

HKSAR Legislative Council
Bills Committee on Competition Bill
Invitation for Submissions on Three Guidelines

Submission by Global Sources

11 July 2011

1 Introduction and statement of interest

Global Sources Ltd. (NASDAQ: GSOL) and its subsidiaries (collectively, **Global Sources**) are a business-to-business media group headquartered in Hong Kong, and a major part of our business includes the operation of trade shows such as the China Sourcing Fairs in Hong Kong (at the AsiaWorld-Expo). We have been closely following the development of the proposed Hong Kong competition ordinance, which would introduce competition law rules to all sectors of the Hong Kong economy. Global Sources has reviewed the three illustrative “regulatory guidelines” which were made available to the Bills Committee by the Commerce and Economic Development Bureau in May and June. We welcome the opportunity to provide comments on the proposed Bill in the context of your Committee’s review of the three guidelines.

Over the years, Global Sources has expressed its concerns many times over the competition conditions in Hong Kong’s exhibition industry. The industry has unique features that are prone to lead to competition distortions. The Hong Kong Trade Development Council (**TDC**) was established in 1966 as a public body whose statutory duty is to promote, assist and develop Hong Kong’s trade with places outside Hong Kong, with particular reference to exports. Over the years the TDC has expanded its activities well beyond its public service mission, and now dominates the exhibition industry in Hong Kong: it owns one of the principal venues for exhibitions (the Hong Kong Convention and Exhibition Centre in Wan Chai), and organises trade fairs in competition with the private sector - those very businesses whose activities it is supposed to promote. In this context it is particularly important to all actors of the Hong Kong exhibition industry, and more generally to all Hong Kong businesses involved in international trade, that competition in the industry remains vigorous, based on the merits and free of undue Government intervention.

The introduction of competition legislation in Hong Kong that would exclude, from its scope of application, statutory bodies carrying out commercial activities (like the TDC) would likely create additional market distortions to the detriment of Hong Kong businesses. The absurdity of a blanket exclusion for statutory bodies, such as the TDC, is further illustrated by the three guidelines on which the Bills Committee is seeking comment.

2 Comments on the three “regulatory guidelines”

Global Sources understands that the enforcement model proposed under the Bill is to set out general principles in the legislation while leaving broad discretion to the Competition Commission, the Competition Tribunal and the Courts in interpreting these principles. This broad discretion for the enforcers is compensated in part by an obligation for the Competition Commission to issue guidelines, albeit on a limited list of specific topics.

Global Sources’ purpose with the present submission is not to comment on the suitability of the proposed enforcement model. Rather, Global Sources wishes to illustrate how the proposed enforcement methodology set out in the guidelines would be seriously flawed, if the proposed exclusion of all statutory bodies is retained.

2.1 The guidelines and the blanket exclusion of all statutory bodies

As your Committee knows from our previous submission,¹ Global Sources has serious concerns with Article 3 of the current draft of the Competition Bill, which proposes to exclude all statutory bodies from the application of the law by default, until and unless the Chief Executive in Council chooses in his or her discretion to subject a particular statutory body or parts of its operations to the law according to Article 5.

Such a blanket status-based exclusion regime is unprecedented. Even the Chinese competition law subjects all organs of the State engaged in commercial activities to the Antimonopoly Law. In the overwhelming majority of competition law jurisdictions (e.g., the European Union, the UK, the USA, Canada, etc.), all operators engaging in economic activity - irrespective of their nature or ownership structure - are subject to the competition law provisions, with only limited exceptions for the provision of certain public services.

It is therefore very disappointing that none of the three guidelines explains how such a “unique” feature of the proposed legislation (namely, the blanket exclusion of statutory bodies) would affect the enforcement of the Competition Ordinance if and when it is enacted. This omission is all the more startling in view of the fact that the guidelines on the conduct rules do discuss in some detail various other exclusions and exemptions provided for under the Bill – all except for the one relating to statutory bodies.

While Global Sources acknowledges that the guidelines are purely illustrative at this stage, it respectfully submits that a proper discussion of the statutory body exclusion in the guidelines would reveal how flawed this exclusion is in the context of the proposed enforcement model. With the statutory body exclusion, the law will be ineffective to address major competition concerns, will increase costs of doing business for private parties, and will see its scope reduced to only those sectors with no statutory body involvement in Hong Kong. It will not be a cross-sector competition law, but a mere continuation of a sector-specific approach, with an added compliance cost for private businesses.

2.2 The Guidelines on Market Definition

The Guidelines on Market Definition appear to be broadly in line with the theoretical framework adopted in established competition law jurisdictions. It is unfortunate, however, that they do not also reflect the pragmatic approach adopted as a first step by foreign competition authorities. Global Sources understands that many foreign competition authorities would typically start their analysis with a common sense approach centred on product characteristics and industry views, before testing this preliminary view using the economics tests described in the Guidelines on Market Definition.

In any case, Global Sources agrees that a proper definition of the relevant market is essential to the implementation of competition law. Unfortunately, the guidelines do not discuss how the proposed market definition methodology would apply to markets where key market players, being statutory bodies, are altogether excluded from the Bill. It would lack common sense and be completely at odds with the economics-based approach proposed in the guidelines to ignore the presence of statutory bodies engaged in commercial activities when defining the relevant markets. Their market presence and market share should be acknowledged in the market definition exercise.

¹ Global Sources' submission to the Legislative Council Bills Committee on the Competition Bill addressing concerns as to the exclusion and exemption mechanism for statutory bodies engaged in an economic activity, 17 November 2010, available at <http://www.legco.gov.hk/yr09-10/english/bc/bc12/papers/bc121129cb1-516-4-e.pdf>.

Let us illustrate this with an example from the exhibition industry in which Global Sources operates. According to a 2009 study of the trade exhibition industry conducted by the Chinese University of Hong Kong and BMT Asia Pacific (which was submitted to the Legislative Council's Commerce and Industry Panel at its meeting on 20 April 2010),² in 2008 TDC-hosted events took up as much as 45% of local exhibitions and none of the private operators had more than 16% market share based on exhibition space.³ If the large part of the market controlled by the TDC were to be artificially "excluded" from the market definition on account of TDC being a statutory body, the private operators would see their market shares nearly doubled, in defiance of market reality. Private operators would perhaps even acquire a "substantial degree of market power" in such an artificial market.

A definition of relevant markets that would ignore commercial reality would lead to a misapplication of the law, as the Government itself recognises in the Guidelines. However, even with a proper definition of relevant markets that would (in line with commercial reality) appropriately include the significant market position of statutory bodies in important sectors of the Hong Kong economy, it would still lead to a misapplication of the law if, once the relevant market is properly defined, the Competition Commission and the courts are powerless to enforce the law against those major players in that relevant market because they are excluded from the application of the law in the first place. This demonstrates how flawed and ludicrous it would be to exclude a statutory body, who is a major player in a market, from the application of the competition law in that very same market.

2.3 The Guidelines on the First Conduct Rule

The Guidelines on the First Conduct Rule set out a framework under which the prohibition of restrictive agreements will be enforced. They also explain how the regime of general exclusions and exemptions will operate. One glaring omission, however, is an explanation of how the exclusion regime proposed for statutory bodies would operate in relation to the First Conduct Rule.

The Guidelines fail to deal with the consequences of a statutory body's involvement in a restrictive agreement

The guidelines do not explain whether private parties involved in restrictive agreements or concerted practices with an excluded statutory body would still be deemed to infringe the first conduct rule. The question is not straightforward and would merit discussion in enforcement guidelines. The text of Article 3 of the Competition Bill is clear: Part 2 (the conduct rules) does not apply to a statutory body. Article 3 allows statutory bodies to enter into restrictive agreements that would otherwise violate the first conduct rule.

Restrictive agreements entered into by excluded statutory bodies with private parties can thus arguably not be found to violate the first conduct rule. Finding otherwise would mean that the agreement would be illegal as regards one party but not for the other party. If that is the position, then private parties will also benefit from the exclusion as soon as a statutory body is involved. In that case many restrictions of competition in Hong Kong will be left unaddressed, and it will be tempting for private parties to involve statutory bodies in their conduct with the sole goal of benefiting from the exclusion.

² Available on the website of the Legislative Council or at http://www.ccl.baf.cuhk.edu.hk/Download/HKEI_study.pdf.
³ Figure 3.4 of the CUHK-BMT Report at page 17.

If, on the other hand, the statutory body will be the only party to benefit from the exclusion, the restrictive agreement will be illegal only as regards the private party. This legal oddity would not only allow bodies set up for the purpose of supporting the public interest to circumvent the law, but would result in making private parties bear the consequence of the statutory bodies' wrongdoing. In addition, private parties will have to bear the cost of verifying legal compliance of their agreements with statutory bodies, while these statutory bodies would bear no such cost, thereby creating an additional disadvantage to private businesses in their dealings with statutory bodies.

This shows that the government has not thought through its proposed exclusion regime for statutory bodies. More harm than good is likely to result from such an ill-conceived policy.

The services of general economic interest exclusion is sufficient to protect legitimate interests of statutory bodies, including those of the Trade Development Council

Article 3 of Schedule 1 to the Bill provides for a general exclusion regime for undertakings entrusted with services of general economic interest, on the model of Article 106(2) of the Treaty on the Functioning of the European Union: "Neither the first conduct rule nor the second conduct rule applies to an undertaking entrusted by the Government with the operation of services of general economic interest in so far as the conduct rule would obstruct the performance, in law or in fact, of the particular tasks assigned to it." Article 2 of the same Schedule provides an additional exclusion from the application of competition rules for conduct mandated by a legal requirement.

Global Sources considers that these provisions already provide more than sufficient comfort that competition law will allow statutory bodies to fully carry out all of their statutory functions. There is no compelling reason for an additional general exclusion regime for statutory bodies which would be completely at odds with Hong Kong's tradition of minimal intervention in the markets and with international best practice.

Global Sources' view is supported by the Guidelines on the First Conduct Rule, which describe how these exclusion regimes would operate. Under this regime, all undertakings, including statutory bodies, which are entrusted with the operation of services of general economic interest or which are otherwise mandated by law to enter into restrictive conduct, will benefit from an exclusion from the law for the purpose of performing their tasks. This exclusion regime has worked well in foreign jurisdictions. It allows companies to benefit from public subsidies. It allows small and medium enterprises to receive favourable treatment mandated by Government. It allows trade and industry associations to play a role in promoting their industry, including by offering and obtaining discounts. Thanks to this regime, all businesses, including small and medium enterprises, will continue benefiting from the advantageous policies and services provided by statutory bodies.

What this regime does not allow, however, is the creation of appreciable restrictions of competition in commercial markets by undertakings under the guise of serving the public interest. They are allowed to restrict competition when it is necessary for the performance of their statutory duties, but they are not given a blank cheque to enter into anticompetitive conduct in business activities unrelated to their public missions.

This exclusion regime keeps distortions to the free operation of markets to a minimum. It therefore defies logic and is very surprising that the Hong Kong Government would allow for broader distortions to the market economy by excluding all statutory bodies from the scope of the proposed law.

As described in the Guidelines on the First Conduct Rule, in the Hong Kong context, all statutory bodies entrusted with the operation of services of general economic interest will be allowed to perform their statutory duties unhampered by competition law, even if the Legislative Council were to amend the Bill and remove the blanket exclusion for statutory bodies. Statutory bodies such as the TDC, the Urban Renewal Authority, Ocean Park, etc. would be able to continue to perform their public interest tasks without concern, even if they did not benefit from the proposed blanket exclusion of statutory bodies. Similar bodies in foreign jurisdictions do perform their role very well without however benefiting from a large-scale exclusion from competition law. It is hard to see why their counterparts in Hong Kong would need a more favourable treatment.

2.4 Guidelines on the Second Conduct Rule

These guidelines also suffer from the defects already discussed above, the main one being their failure to address how the proposed blanket exclusion for statutory bodies would affect the enforcement of the second conduct rule.

Several issues are apparent with the proposed enforcement policy embodied in these guidelines when read together with the statutory body exclusion. The guidelines rightly focus on the establishment of market power as a first step in the analysis, but fail to address the way the analysis will be carried out in relation to markets where statutory bodies are active: would the sales achieved by statutory bodies be considered when determining a company's market share? will their activities be a relevant factor when considering the extent of barriers to entry? etc. The guidelines state that “[m]ore than one undertaking may have a substantial degree of market power in a relevant market”. Would this mean that, facing the inability to challenge conduct engaged into by a statutory body that is the largest actor on the market, the Competition Commission will focus its interest on the largest private party in the market, irrespective of its actual market position?

All of these questions remain unanswered, and show that, far from simplifying the enforcement of the second conduct rule, the statutory body exclusion will instill added complexity and cost in the enforcement of the law.

3 What Global Sources wishes the Bills Committee to do

Global Sources welcomes the initiative of your Committee to seek comments on guidelines that illustrate how the proposed legislation would be enforced in practice. A review of the practical details of the proposed enforcement mechanisms clearly shows how ill-conceived the statutory bodies exclusion is, and how at odds it is with the overall architecture of the Bill.

We are conscious that the Bill allows for a “claw-back mechanism” in its Article 5 that would allow the Government to subject part or all of the activities of specified statutory bodies to the application of the Competition Ordinance. The proposed “claw-back mechanism” for statutory bodies is however so limited that there is no guarantee that it could cure any of the flaws of the general exclusion of statutory bodies. First, the substantive criteria for clawing back any blanket exclusion are much more stringent than the general economic interest test. Second, there is no procedural guarantee whatsoever as to when and how the Chief Executive in Council may or may not use the “claw-back” power, nor is there any way for affected parties to be heard in the decision-making process or to appeal against any administrative action or inaction.

We are also concerned that while statutory bodies would on the one hand be excluded from the burdens and constraints of the law, they would not on the other hand be excluded from the application of the benefits of the law under Article 3 of the Bill. This article allows statutory bodies to complain against violations of the law committed by others and to sue private parties for damages. In other words, they will be able to enjoy all the benefits of the law without suffering from any of its constraints!

Based on the above, Global Sources wishes to reiterate the following recommendations on the way forward with the Competition Bill. Global Sources respectfully submits that changes need to be made to the Bill to ensure that:

- (a) Statutory bodies that are engaging in economic activity are *prima facie* subject to the competition law;**
- (b) If any statutory body engaging in economic activity considers there are grounds for an exemption that goes beyond the existing exclusions set out in Schedule 1 to the Bill, the onus should then be on the statutory body to make an application to the (independent) Competition Commission for an exclusion or exemption;**
- (c) Clear and economically justifiable criteria should be laid down in the law as to the basis on which such statutory bodies might be entitled to an exclusion or exemption, which should require any application to be assessed against an analysis of the impact of the exclusion or exemption on economic efficiency in a cost-benefit framework that identifies the “winners” and “losers” and whether, indeed, there are over-riding benefits that serve the consumer or broader economic interests;**
- (d) Any process for seeking such an exclusion or exemption should:**
 - (i) be transparent and open to the public;**
 - (ii) allow affected parties to be heard;**
 - (iii) be addressed by the Competition Commission;**
 - (iv) be subject to appropriate appeal rights; and**
 - (v) require the Competition Commission to consider and apply to any exclusion or exemption appropriate sunset clauses and other conditions or limitations deemed appropriate in all the circumstances.**

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We hope the Bills Committee will find these comments helpful. Should you wish to discuss any of the points raised we would be happy to accommodate the Committee.

Global Sources