The New Competition Ordinance – Points to Note for Hong Kong's Financial Services Industry

The Hong Kong Competition Ordinance (the "**Ordinance**") came into full effect in Hong Kong on 14 December 2015. The Ordinance which covers the whole economy of Hong Kong was first introduced into the Legislative Council in 2010 and was subsequently passed on 14 June 2012. The full force of the Ordinance was not brought into effect immediately (for three and a half years) but its full implementation was delayed to allow businesses and industries in Hong Kong to understand the new law and take necessary time and steps to comply with its requirements. The objective of the Ordinance is to restrain anti-competitive conduct and any abuse of market power. The Ordinance also covers merger activities but for now, the rules on merger shall only apply to participants in the telecommunications industry.

In recent years, there has been increasing scrutiny of the financial sector by competition regulators in overseas jurisdictions, and this trend is expected to continue here in Hong Kong under the new regulatory regime. For example, the high profile investigations by anti-competition authorities in 2011 on whether some of the largest banks in the world had reached agreements to fix the London interbank offered rate (**Libor**) comes to mind. This article aims to provide an overview on the key provisions of the Ordinance and consider the implications for the financial services industry.

Competition Commission and Competition Tribunal

The Ordinance establishes two new statutory bodies, which are the Competition Commission (**Commission**) and the Competition Tribunal (**Tribunal**). Both bodies have been entrusted with wide investigative and enforcement powers to deal with suspected breaches of the Ordinance as well as to impose significant penalties as a deterrent on offenders. At the very high end of penalties, the Tribunal may impose fines of up to 10 percent of the annual turnover of a business found to be in contravention of a Conduct Rule (as defined below).

Additionally, directors of businesses which breach the Ordinance may face dis-qualification order(s) as a director of up to 5 years, and those who fail to comply with an investigation process or is deemed to engage in active concealment of key documents, or intentionally providing false or misleading information to investigators may face criminal sanctions as well as imprisonment of up to 2 years. Financial services firms should also consider the risk of civil actions by investors.

Businesses in Hong Kong including financial services participants should also be aware that the Ordinance has an extra-territorial reach that aims to curtail anti-competitive behavior in other jurisdictions that has an effect on Hong Kong. As such, companies located outside of Hong Kong as well as companies within Hong Kong, needs to be aware of the implications of the Ordinance and its effect on their businesses.

The First and Second Conduct Rules & Merger Rules

The Ordinance prohibits:
(a) anti-competitive agreements (First Conduct Rule);
(b) abuses of market power (Second Conduct Rule); and
(c) anti-competitive behavior (Merger Rule).

The Ordinance will apply to "undertakings" broadly defined as any entity, regardless of its legal status or the way in which it is financed, which is engaged in economic activity, and includes a natural person engaged in economic activity. It is pertinent to note that the First and Second Conduct Rules (the "Conduct Rules"), the Merger Rules, as well as the enforcement powers of the Commission and the Tribunal do not apply to a "statutory body", except for a specified statutory body listed in a separate regulation to be adopted by the Chief Executive in Council.

(a) First Conduct Rule

The First Conduct Rule provides that, "An undertaking must not make or give effect to an agreement, engage in a concerted practice, or 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."

The First Conduct Rules only applies to 2 or more entities if the relevant entities are of the same undertaking. Whilst this will generally be a matter of fact, specific guidance has been provided by the Commission that for example, if one entity exercises decisive control over the commercial decisions of another, then the Commission will consider the 2 entities as part of the same undertaking. Similarly, a holding company which has control over its respective subsidiaries will be subject to the First Conduct Rule, notwithstanding the fact that these entities are separate legal personalities.

In addition to the above example of agreements between undertakings that act in concerted practices, the First Conduct Rule will also apply in situations where an undertaking, as a member of an association of undertakings (including trade or professional associations), makes or gives effect to any decision(s) which has the object or effect of harming competition. The decision of an association of undertakings may fall within the First Conduct Rule even if the decision is non-binding, for example, an agreement on pricing levels.

(b) 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.*"

The rule goes on to state that conduct may constitute "abuse", if (a) it involves predatory behavior towards competitors, or (b) limits the production, markets or technical development to the prejudice of consumers.

(c) Merger Rule

The Merger Rule prohibits an undertaking from directly or indirectly carrying out a merger that

has or is likely to have the effect of substantially lessening competition in Hong Kong. Currently, the Merger Rule would only apply to the telecommunications industry, whereas merger and acquisition activities in other sectors or industries are not yet within scope and do not need to be reported to the Competition Commission for either prior or post approval. It is to be noted that the First Conduct Rule, the Second Conduct Rule and the Merger Rule apply for all conduct or undertaking(s) located in or outside Hong Kong (except as stated above for the Merger Rule), where such conduct is considered to have the effect of preventing, restricting, or distorting competition in Hong Kong.

Serious Anti-Competitive Conduct

The Guideline on the First Conduct Rule also lists "serious anti-competitive conduct" to include behavior which includes price-fixing, market sharing, output limitation and bid-rigging. If the Commission considers that an entity or person has contravened provisions in the Ordinance which constitutes such "serious anti-competitive conduct", the Commission can directly refer such infringements to the Tribunal for further action. Such serious action is to be contrasted with other infringements such as restrictive agreements between competitors which may only be dealt with via the issue of "warning notices".

The types of practices which constitute "serious anti-competitive conduct" are considered important cornerstones of competition law and we set out below a brief explanation of each specific conduct which shall constitute an infringement of the First Conduct Rule.

i. Price-fixing

Price-fixing refers to an agreement between competitors to either fix, maintain, increase or control prices such as through discounts, rebates, allowances or price concessions in relation to the supply of goods or services. This behavior serves to inflate prices artificially to a level where the competitors are able to undercut each other on price and make a bigger profit. For example, if a financial services association recommends a price, or collectively sets a price for any financial services products or services, this may be considered as price-fixing behavior, regardless of the form presented.

ii. Market sharing

Market sharing refers to agreements between competitors to allocate sales, territories, customers or markets for the production or supply of goods or services. Such behavior may cover agreements to maintain the *status quo*, so that there is an agreement between competitors not to poach or deal with each other's clients or customers, as well as to maintain relationships with their distributors, which lessens competition to the detriment of the general public. Market sharing also includes conduct where competitors agree to restrain competition by not competing in each other's geographic territories, or to expand into a market which is established by a competitor.

iii. Output limitation

Output limitation refers to agreements between competitors to fix, maintain, control, prevent, limit or eliminate the production or supply of goods or services, which reduces competition by limiting the "output" of products or services. For example, competition may be reduced if competitors in an industry "agree" to limit their investment plans in the future or refrain from offering a particular financial product or service to the market.

iv. Bid-rigging

Bid-rigging refers to agreements between competitors to rig the outcome of tenders, by agreeing not to compete or agreeing allow another competitor to be awarded the project or contract.

v. Exchange of Information

Exchange of information refers to agreements between competitors to coordinate prices, which has the object of harming competition. For example, the exchange of competitively sensitive information can directly affect the prices charged or relate to the elements of a pricing policy, such as discounts, costs, and pricing strategies. Competitors that use a third party supplier or distributor as a "conduit" for the indirect exchange of information may also be considered guilt of price fixing with the object of harming competition.

Exemptions and Exclusions

In order to provide businesses with a certain level of comfort during the first few years of operation, the Ordinance lays out several exemptions and exclusions which businesses may avail.

According to Schedule 1 of the Ordinance, certain agreements or institutions are excluded from the application of the Conduct Rules:

(a) agreements enhancing overall economic efficiency;
(b) agreements for compliance with legal requirements;
(c) services of general economic interest;
(d) mergers (other than for telecommunications industry); and
(e) agreements of lesser significance (e.g. agreement / concerted practice or a decision of an association of undertakings if the combined turnover of the undertakings / associations for the turnover period does not exceed HK$200 million in a calendar year).

In addition to the general exclusions provided in Schedule 1 of the Ordinance, the Ordinance provides for possible exemptions. The Commission may grant block exemptions, such as for a particular category of agreements that qualify as excluded agreement. Chief Executive in Council may exempt a specific conduct or class of conduct on public policy grounds or to avoid conflict with international obligations.

Undertakings may apply to the Commission for a decision whether or not an agreement is excluded or exempted. It can be expected that the Commission will only consider strong arguments when granting exclusion applications, especially during the first few years of operation of the Ordinance, until an established body of precedent is established with sufficient case law as guidance for future matters. Also, the general exclusion for agreements of lesser significance will not be available if the agreement is considered as "serious anti-competitive conduct" by the Commission.

As for exclusion and exemption applications for the Second Conduct Rule, such exclusion considerations are essentially the same as the First Conduct Rule, except that the overall economic efficiency argument would not be applicable, and undertakings with turnover of less than HK$40 million during the last financial year will not be subject to the Second Conduct Rule.

Impact of the Competition Ordinance on the Financial Services Industry

The application of the First Conduct Rule and Second Conduct Rule of the Ordinance will mean

that competitors or potential competitors within the financial services industry such as banks, distributors, and asset management companies are prohibited from agreeing to the terms or manner in which they supply or acquire goods and services. Financial services entities, associations of undertakings especially those in a group or related businesses, should consider the implications of the new restrictions or prohibitions.

As a result of the introduction of the Ordinance, the "object" or "effect" of any decision(s) by financial services industry associations could also come under scrutiny by the Commission, if the object or effect of the decision is to influence the conduct of its members in such a way as to cause cartel behavior. Accordingly, it is important that relevant meetings of financial services industry participants are well documented to ensure independent decision-making by the members and avoid any accusations of collaboration between members, such as through keeping or maintaining clear documentation (e.g. agenda notes or detailed meeting/ discussion minutes).

Anti-competitive investigation, if triggered, will represent a significant distraction from the core functions of a business, in terms of lengthy time spent to deal with the authorities as well as related financial cost. Criminal penalties for individuals involved in anti-competitive conduct can also be severe. The increased scrutiny on financial services firms should prompt executives to review their daily day to day operations as well as to conduct an internal audit to ensure the existing business practices as well as arrangements with their distributors or key agencies are compliant with the Ordinance. By setting up a system for appropriate training for all levels of the organization, financial services firms may not only ensure their compliance with the Ordinance but could potentially mitigate any subsequent investigation brought by the Commission on possible contraventions.

Where necessary, businesses should consult with their legal advisors to gain a complete picture of the possible risk areas and where compliance efforts needs to be focused with respect to the new requirements that now apply.

Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual contact at our firm.

Vivien Teu
Partner
Vivien Teu & Co
Tel: (852) 2969 5316
vivien.teu@vteu.co