

# Too much compromise

## The proposed law has too many exemptions and prohibitions that do not extend to M&A agreements

After being banished to the bottom of the legislative 'to-do' list for 12 months in the wake of the global financial crisis, it appears the Hong Kong government is now gearing up for its long-promised competition bill.

In his annual policy address on October 14 2009, Chief Executive Donald Tsang reaffirmed the government's commitment to introduce the bill to Hong Kong's Legislative Council in the 2009/2010 legislative session. This followed comments in late September 2009 by Gregory So, Under Secretary for Hong Kong's Commerce and Economic Development Bureau (CEDB), confirming that drafting of the bill was progressing, and that the government has made several changes to the proposals for the Bill that it had previously set out in a May 2008 Consultation Paper.

Although advocates of a general competition law in Hong Kong will welcome the government's focus on this issue, the information So has provided on proposals has generated a lot of unease. In particular, there are concerns the competition law will be diluted by potentially broad exemptions, while having a disproportionate and severe impact on those commercial entities whose operations may be made a priority for review.

### The topsy-turvy road so far

Active debate on a cross-sector competition law in Hong Kong has been conducted at the highest levels of government since at least 1996, when the Consumer Council issued a report highlighting anti-competitive elements in Hong Kong's economy and recommending

the government take steps to tackle the problem.

In response, the government created the Competition Policy Advisory Group (Compag) to deal with competition issues on an ad hoc basis – but gave it with no statutory powers of investigation or enforcement.

Subsequently, in 2000, the government introduced sector-specific regimes in the telecommunications and broadcasting sectors in Hong Kong. Those regimes regulate anti-competitive conduct and abuse of dominance and, for the telecommunications sector only, merger control.

After several further studies by the Consumer Council and Compag highlighted competition concerns in many sectors of the Hong Kong economy, and perceived success of the sector-specific regimes, the chief executive specifically identified competition as one of the key items on the government's agenda in his policy address in October 2005. As a first step, he appointed a new Competition Policy Review Committee (CPRC) to review and report on the existing competition arrangements. The CPRC's report was published in June 2006, and recommended the adoption of a cross-sector competition law.

A series of public consultations followed, the last of which was held over three months, ending in early July 2008. This consultation followed the government's release of a detailed proposal document on the law in May 2008, and a commitment from the government to push ahead with introduction of the relevant bill in the 2008/2009 legislative session.

The government's May 2008 consultation paper proposed that the law include a general

prohibition on anti-competitive agreements and concerted practices that substantially lessen competition, and a general prohibition on the abuse of a substantial degree of market power (where conduct in breach of such prohibitions did not have clear net economic benefits outweighing their anti-competitive nature). However, the paper noted that the government was undecided on whether the law should include a merger control regime. Despite this and other uncertainties, the government reported that its proposals received widespread public support.

However, in April 2009 the government announced that the Competition Bill was being postponed until at least the 2009/2010 legislative session. The reasons cited included technical problems relating to the proposed civil administration enforcement model of the law and widespread concerns from various stakeholders regarding the proposal to exempt statutory bodies.

### Recent key changes to the proposals

Speaking in late September at an antitrust conference in Hong Kong, So noted that the government had adjusted its position on several matters addressed in the May 2008 Consultation Paper. Amongst other things, the revamped proposals include:

#### Revised institutional arrangements

So confirmed earlier reports that the government now proposes to adopt a judicial model for enforcement of the law – a big departure from previous proposals for a new Competition Commission to hold bold investigatory and adjudicatory powers. The revised institutional arrangements follow several recent cases in Hong Kong that called into question whether the proposal for the Competition Commission to have both prosecutorial and adjudicatory roles, and to be empowered to impose large pecuniary penalties (up to HK\$10 million) without affording investigated parties the types of safeguards that apply in criminal proceedings, would infringe certain human rights in the constitutionally entrenched Bill of Rights.

Under the revamped proposals, the Competition Commission's role will mainly be limited to the conduct of relevant investigations and prosecutions, while a newly established Competition Tribunal will be charged with deciding cases in this area.

However, So also noted that the Commission would be able to issue an Infringement Notice to parties that it believed were acting in contravention of the law, with those parties then having the option of paying an infringement amount (and, where applicable, providing undertakings to cease

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infringement behaviour) to avoid prosecution through the courts.

#### **Some statutory bodies to be subject to the law**

In the May 2008 Consultation Paper, the government proposed that all statutory authorities would be exempt from the law. However, CEDB is now understood to be examining each of Hong Kong's statutory authorities with a view to inclusion in the Bill of a schedule listing specific statutory authorities that will not enjoy a general exemption.

So has confirmed earlier reports that the selection process to determine which statutory authorities should fall under the law was being conducted by reference to factors that include whether (and to what extent) the statutory body:

- (i) is engaged in economic activities, and if so whether for the purpose of regulation these activities are inseparable from and incidental to the provision of essential services;
- (ii) operates in direct competition with private sector entities;
- (iii) engages in conduct that could affect the economic efficiency of a specific market; and
- (iv) enjoys autonomy in decision-making and day-to-day operation.

#### **Existing sector-specific regimes remain**

So said that the government now favours retaining the existing sector-specific competition regimes applicable to Hong Kong's broadcasting and telecommunications sector. Accordingly, Hong Kong's Broadcasting Authority and Telecommunications Authority will enjoy concurrent jurisdiction with the new Competition Commission.

So also indicated that the merger control regime in the Telecommunications Ordinance (which only applied to certain telecommunications licensees) would remain in place, notwithstanding that the government appears to hold the view that merger control regulations are not required in other sectors (as discussed directly below).

#### **No cross-sector merger control regulations**

So indicated that the government had decided that no cross-sector merger control regime should be introduced, at least in the short term.

#### **Compromise and confusion**

Has the government moved too far from its earlier stated aims of ensuring "that anti-competitive conduct in all sectors of the economy should be treated equally" and "the same competition law principles should apply consistently" across the economy?

For example, it has already been made clear that government bodies will be exempt from

the law, notwithstanding the vital role these bodies play in shaping the competitive situation in many of Hong Kong's most pivotal economic sectors, such as property development and public transport. Now, according to the revamped proposals, it also seems that there will be differential treatment for various types of statutory bodies.

While there is some merit in the factors that CEDB is taking into account during its selection process to determine which statutory authorities should fall under the law, there are also concerns that the process could be compromised by political lobbying and tokenism.

Additionally, there is a risk that statutory bodies that are not listed in the relevant schedule to the law may expand their operations over time, and thereby gain an unfair advantage in any area in which they begin to compete with the private sector – before necessary steps are taken to update the schedule.

Another area of inequity relates to the government's new proposal to retain the sector-specific competition regimes for the broadcasting and telecommunications sectors. Although there may be benefits from allowing the existing sectoral regulators in these fields to continue to apply their expertise in respect of competition matters in the industries with which they are familiar, the benefits are outweighed by the risk of separate and potentially conflicting competition principles developing in different parts of the economy.

In particular, telecommunications licensees may rightly feel aggrieved that they will continue to be subject to a merger control regime under Hong Kong's Telecommunications Ordinance notwithstanding that the government now appears to consider that such a regime is generally unwarranted in Hong Kong's small economy, or at least poses administrative burdens for businesses that outweigh resulting benefits.

The government's thinking in relation to merger control also raises concerns about how effective a competition law might be in Hong Kong, as well as potentially serious issues of uncertainty. For example, while competitors in a relevant market will generally be prohibited from coordinating their pricing activities, it appears they will not be prohibited from engaging in mergers or other collaborative structural arrangements (including some joint ventures) that may achieve the same effect.

Moreover, the government has not indicated how such arrangements would be carved out from the more general conduct prohibitions that are proposed. There will need to be very clear guidelines to ensure that a business considering entering into a relevant merger or

acquisition agreement is able to determine whether there is any risk that while the agreement would not be subject to any formal merger control regime, it could nonetheless be scrutinised under the proposed general prohibition on anti-competitive agreements and concerted practices that substantially lessen competition.

Another matter causing concern is the proposed power for the Chief Executive-in-Council to be able to exclude certain activities from the ambit of the prohibition conduct on the basis of overriding "public policy considerations". To date, the government has failed to give any examples of the types of circumstances in which this exemption power may come into play; some argue that interests of key government figures may be too closely aligned with those of Hong Kong's leading conglomerates.

Considering that there are already separate proposals for broad exemptions for the government, relevant statutory bodies, and services of general economic interest (such as water, electricity and postal services), it is difficult to conceive of further circumstances in which it may be appropriate for a catch-all public-policy exemption without even review and recommendations by a body such as the proposed Competition Commission. In this context, it is easy to understand why critics have argued that entrusting the Chief Executive-in-Council with such a power risks uncertainty on the law, and further unbalancing a potential level playing field.

#### **Final comments**

It seems the public consultation phases on the law plus the government's apparent interest in minimising the administrative and other burdens on key economic actors, have led to compromises in the law's operational and enforcement structure.

While the full extent of these compromises will not be known until the bill is introduced into Hong Kong's Legislative Council (should be before July 2010) there is a risk that the overwhelming public support could be eroded.

The bill will finally put Hong Kong on the path to shedding its mantle as one of the world's few developed economies without a general competition law. However, a law with very broad and wide-ranging exemptions, prohibitions that do not extend to relevant M&A agreements, and provisions that do not apply equally to different sectors of the economy (or different bodies within particular sectors), may mean that Hong Kong becomes home to one of the developed world's least effective general competition laws.

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