Hong Kong Competition Commission – Consultation on draft Leniency Policy

Response of Herbert Smith Freehills

1. INTRODUCTION

1.1 Herbert Smith Freehills is grateful for the opportunity to provide comments to the Hong Kong Competition Commission ("**Commission**") in relation to its draft Leniency Policy for Undertakings Engaged in Cartel Conduct ("**Draft Policy**") and accompanying Guide to the Draft Leniency Policy for Undertakings Engaged in Cartel Conduct ("**Guide**") of 23 September 2015.

1.2 We would welcome the opportunity to comment on any further revision of the Draft Policy.

1.3 Herbert Smith Freehills has extensive experience in advising clients in relation to potential immunity/leniency applications to competition authorities globally, including in particular the European Commission, the UK Competition and Markets Authority ("**CMA**")(previously the Office of Fair Trading ("**OFT**")), and the Australian Competition and Consumer Commission ("**ACCC**"). We therefore believe that we are well placed to respond to this consultation.

1.4 The comments contained in this response are those of Herbert Smith Freehills, and do not represent the views of our individual clients.

2. OVERVIEW

2.1 We support the Commission producing a Leniency Policy and its stated aim, as set out in the Guide, of ensuring that potential leniency applicants understand the nature of their obligations should they successfully apply for leniency. We believe that the aim of the Leniency Policy should also be to ensure that potential leniency applicants understand when leniency will be granted. We agree that a leniency policy should be designed to provide a "strong and transparent incentive for a cartel member to stop its cartel conduct and to report the cartel", and that the benefits to the Commission of a successful leniency policy include increased detection and deterrence of cartel conduct, as well as more efficient obtaining of evidence and investigation of such conduct.

2.2 While we believe that the Draft Policy goes some way to securing these aims and benefits, we consider that further improvements could be made in order to ensure that sufficiently clear incentives are present to encourage leniency applications and to ensure that these aims and benefits are achieved.

2.3 Crucially, we believe that greater certainty in the process is required. The decision by a

company to make a leniency application is always a substantial one. Certainty is, therefore, the key element in any leniency regime: in order to take the very significant step of 'blowing the whistle' and committing to the lengthy and onerous process involved in a leniency procedure, potential applicants need to be clear as to their obligations and certain that, if they comply with these obligations, they will be rewarded.

2.4 In particular we consider that:

2.4.1 The Draft Policy should be clearer as to the conditions which must be met by a first applicant for leniency in order for leniency to be granted and provide greater certainty that, if those conditions are met, the Commission will enter into a Leniency Agreement;

2.4.2 In relation to second and subsequent applicants, the Draft Policy should specify what conditions such applicants would need to meet in order to obtain "favourable treatment", be clear that if those conditions are met the Commission will provide favourable treatment, and be clear as to what favourable treatment involves (i.e. what action the Commission will and will not take).

2.4.3 Greater clarity/detail should be provided on a number of procedural steps.

2.5 Our more detailed comments are set out below.

3. SCOPE OF LENIENCY POLICY

Subject matter

3.1 We note that the Draft Policy is stated to apply only to Cartel Conduct, defined as agreements or concerted practices between undertakings that are competitors (or would be absent the cartel conduct) to fix prices, share markets, restrict output or rig bids. We note that this is consistent with the leniency policies of many developed competition regimes (although, as the Commission will be aware, in the UK the leniency regime extends also to vertical price fixing agreements/resale price maintenance between non-competitors).

3.2 We note the statement within the Draft Policy that it "does not preclude the Commission from entering into a leniency agreement with an undertaking with respect to an alleged contravention of a conduct rule which is not covered by the policy." Whilst the flexibility to do so is welcome, without any certainty as to whether leniency would be available for conduct falling outside the scope of the definition of Cartel Conduct and the procedure which would be followed in such a case, there will be limited incentives for undertakings to come forward and disclose such conduct to the Commission. We understand that additional policies under Section 80 of the Ordinance may be forthcoming.

3.3 In light of this, it is important that the boundaries of Cartel Conduct falling within the scope of the Leniency Policy are clear. In particular, the Commission could usefully articulate whether it considers that the sharing of forward looking price information between competitors (or indeed, other commercially sensitive information) would, in itself, amount to fixing prices or Cartel Conduct for the purposes of the Leniency Policy.

Persons

3.4 We note that the Draft Policy only applies to undertakings, but (we assume in light of section 91 of the Competition Ordinance) we also note that where the Commission enters into a Leniency Agreement with an undertaking, leniency will "ordinarily" extend to any current (and named former) director, officer or employee of the undertaking, provided that the relevant individual provides complete, truthful and continuous cooperation with the Commission.

3.5 The qualification of this extension by the use of "ordinarily" is insufficiently certain and requires, in our view, clarification. Such clarification could be provided by including examples of the type of circumstance in which leniency would not extend to those individuals.

3.6 In addition, given it appears that the Leniency Agreement can be terminated as a result of non-compliance by the undertaking (regardless of whether the individuals have complied/co-operated), we consider that greater clarity regarding the effect of such termination on the status of cooperating individuals (e.g. former directors) would be beneficial.

Relief from sanctions

3.7 The 'reward' for blowing the whistle under the Draft Policy is stated to involve the Commission agreeing not to bring or continue proceedings in the Tribunal for a pecuniary penalty. However, due to the definition of "Proceedings" within the Leniency Agreement, the intention appears to be that the scope of the leniency awarded will in fact extend further, for example, so as to commit the Commission not to bring director disqualification proceedings (as against individual employees and directors etc). If this is the intention (which we believe should be the case) then this should be specifically articulated within the Leniency Policy itself.

4. "WINNER TAKES ALL" APPROACH

4.1 We recognise that the so-called "winner takes all" approach (i.e. the limitation of leniency to the first successful applicant) adopted within the Draft Policy is to some extent conditioned by the provisions of the Competition Ordinance and the enforcement model it adopts. We

also recognise that, from the Commission's perspective, the advantage of such an approach is that it may increase detection of cartels by incentivising cartel members to come forward at an early stage, in order to try to be 'first in'.

4.2 However, as evidenced by the experience in other jurisdictions, second and subsequent applicants can often contribute significant information and evidence, either by corroborating the information provided by the first applicant or through providing additional information and evidence (for example, in respect of additional products, territories or time periods), thus assisting the competition authority to successfully prosecute the relevant cartel, and to do so more efficiently. We believe it is therefore important that the Leniency Policy provides sufficient incentives for second and subsequent applicants to provide information and evidence to the Commission. As currently drafted the Draft Policy does not do so, given there is no certainty that any "favourable treatment" will be granted, what this would entail in practice, nor what procedure would be followed. We believe that section 4 of the Draft Policy is unacceptably vague in this respect.

4.3 In this regard the Leniency Policy should in our view: (i) specify what conditions such applicants would need to meet in order to obtain "favourable treatment" (for example we note the concept of "significant added value" under the EU system); (ii) be clear that if those conditions are met the Commission will provide favourable treatment (or seek such favourable treatment from the Competition Tribunal); and (iii) be clear what such favourable treatment will involve (i.e. what action the Commission will and will not take, whether the Commission considers that it can make joint submissions to the Tribunal in this regard[1], including in relation to the level of fine discount the Commission would propose in submissions to the Tribunal). While we note that the final decision in respect of any pecuniary penalty would be for the Tribunal, we consider that the inclusion of this additional detail would provide necessary guidance and incentives for potential second (and subsequent) applicants.

5. CONDITIONS FOR LENIENCY

5.1 We believe that in its current form, the Draft Policy is insufficiently certain as to the requisite conditions for leniency being granted (i.e. for obtaining a marker and then perfecting that marker). It also fails to make it clear whether leniency will always be granted if the conditions are met, which we believe is the cornerstone of a successful leniency regime. We note for example vague references such as "the caller may then be given a

[1] We note that the Draft Policy states that "favourable treatment may include making joint submissions with the cooperating undertaking to the Tribunal on the pecuniary penalty". (Emphasis added).

marker", "the Commission will decide whether or not to make an offer to enter into a leniency agreement" and "if the Commission decides to offer to enter into a leniency agreement" (emphasis added). There is also no indication of the envisaged timeframes involved (e.g. how long will an application be held by the Commission before inviting the applicant to make a proffer?).

5.2 We believe that the Leniency Policy should: (i) clearly state that if leniency is in principle available (i.e. the applicant is first to contact the Commission, the conduct appears to amount to Cartel Conduct, and the Commission has not decided to issue an infringement notice under section 67 of the Competition Ordinance or commence proceedings in the Tribunal) a marker will be granted; (ii) specify and articulate the conditions for leniency, i.e. what threshold must be met and what must be done[2] at each stage (marker, proffer, Leniency Agreement), including what the concept of co-operation requires (this is currently set out in the annexed template Leniency Agreement only); and (iii) clearly state that if these conditions are met then leniency will be granted.

5.3 In this context the Leniency Policy should make it clear whether leniency or favourable treatment can be available after an investigation has already been opened and after inspections have been carried out (together with the process for making applications during an inspection).[3]

5.4 If the specified conditions are met, and in line with the Commission's stated desire to minimise the level of discretion it is able to exercise in this area, there should be no discretion as to whether a Leniency Agreement will be entered into and leniency granted.

5.5 By way of example, the European Commission's leniency policy[4] provides that in order to

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2 In relation to termination of cartel conduct, we suggest that the Leniency Policy makes it clear that the applicant can engage with the Commission on this to agree appropriate steps to minimise the risk that cessation of cartel activities gives rise to any 'tipping off' concerns.

3 We assume this is the intention, by implication, given that the Draft Policy states only that leniency will not be available if it has decided to issue an infringement notice under section 67 of the Competition Ordinance or to commence proceedings in the Tribunal in respect of the relevant Cartel Conduct reported by the undertaking.

4 *Commission Notice on Immunity from fines and reduction of fines in cartel cases* (2006/C 298/11)("**EU Leniency Notice**"). See similarly the UK leniency policy (OFT1495 *Applications for leniency and no-action in cartel cases*, July 2013 ("**UK Leniency Guidance**")), which articulates the conditions for the availability of Type A immunity (including that the applicant is first in, there is no pre-existing investigation, and the information provided must give the CMA "a sufficient basis for taking forward a credible investigation", Type B immunity/leniency (first applicant, there is no Statement of Objections and the information must "add significant value" to the CMA's investigation) and Type C leniency (subsequent

receive immunity the applicant must:

5.5.1 Be first to "submit information and evidence which in the Commission's view will enable it to: (a) carry out a targeted inspection in connection with the alleged cartel; or (b) find an infringement of Article [Article 101 TFEU] in connection with the alleged cartel"; and

5.5.2 Meet the conditions of: continuous co-operation (as amplified within the policy); cessation of cartel activity; confidentiality; and no destruction/falsification/concealment of evidence.

5.6 The Leniency Policy should also make clear whether the information and evidence required to meet the conditions needs to be provided at the proffer stage (in which case the 28 day time-frame may be too short) or as part of the process following entry into of the Leniency Agreement.

5.7 Finally, if it is the Commission's intention that a coercer should not be entitled to leniency, then we believe the Leniency Policy should make it clear that this is a condition of leniency (rather than just requiring the applicant in the Leniency Agreement confirm that it has not coerced other parties to engage in the cartel conduct). It would make sense, in that case, for favourable treatment to nonetheless be available to a coercer (as in the EU and UK) and for the Leniency Policy to make this clear. On this point, we also note the absence of guidance on the meaning of "coerce" in this context. While it may not be possible to provide a definitive definition, the Leniency Policy could usefully provide examples of when an undertaking will be regarded as acting as a coercer and when it would not, as per the position set out in the UK Leniency Guidance.[5]

6. PROCEDURE

Applying for a marker

6.1 We believe that it should be possible for an undertaking to enquire (via its legal advisor) on a no-names basis whether leniency is in principle available (i.e. whether any other undertaking has already obtained a marker), as in the UK for example, in particular given the "winner takes all" approach that has been adopted in the Draft Policy. It would therefore be helpful if the Draft Policy made explicit the possibility for an undertaking to make a leniency application on an anonymous basis.

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applicant or coercer, there is no Statement of Objections and the information must "add significant value" to the CMA's investigation).

[5] At paragraph 2.50 onwards.

6.2 It would be useful if the Leniency Policy could provide a greater level of detail as to what information is required in order to obtain a marker, rather than simply stating as in the Draft Policy that this must include "sufficient details to identify the conduct for which leniency is sought." If (as would appear to be the case) the purpose of the marker is to give the Commission the ability to determine whether a marker remains available in respect of the conduct, it would be helpful for this to be stated explicitly in the Leniency Policy. An example of the level of detail that would likely be acceptable for a marker would also be helpful for potential leniency applicants (and their legal advisors).

6.3 For example the EU Leniency Notice states that the applicant must provide information on the "affected product(s) and territory(-ies), the estimated duration of the alleged cartel and the nature of the alleged cartel conduct".

6.4 In relation to process, we note that it would be useful if the Leniency Policy were to outline clearly the Commission's potential responses to a marker application, including proposed timeframes and the consequences of the Commission deciding not to open an investigation (for example would the applicant still be invited to apply for leniency or would the marker simply be preserved?), and what communication (if any) there would be to applicants second and subsequent in the marker queue.

Invitation to apply for leniency

6.5 Paragraph 2.14 of the Draft Policy currently states that the applicant will be asked to sign a non-disclosure agreement with the Commission which provides that the applicant will keep confidential: (i) the fact that it is submitting an application for leniency; and (ii) the information provided or that will be provided. As discussed further below, clearly carve-outs will be needed from this (including in relation to seeking legal advice and informing other competition authorities that an application has been made to the Commission), and this should be made clear in the Leniency Policy.

Making the leniency application / proffer

6.6 There is a lack of clarity within the Draft Policy as to the extent to which information and evidence needs to be obtained and provided at the proffer stage, including the extent to which any evidence which has already been collated needs to be provided to the Commission. In many systems, such information and evidence is required at the proffer stage in order to "perfect" the marker, but we note the reference in the Draft Policy that the Commission "may ask the applicant to provide access to some [documentary or witness] evidence in support of the proffer" (emphasis added). Further clarity is required.

6.7 Whether the default deadline of 28 days[6] is a realistic period depends to some extent on what information and evidence needs to be provided in advance of any such request from the Commission, but in any event may be challenging as significant investigatory steps may be required before an undertaking is able to provide a detailed description of the cartel and what evidence the undertaking can provide. We therefore welcome the Commission's indication that it may agree to extensions of the 28 day period for completion of the proffer.

6.8 However, it would be useful if the Leniency Policy articulated the process and required justification for seeking and obtaining an extension of this 28 day time period.

6.9 We note the statement in paragraph 2.17 of the Draft Policy that the Commission "will provide an assurance that it will not use this [documentary or witness] evidence against the applicant". Further clarity on the scope of this assurance would be welcome: for example, will this remain the case if ultimately no Leniency Agreement is entered into, or it is entered into and is subsequently terminated. The Leniency Policy should also clarify whether such evidence would be used against individuals.

6.10 We support the Commission's confirmation that a proffer may be made orally.

Leniency agreement

6.11 Paragraph 2.23 of the Draft Policy provides that following entry into of the Leniency Agreement the applicant is "required to provide the Commission with all non-privileged information and evidence in respect of the cartel conduct without delay". Further detail on what this would involve in practice could usefully be included in the Leniency Policy, for example whether the Commission envisages engaging with the applicant in a dialogue on the scope of investigatory steps (for example in terms of forensic IT searching and witness interviews), and on how a timetable will be agreed for this process (given that the specification "without delay" does not take account of the numerous steps that this will involve).[7]

Terminating the Leniency Agreement

6.12 The grounds on which the Commission may terminate the Leniency Agreement, as set out in the Competition Ordinance, are wide. Given the significant consequences of termination, it would be useful if the Leniency Policy set out some indications of how the Commission would interpret these in practice, for example would it terminate on the basis of any failure to comply with the terms of the Leniency Agreement, or only where non-compliance were

6 We ask the Commission to clarify whether this refers to calendar or working days.

7 See on these points, by way of example, the UK Leniency Guidance.

significant, serious, or at least material, and how it would apply the materiality threshold in relation to incomplete information.

6.13 We believe that the Leniency Policy itself should set out the process for termination, making it clear that notice must be given in writing and the applicant has the opportunity to make representations (as set out in the Competition Ordinance).

6.14 We refer to our comments above regarding clarity on the impact of termination on individuals.

6.15 Importantly, we believe that the Leniency Policy needs to set out what use the Commission may and may not make of self-incriminatory evidence provided to it in circumstances where the Leniency Agreement is subsequently terminated. In this respect we do not agree with the provisions of clause 6.1 of the draft Leniency Agreement ("The Commission may use any information or documents provided by [Party] under this Agreement, for the purpose of any investigation and proceedings under the Ordinance"). We do not believe that the Commission should be able to rely on such evidence against the applicant or its individuals.

Statement of agreed facts

6.16 Given in particular the decision not to provide any relief from follow-on damages actions for successful leniency applicants, we note that the requirement for the applicant to sign a statement of agreed facts admitting its participation in the cartel conduct may deter undertakings applying for leniency, in particular where the 'pros' and 'cons' are otherwise finely balanced.

6.17 We believe that, at the least, such a statement should be very brief and contain outline facts only. It should relate only to conduct in Hong Kong. We also believe that it should be possible to provide such a statement orally, and sign a Commission-created copy at the premises of the Commission, in order to minimise disclosure risks should the Commission ultimately decide not to bring proceedings. We also suggest that the Commission keeps this position under review and, if it appears that leniency applicants are being deterred due to the prospect of follow-on damages actions, that the Commission revisits its position.

Confidentiality and non-disclosure

Parties

6.18 We believe that the Leniency Policy should provide examples of where Commission consent for disclosure is likely to be forthcoming, for example in relation to parallel leniency applications where the application is required to inform the relevant competition authority of

other applications, and disclosures to auditors. There should also be a general carve-out allowing disclosure to professional advisers for the purposes of advising on the leniency application and the Commission's investigation, as per the draft Leniency Agreement.

6.19 We note the statement within paragraph 5.4 of the Draft Policy that if a leniency applicant breaches its confidentiality and non-disclosure commitments it "will cease" to be eligible for leniency. We believe that it is sufficient to ensure that the Commission can terminate the Leniency Agreement in the case of a material breach (or decline to offer to enter into the Leniency Agreement if the breach occurred at an earlier stage). We consider that automatic exclusion of leniency in all cases is unnecessary and inappropriate, particularly where a breach is technical in nature and an undertaking has used best efforts to ensure compliance with the draft Leniency Agreement.

Commission

6.20 We note the reference within paragraphs 5.6-5.7 of the Draft Policy to the Commission using "best endeavours" to protect Leniency Application Materials and its policy not to disclose these save in the specified circumstances. While this policy position is welcome, given the importance of this issue (in particular in light of the global trend for increased private damages actions in cartel cases and the potential for material created or disclosed in one jurisdiction to be utilised in another), we submit that in order to ensure leniency incentives are maintained so far as possible, the Commission should articulate more clearly what steps it proposes to take to resist disclosure of such material (for example in light of an application from a third party to a court for such disclosure).

6.21 It would also be useful for the Commission to clarify whether it regards Leniency Application Materials as including documents based on or containing extracts from such materials (and this should also be reflected in the Leniency Agreement).

6.22 We also note paragraph 5.7(d) which implies that the Commission will disclose Leniency Application Materials if the Leniency Agreement is terminated. We believe that the Commission should reconsider this proposed approach (if this is indeed the intention) or at least clarify what is meant by paragraph 5.7(d).

7. TEMPLATE LENIENCY AGREEMENT

7.1 In addition to the comments above, we set out below comments on specific clauses of the template Leniency Agreement.

7.2 Notwithstanding the contents of clause 4.3, we believe that damages actions should be specifically excluded from the definition of Proceedings; no co-operation should be required in relation to such proceedings.

7.3 In relation to clause 4(1)(a)(i) the undertaking should only be required to use its best endeavours to ensure the complete and truthful cooperation of its current officers and employees.

7.4 Clause 4(1)(b)(i) should make reference to the scope of the search being agreed with the Commission.

7.5 In relation to the provision in clause 4(1)(b)(ii) for the Commission to access the undertaking's IT systems and equipment, this should note that the Commission will have due regard during such access to the legitimate interests of the undertaking in protecting confidentiality of its information and maintaining legal professional privilege. We note that the Commission has stated, in its Guideline on Investigations that it will establish and publish a procedure for dealing with disputes with respect to claims to legal professional privilege in the context of the Commission exercising its Investigation Powers, including powers conferred by warrant under section 48 of the Ordinance. We urge the Commission to ensure that a similar procedure is in place for situations involving leniency applications prior to the Competition Ordinance coming into force.

7.6 In relation to clause 4(1)(d) the undertaking should only be required to use its best endeavours to ensure that its current officers, employees and representatives maintain confidentiality.

8. **TIMING**

8.1 We urge the Commission to ensure that the final Leniency Policy is in place prior to the Competition Ordinance coming into force.

Herbert Smith Freehills

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