Submission to Legislative Council

Bills Committee on Competition Bill

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by

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Honourable Chairman and Members,

1. Thank you for the opportunity to address the Bills Committee today. I offer the following submissions on my own behalf, having sixteen years' experience as a competition law practitioner, former regulator and occasional consultant.

2. Hong Kong has a well-earned reputation for the competitiveness of its businesses. A competition law is needed and overdue, however, to protect the competitive process against those few who seek a short-cut to wealth by collusion or abuse of monopoly power.

3. My remarks today address four points that have been raised in debate thus far:

   - *The penalties have been called 'excessive'* – A high cap is justified by the very great costs that anti-competitive abuses cause to the economy.

   - *The competition rules have been said to be 'vague'* – In practice, rules that are grounded in economic principle and expressed in terms that are familiar to the courts are sufficiently certain.

   - *It has been claimed that Competition law would disadvantage SMEs* – Competition law in practice operates to the advantage, not the detriment, of SMEs.

   - *The need for a competition law has not been quantitatively proven* – If the Competition Ordinance breaks or deters a single large cartel, the savings to the public of Hong Kong are likely to exceed the costs of running the Commission by many times.

4. It is my view that the Competition Bill currently before this Committee is a measured, modern and principled law, apt to apply in Hong Kong.

5. I submit that the Merger Rule should be of general application, though the proposal to extend it beyond telecommunications carriers only after a review on that question is pragmatic. That the Bill would give statutory

backing to a leniency regime and an infringement notice procedure is conducive to certainty and the efficient resolution of issues.

'Excessive' Penalty Ceilings

6. The proposed penalty cap of ten percent of global turnover is comparable with penalty caps under competition laws applying in jurisdictions with which Hong Kong trades.

7. In the EU, Mainland China, Australia and New Zealand, turnover-related penalty caps (of various scope) already apply. While federal antitrust law in the United States does not yet specify turnover-based penalties, "treble damages" are available to plaintiffs under the Clayton Act, with the aim of ensuring a sufficient level of deterrence.

8. High caps on fines in no way imply that fines will always be high – businesspeople should have confidence that the experienced superior court judges who will sit on the Competition Tribunal will impose penalties that are proportionate to the infringement.

9. It is entirely necessary that the Competition Tribunal be able to impose substantial penalties in cases in which those are justified. To cap fines at a fixed dollar amount would risk creating a perverse incentive for monopolists or cartel participants to hasten their anti-competitive conduct, or expand its scope, in order to achieve the 'break even point' on a possible fine before the conduct is detected.

10. The Competition Tribunal should be able to impose penalties that are sufficiently high to present a credible sanction against anti-competitive conduct and an effective deterrent. In addition to the level of the cap on penalties, policymakers might consider what specific guidance the competition law can provide to courts regarding determination of appropriate penalties (e.g. the gain to the violator, the economic losses to victims or the value of commerce affected; aggravating and mitigating factors; a multiplier to provide deterrence having regard to detection rates).

'Vague' Competition Rules

11. The draft 'competition rules' are brief but they are not vague – they derive certainty by referring to thoroughly tested and well-understood economic and legal principles. It is not necessary or desirable to add extra words to the competition rules with the aim of making them more certain.

12. On the contrary, adding more words to the rules would actually risk *reducing* the certainty of their meaning. First, wordier, more 'specific' prohibitions typically open more gaps than they close, introducing incentives for 'creative compliance' by structuring deals so as to conform to the narrow word of the law. Secondly, novel formulations of rules will cast doubt on the applicability of legal and economic tests and reasoning

that have become established elsewhere and are understood by businesspeople and their advisors.

13. For the greatest certainty, prohibitions should be formulated in terms that are familiar to businesspeople, their advisors and enforcement agencies around the world. It therefore is reassuring to observe that the competition rules in the current draft Bill use concepts that are recognized and understood in leading jurisdictions.

14. A concern has been expressed that in publishing guidelines on the law the Competition Commission would have too much of a free hand in formulating law or policy. Once again, the surrounding context of thoroughly tested and well-understood competition principles constrains the drafting of guidelines as it does the meaning of the conduct rules. If the Commission proposes any departure from orthodox methods, it is certain to face well-informed criticism and will have to convince the public and LegCo that any novel measures are required by Hong Kong circumstances.

15. Accordingly, the Commission must consult thoroughly on the content of proposed guidelines. For the information of the public, and to reassure all stakeholders that the competition rules are not 'vague,' I submit that the Government should consider publishing pre-consultation drafts of guidelines on key topics such as market definition and assessment of market power.

<u>Competition Law 'Disadvantageous' to SMEs</u>

16. In sixteen years' involvement with competition law, including on the staff of the New Zealand Commerce Commission, I do not recall any case in which a large enterprise brought competition law proceedings against a SME.

17. Enforcement activity against an SME by a competition agency (as opposed to a large enterprise) is also unusual. In the first place, SMEs simply do not possess the substantial degree of market power that is a prerequisite of an abuse of market power finding (e.g. for the second conduct rule). Those cases in which SMEs have incurred penalties have typically involved collusive anti-competitive conduct that is difficult to countenance (e.g. price-fixing by medical practitioners, driving up the cost of treatment for their patients).

18. In many more cases, SMEs *benefit* from competition law. SMEs frequently are the victims of anti-competitive conduct: e.g. when their customer or supplier is a cartel or an anti-competitive monopoly; or when a cartel or an anti-competitive monopoly takes steps to exclude them from a market. As a result, a large proportion of the cases that competition agencies handle arise in intermediate or business-to-business markets.

19. That some Hong Kong SMEs (and certainly not all of them) express anxiety about the Competition Bill perhaps reflects unease that some of them might feel about arrangements in which they currently participate. The new Competition Commission should assist SMEs to ensure that any arrangements in which they are involved are pro-competitive. It is appropriate that the Bill would impose on the Commission duties to "promote public understanding" and promote adoption of appropriate internal controls by businesses.

'Unproven' Benefits of Competition Law

20. The anti-competitive conduct that routinely is stopped by competition agencies around the world is extremely costly to consumers and business customers. For example, the OECD's 2002 *Report on the Nature and Effect of Cartels* estimated that cartels overcharge their customers by 15 to 20 percent. A study of over 200 economic analyses of cartels estimated domestic cartel overcharges to average 17-19 percent and international cartel overcharges 30-33 percent (Connor JM and Bolotova Y "Cartel Overcharges: Study and Meta-analysis" Perdue University 2 October 2005). The forty international cartels successfully prosecuted by the US or EC in the 1990s affected markets having annual sales worth more than USD30 billion (Veljanovski C "Cartel Fines in Europe" *World Competition* 30(1) 65-86, 2007).

21. Moreover, the very existence of a credible competition agency itself has a positive influence on the market, even when the agency is not actively investigating and prosecuting cases, so long as businesses believe that it is ready to do so. This is because having laws against monopolistic abuses, expert staff standing ready to prosecute cases and substantial penalties available where violations are proved *deters businesses from engaging* in anti-competitive behaviour.

22. It will be apparent that deterrence is highly cost-effective – the desired outcome of markets operating competitively is achieved without the public and private costs associated with enforcement proceedings. The Commission should be expected to explain its reasoning for decisions explicitly, which assists in deterring anti-competitive conduct, and to adhere to economic principles, to avoid over-deterrence.

23. Deterrence effects are difficult to observe or measure but, it is certain, do not arise at all unless the relevant laws are in force and the agency has the resources to do its work.

24. Some commentators have likened competition law to regulation, as another 'burden' on businesses. In fact, competition law is quite unlike regulation. Whereas regulation is appropriate where markets are failing, competition law is premised on the view that most markets work well most of the time. As Prof. Paul Geroski (former Chairman of the UK Competition Commission) has pointed out, competition policy "is designed to yield large payoffs from minimal resources" as it "only swings

into operation when serious, egregious problems are believed to exist" (Geroski PA "Is Competition Policy Worth It?" (September 2004).

Concluding Remarks

25. The benefits of competition law for consumers have rightly been stressed in debate so far. I wish to conclude today by emphasizing that competition law, properly administered, is beneficial to businesses – particularly SMEs. Competition law can be expected to enhance Hong Kong's competitive reputation and preserve the vigour of competition in its markets by deterring foreclosure of markets, ensuring reliable price signals, and maintaining opportunities for efficient entry and innovation.

26. I thank the Bills Committee for the opportunity to make these submissions.

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