



**Deacons**  
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## A Brief Guide to the Amended Competition Bill



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# Introduction

After many years of consultation and discussion, a Competition Bill was presented to the Legislative Council on 14th July, 2010. The Bill is presently at the committee stage and the Government is hoping to have the legislation enacted by the end of its term in June 2012. The Bill has however been controversial and concerns have been expressed by the business community and in particular small and medium sized enterprises (“SMEs”) to the effect that the provisions of the Bill were too onerous and the penalties too harsh and that the Bill was too vague such that it is hard for a small organisation to decide whether it is in compliance or not. In response, the Government has put forward amendments in a number of areas and has issued Guidelines on a number of aspects of the Bill. This booklet summarises the Bill including the proposed amendments and deals briefly with the Guidelines.

## The Central Provisions of the Bill; the Competition Rules

The central provisions of the Bill are the First Conduct Rule, the Second Conduct Rule and the Merger Rule. These can be summarised as follows:-

### **The First Conduct Rule**

This prohibits agreements, concerted practices or decisions of associations if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong. Specifically covered are:-

- arrangements which directly or indirectly fix prices or other trading conditions;
- arrangements which limit or control production, markets, technical development or investment; or
- sharing markets or sources of supply.

Agreements, concerted practices or decisions which are made, engaged in or given effect to outside Hong Kong will breach the First Conduct Rule if they have the object or effect of preventing, restricting or distorting competition in Hong Kong. Thus, to an extent the legislation has extra-territorial reach.

The First Conduct Rule prohibits a wide range of ante competitive conduct with the result that the remedies and enforcement actions described below apply to all of them, minor or serious. This gave rise to concerns on the part of SMEs.

In its response to these concerns, the Government’s approach is to specify four types of hard core activities in the Bill that are widely recognised in overseas jurisdictions as anti-competitive and to preserve in respect of these activities the full range of enforcement actions. These are described in the amendments to the Bill as “serious anti-competitive conduct” and comprise:-

- price fixing;
- allocation of sales, territories, customers or markets;

- fixing or limiting the production or supply of goods or services; and
- bid rigging.

In respect of lesser activities, for example, restrictions on advertising, collective refusal to supply or standardisation of agreements, it is proposed that enforcement should be limited to a warning notice procedure. Under this procedure, if the Competition Commission has reasonable cause to believe that there is a contravention of a conduct rule, the Competition Commission may issue a warning notice which requires the addressee to cease contravening the relevant conduct rule within a particular period during which the Competition Commission will not take enforcement action. During this period, the undertaking concerned may cease the relevant conduct or offer a commitment to address the Competition Commission's concern.

If the contravening conduct continues after the period mentioned in the warning notice, the Competition Commission is free to institute proceedings in respect of the alleged contravention which occurs after the period mentioned in the warning notice. This enables the Competition Commission to take immediate action in respect of serious anti-competitive conduct but, in respect of other activities, to adopt a softer approach enabling the relevant undertaking to correct its activities within the period referred to in the warning notice.

In addition, to placate the concerns raised by the business community, the Government is proposing a de minimis exclusion from the First Conduct Rule. This applies to all breaches of the First Conduct Rule other than serious anti-competitive conduct as described above. The de minimis exclusion is such that undertakings otherwise in breach who have a combined turnover in the preceding financial year of less than HK\$100 million will not be considered to be in breach. In the case of an association of undertakings, the threshold will be based on aggregate turnover of members of the association.

### **The Second Conduct Rule**

The Second Conduct Rule provides that 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. This specifically includes predatory behaviour towards competitors and the limiting of production, markets or technical development to the prejudice of consumers.

It is significant to note that Hong Kong has adopted the substantial degree of market power test rather than the dominant level of market power test. There is no definition of substantial degree of market power but one commentator has speculated that it may be held by an undertaking with a 40% market share.

The Second Conduct Rule applies to conduct engaged in outside Hong Kong if it has as its object or effect the prevention, restriction or distortion of competition in Hong Kong.

Again, the SMEs were concerned that this rule might be used against them in a harsh manner.

In response, the Government has proposed a de minimis arrangement in respect of the Second Conduct Rule so that undertakings with a turnover of HK\$11 million or less will be excluded from the application of the Second Conduct Rule.

## The Merger Rule

The Government has decided as a policy matter that there will be no general regulation of merger activities other than the continuation in the new statutory form of the regime for merger control already included in the Telecommunications Ordinance in respect of persons holding carrier licences under that Ordinance, namely a licence for the establishment or maintenance of a telecommunications network which includes fixed lines and mobile or broadcasting networks. In the longer term, the Government may consider extending the Merger Rule so that it has more general application.

The Merger Rule applies to mergers where one or more parties to the merger holds a carrier licence or controls a party that holds a carrier licence and the merger has or is likely to have the effect of substantially lessening competition in Hong Kong. Specifically included are mergers:-

- where two or more undertakings cease to be independent of each other;
- where one or more persons acquires direct or indirect control of the whole or part of one or more other undertakings or the acquisition by one undertaking of the whole or the part of the assets and goodwill of another undertaking;
- where there is the creation of a joint venture to perform on a continuing basis all the functions of an autonomous economic entity.

The Merger Rule applies to mergers effected outside Hong Kong or where any party to the arrangement is outside Hong Kong if in either case the result has the effect or likely effect of substantially lessening competition in Hong Kong.

A concern has been expressed that a merger outside the telecommunications industry might render the parties in breach of the First Conduct Rule or the Second Conduct Rule thereby bringing merger activities outside the telecommunications industry effectively under control by reason of the application of the First Conduct Rule and the Second Conduct Rule.

The Government has recognised that this is a legitimate concern and in revisions to the Bill has clarified that merger activities themselves will be excluded from the application of the First Conduct Rule and the Second Conduct Rule. This does not apply however to the activities of the merged entities themselves which will continue to be subject to the First Conduct Rule and the Second Conduct Rule.

## Application

The legislation will apply to all business sectors and to undertakings engaged in economic activity regardless of their legal status and includes natural persons engaged in economic activity.

The legislation will not apply to the Government. This is likely to be controversial as the Bill passes through the legislative process.

In addition, the Competition Rules will not apply to certain statutory bodies, specified persons or specified activities. The scope of this exclusion will be elaborated in subsidiary legislation. This is also likely to be controversial.

## Exemptions and Exclusions

There are a number of exemptions and exclusions; the main ones are as follows:-

- The First Conduct Rule and the Second Conduct Rule will not apply to types of agreement and conduct where the Chief Executive is satisfied that there are exceptional or compelling reasons of public policy for excluding them.
- The First Conduct Rule and the Second Conduct Rule will not apply to agreements or conduct where the Chief Executive is satisfied that it is necessary to avoid a conflict between the legislation and an international obligation that directly or indirectly relates to Hong Kong.
- The First Conduct Rule will not apply to an agreement that contributes to improving production or distribution or promotes technical or economic progress subject to compliance with certain other statutory conditions.
- The First Conduct Rule and the Second Conduct Rule will not apply to an agreement or conduct to the extent that it is for the purpose of complying with a legal requirement.
- The First Conduct Rule and the Second Conduct Rule will not apply to an undertaking entrusted by the Government with the operation of services of general economic interest.
- Block exemption orders may be made in respect of the First Conduct Rule.
- The Merger Rule will not apply if the economic efficiencies that arise or may arise from the merger outweigh the adverse effect caused by any lessening of competition in Hong Kong.
- The Chief Executive may by order exempt a merger from the application of the Merger Rule if he is satisfied that there are exceptional and compelling reasons of public policy for doing so.

Many of these exemptions will be elaborated in subsidiary legislation which will need to be the subject of a consultation process.

## Competition Commission

There will be established a Competition Commission consisting of five members having experience in industry, commerce, economics, law, SMEs or public policy. Its functions will be:-

- to investigate conduct that may contravene the legislation;
- to promote public understanding of the value of competition;
- to promote the adoption by businesses of appropriate internal controls and risk management systems to ensure compliance with the legislation;
- to advise the Government on competition matters;
- to conduct market studies into matters affecting competition in Hong Kong; and
- to promote research into the development of competition law in Hong Kong.

# Competition Tribunal

The power of adjudication will be vested in a Competition Tribunal comprising six High Court judges. The Competition Tribunal may appoint one or more qualified lay assessors to assist it but the decision of the Competition Tribunal on any particular matter is required to be made by the judicial members of the Competition Tribunal only.

There will thus be a separation between the investigative and prosecutorial powers of the Competition Commission and the adjudication powers of the Competition Tribunal. The Competition Tribunal has a limited power of review in respect of decisions made by the Competition Commission.

## Remedies

A range of remedies is available for breach of the legislation:-

- The Competition Commission may instead of bringing proceedings in the Competition Tribunal for breach of the First Conduct Rule or the Second Conduct Rule issue an infringement notice offering not to bring proceedings on condition that the undertaking concerned makes a commitment to comply with the requirements of the infringement notice. The requirements of the infringement notice originally provided for the notice to include, at the discretion of the Competition Commission, an obligation to pay a sum not exceeding HK\$10 million penalty to the Government, to refrain from any specified conduct or take specified action or to admit contravention of the relevant conduct rule. The recipient of such a notice is not bound to comply with it but failure to do so will put it at risk of proceedings before the Competition Tribunal. The imposition of the HK\$10 million penalty was a concern of the SMEs as being too harsh a remedy and in response to this, the ability to impose an obligation to pay a sum not exceeding HK\$10 million has been removed from the Bill.
- If the Competition Commission has a concern about the possible infringement of a Competition Rule, it may accept from a person a commitment to take any action or refrain from taking action in exchange for which the Competition Commission may agree not to commence proceedings or an investigation.
- The Competition Commission may make leniency agreements in exchange for a person's cooperation in an investigation or proceeding under which it may agree not to bring proceedings.
- The Bill originally provided that the Competition Tribunal may impose a pecuniary penalty for breach of a Competition Rule but in respect of a single contravention the penalty may not exceed 10% of the global turnover of the undertaking concerned for the year in which the contravention occurred or if the contravention continued for more than one year 10% of the global turnover of the undertaking for each year in which the contravention continued. This was also considered to be too harsh a remedy particularly the calculation of the penalty by reference to the global turnover of infringing parties unlimited in point of time. In response, this provision has now been revised so that the limit of the pecuniary penalty will be calculated by reference to 10% of the local turnover

for each year of infringement up to a maximum of three years. If the infringement lasts for more than three years, the three years with the highest local turnover will be chosen.

- The Competition Tribunal has power to make an interim order restraining a person who is engaged in or proposing to engage in conduct that would constitute contravention of a Competition Rule. The interim order may remain in force for a period of not more than 180 days subject to extension by the Competition Tribunal.
- The Competition Tribunal has power to require a person who has contravened a Competition Rule to pay to the Government an amount equal to the costs incidental to any investigation of the contravention.
- The Competition Tribunal has power to make a disqualifying order against a person who was a director of a company which has contravened a Competition Rule when it considers that the person's conduct as a director makes the person unfit to be concerned in the management of a company. This prohibits a person from being a director, liquidator, receiver or manager or directly or indirectly concerned in the formation or management of a company. The disqualification order may be for a period of up to five years.
- In addition to the above remedies which may be granted by the Competition Tribunal, the Competition Tribunal has a wide range of other orders which it might make including, among others:-
  - (a) declarations;
  - (b) restraining orders;
  - (c) orders for payment of damages; and
  - (d) disgorgement orders.
- The legislation also contemplates a private right of action which may be brought by a person who has suffered loss or damage as a result of any act that has been determined by the Competition Tribunal to be a contravention of the First Conduct Rule or the Second Conduct Rule against the person who contravened the rule and any person who has been involved in the contravention. This is known as a follow on right of action.
- In addition as originally drafted, the Bill contemplated a stand alone right of private action in respect of a person who has suffered a loss or damage as a result of a contravention of the First Conduct Rule or the Second Conduct Rule against the person who contravened the conduct rule and any person involved in that contravention in the absence of a determination by the Competition Tribunal of breach of a conduct rule. This stand alone right of action required the claimant to prove breach of the First Conduct Rule or the Second Conduct Rule. This was thought by SMEs to give rise to an oppressive remedy that might be used against them. In response to this, in the revisions to the Bill, the stand alone right of private action has been removed but the position will be kept under review to see whether there is justification to reintroducing it in a few years time. This will not affect the follow on right of action which will continue to be available.

# Guidelines

As mentioned above, the Government has issued three sets of Guidelines in response to the concern that the Bill is too vague.

The main point to note in relation to this is that under the Bill it is for the Competition Commission to issue Guidelines after consulting with appropriate parties. The Competition Commission will be independent from the Government. The Guidelines now issued by the Government will therefore not pre-empt the Competition Commission in any way but represent the Government's suggested approach. To this extent, the Guidelines do not necessarily form a reliable basis for undertakings to assess the impact of the Bill on their businesses.

The Guidelines on the First Conduct Rule include guidance on the use of certain terms used in the Bill and the agreements to which it applies (this includes a discussion on vertical agreements which are expected to be covered by the First Conduct Rule in a more limited fashion). There are also discussions regarding:-

- concerted practices and decisions by undertakings;
- the test applicable to the concept of the object or effect of preventing, restricting or distorting competition;
- examples of conduct that might breach the First Conduct Rule including:-
  - (a) directly or indirectly fixing prices;
  - (b) bid rigging;
  - (c) sharing markets;
  - (d) limiting or controlling production or investment;
  - (e) fixing trading conditions;
  - (f) joint purchasing or selling;
  - (g) sharing information;
  - (h) exchanging information;
  - (i) restricting advertising;
  - (j) setting technical or design standards; and
  - (k) terms of membership of associations and certification.

The Guidelines on the Second Conduct Rule contain guidance on:-

- assessment of market power in the context of a substantial degree of market power;
- the effect of existing competition as well as potential competition;
- the concept of abuse;
- the object or effect of preventing, restricting or distorting competition;

- examples of conduct that would constitute abuse including predatory behaviour, pricing below the average cost, tying and bundling, margin squeezing, refusal to supply goods or services or give access to an essential facility.

The Guidelines on Market Definition include an analysis of how to define the market in terms of the participants in the relevant market, the products in that market and the geographic market. This is relevant to the First Conduct Rule insofar as it relates to limiting or sharing of markets and the Second Conduct Rule insofar as it relates to a substantial degree of market power in a market. It is also relevant in relation to the Merger Rule insofar as factors relating to the market in which the merger parties operate will be taken into account in determining whether a merger has or is likely to have the effect of substantially lessening competition in Hong Kong.

## Conclusion

Apart from the fact that the Merger Rule is limited to the telecommunications sector, the Bill is an up to date competition law which benefits from experience in other jurisdictions and which is generally appropriate to business conditions in Hong Kong. It will certainly be the case that companies carrying on business in Hong Kong will need to review their operations and in particular their standard business terms to ensure compliance. This will also apply in respect of persons carrying on business outside Hong Kong which have a Hong Kong impact.

The proposed amendments to the Bill and the Guidelines clearly go some way to meet the concerns of the opponents; some say they do not go far enough. However, the supporters of the Bill and in particular those representing consumers and the Consumer Council itself say that the changes have watered down the Bill too much. For its part, the Government in the recent Chief Executive's Policy Address continued to express the hope that the Bill will be enacted within the current of legislative session ending in June 2012.

At present, it is not possible to predict whether this will happen but if this does not, the Bill will lapse and the legislative process will need to be commenced again if the new government wishes to proceed with it.

Even if the Bill is enacted, there will be a delay in it being brought into effect because of the need to draft subsidiary legislation and guidelines which themselves will need to go through a consultation process.

# Deacons

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