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A.S. Watson Group

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Chairman of the Bills Committee
Legislative Council
Legislative Council Building
8 Jackson Road
Central, Hong Kong

By Fax (Fax no. 2978 7569) and
By email: hysiu@legco.gov.hk

Dear Sirs,

Submission to Bills Committee on Competition Bill

We thank you for this opportunity to present our views on the Competition Bill ("the Bill") to the Bills Committee.

The A.S. Watson Group ("ASW") has many years of experience of operating retail businesses in other jurisdictions with established competition laws, particularly in the EU where we operate in 19 countries and throughout Asia. Since the Competition Bill appears to be largely based on the EU model – particularly the 'Conduct Rules' – we hope that our comments below will assist the Bills Committee in examining the Bill.

Executive Summary

- The key concepts, such as 'preventing, restricting and distorting competition', 'substantial market power' and 'abuse' are not defined in the Bill. Lack of legal certainty leaves the burden on businesses to carry out complicated economic evaluations requiring specialist advice from lawyers and /or economists.
- The Bill should instead focus on specific, clearly defined types of conduct which substantially lessen competition to the detriment of consumer welfare.
- The detailed prohibitions should be set out in the Bill not left to the future Competition Commission to determine.
- The penalty cap in the Bill is disproportionate to other competition regimes around the world. It should be limited to 10% of Hong Kong turnover in the products or services concerned and should be linked to a restricted period –say previous 1 year's turnover.
- It is premature to include private enforcement rights at the outset of the new law. If private actions are to be permitted, they should be limited to "follow-on" actions, based on proven anti-competitive conduct, not "stand-alone" actions.
- Proper safeguards are required to protect against unmeritorious and vexatious claims, leading to excessive burdens on businesses, the competition authorities and the courts.

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1. The Need for Clarity

Clarity has always been a major problem in EU competition law. The European Commission itself has recognized that EU law is overly broad and that the law should focus on the effect of the agreement / practice on the market and consumers, rather than whether either party's commercial freedom in the market is in some way restricted. The important factor should be whether the agreement/practice substantially lessens the intensity of competition in the market to the extent that it adversely affects consumers. This is more akin to the notion of 'substantially lessen' competition which is used in Australia and Canada (for example).

The risk in using the EU model in Hong Kong is that the Government would effectively be adopting a system which is outdated, even by the EU Commission's own standards, and effectively 'importing' the uncertainties from EU law, which may actually have the opposite effect of stifling competition rather than encouraging it.

A few examples of the current sources of uncertainty in EU law will further help to illustrate this:

(a) 'Prevent, Restrict or Distort Competition'

This is the fundamental basis of the Conduct Rules in the Bill and is identical to the terminology under EU competition law. However, the term 'prevent, restrict or distort competition' is not defined in the Bill, perhaps because the Government believes that Hong Kong businesses could be guided by the EU case law. Unfortunately, however, the EU case law in this respect is extremely unclear, and also deals with a very different economy to that found in Hong Kong, including decisions intended to address EU-specific issues (such as the creation of a single European market) that either do not exist or require very different solutions in a Hong Kong context.

That said, the cases do appear to suggest that any restriction on the commercial freedom of a business in the market place is, in principle, a restriction of competition.

This is a major concern, since many, if not most, commercial arrangements restrict the commercial freedom of the parties in some respect. For example, a clause appointing an exclusive distributor, which is very common in Hong Kong, may be regarded as a restriction of competition because it prevents the supplier from appointing another distributor in the same territory, and prevents the possibility of other distributors in the same territory from competing with each other.

The effect of the Bill in its current form would therefore be that most contractual arrangements would be prohibited, unless the parties could demonstrate (under Schedule 1 paragraph 1 of the Bill) that the agreement produced economic efficiencies which offset the effects of the restriction, an exercise which EU experience shows is a largely an arbitrary and subjective one.

We think it would be unfortunate if the Government were to introduce similar difficulties into Hong Kong by using this concept in the Bill. It could in fact have the effect of stifling rather than enhancing Hong Kong's competitiveness. The uncertainties outlined above, combined with the severe potential sanctions for breaching the law, could deter businesses from entering into arrangements which may be efficient and bring consumer benefits. At the very least it would significantly delay them from doing so whilst they sought, and awaited, a decision from the Commission (a decision which the Commission is only obliged to give in very limited circumstances, under Clause 9(2) of the Bill).

(b) 'Abuse'

The lack of clarity of this concept in EU law is notorious. Despite many efforts over the years to resolve the problem, it is still difficult in many cases to distinguish between vigorous and aggressive competition (which competition laws are supposed to encourage) and anti-competitive conduct. The fact that the Government is proposing to use this term in the Bill without any statutory definition is therefore extremely troubling. By leaving it to the future Competition Commission to decide what this term should mean, the Government is effectively transferring its legislative power.

(c) Exclusion on Grounds of Economic Efficiency

Under EU law, an agreement or practice which is deemed to 'prevent, restrict or distort competition' may be exempted if it creates efficiency benefits which outweigh the anti-competitive effects. The Hong Kong Bill contains a similar exclusion.

However, EU experience shows that deciding whether this economic efficiency exclusion should apply is a very subjective and arbitrary exercise.

Although there is provision in the Bill for companies to apply to the Commission for its view, we note that the Commission is only obliged to give a decision in very limited circumstances and the decision would not be binding on the Tribunal. In any event, such an application would delay businesses in bringing new products and services to the market for the benefit of consumers, contrary to the objective of encouraging competition.

It is evident, therefore, that the existing EU model carries with it significant areas of uncertainty and leaves many questions without any clear answer. It is a real missed opportunity for Hong Kong to simply 'import' these uncertainties into the Bill rather than taking the time to properly define the concepts upfront. As we have experienced in Europe, businesses frequently have to engage specialist lawyers (and sometimes economists) to advise them on the issues outlined above, thereby raising the costs of doing business. However, given the uncertainties, the advice received is often, of necessity, hedged with qualifications and therefore a substantial degree of uncertainty always remains. The result, in some cases, is a chilling of competition as contracts are abandoned or substantially reduced in scope due to the competition law uncertainties surrounding their enforcement.

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We think it would be much better for the Bill to focus the proposed prohibitions on specific, narrowly defined types of conduct which the Government is concerned about, and which Hong Kong's businesses can effectively address by themselves, rather than use a model which has caused the kinds of uncertainties and costs referred to above. This would achieve the Government's objective, whilst at the same time allowing Hong Kong businesses to concentrate on continuing to compete with each other, thereby bringing benefits to consumers.

2. More Stringent Penalties than the EU

The penalty cap in the Bill (10% of worldwide consolidated turnover for each year of an infringement) is excessively high, particularly at the outset of a new competition law. It is disproportionate to other jurisdictions, and would seem to introduce the highest civil penalties of any competition regime worldwide, including the EU where competition law has been in force for over 50 years. In practice, the EU uses turnover in the particular market concerned as the basis for calculating penalties.

The Government may take the view that the penalty cap is only a 'maximum', and in practice the Tribunal will have the discretion to choose a penalty which is appropriate in the circumstances of each case. However, there is a real risk that by setting a maximum which is excessive, if the Tribunal in fact imposes a much lower penalty then it will be criticised for being weak.

We believe a more proportionate cap would be 10% of Hong Kong turnover in the relevant products or services concerned, since the Bill is aimed at conduct which has an effect in Hong Kong. This is the approach taken in many jurisdictions with modern and respected competition laws, including Singapore. Additionally the penalty should be linked to a restricted period only – say previous 1 year's turnover – rather than unlimited for as long as the infringement was ongoing, as suggested by the Bill.

3. Private Enforcement

The Bill allows for private actions – both 'follow-on' actions where there is a finding of infringement by the Commission or Tribunal, and also 'stand-alone' actions, which can be brought irrespective of any investigation or finding of infringement.

We are concerned that allowing such rights of private enforcement from the outset of a new competition law regime will place a disproportionately high burden on businesses who have to deal with unfounded and vexatious claims, whilst at the same time getting to grips with the new legal requirements. Furthermore, it would be a real strain for the Tribunal, with only minimal funding proposed, to handle a large volume of private actions.

We suggest that there would be a real benefit in deferring this proposal, particularly in relation to 'stand-alone' actions, until the new regime is well established and the new Commission and Tribunal have gained experience of operating it. In Singapore, the possibility of 'stand-alone' actions has not been included in the primary legislation, with claims limited to 'follow-on' actions only.

Similarly, if one looks back at the EU experience, private enforcement was only introduced in most EU countries decades after the original establishment of the competition regime. Indeed in the UK, competition-law specific private actions were only introduced as recently as 2003, and are still limited to 'follow-on actions'.

In the EU, the introduction of private actions has taken many years and was attempted only after the basic competition rules were well-established. In this context, it is interesting to note that the European Commission is reviewing the whole framework of private actions in order to ensure sufficient access for private parties, but at the same time offering adequate safeguards to businesses. Joaquin Almunia (Vice President of the European Commission responsible for Competition Policy) in his address at European Competition Day last month confirmed the launch of a public consultation based on: "*the need for a coherent EU framework to strengthen collective redress across Europe… at the same time, we are committed to avoid the excesses and drawbacks of the US system*"

This demonstrates the need to proceed with caution before implementing the current proposals for private actions in the Bill. Indeed, there are in our view strong arguments for using the limited Government and business resources available to emphasise and promote competition law awareness and compliance, rather than to administer what may be large numbers of ill-founded 'stand-alone' actions.

4. Merger Control

Although the Government's stated policy objective is to restrict the application of the merger rule to the telecommunications and broadcasting industries, the Conduct Rules are so broadly drafted that they could be invoked to challenge mergers or acquisitions in other sectors, on the basis that they have the object or effect of preventing, restricting or distorting competition in Hong Kong.

We therefore recommend that the Bill should expressly state that the Conduct Rules do not apply to mergers, so as to achieve the Government's stated objectives, ensure legal certainty and eliminate serious unintended consequences.

Conclusion

Given the uncertainties experienced in Europe arising from broad concepts of 'preventing, restricting or distorting competition' and 'abuse', we would urge the Government not to import these difficulties into Hong Kong and instead to take a step back and adopt a different approach for Hong Kong.

The proposed competition law should focus on specific, clearly defined conduct which has an adverse effect on competition and which is economically inefficient. In other words, only conduct which is universally accepted as substantially harmful (in that it lessens the intensity of competition to the detriment of consumers) and which cannot be offset by efficiency benefits, should be prohibited.

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This would achieve the Government's objective, whilst letting Hong Kong businesses focus on continuing to compete with each other, thereby bringing benefits to consumers.

Yours faithfully,

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