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Response to the HKSARG Discussion Document

Promoting Competition – Maintaining our Economic Drive

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1. The change in government policy to consider the swift enactment of a comprehensive competition law is to be welcomed.

2. The case for a general-cross sector competition law in Hong Kong is made out in my book 'Competition Policy and Law in China, Hong Kong and Taiwan', Cambridge University Press (2005). I also associate myself with the position of the Civic Party on this matter. Hong Kong needs a general competition law with as few exemptions as possible, tailored to the particular structure of the domestic economy and the particular anti-competitive commercial behaviour found here. The existence of closely-held private conglomerate companies that dominate many of the capital-intensive industries and have extensive networks of subsidiaries is a peculiar feature of the Hong Kong economy.

3. This structure cannot be ignored when an appropriate competition law model for Hong Kong is considered. This observation does not seek to condemn 'bigness'; on the contrary higher concentration ratios in capital intensive sectors is to be expected in a 'small' economy, however defined. Economies of scale can also provide welfare efficiencies which are generally beneficial, so long as market entry is not prevented. The issue here is whether the very structure of various markets causes foreclosure by the existence of high or insuperable barriers or by the combination of scale and 'network effects', so that potential competitors are unable to break into numerous ring-fenced markets. Bundling is but one manifestation of this problem. If found to be widespread, which it is believed it is, this causes a economic sclerosis that dampens competition and prevent the creation of new firms that would otherwise enter those markets. Dynamism in the domestic economy falters. Competitiveness gives way to stasis.

4. This is why in addition to behaviour, structure – both excessively concentrative mergers and existing structural phenomena – should be within the purview of a tailored competition law for Hong Kong. However, a merger regime should be light-touch, with high thresholds and an ex-post notification system. Generally only horizontal mergers would be reviewed that met these criteria and thus very few cases would be notifiable. Merger review is also necessary to prevent cartels consolidating into monopolies which would inevitable be created if cartels are forbidden.

5. The suggested structural powers in relation to existing ownership patterns would only be invoked after a market investigation by the new competition authority. Serious anti-competitive problems would have to be identified and

no other remedy could be either negotiated or imposed via behavioural means. Remedial action via divestiture would be subject to a positive resolution by the Legislative Council. Thus the structural powers suggested would be limited and applied only in wholly exceptional cases.

6. A fundamental requirement for the adoption of a successful law in Hong Kong is to have clarity as to the objectives the law seeks to achieve. Without such clarity it is difficult if not impossible to interpret the legislative prohibitions or to apply them appropriately. A clear objective for the law enhances both the ability of private lawyers to advise clients and the public agency who has to enforce the law. Hong Kong has always maintained a close affinity with the ideology of laissez-faire. Classical market economics suggests maximum consumer welfare is the sole justifiable objective of competitive markets and a legislative scheme that purports to enhance competition should have an equally focused approach. If this is the case certain consequences follow. Economic efficiency might well be best achieved by large firms with high market share, so long as they are under sufficient competitive pressure to refrain from monopoly rent seeking and they cannot maintain or enhance effective barriers to entry. This policy would encourage fierce competition and would inevitably result in casualties amongst less efficient firms. This could be justified on the basis that the market is 'red in tooth and claw' and that casualties in the competitive game are both inevitable and beneficial in the Schumpetion analysis of creative destruction.

7. Politically this may be difficult as small players might object to vigorous competition by more efficient larger firms as they would go out of business and many economists and competition academics also think that such a policy may be misguided. Allegations of predation or other exclusionary conduct would need a great deal of economic analysis that may be difficult to obtain and to interpret. However adopting a wider goal for competition law inevitably invites the criticism that objects other than maximisation of efficiency/consumer welfare are illegitimate in a competition law. Thus a political choice has to be made. On balance an economic efficiency goal can be defended. Implementation of that goal can be tempered by guidance issued by the competition authority that would meet the objections to a purely economics focused law.

8. The coverage of the law should be cross-sector and any exemptions kept to a minimum and in the absence of cogent public interest-based justification. It is unjustifiable for natural monopolies in private hands to be automatically exempted since the owners have the greatest desire to obtain maximum monopoly profit. Special pleading for exempt status should be ignored on the basis that public interest should trump private profit.

9. The substance of the law should be based on the existing raft of provisions in the telecommunications sector. However direct copying is highly inadvisable given the significant drafting problems found in the current telecommunications ordinance provisions. Principally abuse of dominance, anti-competitive agreements and mergers and acquisitions should be regulated

along with a market investigation/divestiture power to deal with egregious existing structural deficiencies.

10. The abuse of dominance provisions should not rely on purely formalistic prohibitions as this may well be inimical to ensuring consumer welfare maximisation. High market thresholds can be set and the adoption of a consumer welfare standard would mean that relatively few categories of 'abuse' would be thought detrimental to the competitive market. Protection of the possibility of competition rather than the protection of competitors would be the guiding principal.

11. In relation to restrictive agreements hardcore cartels should be targeted as a primary consumer welfare inhibitor. Other types of agreement, particularly vertical agreements, may not be anti-competitive at all. Block exemptions and de minimus provisions would also provide safe harbours for many restrictive agreements that had no appreciable effect on competition.

12. In relation to mergers only horizontal consolidations would be of primary concern and then only if turnover and high market share thresholds were pertinent. An ex-post notification system would ensure a light-touch regime.

13. In relation to the competition agency the primary consideration should be actual and perceived independence on a par with that enjoyed by the judiciary, given that the agency would be making quasi-judicial determinations. A corporate board of no more than five with a chief executive should be the decision making organ to reduce the risk of aberrant decisions and abuse of procedural safeguards. Accountability should be to the Legislative Council rather than to a government bureau given the importance of maintaining neutrality from the economic decisions that government inevitably has to make. Formal accountability should therefore be to the Legislative Council.

14. The agency must be adequately resourced, the members of the board must be independent of government and industry and have appropriate qualifications in competition law or economics. The agency would need between 50-60 staff of whom 30-40 would be lawyers and economists. This is in line with comparable overseas jurisdictions. The authority would need powers similar to those found in the Telecommunications Ordinance for investigation of anti-competitive conduct and structure.

15. The agency should be the soul competition agency in Hong Kong with all sectors of the economy coming within its purview including the 'communications sector'. The OFTA competition branch should form a core of the new competition commission. This single model authority is based on the need for best use of resources, the build up of institutional knowledge and skill and consistency of application of the legal provisions in cases involving different sectors of the economy. This model will enhance predictability and competence. It will avoid bureaucratic in-fighting. Major investigations and decisions would need the endorsement of the board of the commission. Appeals from decisions of the commission should be to a specialist tribunal

rather than to the ordinary courts. Further appeal would be to the Court of Appeal and Court of Final Appeal on a point of law only.

16. Remedies should be primarily via the commission. However international experience shows that private enforcement of a competition law compliments and supplements public enforcement but in view of local irrational concern over high volumes of litigation, only injunctive relief should be available to private litigants from the competition tribunal. The commission should be able to impose civil fines of up to 10% of turnover of the holding company of the law breaker concerned but financial penalties have been found in and of themselves to be ineffective in deterring repeat offences by the same company and deterring others from engaging in anti-competitive conduct. Fines can be passed on to either shareholders in lower profits or to customers in higher prices. Thus personal penalties are necessary. Criminal penalties against directors are inefficient as the criminal justice system requires higher standards of proof and more elaborate trial processes. Thus to ensure greater compliance with the law a system of director disqualification of up to 10 years should be available in appropriate cases. This would concentrate the minds of errant directors and likely have a greater salutary affect than the distant prospect of imprisonment. The commission should also have a cease and desist power on both an interim and permanent basis.

17. The agency should also have a statutory duty to advise government on all aspects of decision making which might have adverse competition consequences. Should government choose to ignore the commissions advice public justification should be given. The agency should also have an extensive advocacy role to industry and the public, given the new and complex nature of a pro-competition regime. The commission should also have extensive powers of international collaboration including liaising with overseas and mainland authorities on harmonising competition norms worldwide. The commission should also be able to exchange information on cases and the have ability to coordinate enforcement actions. The commission's jurisdiction should include activities that compromise a market in Hong Kong whether as a result of cartel-like activity or when a player is dominant in a Hong Kong market or somewhere else that results in an affect on a Hong Kong market. This is particularly important as Hong Kong imports most of its consumables from outside the territory and is thus vulnerable to anti-competitive conduct that takes place beyond its borders.

18. The commissions should also have power to negotiate settlements, grant leniency or immunity to informants and collaborators; this has proved to be immensely useful overseas in increasing the rate of detection and punishment of cartels. Further, 'whistle-blower' protection is necessary so that employees of law-breakers who inform the authorities are protected from discriminatory action or dismissal from employment by an ability to seek losses for damages sustained by them.

19. The concerns of SMEs of either excessive intrusion into their activities by the new commission or suffering from harassment litigation by larger players are both profoundly mistaken. Block exemptions and de minimus provisions

would ensure that most SME activities were outside the scope of the new ordinance for the simple reason that their actions do not have a significant anti-competitive effect. In relation to abuse of litigation the tribunal would have power to dismiss unmeritorious claims at an early stage and the likelihood of credible grounds for complaint by large incumbents against small competitors is very low. Thus the concerns expressed by the SME sector about the introduction of a comprehensive competition law lack rationality.

20. As regards compliance costs large local or international firms already have to comply with competition regimes worldwide. Compliance of a light-touch Hong Kong regime would involve minimal additional expense. SMEs would not generally be caught by the provisions and therefore their compliance costs would be negligible or zero.

21. Thus the scheme proposed above for a new competition system in Hong Kong amplifies the submission of the Civic Party in some respects but is consistent with it. Such a scheme is appropriate with the actual situation of the Hong Kong economy, adopts international best practice suitable to Hong Kong's particular needs, is sensitive to the areas of concern raised by local business whilst maintaining a logical and principled approach. The system proposed is a light-touch regime that aligns with Hong Kong's traditions. If adopted it would provide a mechanism to help ensure Hong Kong's continued economic prosperity and would open various sectors of the market to competition and allow the creation of new innovative firms that could not only provide new products and services but would also allow entrepreneurs the ability to create new businesses and enhance the opportunities for employment.

22. This scheme is defensible and appropriate for Hong Kong's situation and would bring Hong Kong into line with other developed economies and might also provide a pattern for the mainland authorities to observe in their own efforts to adopt a comprehensive anti-monopoly law in their jurisdiction.

23. I would be happy to amplify any of the comments made in this submission and to comment on the draft of any legislation, if required.

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