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To whom it may concern,

Attached please find my response to the public discussion document . Thanks.

Best regards,

Thomas Cheng

Response to ***Promoting Competition—Maintaining our Economic Drive***

Thomas K. Cheng[1]

I. INTRODUCTION

A. This submission responds to some of the questions posed in the government's public discussion document, *Promoting Competition—Maintaining our Economic Drive*. The author submits these views in his personal capacity. The submission in no way represents the views of the institutions to which the author is affiliated.

II. ENUMERATION OF PER SE VIOLATIONS (QUESTION 6)

A. The CPRC report rejected the designation of certain offenses as per se violations, and instead suggested that every violation should require a proof of anticompetitive effects.

B. It is important to ask what will be achieved by requiring a proof of anticompetitive effects in every allegation of violation, including horizontal price fixing, output allocation, horizontal market allocation, bid rigging, etc. The idea behind such a requirement presumably is that only anticompetitive conduct by a firm that has a large enough market share to cause substantial anticompetitive effects will be caught. This requirement is meant to protect small market players and SMEs. The costs of such a requirement, as opposed to having designated per se violations, are increased litigation expenses. In regimes in which certain offenses are designated as per se violations, the plaintiff would only need to prove the existence of the alleged conduct, and can eschew the elaborate proof of competitive effects, which often involves complex economic analysis and a detailed study of the market. A regime that requires a proof of anticompetitive effects for every allegation of violation would waste valuable enforcement resources.

C. Such resources would not be wasted if it were necessary to determine the anticompetitive effects of the alleged conduct. However, experiences in established jurisdictions have been that such conduct as horizontal price fixing, output restriction, and horizontal market allocation are almost always anticompetitive. The designation of per se violations was originally conceived as a way to simplify the litigation process and to conserve resources. Given the concern in Hong Kong about the potentially high litigation expenses arising from the proposed competition law regime, it would be beneficial for the proposed competition law to designate per se violations. This conservation of litigation resources would be particularly pertinent to SMEs, which are likely to have fewer resources at their disposal.

D. The designation of per se offenses also reduces uncertainty in compliance. Businesses will know clearly what types of competitive conduct are prohibited, which would help to alleviate concerns within the local business community over compliance costs and certainty. This increased legal certainty

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[1] The author wishes to acknowledge the valuable comments of Professor Michal Gal of the University of Haifa and Peter MacMillan on this submission. All errors and omissions remain the author's.

again should be especially pertinent to SMEs, as it reduces the need to seek legal advice. This is not to say that uncertainty will be eradicated altogether. There could still be ambiguity with respect to whether a certain competitive conduct constitutes the designated offense. Yet it is clear that designating per se offenses would increase legal certainty.

E. The concern about protecting small market players and SMEs remains valid. However, requiring proof of anticompetitive effects for every allegation of violation is not the most cost-effective way of addressing that concern. Instead, Hong Kong can look to the experience of the European Community ("EC") with the *de minimis* doctrine, under which conduct of firms with a combined market share below a certain threshold is exempted from prosecution. According to the European Commission's *Notice of Agreements of Minor Importance*, horizontal agreements between parties with less than 10% combined market share, and vertical agreements between parties with less than 15% combined market share, would usually not be targeted by the Commission.[2] In addition, the European Commission emphasizes in the *Notice* that agreements among SMEs rarely cause competition problems.

F. The future competition enforcement agency in Hong Kong could emulate the European Commission's approach, and perhaps issue a similar policy statement regarding SMEs. Even without adopting a formal policy statement, the enforcement agency could adopt an unofficial enforcement policy that focuses on firms with larger market share. Moreover, the enforcement agency could encourage SMEs to apply to the agency for exemptions. There are many ways to spare SMEs the brunt of enforcement. Requiring a proof of anticompetitive effects for every allegation of violation is not one of them.

G. The question remains as to how the designation should be done—should the proposed law contain a list of per se violations, or should the designation be left to the enforcement agency, or perhaps the adjudicatory body. Per se offenses should not be designated in the ordinance itself. Should the need to revise the designations arise, amendment of an ordinance is a much more cumbersome and arduous process than revision of agency policy or guidelines. Another question is whether designation should be done by the enforcement agency or the adjudicatory body. In the U.S., the task has been left to the courts. However, judicial designation is inherently retroactive in the sense that courts cannot issue ex ante rulings without a concrete case at hand. To reduce uncertainty, it would be better to vest the power in the agency, which can announce the designations in advance to put potential parties on notice.

H. In conclusion, the ordinance should be drafted in general terms to prohibit conduct involving more than one undertaking that has the purpose or effect of restricting, distorting, or eliminating competition. The future enforcement agency should then be empowered to issue guidelines enumerating conduct which it deems to be so overwhelmingly anticompetitive that it is presumed to

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[2] European Commission policy is that the so-called hardcore violations, such as price fixing and market allocation, do not benefit from the *de minimis* doctrine. In other words, even if the firms engaging in price fixing have a total market share of less than 10%, the *de miminis* exception does not apply and the Commission may still prosecute these firms. The future enforcement agency in Hong Kong need not follow this approach and may apply the doctrine flexibly, at least during the initial stages of enforcement.

have the purpose or effect of restricting, distorting, or eliminating competition. This approach should provide adequate guidance for compliance while maintaining flexibility should revisions be necessary.

III. DELINEATION OF OFFENCES IN THE ORDINANCE (QUESTION 4)

A. There are two aspects to this issue. The first aspect is whether the proposed law should delineate, in an exhaustive manner, the specific types of anticompetitive conduct that is prohibited by the law. For example, the CPRC report suggests that only price fixing, bid rigging, market allocation, sales and production quotas, joint boycotts, unfair and discriminatory standards, and abuses of dominance should be prohibited. The second aspect is, assuming that the answer is negative to the first question, whether the law should provide examples of prohibited conduct.

B. Limiting the proposed law's prohibition to certain types of conduct would be counterproductive and unresponsive to public concerns. First, business practices and commercial conduct come in a variety of shapes and forms. A particular conduct may not fit neatly into one of the delineated categories, but may nonetheless be clearly anticompetitive. By limiting ex ante the proposed law's prohibition to certain categories of conduct, the focus of enforcement and litigation would be diverted from the competitive effects of the conduct, which should be the chief concern of competition law enforcement. Instead, the agency and the litigants would waste valuable resources on semantics, arguing whether a particular conduct counts as one of the delineated categories of conduct. For example, one of the categories suggested by the CPRC is unfair and discriminatory standards. One can easily imagine litigants spending countless hours arguing whether a certain business practice constitutes a standard, not to mention whether it is unfair and discriminatory, both highly malleable and nebulous terms.

C. Second, the public has voiced its objections to past or current business practices that would probably be considered anticompetitive in other established jurisdictions, but would be excluded in the scheme proposed by the CPRC. Unless a convincing explanation is furnished, it is difficult to justify why certain types of competitive conduct, which the public has found reprehensible and which are regarded as anticompetitive in established jurisdictions, should be allowed to continue. Therefore, Hong Kong should follow the approach of established jurisdictions, and adopt a law that proscribes anticompetitive conduct in general terms.

D. The second aspect of the issue remains—whether the proposed law should provide non-exhaustive examples of proscribed conduct. Doing so would provide guidance to businesses, and does not seem to have much detrimental effect. Otherwise, the provision of examples can be done by the enforcement agency through the issuance of guidelines. Again, doing so through agency guidelines allows more flexibility, as a revision of examples would not entail an amendment of the ordinance. However, doing so in the ordinance itself would send a clearer signal to the local community of the illegality of the enumerated conduct. As long as the examples given in the ordinance are indisputably anticompetitive, insertion of examples in the ordinance should not be problematic.

E. There may be some confusion as to the difference between designating per offenses in the ordinance and providing examples of anticompetitive conduct. While they are very similar in practical terms, designation of per se offenses and enumeration of examples are conceptually different. Assume that horizontal price fixing is both designated as a per se violation and given as an example of anticompetitive conduct in the ordinance. Under the former, if a litigant can prove the existence of horizontal price fixing, it has proved a violation. Under the latter, however, the litigant would still need to show the purpose or effect of restricting, distorting, or eliminating competition. The legal implications of the two in the litigation process are different.

IV. MERGER CONTROL (QUESTION 3)

A. The CPRC report suggested that Hong Kong eschew merger control because the new competition law regime should only regulate competitive behavior, and not market structure. This argument does not withstand scrutiny. Hong Kong should follow international practices and institute a merger control regime.

B. It has been said that the new competition regime should not regulate market structure and should focus on market conduct. However, this dichotomy between regulation of structure and regulation of conduct does not reflect the true state of competition law. Regulation that ostensibly only concerns conduct often entails an examination of the market structure.

1. While regulation of abuses of dominance seems to be focused on market conduct—the abuse itself, it in fact requires an examination of market structure. No abuse is found unless there is dominance in the market. A determination of dominance requires a holistic examination of the market, including market share of the firm at issue, the number and market share of competitors, potential competition, entry barriers, the existence and extent of vertical integration, etc. In short, what is ostensibly regulation of conduct in fact also implicates market structure.

2. Regulation of anticompetitive agreements and collusive conduct may similarly take into account market structure. For example, market conduct that falls under the Rule of Reason often cannot be analyzed in isolation. The overall competitive effects of a conduct must be understood in the context of the market in which it operates. Maximum resale price maintenance, which is a form of vertical price fixing, is an example of such a conduct. One cannot bifurcate competition law into regulation of market conduct and regulation of market structure. The two go hand in hand.

C. Merger control is not regulation of market structure for the sake of regulating structure. The purpose of merger control is the same as that in other branches of competition law, which is to safeguard the competitive process and to promote consumer welfare. Merger control achieves these purposes by preventing the creation of dominant firms and market conditions that are conducive to collusion. Under the structure-conduct-performance paradigm, the competitive conduct and performance of firms in a market is influenced by the market structure. A market with a dominant firm, which can charge supra-

competitive prices, is unlikely to be competitive. However, poor competitive performance is not limited to such a market. For example, firms are likely to collude in a highly concentrated market with a homogenous product and high price transparency. In fact, preventing the creation of oligopolistic market structure that is prone to collusive conduct was the main objective of U.S. merger control until the early 1980s. In sum, market structure has substantial impact on competitive conduct and market performance. Merger control is about minimizing anticompetitive conduct through ex ante examination of market structure. It does so simply by prohibiting ex ante those market structures that have a strong likelihood of limiting competition without offsetting benefits. A competition law regime without merger control is incomplete and ineffective.

D. Merger control is especially important for small economies. As Professor Michal Gal argues in her book "Competition Policy for Small Market Economies"[3], the smallness of the market exacerbates the case for merger control. This is true for several reasons: First, mergers might entrench the market power in a small economy. Especially in industries characterized by high entry barriers, once a market structure is in place, it is difficult to alter or reverse. This is borne out by the experiences of other small economies. Second, as mentioned earlier, merger policy is the most powerful weapon available in the competition policy arsenal to combat tacit collusion or cartel behavior. Because of the difficulty in detecting such conduct, preventing the creation of market structures that tend to facilitate such collusive outcomes becomes more important.

E. At the same time, as Gal points out, mergers might carry many benefits for small economies. Mergers provide the opportunity for the realization of potential efficiencies in oligopolistic markets that would otherwise remain unexploited due to cooperative profit-maximizing strategies that limit the incentives of firms to grow to optimal sizes internally. A welfare-enhancing merger control policy should thus comprise of a set of flexible instruments that explicitly recognize the efficiency benefits of a merger.

F. If the general competition law regime eschews merger control, the telecom sector will remain the only sector subject to a fully functional merger control regime. There is no logical or competition law-related reason that the telecom sector should be singled out for merger control enforcement. Moreover, experience with merger control in the telecom sector has been immensely positive. There is no evidence of excessive regulation on the part of OFTA. Mergers and acquisitions that have no anticompetitive effect have been duly approved. There is no reason to doubt that the future competition enforcement agency cannot perform up to this standard.

G. Initial merger control enforcement can be especially permissive. For example, market share and market concentration/HHI thresholds can be set at a very high level such that the enforcement agency will not challenge a transaction unless overwhelming anticompetitive effects will result.

H. One may argue that such an arrangement will deviate from international best practices. There are two responses to that. First, Hong Kong need not follow

[3] Harvard University Press, 2003, chapter 6.

the HHI thresholds used in other jurisdictions, many of which have larger economies and more experienced enforcement agencies. Different jurisdictions use different HHI thresholds, and most small economies do not follow those of the U.S. or the EC. One may argue that there is in fact no international best practice in this regard. Given the smallness of the Hong Kong economy, high market concentration is a fact of economic life. Higher market concentration thresholds must be used to give firms room to grow to take advantage of economies of scale. Second, even the HHI thresholds used by U.S. enforcement agencies are not as stringent as they seem. The U.S. Department of Justice and Federal Trade Commission have disclosed that the internal HHI thresholds used by them are in fact considerably higher than the official ones.

I. Hong Kong is at liberty to choose the HHI thresholds most appropriate for its economy, without compromising the competitiveness of its economy and the effectiveness of its competitive law regime. Shunning merger control altogether, however, would undermine both.

V. PRIVATE RIGHT OF ACTION (QUESTION 19)

A. There is considerable concern that allowing a private cause of action would lead to excessive and vexatious litigation in Hong Kong. In particular, the prospect of importing into Hong Kong the over-zealous litigation environment in the U.S., by introducing a private cause of action under the new competition law, has caused substantial anxiety. However, it is important to understand that the existence of a private cause of action in U.S. antitrust law is not the sole, or main, cause of the high number of antitrust lawsuits in the U.S. High volume of lawsuits is common across various areas of law in the U.S., including securities litigation, shareholders' derivative action, product liability lawsuits, etc. Antitrust is not alone in this respect. In fact, antitrust is not usually regarded as one of the more litigious areas of law in the U.S.

B. There are many intertwined reasons for the litigious environment in the U.S. One of them is that the U.S. federal civil procedures allow for very liberal discovery by parties, without which private plaintiffs would have much greater difficulty establishing their claims. These discovery rules grant parties access to a wide range of documentary evidence, and tilt the litigation process substantially to the plaintiff's favor. This is because it is usually the plaintiff that is in need of documents from the defendant to prove its case. This is particularly true of antitrust cases. The defendant is more likely to hold crucial information on the market and a particular anticompetitive market practice that allegedly has harmed the plaintiff. Without a similar discovery mechanism in Hong Kong, a private plaintiff would face considerable difficulties proving its case. Private competition law litigation will not reach the level in the U.S.

C. Another reason is that there exist a large number of law firms in the U.S., usually known as plaintiffs' firms, which specialize in filing lawsuits. Aided by contingency fees, these firms often make a fortune by filing multi-billion dollar lawsuits and pressuring the defendant to settle the case. The absence of these law firms in Hong Kong means that introducing a private cause of action under the new competition law should not lead to a flood of litigation.

D. One effective way to limit private lawsuits is to allow them only after the enforcement agency has established wrongdoing in its own administrative action. This can be called follow-on private action. This restriction is in place in the Singaporean competition law. In fact, given the lack of discovery procedures to allow the plaintiff to obtain evidence, plaintiffs are unlikely to succeed in a private lawsuit without the help of a preceding administrative action.

E. Even without this restriction, there are other ways to limit the availability of the private cause of action. U.S. antitrust law uses a number of doctrinal devices to limit the types of private plaintiff that are entitled to bring suit. The most well known of these is known as the *Illinois Brick* doctrine, which emanated from a U.S. Supreme Court case in 1977. In that case, the U.S. Supreme Court held that indirect purchasers, i.e. those that did not purchase directly from the company guilty of the antitrust violation, cannot recover from the company. In other words, end consumers cannot recover in cases in which they purchased the good at issue from the retailers and the antitrust violation is committed by the manufacturers or the wholesalers. Only the retailers will be able to recover. The practical effect of this doctrine is that end consumers are seldom allowed to recover under U.S. antitrust law.

F. Two other doctrines that are used to limit the types of private plaintiff that are entitled to bring suit are standing and antitrust injury. These two doctrines are complex and comprise a full body of case law. This submission will not seek to provide a full explanation of them. One example is the *Brunswick v. Pueblo Bowl-O-Mat* case, in which the U.S. Supreme Court held that a competitor which was hurt by a merger by way of the merged entity's post-merger low prices had no standing to sue because it did not suffer the type of injury which antitrust laws were supposed to prevent. U.S. antitrust law aims to promote competition. Low prices benefit consumers, and are benign in the eyes of antitrust law. A firm that is hurt by low prices resulting from an allegedly anticompetitive conduct may not sue under U.S. antitrust law.

G. If the new competition law allows a private right to sue, it is likely that there will be an initial surge of lawsuits. However, that should not cause grave concern because parties who have long been victims of anticompetitive behavior will seek to take advantage of the new law. Once these initial lawsuits are dealt with, the volume of lawsuits should fall precipitously. Moreover, doctrinal devices similar to what are mentioned above can be introduced, either by way of statutory language or case law, to impose restrictions on the private cause of action.

VI. PUBLIC INTEREST EXCEPTION

A. Various jurisdictions have given public interest different roles and degrees of importance in competition law analysis and enforcement. The idea behind a public interest exception is that there are cases in which non-competition related public policy concerns should be taken into account, and perhaps should trump competition concerns. A public interest exception would incorporate these policy considerations into competition law analysis.

B. Whether the proposed law should provide a public interest exception ultimately is a question about what role Hong Kong wants competition law to

play in its economic policy, and how much faith the city places in the market mechanism. Does Hong Kong want its competition law to be principally, if not exclusively, concerned with market competition? Or does Hong Kong want its competition law to become a broader economic policy tool? Does Hong Kong believe that the market will in most instances arrive at the most efficient resource allocation? Or does Hong Kong believe that the law and the government on occasion should be given the power to temper and tamper with the market mechanism?

C. Hong Kong has long taken pride in its espousal of the free market philosophy and its respect for the market mechanism. In keeping with this long-standing tradition, public interest should be given a very limited role in competition analysis. Competition law should be concerned with competition issues. Other public policy concerns, such as environmental protection and education, should be dealt with on a broader policy level and not in the case-specific context of competition law enforcement. If enforcement of competition law in a specific case would result in detrimental, non-competition related public policy consequences, these consequences should be addressed through other policy tools, and not by bending competition law.

D. A didactic example is the role of public benefit in the telecom sector merger control regime, as described in the *OFTA Merger Guidelines*. While OFTA recognizes public benefit, it has given it a very limited role. In those *Guidelines*, OFTA states that while it is in principle able to consider any type of public benefit, as the term is not defined in the Telecommunications Ordinance, it will most likely accept public benefit of the economic kind. The future enforcement agency should adopt the same approach and limit its consideration of public interest to economically related and competition-related matters.

VII. EXCLUSIONS AND EXEMPTIONS (QUESTION 7)

A. Exemptions

1. The enforcement agency should be given the power to grant ex ante exemptions. Doing so would allow the agency to give clear guidance to businesses. However, it is important to ensure that this power is exercised in accordance with established competition law principles. One way to achieve this is to set out clearly in the ordinance considerations and principles that govern the granting of exemptions by the agency. Another way is for the ordinance to require the agency to set out its approach to granting exemptions in enforcement guidelines.

2. One issue related to exemptions is whether the enforcement agency should be allowed to grant individual exemptions (exemptions that apply only to an individual agreement or conduct) or whether the agency should be limited to categorical, or in the parlance of EC competition law, block, exemptions (exemptions that apply to a category of agreements of conduct). After recent reforms of the EC competition enforcement regime, the European Commission no longer grants individuals exemptions. Private parties are now required to determine for themselves whether their agreements fulfill the

exemption criteria set out in the legislation. The rationale behind this reform is that review of individual exemptions consumes enormous amount of resources that could be better deployed elsewhere, such as in cartel enforcement. The disadvantage is obviously less legal certainty for private parties.

3. Whether the future enforcement agency in Hong Kong should be given the power to grant individual exemptions depends on its resource constraints. An agency that is well funded and staffed by experienced officials would have the wherewithal to handle individual exemption requests. Otherwise, the enforcement agency may be allowed to grant individual exemptions initially, so as to provide more guidance to businesses. After local businesses have become more familiar with competition law, this power can be taken away. This is in some ways similar to the EC experience.

4. Block exemptions for an entire industry are rarely, if ever, justified on competition law grounds. The enforcement agency should clearly reflect this in its exemption policy guidelines. This would deter industry representatives from engaging in wasteful lobbying and would help to shield the enforcement agency from needless political pressure.

B. Exclusions

1. Overseas jurisdictions generally distinguish between exclusions and exemptions. Exemptions are granted to undertakings and entities to which competition law applies. The undertakings or entities are merely exempted from the application of the law, in most cases only for a finite duration. If exclusions are granted, the beneficiaries are excluded from the reach of the law altogether. Exemptions are usually granted by the enforcement agencies, whereas exclusions are provided in the legislation itself.

2. There is no good reason for Hong Kong to provide exclusions to any particular entities or sectors. A sectoral exclusion would defeat the raison d'etre of a cross-sector competition law. Moreover, overseas jurisdictions that have granted exclusions from their general competition law have recently revisited their policies. An example would be the discussions that took place in the Antitrust Modernization Commission in the U.S. regarding certain sectoral exclusions. Any demonstration of a willingness on the part of the government to consider exclusions for a particular entity or sector would in all likelihood result in an avalanche of exclusion requests, needlessly diverting valuable legislative resources from more important issues as Hong Kong structures its competition law regime.

VIII. INSTITUTIONAL DESIGN (QUESTIONS 8 & 9)

A. The public discussion document sets out three possible arrangements for the competition enforcement agency and the adjudicatory mechanism for competition law cases.

B. There are two layers of adjudicatory mechanism that need to be dealt with: the trial level ("adjudicatory body") and the appellate level ("appeals body").

C. In deciding which arrangement best suits Hong Kong's circumstances, attention should be paid to three important considerations:

1. Development of expertise in competition law and economics in the shortest possible time

(i) In the interest of achieving effective competition law enforcement, the sooner the adjudicatory body attains the requisite expertise the better. Given the highly technical nature and prevalence of economic concepts in competition law, the most effective way of accumulating expertise in competition law is to have a specialist court, both on trial and appellate levels. Having the same judges hear all competition law cases would accelerate the process of accumulating expertise.

2. The costs of setting up a separate adjudicatory mechanism

(i) It is likely to be more expensive to set up an adjudicatory mechanism that is separate from the enforcement agency. Putting the adjudicatory body, at least on the trial level, within the enforcement agency would save costs.

(ii) It is important to ascertain the actual cost savings that would be achieved by putting the adjudicatory body within the enforcement agency.

3. The appearance of objectivity of the enforcement agency

(i) Given the public's, especially the business community's, initial skepticism about competition law, it is important for the enforcement agency to maintain an appearance of objectivity. Separating the adjudicatory mechanism from the enforcement agency would best achieve that. Of course, the appearance of objectivity would be undermined if members of the adjudicatory body do not demonstrate independence from business and community interests, and do not possess good knowledge of competition law. A rigorous nomination process should be instituted to ensure that nominees meet both criteria.

D. Among the three options proposed in the public discussion document, Option 2 allows the slowest accumulation of expertise, as judges in the regular courts will not specialize in competition law. Competition law cases will be assigned to different judges over time and past experience will not be built on. One possible remedy for this is to convene a panel of small number of existing judges only whom will be assigned to hear competition law cases. Option 2 is superior to Option 1 in giving an appearance of impartiality. Lastly, although Option 2 will allow us to take advantage of existing court resources, it should not be misunderstood that the option carries no costs. Given limited judicial resources, the time and resources spent by a regular court on a competition law case, which would have been spent on other cases, will result in delay in adjudication for those other cases.

E. Both Option 1 and Option 3 would allow accumulation of expertise within a reasonable time. Option 3, like Option 2, has the advantage of giving an

appearance of impartiality, while Option 1 probably would entail lower set-up costs. However, it is important to determine the actual cost saving.

F. Within or without the enforcement agency, the adjudicatory body will need to be set up. Adjudicatory officials will need to be trained, and support staff hired regardless of the institutional location of the adjudicatory body. Cost savings may be achieved in overhead costs, but these costs can be shared with the appeals body, should one be established. Staff training costs may also be shared with the enforcement agency. As such, the actual cost savings of putting the adjudicatory body within the enforcement agency may be lower than expected.

G. The importance of the appearance of impartiality is highlighted by the experience of the European Commission. The Directorate General of Competition in the European Commission has been criticized for a lack of impartiality in decision-making, precisely because the Directorate handles both the investigation and the adjudication of a case. Reforms have been made to remedy this.

H. The U.S. provides an interesting example in institutional design because both Options 1 and 2 are in use. The CPRC omitted to mention the Department of Justice, Antitrust Division ("DOJ"), as one of the enforcement agencies in the U.S. The DOJ is every bit as important as the Federal Trade Commission ("FTC") in antitrust enforcement. The CPRC report correctly noted that the FTC adopts an institutional design model more akin to Option 1. Meanwhile, the DOJ does not have any adjudicatory function and must try all cases in front of a federal district court. Even a settlement decree between the DOJ and a private party must be approved by a federal court. This arrangement has contributed to an appearance of impartiality in adjudication.

I. Another important aspect of institutional design is the relationship between the management board and the chief executive of the enforcement agency, should such a board be instituted. In particular, it is important to delineate what kind of supervision the board has over the chief executive. While it is important that the chief executive be held accountable to society at large, his independence must also be safeguarded so that he can select and pursue cases shielded from public pressure.

J. Lastly, and probably the most importantly, the future enforcement agency should be amply staffed with economists knowledgeable about industrial organization. The current development of competition law is such that economics is widely and regularly deployed to aid analysis. Many would argue that certain aspects of competition law analysis, such as market definition and assessment of market power, cannot be accurately done without the assistance of economists anymore. The U.S. has long incorporated economists in antitrust work, both in private practice and public enforcement. The EC has followed suit. The European Commission created the position of chief economist a few years ago. The Competition Commission in Singapore also has a chief economist. If Hong Kong wanted to ensure that its competition law enforcement is done rigorously and up to international standards, the future enforcement agency should be adequately supported by economists.

IX. LENIENCY PROGRAM (QUESTION 16)

A. As experiences from other jurisdictions have shown, leniency programs are pivotal to the detection of and enforcement against cartels. While the detailed workings of leniency programs vary across jurisdictions, and there are numerous examples from which Hong Kong can learn, it is crucial that a leniency program is instituted in the proposed competition law regime to facilitate cartel enforcement.

X. ENFORCEMENT POWERS (QUESTIONS 15, 17 & 18)

A. Power to reach binding settlements

1. The enforcement agency should be given the full panoply of powers to deal with potential offenders. The power to open an investigation and the power to initiate a lawsuit are obvious important. In addition to these powers, the agency should be given the powers to handle a lawsuit in the most appropriate manner, including the power to reach a settlement with the defendant. There are many reasons that an enforcement agency would prefer to settle a case instead of litigating it to the end. For example, the case may have little value as a precedent, and the defendant is willing to admit wrongdoing and pay a fine. Under these circumstances, it may be advisable for the agency to settle the case to conserve precious litigation resources, which can be deployed in other more important cases. Therefore, the enforcement agency should be given the power to reach a binding settlement.

2. The more complex issue is whether a settlement between the agency and the defendant should have any preclusive effect on lawsuits by private litigants. The relevance of this question obviously depends on whether private lawsuits are allowed. If they were not, this issue would be moot. If they are allowed, however, there are a number of considerations pertaining to this issue. A defendant would have much greater incentive to settle if a settlement with the agency would foreclose future private lawsuits, even if the defendant must admit responsibility and pay a fine in conjunction with the settlement. One of the common complaints by defendants in other jurisdictions is that settlement with the agency does not bring a close to the case. They still face private lawsuits. However, allowing an agency settlement to have preclusive effect may violate private parties' legitimate expectation for compensation for their injuries resulting from the defendant's anticompetitive conduct. In the U.S., settlement with the enforcement agencies does not preclude private lawsuits. Yet incentives on the part of defendants to settle with the agencies do not seem to be dampened. The balancing of these conflicting considerations is complex and requires further study and contemplation.

3. The enforcement agency should be required to disclose to the public every settlement it has reached, and to provide an explanation for the rationale behind settling the case. This requirement will make sure that the agency will not settle lawsuits out of convenience, or in response to political and other pressure. Accountability of the agency and transparency of its decision-making process will be enhanced.

B. Power to issue cease-and-desist orders

1. The power to issue cease-and-desist orders is pivotal to the effectiveness of the agency's enforcement effort. Without such a power, the defendant could conceivably pay the fine and continue its anticompetitive conduct. It is too early to predict whether this scenario will be a common occurrence and how often the agency will be required to exercise this power. However, to ensure that non-compliance by private parties does not make a mockery of the agency, it should be given the power to issue cease-and-desist orders.

C. Level of penalties

1. How to set the optimum level of fines to deter future violations is a complex issue. There is a wealth of economic literature on this topic. The European Commission has issued guidelines to provide guidance to private parties. The maximum limit on the fine which the European Commission may impose is 10% of the annual total turnover of the undertaking involved in the preceding business year. However, the fines that the European Commission has imposed have been substantially lower than this limit. It will probably take the future enforcement agency some time to come to an established approach to calibrating fines. It may want to follow the European Commission's approach and issue guidelines on this issue after it has acquired some experience. What is needed in the ordinance is flexibility so that the enforcement agency will have room in which to formulate the most effective policy.

XI. INITIAL ENFORCEMENT POLICY

A. Initially, the enforcement agency should focus on competitive practices that clearly violate the law, such as horizontal price fixing, bid rigging, and horizontal market allocation. While these practices are not necessarily easier to prove evidentially, their legal status and competitive effects have long been settled in other jurisdictions. These practices are also conceptually simpler to understand and explain to the adjudicator. Focusing on such practices initially will allow the agency to acquire enforcement experience and build a successful track record before tackling more complex cases, such as those involving non-price related abuses of dominance. Enforcement officials will likely need time to familiarize themselves with the economically intensive nature of competition law cases. And a successful track record will enhance the credibility of the agency in the eyes of the public.

B. The enforcement agency may consider instituting an initial grace period after the law is enacted. During this grace period, firms may report potentially illegal business practices to the agency. As long as they undertake to discontinue such practices, the agency will not pursue enforcement action. This grace period mechanism is useful because firms have significant incentives to discontinue anticompetitive practices, and the enforcement agency will be alerted about which sectors and firms to monitor for possible future violations. The duration of the grace period should not be so short that firms will have insufficient time to seek legal advice. However, it should not

be so long that it undermines the enforcement authority of the agency. A period of six months would be suitable.

XII. EDUCATION

A. One of the most important initial tasks for the competition enforcement agency is to educate the public and the business community about competition law. The agency should explain what competition law does and does not do. Competition law is not industrial policy, and does not direct business activities or seek to protect one type of competitors in the market based on their size, scope of business activity, or other distinctions between competitors. Instead, competition law protects the competitive process and promotes consumer welfare. Firms are still expected, and in fact encouraged, to compete rigorously after the institution of competition law. However, they must compete without resorting to anticompetitive business practices.

B. The enforcement agency should explain to the public and the business community what falls within the scope of competition law. Competition law regulates competitive behavior between firms and transactions that alter the competitive environment of a market. It does not regulate any and all issues that arise in the business relationships between competitors. Nor is it concerned with misleading and deceptive trade practices and consumer protection issues, although consumer protection and competition law enforcement are handled by the same enforcement agency in some jurisdictions. Examples include the Australian Competition and Consumer Commission and the Federal Trade Commission in the U.S.

C. The enforcement agency should explain to the public and the business community what is the scope of permissible competitive and collaborative behavior by firms. This is particularly important because while some competition law offenses, such as horizontal price fixing and bid rigging, may be intuitively obvious to the public, other business practices regulated by competition law, such as information exchange within a trade association and the competitive behavior of a dominant firm, may require more explanation.

D. All this can be achieved through public education and community outreach programs. Aside from the general public, it is especially important to educate the business community. While large companies may be able to afford legal advice from trained competition lawyers, SMEs may not have the same resources at its disposal. The enforcement agency should organize educational programs, such as seminars and short courses, to educate the business community and hopefully to ease concerns about compliance.