Guideline on Investigations*.

Claiming confidentiality in applications

- 3.4 Paragraphs 6.16 and 11.14 of this Guideline, as well as Form AD, the relevant form for an Application for a Decision, set out certain minimum information to be provided to the Commission by applicants. Undertakings may not refrain from providing this information solely on the basis that the information is confidential or defined under section 123(1) of the Ordinance.
- 3.5 As explained further in the Commission's *Guideline on Investigations*, where an applicant wishes to make a claim for confidentiality under section 123(1)(c) of the Ordinance in respect of information provided to the Commission in the context of an application, the applicant should identify the relevant information and provide a statement in writing setting out the reasons why the identified information is, in the applicant's opinion, confidential.
- 3.6 Applicants should submit both confidential and non-confidential versions of their Application for a Decision or Block Exemption Application. As explained elsewhere in this Guideline, the non-confidential version of the application will be published by the Commission on its website with a view to consulting interested parties and/or otherwise released to relevant third parties for the purposes of seeking their views on the application.

Considering the scope of confidentiality claims

- 3.7 Section 126(1) of the Ordinance permits the Commission to disclose confidential information in a number of circumstances. As noted at paragraph 3.2 of this Guideline, section 126(1)(b) of the Ordinance permits the disclosure of information by the Commission in the performance of any of its functions, or in carrying into effect or doing anything authorised by the Ordinance.

- 3.8 To make a Decision or to issue a Block Exemption Order, the Commission will assess the veracity and relevance of information provided by parties. This assessment is often achieved by seeking the views of other parties on information provided to the Commission.
- 3.9 Due to the operation of the Ordinance, unnecessarily broad claims to confidentiality under section 123(1)(c) may:
- (a) impede the Commission's ability to assess and rely on the information provided by a party; and/or
 - (b) increase the risk that information the party does not want to be disclosed is disclosed under section 126(1)(b) of the Ordinance.⁵
- 3.10 Applicants in particular should consider the scope of any confidentiality claim made in relation to their Application for a Decision or Block Exemption Application. While confidentiality claims may often be necessary and appropriate in relation to specific information provided in support of an Application for a Decision or Block Exemption Application, overly broad claims may impede the Commission's ability to assess the application in a timely manner.

4 Other Commission Procedures

- 4.1 Absent an express agreement with the Commission, information provided voluntarily to the Commission by applicants or other parties, including information protected by legal professional privilege, will not be accepted on a 'without prejudice' basis or otherwise on terms that its use is limited for the sole purpose of the Commission making a Decision or issuing a Block Exemption Order.⁶ The Commission can use any information received in the context of an application, with or without notice to interested parties, for other purposes under the Ordinance. This includes for the purposes of considering whether a contravention of the Ordinance has occurred and/or with a view to enforcement where there has been a contravention.⁷
- 4.2 As a general matter, applicants are encouraged to seek legal advice before approaching the Commission about an Application for a Decision or Block Exemption Application.

⁵ See paragraphs 6.11 and 6.12 of the Commission's *Guideline on Investigations* for more information.

⁶ For example, in respect of information which is legally privileged, an applicant might wish to waive privilege only for the purpose of the Commission making a Decision or issuing a Block Exemption Order. Absent an express agreement with the Commission, the Commission will not accept information on this basis for the purposes of an application.

⁷ See further in this respect paragraph 5.16 of this Guideline.

5 Considering Whether to Make an Application for a Decision or Block Exemption Application

- 5.1 Any undertaking may apply to the Commission for a Decision or Block Exemption Order. In addition, associations of undertakings (“**Associations**”) may apply to the Commission for a Block Exemption Order.
- 5.2 There is no obligation on each undertaking involved in an agreement or conduct which is the subject of an Application for a Decision or Block Exemption Application to be a party to the application or to make their own application. However, the Commission expects the cooperation of all undertakings that are party to the agreements in question to provide information which might assist the Commission in its consideration of the Application for a Decision or Block Exemption Application.
- 5.3 The Commission expects the category of agreements that are the subject of a Block Exemption Application to be representative of agreements in wider use in one or more industries, and the applicant must demonstrate that this is the case.
- 5.4 For sector specific Block Exemption Applications, applicants are encouraged to provide evidence showing there is a greater need for cooperation between undertakings in the relevant sector as compared with other sectors in the economy.

Need for a Decision or Block Exemption Order

- 5.5 It is up to undertakings and Associations to assess for themselves whether their agreements and/or conduct comply with the Conduct Rules. The Ordinance provides for certain exclusions and exemptions from the Conduct Rules in limited circumstances.
- 5.6 There is no requirement that there be a Decision or Block Exemption Order before undertakings or Associations may rely on applicable exclusions and exemptions. Undertakings or Associations may self-assess the legality of their conduct having regard to the Conduct Rules and the exclusions and exemptions from those rules.

- 5.7 If an undertaking wishes to seek greater legal certainty, it may wish to apply to the Commission for a Decision or a Block Exemption Order. An Association may similarly apply for a Block Exemption Order.

Whether to apply for a Decision or Block Exemption Order

- 5.8 A Decision may be made by the Commission in relation to the applicability of any exclusion or exemption listed in Figure 1. As discussed at paragraph 1.7 of this Guideline, Block Exemption Orders may only be issued by the Commission in relation to Excluded Agreements.
- 5.9 Where similar agreements enhancing overall economic efficiency are commonly used by undertakings throughout a market, it may be more appropriate for undertaking(s) or Associations to consider seeking a Block Exemption Order for such agreements rather than apply separately for a Decision regarding their specific agreement. This is a matter which should be discussed with the Commission prior to making any application.
- 5.10 There is no need for the Commission to make a Decision before it issues a Block Exemption Order.

Lodging applications

- 5.11 Paragraphs 6.16 and 11.14 of this Guideline set out the minimum information to be included in Applications for Decisions and Block Exemption Applications respectively. Form AD, which is the relevant form for an Application for a Decision, will be available on the Commission's website.
- 5.12 Applicants will generally be required to provide further information during the course of the Commission's review. Applicants will be expected to provide timely responses to any such information requests.
- 5.13 Where documents in support of applications are not available in English or Chinese, the applicant should provide a translation into one of these languages. In the appropriate circumstances, the Commission may require translations only of relevant extracts.
- 5.14 The Commission will publish the most up-to-date requirements for applications on its website to assist applicants.

Fee payable

- 5.15 The Commission may require the payment of a fee in respect of Applications for a Decision and Block Exemption Applications pursuant to section 164 of the Ordinance.⁸ Any fee imposed will be returned if the Commission declines to consider the application. Information on relevant fees will be published on the Commission's website.

Applications for a Decision and Block Exemption Applications do not provide immunity

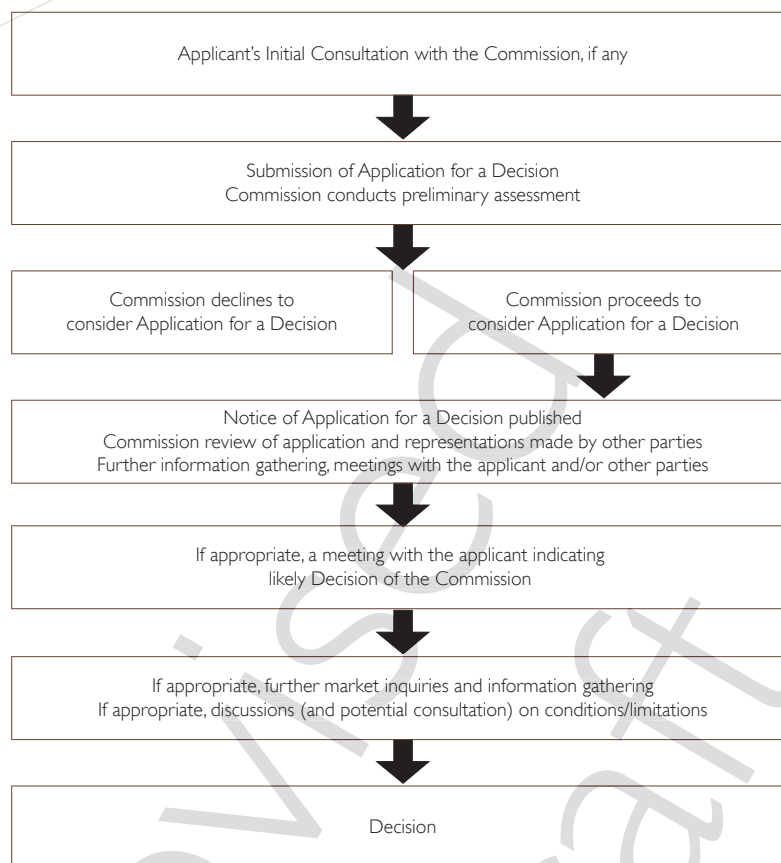
- 5.16 Where an application is made in relation to an existing agreement or conduct, the Ordinance does not afford the undertakings concerned any immunity from enforcement action during the Commission's review of the application. The Commission may in its discretion, initiate enforcement action in respect of any such agreement or conduct (including proceedings before the Tribunal) if it declines to consider an application, make a Decision, or issue a Block Exemption Order. In any such case, the Commission may use information provided by the applicant in the relevant enforcement action as set out in Part 4 of this Guideline.
- 5.17 Applicants are therefore encouraged to seek legal advice before making an Application for a Decision or Block Exemption Application as noted above.

6 Application Process for a Decision

- 6.1 Figure 2 below outlines the main steps in the application process for a Decision.
- 6.2 The Ordinance does not provide any timeframe for the Commission's review of an Application for a Decision or prescribe any deadline for making a Decision. The timing of a particular review will vary depending on, for example, the complexity of the case and the availability of Commission resources. The Commission will, however, endeavour to process applications expeditiously.

⁸ The fees chargeable are to be prescribed in a regulation made by the Chief Executive of the Hong Kong SAR.

Figure 2. Key steps for an Application for a Decision



6.3 The Commission expects Applications for a Decision to be complete and accurate. The Commission intends to specify a timeframe or deadline for the submission of responses to Commission information requests. Applicants should respond in a timely manner to any Commission information requests.

Factors the Commission will consider in determining whether to consider an application

6.4 Under sections 9(2) and 24(2) of the Ordinance, the Commission is only required to consider an Application for a Decision in certain circumstances:

- (a) the application poses novel or unresolved questions of wider importance or public interest in relation to the application of exclusions or exemptions under the Ordinance;
- (b) the application raises a question of an exclusion or exemption under the Ordinance for which there is no clarification in existing case law or decisions of the Commission; and

(c) it is possible to make a decision on the basis of the information provided (collectively, the “**Suitability Factors**”).

6.5 The Commission will generally only consider Applications for a Decision that fulfil all the Suitability Factors.

Novel or unresolved question of wider importance

6.6 In deciding whether an Application for a Decision “*poses a novel or unresolved question of wider importance or public interest*” for the purposes of sections 9(2)(a) and 24(2)(a), the Commission may consider, in particular, the following:

- (a) the economic importance, from the point of view of the consumer, of the products or services concerned by the agreement or conduct; and/or
- (b) the extent to which the agreement or conduct or similar agreements or similar conduct is in widespread usage in the marketplace.

No clarification in existing case law or Commission decisions

6.7 Before submitting an Application for a Decision, an applicant should confirm that there is no existing guidance in the case law or orders of the Tribunal or other Hong Kong courts, or decisions of the Commission.

Sufficient information to make a Decision

6.8 The onus is on the applicant to provide sufficient evidence to support its Application for a Decision.

6.9 Paragraph 6.16 of this Guideline sets out the information the Commission generally requires for the purposes of making a Decision. Applicants should also consider the *Guideline on the First Conduct Rule* and *Guideline on the Second Conduct Rule* to assist them in understanding what evidence is likely to be required to support their Application for a Decision.

Not a hypothetical question

6.10 The Ordinance does not require the Commission to consider an Application for a Decision if it concerns hypothetical questions or agreements.

6.11 In this context, the Commission will not generally consider an Application for a Decision regarding agreements or conduct which have ceased. Undertakings may, however, apply for a Decision in relation to a future agreement or conduct in which they intend to engage. In this case, the applicant must provide sufficient details of the specific agreement or conduct that would enable the Commission to decide on the merits of the Application for a Decision.

Initial Consultation prior to making an Application for a Decision

6.12 Potential applicants may approach the Commission prior to submitting an Application for a Decision (“**Initial Consultation**”). There is no obligation to engage in an Initial Consultation, but the Commission strongly encourages all potential applicants to do so.

6.13 While an Initial Consultation may take place on a confidential basis, confidential information provided to the Commission during an Initial Consultation will be treated in accordance Part 8 of the Ordinance and the terms of this Guideline relating to the provision of confidential information to the Commission. Accordingly, absent an express agreement with the Commission, information provided voluntarily to the Commission in the context of an Initial Consultation, including information protected by legal professional privilege, will not be accepted on a ‘without prejudice’ basis or otherwise on terms that its use is limited for the sole purpose of the Initial Consultation and/or subsequent application. The Commission can use any information received in the context of an Initial Consultation, with or without notice to interested parties, for other purposes under the Ordinance including enforcement purposes (see paragraph 4.1 of this Guideline).

6.14 An Initial Consultation affords the Commission an opportunity to discuss with the applicant jurisdictional and other matters. In particular, the Initial Consultation may allow the Commission and the applicant to prepare for the process of making an Application for a Decision by identifying key issues and possible competition concerns at an early stage and the evidence that the Commission would need to assess these concerns.

6.15 During the Initial Consultation the Commission may highlight to a potential applicant that an alternative procedural route under the Ordinance may be more appropriate depending on the nature of the specific conduct in question. The Commission may also indicate to the applicant whether the Application for a Decision appears likely to satisfy the Suitability Factors.

Preparing an Application

6.16 An Application, accompanied by the appropriate fee, should be made to the Commission by submitting a completed Form AD. Form AD requires, among other things:

- (a) information relating to the applicant and the other parties to the agreement or conduct (including contact information, a description of key business activities, information on controlling shareholders and turnover data);
- (b) a detailed description of the relevant agreement or conduct (including copies of any relevant documents (including agreements or draft agreements));
- (c) information on the provisions or elements of the agreement/conduct which might give rise to competition concerns and an explanation of the nature of those concerns including possible theories of harm;
- (d) an explanation of the applicant's view of the relevant markets involved together with market share data (including for competitors) and other information on the competitive situation in such markets;
- (e) information on affected suppliers and customers and their contact details;
- (f) an explanation (including supporting evidence) as to why the applicant believes the relevant agreement/conduct satisfies the terms of a particular exclusion or exemption; and
- (g) where submissions/applications have been made to competition authorities in other jurisdictions with respect to the same agreement or conduct, a list of the relevant jurisdictions, information on when the submissions/applications were made, and an indication of the status of the various submissions/applications in the jurisdictions concerned.

6.17 The applicant should submit a non-confidential version of the Application for a Decision to the Commission. The non-confidential version will be publicised by the Commission should it decide to consider the Application for a Decision (see paragraph 8.2 of this Guideline).

6.18 The Commission will acknowledge receipt of all Applications for a Decision it receives.

7 Preliminary Assessment of Application for a Decision

- 7.1 The Commission will conduct a preliminary assessment based on the information provided by the applicant. The purpose of the preliminary assessment is to decide whether the Commission will consider the Application for a Decision based on the Suitability Factors and other issues outlined in paragraphs 6.4 to 6.12 of this Guideline.

Potential outcomes of preliminary assessment

- 7.2 After a preliminary assessment of an Application for a Decision, the Commission will either:
- (a) decline to consider the Application for a Decision; or
 - (b) elect to consider the Application for a Decision.
- 7.3 If the Commission declines to consider the Application for a Decision, it will provide an explanation of this outcome to the applicant in writing. Such an outcome does not constitute a Decision under section 11 and/or section 26 of the Ordinance. It also does not indicate the Commission's position on whether the relevant agreement or conduct:
- (a) raises a concern under the Conduct Rules; or
 - (b) is or is not excluded or exempt from the Conduct Rules.
- 7.4 If the Commission elects to consider the Application for a Decision under section 10 or 25 of the Ordinance, it will inform the applicant.
- 7.5 The timeframe for preliminary assessment will depend on the nature and complexity of each matter, as well as the resources available to the Commission at the time. Where the applicant has engaged with the Commission in an Initial Consultation and provides an Application for a Decision consistent with the issues discussed during that consultation, the timeframe for preliminary assessment may be shorter than otherwise.

8 Consideration of Application for a Decision

8.1 Where the Commission decides to consider an Application for a Decision under sections 10 or 25 of the Ordinance, it will:

- (a) publicise the Application for a Decision; and
- (b) engage with parties likely to be affected by a Decision.

Publicising the Application for a Decision

8.2 The Commission will publicise an Application for a Decision in accordance with section 10(1) or 25(1) of the Ordinance, including by posting a notice of the application together with a non-confidential version of the application on the Commission's website.

Engagement with parties likely to be affected by a Decision

8.3 The Commission will engage with, and consider representations from, parties likely to be affected by a Decision (for example, competitors, suppliers, or customers of the applicant) in accordance with section 10(1) or 25(1) of the Ordinance. Pursuant to sections 10(2) and 25(2) of the Ordinance, the Commission will specify the period within which representations about the Application for a Decision may be made when it publishes the notice of the application. Interested parties will be given at least 30 calendar days to make representations about the Application for a Decision beginning after the day on which the notice is first published.

8.4 During this process, the Commission may meet with the applicant and other parties as appropriate. The Commission may also seek the views of trade associations, sectoral regulators or industry representative bodies. The Commission will seek additional information from the applicant or other parties as appropriate.

8.5 With a view to transparency in its decision making, the Commission will generally publish any written representations on its website. For this reason, the Commission requires the applicant and other parties to provide non-confidential versions of their written representations.

Engagement with the applicant

8.6 The Commission may invite the applicant to provide additional written representations or further information in response to representations received from other parties.

- 8.7 During the review of the Application for a Decision, the Commission may also have one or more meetings with the applicant to discuss such matters as the following:
- (a) any concerns raised by the Application for a Decision;
 - (b) any preliminary views about the merits of the Application for a Decision; and
 - (c) any questions raised by the information submitted by the applicant or submitted by or obtained from third parties.
- 8.8 The applicant will be given an opportunity to comment or to make further submissions in a timely manner during or after the relevant meeting.
- 8.9 After the completion of the review of the Application for a Decision and before making a Decision, the Commission may meet with the applicant to convey its views on the merits of the Application for a Decision and any conditions and limitations being considered. The applicant will be given an opportunity to comment at the meeting or in a timely manner after the meeting.
- 8.10 Generally, the Commission will not publish its proposed Decision for public comment. However, the Commission may choose in certain cases to publish a proposed Decision in non-confidential form or release a proposed Decision in non-confidential form to parties likely to be affected by the Decision where:
- (a) the proposed Decision, if made, is likely to be of wider relevance for the market; or
 - (b) the Commission considers that the views of parties likely to be affected by the proposed Decision, if made, would assist the Commission in its assessment of the application.

9 Making a Decision

- 9.1 After reviewing relevant information and considering representations made within the timeframe for consultation, the Commission will make a Decision in accordance with section 11 or 26 of the Ordinance. The Decision may be that the agreement or conduct:
- (a) is not excluded or exempt from the Conduct Rules;
 - (b) is excluded or exempt from one or more of the Conduct Rules; or

(c) is excluded or exempt from one or more of the Conduct Rules, subject to conditions or limitations.

9.2 Sections 11(3) and 26(3) of the Ordinance require the Commission to inform the applicant in writing of the Decision, the date of the Decision and the reasons for it.

9.3 A non-confidential version of the Decision and the Commission's reasons for it will be published on the Commission's website. The Commission will also make an entry in the Commission's register of Decisions and Block Exemption Orders in respect of the Decision.

Effect of a Commission Decision

9.4 Under sections 12 and 27 of the Ordinance, where the Commission makes a Decision that an agreement or conduct is excluded or exempt, the undertaking specified in the Decision is immune from action under the Ordinance with respect to that agreement or conduct.

9.5 The need for conditions or limitations on Decisions will be considered on a case by case basis. However, the Commission will likely limit the duration of a Decision's effect if the Decision confirms the applicability of an exclusion or exemption.⁹

9.6 A Decision that the agreement or conduct is not excluded or exempt from the Conduct Rules does not necessarily mean that the Commission has formed a view on whether it has reasonable cause to believe that a contravention of the Conduct Rules has occurred in connection with that agreement or conduct.

⁹ The Commission will be particularly likely to limit the duration of a Decision to the extent that the Decision provides that an agreement is excluded from the application of the First Conduct Rule by or as a result of the General Exclusion for agreements enhancing overall economic efficiency.

10 Post Decision Matters

Rescission

- 10.1 Sections 14 and 29 of the Ordinance provide that the Commission may rescind a Decision where the Commission has reason to believe that:
- (a) there has been a material change of circumstances since the Decision was made; or
 - (b) the information on which it based the Decision was incomplete, false or misleading in a material particular.
- 10.2 Where the Commission proposes to rescind a Decision, it will advise the undertaking specified in the Decision of its intention to do so and publicise the proposed rescission in accordance with sections 14(2) and 29(2) of the Ordinance, including by posting a notice of the proposed rescission on the Commission's website. This will involve publishing a statement on the Commission's website that it is considering rescinding a Decision and the reasons why, and inviting the undertaking specified in the Decision and those persons it considers likely to be affected to make representations about the proposed rescission within the period specified in the notice.
- 10.3 Under sections 14(4) and 29(4) of the Ordinance, persons making representations will be given at least 30 calendar days to make representations on the proposed rescission beginning after the day on which the notice is published.
- 10.4 In accordance with sections 14 and 29 of the Ordinance, the Commission will engage with, and consider representations from, the persons likely to be affected by the proposed rescission.
- 10.5 With a view to transparency in its decision making, the Commission will generally publish any written representations on its website. For this reason, the Commission requires the applicant and/or other parties to provide non-confidential versions of their written representations.

10.6 Following consideration of any representations received within the period identified in the notice of proposed rescission, the Commission may then proceed to issue a notice of rescission in line with the requirements of sections 14 and 29 of the Ordinance. This will be published on the Commission's website and an entry will be made in the register of Decisions and Block Exemption Orders in accordance with section 34 of the Ordinance.

10.7 Where the Commission rescinds a Decision, undertakings for which the Decision provided immunity from action under the Ordinance lose their immunity from the date the rescission takes effect with regard to anything done after that date.

Compliance with conditions or limitations

10.8 Where the Commission has made its Decision subject to conditions or limitations, the Commission will monitor the undertaking's compliance with those conditions or limitations.

10.9 If an undertaking fails or ceases to comply with a condition or limitation subject to which a Decision has effect, sections 12(2), 13(1), 27(2) and 28(1) of the Ordinance provide that the immunity pursuant to that Decision ceases to apply with effect from the date on which the non-compliance begins.

10.10 Where an undertaking loses its immunity in view of a failure to comply with a condition or limitation, the Commission is entitled under section 13 or 28 to take enforcement action under the Ordinance.

11 Exercise of the Commission's Discretion Whether to Issue a Block Exemption Order

11.1 Section 15(1) of the Ordinance provides the Commission with the discretion to issue a Block Exemption Order where it is satisfied that a particular category of agreement is an Excluded Agreement.

- 11.2 Under section 15(2) of the Ordinance, the process leading to the Commission issuing a Block Exemption Order may be initiated in one of two ways. The Commission may:
- (a) of its own volition and without having received any application, decide to initiate a process to consider whether to issue a Block Exemption Order (“**Commission Initiated Process**”); or
 - (b) in response to an application by one or more undertakings or an Association, decide to initiate a process to consider whether to issue a Block Exemption Order.
- 11.3 The Commission considers that the issue of a sector specific Block Exemption Order should be seen as an exceptional measure. The Commission will take into account whether the resources required for considering whether to issue such a Block Exemption Order are likely to be proportionate to the expected public benefit of issuing the order before commencing this process.
- 11.4 As outlined in paragraphs 5.5 to 5.7 of this Guideline, there is no requirement that the Commission issue a Block Exemption Order in order for undertakings or Associations to rely on the exclusion for agreements enhancing overall economic efficiency. Undertakings or Associations may self-assess the legality of their conduct having regard to the First Conduct Rule and the applicable exclusions and exemptions from those rules.
- 11.5 Block Exemption Orders may be relevant to a substantial portion of the Hong Kong economy. Developing a thorough understanding of the markets and potential impact of the Block Exemption Order may require extensive consultation with multiple stakeholders. The Commission notes that in jurisdictions which provide for a block exemption regime similar to the regime under the Ordinance, it is not unusual for the process leading to the issue of a block exemption to take a considerable period of time.
- 11.6 All undertakings and Associations considering making Block Exemption Applications are strongly encouraged to approach the Commission for an Initial Consultation before making any such application (see paragraphs 11.10 to 11.12 of this Guideline).

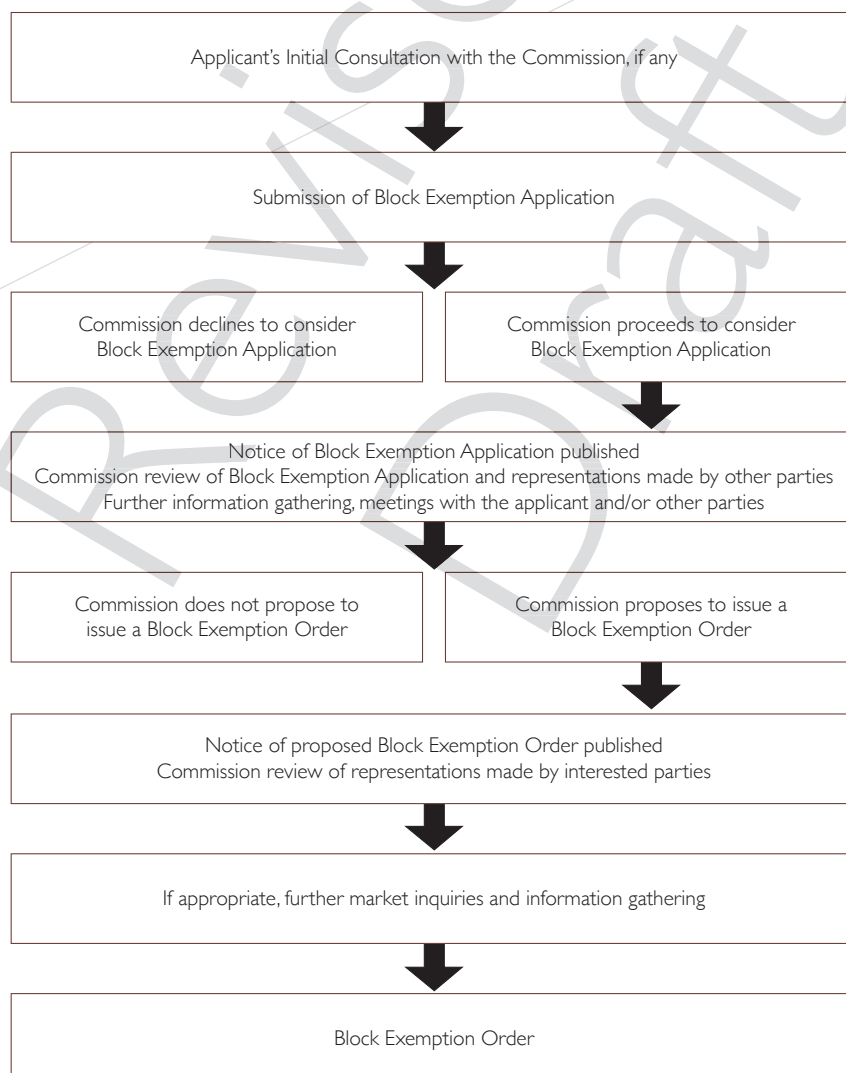
Process for applying to the Commission to issue a Block Exemption Order

11.7 Figure 3 below outlines the main steps in the application process for a Block Exemption Order.

11.8 The Ordinance does not provide any timeframe for the Commission's review of a Block Exemption Application or prescribe any deadline for making a Block Exemption Order. The timing of a particular review will vary depending on, for example, the complexity of the case and the availability of Commission resources.

11.9 A review of a Block Exemption Application is likely to take considerably more time compared with an Application for a Decision.

Figure 3. Key steps for a Block Exemption Application



Initial Consultation for a Block Exemption Application

11.10 Potential applicants should approach the Commission prior to submitting a Block Exemption Application. While there is no obligation to engage in an Initial Consultation, the Commission strongly encourages all potential applicants to do so.

11.11 The Initial Consultation is to identify whether:

- (a) it is possible that the relevant category of agreements may be Excluded Agreements;
- (b) a Block Exemption Application is the appropriate procedure under the Ordinance;
- (c) there is likely to be sufficient evidence available for the Commission to consider issuing a Block Exemption Order; and
- (d) the resources required to consider whether to issue a Block Exemption Order are likely to be proportionate to the expected public benefit of issuing such an order.

11.12 In particular, an Initial Consultation may allow the Commission to indicate to the applicant whether it is likely to consider the Block Exemption Application.

11.13 While an Initial Consultation may take place on a confidential basis, confidential information provided to the Commission during an Initial Consultation will be treated in accordance with Part 8 of the Ordinance and the terms of this Guideline relating to the provision of confidential information to the Commission. Accordingly, absent an express agreement with the Commission, information provided to the Commission in the context of an Initial Consultation, including information protected by legal professional privilege, will *not* be accepted on a 'without prejudice' basis or otherwise on terms that its use is limited for the sole purpose of the Initial Consultation and/or subsequent application. The Commission can use any information received in the context of an Initial Consultation, with or without notice to interested parties, for other purposes under the Ordinance including enforcement purposes (see generally paragraph 4.1 of this Guideline).

Preparing a Block Exemption Application

11.14 A Block Exemption Application, accompanied by the appropriate fee, should be made to the Commission by submitting, among other things:

- (a) information relating to the applicant and the parties to the agreements concerned by the proposed Block Exemption Order (including, to the extent available to the applicant, contact information, a description of key business activities for the parties concerned);
- (b) details of the category of agreement concerned by the proposed block exemption order (including copies of a sufficiently representative sample of agreements falling within the relevant category);
- (c) information on the provisions or elements of the agreements falling within the relevant category of agreement which might give rise to competition concerns and an explanation of the nature of those concerns including possible theories of harm;
- (d) an explanation of the view of the applicant on the definition of the relevant markets affected together with market share data (including for competitors) and other information on the competitive situation in such markets;
- (e) information on affected suppliers and customers and their contact details to the extent available to the applicant;
- (f) an explanation (including supporting evidence) as to why the applicant believes the relevant category of agreement satisfies the terms of section 1 of Schedule 1 to the Ordinance (agreements enhancing overall economic efficiency);
- (g) if relevant, an explanation of factors in support of the applicant's claim that the category of agreements that are the subject of the application are representative of agreements in wider use in one or more industries; and
- (h) in the case of a sector specific Block Exemption Application, evidence showing a greater need for cooperation between undertakings in the relevant sector as compared with other sectors in the economy.¹⁰

11.15 The Commission will publish the most up-to-date requirements for applications on its website to assist applicants.

¹⁰ Applicants for a sector specific Block Exemption Order are encouraged to provide this information but this is not a mandatory requirement.

11.16 The applicant should also provide a non-confidential version of the Block Exemption Application to the Commission. The non-confidential version will be publicised by the Commission should it decide to consider the Block Exemption Application (see paragraph 12.1 of this Guideline).

11.17 The Commission will acknowledge receipt of all Block Exemption Applications it receives.

12 Considering Whether to Issue a Block Exemption Order

12.1 Where the Commission is considering whether to issue a Block Exemption Order, based on either a Commission Initiated Process or a Block Exemption Application, it will:

- (a) publicise by way of a notice on the Commission's website the Commission Initiated Process or Block Exemption Application; and
- (b) engage with persons likely to be affected by a Block Exemption Order.

12.2 The Commission will assess whether the relevant category of agreement is eligible for a Block Exemption Order in accordance with the principles explained in the Commission's *Guideline on the First Conduct Rule*.

12.3 As set out in paragraph 11.8 above, the timeframe for this assessment will depend on the nature and complexity of the matter, as well as the resources available to the Commission at the time.

12.4 After this process, the Commission will elect whether to propose to issue a Block Exemption Order. This means the Commission may:

- (a) not propose to issue a Block Exemption Order;
- (b) propose to issue a Block Exemption Order; or
- (c) propose to issue a Block Exemption Order subject to conditions or limitations.

12.5 If this process was initiated by a Block Exemption Application, the Commission will provide an explanation of this outcome to the applicant in writing.

13 Issuing a Block Exemption Order

- 13.1 Where the Commission proposes to issue a Block Exemption Order, section 16 of the Ordinance prescribes a process that must be undertaken before issuing the Block Exemption Order.
- 13.2 In accordance with section 16(1) of the Ordinance, the Commission will publicise the proposed Block Exemption Order. This will include posting on the Commission's website a notice of the proposed Block Exemption Order.
- 13.3 Under section 16(1) of the Ordinance, the Commission will also engage with, and consider representations from, persons likely to be affected by a Block Exemption Order. The Commission may also invite relevant parties to provide additional written representations or further information in response to representations received. The Commission will seek additional information from parties as necessary.
- 13.4 Under section 16(3) of the Ordinance, persons will be given at least 30 calendar days to make representations on the proposed Block Exemption Order beginning after the day on which the notice is first published.
- 13.5 With a view to transparency in its decision making, the Commission will generally publish any representations on its website. For this reason, the Commission requires the applicant (if any) and other persons to provide non-confidential versions of their written representations.
- 13.6 After the process set out in section 16 of the Ordinance, the Commission will decide:
- (a) not to issue a Block Exemption Order;
 - (b) to issue a Block Exemption Order; or
 - (c) to issue a Block Exemption Order subject to conditions or limitations.
- 13.7 If the Commission decides not to issue a Block Exemption Order, it will provide an explanation of this outcome to the applicant in writing if the process was initiated by a Block Exemption Application. A decision not to issue a Block Exemption Order does not necessarily mean that the Commission has formed a view on whether it has reasonable cause to believe that a contravention of the First Conduct Rule has occurred in connection with the category (or any) of the agreements subject of the Block Exemption Application.

13.8 Where the Commission decides to issue a Block Exemption Order (with or without conditions or limitations), it will proceed to issue the Block Exemption Order in line with the requirements of section 15 of the Ordinance. The Block Exemption Order and the Commission's reasons for issuing it will be published on the Commission's website and an entry will be made in the Commission's register of Decisions and Block Exemption Orders.

Effect of issuing a Block Exemption Order

13.9 Under section 17 of the Ordinance, where the Commission issues a Block Exemption Order, an agreement that falls within a category of agreement specified in the Block Exemption Order is exempt from the First Conduct Rule. However, the Block Exemption Order does not provide any exemption from the operation of the Second Conduct Rule.

13.10 Pursuant to section 15(3)(b) of the Ordinance, the Commission may specify a date from which a Block Exemption Order is to cease to have effect. The need to include conditions or limitations in Block Exemption Orders will be made on a case by case basis.

13.11 The Commission is required by section 19(1) of the Ordinance to commence a review of a Block Exemption Order on the date specified in that order for the commencement of the review. Under section 15(4) of the Ordinance, this review date must occur no later than five years from the date of the Block Exemption Order.

I4 Matters Arising After the Issue of a Block Exemption Order

14.1 The Commission must commence a review of a Block Exemption Order on the date specified in the order for the commencement of the review.

14.2 The Commission may, however, review a Block Exemption Order at any time prior to the specified date in the Order for the commencement of a review if it considers it appropriate to do so. Section 19(3) of the Ordinance provides that when deciding whether or not to review a Block Exemption Order prior to the specified review date, the Commission may consider any number of factors but must consider the following:

- (a) the desirability of maintaining a stable and predictable regulatory environment in relation to competition;
- (b) any developments that have taken place in the economy of Hong Kong or in the economy of any place outside Hong Kong that affect the category of agreement that is the subject of the Block Exemption Order; and
- (c) whether any significant new information relating to the particular category of agreement has come to the knowledge of the Commission since the Block Exemption Order was first issued.

14.3 After its review, the Commission may vary or revoke the Block Exemption Order.

14.4 Where the Commission proposes to vary or revoke a Block Exemption Order, it will publicise the proposed variation or revocation with reasons in accordance with section 20 of the Ordinance. This will include posting a notice of the proposed variation or revocation on the Commission's website and inviting those persons the Commission considers likely to be affected to make representations about the proposed variation or revocation within the period specified in the notice.

14.5 Under section 20(4) of the Ordinance, persons will be given at least 30 calendar days to make representations on the proposed variation or revocation beginning after the day on which the notice is first published.

14.6 In accordance with section 20(2) of the Ordinance, the Commission will engage with, and consider representations from, parties likely to be affected by the proposed variation or revocation.

14.7 With a view to transparency in its decision making, the Commission will generally publish any written representations on its website. For this reason, the Commission requires parties to provide non-confidential versions of their written representations.

14.8 Following a consideration of any representations received within the period identified in the notice of proposed variation and revocation, the Commission may proceed to issue a notice of variation or revocation with reasons in line with the requirements of section 20 of the Ordinance.

Undertakings' compliance with conditions or limitations

- 14.9 Where the Commission has made a Block Exemption Order subject to conditions or limitations, the Commission will monitor compliance with those conditions or limitations.
- 14.10 If an undertaking fails or ceases to comply with a condition or limitation subject to which a Block Exemption Order has effect, sections 17(2) and 18(1) of the Ordinance provide that the immunity pursuant to that Block Exemption Order ceases to apply to that undertaking with effect from the date on which the non-compliance begins.
- 14.11 Where an undertaking loses its immunity in view of a failure to comply with a condition or limitation, the Commission is entitled under section 18(3) of the Ordinance to consider taking enforcement action to the extent that the undertaking is involved in a contravention of the First Conduct Rule.

