Submission in response to the Public Discussion Document "Promoting Competition – Maintaining our Economic Drive"

by

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Executive Summary

Hong Kong needs a new, generally applicable competition law as a matter of urgency, in the interests of ensuring the continued competitiveness of the Hong Kong SAR.

Hong Kong's renowned competitiveness depends primarily on the entrepreneurship of Hong Kong's population but should also be upheld by pro-competitive legislation that is drafted and enforced to penalize any business that would seek to extract profits otherwise than by competitive endeavour. The adoption by Hong Kong of a general competition law would be favourably perceived by Hong Kong's major trading partners and would assist in meeting minimum requirements for bilateral trade liberalization.

Competition laws benefit consumers by reducing the abuses that result in consumers paying higher prices or receiving goods and services of lesser quality than they would under competitive market conditions. They also directly benefit businesses, large and small, which otherwise are disadvantaged by the anti-competitive behaviour of their suppliers or competitors.

A new competition law would be complementary to existing sectoral regulation. While a pro-competitive ideal infuses both telecommunications and broadcasting regulation in Hong Kong, general competition law is different from regulation. The competition authority should emphasize the primacy of markets and be philosophically disinclined to intervene in their operation.

The new competition law should be based on competition jurisprudence and economic principles proven in comparable jurisdictions and tailored to the particular local circumstances of Hong Kong's markets. Hong Kong now has the opportunity to draw on other jurisdictions' long experience with competition law, to adopt the best features of successful regimes. For example, Hong Kong might learn from other jurisdictions' experience and avoid misplacing enforcement

efforts on vertical behaviour, except when such behaviour involves the misuse of power in a relevant market.

The performance of Hong Kong's competition laws, and the authority that administers them, should be periodically reviewed, every three to five years. Such periodic reviews would enable benchmarking of Hong Kong's competition laws and of the authority's performance against international standards. The review will enable the authority to learn from experience as to which aspects of the regime are working and which aspects are not working and permit informed changes to be made accordingly. The system can be regarded as working when the authority is "...taking on the right cases, analyzing them properly, reaching the right decisions for the right reasons, explaining its reasoning, and doing so without a profligate expenditure of public money."[1]

Q.1 Does Hong Kong need a new competition law?

1. *Yes* – Hong Kong will benefit greatly from the introduction of a new, generally applicable competition law.

2. It is critical for the continued international competitiveness of the Hong Kong SAR that competitive forces within Hong Kong should have full play in all sectors of the economy. Hong Kong should give legislative expression to its intolerance of collusion and abuse of market power, where those are detrimental to the efficient operation of markets in Hong Kong.

3. The new competition law should not penalize success. Though a market might have very few suppliers, or even a single (monopoly) supplier, it does not necessarily follow that consumers suffer from any misuse of market power or that the regulator ought to intervene. In general, only if suppliers (or acquirers) are abusing their market power to raise prices or reduce quality, or are colluding between themselves, should the law intervene.

4. The object of competition policy and law is to ensure competitive forces have maximum effect and that the regulator intervenes in the market as little as possible. Competition law will not change the character of Hong Kong's economy as a free and open market but will better protect it against distorting behaviour which would undermine the free market. Threats to the competitiveness of Hong Kong's economy arise not only from within our local market but also from anti-competitive conduct in regional or global markets in which Hong Kong businesses and consumers participate. For example, a cartel fixing prices for goods traded throughout Asia will be detrimental to Hong Kong consumers. In the absence of competition laws in Hong Kong, consumers here have no protection from such conduct. Hong Kong cannot and should not rely on regulators in other economies taking action under their competition laws to protect local consumers here.

5. Businesses that compete actively without exploiting their market power or entering into horizontal arrangements with their rivals should not face compliance costs. Rather, the economy should realize positive "compliance externalities," as producers and consumers alike benefit from the efficient operation of markets for goods and services and inputs to both. The possibility of efficient conduct being wrongly discouraged by the new law may be minimized by Hong Kong's competition law conforming to competition law principles proven internationally. For example, Hong Kong should take advantage of the principles applied in the United Kingdom, Australia and New Zealand in connection with the concept of abuse of market power or market dominance.

6. In considering the question 'is competition policy worth it?' Prof. Paul Geroski, formerly Chair of the UK Competition Commission, observed that "competition policy typically delivers benefits to consumers that vastly outweigh the rather modest costs of running the competition policy regime" and that "the benefits of an active competition policy go further, since firms also benefit from the relief

that attacks against monopolists bring."[2] Prof. Geroski argued, moreover, that "deterrence effects" are a third and major source of benefits that arise when cases set precedents that businesspeople understand and rely on to modify their conduct, disciplining themselves to play by the 'rules of the game.'[3] Such deterrence effects are difficult to measure, since they occur without the authority acting in the particular case, so long as people believe there is a real prospect the authority might take action. Deterrence effects thus spread far beyond the expenditure involved in investigation and enforcement of particular cases.

Q.2 Should any new competition law extend to all sectors of the economy, or should it only target a limited number of sectors, leaving the remaining sectors purely to administrative oversight?

7. Hong Kong's new competition law should be of general application to all sectors of the economy, not targeted to particular sectors.

8. It would be highly undesirable either to limit the application of the competition law to specified sectors or to exclude certain sectors from the application of competition laws.

9. There may be grounds for a particular party or particular conduct not to be subject to the competition laws but the exemption of that party or conduct should be the subject of determination by the authority appointed to administer the competition laws. Overseas experience shows that exemptions are found to be warranted only in circumstances that are unusual. Such circumstances are difficult for lawmakers to foresee, and prone to change over time. It is common in other jurisdictions for parties to be granted an exemption for a limited period of time and for the exemption to expire unless renewed after full reconsideration.

10. In other jurisdictions, the exemption of a whole sector of the economy from the competition laws is exceptional. The trend is towards broader application of the

competition laws, not broader exemptions from them. In Australia, for example, the federal competition statute, the *Trade Practices Act 1974* (Cth.), was amended in 1995 to apply to the Crown in right of each of the Commonwealth, States and principal Territories, which previously had been outside the scope of that regime. It is very unlikely that there is a sector of the Hong Kong economy which should be excluded *in toto* from the obligation to comply with pro-competitive legislation. If there is such a sector, however, the decision to grant it exemption should properly be made by the authority appointed to administer the competition law, after full consideration of, and consultation on, that question. Such an exemption should be limited in time (e.g. to have effect for three years) and any continuation should be subject to a fresh application and reconsideration thereafter, to ascertain whether it is justified beyond that period.

11. To the extent that particular sectors may be affected by conditions that make unique treatment of those sectors desirable, those sectors can be the subject of sector-specific provisions within the general competition law. For example, the Australian *Trade Practices Act 1974* (Cth.) includes provisions specific to the telecommunications industry in Parts XIB and XIC. Alternatively, industry-specific regulation can comfortably operate alongside a competition law that applies economy-wide. For example, in New Zealand the *Commerce Act 1986* is of general application while the *Dairy Industry Restructuring Act 2001*, *Electricity Industry Reform Act 1998* and *Telecommunications Act 2001* additionally impose pro-competitive regulation in the dairy, electricity and telecommunications sectors, respectively.

12. In Hong Kong, it is desirable that the telecommunications and broadcasting sectors should continue to be regulated under sector-specific laws embodying pro-competitive measures (the *Telecommunications Ordinance* (Cap. 106) and the *Broadcasting Ordinance* (Cap. 562)) and should concurrently fall under the ambit of a new Competition Ordinance. This does not impose an onerous obligation, for

the regulated industries are accustomed to observing competitive safeguards already and needn't modify their business conduct. It is vital to ensure that no anti-competitive activity "falls through the cracks." The approach adopted in Singapore whereby the telecommunications sector is excluded from the application of the general competition law is highly unusual, and is inconsistent with the approach taken in Australia, the United Kingdom, the US, Canada and New Zealand. It runs the risk of separate and potentially conflicting competition principles developing in different parts of the economy. In a small economy such as Hong Kong, such an exclusion is also likely to impair the scope for sharing of expertise, information and resources between agencies.

Q.3 Should the scope of any new competition law cover only specific types of anti-competitive conduct, or should it also include the regulation of market structures, including monopolies and mergers and acquisitions?

13. A new competition law should address anti-competitive conduct. It should not target monopolies on the assumption that they necessarily behave in an anti-competitive manner. As the US Supreme Court found in its 1920 *US Steel* decision: "the law does not make mere size . . . or the existence of unexerted power an offense."[4] It is the exercise, or threat of exercise, of the power that monopolies have in their markets, to raise their prices above competitive levels or to reduce the quality of the goods or services they supply, which is objectionable.

14. The economic and legal principles which underlie competition law do not dictate the same outcomes or market structures across different economies. Competition law requires principled analysis of the particular circumstances of each market. While jurisprudence from other economies will provide a guide, adoption of competition law does not entail that US antitrust approaches, for example, will be rigidly imposed on Hong Kong without taking account of the different market conditions prevailing here.

15. Economic analysis of markets and market power is at the heart of competition law, ensuring that competition laws flexibly take account of the differences between large and small markets and open and closed economies. The structure of a market, particularly in a relatively small economy such as Hong Kong's, may well be quite concentrated (in the sense that the market is supplied by relatively few suppliers) yet prices and quality of supply remain at competitive market levels because of the threat of entry by new competitors. That is, with low barriers to new suppliers entering the market, if the incumbent supplier(s) were to charge prices above the competitive market price level, in an attempt to extract monopoly rents, then new firms would be attracted to enter the market by the higher than normal returns and would charge lower prices than the incumbent to win customers from it, until the price returned to the competitive level.

16. Unlike sector-specific laws, competition law is not directly concerned with changing existing market structures or seeking to dismantle any monopolies. Nor does it aim to protect particular competitors. Instead, competition law is concerned with the competitive process itself and its proper operation in all markets. Ultimately, the new competition law should control the acquisition of market power, by conferring on the agency responsible for administering the law the power to block, or unwind, acquisitions of shares or assets that are likely to have the effect of substantially lessening competition in a market in Hong Kong.

17. In the interests of a measured introduction of competition law to a jurisdiction in which it has previously applied on only a limited basis, structure-oriented pro-competitive laws might be legislated for but their commencement deferred. A systematic review of the initial operation of the new competition law should be scheduled at the outset. An independent body, comprising a panel of economic and competition law experts, should be appointed to conduct a comprehensive review of the Hong Kong competition law at, say, three years and six years after the commencement of the law. In the interests of maximum objectivity, the panel

should include overseas experts as well as experts having local experience in Hong Kong. Alternatively the panel's findings should be peer-reviewed by overseas experts. If, three years after the commencement of the Competition Ordinance, the review panel is satisfied that the competition agency is operating as it should, and that the business community and the public adequately understand the laws, and the panel find any other pre-determined criteria are satisfied, then the merger and acquisition provisions could take effect (together with any amendments to the Competition Ordinance that may be found at that time to be necessary).

Q.4 Should a new competition law define in detail the specific types of anti-competitive conduct to be covered, or should it simply set out a general prohibition against anti-competitive conduct with examples of such conduct?

18. The new competition law should contain both a general prohibition on the abuse of market power and specific proscriptions against particular forms of anti-competitive conduct that inhibit the efficient operation of markets and are detrimental to consumers.

19. It is essential that a competition law include both a general proscription against anti-competitive conduct and specifically-focused prohibitions targeting particular kinds of anti-competitive conduct, because the two kinds of provisions function somewhat differently. The general proscription is designedly a catch-all, intended to ensure that changing market conditions and commercial ingenuity do not give rise to a form of conduct that is pernicious but beyond the reach of the specific prohibitions. The specific prohibitions, on the other hand, express with greater precision the kinds of conduct that bring liability and, hence, signal more clearly to firms and individuals the conduct that must be refrained from. Specifically defined conduct may either be prohibited "per se" or may be illegal if it has the purpose or effect or is likely to have the effect of "substantially lessening competition".

20. From the enforcement perspective, the general proscription against anti-competitive conduct tends to be invoked by the regulatory authority – quite properly – as a fallback when the authority has identified conduct that is not within the bounds of a specific prohibition but nevertheless raises significant competition concerns on the basis of accepted tenets of competition economics. Enforcement proceedings tend to be more costly and time-consuming for the authority to run when they are based on a general proscription rather than a specific prohibition. Proof of a suspected infringement of the general proscription must be based on economic principle to a greater extent than proof of an infringement of a specific prohibition, which is established by proving the conduct elements of the prohibition. The general proscription is typically defined in terms of consequences in a market (e.g. *Trade Practices Act 1974* (Cth.) s 46; *Commerce Act 1986* (NZ) s 36).

21. Specific prohibitions of conduct as *per se* illegal start from the basis that conduct of the specified kind will necessarily have anti-competitive consequences, so inquiry into the economic motivation for or consequences of that conduct in the market (its purpose or effect) is not required. Specific prohibitions may also be framed in terms that require that the purpose or effect or likely effect of the conduct be anti-competitive.

22. There are, therefore, essentially three kinds of competition safeguard:

- The general prohibition on anti-competitive conduct, which is subject to a competition test (e.g. a rule forbidding any person taking advantage of a substantial degree of power in a market for the purpose of eliminating or damaging a competitor, preventing entry to the market or deterring competitive conduct in any market).
- Specific prohibitions on conduct that is illegal *per se* (e.g. rules forbidding persons who are in competition with one another from entering into any

contract, arrangement or understanding to fix the price of any good or service). Such "*per se*" rules require a high degree of confidence that the specified conduct is inevitably pernicious.

- Specific prohibitions on conduct that is illegal only if it is engaged in with the purpose or effect or likely effect of substantially lessening competition (e.g. rules forbidding "vertical" restraints, such as restrictions on downstream distributors.) Such "rule of reason" prohibitions signal to businesspeople conduct that is not necessarily unlawful but is likely to attract the authority's scrutiny.

23. Because certainty in the laws is "one of the hallmarks of a civilized jurisprudence,"[5] the general proscription on anti-competitive conduct should not be so general as to confer a broad discretion on the regulatory authority. It should be based on the fundamental principles of competition jurisprudence, for the guidance of enforcers and businesspeople alike. To achieve flexibility, it will necessarily depend to a greater degree on an economic assessment of the conduct in issue, however, than the specific prohibitions on particular forms of conduct. The incorporation of economic assessments of conduct in the determination as to whether conduct is lawful or not has the virtue of allowing for flexibility in the application of the rule. The disadvantage of such an approach is that it tends to provide a less certain signal to businesspeople as to whether a particular form of conduct will be permitted or prohibited. The adverse consequences of uncertainty can be mitigated, however, by providing guidance to persons affected by the rule. This means that the role of published guidelines and other forms of regulatory guidance is of the greatest importance in relation to the general proscription, as is the ability for businesses and their advisers to have recourse to the jurisprudence of comparable jurisdictions.

24. The inclusion of examples in a competition law is unlikely to be of much aid to an interpreter of that law. Anti-competitive conduct may assume such varied forms

that illustrative examples are of very limited utility. Specific features of the setting in which conduct occurs often determine whether that conduct is the result of vigorous competition, which is to be encouraged, or is anti-competitive, and properly to be penalized. A shortly-stated example is unlikely to describe adequately all relevant features of conduct that is proscribed.

25. There are other means, besides setting out examples, of enhancing the certainty of meaning of new legislation. In particular, Hong Kong should take full advantage of the long experience of many comparable common law jurisdictions with competition laws, by modeling our laws on theirs. If the structure and expression of the Hong Kong competition law closely resemble those of laws implemented by comparable jurisdictions, then Hong Kong competition authority staff, businesspeople and their advisors can draw on the principles established and decisions given in those comparable jurisdictions to inform their interpretation of the Hong Kong law and guide their conduct.

26. The new competition authority in Hong Kong should also, as an early priority, publish guidelines, developed in consultation with the public, on how it will apply the laws it is charged with administering. (For suggestions as to the matters which should be the subject of guidelines promulgated by the new competition authority, please refer to Appendix 1 to this paper.)

Q.5 Should a new competition law aim to address only the seven types of conduct identified by the CPRC, or should additional types of conduct also be included, and should the legislation be supported by the issue of guidelines by the regulatory authority?

27. The seven types of conduct identified by the CPRC should be prohibited by the new competition law, together with anti-competitive vertical restraints on competition, where those are engaged in by businesses with a substantial degree of market power.

28. Because the competition law will be new to Hong Kong, it is highly desirable that it should particularize the kinds of conduct that are proscribed. A general prohibition on the misuse of market power, elaborated by guidelines issued by the competition authority will provide sufficient guidance on the effect of that provision. Prohibitions on horizontal agreements between competitors and on particular kinds of vertical conduct that are considered anti-competitive should be specifically described by the competition law, in the interests of certainty and predictability. While the CPRC appears to have focused on horizontal agreements in relation to price-fixing, bid-rigging, market allocation, quotas, joint boycotts and unfair or discriminatory standards, vertical restraints (i.e. between different functional levels of a market) are also prone to be detrimental to businesses and consumers and should be proscribed. Because Hong Kong is a relatively small economy with a relatively large volume of trade by way of distribution and agency relationships, the competition law should apply only where the restraint involves a business having substantial market power and only where the conduct involves an anti-competitive purpose or effect.

29. The competition law should proscribe the following kinds of vertical restraints, where the party engaging in such conduct has a substantial degree of market power and engages in the conduct with the purpose, or with the effect or likely effect of substantially lessening competition in the same or any other market in Hong Kong:

- Product restrictions:
    - supplying goods or services on the condition that the acquirer not acquire goods or services from a competitor of the supplier;
    - acquiring goods or services on the condition that the supplier will not supply goods or services to any person;
    - refusing to supply or refusing to acquire goods or services because the acquirer or supplier has not agreed to a product restraint;

- supplying goods or services on the condition that the acquirer acquire goods or services from a third party; or
- refusing to supply goods or services because the acquirer has refused to acquire goods or services from a third party.

- Customer restrictions:
  - supplying goods or services on the condition that the acquirer not resupply goods or services or will not resupply to particular persons or classes of persons;
  - acquiring goods or services on the condition that the supplier will not supply goods or services to particular persons or classes of persons; or
  - refusing to supply or refusing to acquire goods or services because the acquirer or supplier has not agreed to a customer restraint.
- Territorial restrictions:
  - supplying goods or services on the condition that the acquirer not resupply goods or services in particular places or classes of place;
  - acquiring goods or services on the condition that the supplier not supply goods or services in particular places; or
  - refusing to supply or refusing to acquire goods or services because the acquirer or supplier has not agreed to a territorial restraint.[6]

30. Such prohibitions ought not to apply where the conduct in question occurs between two bodies corporate which are related to one another. It is debatable whether prohibitions on "third line forcing" (i.e. the fourth and fifth forms of product restrictions listed above) should be prohibited *per se*. As opinion is divided on that question, the conservative approach would be to prohibit that conduct subject to a test of anti-competitive purpose or effect. Resale price maintenance (i.e. vertical price fixing) should be prohibited either *per se* or, more conservatively, subject to consideration of its anti-competitive purpose or effect in the particular case.

31. The authority charged with administration of the competition law in Hong Kong should have a duty to issue, and from time to time update, guidelines on the meaning and effect of the competition laws. Such guidelines should not be formally binding on the authority, because changing market conditions and the ingenuity of businesspeople require the regulatory authority to preserve its flexibility of response, but departures by the authority from its guidelines should be exceptional and should be justified in the relevant decision. Depending on the subject matter of the guidelines, it might be appropriate to require that a party (whether the defendant or the competition authority) who seeks to argue for a position that is contrary to a published guideline shall bear the onus of proving that the departure from the guideline is justified in all the circumstances.

32. The publication of guidelines is crucial to the competition authority's role of promoting the competitive operation of markets. Guidelines assist to educate businesspeople about the competitive norms the community expects them to conform to. Because guidelines are not formally binding on the authority (though it should act in conformity with them and should justify departing from them, if it does so), and because they can be quickly and cheaply altered over time, they are a flexible policy instrument. By indicating how the authority is likely to treat conduct of certain kinds, guidelines add clarity and certainty where the rules to which they relate might be expressed in terms which are adaptable to different circumstances but leave some room for uncertainty.

33. In addition to guidelines, the authority should be empowered to issue opinions indicating the authority's views on matters such as the proper definition of a particular market or whether a particular person has "a substantial degree of power in a market." Such opinions would be intended to increase understanding of and compliance with the competition law, in the first few years following commencement of that law. Such opinions would bind the competition authority

for a period, unless circumstances change materially. For example, if the competition authority has given an opinion that a person does not possess a substantial degree of power in a relevant market, that person would be entitled to rely on that opinion for two years, provided that circumstances relating to the applicant and the market remain substantially the same.[7]

Q.6 In determining whether a particular anti-competitive conduct constitutes an infringement of the competition law, should the "purpose" or "effect" of the conduct in question be taken into account? Or should such conduct on its own be regarded as sufficient in determining that an infringement has taken place?

34. Whether an infringement has occurred should depend, fundamentally, on whether consumers in the relevant market have been adversely affected by the conduct. The purpose of the person engaging in the conduct is most likely to be relevant where the conduct is inchoate (i.e. an attempted infringement).

35. Proof of either the suspected infringer's purpose for engaging in the conduct or of the effects of that conduct on the market should be required, except where the particular form of conduct is regarded, consistent with accepted competition economics, as inevitably pernicious to economic efficiency and consumer welfare, such as an agreement between competitors fixing the price of their product.

36. Conduct on its own, without proof of anti-competitive purpose or effect, should constitute an infringement only where engaging in that conduct can be assumed by lawmakers only to have an anti-competitive purpose or effect. For example, the competition laws in most jurisdictions provide that agreements amongst competitors to fix the prices of goods or services are anti-competitive, without requiring proof of an anti-competitive purpose or effect, because price-fixing is necessarily adverse to market efficiency and consumer welfare. So called '*per se* illegality' normally attaches to price fixing, bid rigging and market allocation:

> Price fixing, bid rigging, and market allocation are generally prosecuted criminally because they have been found to be unambiguously harmful, that is, per se illegal. Such agreements have been shown to defraud consumers and unquestionably raise prices or restrict output without creating any plausible offsetting benefit to consumers, unlike other business conduct that may be the subject of civil lawsuits by the federal government. [8]

37. By contrast, vertical non-price restrictions might be economically efficient or might be anti-competitive, depending on the market circumstances and consequences for consumers, so enquiry should be made into the purpose and effect of that conduct (i.e. a "rule of reason" applies).

38. A critical decision for Hong Kong's lawmakers will be to identify which forms of conduct should be prohibited *per se* and which should be the subject of a competition test. In this, Hong Kong should be guided by practice in comparable jurisdictions. *Per se* infringements should include:

- resale price maintenance (i.e. vertical price fixing);
- concerted (horizontal) refusals to deal; and
- horizontal agreements, arrangements or understandings between competitors to fix prices, rig bids or allocate markets.

39. It is important to note that a "purpose" test as a threshold for liability must be applied with caution. If the purpose required is an "objective" purpose, to be inferred from effects, it appears to add little to the "likely effect" of future conduct. If the purpose required is "subjective purpose," then significant difficulties of proof arise. Subjective purpose may be evidenced by documents showing the anti-competitive intentions of officers of the firm under investigation. Identifying such documents is inevitably a slow and expensive process, however, and documentation can be used strategically, to establish a paper record of legitimate business reasons as camouflage for conduct actually engaged in for anti-competitive purposes.

40. The effect or likely effect of impugned conduct is more readily and reliably identified by direct evidence of the impact of that conduct in the market or by

expert economic analysis of the likely consequences of the conduct. An "effects" test also serves to confine enforcers' attention to the economic consequences, rather than perceived moral implications, of business behaviour:

> Intent does not help to separate competition from attempted monopolisation and invites juries to penalise hard competition. It also complicates litigation. Lawyers rummage through business records seeking to discover tidbits that will sound impressive (or aggressive) when read to a jury. Traipsing through the warehouses of business in search of misleading evidence both increases the costs of litigation and reduces the accuracy of decisions. Stripping intent away brings the real economic questions to the fore at the same time as it streamlines antitrust litigation.[9]

41. In short, some forms of conduct (e.g. horizontal arrangements in restraint of trade) should be "*per se*" illegal; the legality of other forms of conduct (e.g. non-price vertical restraints) should be tested by application of a general competition rule and specific prohibitions, both of which require that the effect of the conduct or, within principled bounds, the defendant's purposes for engaging in that conduct be anti-competitive.

Q.7 Should any new competition law allow for exclusions or exemptions from the application of some or all aspects of the law, and if so, in what circumstances should such exemptions apply?

42. *Yes* – the regulatory authority should be empowered to exempt particular conduct, or particular persons, from the application of specified provisions of the competition law.

43. An exemption or authorization power is necessary because it is impossible for lawmakers to foresee and anticipate all eventualities in dynamic and competitive markets. It is common that competition laws are framed in terms which catch particular forms of conduct which, though normally anti-competitive, should be permitted in particular circumstances in the best interests of the public. It is also possible in a small economy that co-operation between competitors at an upstream level may be in the public interest, such as in large infrastructure projects.

44. Decisions to grant or withhold exemptions should be made by the regulatory authority, on a case-by-case basis, with the applicant bearing the onus of establishing why it should not be obliged to comply with the general competition law. The competition law should specify the basis on which an exemption may be granted and the authority should, from time to time, issue guidelines elaborating on the application of the statutory principle.

45. The statutory test for granting an exemption should be based on, essentially, a weighing of the costs and benefits associated with the proposed exemption. For example, in Australia, an authorization may be granted only where the Commission is satisfied:

> ...in all the circumstances that the provision of the proposed contract, arrangement or understanding, the proposed covenant, or the proposed conduct, as the case may be, would result, or be likely to result, in a benefit to the public and that that benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result...[10]

46. In applying such a test, the competition authority should adopt a 'counterfactual' analysis, considering the future state of the relevant markets in Hong Kong if the exemption were granted as compared with the future state of the relevant markets in Hong Kong if compliance were required.[11]

The Regulatory Framework for Competition Law – Options

Q.8 Which would be the most suitable of the three principal options set out in Chapter 4 for a regulatory framework for the enforcement of any new competition law for Hong Kong? The options are -

- **Option One: A single authority with power to investigate and adjudicate**
- **Option Two: Separation of enforcement and adjudication**
- **Option Three: Adjudication by a specialist tribunal**

Q.9 Regardless of the option you may prefer, should the regulator be self-standing or should a two-tier structure be adopted, whereby a full-time

executive is put under the supervision of a management board made up of individuals appointed from different sectors of the community?

47. Design questions in relation to the structure of the competition authority and the scope of its powers and avenues for review or appeal are interrelated.

48. The foremost consideration in structuring the authority and describing its powers should be ensuring its autonomy: it must be independent of both business and government, and seen to be so. The key decision points are:

- How should the authority be staffed?
- How should the authority be resourced and held accountable for its expenditures?
- Should decision-making power be vested in an individual or a panel?
- Should the authority be empowered to impose penalties or should it apply to the courts to do so?
- Should appeals be heard by the courts or by a specialist competition appeals tribunal?

49. In Hong Kong, the preferable model should entail appointment of a full-time professional regulatory staff independent of any department of the executive government. Competition law should be impartial, protecting the competitive process, and independent of economic policy, which commonly aims to encourage the development of particular industries. Competition law should not become a formal or informal instrument of government economic policy, such as promoting "national champions", or of government social policy, such as restricting competitive activity for social objectives, however meritorious. Other governmental mechanisms should be used to achieve these objectives.

50. Decision-making authority would best be vested in a panel of individuals with relevant expertise in law, business, accountancy and economics, rather than an individual. While it is workable for an individual to have regulatory responsibility

in relation to a particular industry, the demands of applying a general competition law to all sectors of the economy should be shared among a panel of appropriately qualified persons. To ensure consistency of decisions and strong day-to-day leadership of the organization, it is desirable that the chair of the authority should be appointed on a full-time basis. Other members of the authority might be part-time appointees. Usually, decisions of the authority should be made by a quorum of three members. A panel of five or more members should be appointed, to ensure a quorum (of three members) can be formed in case some members are unavailable due to other commitments, conflicts of interests, or for other reasons.

51. The competition authority should have adequate investigative powers and resources to resolve all matters coming before it and should have adjudicative powers in relation to waivers, exemptions, merger clearances (in future) and the like. Enforcement and the imposition of penalties should, however, be entrusted to the courts. This is more consistent with the conventional distribution of legal power between the executive and judiciary in common law jurisdictions. While the courts of Hong Kong do not at this time have extensive competition expertise, they can be expected to develop such expertise quite rapidly, particularly with the assistance of expert counsel appearing in the matters brought before them. The appointment to the Court of Final Appeal of judges who come from courts which apply competition laws affords Hong Kong a unique avenue for access to competition law expertise.

52. Consideration should be given to authorizing the appointment of one or more expert competition economists as lay members of the Court of First Instance and Court of Final Appeal, to assist the presiding judge or judges in competition law cases. This measure has proved valuable in New Zealand, where economists have been appointed as lay members of the High Court since 1990.[12]

53. If the power to impose penalties is limited to the courts, rather than being vested in the competition authority, then penalty decisions made by a court would properly be appellable to a higher court. A regime for court-imposed penalties has strong virtues of independence and transparency. This is the preferable regime for competition law in Hong Kong. If the competition authority had the power to impose penalties, then a competition tribunal authorized to undertake merits reviews might be warranted, but such a regime is likely to be costly and is less likely to be perceived as maximizing the values of transparency and independence than one centred on the courts of Hong Kong.

54. To the extent that the competition authority is authorized to impose "quasi penalties," (e.g. warning letters or competition notices), a single level of internal review might be provided for. In that case, such review should be informal, timely, and administered at minimal cost to the authority and the applicant, with further recourse to the courts at the applicant's option.

55. It is imperative to the success of the competition regime that the competition authority be financially well-resourced and staffed by personnel suitably qualified by their training and experience in competition law and economics. Currently, competition expertise in Hong Kong is concentrated in the Broadcasting Authority, OFTA, and the regulated telecommunications operators and broadcasters. To obtain sufficient personnel with appropriate expertise, the competition authority might second talent from the local regulators and either recruit or second personnel from overseas organisations, while also investing in the training and education of local lawyers, economists and investigators. Secondments to the Hong Kong competition authority from authorities in other places and secondments of Hong Kong staff to overseas authorities will both help to build expertise within the Hong Kong competition authority. The competition authority should be sufficiently funded to be able to retain people of high calibre

and to provide the library, research tools, infrastructure and support its staff will need to carry out successfully the authority's mission.

56. The authority should place emphasis on its educative role, ensuring businesspeople in Hong Kong and those who do business here understand the competition law. The authority should be a strong supporter of university and private sector training in competition law and economics, in the interests of building competition expertise among Hong Kong professionals.

57. The competition authority will inevitably be subject to appeals and judicial review applications. It must be adequately resourced to participate in such proceedings without compromising its routine activities. In particular, it should have access to a litigation fund that is separate from its ordinary operating funds, in order that investigative and enforcement decisions should not be constrained by a concern to avoid controversy and the expense involved in responding to any legal challenge.

Enforcement and Other Regulatory Issues

Q.10 In order to help minimize trivial, frivolous or malicious complaints, should any new competition law provide that only the regulatory authority has the power to conduct formal investigations into possible anti-competitive conduct?

58. It is only necessary for the appointed competition authority in Hong Kong to have formal powers to investigate possible anti-competitive conduct. Other persons or bodies should be able, consistent with the ordinary rules of standing, to bring civil proceedings in respect of possible infringements, but they must do so without the benefit of investigative powers.

59. Infringements of competition laws are frequently brought to regulators' attention as a result of complaints made by customers and competitors of the infringing business. Occasionally, frivolous complaints are made to the staff of competition authorities. Overseas experience indicates that trivial, frivolous or malicious

complaints of anti-competitive conduct are not a persistent problem and normally can quickly be resolved by authority staff, without significant cost to the authority or harm to the person against whom the allegation is made.

60. It is very unlikely that frivolous or vexations proceedings would be initiated before a court. Competition litigation is typically complex and expensive, which will normally deter private parties from bringing trival or malicious cases. The courts can be expected to deal appropriately and expeditiously with any such unmeritorious application. The remote risk of such a complaint is not sufficient to justify barring private enforcement actions.

61. Where actions for damages for breach of competition laws may be brought by affected parties, they seldom succeed in the absence of a prior finding of infringement by the regulatory authority. In this connection, legislators should consider whether an extension to the ordinary limitation period is justified, in order that a person suffering loss as a result of the breach of the law is not out of time to claim compensation for that breach by the time the authority has completed its investigation and made its findings.

Q.11 What formal powers of investigation should a regulatory authority have under any new competition law?

62. Hong Kong's competition authority should have strong formal powers of investigation. Without such powers, the authority would be greatly handicapped in its ability to identify and deal effectively with anti-competitive conduct.

63. The competition authority should have the powers to:

- consult with persons it considers may assist it;
- require a supplier of goods or services to prepare and furnish to the authority forecasts, forward plans or other information;

- require a supplier of goods or services to produce to the authority documents and information relating to the supplier's prices, revenues, terms of supply or operations in respect of specified goods or services;
- require a person to answer questions about any matter the authority has reason to believe may be relevant to an investigation;
- require a supplier of goods or services to produce an expert opinion from a suitably qualified person in relation to specified matters;
- require a person to furnish to the authority any information or class of information which the authority considers it is necessary or desirable to obtain;
- require a person to produce to the authority any document or class of documents which the authority considers it is necessary or desirable to obtain;
- require a person to appear before the authority to give evidence verbally or in writing and produce any document or specified class of documents which the authority considers it is necessary or desirable to obtain;
- receive evidence under oath or affirmation; and
- conduct searches of premises and computers pursuant to a valid search warrant issued in accordance with normal procedures in Hong Kong.

Q.12 Should failure to co-operate with formal investigations by the regulatory authority be made a criminal offence?

64. *Yes* – It should be a criminal offence for any person to:

- refuse or fail, without reasonable excuse, to comply with a notice to prepare and furnish information;
- refuse to produce any document that person is required to produce;
- furnish information or produce a document or give evidence knowing it to be false or misleading;
- attempt to deceive or knowingly mislead the authority in relation to any matter before it;

- refuse or fail, without reasonable excuse, to appear before the authority to give evidence;
- refuse to take an oath or make an affirmation as a witness;
- refuse, having taken an oath or made an affirmation, to answer any question put to him or her; or
- resist, obstruct or delay an employee of the authority acting pursuant to a valid search warrant.

65. Penalties for such offences should be in line with those for comparable offences under *Telecommunications Ordinance* (Cap. 106) s 35A: i.e. offenders should be liable on summary conviction to a fine at level 6 and to imprisonment for 6 months.

Q.13 How might a competition regulatory authority deal with the disclosure of information that comes to its knowledge having regard to the need to protect various categories of confidential information on the one hand, and the need to make appropriate disclosure in order to take forward an investigation when the circumstances so require?

66. Confidentiality is frequently claimed in respect of information disclosed to regulators and competition authorities in the course of their investigations. The appropriate way in which to deal with confidential information depends on the character of that information, the circumstances in which it is received and the nature of the proceeding to which it relates. While public consultation should play a central part in the competition authority's processes, the general publication of commercially sensitive information is not always necessary and can cause significant commercial prejudice to market participants. If the authority does not recognize and appropriately protect legitimate confidentiality interests, it is likely to find that the quality of information made available to it will suffer.

67. Often, the confidentiality of information can adequately be protected by limiting the extent of disclosure of commercially sensitive data, for example, by redacting

from publicly available reports the amounts of revenues or percentage shares of markets, while disclosing that data (or equivalent findings) to persons having a direct interest in the proceedings. The competition regulator should also consider whether disclosure of commercially sensitive information should be restricted to individuals who have signed a deed by which they undertake to use the information only for the purposes of the consultation for which it is disclosed, not to disclose or copy the information and to destroy it promptly on notice to do so. The Hong Kong competition authority should be empowered to regulate its own procedure by way of restricting the extent of disclosure of information it deems to be commercially sensitive.

68. It should be expected that the regulator will sometimes receive information that cannot properly be disclosed to any person outside the authority. (For example, potentially damning information sometimes is provided by persons who are continuing customers of the business under investigation.) If the confidential status of any information is such that the veracity of that information cannot be tested through consultation, the authority must discount the weight it attaches to that information.

69. The Hong Kong competition authority should anticipate receiving a certain fraction of claims for confidentiality that it ought not to uphold. In such cases, the authority should normally give the person providing that information the opportunity to withdraw it, before the authority discloses the information to any other person.

70. In order to minimize unfounded claims for confidential treatment of information and to avoid unpleasant surprises for providers of information, the competition authority should publish guidelines setting out how it will handle information which is asserted to be confidential in nature. Such guidelines should also deal with the competition authority's policy in respect of disclosing information to the

Hong Kong Police, Independent Commission Against Corruption or other local or foreign regulatory or law enforcement agencies.

71. The Hong Kong competition authority should be empowered under the competition law to procure information on behalf of, and provide information to, duly appointed competition authorities or equivalent enforcement agencies in other jurisdictions. It is increasingly common for anti-competitive activities – particularly cartels – to be carried on multi-nationally. Competition authorities in all jurisdictions benefit from the ability to share information freely.

Q.14 Should the existing sector specific regulators that also have a competition role continue to play such a role if a cross-sector competition regulatory authority were to be established?

72. *Yes* – the current sectoral regulators for the broadcasting and telecommunications sectors should retain their current roles in respect of competition in those industries. While the new competition authority would benefit from access to the expertise and industry knowledge residing in the Telecommunications Authority and Broadcasting Authority, it is undesirable to disrupt the operation of those sectoral regulators at the time of establishing general competition law. While a pro-competitive ideal infuses both telecommunications and broadcasting regulation in Hong Kong, general competition law is different from regulation. The competition authority should emphasize the primacy of markets and be philosophically disinclined to intervene in their operation.

73. In other jurisdictions, competitive safeguards particular to the telecommunications industry are administered by the general competition regulator. Until 1997 the Australian Telecommunications Authority (Austel) administered the industry-specific competitive safeguards under the Commonwealth *Telecommunications Act*, while the Trade Practices Commission administered the economy-wide competition law (which also applied to telecommunications sector businesses).

Today, the Australian Competition and Consumer Commission administers both the general competition law under the *Trade Practices Act 1974* (Cth.) and also the competition provisions of that Act that are specific to telecommunications carriers and carriage service providers. In New Zealand, the Commerce Commission administers both the general competition law under the *Commerce Act 1986* and also pro-competitive regulation of the telecommunications sector under the *Telecommunications Act 2001*.

74. In Hong Kong, it should not be considered onerous for broadcasters and telecommunications licensees to be subject to industry-specific pro-competitive regulation by the existing sectoral regulator and, at the same time, the economy-wide competition law administered by a new competition authority. Provided that the competition laws under the *Broadcasting Ordinance* and the *Telecommunications Ordinance* are in harmony with the principles of the new general competition law, there should be no additional compliance burden to be borne by broadcasters or telecommunications licensees. If a broadcaster or telecommunications licensee is conducting its business in a manner that is compliant with the competition safeguards under the *Broadcasting Ordinance* or *Telecommunications Ordinance*, then it should have no concern that it might infringe the general competition law.

75. It might be perceived that if a single industry is subject to regulation by two separate bodies, there is a risk of inconsistency in the application of rules by each of them or of "forum-shopping" by regulated firms. Such risks can largely be avoided by ensuring open channels of communication between each authority. Temporary secondments of staff from one body to the other, and cross-memberships of the agencies at the decision-making level are likely to assist consistency of approach. For example, in New Zealand the Chair of the Electricity Commission has been an Associate Commissioner of the Commerce Commission and the Telecommunications Commissioner is a member of the Commerce

Commission. In the United Kingdom, the telecommunications regulator and the competition regulator have been required to enter a formal agreement which establishes a process for determining the responsibility of each body to investigate and deal with complaints when their jurisdiction overlaps. This arrangement has proven very effective and might have application in Hong Kong.

Q.15 Should breaches of any new competition law be considered civil or criminal infringements? What levels of penalty would be suitable?

76. Both civil and criminal liability should be provided for under the new competition law. It is not appropriate that all breaches should entail criminal responsibility and it would unnecessarily burden the competition authority if it were required to prove every infringement to the criminal standard of proof. In the majority of cases in which enforcement action is warranted, a civil pecuniary penalty will be appropriate, with the infringement being proved on the balance of probabilities.

77. In cases in which the infringement is egregious, criminal responsibility should attach. The competition authority should have discretion to determine whether a case should be the subject of criminal prosecution. In Australia, criminal proceedings do not currently lie in respect of conduct infringing the restrictive trade practices provisions.[13] In the United States, the Department of Justice summarises its enforcement decisions as follows:

> Violations of Section 2 [of the Sherman Act, which prohibits monopolization, attempts and conspiracies to monopolize] are generally not prosecuted criminally. Criminal prosecution is warranted, however, in circumstances where violence is used or threatened as a means of discouraging or eliminating competition, such as cases involving organized crime. [...] Price fixing, bid rigging, and market allocation are generally prosecuted criminally because they have been found to be unambiguously harmful, that is, per se illegal.[14]

78. In Hong Kong, it might be considered appropriate to defer criminal liability for a short period, until market participants have become aware of the competition law and its requirements. Such a period should not be longer than two years. After that

period, it should be a criminal offense to be knowingly concerned in serious (so-called "hard-core") cartel conduct.[15]

79. Maximum monetary penalties indicate to the courts how seriously a contravention is viewed[16] but the new competition law should not merely fix pecuniary penalties at a particular monetary level (eg HKD50 million). Penalties ought to be related not only to the nature of the conduct concerned, but also to the corporation's means and the extent of the harm caused by the unlawful conduct. Pecuniary penalties should be set by reference to the infringing party's gains from the unlawful conduct or its annual turnover. For example, in New Zealand pecuniary penalties are linked to the amount of the unlawful gain, or the turnover of the business, subject to an absolute cap: the penalty may not exceed "...the greater of three times the unlawful gain, NZD10 million ... or ten percent of the total turnover of the enterprise".[17]

80. Monetary penalties may be linked to the quantum of the financial gain achieved by the unlawful conduct. Such penalties aim to deter conduct by imposing a penalty that represents some multiple of the harm caused. For example, the civil penalty for insider trading under the *Securities Amendment Act 1988* (NZ) is three times the amount of the gain made or the loss avoided in buying or selling the securities. The amount of the unlawful gain can be assessed by accounting for the profits or, with less difficulty, by an estimate of gains realized.

81. Monetary penalties may also be assessed in relation to the turnover of the business that is guilty of the infringement. Turnover penalties relate indirectly to the likely magnitude of gains but avoid an accounting for the profits derived.

82. In the UK, some provisions of the *Competition Act 1998* (UK) are disapplied to businesses with annual turnover of less than GBP20 million. Turnover penalties in the UK may not exceed ten percent of the relevant turnover of the undertaking. In

the US, fines for specified infringements must be related to the volume of commerce affected by the violation: fines on individuals must be "one to five percent of the volume of commerce" affected and for corporations "20 percent of the volume of affected commerce." [18] US regulators are also required to implement policies to reduce or waive civil penalties, in appropriate cases involving infringements by small businesses, pursuant to the *Small Business Regulatory Enforcement Fairness Act of 1996*.[19] In Hong Kong, SMEs ought not to be exempted from the application of the general competition law, but regard should be had to the size of the enterprise, and its turnover, when assessing the magnitude of any penalty to be imposed.

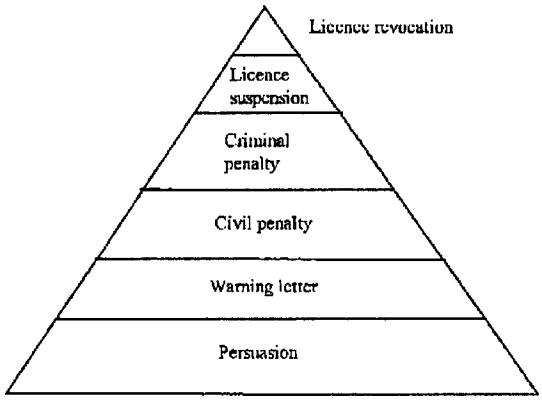
83. It is also necessary to consider by whom civil and criminal penalties should be borne. Policymakers are increasingly recognizing the efficacy of imposing personal liability on individuals who are responsible for the anti-competitive conduct of the companies they direct. The deterrence effects of competition laws are greatest when companies' decision makers recognize they may personally bear financial liability or be imprisoned if they culpably involve the company in anti-competitive practices. Leniency programmes are also likely to be most effective where companies' officers are motivated to co-operate with the competition authority by the threat of personal liability. To preserve the deterrent effect of personal liability, the competition law should forbid companies from indemnifying their directors, servants or agents against liability for pecuniary penalties arising out of breach of the competition law.[20] (For penalty provisions excerpted from the Australian legislation, please refer to Appendix 2 to this paper.)

84. The new competition law in Hong Kong should take advantage of recent thought on how best to sanction corporate bodies. In determining the sanctions that should apply in cases of breach of the competition laws, it is appropriate to consider not merely choices between civil and criminal liability, or the maximum levels of particular penalties, but rather a spectrum of sanctions including civil

and criminal penalties, on individuals as well as corporations, and both monetary and non-monetary penalties. While plain breaches of the competition laws should be prosecuted and penalized, with emphasis on deterring others from engaging in similar conduct, there is also a role for enforcement strategies designed to ensure compliance rather than solely to punish infringement.

85. As Ayres and Braithwaite,[21] and Fisse and Braithwaite,[22] have argued, agencies should have access to a range of enforcement mechanisms of differing severity. This notion is illustrated by the metaphor of the "pyramid of enforcement."

Fig. 1 *Example of a Pyramid of Enforcement*[23]



86. When a compliance problem arises, the authority should be able to respond by deploying a sanction of the appropriate degree of stringency (i.e. at the appropriate altitude in the pyramid). If suitable corrective action is not then taken, the agency should be able to escalate its intervention, deploying other and increasingly severe sanctions until compliance is obtained. The existence of stronger enforcement measures which are kept in reserve and not prematurely exercised should serve to encourage regulated firms' cooperation with compliance-oriented enforcement.

87. The competition authority should be empowered to:

- issue and publish warning letters;
- issue competition notices;
- make (or obtain) orders for non-monetary penalties;
- accept enforceable undertakings; and
- obtain "cease and desist" orders.

88. Warning letters would have a particular role in the early stages of the regime. By writing such a letter to a possible infringer of the competition law, the authority would signal to the persons immediately involved, and to other parties generally, how the authority interprets the law and when it will consider the law to be infringed. If parties do not modify their conduct following the warning, the authority should escalate its response.

89. A "competition notice" procedure [24] should be legislated for, enabling the competition authority to put a business on notice that the authority has reason to believe the business has infringed, or is infringing, or might in future infringe the competition law. Such notices would not of themselves amount to a finding of liability but might give rise to rights of action if the conduct is persisted in or recurs. In essence, a competition notice would be advisory rather than mandatory, but would clearly signal the authority's view that specified conduct is unlawful and the recipient (and other prudent firms) should immediately apprehend the need to refrain from that conduct. Enforcement action might be initiated by the authority where the recipient of the competition notice has failed to desist from the impugned behaviour within the period specified in the notice.

90. A competition authority's main role should be to deter firms from engaging in anti-competitive conduct, and it is likely to have to bring civil and criminal enforcement proceedings from time to time to do so. The competition authority should, however, have available to it alternative measures to procure compliance,

so a range of other quasi-penalties and non-monetary penalties should also be considered.

91. Non-monetary orders that the competition authority might be authorized under the competition law to make include:[25]

- Disqualification from government contracts – the government may refrain for a period from doing business with organizations which have failed to comply with the competition law.
- Supervisory or probation orders – internal discipline orders or organizational reform orders should require action to be taken by the company within a specified time, with the aim of preventing recurrence of the anti-competitive conduct.
- Community service orders – a corporate offender might be directed to take some action to the benefit of the community, or a section of it, particularly where the defendant's limited resources make recovery of a substantial pecuniary penalty problematic.
- Adverse publicity orders – requiring the infringing corporation to publish the facts of its wrongdoing under the competition law and the details of what it has been required to do aim at deterrence by 'shaming' the offender.

Q.16 Should any new competition law include a leniency programme?

92. *Yes* – Leniency programs have been implemented in many comparable jurisdictions. Their advantage lies in detection and enforcement action being greatly facilitated by the participant in the prohibited conduct being required (as a condition of leniency) to co-operate fully in the authority's investigation of the matter.

93. The efficacy of leniency programs depends, in part, on the ability of parties who have engaged in anti-competitive conduct affecting markets in multiple jurisdictions to seek leniency by initiating co-operation, simultaneously, with the competition authorities in all (or as many as possible) of the countries in which the conduct occurred.

Q.17 Should any new competition regulator be empowered to issue orders to "cease and desist" from anti-competitive conduct?

94. *Yes* – Cease and desist orders should be available to the Hong Kong competition authority but, consistent with that authority not itself having enforcement jurisdiction, such orders should be issued by a judge in chambers, on *ex parte* application by the competition authority.

95. The efficacy of cease and desist measures depends on them being able to be deployed quickly by the competition authority. Where the companies that are the subject of such orders have the opportunity to oppose the orders, there is a real risk that the question of whether the threshold for issuance of the order has been met will become a contest over the merits of the authority's case. The firm under investigation will take every opportunity to open such a dispute at an early stage, when the authority might have a *prima facie* case of infringement but has not completed its investigation.

96. Because cease and desist orders are likely to be highly disruptive to the business of the person against whom they are issued, they should have effect for a specified period of time and be subject to renewal on application by the authority.

Q.18 As an alternative to formal proceedings, might any new competition regulator have the authority to reach a binding settlement with parties suspected of anti-competitive conduct?

97. *Yes* – The ability of the regulatory authority to enter into an administrative settlement with regulated firms should be expressly provided for in the competition law. The competition authority should have discretion whether to pursue proceedings against a party that has infringed the competition law but should be able to exercise its discretion not to bring proceedings where it is satisfied that the infringing party is taking proper steps to rectify its conduct and avoid any future breach of the law.

98. The competition authority should also have the express power to accept from persons who are subject to the competition law written undertakings that are binding and enforceable. The authority ought not to demand or require an undertaking but should have the power to raise it as an option which the investigated party can elect to pursue or not. Such undertakings might commit the person giving them to take specified action in order to comply with the law, refrain from specified action in order to comply with the law or to take or refrain from specified action in order to ensure infringement of the law does not recur. The Australian Competition and Consumer Commission has indicated that such undertakings made to it[26] should normally include:

- a positive commitment to cease the particular conduct and not recommence it;
- corrective action to undo the harm caused by the alleged breach and mechanisms for compensation for parties adversely affected by the conduct;
- implementation of a program to improve the company's overall compliance with the law;
- consent to the undertaking being placed on the public record and open to public scrutiny; and
- novel requirements, where appropriate, such as implementation of compliance training for staff or publicity of the facts of the infringement and outcome.

99. By way of example, the ACCC accepted an enforceable undertaking in December 2006 from a national computer distributor which admitted it had engaged in resale price maintenance by threatening two of its dealers with cancellation of their dealerships unless they stopped discounting and raised their prices to the 'recommended retail' price levels. The company undertook:

- not to engage in resale price maintenance;
- to implement a trade practices compliance programme;
- to implement an audit process to determine whether any other dealers have been subject to resale price maintenance; and
- to write to all of its dealers to advise them of the outcome of the ACCC's investigation, of their freedom to set their own prices, that they should not place pressure on other dealers who offer discounted prices, and that they should not seek to induce the company to take action against dealers who offer discounted prices.[27]

100. If the person giving the undertaking subsequently breaches it, the competition authority should be empowered to apply to the court for:

- an order directing the person to comply with the undertaking;
- an order directing the person to pay a pecuniary penalty;
- an order directing the person to pay compensation to any other person who has suffered loss or damage as a consequence of the breach of the undertaking; or
- such other order as the court considers appropriate.

Q.19 Should any new competition law allow parties to make civil claims for damages arising from anti-competitive conduct by another party?

101. *Yes* – a party who suffers loss as a result of a breach of the competition laws by another party should have the right to seek a remedy in damages for that loss. The competition authority should also be authorized to seek damages or restitutionary

relief on behalf of affected parties. If the court considers it appropriate to order the defendant to pay a pecuniary penalty in respect of anti-competitive conduct and to pay compensation to a person who has suffered loss or damage but the defendant is unable to pay both, then the court should be required to give preference to making an order for compensation.[28]

102. The right to redress in damages is an appropriate consequence of the fact that a business that has infringed the competition laws has engaged in unlawful conduct causing loss to a person. Liability to civil damages is also justified as a further deterrent to engaging in anti-competitive conduct.

103. A finding by the authority or a court that the defendant has infringed the competition laws should not be a legal prerequisite for bringing a private civil action, though, as a practical matter, it will almost inevitably be a necessary first step. In the United States, a successful federal prosecution of collusion may be used as *prima facie* evidence by a private party bringing civil antitrust proceedings. The court's findings of fact in enforcement proceedings brought by the competition authority should be admissible as *prima facie* evidence of those facts in subsequent civil proceedings.[29]

Q.20 How should any new competition law address the concerns that our business, especially our SMEs, may face an onerous legal burden as a result of such civil claims?

104. An onerous legal burden arising in case of a proven breach of the competition laws is properly part of the disincentive to any business to engage in anti-competitive conduct. There is no good policy ground to ameliorate that burden in the long term, though a grace period might be justified for a short time following the commencement of the competition law. During such a grace period, suspected infringements by SMEs could be addressed by warning letters and administrative orders, rather than civil or criminal prosecution. After, perhaps, eighteen months

or two years from commencement of the Ordinance, the authority's enforcement strategy might place increased emphasis on prosecution.

105. In general, competition laws do not impose an onerous compliance burden, or liability burden, on SMEs. SMEs normally do not have a sufficient degree of power in the markets in which they operate to be able to engage in the kinds of behaviours that competition laws proscribe. If an SME falls foul of the competition law, it is most likely to be because it has participated in a horizontal agreement with its competitors (e.g. to fix prices, boycott a supplier or rig a bid). In such a case, it is difficult to see that the guilty firm should be shielded from liability.

106. Rather than bearing an onerous burden, SMEs benefit greatly from competition law. Abuses of market power by large enterprises, which raise the prices or reduce the quality of productive inputs traded in wholesale markets are just as detrimental to SMEs as the same abuses are to consumers when practiced in retail markets. It is also the SMEs who are most vulnerable to lose market share if large enterprises misuse their market power to prevent or hinder competition or to eliminate a competitor from a market. Such conduct being clearly detrimental to the competitive process, it should be prohibited and punished under the laws of Hong Kong.

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1 Geroski, Paul "Is Competition Policy Worth It?" in Competition Commission *Essays in Competition Policy* (August 2006).
2 Ibid.
3 Ibid.
4 *United States v United States Steel Corporation et al* (1920) 251 U.S. 417.
5 Diamond, A.L. "Codification of the Law of Contract" (1968) 31 *Modern Law Review* 361 at 370.
6 Steinwall, R. *Annotated Trade Practices Act 1974* (Butterworths, 2006) at 10,785.10.
7 Cf. Broadcasting Services Act 1992 (Cth) s 74.
8 Antitrust Division, United States Department of Justice "An Antitrust Primer for Federal Law Enforcement Personnel" (August 2003, revised April 2005) p 4.
9 *AA Poultry Farms Inc v Rose Acre Farms Inc* 881 F2d 1396 (7th Cir. 1989) Easterbrook J.
10 Trade Practices Act 1974 (Cth.) s 90(6) (emphasis added).

11 See, e.g. Commerce Commission *Mergers and Acquisitions Guidelines* (January 2004).

12 Commerce Act 1986 (NZ) s 78: "...a Judge of the Court may, of his own motion or on the application of any party to the proceedings, require any person or persons appointed as a lay member or lay members of... the High Court pursuant to section 77 of this Act, to hear and determine the proceedings as an additional lay member or additional lay members of the Court." Similarly, R 706 of the *US Federal Rules of Evidence* permits a judge to appoint an expert witness to be a court witness, though this opportunity is "little used, in part, because judges lack confidence in their ability to pick a neutral" Posner, RA "The Law and Economics of the Economic Expert Witness" (1999) 13 *Journal of Economic Perspectives* 91.

13 Trade Practices Act 1974 (Cth.) s 78. Note, however, that the Federal Treasurer announced in 2005 the Government's intention to amend the Act to introduce criminal penalties for serious cartel conduct. "The maximum penalties for the offence will be a term of imprisonment of five years and a fine of $220,000 for individuals and a fine for corporations that is the greater of $10 million or three times the value of the benefit from the cartel, or where the value cannot be determined, 10 per cent of annual turnover." The Hon. Peter Costello (Media Release, 2 February 2005).

14 Antitrust Division, United States Department of Justice "An Antitrust Primer for Federal Law Enforcement Personnel" (August 2003, revised April 2005) p 4.

15 In 1998, the OECD Council adopted the *Recommendation Concerning Effective Action Against Hard Core Cartels* which identified four types of conduct as falling within the definition of a hard core cartel: "a ''hard core cartel' is an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating customers, suppliers, territories, or lines of commerce . . .". The Recommendation states that this general definition "...does not include agreements, concerted practices, or arrangements that i) are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies, ii) are excluded directly or indirectly from the coverage of a Member country's own laws, or iii) are authorised in accordance with those laws. However, all exclusions and authorisations of what would otherwise be hard core cartels should be transparent and should be reviewed periodically to assess whether they are both necessary and no broader than necessary to achieve their overriding policy objectives."

16 See, e.g. *Hayes v Weller* (No 2) (1988) FLR 64.

17 Commerce Act 1986 (NZ) s 80(2B).

18 US Sentencing Commission *Federal Sentencing Guideline Manual* (December 2001).

19 Pub L No 104-121, 101 Stat 847 (US).

20 Commerce Act 1986 (NZ) s 80A.

21 Ayres, I. and Braithwaite, H. *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992) at 35 - 53.

22 Fisse, B. and Braithwaite, J. *Corporations, Crime and Accountability* (Cambridge: Cambridge University Press, 1993) at 140 - 145.

23 Ayres and Braithwaite, op cit., figure 2.1.

24 See, for example, Trade Practices Act 1974 (Cth.) ss 151AKA, 151 AL; Broadcasting Services Act 1992 (Cth) Part 14E.

25 Australian Law Reform Commission Report No 95 "Principled Regulation: Federal Civil and Administrative Penalties" (Canberra, 2002).

26 Trade Practices Act 1974 (Cth) s 87B; see Australian Competition and Consumer Commission "Section 87B of the Trade Practices Act" (August 1999). See also Broadcasting Services Act 1992 (Cth) s 205X.

27 Australian Competition and Consumer Commission *ACCC Journal* Issue Number 33.

28 See, e.g., Trade Practices Act 1974 (Cth.) s 79B.

29 See, e.g., Trade Practices Act 1974 (Cth.) s 83.

Appendix 1 – Guidelines

The new Hong Kong competition authority should develop and publish guidelines on the following matters, in consultation with business and the public:

- Market definition, assessment of market power and the assessment of effects on competition;
- Leniency Policy and Co-operation Policy;
- The authority's approach to the exercise of its powers to compulsorily acquire information;
- The handling of confidential information;
- The sharing of information with regulators and law-enforcement agencies in Hong Kong and overseas;
- Policy in respect of penalties and enforcement;
- The circumstances in which the Authority will accept enforceable undertakings; and
- The authority's approach to applications for exemption.

Appendix 2 – Selected Penalty Provisions from the Australian *Trade Practices Act 1974* (Cth.)

Section 77A - Indemnification of officers

(1) A body corporate (the first body), or a body corporate related to the first body, must not indemnify a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against any of the following liabilities incurred as an officer of the first body:

(a) a civil liability;

(b) legal costs incurred in defending or resisting proceedings in which the person is found to have such a liability.

Penalty: 25 penalty units.

[...]

Section 82 - Actions for damages

(1) Subject to subsection (1AAA), a person who suffers loss or damage by conduct of another person that was done in contravention of a provision of Part IV, IVA, IVB or V or section 51AC may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention.

Section 83 - Finding in proceedings to be evidence

In a proceeding against a person under section 82 or in an application under subsection 87(1A) for an order against a person, a finding of any fact by a court made in proceedings under section 77, 80, 81, 86C or 86D, or for an offence against a provision of Part VC, in which that person has been found to have contravened, or to have been involved in a contravention of, a provision of Part IV, IVA, IVB, V or VC is prima facie evidence of that fact and the finding may be proved by production of a document under the seal of the court from which the finding appears.

Section 86C - Non-punitive orders

(1) The Court may, on application by the Commission, make one or more of the orders mentioned in subsection (2) in relation to a person who has engaged in contravening conduct.

(2) The orders that the Court may make in relation to the person are:

(a) a community service order; and

(b) a probation order for a period of no longer than 3 years; and

(c) an order requiring the person to disclose, in the way and to the persons specified in the order, such information as is so specified, being information that the person has possession of or access to; and

(d) an order requiring the person to publish, at the person's expense and in the way specified in the order, an advertisement in the terms specified in, or determined in accordance with, the order.

(3) This section does not limit the Court's powers under any other provision of this Act.

(4) In this section:

"**community service order**", in relation to a person who has engaged in contravening conduct, means an order directing the person to perform a service that:

(a) is specified in the order; and

(b) relates to the conduct;

for the benefit of the community or a section of the community.

Example: The following are examples of community service orders:

(a) an order requiring a person who has made false representations to make available a training video which explains advertising obligations under this Act; and

(b) an order requiring a person who has engaged in misleading or deceptive conduct in relation to a product to carry out a community awareness program to address the needs of consumers when purchasing the product.

"**contravening conduct**" means conduct that:

(a) contravenes Part IV, IVA, IVB, V or VC or section 75AU, 75AYA or 95AZN; or

(b) constitutes an involvement in a contravention of any of those provisions.

"**probation order**", in relation to a person who has engaged in contravening conduct, means an order that is made by the Court for the purpose of ensuring that the person does not engage in the contravening conduct, similar conduct or related conduct during the period of the order, and includes:

(a) an order directing the person to establish a compliance program for employees or other persons involved in the person's business, being a program designed to ensure their awareness of the responsibilities and obligations in relation to the contravening conduct, similar conduct or related conduct; and

(b) an order directing the person to establish an education and training program for employees or other persons involved in the person's business, being a program designed to ensure their awareness of the responsibilities and obligations in relation to the contravening conduct, similar conduct or related conduct; and

(c) an order directing the person to revise the internal operations of the person's business which lead to the person engaging in the contravening conduct.

Section 86D - Punitive orders--adverse publicity

(1) The Court may, on application by the Commission, make an adverse publicity order in relation to a person who:

(a) has been ordered to pay a pecuniary penalty under section 76; or

(b) is guilty of an offence under Part VC.

(2) In this section, an adverse publicity order, in relation to a person, means an order that:

(a) requires the person to disclose, in the way and to the persons specified in the order, such information as is so specified, being information that the person has possession of or access to; and

(b) requires the person to publish, at the person's expense and in the way specified in the order, an advertisement in the terms specified in, or determined in accordance with, the order.

(3) This section does not limit the Court's powers under any other provision of this Act.

Section 86E - Order disqualifying a person from managing corporations

(1) On application by the Commission, the Court may make an order disqualifying a person from managing corporations for a period that the Court considers appropriate if:

(a) the Court is satisfied that the person has contravened, has attempted to contravene or has been involved in a contravention of Part IV; and

(b) the Court is satisfied that the disqualification is justified.

Note: Section 206EA of the Corporations Act 2001 provides that a person is disqualified from managing corporations if a court order is in force under this section. That Act contains various consequences for persons so disqualified.

(2) In determining whether the disqualification is justified, the Court may have regard to:

(a) the person's conduct in relation to the management, business or property of any corporation; and

(b) any other matters that the Court considers appropriate.

(3) The Commission must notify ASIC if the Court makes an order under this section. The Commission must give ASIC a copy of the order.

Note: ASIC must keep a register of persons who have been disqualified from managing corporations: see section 1274AA of the Corporations Act 2001.

(4) In this section:

"ASIC" means the Australian Securities and Investments Commission.

Section 87 - Other orders

(1) Subject to subsection (1AA) but without limiting the generality of section 80, where, in a proceeding instituted under this Part, or for an offence against Part VC, the Court finds that a person who is a party to the proceeding has suffered, or is likely to suffer, loss or damage by conduct of another person that was engaged in (whether before or after the commencement of this subsection) in contravention of a provision of Part IV, IVA, IVB, V or VC, the Court may, whether or not it grants an injunction under section 80 or makes an order under section 82, 86C or 86D, make such order or orders as it thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention (including all or any of the orders mentioned in subsection (2) of this section) if the Court considers that the order or orders concerned will compensate the first-mentioned person in whole or in part for the loss or damage or will prevent or reduce the loss or damage.

(1A) Subject to subsection (1AA) but without limiting the generality of section 80, the Court may:
(a) on the application of a person who has suffered, or is likely to suffer, loss or damage by conduct of another person that was engaged in in contravention of Part IVA, IVB, V or VC; or
(b) on the application of the Commission in accordance with subsection (1B) on behalf of one or more persons who have suffered, or who are likely to suffer, loss or damage by conduct of another person that was engaged in in contravention of Part IV (other than section 45D or 45E), IVA, IVB, V or VC;
make such order or orders as the Court thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention (including all or any of the orders mentioned in subsection (2)) if the Court considers that the order or orders concerned will:
(c) compensate the person who made the application, or the person or any of the persons on whose behalf the application was made, in whole or in part for the loss or damage; or
(d) prevent or reduce the loss or damage suffered, or likely to be suffered, by such a person.

[...]

(1C) An application may be made under subsection (1A) in relation to a contravention of Part IV, IVA, IVB, V or VC even if a proceeding has not been instituted under another provision in relation to that contravention.

(1CA) An application under subsection (1A) may be made at any time within 6 years after the day on which the cause of action that relates to the conduct accrued.

[...]

(2) The orders referred to in subsection (1) and (1A) are:
(a) an order declaring the whole or any part of a contract made between the person who suffered, or is likely to suffer, the loss or damage and the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct, or of a collateral arrangement relating to such a contract, to be void and, if the Court thinks fit, to have been void ab initio or at all times on and after such date before the date on which the order is made as is specified in the order;
(b) an order varying such a contract or arrangement in such manner as is specified in the order and, if the Court thinks fit, declaring the contract or arrangement to have had effect as so varied on and after such date before the date on which the order is made as is so specified;
(ba) an order refusing to enforce any or all of the provisions of such a contract;
(c) an order directing the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct to refund money or return property to the person who suffered the loss or damage;
(d) an order directing the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct to pay to the person who suffered the loss or damage the amount of the loss or damage;

(c) an order directing the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct, at his or her own expense, to repair, or provide parts for, goods that had been supplied by the person who engaged in the conduct to the person who suffered, or is likely to suffer, the loss or damage;
(f) an order directing the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct, at his or her own expense, to supply specified services to the person who suffered, or is likely to suffer, the loss or damage; and
(g) an order, in relation to an instrument creating or transferring an interest in land, directing the person who engaged in the conduct or a person who was involved in the contravention constituted by the conduct to execute an instrument that:
(i) varies, or has the effect of varying, the first-mentioned instrument; or
(ii) terminates or otherwise affects, or has the effect of terminating or otherwise affecting, the operation or effect of the first-mentioned instrument.

Section 87B - Enforcement of undertakings

(1) The Commission may accept a written undertaking given by a person for the purposes of this section in connection with a matter in relation to which the Commission has a power or function under this Act (other than Part X).

(1A) The Commission may accept a written undertaking given by a person for the purposes of this section in connection with a clearance or an authorisation under Division 3 of Part VII.

(2) The person may withdraw or vary the undertaking at any time, but only with the consent of the Commission.

(3) If the Commission considers that the person who gave the undertaking has breached any of its terms, the Commission may apply to the Court for an order under subsection (4).

(4) If the Court is satisfied that the person has breached a term of the undertaking, the Court may make all or any of the following orders:
(a) an order directing the person to comply with that term of the undertaking;
(b) an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach;
(c) any order that the Court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach;
(d) any other order that the Court considers appropriate.

Section 87CA - Intervention by Commission

(1) The Commission may, with the leave of the Court and subject to any conditions imposed by the Court, intervene in any proceeding instituted under this Act.

(2) If the Commission intervenes in a proceeding, the Commission is taken to be a party to the proceeding and has all the rights, duties and liabilities of such a party.

Section 87CD - Proportionate liability for apportionable claims

(1) In any proceedings involving an apportionable claim:
(a) the liability of a defendant who is a concurrent wrongdoer in relation to that claim is limited to an amount reflecting that proportion of the damage or loss claimed that the court considers just having regard to the extent of the defendant's responsibility for the damage or loss; and
(b) the court may give judgment against the defendant for not more than that amount.

(2) If the proceedings involve both an apportionable claim and a claim that is not an apportionable claim:
(a) liability for the apportionable claim is to be determined in accordance with the provisions of this Part; and
(b) liability for the other claim is to be determined in accordance with the legal rules, if any, that (apart from this Part) are relevant.

(3) In apportioning responsibility between defendants in the proceedings:
(a) the court is to exclude that proportion of the damage or loss in relation to which the plaintiff is contributorily negligent under any relevant law; and
(b) the court may have regard to the comparative responsibility of any concurrent wrongdoer who is not a party to the proceedings.

(4) This section applies in proceedings involving an apportionable claim whether or not all concurrent wrongdoers are parties to the proceedings.

(5) A reference in this Part to a defendant in proceedings includes any person joined as a defendant or other party in the proceedings (except as a plaintiff) whether joined under this Part, under rules of court or otherwise.

Section 151AL - Part B competition notices

(1) The Commission may issue a written notice:
(a) stating that a specified carrier or carriage service provider has contravened, or is contravening, the competition rule; and
(b) setting out particulars of that contravention.

(2) A notice under subsection (1) is to be known as a Part B competition notice.

Threshold for issuing Part B competition notices

(3) The Commission may issue a Part B competition notice relating to a particular contravention if the Commission has reason to believe that the carrier or carriage service provider concerned has committed, or is committing, the contravention.

Notice may be issued after proceedings have been instituted

(4) To avoid doubt, a Part B competition notice may be issued even if any relevant proceedings under Division 7 have been instituted.

Note: For the effect of a Part B competition notice, see subsection 151AN(1).

Section 151AN - Evidentiary effect of competition notice

(1) In any proceedings under, or arising out of, this Part, a Part B competition notice is prima facie evidence of the matters in the notice.

[...]