A challenging time

Hong Kong gets serious about competition law

*by **Suzanne Rab****

Hong Kong will imminently join the ranks of most of its Asian neighbours including mainland China, Indonesia, Japan, Malaysia, Singapore, South Korea, Taiwan, Thailand and Vietnam in implementing modern economy-wide competition law. The much awaited and fiercely contested legislation - the Competition Ordinance of 14 June 2012 (CO) - will come into force on 14 December 2015. Guidelines on how the new Competition Commission (Competition Commission) and the Communications Authority will apply the CO were published on 27 July 2015.

Drafting the law, regulations and guidance is only a first step in embedding and enforcing an effective competition law. With the spread and diversity of competition laws across Asia in recent years, a challenge for international businesses is knowing where enforcement is credible and where it is not. At one level, Hong Kong is already among the strongest economies in the world despite its relatively small population and territory. This vibrancy has been attributed by some to a policy against government intervention or regulation of markets in previous years. It may be asked what competition law can achieve against this background and how businesses can address the challenges of nascent competition law enforcement in the territory.

Challenge No 1 – Culture

The adoption of the CO followed years of consultation and friction between industry, consumer groups and government. It was questioned whether there was a need for a general competition law in Hong Kong. When the Hong Kong government issued its competition policy in May 1998, through a formal policy statement and establishment of the Competition Policy Advisory Group (COMPAG), it stated that, instead of introducing a general competition law, it would adopt a sector-specific competition policy framework for the telecommunications and broadcasting sector. This was based on a view that an economy-wide competition law "would not be able to take into account the specific requirement of the individual sectors," and that having such a law would be overkill. Ultimately, this made way for a government announcement in 2007 that Hong Kong would follow the footsteps of its neighbours – and notably Singapore that had enacted cross-sector competition law in 2004. The final enactment reflects a process of engagement with stakeholders that will need to continue if the new regime is to win over hearts and minds into the future.

Challenge No 2 – Capture

Opponents of competition law will seek to influence the political and enforcement process for their own interests and will resist change where the status quo favours them.

Over 98% of Hong Kong's businesses are SMEs and they are likely to be among the chief beneficiaries of competition law where anticompetitive practices of stronger players may be restricting their business. However, concerns were raised that compliance with competition law could increase the costs and regulatory burdens of SMEs. Another concern was the fear that the law could be used strategically by stronger players to exert undue commercial pressure based on an unfounded allegation of breach of the CO.

The CO introduces two safeguards for SMEs. First, there are exemptions from the behavioural prohibitions. There are specific exemptions for small and medium-sized enterprises (SMEs) whose conduct will not infringe the First Conduct Rule prohibiting anticompetitive agreements where the businesses engaging in the practices have a combined turnover in Hong Kong of less than HK$200m. The Second Conduct Rule prohibiting abuse of substantial market power does not apply to businesses with local turnover of less than HK$40m. However, serious anticompetitive conduct including price-fixing, market sharing, output limitation and bid-rigging will not benefit from exemption. Secondly, the right to bring private actions is limited. Private actions can only be brought as follow-on actions (ie following a finding of an infringement by the Competition Tribunal (Tribunal)).

Another group that has urged the Competition Commission to take into account its specific features is the shipping industry. A strict application of the CO could mean that the joint operational agreements that up to now have formed the bedrock of the industry would be illegal unless they can benefit from an individual or block exemption. Shipping lines and associations have objected that unless competition law reflects the rationalisation and economies of scale that their co-operation agreements bring about, this could result in Hong Kong losing out as a transhipment hub to other destinations such as mainland China which have taken a more relaxed attitude to competition law enforcement against such arrangements.

So far there is little sign of overt and illegitimate pressure being brought to bear on the Competition Commission to dilute its enforcement priorities. However, the risk is not to be underestimated and as the Competition Commission develops its experience, it will inevitably come into conflict with interest groups and will need to stand strong to its principles.

Challenge No 3 – Credibility

The future success of the Hong Kong competition regime will depend on the Competition Commission continuing to engage with and foster the support of the business and international antitrust community for its work. Beyond that, the following factors have an important role to play:

- **Independence.** The Competition Commission is an independent statutory body established to enforce the CO. It will want to vehemently demonstrate its independence and

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resist criticism that it is hostage to stakeholder capture and government override.

- **Accountability.** Hong Kong has adopted many of the features of the US prosecutorial system in antitrust matters where, effectively, the Competition Commission needs to apply to a judicial body to enforce its rulings. For serious anticompetitive conduct, the Competition Commission will not issue a warning notice before bringing proceedings before the Tribunal that has been set up to adjudicate on whether or not there has been an infringement. This provides an important check and balance against the criticism that too much power is vested in one authority.
- **Transparency and procedural propriety.** The procedures of the Competition Commission must be transparent if the public and business community are to have confidence in the process and the suitability of the measures adopted during and as a result of the Competition Commission's investigations. The Competition Commission has published six guidelines on its enforcement approach, which followed consultation on the drafts. Guidance on the Competition Commission's approach to leniency was published for consultation on 23 September. It reinforces the message that the Competition Commission is serious in its enforcement priorities. However, key to the effectiveness of its application will be whether business believes that there is sufficient legal certainty over the circumstances in which leniency will be available.

Challenge No 4 – Co-ordination

Before the CO, there was no industry-wide competition law in Hong Kong. A limited sector-specific competition law existed under the Telecommunications Ordinance (TO) and the Broadcasting Ordinance (BO). While the Competition Commission will have the power to apply the CO to all sectors of the economy, the Competition Commission and the Communications Authority will have concurrent jurisdiction to apply the CO in relation to the practices of undertakings in the telecommunications and broadcasting sector.

There is no reason why the concurrent application of competition law by the Competition Commission and the Communications Authority should not work well but it will need to be founded on mutual trust and co-ordination. A memorandum of understanding on how the respective authorities will deal with cases is a starting point. The general principle is that the regulator that will be responsible for a case depends on which one is better or best placed to do so.

International and intergovernmental co-operation will be critical in combating anticompetitive cross-border activity affecting Hong Kong. This recognises that (1) Hong Kong may face challenges in ensuring practical assistance from authorities outside its borders where no formal co-operation arrangements are in place; (2) overseas authorities and businesses operating outside Hong Kong may legitimately seek to protect their own interests against competition law investigations in Hong Kong, which puts a sharp focus on the role of the Tribunal in providing checks and balances; and (3 there may be a limit to the extent to which the Competition Commission is empowered to collaborate with international agencies where the practices at issue taking place within its borders produce harmful effects overseas but not within Hong Kong.

Challenge No 5 – Cartels

The debates throughout the history of the CO and its implementation have been focused to a large extent on the impact of cartels. In fact, contrary to the belief that there is less of a need for competition law in smaller economies, it may be argued that the need is in fact greater in a smaller economy. The small size of the market, the fewer the number of competitors and the fact that "everyone knows everyone else" can render more likely the conditions for collusion.

Unsurprisingly, the first basic tenet of the CO – the First Conduct Rule – reflects a prioritisation of the need to combat cartels. Four types of such anticompetitive conduct are categorised as particularly serious, namely price-fixing, market allocation, output restriction and bid-rigging. The Competition Commission can issue an infringement notice in respect of such serious anticompetitive conduct without issuing a warning notice and reflective of the view that such practices are, of themselves, particularly pernicious.

A further issue relates not to the issue of local cartels but that of international cartels affecting Hong Kong. The cross-border challenges of enforcement are likely to be intensified in the case of cartels which may require regulation and powers on a different level to those in the CO and accompanying regulations (ie with enforcement as opposed to merely subject-matter jurisdiction over parties located outside Hong Kong). Cartels have traditionally been difficult to prove because of their secretive nature and the global scope of activities. Hong Kong is therefore likely to find itself needing to negotiate bilateral treaties with other countries to address transborder cartel issues.

Challenge No 6 – Concentration

At present, Hong Kong does not have general merger control outside the telecommunications sector. The sector-specific merger control regime is contained in the CO as the Merger Rule (section 3 of Schedule 7 of the CO). Transactions that have or are likely to have the effect of substantially lessening competition in Hong Kong are prohibited. Merger control is voluntary in that there is no obligation to notify the Competition Commission of a relevant transaction before or after its implementation. However, the Competition Commission may investigate a merger that falls within the Merger Rule so it may be advisable to discuss a transaction falling within its scope with the agency before it is implemented. The decision by Hong Kong to prioritise its competition law enforcement on conduct and particularly cartels rather than merger control is understandable at the early stages of adoption of competition law. Malaysia has taken a similar course.

The sector-specific focus of merger control on the telecommunications sector is partly explicable by the historic development of the sector. Hong Kong has been renowned as having one of the most competitive mobile telecommunications markets largely due to an open market policy in the 1990s. However, the market is consolidating as illustrated by the acquisition of CSL by HKT.

The likely impact of mandatory and sector-wide merger control on companies looking for opportunities to invest in Hong Kong has not been examined in depth. Likewise, as local companies consolidate, this can raise an inevitable desire to grow national champions which might be more competitive on the international level. Left unchecked, this can also create structural barriers to entry

into Hong Kong, with the result that it becomes less attractive for new entry from home or overseas. The need for industry-wide merger control is expected to be revisited in a few years.

Challenge No 7 – Cost-benefit

There is a need to put in place the human and institutional resources to ensure the development of a credible regulator that is able to enforce the law intelligently and effectively.

The Competition Commission comprises 14 members including the chairperson and is actively recruiting staff across multiple disciplines (including law, economics and finance).

Despite the progress achieved by the Competition Commission to date, like any new regulator it will be charting new ground. A test will be in the quality of its decisions and whether they stand up before the Tribunal.

A further cost consideration relates to the costs of compliance for the authority and business. The CO creates the framework for individual or block exemptions. Agreements that enhance economic efficiency or that are entered into to comply with a requirement of Hong Kong law or where the undertaking is entrusted by the Hong Kong government to operate services of general economic interest are excluded from the First Conduct Rule.

In this regard, an undertaking may make an application to the Competition Commission to determine the applicability of the exclusions or exemptions set out in the CO. This procedure resembles that existing in the EU prior to 1 May 2004 where the European Commission was empowered to issue individual exemptions from the prohibition against anticompetitive agreements contained in what is now article 101 of the treaty on the functioning of the EU.

The extent to which businesses will avail themselves of the procedure to make an application for exemption remains to be seen. One important factor affecting the incentives of parties to seek an exemption is the publicity of the process as the Competition Commission will consult with third parties on the decision whether to grant an exemption.

Challenge No 8 – Compensation

Private actions based on infringement of the CO can only be brought after the Tribunal has ruled that there has been a violation following an application by the Competition Commission for the imposition of a fine or an order to stop the infringing practices.

This represents a significant limitation on the right of victims of anticompetitive activity to claim compensation for their losses. This is mitigated in part by the ability of the Tribunal on the application of the Competition Commission to make an order for damages payable to any person who has suffered loss or damage as a result of the anticompetitive conduct. However, the government is understood to be considering the need for a standalone competition law private action in the years after implementation of the CO.

It remains to be seen whether the current legal framework for private actions will achieve a proper balance between public and private enforcement. In this respect the approach in Hong Kong goes against the general policy trend in this area internationally.

Challenge No 9 – Criminalisation

The penalties for substantive violations of the CO are administrative, albeit that the Court may impose criminal sanctions for failure to co-operate with a Competition Commission investigation.

It is notable that the financial penalties are directed at businesses rather than individuals, albeit the Tribunal may impose a wide range of sanctions including disgorgement of illegal gains (or avoided losses) as a result of the anticompetitive conduct, payable to the government of Hong Kong or any other specified person.

Various criminal penalties are available to the courts. However, these are limited to situations where an undertaking or a person has not complied with an investigation into a breach of the competition law or has actively obstructed such an investigation.

Advocates of criminalisation of competition law and the direct imposition of punishments on individuals argue that this is necessary to incentivise compliance and deter serious violations.

There is clearly a trade-off between deterrence goals and ensuring adequate protection for the rights of the defence. The ability to deploy criminal penalties is useful but experience suggests that the authority should choose its cases carefully and proceed steadily. Certainly in the early stages of adoption and enforcement of competition law, a regime cannot perhaps be criticised for seeking to establish a strong track record of administrative enforcement before undertaking criminal prosecution.

Challenge No 10 – Compliance

As part of its competition law advocacy, the Competition Commission has already emphasised the importance of competition law compliance programmes. The Competition Commission states on its Frequently Asked Questions website that: "Businesses can make references to other jurisdictions such as the European Union, the United Kingdom, Australia, Singapore and Malaysia where indicative checklists are available to help companies think through the compliance process and requirements."

However, creating a culture of compliance can be challenging, especially where business practices that previously escaped legal penalties become competition law infringements for the first time. Such practices (for example, bid-rigging) may be endemic across an industry and embedded in accepted business culture and it can be difficult for old habits to die.

Conclusions

The new competition regime in Hong Kong including the Competition Commission itself has only a limited time to demonstrate its value. Its legacy may, however, be felt many years into the future. The immediate 12 months will be important in securing the legitimacy of the new regime, although it may take much longer for a culture of compliance to bed down.

The Competition Commission will need to choose its cases carefully in order to build its reputation and credibility. In the earlier stages of competition enforcement, there is understandably a public expectation to secure "wins". At the same time, the Competition Commission will tarnish its reputation if it pursues cases on the basis of popular pressure and which do not stand up to judicial scrutiny before the Tribunal. This will require the exercise of some discretion from the Competition Commission in deciding which cases to pursue.