For discussion

Bills Committee on
Competition Bill

Responses to Follow-up Questions
Arising From the Meeting on 9 November 2010

Purpose

This paper responds to the questions raised by Members at the meeting on 9 November 2010.

Draft regulatory guidelines

2. We appreciate Members' concern about legal certainty, especially on how the conduct rules will be interpreted and implemented under our proposed general prohibition approach. To facilitate Members' scrutiny of the Competition Bill (the Bill), we will make a separate submission specifically on the guidelines when we start the clause-by-clause scrutiny of the major prohibitions of the Bill, with a view to explaining some key concepts pertinent to the application of the conduct rules (such as market definition and market power) and providing more examples of anti-competitive conduct which will likely be targeted by a competition law.

Relevant turnover for the calculation of pecuniary penalty

(a) Policy intention

3. The objective of the Bill is to prohibit and deter undertakings in all sectors from adopting abusive or other anti-competitive practices which have the object or effect of preventing, restricting or distorting competition in Hong Kong. To ensure that the future cross-sector

competition law will be able to effectively combat all types of anti-competitive conduct and deter infringing undertakings from engaging in any prohibited conduct, it is imperative to provide for adequate sanctions under the Bill to cater for infringements of varying seriousness and gravity. To this end, Part 6 of the Bill empowers the Competition Tribunal (the Tribunal) to apply a full range of remedies for contravention of a competition rule. These remedies, as set out in Part 6, Schedules 3 and 4, are in line with those adopted in comparable overseas competition jurisdictions. That said, small and medium enterprises (SMEs) would not be the target of enforcement of the future Competition Commission (the Commission) as reflected in major overseas competition jurisdiction. (also see paragraphs 15 and 16)

4. The Bill has expressly empowered the Tribunal to impose pecuniary penalty up to 10% of global turnover of the undertaking concerned. This level is a legal maximum. The Tribunal has full power to determine an appropriate amount of the pecuniary penalty having regard but not limiting to factors outlined in clause 91(2) of the Bill, including (i) the nature and extent of the anti-competitive conduct in question; (ii) the loss or damage caused by the conduct; (iii) the circumstances in which the conduct took place; and (iv) whether the undertaking had prior contravention. This is indeed, an improvement, which we have intentionally introduced in the Bill, as compared with some overseas jurisdictions, to strengthen the certainty and clarity of the pecuniary penalty. These factors are also consistent with considerations taken by overseas jurisdiction when determining the pecuniary penalty (also see paragraphs 5 to 7).

(b) Overseas examples

5. In so far as pecuniary penalty is concerned, our proposed 10% global turnover cap is consistent with the approach taken by the European Commission (EC) and the United Kingdom (UK)[(1)]. Compared to

(1) Pursuant to Article 23(2)(a) of Council Regulation (EC) No 1/2003, the EC may, by decision, impose fines on undertakings and associations of undertakings where, either intentionally or negligently, they infringe Article 81 or 82 of the Treaty. For each undertaking and association of undertakings participating in the infringement, the fine shall not exceed 10% of its total turnover in the preceding business year. Where the infringement of an association relates to the activities of its members, the fine shall not exceed 10% of the sum of the total turnover of each member active on the market affected by the infringement of the association.

Singapore's approach which links the maximum pecuniary penalty to the infringing undertaking's local turnover only, our proposed cap can better cope with the prevailing trend of globalized business operation and safeguard against possible manipulations through corporate structuring or accounting methods such as in the booking of turnover.

6. Many overseas competition jurisdictions have supplemented the provisions of their competition law on pecuniary penalty by regulatory guidelines in respect of the considerations taken for determining the appropriate amount of penalty. For instance, the EC published in 2006 its new guidelines on the method of setting fines to provide a more scientific and transparent method of calculating the amount of the fine for competition law infringements. In gist, the new method for calculating fines starts with the derivation of a 'basic amount' of the fine, which is then subject to appropriate upward and/or downward adjustments. The 'basic amount' will be ascertained with reference to –

(i) the value of firm's sales of goods or services to which the infringement directly or indirectly relates in the relevant geographic area during the last full business year;
(ii) the gravity and duration of the infringement; and
(iii) whether the firm has engaged in horizontal price-fixing, market-sharing and output-limitation agreements.

7. The basic amount can be adjusted upward and downward adjustments having regard to -

(i) the relevant aggravating circumstances (such as refusal to co-operate during investigation and repeated infringements);
(ii) mitigating circumstances (such as terminating the infringement as soon as the EC intervenes and limited involvement in the infringement)

As for the UK, section 36(8) of the Competition Act 1998 stipulates that no penalty fixed by the Office of Fair Trading (OFT) under this section may exceed 10% of the turnover of the undertaking (determined in accordance with such provisions as may be specified in an order made by the Secretary of State). The Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (Statutory Instruments 2004 No. 1259) amended the corresponding Order made in 2000 by stipulating that the applicable turnover would be worldwide turnover instead of turnover in the UK only.

8. In addition to the above considerations, we also note from our research on the EC approach that the pecuniary penalty can be further adjusted under the following circumstances –

(i) In the case of larger firms with particularly large turnover beyond the sales of the goods or services to which the infringement relates, the EC may increase the fine to ensure it has a sufficient deterrent effect.

(ii) The EC may also take into account the need to increase the fine in order to exceed the amount of gains improperly made as a result of the infringement.

(iii) The EC may consider the undertaking's inability to pay on the basis of objective evidence that the imposition of a fine would irretrievably jeopardise the economic viability of the firm concerned and cause its assets to lose all their value.

(iv) The EC will reduce the fine derived by the new method if it exceeds the legal maximum, i.e. 10% of the undertaking's total worldwide turnover in the preceding business year.

9. The following two cases from the EC are overseas case law examples on the imposition of pecuniary penalty -

(i) In May 2009, the EC imposed a fine of 1.06 billion euros on Intel for abuse of dominant position through two specific forms of illegal practices throughout the period October 2002 – December 2007. First, Intel gave wholly or partially hidden rebates to computer manufacturers on condition that they bought all, or almost all, their x86 central processing units (CPUs) from Intel. Intel also made direct payments to a major retailer on condition that it stocked only computers with Intel x86 CPUs. Second, Intel made direct payments to computer manufacturers to halt or delay the launch of specific products containing a competitor's x86 CPUs and to limit the sales channels available to these products. The fine, representing 4.15% of Intel's turnover in 2008, had been calculated on the basis of the value of Intel's x86 CPU sales in the European Economic Area (EEA), the duration (five years and three

months) and gravity of the infringement.

(ii) In November 2010, the EC fined 11 air cargo carriers a total of 799 million euros for operating a worldwide cartel coordinating their action on surcharges for fuel and security without discounts over a six year period, which affected cargo services within the EEA. In setting the level of the fines, the EC took into account the sales of the companies involved in the market concerned, the very serious nature of the infringement, the EEA-wide scope of the cartel and its duration. All carriers were granted a 50% reduction on sales between the EEA and third countries in order to take into account the fact that on these routes part of the harm of the cartel fell outside the EEA. The EC increased the fine for one carrier by 50% for its previous involvement in a cartel in the airline sector. All carriers received a reduction of 15% on account of the general regulatory environment in the sector which can be seen as encouraging price coordination. Four carriers were also granted a 10% reduction for limited participation in the infringement. As the fines on two companies would have exceeded the legal maximum of 10% of their 2009 turnover, the amount (before possible leniency considerations) was reduced to this level.

10. As the regime adopted in the Competition Bill is very similar to the EC, the Commission and the Tribunal will no doubt adopt more or less the same parameters in their application for and determination on a pecuniary penalty respectively. Having regard to overseas approach to the determination of pecuniary penalty and relevant case law as well as the improvements which we have introduced to the Competition Bill in respect of pecuniary penalty, we consider it appropriate not to confine the scope for calculation of pecuniary penalty to the type of business activity relating to the contravention in question or to local turnover, as this may undermine the future Tribunal's flexibility to impose an appropriate amount of pecuniary that has a sufficient deterrent effect, especially in the case of serious and prolonged contravention of a competition rule.

11. As to whether the turnover of the subsidiary concerned, instead of the turnover of the parent company, would be taken into account in the

calculation of pecuniary penalty, we consider that it should be determined on a case-by-case basis, having regard to the extent of involvement of the parent company in the anti-competitive conduct in question. The key consideration is whether the parent company has sufficient control over its subsidiaries such that the subsidiaries have no real autonomy in its action. Should we take into account the turnover of the subsidiary concerned only, a company could circumvent the rule of pecuniary penalty and avoid being held responsible for its anti-competitive conduct by using a subsidiary company with no substantial turnover.

Issues and concerns relating to SMEs

(a) Assessment on substantial degree of market power

12. On Members' suggestion to state in the Bill the relevant matters to be taken into account in considering whether an undertaking has a substantial degree of market power, the assessment of market power involves, above all, the derivation of a market definition on which the market share of the undertaking concerned is compiled. Other factors, including but not limited to the market shares of competitors, the ease of entry into the market, the bargaining power of the buyers etc. are also relevant and have to be taken into account in the assessment. Whilst there may be merits of stipulating a non-exhaustive list of these factors in the Bill for the sake of legal clarity, such formulation may expose the future Commission to more judicial reviews given the complexity of the competition cases. We consider it more appropriate and prudent to cover the considerations in the assessment in the regulatory guidelines to be drawn up by the future Commission. Indeed, our approach is similar to that adopted by the United Kingdom (UK) Competition Act from which we have drawn majority of our reference in drafting the Bill. Moreover, the Commission will be required by law to go through a consultation process when preparing the guidelines.

(b) Chinese text of Clause 21(1) of the Bill

13. As for the suggestion to amend the Chinese text of clause 21(1) of the Bill from "在市場中具有相當程度的市場權勢的業務實體" to

"具有足以影響市場的權勢的業務實體", if adopted, the corresponding English text would have to be amended accordingly from "an undertaking that has a substantial degree of market power in a market" to, say "an undertaking that has the sufficient power to affect a market". Whilst we understand that the primary objective of the suggested amendment is to allay the concerns of SMEs, the change will nevertheless alter the language of the second conduct rule and make it deviate from the corresponding provisions concerning prohibition on abuse of market power adopted in other major overseas competition jurisdictions. This would hinder the future competition authorities to make reference to the plenty of case laws available in comparable competition regimes, which is particularly crucial during the early phase of operation of the new law amidst the lack of local precedents. Thus, we are inclined to keep the present language, and we consider that the Commission's guidelines are a more appropriate platform for a detailed interpretation of the relevant clause.

(c) Number of complaints received by the Competition Policy Advisory Group involving SMEs

14. As at November 2010 the Competition Policy Advisory Committee (COMPAG) looked into 118 complaints of practices and conducts that give rise to competition concerns. Without a supporting legal framework, COMPAG being an advisory, non-statutory body does not possess any enforcement powers that allow for a full investigation or market studies. Collection of information such as headcounts, turnover or market share for the purpose of classifying subject companies is difficult. Hence, we have no statistics on the number of COMPAG complaints against SMEs vis-à-vis the total of cases handled.

(d) Comments on matters relating to SMEs in respect of competition policies in selected jurisdictions

15. Our key observations on the Annex concerning competition policies in respect of SMEs in selected jurisdictions (European Union, United Kingdom, United States and Singapore) are set out as follows –

(a) There are no exemptions specifically for 'SMEs' from the respective

competition legislation. In most cases, the total market share of SME parties to an agreement is not likely to be significant enough to create an appreciable adverse effect on competition in a market. Thus, regulation of SME conduct is seldom a priority of competition authorities, save for some hard-core anti-competitive conduct such as price-fixing, bid-rigging, market sharing and limiting production.

(b) The "de minimis" approach, i.e. the enforcement authorities will not pursue a case where the aggregate market share or combined annual turnover of the undertakings involved does not exceed a certain level, is commonly set out in the guidelines or regulations rather than in the principal competition legislation. These guidelines and regulations are usually issued or made by the enforcement authority after enactment of the competition law. In fact, this is also the approach we intend to adopt under the proposed competition regime.

(c) OECD has stated that small businesses often support the competition law because they benefit from having an opportunity to enter the market and fairness among participants in the market. In the European Union (EU), there are seldom any reports about concerns of SMEs being accused of engaging in anti-competitive conduct. Similarly, there are rarely any cases accusing SMEs of violating the competition law in the UK.

(d) The competition authorities are usually responsible for conducting educational programmes to help SMEs avoid anti-competitive practices to facilitate their compliance with the respective competition laws. This is also one of the statutory functions which we have proposed for the Commission and will be one of its major focuses during the transitional period before commencement of the competition rule.

16. Taking into account the above overseas experience, we consider that the approach of deferring to the future Commission to set out the details of any "de minimis" arrangements in the regulatory guidelines during the transitional period should largely meet SMEs' wish to have a clearer understanding on the "de minimis" approach before the competition rule comes into effect,. This approach would also provide

sufficient flexibility for the Commission to devise a "de minimis" approach that best fits Hong Kong's actual needs and to cater for variations in different sectors or changes in market circumstances over time.

Other issues

(a) 'Consumer protection' as an object of the Bill

17. The objective of introducing a cross-sector competition law is to combat anti-competitive conduct in all sectors to enhance the free flow of trade and to provide a level-playing field for businesses to compete amongst themselves in a fair and healthy manner. Such an environment will in turn foster innovation and emergence of quality products and services, thereby ultimately benefiting consumers through the availability of more value-for-money choices. In other words, enhancing consumer welfare is undoubtedly among the intended outcomes of our proposed competition law and is consistent with the purpose of the legislation mentioned in the 2008 public consultation document, i.e. to enhance economic efficiency and thus the benefit of consumers through promoting sustainable competition. One of the purposes of the Bill is to preserve competition for the benefit of consumers. Consumer protection comprises a much broader range of issues and measures, many of which do not fall under the coverage of the Bill. Moreover, we consider it not appropriate to mention consumer protection in the preamble of the Bill. It is also worth noting that the phrase "allowing consumers a fair share of the resulting benefit", which appear in Article 101(3) of the Treaty on the Functioning of the European Union and section 9 of the UK Competition Act, is concerned about the criteria for applying individual and block exemptions for specific agreement or category of agreement on economic benefit grounds, instead of relating to the objectives of their respective competition law.

(b) Statistics on multinational corporations

18. The Administration does not collate any statistics on the number of multinational corporations (MNCs) in Hong Kong, nor the business

reach of MNCs by product or service sectors.

Advice sought

19. Members are invited to note the contents of the paper.

Commerce and Economic Development Bureau
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