DEFINING AND REGULATING HARDCORE CARTELS IN HONG KONG: AGENCY RECONCILING THE DIVERGENCE BETWEEN LEGISLATORS AND INTERNATIONAL STANDARD

Sinchit Lai*

In 2012, Hong Kong passed the Competition Ordinance, the region's first cross-sector competition law. In the statute, the government introduced a legal term called "Serious Anti-competitive Conduct" which includes four conducts, namely price fixing, output restriction, market allocation and bid rigging. At a glance, this legal term is very similar to another term called "Hardcore Cartels" introduced by OECD in 1998. In fact, the two terms are different because "Hardcore Cartels" includes only the four conducts formed horizontally (e.g. between competitors) while "Serious Anti-Competitive Conduct" includes the four conducts formed both horizontally and vertically (e.g. between distributors and retailers). This created a divergence between the international standard and Hong Kong legislators. Based on the definition of "Serious Anti-Competitive Conduct," Hong Kong legislators formed a dual-track system by imposing differentiable statutory regulations to conducts that the legislators believed to be more and less serious. Thereafter, the local law enforcement agency created two more terms known as "Cartel Conduct" and "The Four Don'ts" based off the statute. This is identified as an attempt of the agency to reconcile the divergence. After reviewing the legislation history, this Comment suggested that the divergence was formed by ignorance when the Hong Kong government proposed to the legislators to introduce the term "Serious Anti-Competitive Conduct" in the statute in response to the concern of SMEs. Furthermore,

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* S.J.D. Candidate, University of Pennsylvania Law School. LL.M, 2017, University of Pennsylvania Law School; J.M., 2016, Tsinghua University; B.Econ & Fin, 2013, University of Hong Kong. First, I want to thank my family – especially my father Wallace, mother Esther, sister Jenny, and brother Hench – for their love and support all the time. Section I(A), I(C) and II of this Comment are extracted and modified from the graduation thesis I submitted to the Tsinghua University for my Juris Master degree earned. I express my gratitude to Professor Ciyun Zhu for her supervision and guidance towards the thesis, and to Professor Jonathan Klick for his inspirations and comments on this Comment. All opinions and errors are my own.

this Comment analyzes the divergence based on rule of evidence developed in the U.S. judicial experience and suggests that the divergence is unjustified. Also, this Comment points out the limitations of the agency's attempt to reconcile the divergence. This Comment concludes that the divergence and reconciliation all together unintendedly created more legal uncertainties and discouraged companies to form some agreements that may induce net pro-competitive effects. Thus, this Comment urges for amending the definition of "Serious Anti-Competitive Conduct" in Hong Kong's Competition Ordinance.

INTRODUCTION

In the field of antitrust, there are different kinds of anti-competitive behaviors. Among all these behaviors, which are the most severe ones? Internationally, there is a general consent – "hardcore cartels."[1] The term hard "core cartels" was first introduced by the Organisation for Economic Co-operation and Development (OECD) in 1998.[2] Although collusions in the form of hardcore cartels have existed long before the term was created, the terminology itself is relatively new. Over the last two decades, there has been growing acceptance and application of such terminology. For example, "hardcore cartels" started to appear in government officials' speeches and legal documents in some countries.[3] In addition, the terminology has regulatory implications to some countries.[4] In 2012, Hong Kong passed the Competition Ordinance (hereinafter the Ordinance)[5] – the region's first cross-sector competition law.[6] This marked the breakthrough of the application of the term "hardcore cartels" as the ordinance included a legal term called "serious anti-competitive conduct," which at a glance is very similar to "hardcore cartels."[7] The introduction of such definition in the statute is significant because it enabled the Hong Kong government and legislators to further develop a dual-track system in the Ordinance with innovative mechanisms during the legislative process.[8] However, upon a closer look, the definition of "serious anti-competitive conduct" introduced by Hong Kong legislators is different from "hardcore cartels" as recognized

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1. *Infra* Section I.
2. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [OECD], RECOMMENDATION OF THE COUNCIL CONCERNING EFFECTIVE ACTION AGAINST HARD CORE CARTELS [C(98)35/FINAL] (1998), https://www.oecd.org/daf/competition/2350130.pdf.
3. *See* James M. Griffin, Dep't of Justice, Address before American Bar Association Section of Antitrust Law 48th Annual Spring Meeting at Washington D.C. (Apr. 6, 2000) ("Rather, the cartels that we have prosecuted criminally have invariably involved hardcore cartel activity—price fixing, bid-rigging, and market- and customer-allocation agreements); *see also* European Commission Memoranda, *infra* note 80 (utilizing the term hardcore cartel in a European Commission press release).
4. *Infra* Section I(C).
5. Competition Ordinance, (2018) Cap. 619, 1-2, §1 (H.K.), https://www.elegislation.gov.hk/hk/cap619!en-zh-Hant-HK@2018-04-20T00:00:00.assist.pdf?FILENAME=Assisted%20Bilingual%20PDF%20(English%20and%20Traditional%20Chinese).pdf&DOC_TYPE=G&PUBLISHED=true.
6. Neil Carabine & James Wilkinson, *Hong Kong's New Competition Law Takes Effect – Are You Compliant?*, 5 HONG KONG LAWYER (2016), http://www.hk-lawyer.org/content/hong-kong%E2%80%99s-new-competition-law-takes-effect-%E2%80%93-are-you-compliant.
7. *Infra* Section II(A).
8. *Infra* Section II(C).

internationally.[9] Furthermore, after the Ordinance was passed, the law enforcement agency in Hong Kong, the Competition Commission, introduced terminologies such as "Cartel Conduct" in its guideline and "the four don'ts" in its publications.[10] These two terms have a definition different from "serious anti-competitive conduct," but the same as "hardcore cartels."[11] This could be viewed as an example of a law enforcement agency exercising its discretion to reconcile the divergence between the legislator and international standard.[12]

After Hong Kong passed the Ordinance in 2012, some scholars have written about the regulation of cartels in Hong Kong..[13] Moreover, some studies reviewed the ordinance on a more macro scale and briefly touched on the "serious anti-competitive conduct."[14] Most recently, there was a comparative study published about the regulation of distribution agreements (i.e. vertical agreements formed between manufacturers and distributors), between China and Hong Kong. This study involves analysis on the regulation of retail price maintenance, a form of vertical price-fixing agreements in Hong Kong.[15]

Distinct from the above studies, this Comment addresses: (1) What and why is there a divergence between the international standard and Hong Kong legislators (Section I & II); (2) Is such divergence justifiable based on the U.S. experience In other words, is "serious anti-competitive" a better definition of severe anti-competitive behaviors than "hardcore cartels" from the U.S. view point (Section III); and (3) How did the law enforcement agency in Hong Kong reconcile the divergence (Section VI) and what are the limitations and implications of the reconciliation (Section V).

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9. *Infra* Section II(A).

10. *Infra* Section IV(A)&(B).

11. *Id.*

12. *Infra* Section IV(C).

13. *See* Sandra M. Colino, *Sanctions for Cartel Conduct in Hong Kong: Past and Present*, CPI ANTITRUST CHRONICLE (Sept. 30, 2015) (examining the penalties available under the Ordinance); Sandra M. Colino, *Punishing Cartel Behavior: Means to Encourage Compliance with the Hong Kong Competition Ordinance*, *in* CARTELS IN ASIA: LAW & PRACTICE 315 (Thomas Cheng et al. ed., 2015) (assessing the suitability of punishments under the Ordinance as an effective deterrence to anti-competitive behavior).

14. *See, e.g.*, Kelvin H. Kwok, *The New Hong Kong Competition Law: Anomalies and Challenges*, 37 WORLD COMPETITION. L. & ECON. REV. 541, 544 (2014) (discussing the implications of restricting serious anti-competitive conduct); Knut Fournier, *The New Hong Kong Competition Law in Domestic and Global Context* 16 (Dec. 24, 2012) (unpublished manuscript), https://ssrn.com/abstract=2193490 (noting that certain undertakings must not entail such conduct).

15. Sandra M. Colino, *Distribution Agreements under China's Anti-Monopoly Law and the Hong Kong Competition Ordinance*, 1 CHINA ANTITRUST L.J. (2017).

I. INTERNATIONAL STANDARD: "HARDCORE CARTELS" AS THE MOST SEVERE ANTI-COMPETITIVE BEHAVIORS

A. *Definition*

What are "hardcore cartels"? To answer this question, we must first understand what a "cartel" is. Ordinarily, in markets with multiple companies, individual companies need to compete against each other for more profit. At the same time, these independent companies understand that competition will impose pressure on them to reduce prices, and hence reduce profits. Therefore, two or more competing companies may form agreements to act collectively and restrain competition to raise profit.[16] Under such setting, either the combination of firms, the agreement or the collective conduct could be named as a "cartel."[17] Since cartels only exist between competing firms, the term is also used as a synonym of "horizontal agreement" in the area of antitrust.[18] Having said that, "cartel" is not typical legal terminology, as many countries did not include and define it in their statutes.[19]

Based on the above definition of "cartel," there was the introduction of a distinct and narrower concept – "hardcore cartels" - by the OECD Council in the *Recommendation of the council concerning Effective Action against Hardcore Cartels* adopted in 1998.[20] As defined in the *Recommendation* by the Council, a "hardcore cartel" is: "an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce."[21]

16. *See, e.g.*, United States v. National Lead Co., 63 F. Supp. 513, 523 n.5 (S.D.N.Y. 1945) (explaining the US attorney's suggested definition for the term "cartel"); Keith N. Hylton, *Cartels*, ANTITRUST LAW: ECONOMIC THEORY AND COMMON LAW EVOLUTION 68 (2003) (describing how forming agreements to restrict price, output, and competition is cartel behavior).

17. National Lead Co., *supra* note 16, at 523 n.5.

18. *See, e.g.*, Marie-Claire Cordonier Segger, *Sustainable Development in the Negotiation of the FTAA*, 27 FORDHAM INT'L L.J. 1118, 1198 (2003) (analyzing the global adoption of competition laws, including prohibitions on horizontal restraints); Thomas Cottier, *BOOK REVIEW: Law and Competition in Twentieth Century Europe: Protecting Prometheus*, 3 J. INT'L ECON. L. 187, 188 (2000) (discussing a history of the prohibition of horizontal agreements); Xiaoye Wang, *Issue Surrounding the Drafting of China's Anti-Monopoly Law*, 3 WASH. U. GLOBAL STUD. L. REV. 285, 286 (2004) (distinguishing between horizontal and vertical agreements).

19. *Infra* Section I.

20. OECD, *supra* note 2.

21. OECD, *supra* note 2, at 3.

Simply speaking, the four hardcore cartels are price fixing, output restrictions, market allocation and bid rigging as OECD has listed on its website.[22] As explicitly defined, the four hardcore cartels are only limited to "arrangement by competitors."[23] Thus, more precisely, the four hardcore cartels are horizontal price fixing, horizontal output restrictions, horizontal market allocation and horizontal bid rigging.

B. *Seriousness*

In the *Recommendation*, the Council urged governments of its member countries to make sure that their competition laws could effectively combat hardcore cartels and cooperate in fighting against such cartels.[24] Among all different cartels, why did the Council categorize the above four conducts only and recommend its member countries to focus on prohibiting them? One of the reasons is that the Council considered the seriousness of hardcore cartels.[25] As described in the *Recommendation* by the Council, hardcore cartels are "the most egregious violations of competition law" which reduces output and increases the price of goods and services in many countries.[26] However, one may not be satisfied that OECD has simply used the adverse output and price effect to justify hardcore cartels as the most serious violations of competition law. The same adverse effects could apply to non-hardcore cartels as well (i.e. cartels that don't fall into the above four categories).

In order to verify OECD's claim, the author has provided a justification based on the U.S. judicial experience below. As one of the fundamental principles in the U.S. antitrust law, the "rule of reason" (RoR) was first introduced in the dissent of *United States v. Trans-Missouri Freight Ass'n*[27] in 1897, adopted in *Standard Oil Co. v. United States*[28] in 1911, and further elaborated on in *Bd. of Trade of Chicago v. United States*[29] in 1918.[30] The philosophy behind the RoR is that although anti-competitive effect is found from an agreement, it is not prohibited if it also generates pro-competitive effect that will outweigh its anti-competitive effect.[31] In practice, the court

22. Council of OECD, *Cartels and anti-competitive agreements*, OECD (Jun. 1, 2017), http://www.oecd.org/competition/cartels/.
23. OECD, *supra* note 2, at 3.
24. OECD, *supra* note 2, at 2-3.
25. OECD, *supra* note 2, at 2.
26. *Id.*
27. 166 U.S. 290, 343-374 (1897).
28. 221 U.S. 1 (1911).
29. U.S. 231 (1918).
30. ANDREW I. GAVIL ET AL., ANTITRUST LAW IN PERSPECTIVE 102-104 (3d ed. 2017).
31. *Id.* at 102-104; In *Bd. of Trade of Chicago* (1918), the court held that, "The true test

would adopt a "reasonableness test" to evaluate the anti-competitive and pro-competitive evidence submitted by the plaintiff and defendant respectively. If evidence presented demonstrates that the anti-competitive effect of the challenged conduct outweighs its pro-competitive effect, then the conduct would be conceived as an unreasonable restraint of trade that violates section 1 of the Sherman Act.[32] As one could imagine, it is costly to adopt a reasonableness test since it takes time and money for both the plaintiff and defendant to prepare evidence and for courts to analyze them. Following the development of the RoR in the cases mentioned above, the "*per se* rule" began to take shape in *United States v. Trenton Potteries Co*.[33] in 1927 and became well-settled *in United States v. Socony-Vacuum Oil Co*.[34] in 1940.[35] In contrast to the reasonableness test, the *per se* rule presumes certain categories of conduct would unreasonably restrain trade. In other words, once the court has found that a challenged conduct falls into a recognized *per se* illegal category (e.g. price fixing or market division), a defendant's attempt to submit evidence to demonstrate "reasonableness" is precluded.[36] So, how did U.S. courts decide whether a particular category of conduct should be recognized as a *per se* violation? The simple answer is the judicial experience developed over years. As well described by the court in *United States v. Topco Assocs*. in 1972, "[i]t is only after considerable experience with certain business relationships that courts classify them as *per se* violations of the Sherman Act."[37] In other words, if a category of conduct has been repeatedly conceived by the court as an unreasonable restraint of trade under the reasonableness test, the court would be confident enough to classify such conduct as a *per se* violation. One key benefit of having a bright line *per se* rule is to reduce, if not eliminate, the aforesaid cost to prepare evidence and conduct evaluation. Noteworthy is the fact that *per se* rule is not a distinct rule from the RoR.[38] Instead, the *per se* rule falls on one end of the RoR continuum which flows to the "full (comprehensive) RoR" on the other end, with "quick look RoR" lying in-between.[39] Further down the road, *National Society of Professional Engineers v. United States*[40] in

of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." *Bd. of Trade of Chicago*, *supra* note 29 at 238.

32. ANDREW I. GAVIL ET AL., *supra* note 30, at 246-248.
33. 273 U.S. 392 (1927).
34. 310 U.S. 150 (1940).
35. ANDREW I. GAVIL ET AL., *supra* note 30, at 111.
36. *Id*. at 181.
37. 405 U.S. 596, 607-608 (1972).
38. ANDREW I. GAVIL ET AL., *supra* note 30, at 248.
39. *Id*.
40. 435 U.S. 679 (1978).

1978 and *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*[41] in 1979 set forth the modern analytical framework of the rules.[42] To some extent, since *Broadcast Music, Inc.*, the *per se* rule became less bright line then before. For instance, this was at first sight a price fixing case which fell into one of the *per se* illegal categories. However, the court refused to apply the *per se* rule since the challenged conduct was not a "naked [restraint] of trade with no purpose except stifling of competition".[43] Although courts no longer mechanically determine whether a challenged conduct falls within or outside a *per se* illegal category, the fundamental rationale to trigger the *per se* rule remained unchanged at least until 1998 when OECD introduced the definition of hardcore cartels. For example, in *Diaz v. Farley* decided in 1998, the lower court quoted and followed a Supreme Court decision made a decade ago that:

> Certain categories of agreements. . .have been held to be *per se* illegal, dispensing with the need for case-by-case evaluation. We have said that *per se* rules are appropriate only for 'conduct that is manifestly anticompetitive,'. . .that is, conduct 'that would always or almost always tend to restrict competition and decrease output[.]'[44]

From the above, we could infer that when a conduct was analyzed by a U.S. court under the *per se* rule, the conduct was considered as a more serious violation of antitrust law in the state or country. Again, it was because (1) the anti-competitive effect was certain for conducts that applied the *per se* rule (but not to the conducts that applied the full RoR) and (2) the court was confident that the anti-competitive effect of conducts that applied the *per se* rule almost always outweighed its pro-competitive effect, if any. Keeping this in mind, the author reviewed U.S courts' opinions on the four types of horizontal agreements within 15 years prior to 1998, when the definition of hardcore cartels was introduced, to determine whether the U.S. shared OECD's view that hardcore cartels are more, if not the most, egregious violations of competition law.

1. Horizontal Price Fixing or Output Restriction

First, regarding U.S. court's attitude towards horizontal price fixing or output restrictions, the author refers to Supreme Court's opinion over *National Collegiate Athletic Ass'n v. Board of Regents* decided in 1984.[45]

41. 441 U.S. 1 (1979).
42. ANDREW I. GAVIL ET AL., *supra* note 30, at 124.
43. *Id.* at 19.
44. 15 F. Supp. 2d 1138, 1143 (D. Utah 1998).
45. 468 U.S. 85 (1984).

The National Collegiate Athletic Association (NCAA) was an association formed by many universities for the sake of regulating collegiate sports.[46] The NCAA allowed two carrying networks, American Broadcasting Cos. (ABC) and Columbia Broadcasting System (CBS), to show a certain number of games and restrained how many times a team could be shown, at a minimum aggregate price (i.e. output restrictions and price fixing respectively).[47] Schools were not allowed to negotiate with the networks.[48] Thus, when some schools formed the College Football Association (CFA) to show more games, the NCAA threatened to punish them by not showing their games (not only football, but all other sports).[49] The University of Oklahoma then sued the NCAA and alleged that the NCAA restrained televised football and violated section 1 of the Sherman Act.[50] The court affirmed that "Horizontal price fixing and output limitation are ordinarily condemned as a matter of law under an 'illegal *per se*' approach because the probability that these practices are anti-competitive is so high."[51] However, the court refused to apply the *per se* rule in this case because it acknowledged that this was a case involving the sports industry. The court believed that in order for league sports to exist, there must be some sort of horizontal agreements.[52] Instead, the court applied the RoR.[53] Although the court adopted such a rule that is far more favorable to the defendant, the court did not abandon the apparentness of the anti-competitive effect of the challenged conduct.[54] Furthermore, the court decided that the pro-competitive effects of the challenged conduct suggested by the defendant could not justify the restraint of trade, thus failed the RoR and violated the law.[55] From the above, we could tell that U.S. courts did believe that price fixing and output restrictions are more serious anti-competitive conducts. First, these conducts ordinarily fall into the *per se* illegal categories. Second, even under a rare situation like the NCAA, that involved the sports industry and RoR was applied, both conducts could not be justified. Noteworthy is the fact that price fixing and output restrictions are two different types of conduct. The existence of either of them could trigger the *per se* rule. For example, as a lower court stated a few years later, the "*NCAA* indicates that horizontal output restrictions, even if unaccompanied by price fixing, should ordinarily

46. *Id.* at 88-89.
47. *Id.* at 91-94.
48. *Id.*
49. *Id.* at 94-95.
50. *Id.* at 88.
51. *Id.* at 100.
52. *Id.* at 100-102.
53. *Id.* at 103.
54. *Id.* at 106.
55. *Id.* at 113-120.

be declared *per se* illegal."[56]

2. Horizontal Market Allocation

Second, regarding U.S. court's attitude towards horizontal market allocation, the author refers to *Palmer v. BRG of Georgia, Inc.* decided in 1990.[57] BRG of Georgia, Inc. (BRG) and Harcourt Brace Jovanovich Legal and Professional Publications (HBJ) are two bar review companies.[58] They entered into an agreement whereby HBJ would not do business in Georgia and BRG would not do business outside Georgia.[59] Immediately after the agreement, HBJ ceased its operations in Georgia and BRG increased the price of its course from $150 to over $400.[60] Petitioners, law school graduates who contracted to take BRG's course, alleged the agreement between the two bar review companies violated section 1 of the Sherman Act.[61] The court identified the agreement as one that allocated territories between competitors (i.e. horizontal market allocation) and held that it was unlawful on its face by quoting *United States v. Topco Associates, Inc.*[62] as follows:

> One of the classic examples of a *per se* violation of § 1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition . . . . This Court has reiterated time and time again that '[h]orizontal territorial limitations . . . are naked restraints of trade with no purpose except stifling of competition.' Such limitations are *per se* violations of the Sherman Act.[63]

Similar to price fixing and output restriction, the court classified market allocation as one of the *per se* illegal categories. In general, it is believed that market allocation has more anti-competitive effect than price fixing. It is because under a price fixing agreement, conspirators could still compete against each other in terms of quality of the goods or services. However, with market allocation, conspirators would not even have pressure to engage in non-price related competition.[64]

56. R.C. Dick Geothermal Corp. v. Thermogenics, Inc., 1987 U.S. App. LEXIS 11681, at *12 (9th Cir. 1987).
57. 498 U.S. 46 (1990).
58. *Id.* at 47.
59. *Id.*
60. *Id.*
61. *Id.* at 46-47.
62. *Topco Associates*, *supra* note 37, at 608.
63. *Palmer*, *supra* note 57, at 49.
64. ERNEST GELLHORN ET AL., ANTITRUST LAW AND ECONOMICS IN A NUTSHELL 237 (5th ed. 2004).

3. Horizontal Bid Rigging

Last, regarding the U.S. court's attitude towards horizontal bid rigging, the author refers to *United States v. Cinemette Corp. of America* decided in 1988.[65] Between 1985 and 1986 at Altoona, a city in Pennsylvania, movie exhibitors needed to compete for a license to show a film by submitting a bid to a distributor on a movie-by-movie and theatre-by-theatre basis.[66] Therein, three theater operators, including Cinemette Corporation of America (Cinemette), entered into a "split agreement."[67] Under the agreement, exhibitors would allocate among themselves films offered by a distributor and refrain from competing with each other.[68] Hypothetically, a distributor asked exhibitors to submit bids to compete for the right to show a movie called "ABC." Then all exhibitors might secretly agree Cinemette was the winning exhibitor and will show this film. To do so, except for Cinemette, all exhibitors would not submit a bid to the distributor. Without competition, the distributor would have no choice but to name Cinemette the winner even though Cinemette's bid might be less favorable than what the distributor had expected from a genuine competitive process. The court recognized the split agreement as a bid rigging agreement that fell within the *per se* illegal category as follows: "An agreement between competitors pursuant to which contract offers are to be submitted to or withheld from a third party constitutes bid rigging . . . and bid rigging repeatedly has been held to be a *per se* violation of § 1 of the Sherman Act, as a type of price fixing."[69]

In practice, bid rigging exists in different forms. Based on the facts in this case, we could see that the court was right, and the split agreement was indeed a specific form of bid rigging known as bid suppression.[70]

The cases above reveal that, prior to OECD introducing the term hardcore cartels, the four conducts (horizontal price fixing, output restriction, market allocation and bid rigging) were classified as *per se* illegal in the U.S. judicial system. It is hard to tell whether the four conducts are more severe than those conducts that fell into the *per se* illegal category.[71] However, there is no doubt that the four conducts stood out from other cartels that were usually treated under the RoR. Thus, OECD's claim that hardcore cartels

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65. 687 F. Supp. 976 (1988).
66. *Id.* at 977.
67. *Id.*
68. *Id.* at 977-978.
69. *Id.* at 979.
70. OECD, GUIDELINES FOR FIGHTING BID RIGGING IN PUBLIC PROCUREMENT 1–3 (2009), http://www.oecd.org/competition/cartels/42851044.pdf.
71. In 1998, as recognized by courts, conducts such as tying arrangements and horizontal refusals to deal also fell into the *per se* illegal category. *See* Diaz v. Farley, 15 F. Supp. 2d 1138, 1144 (D. Utah 1998). (providing examples of conduct treated with *per se* analysis).

are the most serious violation of competition law is partially justified.

C. *Regulation*

As said, in 1998, OECD adopted the *Recommendation of the Council Concerning Effective Action Against Hardcore Cartels* in which it introduced the term hardcore cartels and urged its member countries to make sure that their competition laws could effectively combat hardcore cartels and cooperate in fighting against such cartels. Thereafter, OECD's Competition Committee spent a lot of effort in implementing the *Recommendation* and submitted reports to the OECD in 2000, 2002 and 2005 regarding its work done and the progress of its member countries in fighting against hardcore cartels.[72] In light of the seriousness of hardcore cartels and the effort of the Competition Committee, many countries have strengthened the combat against them.[73] However, "hardcore cartels" itself is not adopted as a legal terminology. For example, in the fundamental statutory competition law of Australia, Canada, China, European Union, Singapore, United Kingdom and United States (in alphabetical order), there is not a legal term created to clearly define and cover only the four hardcore cartels.[74] That said, except for the U.S., all the above countries or intergovernmental organizations do enumerate some, if not all, of the four conducts in their

72. OECD, HARD CORE CARTELS: THIRD REPORT ON THE IMPLEMENTATION OF THE 1998 COUNCIL RECOMMENDATION 7-8 (2005), https://www.oecd.org/competition/cartels/35863307.pdf.

73. *Id.*

74. *See, e.g.*, Australia – *Competition and Consumer Act 2010* (Cth) (Austl.), https://www.legislation.gov.au/Details/C2017C00062; Canada - Competition Act, R.S.C. 1985, c. C-34 (Can.), http://laws-lois.justice.gc.ca/eng/acts/C-34/index.html; China - Zhonghua Renmin Gongheguo Fanlongduanfa (中华人民共和国反垄断法) [AntiMonopoly Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), translated in Lawinfochina, http://www.lawinfochina.com/display.aspx?lib=law&id=0&CGid=96789; European Union - Consolidated Version of the Treaty on the Functioning of the European Union art. 101-109, Jun. 7, 2016, 2016 O.J. (C 202) 88, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2016:202:FULL&from=EN; Council Regulation (EC) No. 1/2003 of 16 December 2002, 2002 O.J. (L 1) 1, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003R0001&from=EN; Singapore – Competition Act, c. 50B http://statutes.agc.gov.sg/aol/download/0/0/pdf/binaryFile/pdfFile.pdf?CompId:a5c81af7-2538-4a5e-b06f-63d6ee459b0a; United Kingdom – Competition Act, 1998, c. 41 (U.K.), http://www.legislation.gov.uk/ukpga/1998/41; Enterprise Act, 2002, c. 40 (U.K.), http://www.legislation.gov.uk/ukpga/2002/40/contents; United States - Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1890); Clayton Act, 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53 (1914) ; The Federal Trade Commission Act, 15 U.S.C. §§ 41-58 (1914); Robinson-Patman Act, 15 U.S.C. § 13 (1936) (listing fundamental competition laws of different countries).

statute as agreements that would violate the law.[75] [76] Noteworthy is the fact that among these countries or intergovernmental organizations, the United Kingdom and Australia have used "cartel provisions" and "cartel offence" respectively as the titles of the sections that enumerate illegal conducts.[77] Taking United Kingdom as an example, its cartel offence covers only the four hardcore cartels. Having said that, the law does not define cartel as a legal terminology, such as the law does not use cartel as a noun elsewhere in the law. Although no country has adopted "hardcore cartels" as a legal terminology in its statute, many have taken stronger measures in different ways to combat the four hardcore cartel conducts. Following are five examples: (i) in terms of evidence, as discussed, the U.S. has applied the less defendant-favorable *per se* rule to hardcore cartel conducts and the more defendant-favorable full RoR to other cartels; (ii) in terms of commitment, the European Union established the Commitment Decisions system under article nine of *Council Regulation (EC) No. 1/2003*.[78] Simply speaking, such a system allows the suspected company to make a promise (i.e., commitment) to the European Commission in exchange for not receiving an infringement decision.[79] According to a memo issued in 2004 by the European Commission, hardcore cartels are clearly excluded from the privilege of the above commitment procedures.[80] The memo did not clarify the definition of hardcore cartels. Yet, in a document the European Community (EC) submitted to the World Trade Organization (WTO) in

75. *See, e.g.*, Australia – *Competition and Consumer Act 2010* (Cth) s 44ZZRD (Austl.); Canada - Competition Act, R.S.C. 1985, c. C-34, art. 45 & 47 (Can.); European Union - Consolidated Version of the Treaty on the Functioning of the European Union art. 101, Jun. 7, 2016, 2016 O.J. (C 202) 88; Singapore – Competition Act, chapter 50B (enacted 2004, revised Jan. 31, 2006, consolidated informally Jan. 22, 2016), section 34; United Kingdom – Enterprise Act, 2002, c. 40, § 188 (U.K.).

76. For example, China is one of the countries that enumerated some, but not all of the hard core cartels in its statute. More specifically, China enumerated horizontal price fixing, output restrictions and market allocations, but not bid rigging under Article 13 of its Anti-Monopoly Law. In a separated study, the author argued that China should add bid rigging as one of the enumerations under the article. Sinchit Lai, Note, *Bid Rigging, a Faintly Discernible Enumeration under Article 13 of the Anti-Monopoly Law in China*, 12 U. PA. ASIAN L. REV. 244 (2016).

77. Australia - Competition Act, *supra* note 74, at s 44ZZRD; United Kingdom - Competition Act, *supra* note 74, at § 188.

78. Council Regulation (EC) No. 1/2003 of 16 December 2002, art. 9, 2002 O.J. (L 1) 1, 9, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003R0001&from=EN.

79. EUR. COMM'N, *Antitrust: commitment decisions – frequently asked questions*, http://europa.eu/rapid/press-release_MEMO-13-189_en.htm (last visited July 7, 2017).

80. European Commission Memoranda MEMO/04/217, Commitment decisions (Article 9 of Council Regulation 1/2003 providing for a modernised framework for antitrust scrutiny of company behaviour) (Sept. 17, 2004), http://europa.eu/rapid/press-release_MEMO-04-217_en.htm?locale=en.

2002, the EC clearly expressed that they referred to hardcore cartels as organizations that engaged in price fixing, output restriction, market allocation and bid rigging between competitors.[81] Such interpretation was in line with OECD's definition; (iii) in terms of exclusion, Singapore has presumed that "small or medium enterprises" with a market share below a certain threshold, aggregately or separately, have no appreciable adverse effect on competition even if they formed anti-competitive agreements.[82] Thus, these small or medium enterprises are excluded from section thirty-four of the country's Competition Law that, similar to section one of the Sherman Act in the U.S., prohibits anti-competitive agreements.[83] However, the above exclusion does not apply to restrictions placed on "hardcore" entities involving horizontal price fixing, output restriction, market allocation and bid rigging;[84] (iv) in terms of sanctions, personnel of undertakings that engaged in hardcore cartels may be subject to criminal punishment in some countries, such as the United Kingdom.[85] An example is the marine hose case decided in 2008, in which the three natural-person defendants were sentenced to jail for two and a half years;[86] (v) in terms of law enforcement, the Antitrust Division of the U.S. Department of Justice has long had a specialized criminal enforcement team separate from the civil enforcement team which focuses merely on "hardcore" violations like price fixing, market allocation and bid rigging.[87]

Overall, there are three takeaways from this section. First, it establishes that "hardcore cartels" is a distinct concept from a cartel. Under the definition of cartel, "hardcore cartels" is a narrower concept that covers only four specific types of conduct. Second, hardcore cartels are distinguished from cartels by the OECD for a good reason. One of the key reasons is that, in 1998, the OECD acknowledged that the four conducts were more serious than the remaining cartels. Third, although "hardcore cartels" is not adopted

81. EUR. COMM'N, *International Hard Core Cartels and Cooperation Under a WTO Framework Agreement on Competition, Submission for the WTO Working Group on the Interaction between Trade and Competition Policy (WGTCP)* 1 (June 24, 2002), http://trade.ec.europa.eu/doclib/docs/2003/april/tradoc_111260.pdf.

82. COMPETITION COMM'N OF SINGAPORE [CCS], COMPETITION COMMISSION OF SINGAPORE GUIDELINES ON THE MAJOR PROVISIONS 2016 8 (2016), https://www.ccs.gov.sg/~/media/custom/ccs/files/legislation/ccs%20guidelines/e%20gazette%205pm/guidelines%20on%20the%20major%20provisions%202016.ashx.

83. *Id.*

84. *Id.* at 8-9.

85. Enterprise Act, 2002, c. 40, § 190 (U.K.).

86. R v. Whittle, Allison, and Brammar [2008] EWCA Crim. 2560, [2009] Lloyd's Rep. FC 77, available at http://www.bailii.org/ew/cases/EWCA/Crim/2008/2560.html.

87. Gerald F. Masoudi, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, Address at the Cartel Conference Budapest (Feb. 16, 2007) (transcript available at https://www.justice.gov/atr/file/519316/download).

as a legal terminology in different countries' antitrust statutes, the creation of the term itself has profound policy implications. As discussed, many countries have introduced procedures that apply only to hardcore cartels, but not to other cartels. Again, these "special treatments" can be justified by the seriousness of hardcore cartels.

II. DIVERGENCE: "SERIOUS ANTI-COMPETITIVE CONDUCT" FORMED IN THE ORDINANCE BY HK LEGISLATORS

A. *Definition*

Unlike many other countries, Hong Kong "tried" to differentiate hardcore cartels from other cartels by defining a legal terminology, namely "serious anti-competitive conduct," in its Competition Ordinance, the region's first cross-sector competition law passed by the Legislative Council on June 14, 2012.[88] This made it the first jurisdiction to make such an attempt. However, such attempt was not fully successful because the definition of "serious anti-competitive conduct" diverged from that of "hardcore cartels," which is widely accepted internationally.

In line with many other countries, prohibiting anti-competitive agreements is one of the important pillars in Hong Kong's Ordinance. Sections six to eight of the Ordinance, also known as the First Conduct Rule, is dedicated to defining what agreements are prohibited.[89] Section six provides a general definition of anti-competitive agreements that are illegal but does not enumerate any conduct as an example. Simply speaking, the Ordinance prohibits agreements with an object or effect to prevent, restrict or distort competition in Hong Kong.[90] Thereafter, section seven defines "object" and "effect" and section eight describes the jurisdiction of the Fist Conduct Rule geographically.[91]

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88. Competition Ordinance, *supra* note 5, at §2.

89. *Id.* at §§ 6-8.

90. Section 6(1) of the Competition Ordinance prohibits anti-competitive "agreements, concerted practices and decisions" as follows: (1) 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.

In this Comment, the word "agreements" is used generally for "agreements," "concerted practices" and "decisions." Competition Ordinance, *supra* note 5, at § 6. Section 2 of the Competition Ordinance defined "undertaking" as: "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." *Id.* at § 6. In this Comment, words like "corporation" and "company" are used instead of "undertaking" to make it easier for the reader to read.

91. *Id.* at §§ 7-8.

On top of the above, the Ordinance defines "serious anti-competitive conduct". Section two of the Ordinance interprets different terminologies used in the law. One of the terms defined is "serious anti-competitive conduct," which:

> means 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.[92]

At a glance, "serious anti-competitive conduct" is very similar to "hardcore cartels" defined by OECD because both of them have enumerated the four conducts, namely price fixing, output restriction, market allocation and bid rigging. However, on a closer look, one would notice that the definition of "serious anti-competitive conduct" created by Hong Kong legislators is indeed different from "hardcore cartels" as recognized internationally. On one hand, as defined, hardcore cartels refer only to the four agreements made between competitors. Therefore, hardcore cartels are limited to horizontal price fixing, output restriction, market allocation and bid rigging. On the other hand, serious anti-competitive conduct covers "any conduct", as described in the ordinance, that consists of the four conducts. In other words, it implies that serious anti-competitive conduct covers not only horizontal, but also vertical price fixing, output restriction, market allocation and bid rigging. Different from horizontal agreements that represent agreements between competitors on the same level of the supply chain, vertical agreements are agreements formed between firms at different levels of the supply chain (e.g., between a manufacturer and retailer of a certain good).[93] In short, serious anti-competitive conduct, as introduced in Hong Kong, is a broader definition than hardcore cartels. Compared to hardcore cartels, the former includes four more conducts that are vertical price fixing, vertical output restriction, vertical market allocation and vertical bid rigging. Such difference is what the author noted as the divergence between the Hong Kong legislators' view and the definition accepted by the international standard.

For instance, the label of "serious anti-competitive conduct" has a strong signaling effect to the general public. Recall that one of the key reasons for why the concept of hardcore cartels stands out from cartels is its seriousness. Therefore, the terminology used by Hong Kong is literally

92. *Id.* at § 2.
93. ERNEST GELLHORN ET AL., *supra* note 64, at 333.

much more precise and concise than "hardcore cartels" used by OECD or "cartel" used by countries like the United Kingdom. Even laymen who have never studied antitrust law could easily understand the harmful nature of the four conducts. The author could imagine that, after reading section two of the Ordinance, which includes the definition of serious anti-competitive conduct, companies would feel reluctant to enter into any of the four agreements enumerated without consulting counsel. Would defining serious anti-competitive conduct in the statute provide more legal certainty to the public? Surprisingly, the answer is – it depends. Indeed, the term "serious anti-competitive conduct" has a strong signaling effect. However, if the terminology itself doesn't match its content, confusion instead of clarity will result. In other words, if the four vertical agreements (i.e., the divergence) do not seriously restrain competition in general, then the term "serious anti-competitive conduct" is misleading to the public. Thus, the next Section of this Comment will analyze whether the divergence is indeed seriously anti-competitive.

B. *Regulation*

Similar to other countries, Hong Kong's Competition Ordinance adopted a dual-track system which provides relatively harsher procedures for serious anti-competitive conduct compared to all other anti-competitive agreements that would violate the First Conduct Rule. More precisely, there are two sets of special procedures the Ordinance introduced to combat serious anti-competitive conduct. Before introducing these measures, the author would like to highlight another breakthrough of the Ordinance. Recall that the United Kingdom has introduced a term like "cartel offence" as the title of the section that enumerates hardcore cartels in its statute.[94] However, as discussed, such term is not regarded as a legal terminology, as the U.K. law does not use cartel as a noun elsewhere in the law. In contrast, Hong Kong's Ordinance does use serious anti-competitive conduct as a noun to represent the four conducts collectively when it describes the two sets of harsher procedures.

1. The Dual-Track Exclusion System

The first set of harsher procedures is under a particular exclusion from the First Conduct Rule known as an "agreement of lesser significance."[95] Schedule one of the Competition Ordinance offers exclusion procedures in

94. Competition Act, *supra* note 74, at § 188.
95. Competition Ordinance, *supra* note 5, at Schedule 1 § 5.

six different forms. Agreements of lesser significance is one of them, and it's the only one that distinguishes between serious anti-competitive conduct and other illegal agreements. Simply speaking, if several companies formed an anti-competitive agreement prohibited by the First Conduct Rule, but the companies' *aggregate* turnover does not exceed 200 million Hong Kong dollars, the agreement is excluded from the First Conduct Rule.[96] In other words, several small companies are allowed to form anti-competitive agreements, as long as they don't become too big after getting together. As the title of the procedure (i.e. "agreement of lesser significance") suggests, these agreements are less significant to the market, although remaining anti-competitive in nature. However, the ordinance also clearly states that the above exclusion does not apply to agreements that involve serious anti-competitive conduct.[97] It means that legislators do not tolerate serious anti-competitive conduct, even if they are formed between relatively small companies.

2. The Dual-Track Commitment System

The second set of dual-track procedures is formed by two commitment systems, namely "Warning Notices" and "Infringement Notices", following the investigation process.[98] The former applies to agreements not involving serious anti-competitive conduct, while the latter applies to those that do involve serious anti-competitive conduct. Either system is triggered when the HKCC, the law enforcement agency, has reasonable cause to believe that an agreement that violates the First Conduct Rule was formed.[99] At that time, if the HKCC has reasonable cause to believe that the agreement does not involve serious anti-competitive conduct, it will follow the Warning Notice system; otherwise, it will follow the Infringement Notice system.[100] Next, the author will briefly introduce the two systems one after another, then explain why the Infringement Notice system is not only different from, but also harsher than the Warning Notice system.

The Warning Notice system can be found at section 82 of the Ordinance. Again, this system is triggered when the HKCC believes that some companies formed an agreement that violates the First Conduct Rule but does not fall into the definition of serious anti-competitive conduct. Once the above condition is met, the HKCC *must* issue a "warning notice"

96. *Id.* at Schedule 1 § 5(1).
97. *Id.* at Schedule 1 § 5(2).
98. *Id.* at §§ 66-78, 82.
99. *Id.* at §§ 67(1)(a)(i), 82(1).
100. *Id.*

to the companies before bringing proceedings in the Competition Tribunal.[101] In the notice, the HKCC will describe the alleged illegal conduct, identify the suspected companies involved and identify the evidence the HKCC is using to support its allegation.[102] Most importantly, the notice will require the suspected company to cease the illegal conduct within a specific warning period, and not to repeat that conduct afterwards.[103] If the suspected company continues or repeats the illegal conduct after the warning period, the HKCC may bring proceedings in the Competition Tribunal against these companies.[104] The above implies that, if the suspected company does cease the alleged conduct and does not repeat it after the warning period specified in the notice, the HKCC could not proceed to the Competition Tribunal. In other words, the Warning Notice system requires the law enforcement agency to provide a second chance to companies engaging in relatively less serious anti-competitive agreements by giving them time to rectify their illegal conduct. Regarding how to cease the illegal conduct, as required by the law, indications will be provided by the HKCC in the notice.[105] Moreover, if the notified company wants more time to rectify its conduct, it could apply to the HKCC for an extension of the warning period.[106] Of course, such application must be made before the original period granted expires and is subject to the HKCC's approval.[107] Thus, the suspected companies should be able to avoid going to the Competition Tribunal and being penalized if they are willing to do so. Furthermore, as the law does not require the suspected company to make any promise to the HKCC upon receiving the warning notice, this is quite different from the Infringement Notice system introduced below.

The Infringement Notice system can be found in sections 66 to 78 of the Ordinance. Unlike the Warning Notice system, the Infringement Notice system is triggered when the HKCC believes that some companies formed an agreement which *does* involve serious anti-competitive conduct.[108] Once the above condition is met, and no proceeding in the Competition Tribunal has already been brought, the HKCC *may* issue an "infringement notice" to the companies before bringing proceedings in the Competition Tribunal.[109] However, in contrast to the Warning Notice system, a company must commit to complying with the requirements set forth in the infringement notice in

101. *Id.* at § 82(1).
102. *Id.* at § 82(2)(a)-(c).
103. *Id.* at § 82(2)(d)(i).
104. *Id.* at § 82(2)(d)(ii)-(iii).
105. *Id.* at § 82(2)(e).
106. *Id.* at § 82(6)-(7).
107. *Id.*
108. *Id.* at § 67(a).
109. *Id.* at § 67(2)-(3).

exchange for the second chance.[110] The requirements may include, but are not limited to, refraining from any specified conduct, taking any specified action and/or admitting to illegal conduct.[111] Similar to a warning notice, an infringement notice will describe the alleged illegal conduct, identify the suspected companies involved and identify the evidence the HKCC is using to support its allegation.[112] Moreover, an infringement notice specifies both (i) the notification period, which is the time given to the notified company for it to decide whether to accept the HKCC's offer by making a commitment, and (ii) the compliance period, which is the time the company is required to keep its commitment afterwards.[113] Of course, the notified company has no obligation to make a commitment.[114] Yet, if the notified company does make a commitment within the notification period, the HKCC cannot bring proceedings in the Competition Tribunal against that company unless it fails to keep its promise.[115] Unlike under the Warning system, the law does not state that the HKCC has authority to extend the notification upon receiving application from the recipient company. Comparing the two notice systems, it is easy to see why the Infringement Notice system, which applies to serious anti-competitive conduct, is harsher than the Warning Notice system, which does not. First, in both situations, a company is believed to have engaged in anti-competitive conduct that violates the First Conduct Rule. However, if no serious anti-competitive conduct is involved, it is mandatory for the HKCC to offer the suspected company a second chance under the Warning Notice system. Moreover, the suspected company does not need to make any commitment beyond stopping its illegal conduct forever. In contrast, when serious anti-competitive conduct is involved, it is at the HKCC's discretion to offer the suspected company a second chance under the Infringement Notice system. Also, the suspected company needs to make a commitment not only to rectify its illegal conduct, but probably also to admit to the alleged conduct. This is definitely less favorable to the suspected company.

C. *Legislation History*

By defining serious anti-competitive conduct and introducing harsher procedures for them, Hong Kong legislators have created a dual-track system in the Ordinance. This made Hong Kong the first jurisdiction attempting to

110. *Id*. at § 67(2).
111. *Id*. at § 67(3).
112. *Id*. at § 69.
113. *Id*. at § 66, 69(f).
114. *Id*. at § 68.
115. *Id*. at §§ 75-76.

capture the definition of hardcore cartels and transplanting it into its law as a legal terminology. However, as said, the definition of serious anti-competitive conduct has deviated from hardcore cartels, an international standard of "the most egregious violations of competition law."[116] Why did Hong Kong legislators define serious anti-competitive conducts in the Ordinance in the first place? Why was a dual-track system formed in the Ordinance? Why is there a divergence between the Hong Kong legislators' view and the international standard? To answer these questions, we will have a quick review of the relevant legislation history.

In November 2006 and May 2008, the Hong Kong government conducted its first and second rounds of public consultation on the region's competition policy.[117] After the 2006 consultation, the government published a discussion paper. This paper pointed out that, after assessing the feedback from the public during the consultation period, some concerns were found "in the business sector – especially among some SMEs – at the possible effect that a new competition law might have on business operations."[118] First, some small and medium-sized enterprises (SMEs) worried that they might unwittingly fall afoul of the new law while others worried that large companies might use litigation as a strategic tool to harass them.[119] Thus, the government stated that it would keep in mind the concerns of SMEs when it drafted the new competition law for Hong Kong.[120] In the 2008 public consultation paper, the government did respond to the SMEs' concerns. For example, after consulting local and overseas experts, the government believed that an anti-competitive agreement formed between SMEs would not have sufficient market power to lessen competition substantially unless such agreement involved "'hard-core' conduct."[121] The government referred to hardcore conduct as "price fixing, bid rigging, output restriction and market allocation."[122] This is the very first time the government mentioned the term "hardcore conduct" and briefly elaborated the term in its consultation paper. It is not hard to see that the government

116. OECD, *supra* note 2.

117. LEGIS. COUNCIL, *Updated Background Brief on the Introduction of a Competition Law in Hong Kong 2* (Jun. 28, 2010) (H.K.), http://www.legco.gov.hk/yr09-10/english/panels/edev/papers/edev0628cb1-2301-4-e.pdf.

118. ECON. DEV. AND LAB. BUREAU, *Way Forward for Competition Policy* 1-2 (Mar. 2007) (H.K.), http://www.legco.gov.hk/yr06-07/english/panels/es/papers/es0326cb1-1178-1-e.pdf.

119. *Id.* at Annex Chapter 2, 6-7.

120. *Id.* at 4.

121. COMMERCE AND ECON. DEV. BUREAU, *Public Consultation on Detailed Proposals of a Competition Law* 6 (May 6, 2008) (H.K.), http://www.legco.gov.hk/yr07-08/english/panels/es/papers/edev0506-citbcr05622513-e.pdf.

122. *Id.* at Annex 45.

was trying to refer to hardcore cartels as defined by the OECD. However, the government did not clearly specify that "hardcore conduct" was only limited to agreements between competitors (i.e. horizontal agreements). Therefore, on one hand, highlighting "hardcore conduct" in the consultation paper had far-reaching significance to defining "serious anti-competitive conduct" in the Ordinance that eventually passed. On the other hand, it seems that the later divergence between the legislators and the international standard has long been buried in the consultation stage, likely by ignorance. Second, to address the SMEs' concerns, the government suggested the law require the HKCC to later clarify in its guidelines that a "*[d]e minimis* approach" would be adopted.[123] Under such approach, if several companies form an anti-competitive agreement, they would not be penalized if their aggregate market share does not exceed a certain threshold unless the agreement involves "hardcore conduct."[124] The government has referenced other jurisdictions, such as the U.S. and Singapore, when making this suggestion.[125] Thus, such proposal is very similar to the Singapore exclusion system introduced in the previous section of this Comment. This is exactly the prototype of the "agreement of lesser significance," which, as discussed earlier, was adopted in the Ordinance eventually.[126] The government's response to the SMEs' concern is not limited to the above two discussions.[127] Yet, they are the two examples that are most relevant to this Comment. Another point worth mentioning is that, in the consultation paper, the government suggested that the law should give a general definition of what agreements are prohibited and not give a list of examples of anti-competitive agreements.[128] In doing so, the government intended to avoid spending unnecessary resources on arguing whether a specific agreement is prohibited. Instead, it is much simpler to focus on whether a presented agreement has the purpose or effect of lessening competition substantially.[129]

After consulting the public, in September 2008, the government published a report for the second consultation.[130] The report pointed out that various measures proposed by the government to address SMEs' concerns

123. *Id.*
124. *Id.*
125. *Id.*
126. *See supra* notes 90 92- and accompanying text
127. More examples of the government's response to the SMEs' concerns can be found at Chapter V of the 2008 consultation paper. COMMERCE AND ECON. DEV. BUREAU, *supra* note 121, at 44-47.
128. *Id.* at 23-24.
129. *Id.* at 25.
130. COMMERCE AND ECON. DEV. BUREAU, *Report on Public Consultation on the Detailed Proposals for a Competition Law* (Sept. 2008) (H.K.), http://www.cedb.gov.hk/citb/doc/en/publication/Consultation_Report_30_9.pdf.

were well acknowledged, including the *de minimis* approach.[131] Some respondents suggested the threshold used in the approach could be measured in terms of not only market share, as the government proposed, but also the turnover of the companies involved.[132] However, some other respondents remained worried that the new law would affect SMEs adversely.[133] On the other hand, some respondents suggested, in addition to having a general definition of illegal agreements, the new law should include a non-exhaustive list of examples of conduct that would commonly be considered anti-competitive.[134] By doing so, the new law could provide more legal certainty to the business sector.[135]

On July 2, 2010, the Hong Kong government gazetted the Competition Bill (hereinafter the Bill).[136] The proposed law was submitted to the Legislative Council twelve days later for First Reading.[137] Similar to the Ordinance eventually passed, the First Conduct Rule in the Bill gave a general definition of prohibited agreements.[138] The general terms are pretty much the same between the Ordinance and the Bill. Unlike the Ordinance, the Bill subsequently clarified the general term as follows: "applies in particular to agreements, concerted practices and decisions that — (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development or investment; or (c) share markets or sources of supply."[139]

Obviously, the three examples of illegal conduct enumerated are price fixing, output restriction and market allocation - three of the hardcore conducts identified by the government in the 2008 consultation paper.[140] The government explained that these examples were included to "enhance the certainty and clarity of the law."[141] In contrast to the Ordinance, the Bill did not define serious anti-competitive conduct, or other terms close to it, elsewhere. Without distinguishing serious anti-competitive conduct, there was no dual-track system built in the Bill. First, there was an Infringement

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131. *Id.* at 6.
132. *Id.*
133. *Id.*
134. *Id.* at 16.
135. *Id.* at 4.
136. GOVERNMENT OF HONG KONG SPECIAL ADMINISTRATIVE REGION (GovHK), *Competition Bill Gazetted* (July 2, 2010) (H.K.), http://www.info.gov.hk/gia/general/201007/02/P201007020101.htm.
137. *Id.*
138. Competition Bill, (2010) C879, §6(1) (H.K.), http://www.legco.gov.hk/yr09-10/english/bills/b201007022.pdf.
139. *Id.* at §6(2).
140. COMMERCE AND ECON. DEV. BUREAU, *supra* note 121.
141. LEGIS. COUNCIL, *Legislative Council Brief Competition Bill* 2 (July 2, 2010) (H.K.), http://www.legco.gov.hk/yr09-10/english/bills/brief/b35_brf.pdf.

Notice system, but no Warning Notice system in the Bill.[142] Although they were named the same, the Infringement Notice system in the Bill was different from that in the Ordinance passed later on. The key difference was that the former was applicable to all illegal agreements while the latter was only applicable to serious anti-competitive conduct. In other words, price fixing, output restriction, market allocation and bid rigging were not treated harsher than other conducts in the Bill. Under the notice system in the Bill, whenever the HKCC believed that some companies formed an agreement, regardless of its seriousness, the HKCC could offer the companies a second chance conditional to the companies' commitment to comply.[143] On the other hand, the Bill did not include a *de minimis* approach (i.e. the prototype of the "agreement of lesser significance" later adopted in the Ordinance) as suggested in the 2008 consultation paper.[144] Actually, early when the government conducted the 2008 consultation, it noticed that the *de minimis* system could be established either in the new law or agency guideline after referencing international experience.[145] Considering the fact that Hong Kong is a small economy, the government expressed its intent to follow Singapore and let the agency set up the *de minimis* system in its guideline.[146]

As a general procedure of lawmaking in Hong Kong, First Reading is simply the Clerk of the Legislative Council reading out the title of the bill.[147] Then, the Council will order the bill to be set down for Second Reading, and the debate of the bill will be adjourned.[148] At a subsequent meeting, the House Committee will order to form a Bills Committee to scrutinize the bill if, and only if, the bill is too controversial or complicated.[149] On October 8, 2010, Hong Kong's legislators formed a Bills Committee on Competition Bill (BCCB) to scrutinize the Bill.[150] During deliberations, the BCCB noted that the Bill had adopted a general prohibition approach to combat hardcore conduct and non-hardcore conduct.[151] Some members of the Committee worried that "SMEs might unwittingly breach the law because of the lack of certainty in this catch-all general prohibition."[152] Further, such approach

142. Competition Bill, *supra* note 138, at §65-77.

143. *Id.* at §66(2).

144. COMMERCE AND ECON. DEV. BUREAU, *supra* note 121.

145. COMMERCE AND ECON. DEV. BUREAU, *supra* note 121, at Annex 46.

146. *Id.*

147. LEGIS. COUNCIL SECRETARIAT, *How Laws are Made* 2 (Feb. 2017) (H.K.), http://www.legco.gov.hk/education/files/english/Factsheet/Factsheet7.pdf.

148. *Id.*

149. *Id.*

150. LEGIS. COUNCIL SECRETARIAT, *Report of the Bills Committee on Competition Bill* 3 (May 23, 2012) (H.K.), http://www.legco.gov.hk/yr09-10/english/bc/bc12/reports/bc120530cb1-1919-e.pdf.

151. *Id.* at 7.

152. *Id.* at 7.

would create a "huge burden for SMEs as the inadvertent breach of a less serious nature might still attract a heavy fine."[153] As a result, some members of the Committee suggested the government adopt a "two-track approach."[154] In response, the government acknowledged: "the market needs a swift and effective response to hardcore anti-competitive activities because they almost always have an adverse impact on competition, the Administration accepts a lighter enforcement approach in respect of non-hardcore activities."[155]

In other words, the government was willing to take the advice of the Committee and adopt a dual-track system by introducing more lenient procedures for non-hardcore conduct. First, the government proposed to specify "price-fixing, bid-rigging, market allocation and output control, as 'serious anti-competitive conduct' in the Bill."[156] These conducts are chosen because the government noticed that oversea jurisdictions have recognized them as conducts which "will always have an adverse impact on competition."[157] Second, the government proposed to introduce a Warning Notice system for non-hardcore conduct.[158] By doing so, companies that participated in non-hardcore conduct could be warned before the HKCC took any legal proceedings. The government suggested that if companies were given a chance to correct their mistakes, their exposure to sanctions would be reduced.[159] The Committee recognized that this could reduce the risk of companies, particularly SMEs, falling foul of the law unknowingly.[160] On the other hand, some members of the BCCB argued the SMEs have limited impact on the economy and should be completely exempted from the Bill.[161] The government disagreed with the Committee and claimed that SMEs could make a significant impact on the market after collusion.[162] Therefore, the Committee recommended that the government reference other countries and include a *de minimis* exclusion system in the Bill to provide greater certainty to SMEs.[163] The government agreed to do so but clearly stated that such exclusion is not applicable to the four hardcore conducts since they almost always affect competition adversely.[164]

153. *Id.*
154. *Id.*
155. *Id.* at 8.
156. *Id.*
157. *Id.*
158. *Id.* at 9.
159. *Id.*
160. *Id.*
161. *Id.* at 9-10.
162. *Id.* at 10.
163. *Id.*
164. *Id.*

On June 6, 2012, the Second Reading debate of the Bill was resumed.[165] On the same day, after the debate, a vote was taken on the motion for the Second Reading of the Bill.[166] The majority of the legislators present voted in favor of the motion. Thus, immediately, the lawmaking process proceeded to the Committee Stage in which Legislative Council sat as a "Committee of the whole Council."[167] At this Committee Stage, the Secretary for Commerce and Economic Development (Secretary for CED), who represented the government, moved for amendments to the Bill.[168] These amendments included, but were not limited to, the following: (i) deleting section 6(2) which contained the three conducts listed as examples supplementing the general prohibition under First Conduct Rule[169]; (ii) adding a term "serious anti-competitive conduct" in section 2(1) which covers the four hardcore conducts defended by the Hong Kong government;[170] (iii) introducing a dual-track commitment system, as proposed, by adding the Warning Notice system[171] and amending section 66 of the Infringement Notice system[172]; and (iv) adding the "agreement[] of lesser significance" exclusion system at Schedule 1 of the Bill as proposed.[173] In some subsequent meetings, the amendments moved for by the government were adopted.[174] On June 14, 2012, the Secretary moved a motion that "[t]he bill be read the third time and do pass," the Bill proceeded to Third Reading.[175] Then, the legislators voted, and the motion was passed.[176] The Competition Bill completed its passage in the Legislative Council.[177]

A few questions were raised at the beginning of this subsection. Now

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165. LEGIS. COUNCIL, *Council Meeting*, (Jun. 6, 2012) (H.K.), http://webcast.legco.gov.hk/public/en-us/SearchResult?MeetingID=M11100023.

166. *Id.*

167. *Id.*

168. *Competition Bill at the Committee Stage (with Amendments to be Moved by the Secretary for Commerce and Economic Development)*, (Jun. 6, 2012) (H.K.), http://www.legco.gov.hk/reporter/english/legco_bill201206201-e.pdf.

169. *Id.* at 4.

170. *Id.* at 1-2.

171. *Id.* at 15-18.

172. *Id.* at 14.

173. *Id.* at 35-37.

174. LEGIS. COUNCIL, *The LegCo Reporter Issue No. 33*, (Jun. 20, 2012) (H.K.), http://app.legco.gov.hk/reporter/english/report.aspx?i=52; LEGIS. COUNCIL, *The LegCo Reporter Issue No. 31*, (Jun. 9, 2012) (H.K.), http://app.legco.gov.hk/reporter/english/report.aspx?i=50.

175. LEGIS. COUNCIL, *Council Meeting* (Continuation of the Council meeting of 13/6/2012), (Jun. 14, 2012) (H.K.), http://webcast.legco.gov.hk/public/en-us/SearchResult?MeetingID=M12060029.

176. *Id.*

177. In general, if the motion on Third Reading is passed, a bill completes its passage in Hong Kong. LEGIS. COUNCIL SECRETARIAT, *supra* note 147, at 3.

that a brief review of the legislation's history has been given, this comment will address those questions. First, why was a dual-track system formed in the Ordinance? The simple answer is that the legislators did that in response to the concerns of the SMEs. Starting from the consultation in 2006, SMEs have expressed their worries.[178] Although the government made some suggestions during the second consultation in 2008, the SMEs' worries remained.[179] Therefore, the legislators, represented by the BCCB, pressured the government to respond to the voice of the SMEs when the Bill was scrutinized prior to the resumption of the Second Reading in 2012. In response, the government proposed a lot of changes and submitted amendments to the Bill, which were eventually passed.[180] This explanation also helps answer the second question - why did Hong Kong legislators define serious anti-competitive conducts in the Ordinance in the first place? Clearly, serious anti-competitive conduct was defined mainly to facilitate the government in creating the dual-track system and to provide more legal certainty. The third question is why is there a divergence between Hong Kong legislators' standards and the international standard? Early in the 2008 consultation, after conferring with experts and referencing international experience, the government noticed that some anti-competitive activities were more serious than others. The government referred to these more serious activities as hardcore conducts, namely price fixing, output restriction, market allocation and bid rigging. However, as said, the government was not aware that international communities would only refer to the four conducts between competitors (i.e. horizontal agreements) as "the most egregious violations of competition law."[181] Nonetheless, the government continued to use its own definition of hardcore conduct and developed the term "serious anti-competitive conduct" later on when responding to the needs of SMEs and the BCCB.[182] The author of this Comment has not seen evidence of legislators challenging whether this definition should exclude vertical agreements during the Committee Stage debate. Therefore, such subtle difference between hardcore cartels and serious anti-competitive conduct snuck into the Ordinance of Hong Kong. Although the definition of serious anti-competitive conduct was invented and proposed by the government, the legislators were responsible for this too because they had eventually voted for the law.

III. ANALYZING THE DIVERGENCE BETWEEN INTERNATIONAL

178. ECON. DEV. AND LAB. BUREAU, *supra* note 118, at 1-2.
179. COMMERCE AND ECON. DEV. BUREAU, *supra* note 130, at 6.
180. *Supra* notes 168-174.
181. OECD, *supra* note 2, at 2.
182. *Competition Bill at the Committee Stage*, *supra* note 170, at 1-2.

STANDARD AND HK LEGISLATION USING U.S. CASES

So far, we have learned not only that there is a divergence between the international standard and Hong Kong legislation, but also why such divergence exists. The next question would be: is such divergence justifiable? In other words, whether vertical price fixing, vertical output restriction, vertical market allocation and vertical bid rigging included in the definition of serious anti-competitive conducts, but not in hardcore cartels, are indeed more severe violations of antitrust law. In Section I.B of this Comment, the author has spent a lot of time explaining the rationale behind the analysis used to justify that hardcore cartels defined by the OECD is more serious than many other cartels. In short, conducts analyzed by the U.S. court under the *per se* rule are more serious than conducts analyzed under the RoR. Similarly, in this Section, the author has selected a U.S. case for each of the four vertical activities and looked into the court's attitude towards these cases. Different from Section I.B, cases selected for analysis in this Section, except for the very old vertical market allocation case, were decided within fifteen years from 2012, instead of from 1998. In Section I.B, we have chosen cases before 1998 because we wanted to see whether the definition of hardcore cartels was justifiable, at least in term of seriousness, at the time it was introduced. In contrast, in this Section, we would like to see whether the definition of serious anti-competitive conducts is still justifiable now. Obviously, the international communities' attitude towards the four vertical agreements might have changed over time. Relevant cases continued to develop between 1998 when OECD introduced the term hardcore cartels and 2012 when Hong Kong introduced the term of serious anti-competitive conduct. As overseas courts shifted from applying the *per se* rule to applying the RoR to the four vertical conducts rule, Hong Kong should have captured the recent development and excluded those conducts from the definition of serious anti-competitive conduct. Not to mention that, in reality, there has not been a strong opinion that the four vertical conducts are a more serious violation of antitrust law. Therefore, most of the cases selected below were decided within 15 years before 2012 when the Competition Ordinance of Hong Kong was passed.

A. *Vertical Price Fixing*

Regarding U.S. courts' attitudes towards vertical price fixing, the author refers to the Supreme Court's opinion in *Leegin Creative Leather Prods. V. PSKS, Inc.*, decided in 2007.[183] This is a significant case since the

183. Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877 (2007).

Supreme Court overruled an almost 100-year old precedent set forth in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[184] which established that vertical price restraints are *per se* violations of the Sherman Act.[185]

Leegin Creative Leather Products, Inc. (hereinafter Leegin), the defendant in the case, was a company which manufactured leather goods and accessories.[186] Leegin had many retailers that helped distribute its products.[187] PSKS, Inc., (hereinafter PSKS), the plaintiff in the case, was a retailer that once distributed Leegin's products.[188] Leegin's business strategy was to have its retailers focus on customer service, instead of discounting.[189] Thus, the company introduced pricing policies and refused to sell to retailers that sold its products below the suggested price.[190] PSKS violated the price policy and offered consumers a twenty percent discount for Leegin's products.[191] Leegin discovered this discount and requested PSKS to cease discounting.[192] PSKS refused to do so.[193] Therefore, Leegin stopped selling to PSKS. As a result, PSKS suffered economic loss and, hence, sued Leegin under section 1 of the Sherman Act for fixing the price with its retailers.[194] Lower courts, basing their decisions mainly on the standard set forth by the Supreme Court in the 1911 *Dr. Miles* case, ruled against the defendant by holding that vertical minimum price fixing was a *per se* violation of the Sherman Act.[195] Yet, Leegin argued that the RoR should have applied instead and appealed to the Supreme Court.[196] The key issue presented before the Supreme Court was, should the *per se* rule or the RoR be applied to vertical price restraints, including the minimum resale price maintenance agreements formed between manufacturers and their retailers.[197]

In response, the Supreme Court first reviewed the rationales upon which *Dr. Miles* relied and rejected their justifications for a *per se* rule against vertical minimum resale price agreements.[198] Then, the Supreme Court turned to evaluate the economic effects (i.e. pro-competitive and anti-competitive effects) of such agreements to determine whether the *per se* rule

184. Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).
185. *Leegin Creative Leather Prods.*, 551 U.S. at 881.
186. *Id.* at 882.
187. *Id.*
188. *Id.*
189. *Id.*
190. *Id.* at 883.
191. *Id.* at 884.
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.* at 885.
196. *Id.* at 884-85.
197. *Id.* at 885.
198. *Id.* at 887-89.

was nonetheless appropriate.[199] On the pro-competitive side, the court identified that vertical minimum resale price agreements could stimulate interbrand (non-price) competition by reducing intrabrand (price) competition.[200] And it was interbrand competition, rather than intrabrand competition, that antitrust laws primarily aimed at protecting.[201] For example, Leegin had many retailers that sold their products to consumers. These retailers needed to compete among themselves for more sales (i.e. intrabrand competition), by engaging in price and or non-price competition. Price competition would simply be reducing the resale price of Leegin's product, while non-price competition could be in the form of increasing sales services or promotions. However, providing better services or more promotions was costly. Therefore, there was a tradeoff between price competition and non-price competition.[202] For instance, by setting a minimum resale price, Leegin could ensure its retailers sufficient profit margins to provide quality services and enough promotions.[203] In addition, if there was no agreement on resale price, some retailers might free ride on the efforts of other retailers under the same brand in providing services and promotions. Sparing retailers that effort would benefit the entire Leegin brand, rather than just its own store. Therefore, the retailer that did not make that effort would be able to reduce price and "steal" other retailers' consumers. Thus, Leegin's retailers would be discouraged from providing more services and promotions. As seen, overall, having a minimum resale price agreement could ensure a certain level of non-price competition among Leegin's retailers (i.e. intrabrand competition). Since there were more services and promotions provided by Leegin's retailers, retailers of other manufacturer brands would face pressure to follow suit to avoid losing their consumers. For that reason, the Supreme Court suggested that a vertical price restraint could be pro-competitive by reducing intrabrand price competition, and hence increasing interbrand non-price competition. Furthermore, since some manufacturers might position themselves as "high-price, high-service brands", this gave room for "low-price, low-service brands" to enter the market.[204] Vertical minimum resale price agreements would also be considered pro-competitive as they could not only provide more brand options to consumers, but also stimulate intrabrand price and non-price competition in the industry.[205]

199. *Id.* at 889.
200. *Id.* at 890.
201. *Id.*
202. *Id.*
203. *Id.* at 891-92.
204. *Id.*
205. *Id.* at 890-91.

On the other hand, the Supreme Court identified four circumstances under which having vertical minimum resale price agreements might be anti-competitive. First, such agreements could be used to facilitate horizontal price-fixing agreements among manufacturers mainly for obtaining monopoly profits.[206] Having each manufacturer set a minimum resale price for its retailers could be helpful to the cartel among manufacturers. It is because this could not only discourage individual manufacturers from reducing the price by making it more troublesome to do so, but also because it could assist the cartel in identifying betrayers who set a price below the agreed level.[207] Second, vertical minimum resale price agreements could be used to facilitate horizontal price fixing agreements among retailers.[208] Normally, retailers that work for a particular manufacturer could compete against each other by reducing costs (e.g. distribution cost), and hence resale price. This means that the cost reduction driven by competition is largely captured by consumers in the form of lower prices. Therefore, some retailers have an incentive to form a cartel and force the manufacturer to set a minimum resale price for all retailers so that they could all enjoy more profits by facing less price competition.[209] In either case, a conspiracy among manufacturers or retailers, or a vertical minimum resale price agreement used to facilitate a horizontal price-fixing scheme, which is *per se* illegal, would be found by the courts to be a violation of the Sherman Act even under the RoR.[210] Third, resale price maintenance could be anti-competitive when adopted by a manufacturer due to the coercion of its dominant retailer.[211] In such cases, the dominant retailer could enjoy a certain level of profit even without reducing its distribution cost.[212] Fourth, vertical minimum resale price agreements could be anti-competitive when adopted by a dominant manufacturer to harm its competitors.[213] By providing its retailers more profit through the price agreements, the manufacturer could in exchange ask its retailers not to distribute goods for other manufacturers.[214]

As identified by the Supreme Court and presented above, vertical resale price agreements could have pro-competitive and or anti-competitive effects. It would be hard to determine whether a vertical resale price agreement is pro-competitive or anti-competitive overall without evaluating the specific

206. *Id*. at 892.
207. *Id*.
208. *Id*. at 893.
209. *Id*.
210. *Id*.
211. *Id*. at 893-94.
212. *Id*.
213. *Id*. at 894.
214. *Id*.

circumstances.[215] Although applying the *per se* rule, rather than RoR, to conduct is less administratively costly to courts, it is counterproductive to society if doing so prohibits conduct that could generate a net pro-competitive effect.[216] Since vertical resale price agreements do not "always or almost always tend to restrict competition and decrease output," the court thought it would be risky to categorize such agreements as *per se* violations of the Sherman Act.[217] Mainly based on the above analysis, the court overruled *Dr. Miles* and held that vertical price restraints should be judged by the RoR.[218]

As seen through this analysis, the Supreme Court refused to apply the *per se* rule, which applies to "hardcore cartels," to a vertical minimum resale price agreement.[219] Because such vertical agreements, together with other forms of vertical price-fixing agreements, have the possibility of creating a net pro-competitive effect that benefits society, the author suggests that vertical price-fixing agreements should not be put on par with "hardcore cartels" and placed in the same category as "serious anti-competitive conducts" in Hong Kong's Competition Ordinance.

B. *Vertical Output Restriction*

Given that a horizontal output restriction agreement would be something like several competitors agreeing to sell less quantity of a type of good, one may expect vertical output restriction cases to look like a manufacturer setting a limit on the number of its products that its distributors could sell. This is exactly the kind of case the author has tried to identify for this Comment. Unfortunately, the author could not find any case that shared the same parameters. Therefore, before introducing the less ideal case selected for our analysis, the author briefly suggests below why a lawsuit with the above described vertical output restriction may be extremely rare.

Assume that there was a dominant manufacturer in an industry which sold its product to the market via two distributors. First, would the manufacturer have an incentive to limit its output? The answer is probably yes. Just like any monopoly, the manufacturer could raise selling price by reducing output and hence extract monopoly profit. Having two distributors introduced between the manufacturer and consumers did not seem to alter such a monopoly profit extracting mechanism. Second, how could the

215. *Id.*

216. *Id.* at 894-95.

217. *See id.* (quoting Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988)).

218. *Id.* at 907.

219. *Id.*

manufacturer limit its output in the market? It seems that there could be three ways in which the manufacturer could achieve such goal: (1) selling the goods to the two retailers at a higher price to discourage them from buying, (2) setting a limit on the quantity of goods the two retailers could buy from the manufacturer or (3) setting a limit on the quantity of goods the two retailers could sell to consumers. Although all three approaches could reduce supply in the market, approaches (1) and (2) seem to be more acceptable to retailers. It is simply because the manufacturer, like all sellers in the market, has a right to set the selling price of its goods and decide the quantity of goods to be sold to its retailers. Approach (3) is more problematic and most likely to trigger disputes because it gives retailers the feeling that they are restrained by the manufacturer. When attempting to reduce output in the market, since the manufacturer always has the option to adopt approaches (1) or (2) to avoid the complications of approach (3), this may explain why it is rare to see a lawsuit involving an approach (3) agreement. Having said that, there is a reason why approach (3) could be preferable to the manufacturer. That is, approach (3) is the only way the manufacturer could eliminate retailers' ability to control supply in the long run by hoarding the manufactured good over time for future sales.

An ideal case for our analysis would be one that involves an approach (3) type of agreement between a manufacturer and its retailers, which clearly specifies the maximum quantity of goods the latter could sell. However, as said, the author could not identify such a case after exerting his best effort. Therefore, a less ideal case is selected for this subsection to analyze U.S. courts' attitude towards vertical output restriction agreements. The case chosen is *Ezzo's Invs., Inc. v. Royal Beauty Supply, Inc.*, decided by the United States Court of Appeals for the Sixth Circuit in 2001.[220] In this case, the plaintiff distributor alleged that its output of defendant manufacturer's product was restricted, but in a way other than the defendant specifying a quantity and prohibiting the plaintiff from selling more than that quantity of products.

Matrix Essentials, Inc., (hereinafter Matrix), was a company that produced professional salon products.[221] Royal Beauty Supply, (hereinafter Royal), was Matrix's Nashville area distributor that would reach out to salons and see if they were interested in reselling Matrix's salon products.[222] Matrix and its distributors, including Royal, formed agreements which allowed the latter to sell, "Matrix products only to salons that derive more than 50% of their revenue from hair-care services rather than product sales,"

220. Ezzo's Invs., Inc. v. Royal Beauty Supply, Inc., 243 F.3d 980 (2001).
221. *Id.* at 983.
222. *Id.*

(hereinafter 50% rule).[223] Basically, this policy distinguished between (1) salons whose main source of income was derived from providing hair-care services and (2) salons whose main source of income was derived from selling salon products. The plaintiff salon in this case, Ezzo's Investment, Inc. (hereinafter Ezzo), belonged to the second group.[224] In 1989, when Royal attempted to sell Matrix's product to Ezzo for resale, it was undisputed that Ezzo did not fulfill the 50% rule. During the negotiation process, Ezzo claimed that it had expressed to Royal that it was not willing to be bound by the 50% rule; while Royal claimed that Ezzo "agreed to add styling chairs to [its] salon in order to increase service revenues" to comply with the 50% rule.[225] Ezzo contended that an agreement to add styling chairs was formed.[226] Thereafter, Ezzo did successfully buy Matrix's product from Royal and started to resell them for a couple of months.[227] Later on, Royal received complaints from other Nashville salons that Ezzo had been violating the 50% rule and offering discounts for Matrix's products.[228] In response, Royal required Ezzo to sell Matrix's products at the suggested retail price; otherwise, it would cut Ezzo off.[229] Ezzo refused to follow.[230] Soon after that, Royal stopped selling to Ezzo on the basis that the latter breached the 50% rule.[231] Then, Ezzo filed a lawsuit against Matrix and Royal.[232] The case was first decided by the United States District Court for the Middle District of Tennessee (hereinafter the lower court). Ezzo alleged that the 50% rule between Matrix and Royal was a vertical restraint that constituted a *per se* violation of section 1 of the Sherman Act, because the rule "throttles output and discourages or prevents price competition."[233] Yet, while granting a partial summary judgment to Matrix, the lower court applied the RoR and held that the 50% rule did not violate the Sherman Act.[234] Thus, Ezzo appealed.[235] On appeal, the United States Court of Appeals for the Sixth Circuit, (hereinafter the appeals court), addressed two issues: (1) whether it was appropriate for the lower court to examine the case under RoR and (2) whether it was proper for the lower court to find no violation of the

223. *Id.*
224. *Id.*
225. *Id.*
226. *Id.*
227. *Id.*
228. *Id.* at 984.
229. *Id.*
230. *Id.*
231. *Id.*
232. *Id.*
233. *Id.* at 984-85.
234. *Id.* at 983.
235. *Id.*

Sherman Act under RoR.[236]

First, the appeals court held that it was proper for the lower court to examine the 50% rule under RoR.[237] The court explained that it would normally examine an unlawful restraint on trade action under the RoR on a case-by-case basis. Exceptions have been given to conduct, which would be treated according to the *per se* rule instead, "that would always or almost always tend to restrict competition and decrease output."[238] In addition to the general rules stated above, the appeals court further explained that vertical agreements are treated differently from horizontal agreements.[239] The court held that vertical agreements would be examined under the RoR unless they involved restraints on price.[240] This is because, without price restriction, vertical agreements primarily affect intrabrand competition, rather than interbrand competition, and this is not the primary concern of antitrust law.[241] In contrast, horizontal agreements primarily affect interbrand competition, which is the main concern of the law.[242] The key argument of Ezzo related to the rules specific to the vertical agreement was that the 50% rule limited output to fix prices at a suggested retail level, and hence affected interbrand competition.[243] The appeals court rejected such argument by disagreeing that the 50% rule could or was to limit sales, since salons could still increase sales of Matrix's product without violating the rule agreed with Matrix, for example, by increasing the volume of hair-care services.[244]

Then, relying on a similar rationale, as one of three bases, the appeals court affirmed that it was proper for the lower court to find no violation of the Sherman Act under RoR.[245] Citing its own precedent, the appeals court held that, to make his or her case under the RoR, a plaintiff would need to show that an alleged vertical restraint has adversely affected competition at interbrand level.[246] As described above, Ezzo did attempt to prove this.

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236. *Id.* at 985-989.

237. *Id.* at 985.

238. *Id.* at 986 (quoting NW. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co., 427 U.S. 284, 289-290 (1985)).

239. *Id.* at 986-87.

240. *Id.* at 987 (citing Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717, 735 (1988)).

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.* at 988 (explaining that the other two bases were about Matrix's market power and the possibility of Matrix acting independently (i.e., a justification for imposing restrictions, if any)).

246. *Id. (citing* Crane & Shovel Sales Corp. v. Bucyrus-Erie Co., 854 F.2d 802, 810 (6thCir. 1988)).

Ezzo's theory that the 50% rule adversely affected interbrand competition was built on the assumption that the supply of Matrix's products was restricted by preventing salons from "aggressive merchandising".[247] However, the court held that such a premise was incorrect since, as explained, salons could get around the rule and increase the supply of Matrix's products. Thus, the appeals court decided that Ezzo failed to offer evidence to prove adverse effects on interbrand competition under the 50% rule, which was one of the reasons for the court to believe that the 50% rule was not an unreasonable restraint on trade.[248]

From the above, first, one could see that vertical output restriction cases are extremely uncommon. Given that these kinds of cases are not decided over and over again in U.S. courts, how would courts be confident that this conduct is almost always anti-competitive? This means that it is extremely unlikely for courts to apply the *per se* rule when analyzing vertical output restriction agreements. Second, even if there is a dispute about a vertical restraint of output, as demonstrated in *Ezzo's,* the court may find that the agreement could not limit output successfully and the restraint may survive the more lenient RoR examination. Therefore, the author suggests that vertical output restrictions are less likely to be harmful than hardcore cartels and should not be categorized as "serious anti-competitive conduct" in Hong Kong's Competition Ordinance.

C. *Vertical Market Allocation*

The case selected for this subsection, *Continental T.V., Inc. v. GTE Sylvania Inc.*, was decided in 1977 by the Supreme Court.[249] This is a classic case of its kind. Although it is a very old case, it has not been overruled over the years.[250] Therefore, the analysis below is valid not only, (in the U.S. courts), in 2012 when Hong Kong defined serious anti-competitive conduct, but also now. It means that if Hong Kong today considers whether to exclude vertical market allocation agreements from the definition of serious anti-competitive conduct, this case could be used as a reference.

In GTE Sylvania Inc., (hereinafter Sylvania), the defendant in the case, manufactured TVs and had one to two percent of the U.S. market.[251] In 1962, it began selling TVs directly to a small group of franchised retailers.[252] The franchise agreement did not grant an exclusive territory, but it did limit

247. *Id.* at 987.
248. *Id.* at 988-89.
249. Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).
250. The author shepardized the case and found that the case has not been overruled yet.
251. *Cont'l T.V., Inc.*, 433 U.S. at 38.
252. *Id.*

retailers at Sylvania's discretion and prevented them from selling anywhere but their franchised locations.[253] This arrangement seemed to work; Sylvania's market share rose to five percent.[254] Continental T.V., Inc., (hereinafter Continental), was one of Sylvania's franchisees and was one of the best distributors Sylvania had.[255] Later on, two disputes arose between Sylvania and Continental. First, Sylvania assigned the second franchisee very close to Continental in San Francisco. Continental was upset about it.[256] Second, Continental attempted to open a store in Sacramento where there were other Sylvania retailers already. Sylvania denied the request.[257] Eventually, the dispute between Sylvania and Continental escalated.[258] Therefore, Continental sued Sylvania alleging that the location restriction clause prohibited the sale of products other than from the specified location, violating section 1 of the Sherman Act.[259]

The key issue in the case was: should the *per se* rule or RoR be applied to vertical market allocation agreements?[260] Ultimately, in this case, the court decided that RoR should be applied instead of the *per se* rule.[261] The court did so because it acknowledged the complexity of vertical market allocation agreements.[262] The court explained that such agreements might not only reduce intrabrand competition but might also stimulate interbrand competition at the same time.[263]

On one hand, intrabrand competition is reduced because of the decline in the number of sellers of the same brand (e.g., franchised retailers in this case) in a particular location.[264] Obviously, if there are two franchised retailers selling the exact same branded product who are located next to each other, consumers are very likely to buy from the retailer offering the lower price. This gives the two retailers huge pressure to compete on price. However, if they are far apart from each other, the price competition would be less vigorous. Although consumers who live nearby a particular retailer can choose to shop at the farther retailer, they may be reluctant to do so. This is because it is costly to obtain price information from the latter retailer and make a price comparison, and it is costly to travel to the latter shop just for

253. *Id.*
254. *Id.*
255. *Id.* at 39.
256. *Id.*
257. *Id.*
258. *Id.* at 40.
259. *Id.*
260. *Id.* at 41-42.
261. *Id.* at 58-59.
262. *Id.* at 51.
263. *Id.*
264. *Id.* at 54.

the purchase. Although not giving further elaboration, the court implied that the above reduction of intrabrand competition could stimulate interbrand competition as well.[265] The logic is simply that with fewer sellers of a particular brand in an area, competition therein is less saturated. This makes it more attractive for sellers of the same product, but with different brands, who are not bound by the vertical agreement to start doing business there.

On the other hand, interbrand competition is stimulated also because of the elimination of the free rider problem.[266] Recall the example raised earlier in which two franchised retailers sold the exact same branded product and sat next to each other. If one of the two retailers spent money on advertising on the radio about the good quality of its product, would the second retailer also spend money to do a promotion? The answer is no. It is because the products sold by the two retailers are identical. When consumers are attracted by the advertisement to the first retailer, they will notice that there is another shop selling the same product next door. They will compare the prices before making a purchase decision. Although the first retailer has spent money on advertising, it has obtained no advantage over the second retailer on getting more sales from the investment. If a consumer is attracted to the location by the first retailer's advertisement and eventually shops at the second retailer, we describe this as the second retailer free riding on the first retailer's investment. Therefore, knowing this, both retailers would be hesitant to make such an investment. As a result, promotion investment in that area would be less than optimal and inefficiency would occur. Most importantly, for our concerns, the competitiveness of the two retailers in that area would drop as a whole, resulting in less competition with retailers that sell other brands therein (i.e., interbrand competition). This is because the two retailers' competitors, selling products of a different brand, may spend money on advertisements to gain popularity. Thanks to the advertisements, consumers may be persuaded that the advertised brand's product has a better quality (which may not be true in reality). Hence, some consumers may buy from the advertised brand even if it charges a higher price than the unadvertised brand. As a result, the advertising retailer may charge higher prices as it faces less pressure to compete with the two retailers that are discouraged to promote their brand due to the free rider problem. In other words, with vertical market allocation agreements, the two franchised retailers that sold the exact same branded product would have less incentive to free ride each other and higher incentive to spend money in advertising.

265. *Id. (*holding that "[a]lthough intrabrand competition may be reduced, the ability of retailers to exploit the resulting market may be limited both by the ability of consumers to travel to other franchised locations and, perhaps more importantly, to purchase the competing products of other manufacturers.")

266. *Id.* at 54-55.

Therefore, the two retailers' competitiors, selling products of a different brand, would not only need to compete with the two retailers on the quality of advertisments, but also face pressure to charge a lower price to prevent the two retailers from stealing their consumers by advertising. This is why the court held that vertical market allocation could stimulate interbrand competition.

All in all, as said, the court believes that vertical market allocation agreements could reduce intrabrand competition and stimulate interbrand competition at the same time. As explained by the court in 1977 and elaborated above, the reduction of intrabrand competition may generate anti-competitive effects, while the stimulation of interbrand competition may generate a pro-competitive effect. Without weighing the two effects, it is hard to tell which effect would outweigh the other in a particular case. The author believes this is why the court refused to classify vertical market allocation agreements as a *per se* illegal category and decided that RoR should be applied in *Continental T.V., Inc. v. GTE Sylvania, Inc.* Since such vertical market allocation agreements may create net pro-competitive effects and benefit the economy, they should not be put on par with "hardcore cartels" and placed in the same category as "serious anti-competitive conduct" in Hong Kong's competition law.

D. *Vertical Bid Rigging*

Lastly, regarding U.S. courts' attitude towards vertical bid rigging, the author refers to *Phillips Getschow Co. v. Green Bay Brown County Professional Football Stadium District*, decided in 2003 by the United States District Court for the Eastern District of Wisconsin.[267] Although this is neither a popular case nor a case decided by the Supreme Court, the author is citing this case because it has a few insightful points that could help us to understand why vertical bid rigging should not be regarded as serious anti-competitive conduct. Moreover, this case was decided before 2012 when Hong Kong defined serious anti-competitive conduct. Therefore, the Hong Kong government or legislators could have referenced this case back then. If Hong Kong today considers whether to exclude vertical bid rigging agreements from the definition of serious anti-competitive conduct, this case could be used as a reference because it has not yet been overruled.[268]

In Wisconsin, there is an outdoor athletic stadium called Lambeau Field. Once, the field needed to be renovated. Defendants, a football

267. Phillips Getschow Co. v. Green Bay Brown Cty. Prof'l Football Stadium Dist., 270 F. Supp. 2d 1043 (E.D. Wis. 2003).

268. The author shepardized the case and found that the case has not been overruled yet.

stadium municipality, a developer and a general contractor (hereinafter defendants) were responsible for the renovation project.[269] The defendants invited companies to bid on the heating, venting and air conditioning contract.[270] The plaintiff, Phillips Getschow Company, was one of the contractors that submitted a bid for the contract.[271] The bidding was supposed to be closed, meaning "that bid amounts were not to be disclosed until a contract was awarded, and that the lowest bid was to be accepted by the defendants."[272] In the first, and supposedly the only, round of bidding, the plaintiff submitted the lowest bid.[273] However, thereafter, the defendants disclosed the bid amounts to a few privileged bidders and allowed them to submit a new and lower bid.[274] Therefore, some bidders, not including the plaintiff, withdrew their first bid and submitted a second bid. Eventually, a contractor beat the informationally underprivileged plaintiff and was awarded the contract with a new lowest bid.[275] The plaintiff alleged that the conduct between the defendants and privileged contractors unreasonably restrained trade and violated, for example, section 1 of the Sherman Act.[276] The defendants filed a motion to dismiss for failure to state a claim.[277] The plaintiff opposed the motion to dismiss mainly by arguing that the bid rigging scheme in question was a *per se* violation of the law.[278] Eventually, the court granted the motion to dismiss because the plaintiff did not alleged an *antitrust* injury.[279] More details of the court's analysis are presented below.

As elaborated by the Wisconsin court, citing cases like *Brunswick Corp. v. Pueblo Bowl-O-Mat. Inc.*, to support a civil lawsuit for restraint of trade, a plaintiff must prove *antitrust* injury – the type of injury antitrust laws were intended to prevent.[280] More specifically, an *antitrust* injury is a plaintiff's loss that flows from the competition-reducing aspect of the defendant's conduct.[281] This means that a plaintiff needs to link its losses to a defendant's conduct that reduces output or increases prices to consumers, instead of only to the plaintiff itself.[282] Therefore, if a defendant's conduct increased competition (i.e., was not anti-competitive conduct) and constituted a loss to

269. *Id.* at 1044.
270. *Id.*
271. *Id.* at 1045.
272. *Id.*
273. *Id.*
274. *Id.*
275. *Id.*
276. *Id.* at 1045-46.
277. *Id.* at 1045.
278. *Id.* at 1049.
279. *Id.* at 1051.
280. *Id.* at 1046.
281. *Id.*
282. *Id.* at 1047.

a plaintiff, such loss would not be viewed as an *antitrust* injury by a court.[283] This is exactly why courts believe that antitrust law is "the protection of competition, not competitors."[284]

Indeed, the plaintiff in our Wisconsin case suffered an injury because it was not awarded the renovation contract in light of the improper vertical bid rigging scheme. However, such injury was not an *antitrust* injury because the court did not view the vertical bid rigging scheme as anti-competitive conduct. Instead, the scheme was considered by the court as one that increased competition since privileged contractors were allowed to submit a new bid resulting in a lower procurement price to the defendants.[285]

In response to the plaintiff's claim that the bid rigging scheme in question was a *per se* violation of section 1 of the Sherman Act, the court rejected the claim mainly for two reasons. First, the court held that the existence of a *per se* violation without *antitrust* injury was not sufficient for the plaintiff to recover damages in a civil action.[286] In other words, the court meant that even if conduct was classified by the previous court as a *per se* violation, the plaintiff must still show *antitrust* injury. Second, the court distinguished between horizontal bid rigging and vertical bid rigging. The court noted that *United States v. Portsmouth Paving Corp.*, cited by the plaintiff, involved a bid rigging agreement formed between competitors (i.e., horizontal bid rigging).[287] In contrast, the current case involved bid rigging schemes formed between purchasers and suppliers (i.e., vertical bid rigging).[288] The court highlighted defendants' right to favor and switch suppliers and stressed that exercising such right did not violate the Sherman Act.[289] The court did acknowledge the improperness of the vertical scheme in question, but it also noted that there were other laws, such as unfair competition law and business tort law, which could provide remedies to companies that encountered improper business conduct.[290] From the court's analysis, we could see that the court did not agree with the plaintiff that the bid rigging scheme in question was a *per se* violation.

Although not mentioned by the court, we could infer from the court's analysis that vertical bid rigging should not be classified as a *per se* illegal category. Moreover, when analyzed under the reasonableness test, vertical bid rigging should not be considered as an unreasonable restraint of trade. This is because, when conducting the *antitrust* injury analysis, the court

283. *Id.* at 1046.
284. *Id.*
285. *Id.* at 1048.
286. *Id.* at 1049.
287. *Id.*
288. *Id.* at 1050.
289. *Id.*
290. *Id.*

clearly held that vertical bid rigging, at least the one in question, has a pro-competitive effect but no anti-competitive effect. Therefore, it would not fit into the *per se* illegal category that represents conduct that almost always involves anti-competitive effects and no pro-competitive effects. In addition, vertical bid rigging would survive a RoR test that weighs the anti-competitive and pro-competitive effects of a conduct. This is because vertical bid rigging that has a pro-competitive effect, but no anti-competitive effect, generates a net pro-competitive effect. Therefore, the author suggests that vertical bid rigging is the least harmful among the four vertical agreements included in Hong Kong's definition of "serious anti-competitive conduct," and it should be removed from such definition.

E. *Divergence Justified or Not?*

Overall, U.S. courts' attitude towards price fixing, output restriction, market allocation and bid rigging agreements formed vertically is strikingly different from that towards the same four agreements formed horizontally. As demonstrated in Section I of this Comment, U.S. courts classified the four agreements formed between competitors as *per se* illegal. Courts did so because, through judicial experience, they were confident that these agreements almost always generate a net anti-competitive effect. In contrast, U.S. courts applied the RoR, which is more lenient to defendants, to examine the same agreements formed vertically. This reflects that courts are not sure if these vertical agreements always unreasonably restrain competition. The results of the four vertical cases also reflect that it is possible for these vertical agreements to survive the RoR examination. Most importantly, these decisions show that some vertical agreements are not only free from anti-competitive effect at all, but also create a net, if not pure, pro-competitive effect. Recall the question raised at the beginning of this section: are vertical price fixing, output restriction, market allocation and bid rigging all included in the definition of "serious anti-competitive conduct" created by Hong Kong legislators but not in the definition of "hardcore cartels" created by OECD, indeed more severe violations of antitrust law? Based on the analysis presented in this Section, the answer is clearly negative. So, what are the implications for Hong Kong?

As explained in Section II of this Comment, the label of "serious anti-competitive conduct" has a strong signaling effect to the general public in Hong Kong. Even a layman who has never studied antitrust law could easily understand the harmful nature of the conduct covered under the term. Companies, after reading section two of the Ordinance, which includes the definition of serious anti-competitive conduct, would easily be discouraged from entering into any of the conduct enumerated, including the four vertical agreements in question. In addition, "serious anti-competitive conduct" is more than just a label as it entails real legal consequences. As described, also in Section II of this Comment, Hong Kong's Ordinance adopted a dual-track system which provides relatively harsher procedures to "serious anti-competitive conduct" compared to all other anti-competitive agreements that are prohibited by the First Conduct Rule.[291] First, if several small corporations form one of the four vertical agreements and the combination is not too big, they could not enjoy the "agreement of lesser significance" exclusion.[292] This means that these small corporations need to worry if the vertical agreement has violated the First Conduct Rule. Second, the harsher commitment system, Infringement Notice system, applies to "serious anti-competitive conducts."[293] Under such a system, a second chance from the law enforcement agency is not guaranteed to corporations suspected of engaging in any of the four vertical agreements. Also, these suspected corporations may need to make commitments beyond stopping their illegal conduct forever, such as refraining from any specified conduct, taking any specified action and/or admitting to illegal conduct. Knowing these discriminating and harsher legal consequences, corporations would be discouraged from the outset to participate in the four vertical agreements which may not be anti-competitive. There are two ways a company could learn these consequences, either by studying the Ordinance or through public examples. Such discouragement is undesirable because these non-anti-competitive conducts could be productive to the economy (i.e. contribute to the Gross Domestic Product of Hong Kong). Not to mention that some of the vertical agreements may be pro-competitive. They should be encouraged, rather than discouraged.

Indeed, the dual-track system was designed to discourage certain agreements - "serious anti-competitive conduct." Yet, as the title of the terminology and legislation history has suggested, such discrimination is based on the belief that some conduct is more serious than others. However, as demonstrated in this Section, the four agreements formed vertically are far less severe than those formed horizontally. Therefore, it is unjustified to apply harsher procedures to vertical agreements on par with "hardcore cartels." Nor is it justifiable to discourage companies from engaging in these vertical conducts since they do have the potential to create a net pro-competitive effect and benefit Hong Kong's economy.

Last, but not least, there is the problem related to enforcement resources allocation. Ideally, it would be great if the agency could strike down all anti-competitive conducts. However, in reality, this is impossible as the agency

291. *Supra* Section II(B).
292. *Supra* Section II(B)(1).
293. *Supra* Section II(B)(2).

has limited resources in combating anti-competitive effects. This means that, for the good of society, the agency must use its resources wisely, by allocating its resources to fight against the most harmful conducts. It is because this could generate the highest return to society. However, what is the most harmful conduct? If the agency fully endorses the legislators, it would think the most harmful conduct is "serious anti-competitive conduct" as defined in the Ordinance. Then, it would treat all four types of conduct, whether formed horizontally or vertically, equally and pay its attention to them evenly. Yet, as explained, the four vertical agreements are less harmful. This means enforcement resources are not allocated to their best use, causing inefficiency to society.

In short, the above suggests that, first, the four vertical agreements included as "serious anti-competitive conduct" by Hong Kong legislators are not as harmful as hard-core cartels. Hence, it is unjust to treat these vertical agreements equally harshly as hard-core cartels under the Ordinance. Moreover, the divergence is undesirable to Hong Kong as it would not only over-discourage the formation of vertical agreements that could be constructive to the region but may also guide the agency to allocate enforcement resources inefficiently. Therefore, the author suggests that Hong Kong legislators should not have diverged from international standards and categorized the four vertical agreements, together with hard-core cartels, as "serious anti-competitive conduct" under Hong Kong's competition law.

IV. RECONCILIATION: "THE FOUR DON'TS"/"CARTEL CONDUCT" FORMED *OFF* THE ORDINANCE BY HK LAW ENFORCEMENT AGENCY

After a competition law was passed by legislators, it would be enforced by a statutory agency. In Hong Kong, as introduced, this agency is named the Competition Commission (HKCC).[294] Although the HKCC's power is given by Hong Kong's legislators and bound by the Competition Ordinance, the agency does possess some discretionary power in delivering its duties.[295] Such power enables the agency to exercise its own will based on its expertise and understanding of competition law. For example, after reading the definition of "serious anti-competitive conduct," it could decide whether to fully endorse with the legislators and, when it has a choice, treat the four agreements formed vertically as harshly as those formed horizontally. Therefore, by observing what the agency has done subsequent to the passage of the Ordinance, one could understand what the agency's attitude is towards

294. *See* COMPETITION ORDINANCE, (2015) Cap. 619 ,110, §129 (H.K.).
295. *Id.* at §131.

the divergence formed. For example, if the agency shares the legislators' view on this matter, the agency should widely adopt and apply the term "serious anti-competitive conduct." However, this has not been the case in reality. In fact, the agency did not utilize the term created by the legislators but created two new terms off the statute: "the Four Don'ts" and "Cartel Conduct," whose definitions are distinct from "serious anti-competitive conduct."

A. *The Four Don'ts*

One of the functions given to the HKCC by the Ordinance is "to promote public understanding of the value of competition and how this Ordinance promotes competition."[296] Therefore, soon after the Ordinance was passed, the HKCC decided to issue publications as educational tools which would be "in line with international best practices" to provide guidance for businesses to comply with the law.[297] In December 2014, the HKCC published a brochure titled *Competition Ordinance and SMEs*.[298] This is one of the very first publications issued by the HKCC.[299] It came even before significant publications like the six guidelines and two policies.[300] The brochure aimed at helping SMEs to learn their rights and duties under the law in an easy-to-understand approach.[301] To do so, the HKCC created a term "The Four Don'ts" and emphasized that SMEs should never engage in the conducts covered under such term.[302] As the name has suggested, "The Four Don'ts" are the four things that businesses should not do. Defined by the HKCC, they are agreements with competitors to fix prices, restrict output, share markets or rig bids.[303] Since the "Four Don'ts" only cover agreements formed between competitors, this new term essentially refers to "hard-core cartels" as introduced by the OECD, but not

296. *Id.* at §130.
297. COMPETITION COMM'N, ANNUAL REPORT 42 (2014) (H.K.), https://www.compcomm.hk/en/media/reports_publications/files/2013_14_CC_Annual_Report.pdf.
298. COMPETITION COMM'N, COMPETITION COMMISSION PUBLISHES "THE COMPETITION ORDINANCE AND SMES" BROCHURE (2014) (H.K.), https://www.compcomm.hk/en/media/press/files/SME_brochure_press_release_Eng_20141230.pdf.
299. COMPETITION COMM'N, PRESS RELEASES & ANNOUNCEMENT, https://www.compcomm.hk/en/media/press/press_announce.html (last visited Feb. 6, 2018).
300. *Infra* Section IV(B).
301. COMPETITION COMM'N, *supra* note 297 .
302. COMPETITION COMM'N, THE COMPETITION ORDINANCE AND SME'S (2014) (H.K.), https://www.compcomm.hk/en/media/reports_publications/files/CC_SME_Brochure_Eng.pdf.
303. *Id.* at 4 - 5.

"serious anti-competitive conducts" as created by Hong Kong legislators. Why didn't the HKCC apply the term "serious anti-competitive conduct" provided in the law and warn businesses not to engage in the four agreements formed, not only horizontally, but also vertically? One can't say that it is because the "Four Don'ts" are easier to understand by businesses than "serious anti-competitive conduct," since the meaning of the latter is also very apparent from the term itself. Instead, the author suggests that it is because HKCC was truly, as it claimed, "in line with international best practices" when preparing these publications.[304] That is, the HKCC did not believe that the most severe anti-competitive conducts are anything more than hardcore cartels and clearly do not include the four vertical agreements. In the brochure, the agency did express its attitude towards vertical agreements.[305] As it explained, almost all vertical agreements do not harm competition and violate the competition law in Hong Kong.[306] That said, the HKCC did acknowledge that vertical agreements are not immune from contravening the law.[307] The HKCC highlighted Resale Price Maintenance as the most alarming vertical agreement.[308] Even for this kind of agreement, the agency stated that it must be considered on a case-by-case basis to see if it is illegal.[309] For example, a Resale Price Maintenance agreement may not have an objective to harm competition or may have an efficiency justification.[310] This understanding is in line with what we have learned about vertical price-fixing agreements in Section III of this Comment.

The Ordinance came into full effect in December 2015.[311] A month before that, the HKCC published a practical toolkit titled *How to comply with the Competition Ordinance*.[312] The toolkit aims at helping businesses, especially SMEs, to review their conduct and set up an effective compliance strategy.[313] Similar to the brochure published in 2014, this toolkit used the term "The Four Don'ts" and stressed that businesses should never engage in the four conducts with competitors.[314] The brochure also reiterated that

304. COMPETITION COMM'N, *supra* note 297, at 42.
305. COMPETITION COMM'N, *supra* note 302.
306. *Id.*
307. *Id.*
308. *Id.* at 10.
309. *Id.*
310. *Id.*
311. COMPETITION COMM'N, COMPETITION ORDINANCE COMES INTO FULL EFFECT TODAY (2015) (H.K.), https://www.compcomm.hk/en/media/press/files/Competition_Ordinance_Comes_into_Full_Effect_Today_EN.pdf.
312. COMPETITION COMM'N, COMPETITION COMMISSION PUBLISHES PRACTICAL COMPLIANCE TOOLKIT FOR SMES (2015) (H.K.), https://www.compcomm.hk/en/media/press/files/20151102_PressRel_Toolkit_Eng.pdf.
313. *Id.*
314. COMPETITION COMM'N, HOW TO COMPLY WITH THE COMPETITION ORDINANCE 4

vertical agreements generally don't harm competition, except for Resale Price Maintenance arrangements.[315] As one of the key components of the toolkit, there is a checklist that helps businesses to identify their risk of violating the law.[316] Risks are classified into three levels: high, medium and low.[317] Only "The Four Don'ts" and vertical agreements that impose fixed or minimum resale prices were labeled as high risk activities.[318] Again, why didn't the HKCC describe every conduct under "serious anti-competitive conduct" as high risk? It is clearly because the HKCC did not think that vertical output restriction, market allocation or bid rigging are as harmful as other high-risk conduct, and businesses should not be discouraged from engaging in these activities. In other words, the agency's choice reflected that the agency has leaned against the international standard, rather than local legislators.

The creation of the term "The Four Don'ts" and publications mentioned above have a long-lasting impact. In the following two years, the HKCC organized multiple public seminars on the Competition Ordinance to educate society.[319] For example, the author attended one public seminar in person held on February 1, 2016 in Hong Kong.[320] At the seminar, the two publications introduced above were distributed to the audience. One of the key messages the agency tried to deliver to the audience was that businesses should not worry too much as long as they don't engage in "The Four Don'ts." The agency did not tell the audience not to engage in all eight kinds of "serious anti-competitive conduct," as defined by the law. From the event pictures posted on the agency's webpage, one could see that the publications have continued to be used in subsequent, and most recent seminars.[321] This means the agency is still using the term "The Four Don'ts"

(2015) (H.K.), https://www.compcomm.hk/en/media/reports_publications/files/CC_SME_Compliance_Toolkit_Eng.pdf.

315. *Id.* at 5.

316. *Id.* at 8-9.

317. *Id.*

318. *Id.*

319. COMPETITION COMM'N, ANNUAL REPORT 38 (2016) (H.K.), https://www.compcomm.hk/en/media/reports_publications/files/2015_16_CC_Annual_Report.pdf; COMPETITION COMM'N, COMPLETED EVENTS, https://www.compcomm.hk/en/media/campaigns_events/completed/completed_events.html (last visited Feb. 7, 2018).

320. The author has the confirmation email from the Competition Commission as proof (on file with the author).

321. From the webpage of the Competition Commission, one could see how the cover of the two publications look alike. COMPETITION COMM'N, OTHER PUBLICATIONS, https://www.compcomm.hk/en/media/reports_publications/other_publications.html (last visited May 17, 2018). From the event pictures uploaded by the Competition Commission, one could see that the two publications were still being used - COMPETITION COMM'N, SEMINAR ON COMPETITION ORDINANCE ON DECEMBER 1, 2017,

created by itself to communicate and educate the general public.

B. *Cartel Conduct*

According to Section 35 of the Competition Ordinance, Hong Kong's Competition Commission (HKCC), the law enforcement agency of the Ordinance, must issue guidelines to provide guidance on how the HKCC intends to interpret and give effect to the Ordinance.[322] Following the Ordinance, in 2015, the HKCC has published six guidelines.[323] In addition, as a supplement to the ordinance and guidelines, the HKCC issued the *Enforcement Policy* in November 2015 to announce its plans for its work.[324] In the *Policy*, the HKCC acknowledged that their resources are limited for investigation and enforcement.[325] Therefore, HKCC indicated that it would exercise its discretion and direct resources to encourage compliance with the law, especially during the first few years of the operation of the Ordinance.[326] More specifically, the HKCC would encourage compliance with the law not to perform conducts that are "clearly harmful to competition and consumers in Hong Kong," through education, engagement and enforcement.[327] Here, the HKCC explicitly stated that it would give priority to investigating cases involving Cartel Conduct and "other agreements contravening the First Conduct Rule causing significant harm to competition in Hong Kong."[328] Cartel Conduct is not a term covered by the Ordinance. It was introduced as an official term in Hong Kong by the HKCC. As defined by the HKCC,

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https://www.compcomm.hk/en/media/campaigns_events/completed/completed_events.html (last visited Feb. 7, 2018); COMPETITION COMM'N, SEMINAR ON COMPETITION ORDINANCE ON AUGUST 24, 2017, https://www.compcomm.hk/en/media/campaigns_events/seminarsworkshops_20170824.html (last visited Feb. 7, 2018); COMPETITION COMM'N, SEMINAR ON COMPETITION ORDINANCE ON NOVEMBER 23, 2016, https://www.compcomm.hk/en/media/campaigns_events/seminarsworkshops_20161124.html (last visited Feb. 7, 2018).

322. COMPETITION ORDINANCE, (2015) Cap. 619 ,110, §135 (H.K.).

323. COMPETITION COMM'N, GUIDANCE, https://www.compcomm.hk/en/legislation_guidance/guidance/guidance.html (last visited July 11, 2017).

324. COMPETITION COMM'N, COMPETITION COMMISSION PUBLISHES ENFORCEMENT POLICY AND CARTEL LENIENCY POLICY (2015) (H.K.), https://www.compcomm.hk/en/media/press/files/20151119_PressRel_Policy_Documents_Eng.pdf.

325. COMPETITION COMM'N, ENFORCEMENT POLICY 2-3 (2015) (H.K.), https://www.compcomm.hk/en/legislation_guidance/policy_doc/files/Enforcement_Policy_Eng.pdf.

326. *Id.* at 3.

327. *Id.*

328. *Id.*

Cartel Conduct, simply speaking, refers to price fixing, market allocation, output restriction and bid rigging agreements formed between companies "in competition with each other."[329] In other words, Cartel Conduct shares the definition of both "The Four Don'ts" created by HKCC itself and "hardcore cartels" introduced by the OECD, but is different from the "serious anti-competition conduct" created by Hong Kong's legislators. In contrast, the HKCC did not provide a definition for its other priority, which is cases involving, "other agreements contravening the First Conduct Rule causing significant harm to competition in Hong Kong."[330] However, it seems that these other agreements do not refer to the four agreements formed vertically. Otherwise, why would the HKCC not use the more authoritative term "serious anti-competitive conduct" which was already in the law for both Cartel Conduct and other agreements? Why did the HKCC not inform the public that "serious anti-competitive conduct" is most serious, as suggested by the law, and that it would prioritize combating them? It is clearly because the HKCC did not share the same view as Hong Kong legislators that the four vertical agreements are at least as severe as hard-core cartels. When explaining in the *Enforcement Policy* why it planned to treat Cartel Conduct differently, the HKCC stated that, "[c]artels differ from most other forms of anti-competitive conduct in that they are universally condemned as economically harmful behavior."[331] This reveals that the agency, not only realized and acknowledged the existence of an international standard (in identifying which conducts are more serious), but also defined and discriminated "Cartel Conduct" based on such a standard.

In the very same month, together with the *Enforcement Policy*, the HKCC published the *Leniency Policy* under section 80 of the Ordinance.[332] According to section 80, the HKCC may form a leniency agreement with a person "that it will not bring or continue proceedings . . . for a pecuniary penalty in respect of an alleged contravention of a conduct rule against," in exchange for the "person's co-operation in an investigation or in proceedings under [the] Ordinance."[333] As designed by the HKCC and announced in the *Leniency Policy*, the agency would only offer such a forgiving opportunity to the first whistle-blower that has engaged in "Cartel Conduct."[334] The definition of "Cartel Conduct" here, is identical to the one introduced in the

329. *Id.* at 4.
330. *Id.* at 3.
331. *Id.*
332. *Id.* at 8.
333. COMPETITION ORDINANCE, (2015) Cap. 619 ,110, §80 (H.K.).
334. COMPETITION COMM'N, THE LENIENCY POLICY FOR UNDERTAKINGS ENGAGED IN CARTEL CONDUCT 3 (2015) (H.K.), https://www.compcomm.hk/en/legislation_guidance/policy_doc/files/Leniency_Policy_Eng.pdf.

Enforcement Policy.[335] Just to elaborate the policy in a simpler way: several companies conspired and implemented policies constituting Cartel Conduct. One of the members of the conspiracy (i.e. the whistle-blower) could turn itself in to the agency and promise to cooperate with the agency. Then the member company would become immune to being penalized by the government for its wrongdoing.[336] However, only the first whistle-blower who successfully made a leniency agreement with the agency could enjoy such an exemption. Such first-in-the-door requirement was included to incentivize a member of the conspiracy to be the first to apply for leniency.[337] But why did the agency, after exercising its discretion, limit leniency to "Cartel Conduct"? To make it clear, the author is not challenging the cartel-conduct-only requirement itself, as this is nothing new in the field of antitrust. In fact, the U.S. first introduced a similar policy known as the Leniency Program back in 1978, and revised it substantially in the early 1990s.[338] In the U.S., leniency is only available to an applicant that engaged in a criminal violation (i.e. horizontal price fixing, output restriction, market allocation or bid rigging).[339] What the question raised really means is: why did the HKCC abandon the term "serious anti-competitive conduct" offered by legislators when designing the applicability of the leniency policy? The following introductory paragraph of the *Leniency Policy* may shed some light on the question: "Leniency is a key investigative tool used by competition authorities around the world to combat cartels. Cartels differ from other types of anti-competitive conduct. First, they are universally condemned as economically harmful. Second, cartels are usually organised and implemented in secret, making them more difficult to detect."[340]

From the choice of words like "the world" and "universally," there is no doubt that the HKCC realized the existence of an international standard. That is, hardcore cartels are the most harmful conduct and they should be treated differently. Moreover, the paragraph shows that the agency supported the international standard and relied on such a standard when

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335. *Id.* at 4.

336. *Id.* at 3 (explaining that even so, the whistle-blower is still liable for damages, if any, to private bodies).

337. *Id.* at 2.

338. DEP'T OF JUSTICE, FREQUENTLY ASKED QUESTIONS ABOUT THE ANTITRUST DIVISION'S LENIENCY PROGRAM AND MODEL LENIENCY LETTERS 1 (2017), https://www.justice.gov/atr/page/file/926521/download.

339. *Id.* at 6; *see also*, DEP'T OF JUSTICE, PRICE FIXING, BID RIGGING, AND MARKET ALLOCATION SCHEMES: WHAT THEY ARE AND WHAT TO LOOK FOR 1-3 (2005 ed. 2001), https://www.justice.gov/atr/file/810261/download (showing that criminal violations only refer to certain agreements formed horizontally).

340. COMPETITION COMM'N, THE LENIENCY POLICY FOR UNDERTAKINGS ENGAGED IN CARTEL CONDUCT 2 (Nov. 2015) (H.K.), https://www.compcomm.hk/en/legislation_guidance/policy_doc/files/Leniency_Policy_Eng.pdf.

creating its leniency policy. This also means that the HKCC did not believe in the legislators that the four vertical agreements are equally harmful and should be treated especially as hard-core cartels.

C. *Why Reconcile?*

From the above, one can see that the HKCC did not embrace the term "serious anti-competitive conduct" as defined by legislators in the ordinance. Otherwise, why would the agency bother to create its own terms "The Four Don'ts" and "Cartel Conduct"? If the agency agreed that all eight types of conduct under "serious anti-competitive conduct" are more harmful, it would have applied the term and regulated all the eight conducts differently under its *Enforcement Policy* and *Leniency Policy*. In reality, the agency did not do so, but created terms that have the same definition as hard-core cartels. This reflects that the agency realized that price fixing, output restriction, market allocation, or bid rigging agreement, formed vertically, are less harmful than those formed horizontally. From a broader perspective, this could be viewed as an attempt by the agency to form its own dual-track system to reconcile the divergence between international standards and Hong Kong legislators. The agency's moves were not without reason. As discussed, the agency was aware of, and also referenced, the international standard when creating its terminologies and policies.[341] So, why was the HKCC aware of the international standard and why could it appreciate such a standard?

First, the agency has expertise in competition law. To understand this, one could look at the profiles of the management of the HKCC before the reconciliation started to take place. On April 26, 2013, the Chief Executive of Hong Kong appointed the first group of fourteen Competition Commission Members, including a Chairperson.[342] These fourteen members were responsible for supervising the work of the executive arm of the agency and approving major decisions.[343] They were experts from different professionals or sectors.[344] Among these Members, one the author particularly wants to highlight is Thomas Cheng. At that time, he was an

341. COMPETITION COMM'N, *supra* note 297, at 42; COMPETITION COMM'N, *supra* note**Error! Bookmark not defined.**, at 2.

342. THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, GOVERNMENT ANNOUNCES APPOINTMENTS TO COMPETITION COMMISSION (Apr. 26, 2013) (H.K.), http://www.cedb.gov.hk/citb/en/Pub_Press/Press_Releases/2013/P201304260200.html.

343. COMPETITION COMM'N, ANNUAL REPORT 2012/2013 16 (2013) (H.K.), https://www.compcomm.hk/en/media/reports_publications/files/2012_13_CC_Annual_Report.pdf.

344. *Id.* at 8-15.

Associate Professor at the Faculty of Law of the University of Hong Kong, specializing in Antitrust Law.[345] He earned law degrees from Harvard Law School and the University of Oxford.[346] Therefore, Professor Cheng, if not anyone else among the Competition Commission Members, must know the international standard and probably has shared this knowledge with other Members. Moving forward, in July 2014, the HKCC appointed its first Chief Executive Officer Dr. Stanley Wong.[347] Dr. Wong, before joining the HKCC, had almost 30 years of experience practicing Competition Law in Canada. He was a Member of the Competition Authority in Ireland.[348] He provided advisory services about competition law to agencies and courts around the world, including the European Commission.[349] He also participated in the work of OECD, the institution that defined hardcore cartels.[350] There is no doubt that he also understands very well the international standard that hardcore cartels, but nothing more, are accepted universally as the most severe anti-competitive conducts.

Second, after its establishment and before the reconciliation started to take place, the HKCC developed and maintained a strong tie with international competition forums and authorities. This has helped the HKCC to learn and appreciate international norms in the field of Antitrust. For example, in December 2013, the agency joined the International Competition Network (ICN), an international community formed by and for competition authorities.[351] One of INC's functions was to promote procedural and substantive benchmarks worldwide.[352] Thus, it would not be a surprise if Hong Kong, as a member of the ICN, has learned and imported some international standard from there. In addition, the HKCC engaged in different forms of international exchanges to learn more about the practice and operation of overseas competition authorities.[353] In 2013 and 2014, the agency met and exchanged ideas with many overseas delegates, such as those from the Competition Commissions of Singapore, the European

345. *Id.* at 10.

346. HKU FACULTY OF LAW, ACADEMIC STAFF THOMAS CHENG, http://www.law.hku.hk/faculty/staff/cheng_thomas.php (last visited Feb. 7, 2018) (H.K.).

347. COMPETITION COMM'N, COMPETITION COMMISSION ANNOUNCES APPOINTMENT OF CHIEF EXECUTIVE OFFICER (July 21, 2014) (H.K.), https://www.compcomm.hk/en/media/press/files/press_releaseCompetitionCommissionAnnouncesAppointmentofChiefExecutiveOfficer.pdf.

348. *Id.*

349. *Id.*

350. *Id.*

351. COMPETITION COMM'N, INTERNATIONAL LIAISON, https://www.compcomm.hk/en/about/international_liaison/overview.html (last visited Feb. 7, 2018) (H.K.).

352. *Id.*

353. COMPETITION COMM'N, *supra* note 297, at 35.

Commission, the Australian Independent Pricing and Regulatory Tribunal, the Competition Commission of the United Kingdom, the French Competition Authority and the Belgian Competition Authority.[354] These interactions enabled the HKCC to get a sense of what some of the consensuses formed among international authorities were.

In short, this Section has revealed the agency's attempt to reconcile the divergence between Hong Kong legislators and international standards, mainly by creating the two terms "The Four Don'ts" and "Cartel Conduct" and its own dual-track system *off* the statute accordingly. Moreover, this Section explained why the agency could appreciate the international standard. Knowing this is important because it helps us understand the source of motivation for the agency to implement its reconciliation scheme.

V. REFLECTIONS

Intuitively, one may ask: Did the HKCC succeed in reconciling the divergence? To answer this question, one needs to evaluate the effectiveness and limitations of the reconciliation taken by the HKCC. As explained at the end of Section III of this Comment, given that the four vertical agreements are not as harmful as hardcore cartels, it is unjustified to discriminate and discourage the former by: (1) applying the harsher commitment system, Infringement Notice system, to the four vertical agreements, (2) not allowing them to enjoy the "agreement of lesser significance" exclusion and (3) creating fear among the public that the four vertical agreements are illegal through the signaling effect of the term "serious anti-competitive conducts" itself. Moreover, labeled as (4), the divergence may lead the agency to misallocate its enforcement resources and result in inefficiency to society.[355] This would be the four aspects the author used to evaluate the successfulness of the reconciliation.

Under the current status of the Ordinance and policy of the HKCC, the reconciliation does have a chance to greatly suppress the dual-track system created by legislators. What is special about the current status of the Ordinance? Surprisingly, private enforcement of the Ordinance is limited. To private individuals, no matter an average person or corporation, the Ordinance only provides "follow-on" actions to be brought in the Competition Tribunal.[356] According to Section 110 of the Ordinance, private individuals damaged by anti-competitive conduct could only bring private actions after (1) the Competition Tribunal determined that there was a

354. *Id.* at 36-38.

355. *Supra* Section III(E).

356. COMPETITION COMM'N, *supra* note 343, at 23; Competition Ordinance, *supra* note 5, at Part 7.

contravention of the Ordinance or (2) the wrongdoer admitted to his or her contravention in a commitment accepted by the agency.[357] In other words, if a private individual believes that it has suffered a loss due to an anti-competitive conduct, and there is no prior Competition Tribunal conviction or commitment accepted by the agency, the individual could not initiate a suit against the wrongdoer in the Competition Tribunal. Under such circumstance, all the private individual could do is to file a complaint to the HKCC.[358] However, after receiving the complaint, the agency is not required to conduct an investigation if it thinks that the complaint is unreasonable.[359] It is unclear what would constitute "unreasonable." For example, could the agency not investigate a complaint involving a vertical output restriction, market allocation or bid rigging agreement if the agency believes that these conducts are unlikely to harm competition?[360]

If the answer is positive, the reconciliation initiated by the agency is quite efficient in suppressing the divergence created by the legislators. First, it could screen out complaints that involve the serious anti-competitive conduct formed vertically and only follows on complaints that involve hardcore cartels. Yet, this may put the agency in an embarrassing situation as it has to answer complainants' questions, such as, "why do you think my complaint against a vertical market allocation agreement is unreasonable while the law states that it is a serious anti-competitive conduct?" On the other hand, the agency could start its own investigation even without any complaint, as long as the agency has reasonable cause to suspect that there was, is, or will be a contravention of the Ordinance.[361] Relying on the *Enforcement Policy*, it is expected that most of the investigation started by the agency would be against Cartel Conduct. Therefore, with its discretionary power in deciding what to investigate, the agency could avoid starting an investigation against the four vertical agreements. For instance, this prevents inefficiency as a result of misallocation of enforcement resources. Also, very few, if any, vertical agreements would need to experience harsher treatments under the dual-track commitment or exclusion system. Then, from the point of view of businesses engaging in vertical agreements, they (1) get a sense from the market that the agency is not going after them vigorously and (2) have little chance to hear the rest sharing experience of those harsher treatments. Thus, businesses need to worry less

357. Competition Ordinance, *supra* note 5, at §110.
358. *Id.* at §37.
359. *Id.*
360. The author did not list vertical price-fixing agreement as an example because the agency has stated that minimum resale price agreement has a high risk of violating the Competition Ordinance.
361. Competition Ordinance, *supra* note 5, at §39.

about experiencing the harsher Infringement Notice system and not being able to enjoy the "agreement of lesser significance" exclusion themselves. Hence, they would be less discouraged from engaging in the vertical conduct which may benefit Hong Kong's economy.

However, what if the agency's belief that certain conduct is unlikely to harm competition does not make related complaints "unreasonable"? In other words, what if the agency could not refuse to investigate a complaint involving a vertical output restriction, market allocation, or bid rigging agreement even if the agency believed that the conduct was unlikely to harm competition? In this case, the agency would be less able to suppress the problems caused by the dual-track commitment and exclusion systems. It is because even if the agency does not actively start its own investigation against the vertical conduct, it still needs to conduct an investigation when it receives complaints. That said, there are still certain things the agency could do to uphold its reconciliation. For example, it is possible that after investigation, the agency has reasonable cause to believe that a vertical "serious anti-competitive conduct" that violates the First Conduct Rule was formed. Such conduct could be one formed by several small companies that failed to enjoy the "agreement of lesser significance" exclusion under the existing law. In any event, the harsher Infringement Notice system applies. This means that a second chance is not guaranteed, and the agency may proceed the case to the Competition Tribunal. The agency could exercise its discretionary power and choose not to sue the suspected company. Then, the agency could continue to focus on other cases that involve hardcore cartels. However, in exchange, the company must commit to complying with requirements set forth in the Infringement Notice in exchange for the second chance. As described, these requirements may include, but are not limited to, refraining from any specified conduct, taking any specified action and/or admitting to illegal conduct.[362] Of course, again, the agency could exercise its discretionary power to be more lenient to the suspected companies in terms of the requirements. Nonetheless, making a commitment under such system, even at the most lenient level, is still undesirable to the suspected company. Companies would spread their unpleasant experience in the industry and discourage others from forming vertical agreements. Isn't this great? No! This is great only in deterring horizontal agreements as they are almost always anti-competitive. However, vertical agreements may not be anti-competitive; society does not want to discourage them as much as horizontal agreements. In other words, it is fine to penalize companies that engage in anti-competitive vertical conduct. However, these examples should not over-discourage the formation of productive and pro-competitive

362. Competition Ordinance, *supra* note 5, at § 67(3).

vertical agreements in the market. Therefore, if the agency's belief that certain conduct is unlikely to harm competition does not make related complaints "unreasonable," the effectiveness of the reconciliation would be weakened.

From the above, one could see that one major drawback of the reconciliation is that it relies on the agency's belief. However, this could be quite unstable. What if, even worse, the agency changes its mind and chooses to believe the legislators, rather than the international standard that the four vertical agreements are as harmful as hardcore cartels? This is not impossible, given that the agency is controlled by a handful of people like around fourteen Commission Members and one CEO. All they need to do to reverse the status quo is to amend its publications, such as brochures and the two *Policies*. Then, the agency would abandon using the term "The Four Don'ts" and tell the public not to engage in all eight conducts under "serious anti-competitive conducts." Moreover, the agency would actively investigate all of the conduct. As explained, such misallocation of enforcement resources is ineffective to society. From the businesses' perspective, participating in the four vertical agreements would have a high possibility to be investigated, as high as one engaging in hard core cartel conducts. Companies experiencing the proceedings would complain how they were not guaranteed a second chance under the Infringement Notice system or how they were not excluded if the agreement formed was of lesser significance. As a result, deterrence to form the four vertical agreements, including those which may have net pro-competitive effects, would be unpleasantly high.

Optimists may argue that of course the agency (1) could refuse to investigate conduct that they don't find likely to be harmful and (2) would not abandon international standards, and therefore the reconciliation would remain effective. The author tends to agree on the two premises. However, such argument failed to take into account that private actions would likely be expanded in the Ordinance in the future. In the week before the Ordinance came into full effect in December 2015, the Chairman of the HKCC, Ms. Anna Wu Hung-yuk, was interviewed by the local media. At the interview, she agreed that the Ordinance needed to be reviewed in three years and should consider giving individuals the right to take private actions independently (i.e. standalone private action).[363] This means that this topic may be brought up for discussion soon in late 2018. Also, this suggestion may be realized and become part of the law in the foreseeable future. When

363. *Jingzhengli Liangloudong Xue Xiaofeizhe Quanyi*, *The Two Loopholes of the Competition Ordinance Cut Consumer Rights*, [*競爭例兩漏洞 削消費者權益*], XIRI TAIYANG (SUN.ON.CC) [昔日太陽], Dec. 7, 2015 (H.K.), http://the-sun.on.cc/cnt/news/20151207/00407_011.html.

that day comes, the flood gates of private antitrust litigation might be opened. This has little to do with the dual-track commitment system as it's triggered by the agency's investigation. And the agency still has much control in deciding whether to investigate suspicious conduct. Yet, the "agreement of lesser significance" exclusion is out of the agency's hands. In the past, if the agency received a complaint involving a vertical serious anti-competitive conduct formed between small companies, it could give it a second chance even under the harsher commitment system. While private individuals are allowed to bring a suit by themselves, these small companies could not enjoy the exclusion and would need to confront the plaintiffs in the Competition Tribunal. Since these vertical agreements are usually not anti-competitive, they do have a good chance to survive in litigation. However, it would cost the defending companies a lot of time, if not also money in terms of legal cost, in the litigation. Foreseeing this, companies would be discouraged to engage in the four vertical agreements which may be productive and pro-competitive to the market. As a result, the effectiveness of agency's reconciliation would be substantially weakened.

Skeptics could argue there is also a chance that standalone private actions would never be provided to private individuals. An argument could be made that proponents would face huge resistance from the SMEs which prefer less litigation. Indeed, the SMEs are powerful in Hong Kong. As documented in Section II, both Hong Kong legislators and government had heavily weighted the voice of SMEs when drafting the law. Let's assume the status quo would continue to maintain, which is extremely unlikely, that is: (1) the agency could refuse to investigate conduct that they don't find likely to be harmful, (2) the agency would not abandon the international standard, and therefore, the reconciliation would remain effective, and (3) there would be no standalone private action. Even if this came true, there is one major problem the agency could try to lessen, but never be able to eliminate. As explained before, the term "serious anti-competitive conducts" in the statute has a great signaling effect.[364] Furthermore, the mismatch between the substance (i.e. the fact that the four vertical agreements are not severe conducts) and the signaling effect of the term creates confusion, rather than legal certainty, to the public. Both the above could easily discourage companies from engaging in relevant vertical conduct, which may benefit the economy. Credit should be given to the agency for attempting to suppress the confusion by avoiding the wide application of the legal term. However, in order to educate the public in an easy-to-understand way and form its own dual-track system, the agency had no other option, but to create two new terms, namely "The Four Don'ts" and "Cartel Conduct."

364. *Supra* Section II(A).

Unfortunately, with more terminologies flowing around in society, legal certainty was weakened, rather than improved. It is especially true when these terms do not share the same meaning. With the agency's hard work in promoting its own terms, the author does believe that the two terms formed off the statute are more well-known to businesses. Having said that, a cautious and timid company is likely to study the statutes, in addition to merely listening to what the agency says, before preparing its strategy to comply with the Ordinance. The company may learn from section two of the Ordinance that the four conducts are considered "serious anti-competitive conducts" no matter if formed horizontally or vertically. This would definitely discourage the company from engaging in vertical conduct. Most importantly, when the company is confused by having different terms, it would tend to rely on the one stated in the statute as it is more authoritative than the two formed off the statute. Of course, if the company takes further steps, such as to consult a law firm or the agency, it could find out that the risk of these vertical activities are actually not as high as hardcore cartels. Yet, it is costly to the company to figure out the true risk of participating in the four vertical conducts. Moreover, it is unjust to put this burden on the company. Instead of discouraging these potential beneficial business agreements, the Ordinance should encourage them.

So, how could the current system change towards motivating these four vertical agreements? Looking forward, the author proposes to amend the definition of "serious anti-competitive conducts" under section two of the Ordinance. The amendment is simple, but significant. That is, legislators should limit the definition of "serious anti-competitive conducts" formed between competitors. This is essentially the same to say that the amended version of "serious anti-competitive conducts" would only cover hardcore cartels and exclude the four vertical conducts. First, the dual-track system would be justified. It is because it correctly reflects the harmfulness of different conducts and applies the appropriate level of punishment and deterrence to them accordingly. Second, the amendment could prevent agency from changing its mind in the future and allocating scarce enforcement resources to combat less harmful conducts. In other words, certain stability of competition policy could be ensured and the likelihood of inefficiency resulting from misallocation of enforcement resources would be reduced. Third, legal clarity would be improved. It is because although there may still be three different terms flowing around in the market, companies would not be confused since they all share the same meaning. In fact, after legislators amend the law, the agency could consider abandoning the use of the term "The Four Don'ts" and "Cartel Conduct," and replacing them by amendment to "serious anti-competitive conducts." Sometimes, less is more. Fourth, after amending the term, the four agreements would be encouraged. For instance, the term would no longer send out incorrect signals that discourage companies from engaging in vertical agreements which may benefit society. This is simply because only hardcore cartels would be identified and promoted as the most severe conduct after the legal term is revised. But why would the vertical agreements be promoted? Put yourself into the shoes of a company. You are a small company considering forming a vertical agreement with another company. You know that this is a profitable plan. However, you are not sure if it's against the Ordinance. If the term is amended, you would not hesitate to enter into that agreement. It is because, first, the agreement has a good chance to be excluded by the law as an "agreement of lesser significance." This is something you could confirm easily by checking yours and your business partners' aggregate turnover. If the agreement does count as lesser significance, even if the general public is given the right to bring standalone private actions in the future, you would still be immune to violating the Ordinance. Second, if you are not excluded, you know for sure that a second chance is guaranteed by the agency. As now, the agreement is no longer a "serious anti-competitive conducts" and the more lenient Warning Notice system applies. Of course, you would still worry about standalone private actions. That said, the chance of being sued by private parties would be lower if the law is amended. That is because not only would you study the law, but potential plaintiffs would do so as well. If the definition of "serious anti-competitive conducts" is as it is now, if standalone private actions are provided, potential plaintiffs would be more eager to sue under the four vertical conducts. It is because they have good reason to believe that they could win as you have participated in so called serious anti-competitive conducts. In contrast, if the law is amended, potential plaintiffs won't strongly believe that they have a case and will hesitate to start a costly legal process.

At the end, to be clear, the author is not arguing that Hong Kong should not be harsh to vertical anti-competitive conducts. Indeed, although unlikely, it is possible for vertical agreements to be anti-competitive. However, what the author is really challenging is: why should these four vertical agreements be treated as harsh as hardcore cartels? In other words, if legislators introduce a dual-track system in its competition law, where should they draw the line between the two tracks? Whether the choice to draw the line at a particular space is justified? What are the consequences to society if legislators draw the line in such way? Are these consequences desirable to society? The author believes that, as demonstrated above, the proposed version of "serious anti-competitive conducts" could offer Hong Kong better answers to all these questions than does the existing one.

CONCLUSION

In 1998, OECD defined hardcore cartels, which includes horizontal price fixing, output restriction, market allocation and bid rigging, as the most harmful anti-competitive conducts. Then, this has developed into a standard widely accepted by international communities. Many countries introduced a dual-track system in their competition law. Hong Kong was no exception. It attempted to follow suit when it created its Competition Ordinance, which was eventually passed in 2012.

However, the dual-track system created by Hong Kong legislators was imperfect as they added vertical price fixing, output restriction, market allocation and bid rigging on top of hardcore cartels and defined them all together as "serious anti-competitive conducts" *in* the statute. U.S. judicial experience has shown that the four vertical agreements are not only less likely to be anti-competitive than hardcore cartels but may also generate pro-competitive effects. Even if these agreements have no effect on competition, they should still be appreciated as they may promote economic growth. Moreover, the divergence has led to multiple unpleasant consequences. The major ones are creating legal uncertainties and discouraging businesses to engage in vertical agreements that have the potential to benefit Hong Kong's economy. The above have put the justifiability of the divergence in question.

Subsequently, the local law enforcement agency tried to reconcile the divergence between Hong Kong legislators and the international standard, by creating its own dual-track system *off* the statute. Unfortunately, although the reconciliation does have some effectiveness in suppressing the adverse effect of the divergence, the reconciliation was not without limitations. For example, the reconciliation formed *off* the statute is less stable and authoritative. Moreover, it is expected that the Ordinance would expand the ability of private individuals to bring a competition lawsuit in the Competition Tribunal in the foreseeable future. These all would bring uncertainties and challenges to the success of the reconciliation scheme.

Therefore, this Comment suggests that the existing law should be amended. Specifically, the four vertical agreements should be excluded from being recognized as "serious anti-competitive conducts" *in* the statute. Although this recommendation sounds simple, this Comment demonstrates how it could effectively fix the existing problems, benefit Hong Kong immediately, and confront future challenges.