Hong Kong Competition Ordinance

Second Anniversary

Freshfields Bruckhaus Deringer

Hong Kong Competition Ordinance – Second Anniversary

Regime continues to evolve (slowly)… 2018 a crunch year?

Hong Kong's competition regime is still relatively new and so perhaps not surprisingly it remains something of a work in progress. While there have been a small number of "firsts" – such as the first two cases taken to the Competition Tribunal (***Tribunal***) and the issuance of the first block exemption order (for the shipping sector) – output from the Competition Commission (***HKCC***) remains relatively modest. In addition, from an institutional perspective, the authority has undergone significant change with an overhaul of its senior leadership team during the course of 2017.

Looking ahead, the next year or two will be critical for the authority and its new leadership in demonstrating that it is an active and effective regulator, and that the competition regime as a whole is a force for good in Hong Kong. This will be particularly important if the authority intends to seek legislative changes to the Competition Ordinance (***CO***) to address some of the perceived weaknesses in the current regime.

Key events in the HKCC's second year of enforcement

In its first year of enforcement, the HKCC made steady progress, launching an investigation into whether to issue a block exemption order in the shipping sector, completing a market study concerning the residential building renovation and maintenance sector, and initiating investigations into suspected breaches of the CO, including by carrying out several dawn raids.

Moving into its second year, the HKCC has reached some further, important milestones but overall output has remained fairly limited.

23 March 2017
Commenced proceedings in the Tribunal against 5 companies in the IT sector

4 May 2017
Announced the findings of its study into Hong Kong's auto-fuel market

8 August 2017
Issued its first block exemption order concerning agreements in the shipping sector

14 August 2017
Commenced proceedings in the Tribunal against 10 construction and engineering companies

4 September 2017
Brent Snyder succeeded Rose Webb as Chief Executive Officer

Five key milestones in HKCC's second year of enforcement

1

Monkey off its back? HKCC takes first cases to the Tribunal

Living up to the expectation that it would start to bring cases to the Tribunal in its second year, the HKCC brought two cases in 2017:

- on 23 March 2017, the HKCC took five IT companies to the Tribunal for allegedly rigging bids in a tender for the supply and installation of a new IT server system. The case was brought before the Tribunal just nine months after the HKCC received the complaint (the ***IT case***); and
- on 14 August 2017, the HKCC took ten local construction and engineering companies to the Tribunal for an alleged market-sharing and price-fixing cartel relating to the renovation of over 800 flats in a public housing estate. The ten companies allegedly divided the renovation projects in three residential blocks in the public housing estate between themselves, and advertised renovation services at the same prices to the tenants (the ***building renovation case***). The case follows the HKCC's 2016 market study report on the building renovation and maintenance sector which identified potential anti-competitive activity in the sector.

"Any suspected anti-competitive conduct should be reported to the Commission. The Commission will use the full extent of its powers to combat such practices."

*Anna Wu, Chairperson of the HKCC**

*HKCC press release, "Competition Commission takes market sharing and price fixing case to Competition Tribunal", 14 August 2017

No doubt the HKCC will be pleased to have taken its first cases to the Tribunal but the real test of success will not come until the first substantive trial which will only take place in June 2018.

2

Publication of the first block exemption order

The HKCC issued its first block exemption order on 8 August 2017, a little over 18 months after the Hong Kong Liner Shipping Association had applied to the HKCC for a block exemption from the application of the CO for two types of shipping liner agreements:

- vessel sharing agreements (***VSAs***): agreements between carriers within a shipping consortium to operate a liner service along a specified route using a specified number of vessels (akin to an airline code-sharing arrangement); and
- voluntary discussion agreements (***VDAs***): agreements that allow carrier members to exchange information including supply and demand forecasts, freight rates and surcharges.

The block exemption order exempts VSAs (where the parties do not collectively exceed a market share limit of 40 per cent) but not VDAs. In respect of the latter, the HKCC was not persuaded that the claimed efficiencies would outweigh the potential restriction of competition resulting from VDAs. In particular, the authority noted a lack of evidence or data in support of the arguments for exempting VDAs. While their omission from the block exemption does not mean that VDAs necessarily infringe the CO, the approach taken by the HKCC – which is consistent with that taken by the European Commission – contrasts with the more permissive approach taken in other Pacific Rim jurisdictions such as Malaysia and Singapore, where VDAs are exempted.

The block exemption order is effective for five years and will be reviewed by the HKCC on or before 8 August 2021.

3

Extra litigation funding for the HKCC

The Hong Kong government announced in October 2017 that it would set aside an additional standalone payment of HK$200 million (approximately US$25.6 million) – a "fighting fund" – for the HKCC to bring cases to the Tribunal. Ms. Anna Wu, Chairperson of the HKCC, expects the funding to last for five years. The government also announced its plan to increase the HKCC's annual grant.

This is clearly positive for the HKCC and dispels the initial scepticism that the HKCC might not have the funding to take cases to the Tribunal and would therefore not be capable of enforcing the CO effectively.

4

HKCC completes market study in auto-fuel industry

Amidst public outcry over Hong Kong's high petrol prices, the HKCC undertook a market study to analyse competition concerns, particularly the consistency of retail pump prices across retailers. In its May 2017 report, the HKCC stated that it had found no evidence of anti-competitive conduct among market players, and concluded that price consistency was due to "parallel pricing" – which does not infringe the CO.

However, the HKCC did identify some circumstances that could hinder competition and contribute to high prices, such as the availability of effectively only one single petrol product and the low visibility of pump prices.

To address these issues, the HKCC suggested various measures to the government including (i) the re-introduction of an alternative, cheaper grade of petrol (95 RON petrol); (ii) increasing the number of petrol filling station (***PFS***) sites; (iii) reviewing the tendering system for PFS sites; (iv) requiring the PFS to prominently display pump prices and discounts; and (v) exploring potential structural reform options.

As at September 2017, the Environment Bureau had reached out to market players for comments on the HKCC's suggestion to re-introduce 95 RON petrol. However, as of the end of 2017, none of the HKCC's proposed measures had been adopted yet.

5

New senior management with impressive local and overseas experience

The HKCC underwent an overhaul of its senior management during 2017, replacing its Chief Executive Officer (***CEO***) , Head of Enforcement, General Counsel and Chief Economist. The new team combines impressive domestic and international experience as well as antitrust and litigation expertise. While there may be the inevitable bedding down period for the new team, their arrival is likely to invigorate enforcement activity.

- Mr. Brent Snyder was appointed as CEO for a term of three years commencing 4 September 2017. Mr. Snyder was formerly the deputy assistant attorney general for criminal enforcement in the antitrust division of the Department of Justice of the United States.
- Dr. Lilla Csorgo, former Chief Economist of New Zealand's Commerce Commission, joined the HKCC as its Head of Economics & Policy in May 2017.
- Mr. Steven Parker, former chief litigation counsel with the Hong Kong Monetary Authority (***HKMA***), joined the HKCC in July 2017 as Executive Director (Legal Services).
- Mr. Jindrich Kloub, former cartels official with the European Commission, joined the HKCC in October 2017 as Executive Director (Operations).

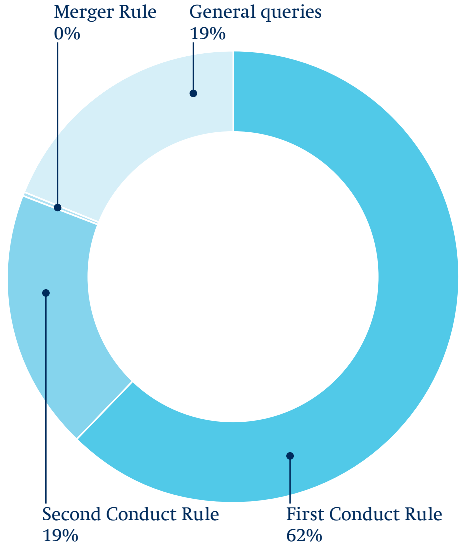
HKCC enforcement trends

Types of complaints/enquiries received and processed by the HKCC

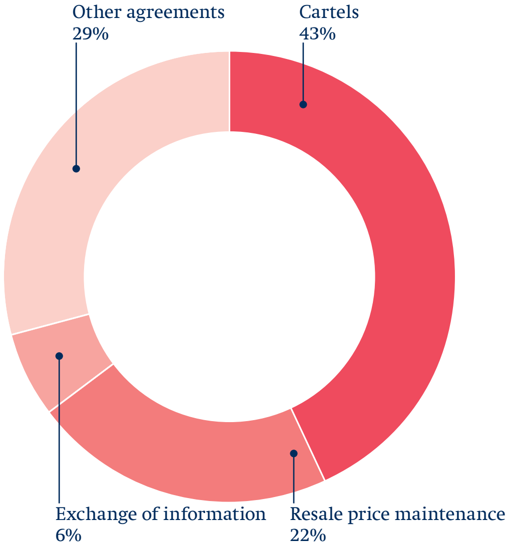
As at the end of October 2017, the HKCC had received and processed over 2,500 complaints and enquiries since the CO came into full effect. Approximately 60 per cent of the complaints relate to the First Conduct Rule (cartels / other anti-competitive agreements), approximately 20 per cent to the Second Conduct Rule (abuse of a substantial degree of market power), another 20 per cent to the general state of competition, and a very small number to the Merger Rule.

Around 160 cases have been escalated for further assessment, of which over 10 per cent have proceeded to the in-depth investigation stage.

Complaints and enquiries received by HKCC (as at October 2017)

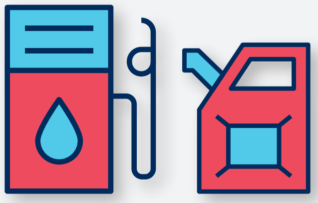


Breakdown of complaints and enquiries on First Conduct Rule (as at October 2017)



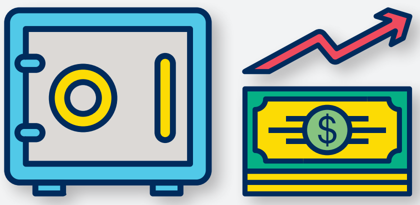
Sector-by-sector analysis

Auto-fuel



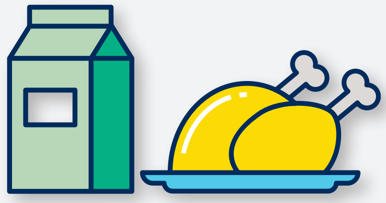
- The HKCC published its market study – see point 4 of "Five key milestones" on page 3.

Banking & financial services



- In December 2017, 14 local and international banks applied to the HKCC for an exemption/exclusion order for the Code of Banking Practice from the application of the CO on the grounds of "compliance with legal requirements".
- Although compliance with the Code is voluntary, it has been endorsed by the HKMA, which requires and monitors compliance by all banks. The Hong Kong Association of Banks had previously suspended 18 provisions of the Code in December 2015, mostly related to fee practices, to avoid raising concerns under the CO.

Food & groceries

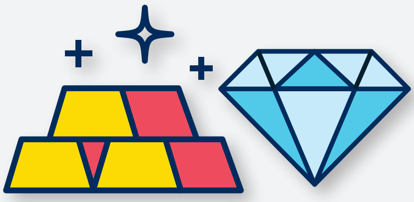


- In April 2017, the HKCC voiced concerns over a draft government-led industry code relating to the marketing of formula milk and food products for infants and young children. The Hong Kong government subsequently modified the code and reduced the restrictions on promotional activities and sales inducements to address competition concerns. The code was released in June 2017.
- In July 2017, a panel of lawmakers highlighted concerns about the "monopolistic situation" in the public markets managed by Link Real Estate Investment Trust. The lawmakers also urged the HKCC to take proactive action to review the competitive conditions and make recommendations on how to enhance competition through a market study and policy advice.

Insurance

- In February 2017, the Hong Kong Federation of Insurers said that it would no longer provide an estimate to the Hong Kong government on the impact on insurance premiums of a government proposal to adjust statutory compensation for work-related injuries and deaths in view of the CO.

Gold & jewellery



- Two of Hong Kong's leading associations of jewellers released a new code of practice in August 2017 to promote competition compliance, among other matters. The code lists what retailers should and should not do under the First and Second Conduct Rules, provides competition guidelines which the associations should comply with, and highlights the importance of free market competition. It is expected that 60 per cent of the members will adopt the code on a voluntary basis over the next three years.

Real estate, construction & building renovation & maintenance

- In August 2017, the HKCC tooks construction and engineering companies to the Tribunal – see point 1 of "Five key milestones"on page 2.
- In the HKCC's market study report on the building renovation and maintenance sector published in May 2016, the HKCC noted that potential anti-competitive behaviour was present in the sector, and stated that it was monitoring the sector. It is therefore perhaps unsurprising that the HKCC has picked this case as its second case before the Tribunal.

Technology, media & telecommunications

- In March 2017, the HKCC took IT companies to the Tribunal – see point 1 of "Five key milestones"on page 2.
- Communications Authority (CA) which shares concurrent jurisdiction with the HKCC in enforcing the CO in the telecommunications and broadcasting sectors.
- Mr. Albert Wong Kwai-huen, a former HKCC commissioner, was appointed as the chairperson of the CA for a term of two years from 1 April 2017. Mr. Wong has stated that there are many areas where the CA can work with the HKCC, and further noted that while telecommunications mergers are not exceptionally active in Hong Kong, such mergers are highly likely to trigger competition concerns.
- In October 2017, the CA decided not to commence an investigation concerning the acquisition of Hutchison Global Communications Investment Holding Limited by I Squared Capital. This is the third case the CA has reviewed since the CO's entry into force. In all three cases, the CA decided not to commence a formal investigation.

What to look out for in 2018?

1

Continued uptick in enforcement, potentially more complex cases

Buoyed by its new leadership team and additional litigation finding, enforcement is likely to pick up. While cartels will remain the key focus, other potential violations, such as illegal information exchange, resale price maintenance and abuses of market power under the Second Conduct Rule will not escape scrutiny – indeed the authority has stated that it currently has a number of active non-cartel investigations.

The authority will not stick rigidly to enforcement quotas but pursue the "right" cases – ie, those most relevant to Hong Kong consumers and which help develop the jurisprudence in Hong Kong. And don't expect the authority to stick only to simple and/or small – "bread and butter" – cases. It will not shy away from selecting more complex and time-consuming – potentially more "blockbuster"- type – cases.

2

The price for infringing the CO

The Tribunal will decide the first two cases under the CO and determine whether the HKCC gets off to a winning start. Watch out for the level of fines imposed by the Tribunal and whether it follows the advice of the HKCC in this respect.

3

Potential enforcement against individuals (as well as companies)

The HKCC appears keen to enforce the CO against individuals and it has been reported that HKCC members are likely to deliberate individual penalty guidelines in 2018. While consistent with practice in other jurisdictions such as the United States, this is likely to be an area of contention given concerns amongst the legal community that the competition regime is not adequately set up – for example, in terms of rights of defence and due process – for individuals to be held liable under the CO.

Also, watch out for which individuals the HKCC seeks to pursue – potentially senior decision-makers rather than junior employees who were simply following orders given by more senior staff.

"We can't send somebody to jail, but there are pecuniary penalties for individuals who participate in cartel violations or serious anti-competitive misconduct."

*Brent Snyder, CEO of the HKCC**

*South China Morning Post, "Hong Kong's new Competition Commission head wants to jail those who flout laws", 6 November 2017

4

A revised leniency policy

The HKCC is likely to revise its leniency policy, in particular in relation to: (i) the applicability of the policy to individuals (at the moment, it only applies to companies); and (ii) protection for second / third / etc. leniency applicants (the current leniency regime is a "one and done" regime, which means that only the first applicant is immune from prosecution).

The authority may also introduce:

- a leniency plus scheme, whereby a company under investigation for one cartel would be offered a fine reduction for the first cartel where it reports (and receives full leniency protection for) other cartel conduct; and
- on the flipside, a penalty plus scheme, whereby the HKCC would recommend higher fines for companies that could have sought leniency plus but failed to do so.

5

Market study as precursor to enforcement

The HKCC will launch another market study which, as was the case in relation to building renovation and maintenance, may be used as a precursor to launching individual investigations into any specific anti-competitive activity that is uncovered. While it is difficult to predict which sector the authority will target, it is likely to be consumer-facing as this will have the most direct impact and relevance for Hong Kong citizens.

6

More applications for exclusion / exemption decisions?

It is surprising that the HKCC has received only one block exemption application (from the shipping sector) and one individual exclusion application (from the banking sector) to date. In fact, before her departure, Ms. Rose Webb, the former HKCC CEO, noted that the authority had expected more applications for exemption / exclusion, particularly on vertical agreements and distribution agreements.

However, it is unclear whether we will see more applications in the future. While the experience in the shipping block exemption provides helpful insights into the evidence required to satisfy the exemption criteria under the CO, the HKCC's review in that case took a long time which is likely to give parties pause for thought before deciding whether to approach the authority with a similar application or instead rely on their own self-assessment.

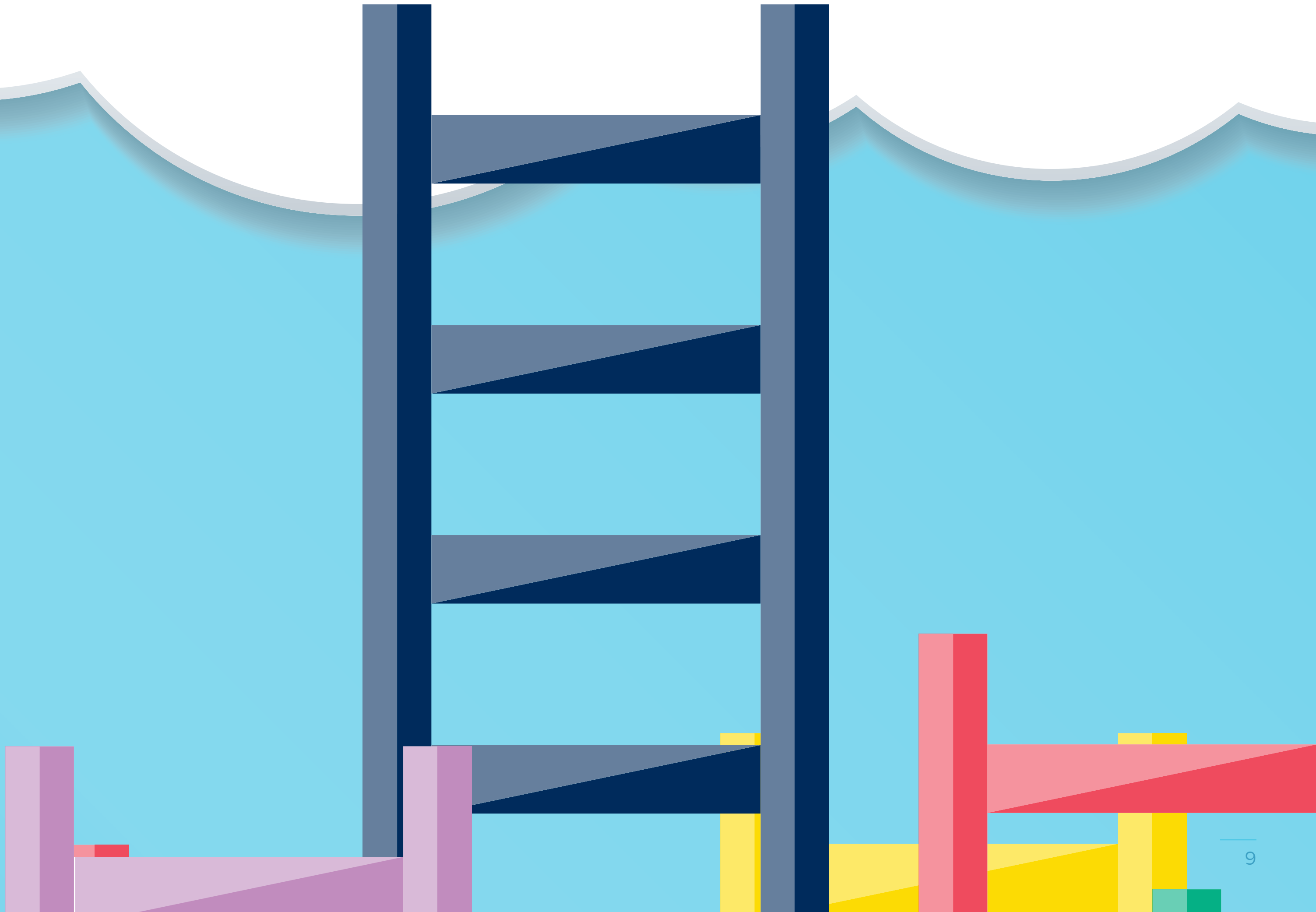
7

Potential reform of the CO

Mr. Snyder noted that the HKCC will form a view in early 2018 on whether aspects of the CO should be revised, although he also cautioned against reforms before the first cases have been decided by the Tribunal. An economy-wide merger control regime, information-gathering powers for market studies, a removal of the exemption for statutory bodies and the introduction of a comprehensive right to bring standalone claims in the Tribunal have all been mooted in the past and are up for debate.

"In light of the HKCC's expected uptick in enforcement, companies should review whether they have a robust compliance policy and effective procedures in place to handle an antitrust investigation. There is no time like the present to make sure you are prepared!"

Alastair Mordaunt,
Head of Hong Kong Antitrust and Co-Head of Asia Antitrust,
Freshfields Bruckhaus Deringer



Our Hong Kong contacts

Alastair Mordaunt
Partner, Head of Hong Kong Antitrust / Co-head of Asia Antitrust
T +852 2846 3396
E alastair.mordaunt@freshfields.com

Ninette Dodoo
Counsel, Co-head of China Antitrust
T +86 10 6535 4525 / +852 2846 3300
E ninette.dodoo@freshfields.com

Nicholas French
Partner, Co-head of China Antitrust
T +852 2913 2710
E nicholas.french@freshfields.com

Paul Seppi
Associate
T +852 2846 3435
E paul.seppi@freshfields.com

William Robinson
Partner
T +852 2846 3336
E william.robinson@freshfields.com

Joy Wong
Associate
T +852 2846 3371
E joy.wong@freshfields.com

freshfields.com