Introduction

Whether and how to regulate conglomerates has been a firestorm of controversy in competition law. Suspicious anti-competitive behaviours of conglomerates may be put on inquiry under conventional competition law enforcement or through merger control. Conglomerates (or conglomerate merger) refer to a single economic entity (for the case of merger, different undertakings to be merged) which comprises groups of companies that do not operate in the same product market or without a supply relationship.[1] Supported by evidence in empirical findings[2], although efficiency is widely recognised as a benefit of conglomerates[3], the presence of countervailing effects of conglomerates has led to diverging views in both academia and practice, making legal enforcement challenging.[4]

This article is organised as follows: the first part discusses the theories of harm of conglomerates from economic reasoning and case laws. Having observed the overlapping economic reasoning and effects of conglomerates to those of horizontal and vertical restraints, this brings to the discussion on available tools and legal grounds which the Hong Kong Competition Commission could rely on to regulate anti-competitive behaviours of conglomerates. The second part recommends changes to the existing competition law regimes in Hong Kong, particularly pointing to a lack of flexible enforcement tools as compared to

[1] OECD Directorate for financial and enterprise affairs competition committee, Roundtable on Conglomerate Effects of Mergers - Background Note by the Secretariat, 2020, p.6.

[2] See, for example, Goldberg, Lawrence. The Effect of Conglomerate Mergers on Competition, *The Journal of Law & Economics*, 1973, 16(1), pp.137-158.

[3] Agreed by 84.6% of responding authorities in the ICN Conglomerate Mergers Project Report, efficiencies are generated through integrating complementary products or services (in different markets) within a single party. Report available at: https://www.internationalcompetitionnetwork.org/wp-content/uploads/2020/09/MWG_ConglomerateMergersReport.pdf, p.10.

[4] *Ibid.*, the same report reflects different opinions across jurisdiction on monitoring conglomerates.

our international counterparts in Asia, Europe and the United States. A conclusion then follows.

Part 1: Conglomerates theories of harm

Despite widely agreed potential efficiency, theories of harm of conglomerates overlap with the reasoning for those of vertical and horizontal restraints. These include:

1. Coordinated effects
2. Unilateral effects

Coordinated effects

Axel Springer v ProSiebenSat (2006) illustrates coordinated effects in conglomerates. The structure of conglomerates enables transparency through access to market information, making it easier for the undertakings to compete in the market than they otherwise would be.[5] Although companies in a conglomerate do not operate in the same product or service market, the information uncovers the underlying links between different markets and incentivises conglomerates to distort interdependence between rivals in 'a complementary manner dividing up product and geographical markets'[6], which is magnified by the overlapping of directorships.[7]

[5] Bundeskartellamt, *Conglomerate Mergers in Merger Control, Review and Prospects*, 2006.
[6] *Allianz v AGF*(1998), para.56.
[7] McHugh, Nick and Webster, Belinda Competition Law: Coordinated Effects in Mergers and Acquisitions - Implications of Cross-Directorships, *Keeping Good Companies*, 2010, 62(1), pp.40-42.

In some cases, although groups of companies under the same conglomerate does not operate in the same product market, they may be considered as weak substitutes (or 'neighbouring goods'[8]), such as coffee and tea. Technical interoperability assists conglomerates to distort interdependence by allowing them to bring different product markets into contact to discourage aggressive price cuts that might otherwise be made.[9] In this scenario, conglomerates would bring adverse price effects similar to the situation in horizontal agreements.[10] The EU Commission articulated such effect in *Tetra Laval/Sidel*: the case concerned the merger of two undertakings producing carton and PET plastic packaging equipment, each being the dominant player in their respective markets. The Commission submitted: without such merger, the separate entities would have to compete vigorously in order to survive by either innovating or price cutting. If the two entities form a single economic unit, it means the motivation for them to stay competitive is eliminated.[11] Therefore, the effect is said to be similar to the effects brought by horizontal restraints.

Unilateral effects

"Market theory" is one theory that explains the formation of conglomerates.[12] By forming a conglomerate, it is a quick strategy for the single economic unit to scale up operations and reduce institutional risks for contract negotiations. Although it realises productive efficiency

[8] Neven, Damien. *The analysis of conglomerate effects in EU merger control*, 2005, p.5

[9] Areeda, Phillip and Turner, Donald. Conglomerate Mergers: Extended Interdependence and Effects on Interindustry Competition as Grounds for Condemnation, *University of Pennsylvania Law Review*, 1979, 4, pp.1082-1103.

[10] *Ibid.*

[11] *Supra* n.8.

[12] Bourreau, M. and A. de Streel, "*Digital Conglomerates and EU Competition Policy*", 2019. Available at: http://www.crid.be/pdf/public/8377.pdf. Access: 2 Dec 2020.

because scaling and the reduced institutional risks are translated to lower price for consumers, concerns of conglomerates arise from the abuse of dominant position, such as through tying and bundling.[13]

Tying and bundling can be a strategy to foreclose competition. A dominant player in market A could team up with a player in a competitive market B under the same conglomerate and leverage its dominant position to foreclose competitors in market B. This is especially the case where inferior substitutes are available in market A so that they limit the surplus which the dominant player could maximise[14]: A dominant player could merge with an undertaking that produces complements of its products (market B). By tying and bundling products from market A (main product) and B (complement) together at a discounted price (or through predatory pricing), the law of demand and supply means customers are incentivized to obtain the paired and cheaper offer rather than buying them separately from the competitors of the conglomerate. In this way, competitors of the complement market (market B) may be foreclosed.[15]

Available tools for the HKCC

Exemplified by tying and bundling, anti-competitive behaviours of conglomerates appear to overlap with those of horizontal or vertical restraints. It follows that these behaviours are

[13] Church, Jeffrey. The Church Report's Analysis of Vertical and Conglomerate Mergers: A Reply to Cooper, Froeb, O'Brien, and Vita, *Journal of Competition Law and Economics*, 2005, 1(4), pp.797-802.

[14] Whinston, Michael. "Tying, Foreclosure, and Exclusion.", *American Economic Review*, 1990, 80(4), pp.837-859.

[15] Due to limited capacity, this article only illustrates one example of how tying and bundling could assist conglomerates to achieve foreclosure effects. For a detailed list of examples and discussions, see, for example: Church, Jeffrey. *The Impact of Vertical and Conglomerate Mergers on Competition*, 2004, , also: Whinston, Michael."Exclusivity and Tying in U.S. v. Microsoft: What We Know, and Don't Know., *Journal of Economic Perspectives*, 2001, 15, pp.63-80.

capable of being caught by both the First and Second Conduct Rule in Hong Kong. However, the major barrier to rely on the First Conduct rule is that agreements are formed between (but not within) 'single economic units'. Technically speaking, companies within a conglomerate are not considered as independent entities as they are regarded as parent and subsidiary. It follows that the Commission may find it hard to rely on the First Conduct Rule as a practical matter.

Alternatively, the Second Conduct Rule appears to be a more reliable legal ground to catch anti-competitive behaviours of conglomerates in Hong Kong. A challenge under section 21 is the requirement for 'substantial degree of market power', which the Commission may find it hard to satisfy due to the ownership structure of conglomerates in Hong Kong. It was found, the leading two property developers in Hong Kong only accounted for approximately 30% market share (which is not presumed to be holding substantial market share in EU) in the first-hand residential property market.[16] One may argue the nature of property development requires a developer to be big enough to achieve economies of scale, especially for infrastructure investment which may last for decades, therefore, they should be subject to a higher threshold to be considered as 'having substantial market power'. Whilst this may be true, the problem of land developers in Hong Kong is that many of them have their own subsidiaries of property management (and other associated) service providers. They could easily raise exploitative and exclusionary practices through tying and bundling against suppliers which smaller companies found it hard to compete.

Nonetheless, there are two saving graces under the Second Conduct Rule. First, in contrast to the EU Article 102 TFEU, conduct that has both '**object** and effect' (emphasis mine) could already satisfy s.21. It also seems s.21 has a much lower threshold of what is considered as

[16] Poon, Alice. '*Land and the ruling class in Hong Kong*', 2005.

having ‘substantial degree of market power’ when comparing to our EU counterpart: an expectation of 30% or 40% may suffice.[17] Second, for some anti-competitive behaviours such as predatory pricing, Guideline on the Second Conduct Rule published by the Commission (section 5.7) wrote: ‘**at its discretion**, consider the extent to which the predating undertaking is in the longer term able to “recoup” its short term losses…’ (emphasis mine). Despite not being a legal document, this Guideline may be admissible as evidence to establish or negate the matter (section 35 in Competition Ordinance). The relatively lower threshold for market share and flexibility could empower the Commission and increase the chances for successful prosecution. At the very least, the Second Conduct Rule is a better enforcement tool than the First Conduct Rule.

Finally, although merger control is available in Hong Kong, it only applies to the telecommunication industry for the moment, which is an apparent limitation. In response, a few recommendations are provided as follows.

Part two: recommended changes to the Competition Ordinance

Hong Kong has been topping the position on The Economist’s Crony Capitalism Index way ahead of the runner-up of Russia and Malaysia[18] for years, the power of conglomerates in Hong Kong has been severely expansive. Whilst this business structure assisted the family-oriented conglomerates in Hong Kong to overcome initial institutional challenges, currently

[17] Cheng, Thomas. Ready for Action: Looking Ahead to the Implementation of Hong Kong’s Competition Ordinance, 2014, 5, *Journal of European Competition Law & Practice*, pp.88-93.

[18] Wong, Richard. Hong Kong is the king of crony capitalism and that should be a worry for the Competition Commission, *SCMP Opinions*. Available at: https://www.scmp.com/business/article/1967952/hong-kong-king-crony-capitalism-and-should-be-worry-competition-commission

being a well-developed economy, conglomerates have shaped an environment that has softened competition, making it especially hard for the SMEs in Hong Kong to thrive.

Merger review is an apparent limitation as it applies only to the telecommunication sector in Hong Kong. Whilst telecommunication certainly deserves restrictions, other types of conglomerates such as land developers have, on multiple occasions, displayed their market influence in a way that is harmful to consumers.[19] However, to defend Hong Kong's crown to be a free market economy, having hard rules for merger review may appear stringent to the business community. Instead, Hong Kong can learn from Japan and South Korea, which use 'superior bargaining position' (in Japan, 'unreasonable restraint of trade') as the standard. Since the Second Conduct Rule requires a 'substantial degree of market power', this greatly limits the applicability of the rule. Therefore, flexibility is the advantage of using 'superior bargaining position' as the standard. South Korea intended to use 'substantial degree of market power' without satisfying the threshold of 'substantial market power' as a strategy to monitor economic activities of *chaebol*, which is in many ways similar to the conglomerates in Hong Kong.[20] In consideration that superior bargaining position does not equate to market power on many occasions[21], the standard of 'superior bargaining position' is a more flexible approach than 'substantial market power' to bring legal actions.

Parallel exclusion is another softer approach to scrutinize behaviours contrary to the spirit of competition law. Parallel exclusions refer to conducts engaged by multiple firms that block or slow would-be market entrants. By being a relatively new jurisdiction in the world of

[19] See Poon, Alice. '*Land and the ruling class in Hong Kong*', which illustrated the Author's observation on how landowners extracted unearned increment from their communities.

[20] Especially the biggest four family businesses in Hong Kong, which is agreed and recognised in the World Bank's 'East Asian Miracle report' to be similar to the chaebol in South Korea and keiretsu in Japan.

[21] For example, Article 23 of MRFTA in South Korea enlists 5 instances, such as forced purchase (*Seoul City Gas*) and imposition of disadvantage (*LG Electronics*), which are behaviours which do not necessarily require substantial market power.

antitrust, legal grounds to charge behaviours such as those enlisted under Art. 23 MRFTA appears to be limited till date. In the US, 'unfair methods of competition' would violate section 5 of FTC not only because of the Sherman and Clayton Act, but also because these are activities that 'contravene the spirit of antitrust laws and those that, if allowed to mature or complete, could violate the Shearman or Clayton Act'.[22] In order words, there is no doctrine of conspiracy under the Hong Kong Competition Ordinance at this moment. The Commission still has to show an abuse of an undertaking's substantial degree of market power, despite the relatively low threshold of market power required under the Second Conduct Rule. As a relative new law, the risk of introducing the doctrine of conspiracy may shock the business community at this juncture. Nonetheless, the 'superior bargainingpower' approach is worth learning.

In the UK and the US, the issue of interlocking directorates is addressed by the United Kingdom Office of Fair Trading (OFT) and the Clayton Act. However, there is no similar section in the Competition Ordinance that addresses the same issue. The problem of interlocking directorates in Hong Kong is more well-explored in the context of corporate governance, which often concerns related-party transactions between subsidiaries in an inter-locking style of ownership structure. In the arena of competition law, these directors could serve as institutional facilitators to smoothen the exchange of market information and strategy formations between subsidiaries within the conglomerates. In any case, it was criticised that interlocking directorship is a worrying trend in Hong Kong.[23] One way to monitor the problem without any amendment is through the First Conduct Rule by submitting employment contracts as the agreements. However, relying on the First Conduct Rule

[22] United States of America Federal Trade Commission Washington, 'Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act', 2015.
[23] Bryane, Michael and Say, Goo. Last of the Tai-Pans: Improving the Sustainability of Long-Term Financial Flows by Improving Hong Kong's Corporate Governance, *AIIFL WORKING PAPER 31*, 2013, 16.

requires a proof that the subsidiaries are separate ‘single economic units’ and to establish the causation between inter-directorship relations and the anti-competition effects, which does not appear to be straightforward. Therefore, introducing a law prohibiting or restricting inter-directorship relations would be the most effective way. However, as mentioned, considering that the Competition Ordinance is still new, this may fit into the schedule only in the long run.

Conclusion

In consideration that conglomerates’ theories of harm manifest similar effects to those of vertical and horizontal constraints, the existing Competition Ordinance appears to provide usable tools to theoretically regulate anti-competitive behaviours of conglomerates under the Second Conduct Rule. Nonetheless, more effective tools depend on future refinement of the Competition Ordinance, especially by learning from our Asian counterparts like Japan and South Korea which we share similarities with.