Responses to Objections to the Hong Kong Competition Bill

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Since the Competition Bill was introduced to Hong Kong's Legislative Council in July 2010, a number of objections have been expressed against the Bill or particular features of it. In this open letter, we summarise twelve of the principle objections and comment on them, in the light of international experience.

Objection one: 'Hong Kong is very competitive and does not need a competition law'

The view that Hong Kong is competitive and so does not need a competition law is misconceived. While Hong Kong's exporters and some sectors of Hong Kong's domestic economy are highly competitive, a number of domestic markets in Hong Kong display single firm dominance or a high degree of market concentration. Examples include the supply of piped gas, electricity, supply of fuel oil, supermarkets and the supply of new private sector residential housing. Market concentration is not necessarily bad in itself but in more concentrated markets there is always a greater risk that anti-competitive conduct might occur. Most anti-competitive activity is engaged in secretly and, as the government currently has no power to investigate suspected anti-competitive practices, evidence is difficult to obtain. Overseas experience clearly shows, however, that small economies are particularly prone to high market concentration and that cartels are more likely to operate in markets that have few suppliers: monitoring and enforcing their cartel agreements is easier in concentrated markets than in markets having numerous participants.

International cartels often target jurisdictions that have no competition legislation. This means that Hong Kong businesses and consumers may well be paying higher prices for products due to anti-competitive agreements made by multi-national companies (MNCs) that target Hong Kong markets. Evidence for this phenomenon was noted during the WTO discussions concerning the interrelationship between trade and competition. (See Background Note WTO Secretariat on Provisions on Hardcore Cartels, 20 June 2002, WT/WGTCP/W/191, at paragraph 8.)

Small jurisdictions can take advantage of the uncovering of global cartels by major jurisdictions such as the USA, the EU and Japan to take local enforcement proceedings to bring pro-competitive benefits to their consumers and SMEs who are victimized by international cartels. This would be another benefit of enacting a Hong Kong competition law.

Lastly, foreign competition regimes also generally target the uncompetitive parts of their domestic economies, as this is where a competition law can bring the greatest benefits to consumers and SMEs. A Hong Kong competition law would bring similar benefits to local consumers and SMEs.

Objection two: 'Competition laws are weapons of trade wars that protect domestic industries'

Governments can use laws to protect domestic industries from competition, e.g. by use of external barriers to trade such as tariffs, quotas and 'standards' rules that inhibit imports and favour local firms. Other internal measures to protect domestic producers include an industrial policy that promotes statutory monopolies, administratively-inspired mergers, government backed credits, licensing and regulatory systems that suppress competition in an industry and exclude foreign participation.

While governments potentially can abuse or misapply their laws for undesirable ends, we are aware of no case internationally in which competition laws have been used in this way. Any law can be misapplied for ulterior motives if the government is mendacious or incompetent. This is not an argument against competition law *per se*: rather, it is a call for proper application and enforcement of the law.

Objection three: 'Enacting a competition law will undermine the competitiveness of Hong Kong industries'

This objection is without foundation. Hong Kong companies active in international markets are highly competitive and must already comply with competition laws in over 100 countries and territories that have competition law. The suggestion that a competition law would undermine the international competitiveness of Hong Kong industries is illogical. The Hong Kong Competition Bill is designed to enhance competitiveness, not diminish it, primarily in the domestic economy, so bringing the benefits of greater competition to markets within Hong Kong where anti-competitive practices undermine the competitive process.

Professor Michael Porter, the renowned business scholar from Harvard Business School, comes to this conclusion in his book *The Competitive Advantage of Nations*. He expressed the view that an appropriate competition law strengthens domestic firms through competition and so prepares them better than cozy cartel arrangements to meet external competitors.

Lastly, in an open economy such as Hong Kong's, ensuring that domestic businesses can take advantage of the keenest input prices is essential and a competition law helps price competition by preventing anti-competitive restrictions that raise input prices in the domestic economy.

Objection four: 'It is inappropriate to use the EU model as the basis for the Hong Kong competition law as the EU and Hong Kong are very different jurisdictions in terms of size, nature of the economy and business culture'

The Hong Kong Competition Bill is not based exclusively on the EU legislative model. The current Bill prohibits two principal kinds of misconduct – abuse of substantial market power and anti-competitive agreements. It does not adopt an abuse of dominance test, the EU standard, but rather a variation based on Hong Kong's market structure and conditions. The prohibition of anti-competitive agreements is common globally, though there are variations as regards whether only horizontal agreements (price-fixing, bid-rigging, or market allocation) or some types of vertical agreements (distribution agreements, resale price maintenance) are caught.

The two conduct prohibitions are not exclusive to the EU system but generally accepted as the core anti-trust provisions essential to any well-functioning competition law. Both large and small economies prohibit these behaviours, as they are universally seen as inimical to the effective functioning of the competitive process. Further, the institutional arrangements contained in the Hong Kong Bill do not mirror the EU enforcement system. They are more like those found in common law jurisdictions such as the USA, Australia and Ireland.

Thus, neither the legal rules nor the enforcement machinery of the Hong Kong Bill should be categorized as a copy of the EU competition regime. It should be noted, additionally, that each of the EU member states (currently 27) has voluntarily adopted national legislation to substantially mirror the EU provisions in their national laws. Many small nations, such as Malta, Slovenia, Latvia, Lithuania and Estonia, have adopted systems similar to the EU model, without ill effect. It should also be noted that the primary prohibitions and structure of the Hong Kong Bill is similar (but not identical) to the Singapore Competition Act, another jurisdiction that has a relatively small domestic economy. The germane issue is whether Hong Kong wishes to tackle abuses of market power by single firms that exercise power in their markets and the collective subversion of free and open competition by use of cartels. The Hong Kong law appropriately addresses both issues.

Objection five: 'The Hong Kong law is too ambitious and too extensive'

The Competition Bill is, on the contrary, modest in its reach. First, the two conduct rules are not broader in ambit than the principle conduct restrictions in any established competition law.

Secondly, Hong Kong's Bill includes no merger control regime except in relation to the telecommunications sector, which represents a reform of the existing merger regime for carriers. The lack of a comprehensive merger control system is, in fact, very unusual internationally. Consequently, the proposed Hong Kong law is not overbroad and indeed the fact that mergers are not included makes the Bill unusually narrow by international standards.

Objection six: 'The Bill should only prohibit specifically defined conduct; the Bill is unclear and ambiguous'

The Bill prohibits two types of conduct -- anti-competitive agreements and abuse by an undertaking of substantial market power. These provisions are entirely congruent with competition regimes in overseas jurisdictions including the Mainland and Singapore. They have proved flexible and suitable to all types of economy, both large and small and are tailored to deal with the multiple ways in which the process of competition can be subverted. If a limited list of specific types of conduct were strictly defined and identified as unlawful, skillful lawyers and their clients would merely devise a change in the form (but not the substance) of the activity so that it fell outside the prohibition, while the substantive harm to competition would remain and not be addressed. This type of 'form-based' prohibition was tried in many jurisdictions in the past, for example UK and India, but was found to be ineffective. Modern competition laws generally use similar formulations to those found in the Hong Kong Bill, so that they can address the actual economic harm caused by anti-competitive practices and not merely provide a rigid legal formula that can easily be avoided.

As the Bill attempts to uphold the process of competition, attempting to set out in primary legislation all the instances and particular circumstances in which the law would apply is impractical and impossible. No competition law anywhere in the world attempts to do this. Specifying in finer detail the factual situations in which the law would apply is invariably left to the competition agency, which will be composed of experts who can draw on experience in other comparable jurisdictions and provide specific guidance and clarity to industry and consumers as to when and how the specific provisions of the law will apply. Dealing with economic activity, which is constantly evolving, requires flexibility within a sound legal operating framework. Erroneous decisions by the competition agency can be corrected by the Tribunal or the appellate courts. Every competition agency provides detailed guidance to the public and so business should not be overly concerned by this approach. In this way, competition law can be both flexible and responsive to changing circumstances and error can always be corrected by the courts, if the agency mistakenly interprets the law.

Objection seven: 'The Bill should only target large businesses that abuse monopoly power or operate cartels and small businesses should be exempt'

The purpose of a competition law is to protect the process of competition -- because the competitive process drives firms to attract customers by offering better products and services at lower prices. Successful firms benefit by increasing sales and profits, weaker firms exit the market, unless they can learn to compete with better products or services or keener prices. This principle applies irrespective of the size of the firms concerned as the benefits to successful firms, consumers (whether other businesses or private individuals) and the overall efficiency of the economy is the same. Thus the law should apply equally to all firms.

Small firms have little to worry about from a competition law and often a lot to gain from it. Firstly, small firms (by definition) rarely have market power, other than in very narrow, specialized markets which are extremely rare. Usually a small firm cannot exercise market power by the very reason of its smallness. Small firms in most markets compete with other small firms or with larger ones. Since a small firm does not have substantial market power, it cannot abuse it and therefore the abuse of market power law does not apply to it.

Where small firms collectively agree to rig-bids, fix prices or allocate markets, however, the law should apply because this conduct is the most blatant and harmful type of anti-competitive behavior, harms consumers by increasing prices, and benefits no-one except the colluding firms.

Some jurisdictions do exempt some types of anti-competitive agreements between small firms which collectively have very low market share (say, less than 10%) but even in these jurisdictions hard-core agreements such as price-fixing and bid-rigging are not exempted.

Where a competition agency discovers a restrictive agreement between two small firms that have a minimal market share, the agency would be very unlikely to prosecute such a case, as its economic impact on the market would be negligible. Such a case would normally be dealt with by the issuance of a warning. The Hong Kong Competition Commission would deal with such cases in guidance to be issued after the Bill is approved. Examples of such guidance/regulations can be found in the European Commission *Notice on agreements of Minor Importance* and the UK *OFTs Guidance on Agreements and Concerted Practices* (2004) p.8.

Objection eight: 'The high cost of compliance with a competition law will deter foreign companies from operating in Hong Kong and increase the burden on the SME sector'

Competition law now applies in over 100 countries and territories including all major developed economies worldwide, such as the USA, Canada, the EU and its 27 member states, and in this region in the PRC, South Korea, Japan, Taiwan, Vietnam, Singapore, Thailand, Malaysia and Indonesia. Multi-national companies (MNCs) have to deal with competition law in all these jurisdictions. The incremental compliance costs to MNCs of complying with a Hong Kong competition law will be very small. There is absolutely no evidence that enactment of a Hong Kong competition law will in any way affect MNCs' decisions to do business or locate their regional HQs in Hong Kong.

As regards domestic SME's, as stated above, a competition law will seldom apply in the absence of hard-core anti competitive activities such as price fixing or bid rigging. SMEs globally usually welcome a competition law as it provides the possibility of greater market access in sectors that might otherwise be foreclosed to them.

Further, the lack of competition law is sometimes considered as a trade barrier and may deter MNCs from entering a local market. In the 1990s, the EU made this argument and advocated the inclusion of competition law in the WTO regime.

Objection nine: 'The proposed penalties are too high'

The enforcement regime in the Bill provides two main methods to ensure compliance with the law. In the first instance, the Commission can issue an "infringement notice" to a firm it believes has broken the conduct rules. If the firm accepts the complaint and that it has broken the law, it can prevent further action being taken by accepting the notice. The firm must comply with stipulations in the notice, end the offending conduct, promise not to repeat it and pay the sum of money specified (to a maximum of HK$10 million) to the government. The amount of the sum paid would be determined by the Commission, based on the gravity of the infringement. In this type of enforcement, no further action would be taken before the Tribunal. It would be highly likely that, unless the infringement was especially grave or a repeat offence, SMEs who broke the conduct rule on restrictive agreements would be dealt with in this way.

The Bill does provide that if the Commission considers that the breach of the law is serious and that the Infringement Notice procedure would not adequately deter or punish the breach of the law, it can take the matter to the Competition Tribunal, which is headed by a High Court judge. Only the Tribunal can impose penalties on an unwilling party.

The maximum financial penalty that can be imposed is 10% of global turnover. The high maximum penalty is required to adequately deter large companies who engage in serious breaches of the law and damage the interests of Hong Kong consumers -- including SMEs -- who inevitably suffer when serious breaches of the law are committed by large companies. For example, Hong Kong SMEs probably suffered damage from the international air cargo cartel operated by various airlines, when those SMEs used air freight services. The high penalty ceiling is designed to deter big business from committing egregious breaches of the law that cause significant economic harm to Hong Kong businesses and consumers.

Reducing the maximum penalty would reduce deterrence, as big firms may gamble that the prohibited conduct generates a higher profit than the fine imposed. Reducing the maximum fine will also render the leniency process (whereby the first member of a cartel who provides information to the authorities may escape punishment) less effective by reducing the economic incentive to expose the cartel.

Capping the fine in terms of the line of business that was affected would not be a sensible way to proceed, would greatly reduce the deterrent effect, and other jurisdictions do not adopt such a system.

Objection ten: 'Stand-alone private rights of action will create excessive litigation and compliance costs'

It is most unlikely that large volumes of private litigation will result in Hong Kong from the passage of the Bill. Private rights of action in most other jurisdiction have not led to high private litigation rates. The USA does have more private suits but that is a result of particular features of the American court system – jury trials of civil claims; statutory trebled damages; extensive discovery procedures; class action law suits; a rule that each side pays its own costs but in antitrust suits a winning plaintiff can recover legal costs in addition to high damages and finally that lawyers accept cases on a contingency fee ('no-win, no-fee') basis. All of these factors favour high levels of plaintiff litigation in the USA. But these features are specific to the USA. None of them apply in Hong Kong. Also the Bill provides that the Commission can intervene in private cases it thinks have no merit and the Tribunal has power to strike out unmeritorious claims. Consequently, it is most unlikely that the Bill will lead to high levels of litigation in Hong Kong.

Objection eleven: 'Competition law is incompatible with rights of intellectual property ownership'

This is a false argument. Both intellectual property rights (IPRs) and competition law have the same objective – fostering efficient use of resources and encouraging innovation by providing economic incentives to succeed in the competitive race. IPRs reward inventors who secure a patent with the exclusive right to exploit the invention for a limited period. Copyright and trade mark law provide similar exclusivity to encourage creativity and investment in brands. Protecting and rewarding innovation is vital in any modern economy to provide the economic incentive to bring new products to the market and to invest in existing products. Everyone is free to invest in their own product and whilst one has exclusivity in ones' own product, competitors have the freedom to invent competing products and to develop their own brands. IPRs actually foster competition in the market and provide the economic incentive to invest in research and development and the development of one's own branded products.

Competition law protects the competitive process. There is no incompatibility between promoting the creation of IPRs and the exercise of those exclusive rights within the terms of the relevant law that creates those rights.

The exercise of those IPRs can, on occasion, be abused to the detriment of the competitive process where, for example, the patent holder attempts to exclude competing products by use of its market power. In such circumstances, the illegitimate exercise of market power could breach the law. But cases such as this are rare.

Objection twelve: 'Statutory bodies should be dealt with on the same basis as private firms under the competition law'

We consider that statutory bodies that participate in markets should, in principle, be included in the purview of the competition law, so that government businesses and private businesses are treated equally under the law and to ensure that deliberate or unintentional acts by such government businesses do not undermine competitive markets.

If there is an overriding issue of public policy that is considered more important than the process of competition in a particular case, then the Competition Commission should be the body to adjudicate on this issue, or it should be consulted by government to assess the impact of an exemption, if the government itself is the decision maker. Excluding all statutory bodies or including some bodies but excluding others without a fair and transparent process undermines the credibility of the competition law as a whole.

The Government and the Legislative Council should reconsider how the issue of statutory bodies should be dealt with under the Bill, bearing in mind the factors outlined above.

It should be noted that even in Singapore, where statutory bodies are exempted entirely, the policy making process is addressed by guidelines issued by the Singapore Competition Commission. Further, the first case finding an abuse of dominance concerned a 'government linked company' -- SISTIC, a ticketing services provider that is wholly owned by government entities. SISTIC was recently found to have breached competition law by abusing its dominant market position by adopting exclusive ticket agreements with various venues in Singapore. This conduct foreclosed the market and damaged competition. SISTIC was fined SGD989,000 (HKD5.97 million) and required to modify its contractual arrangements to remove the obligation of exclusivity. In such a case we see an economically principled decision, beneficial to consumers and binding on a government-linked business. Hong Kong consumers deserve no less.

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