

**Third Meeting of the
Economic and Employment Council**

***Agenda Item 5: Effective Implementation of
Hong Kong's Competition Policy***

Purpose

This paper informs Members of Hong Kong's competition policy - the objective, approach and implementation to date.

Objective

2. The objective of the Government's competition policy is to enhance economic efficiency and free trade, thereby also benefiting consumers. Competition is a means to achieving the said objective, and not an end in itself.

3. The Government considers that competition is best nurtured and sustained by allowing the free play of market forces and keeping intervention to the minimum. It will not interfere with market forces simply on the basis of the number of operators, scale of operations, or normal commercial constraints faced by new entrants. The Government will take action only when market imperfections or distortions limit market accessibility or market contestability, and impair economic efficiency or free trade, to the detriment of the overall interest of Hong Kong. It will strike a balance between competition policy considerations on the one hand, and other policy considerations such as prudential supervision, service reliability, social service commitments, safety, etc., on the other.

Comprehensive competition legislation

4. In formulating Hong Kong's policy on competition and implementation approach, the Government had -

- (a) carefully considered the pros and cons of comprehensive competition legislation;
- (b) made reference to the experience of other countries in their competition policies or laws; and

- (c) conducted a consultation exercise involving over 110 organizations, including chambers of commerce, trade and professional associations, key players in various business sectors, and tertiary institutions between December 1996 and March 1997. The consultation list is at **Annex I**.

Community reservations on competition law

5. At the time of the consultation, a clear majority of respondents expressed reservations on a general competition law. Many respondents did not believe the extent of unfair trade practices in Hong Kong warranted legislative regulation. Some acknowledged that even if there were competition-related problems, it was debatable whether legislating was the right solution. Others were concerned that an all embracing competition law would be controversial and generate uncertainty as to whether a practice was prohibited under such laws. There were some who favoured a competition law, with reservation on the substance.

6. The concerns about controversy and uncertainty are understandable -

- (a) while the competition laws in many economies prohibit agreements which have the purpose or effect of **substantially lessening competition**, there is no objective criteria in defining “the relevant market” and “substantially” etc.; and
- (b) in many economies, exemptions to competition laws may be granted on ground of public interest or other public policy consideration. However, there is no objective criteria in defining “**public interest**” and the conditions under which such public interest outweighs competition consideration. For example –
 - (i) in the United States, the federal government and its agencies are immune from suit under the anti-trust laws. Certain activities of agricultural cooperatives, insurance business, air carriers and shipping companies are also exempted; and
 - (ii) in the latest draft of the Competition Bill released for public consultation by the Singapore Government, almost all public utility services and “strategic sectors” as defined by

the Singapore Government, i.e. electricity and gas, public transportation, telecommunications, postal services, media, cargo terminal operations, armed security services, potable water supply, waste water management services and activities of clearing houses are **excluded** from the draft Bill.

Experience of other economies

7. In the meantime, studies by the Government revealed that many economies, e.g. Korea and New Zealand which had enacted a competition law, had done so when their economies were about to be transformed from a highly-regulated mode to a more liberalized one. The situation in Hong Kong is entirely different: the Hong Kong economy has always been free and open.

8. After careful consideration of the views expressed during the consultation period, the experience of other economies, and having regard to Hong Kong's situation as a small, open and externally-oriented economy, the Government decided to -

- (a) adopt a comprehensive competition policy for Hong Kong; and
- (b) establish a high-level Competition Policy Advisory Group (COMPAG), chaired by the Financial Secretary with non-official participation. COMPAG is charged with the responsibility to examine, review and advise on competition issues that have policy or systemic implications. The terms of reference and membership of COMPAG are at **Annex II**.

In May 1998, COMPAG issued a *Statement on Competition Policy* (the Statement) (**Annex III**) which provides a comprehensive, transparent and over-arching competition policy framework, setting out the Government's policy objective and offering specific pointers to facilitate compliance with the policy.

Sector-specific approach

9. Pursuant to this objective, we adopt a sector-specific approach which takes into account the needs and actual circumstances of different sectors, and adopts legislative or administrative measures, as appropriate, to

preserve a competitive business environment in individual sectors. Thus, in the light of the special circumstances in the telecommunications and broadcasting sectors, provisions against anti-competitive practices are included in the legislation that set out the overall regulatory framework for these sectors. To promote competition, enhance efficiency and increase opportunities for market access, a code of practice is being developed for the retail payment systems (including the Easy Pay System) sector.

Implementation

Phase I: government and public organisations

10. As a start, competition policy is promoted and implemented within the government and amongst the public organisations. Under the direction of COMPAG, bureaux/departments and public organisations are required to review all existing policies/measures to ensure consistency with and develop new initiatives to give effect to competition principles. COMPAG, through its Secretariat, tenders advice on and keeps track of investigations and follow-up actions on cases of complaints of anti-competitive practices. In addition, COMPAG initiates reviews of cases with systemic implications that may not have aroused public concern. **Annex IV** are some examples of activities in these areas.

Phase II: involving the private sector and nurturing a pro-competition culture

11. We are aware that promoting and ensuring fair competition is not just a government matter. The community, in particular the business sector, also has an important role to play. To this end, we have since 2003, adopted a two-pronged approach in seeking to involve the businesses and the community at large in the second phase in the implementation of the competition policy.

A. Guidelines to maintain a competitive environment and define and tackle anti-competitive practices

12. For the purpose of promoting competition among private enterprises, COMPAG consulted 30 chambers of commerce and trade and industry organizations, and with their assistance, formulated a set of *Guidelines to maintain a competitive environment and define and tackle anti-competitive practices* (the Guidelines). These Guidelines (**Annex V**) were promulgated in September 2003 and provide pointers with objective

benchmarks and principles to assess Hong Kong's overall competitive environment, define and tackle anti-competitive practices, and ensure consistent application of competition policy across sectors. Also included in the Guidelines are a three-step broad economic test to determine whether the Government should take action against a conduct, the mechanism for initiating action against anti-competitive practices, and appeal procedures against government decisions.

13. The Guidelines draw attention to and arouse awareness of the Government's pro-competition policy. The Guidelines are not mandatory provisions but encourage self-regulation.

14. The business sector is generally supportive of the Guidelines -

- (a) Local associations: the Hong Kong Retail Management Association, for instance, has developed a code of conduct to encourage self-regulation against anti-competitive practices and promote competition in the supermarket sector in the first instance. The Hong Kong General Chamber of Commerce has set up an Expert Group on Competition under the auspices of the Hong Kong Coalition of Service Industries to review competition policy; while
- (b) Associations of overseas businesses in Hong Kong: the American Chamber of Commerce, the Australian Chamber of Commerce and the Singapore Chamber of Commerce, for example, have undertaken to promote the Guidelines to their members through newsletters, publications or other means.

B. Nurturing a pro-competition culture

15. To nurture a pro-competition culture in the community, COMPAG reckons that work should begin with the students and youth. To this end, we have launched a publicity programme to raise awareness and promote competition concepts in schools and among the youth -

- (a) An interactive game for senior primary (Primary 4 to Primary 6) and junior secondary (Form 1 to Form 3) school students was launched with the Hong Kong Education City (www.hkedcity.net) in June 2004 to introduce competition concepts by means of a game; and

- (b) In collaboration with the Education and Manpower Bureau, competition concepts will be integrated into the Integrated Humanities curriculum of senior secondary school in 2004-05.

Feedback from the International Community

16. COMPAG regularly monitors and reviews Hong Kong's competition policy having regard to developments both locally and overseas. We are aware that some members of the international community may not fully appreciate the rationale of our approach to competition and will continue to take every opportunity to enhance the international community's understanding. The general feedback is positive.

Freest economy in the world

17. Hong Kong has been ranked as the freest economy in the world by the Heritage Foundation in the US for the 10th year since 1994; and by Canada's Fraser Institute in conjunction with the Cato Institute in the US since 2001. This is testimony to the effectiveness of the Government's competition policy.

World Trade Organization (WTO) Trade Policy Review (TPR)

18. During the WTO's 2002 TPR on Hong Kong, the WTO Secretariat questioned the "effectiveness" of the sector-specific approach to competition in its 2002 TPR Report and opined that the absence of a comprehensive policy to address anti-competitive practices and the entrenchment of a few dominant conglomerates in the domestic market could constitute an obstacle to greater competition from domestic and foreign firms, especially in the provision of services, thereby possibly discouraging foreign direct investment.

19. In response to these questions, the Government elaborated on Hong Kong's competition policy at the TPR meeting in Geneva in December 2002. WTO members noted in their statement after the review that Hong Kong has a very competitive market, that Hong Kong's competition policy is "a text book case of the market economy at work", and that an all embracing competition law might not be required in certain circumstances. An International Monetary Fund paper referred to by the WTO Secretariat in its 2002 TPR Report on Hong Kong also concluded that HKC is "neither significantly more nor significantly less competitive than the average OECD countries", all of which have enacted competition law.

Asia Pacific Economic Cooperation (APEC)

20. Under the APEC peer review mechanism, an APEC Review Team consisting of a Moderator and a Discussant and assisted by an Expert, who provided analytical and technical support, conducted a field study in Hong Kong for the purpose Hong Kong, China (HKC)'s Individual Action Plan (IAP) in 2003-04.

21. Some APEC Members had raised questions in the questionnaire for the Peer Review on HKC's sector-specific approach to competition. The Expert conducted a field visit to Hong Kong. He was given a detailed account of Hong Kong's sector-specific approach to competition and the work done by COMPAG. Presenting his Study Report at the Peer Review Session held in Phuket, Thailand on 21 August 2003, the Expert expressed his support for HKC's sector-specific approach and set out in detail the rationale behind HKC's competition policy. He agreed that this approach was effective and had much merit, given the increasing divergence between sectors, their structures and their needs, in the modern economy. He also drew attention to competition policy guidelines which were subsequently promulgated by COMPAG in September 2003.

Conclusion

22. Taking into account Hong Kong's open economy, the competitive business environment, and recent developments at the multilateral forum, COMPAG opines that the Government's non-interventionist policy and its proactive approach in promoting competition supported by sector-specific measures as necessary, suit the needs of Hong Kong. COMPAG will continue to monitor developments to ensure that Hong Kong's competition policy continue to serve Hong Kong's interests.

Consultation list

(A) **Chambers of Commerce**

(8 of 12 responded, as highlighted in italics)

The American Chamber of Commerce in Hong Kong
The Australian Chamber of Commerce in Hong Kong
The British Chamber of Commerce in Hong Kong
The Canadian Chamber of Commerce in Hong Kong
The Chinese General Chamber of Commerce
The Chinese Manufacturers' Association of Hong Kong
The Hong Kong General Chamber of Commerce
The Indian Chamber of Commerce Hong Kong
The Hong Kong Japanese Chamber of Commerce & Industry
The Korean Chamber of Commerce in Hong Kong
The Swedish Chamber of Commerce in Hong Kong
The Singapore Chamber of Commerce (Hong Kong)

(B) **Trade Commissions and Business Associations**

(6 of 12 responded, as highlighted in italics)

British Trade Commission
Italian Business Association
Mexican Business Association of Hong Kong Limited
The Finnish Business Council
The Dutch Business Association
The German Business Association of Hong Kong Limited
Hong Kong French Business Association
New Zealand - Hong Kong Business Association
Swiss Business Council in Hong Kong
The Japan External Trade Organisation of Hong Kong
The Spanish Business Association
The Hong Kong Exporters' Association

(C) **Trade and Industry Bodies**

- (1) General
(all 10 responded)

Trade Advisory Board
Hong Kong Retail Management Association
Federation of Hong Kong Industries
Hong Kong Productivity Council
Hong Kong Trade Development Council
Hong Kong Association of Freight Forwarding Agents Limited
Small and Medium Enterprises Committee
Hong Kong Committee for Pacific Economic Cooperation
Textile Advisory Board
Rice Advisory Committee

- (2) Financial Services
(all 6 responded)

The Hong Kong Association of Banks
Hong Kong Monetary Authority
Securities and Futures Commission
The Stock Exchange of Hong Kong
Hong Kong Futures Exchange Limited
The Hong Kong Association of Restricted Licence Banks & Deposit-taking Companies

- (3) Gas and Power Supply
(6 of 7 responded, as highlighted in italics)

China Light & Power Company, Limited
The Hong Kong and China Gas Company Limited
The Hongkong Electric Company Limited
Caltex Oil Hong Kong Limited
Esso Hong Kong Limited
Mobil Oil Hong Kong Limited
Shell Hong Kong Limited

- (4) Shipping
(All 6 responded)

Modern Terminals Limited
Sea-Land Orient Terminals Limited
COSCO-HIT Terminals (Hong Kong) Limited
Hongkong International Terminals Limited
The Hong Kong Shippers' Council
Hong Kong Liner Shipping Association

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- (5) Telecommunications
(all 6 responded)

Office of the Telecommunications Authority
Hong Kong Telecommunications Limited
Hutchison Telecommunications (Hong Kong) Limited
New T&T Hong Kong Limited
New World Telephone
Hong Kong Telecom Association

- (6) Broadcasting
(all 9 responded)

Broadcasting Authority
Television and Entertainment Licensing Authority
Radio Television Hong Kong
Asia Television Limited
Satellite Television Asian Region Limited
Television Broadcasts Limited
Wharf Communications Investments Limited
Metro Broadcast Corporation Limited
Hong Kong Commercial Broadcasting Company, Limited

- (7) Residential Property Market
(9 of 13 responded, as highlighted in italics)

Land Development Corporation
Hong Kong Housing Society
Hong Kong Housing Authority
Land and Building Advisory Committee
Long Term Housing Strategy Review Steering Group
Hong Kong Association of Property Management Company
Chartered Institute of Housing Hong Kong Branch
Chartered Institute of Building
Hong Kong Real Estate Agencies Association
The Real Estate Developers Association of Hong Kong
Property Agencies Association Limited
Hong Kong Institute of Real Estate Administration
Society of Hong Kong Real Estate Agents

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- (8) Transport
(3 of 9 responded, as highlighted in italics)

Transport Advisory Committee
Mass Transit Railway Corporation
Kowloon Canton Railway Corporation
Citybus Company Limited
KMB Company Limited
CMB Company Limited
New Lantau Bus Company Limited
Star Ferry Company, Limited
Hong Kong Ferry (Holdings) Company Limited

- (9) Travel Industry
(both responded)

Travel Industry Council of Hong Kong
Hong Kong Tourist Association

- (10) Insurance Industry
(1 responded)

The Hong Kong Federation of Insurers

- (11) Supermarkets
(2 of 6 responded, as highlighted in italics)

Wellcome Company Limited
Hong Kong Convenience Stores Limited
Guangnan (KK) Supermarket Limited
Park'N Shop Limited
Circle K Convenience Stores (HK) Limited
China Resources Purchasing Company Limited

(D) **Professional Associations**
(8 of 10 responded, as highlighted in italics)

The Law Society of Hong Kong
The Hong Kong Bar Association
Hong Kong Institute of Architects
The Hong Kong Institute of Engineers
Hong Kong Institute of Planners
The Hong Kong Institute of Surveyors
The Hong Kong Management Association
Hong Kong Society of Accountants
The Hong Kong Medical Association
The Hong Kong Association of the Pharmaceutical Industry

(E) **Tertiary Institutes**
(6 of 7 responded, as highlighted in italics)

*Hong Kong Centre for Economic Research and
School of Economics and Finance, the University of Hong Kong*
Department of Economics, the Chinese University of Hong Kong
Department of Economics and Finance, City University of Hong Kong
*Department of Economics, the Hong Kong University of
Science and Technology*
Department of Economics, Hong Kong Baptist University
Department of Business Studies, Hong Kong Polytechnic University
Centre for Public Policy Studies, Lingnan College

(F) **Others** (6 submissions)

Hong Kong Democratic Foundation
*Members of Alumni of Class of 94, 95 & 97, Property Agency
Programme, City University of Hong Kong*
Kwai Tsing District Board
Kowloon City District Board
Shatin District Board
Kwun Tong District Board

Competition Policy Advisory Group Terms of Reference and Membership

COMPAG was set up under the chairmanship of the Financial Secretary in December 1997 to review competition issues that have substantial policy or systemic implications. Its terms of reference and membership are set out below -

Terms of Reference

- (a) To agree and promulgate a policy statement on the promotion of competition in Hong Kong.
- (b) To identify areas in the economy, particularly within the existing government framework, that may not be fully compatible with the promotion of competition and economic efficiency, and review scope for refinement.
- (c) To consider and review initiatives from bureaux and departments, or others as appropriate, on how to promote competition in Hong Kong.
- (d) To consider competition-related matters which may have a bearing on government policy

Membership

- Chairman – Financial Secretary
- Members – Secretary for Commerce, Industry and Technology
 - Secretary for Financial Services and the Treasury
 - Secretary for Economic Development and Labour
 - Permanent Secretary for Commerce, Industry and Technology (Commerce and Industry)
 - Permanent Secretary for Financial Services and the Treasury (Treasury)

- Permanent Secretary for Economic Development and Labour (Economic Development)
 - Director-General of Trade and Industry
 - Government Economist
 - Consumer Council
- Secretary – Principal Assistant Secretary for Economic Development and Labour (Economic Development)
- Observers – On a need basis

Statement on Competition Policy

Introduction

1. This Statement sets out the objective of the Government of the Hong Kong Special Administrative Region's competition policy and offers some specific pointers to facilitate compliance with the policy.

Objective

2. The objective of the Government's competition policy is to enhance economic efficiency and free flow of trade, thereby also benefiting consumer welfare. The Government is committed to competition as a means to achieving the said objective, and not as an end in itself.
3. The Government considers competition is best nurtured and sustained by allowing the free play of market forces and keeping intervention to the minimum. We will not interfere with market forces simply on the basis of the number of operators, scale of operations, or normal commercial constraints faced by new entrants. We will take action only when market imperfections or distortions limit market accessibility or market contestability, and impair economic efficiency or free trade, to the detriment of the overall interest of Hong Kong. We will strike the right balance between competition policy considerations on the one hand, and other policy considerations such as prudential supervision, service reliability, social service commitments, safety, etc., on the other.

Pro-competition Principles

4. All government entities, and public- and private-sector bodies are encouraged to adhere to the following pro-competition principles for the purpose of enhancing economic efficiency and free trade –
 - a. maximizing reliance on, and minimizing interference with, market mechanism;
 - b. maintaining a level-playing field;

- c. minimizing uncertainty and fostering confidence in system fairness and predictability by –
 - i. consistent application of policies;
 - ii. transparent and accountable operations; and
 - iii. adherence to equitable and non-discriminatory standards and practices.

Restrictive Practices

- 5. The Government recognizes that not all practices that limit market accessibility or contestability impair economic efficiency or free trade. Only those that do, and are not in the overall interest of Hong Kong, should be attended to. The determination of whether a practice is restrictive, detrimental to economic efficiency or free trade, and against the overall interest of Hong Kong must be made in the light of the actual situation. The intended purpose and effects of the practice in question, and the relevant market or economic conditions, etc., must all be taken into account.
- 6. As each practice must be examined on its own, it is difficult and misleading to generalize. For illustrative purpose only, some business practices which may warrant more thorough examination are set out below –
 - a. price-fixing* intended to distort the normal operation of the market, increase the cost for purchasers, and have the effect of impairing economic efficiency or free trade;
 - b. bid-rigging*, market allocation*, sales and production quotas* intended to distort the normal operation of the market, increase the cost for and reduce the choice and availability to purchasers, and have the effect of impairing economic efficiency or free trade;
 - c. joint boycotts* intended to distort the normal operation of the market, deprive supply or choice to the targets of the boycott, and have the effect of impairing economic efficiency or free trade; and
 - d. unfair or discriminatory standards* among members of a trade or professional body intended to deny newcomers a chance to enter or contest in the market, and have the effect of impairing economic efficiency or free trade.

7. The Government further recognizes that scale of operation or share of the market per se does not determine whether a business is anti-competitive or not. The determining factor is whether a business, through abusing its dominant market position, is limiting market accessibility and contestability and giving rise to economic inefficiency or obstruction of free trade to the detriment of the overall interest of Hong Kong. Each case has to be examined on its own. For illustrative purpose only, some examples that may involve an abuse of market position are set out below-
 - a. predatory behaviour such as selling below cost for the purpose of driving out competition followed by substantial price increases in an area of economic activity where there are constraints to market accessibility and contestability;
 - b. setting retail price minimums for products or services where there are no ready substitutes; and
 - c. conditioning the supply of specified products or services to the purchase of other specified products or services or to the acceptance of certain restrictions other than to achieve assurance of quality, safety, adequate service or other justified purposes.

Approach

8. There is no international standard or consensus on what is the best approach to achieve competition in order to enhance economic efficiency and free flow of trade. Some economies have competition laws which differ widely in scope of control, enforcement mechanisms and remedies available. Other economies shun the legislative route. The choice is heavily influenced by the characteristics, development history and socio-economic background of an economy.

* These are various forms of horizontal restraints among competitors typically for the purpose of raising or fixing prices (so-called "price-fixing"), compressing bid prices ("bid-rigging"), allocating specific customers or sales territories to particular firms and not competing over the territory or customers of other firms ("market allocation"), setting quotas on the supply of certain goods or services in order to push prices up ("sales and production quotas"), and not dealing with firms that supply other firms in their market ("collective boycotts").

9. For Hong Kong, a small and externally-oriented economy which is already highly competitive, the Government sees no need to enact an all-embracing competition law. To maintain overall consistency in the application of the competition policy, we provide a comprehensive, transparent and over-arching competition policy framework through this Policy Statement and reinforce this with sector-specific measures not limited to laws.
10. In the Hong Kong environment, the Government is promoting economic efficiency and free trade through competition by –
 - a. raising public awareness of the importance of competition for the enhancement of economic efficiency and free trade;
 - b. identifying, on a sectoral basis, obstacles and constraints imposed by the Government and other public sector entities which limit market accessibility and contestability and compromise economic efficiency and free trade to the detriment of the overall interest of Hong Kong, and removing them through voluntary, administrative, legislative, etc., measures as appropriate;
 - c. initiating pro-competition measures, on a sectoral basis, in the Government and public sector through administrative, legislative, etc., measures as appropriate;
 - d. encouraging the private sector to embrace competition and its stated objective of enhancing economic efficiency and free trade through voluntary action;
 - e. supporting the Consumer Council's work in drawing up codes of practice that promote competition and its stated objective of enhancing economic efficiency and free trade;
 - f. working together with the Consumer Council to encourage the private sector to adopt pro-competition measures, such as self-regulatory regimes that preserve and enhance free competition; and to monitor and review business practices in sectors prone to anti-competition behaviour;
 - g. establishing a central repository of competition-related concerns and complaints to facilitate the identification of possible deficiencies and areas for improvement; and

- h. providing a dedicated forum under the Financial Secretary (already established and known as the Competition Policy Advisory Group or "COMPAG" in short) to review policy issues related to competition.

Implementation

11. The Government is committed to pro-actively nurture and sustain competition for the purpose of enhancing economic efficiency and free trade. COMPAG will invite all government entities to adhere to the Statement, propose initiatives for furthering the policy objective, examine the impact of all new proposals on competition and, where appropriate, bring this to the attention of the Executive Council and the Legislature. They are also expected to ensure that all statutory bodies under their charge pay heed to the Statement as well.
12. The Government calls upon all businesses to cease existing, and refrain from introducing, restrictive practices that impair economic efficiency or free trade on a voluntary basis. Where justified, the Government will take administrative or legal steps as appropriate to remove such practices if necessary.
13. Alleged restrictive practices in the public and private sectors may be referred to the concerned policy bureau or government department for consideration. Separately, the COMPAG Secretariat will keep track of all referrals and bring these to the attention of COMPAG should there be substantial policy or systemic implications.

Competition Policy Advisory Group
May 1998

Examples of Competition Policy Implementation

I. New initiatives by the Government to promote competition

Competition in the fuel supply market and new tendering arrangements for petrol filling stations

To facilitate new entrants and enhance competition in the retail fuel market, the Government has since July 2000, put up existing petrol filling station (PFS) sites for tender upon lease expiry instead of automatically renewing the tenancy. To further promote competition, the Government has, in June 2003, introduced new tendering arrangements for PFS sites.

2. Hitherto, PFS sites have been put up for tender one by one, with the site offered for tender in a particular exercise awarded before the tender invitation period for the next tender exercise closes. Tenderers who wish to acquire multiple sites can bid for each and every available site in successive tender exercises. This arrangement does not, however, provide certainty to tenderers who are successful in obtaining one site in a particular tender exercise that they will be successful in subsequent tenders. This uncertainty in acquiring a "commercially viable mass" of PFS, thereby achieving economy of scale, is perceived as a potential drawback which discourages newcomers from entering the fuel supply market.

3. To enable new market players to acquire a “commercially viable mass” sites to achieve economies of scale, the Government has, since June 2003, offered PFS sites for tender in batches of five sites. Tenderers were permitted to submit a “super bid” for all five sites or submit separate bids for individual sites. Maximizing total revenue from the tender exercise remains the overall objective in the award of the PFS sites. Hence, the tender price of a 'super bid', if any, will be compared with the aggregate of the tender prices of individual bids to be accepted for each of the sites. If the latter turns out to be higher than that of the 'super bid', the PFS sites will be awarded to the successful individual bids. That is to say, 'super bids' will not take precedence over individual bids.

4. 15 PFS sites were put out for tender in three batches (each consisting of 5 sites) in June 2003, October 2003 and February 2004. Two new players, Sinopec (Hong Kong) Limited [Parent Company Name: China Petroleum & Chemical Corporation] and Chinaoil (Hong Kong) Corporation Limited [Parent Company Name: Petrochina International Company Limited], have successfully entered the market by securing all five PFS sites in the batch included in the tenders held in October 2003 and February 2004 respectively.

5. The Government will conduct a review later this year of the new tendering arrangements, which would include, inter alia, responses from existing and new market players, the impact on pump prices etc.

II. Cases reviewed by the Competition Policy Advisory Group

Case 1 : Alleged price fixing by operators of car parks under short-term tenancy in Kwai Tsing

6. In November 2002, some container truck drivers complained to the Lands Department that an operator of car park under short-term tenancy (STT) in Kwai Tsing attempted to monopolize the operation of such STT car parks in the district. This had resulted in higher parking charges. They also alleged that this operator, together with another STT car park operator in the district, each deliberately left one of their car parks vacant so as to reduce supply and to charge higher parking fees for the more popular car parks operated by them.

7. The Lands Department advised that these STT car parks were let by open tender in accordance with the normal land administration practice. At the time of the complaints, there were 24 STT car park sites operated by six different car park companies in the Kwai Tsing District. In addition, there were over 300 lorry parking spaces available in the district yet to be leased. In general, different fees were charged by different car park operators based on their own commercial and market considerations. There was no evidence of market monopoly. The two parking sites previously left vacant were at less central locations. They had been opened for business since late November 2002.

8. Having reviewed the existing practices, the Lands Department had adopted a number of additional measures to improve the control of STT car parks and to prevent any attempt by a STT car park

operator to engage in anti-competitive practices. These measures included –

- (a) include conditions in future tenancy agreements requiring the car park company to commence operation of a car park and continue to do so throughout the tenancy at a scale satisfactory to the Lands Department, or else the tenancy may be cancelled;
- (b) split a site, if feasible, into two or more lots, and tender them simultaneously without letting any company operate in more than one of those lots;
- (c) keep a performance record of car park operators and consider such records when assessing their tenders for future STT car parks. Lands Department is not bound to accept the highest tender; and
- (d) monitor the parking needs of districts, in conjunction with the Transport Department, with a view to maintaining sufficient parking spaces to meet the demand.

Case 2 : Exclusivity arrangement in an Incentive Scheme Agreement for the Hong Kong Mortgage Corporation's Mortgage Insurance Program

9. The complainant sent a letter to the Secretary for Financial Services and the Treasury on 12 December 2002 drawing his attention to

an exclusivity arrangement stipulated in an Incentive Scheme Agreement for the Hong Kong Mortgage Corporation's ("HKMC") Mortgage Insurance Program ("MIP"). The exclusivity arrangement required every bank joining the Incentive Scheme of the MIP to only use the HKMC as the exclusive provider of mortgage insurance. The complainant considered that the exclusivity arrangement anti-competitive as it restricted banks' desire to pursue opportunities with other mortgage insurance providers in the private sector. It further alleged that the HKMC could be viewed as taking advantage of its status to "monopolize" the mortgage insurance market.

10. Having looked into the case of the exclusivity clause included in the relevant agreement for the Incentive Scheme, the Financial Services and the Treasury Bureau (FSTB) were of the view that the relevant clause was meant to be a risk mitigation measure rather than an anti-competitive device, and replied to the complainant accordingly on 29 January 2003 -

- (a) It is entirely optional for banks to join or opt out from the Incentive Scheme, which would not affect their right to remain within the MIP. The exclusivity clause does not prohibit banks from entering into mortgage insurance arrangements with other service providers. If a bank wishes to enter into insurance arrangements with other insurers and wishes to retain the incentive benefits which it has accrued under the Incentive Scheme, it can do so provided that a 12-month notice period is given to the HKMC indicating its intention to withdraw from the Incentive Scheme on expiry of the notice period. The

12-month notice period is a risk mitigation measure designed to protect the HKMC and its reinsurers against the risk of banks imprudently underwriting a large number of MIP loans to qualify for the Incentive Scheme and then suddenly withdrawing from the Scheme. If it wishes to quit within the notice period, it would only lose the incentive benefits that it has accrued under the Scheme. In short, the exclusivity clause does not require a bank to join, or prohibit it from leaving, the Incentive Scheme.

- (b) HKMC has clarified that the purpose of the exclusivity clause is to guard against the risk of adverse selection, which could arise if a bank is allowed to engage other insurance providers at the same time, particularly if one of them is a close affiliate of the bank. This is that the bank may deliberately assign the more risky loans to the HKMC and the less risky loans to the insurance providers associated with itself to its own benefit. While the risk of adverse selection is always there even under the ordinary MIP, the reduction in premium under the Incentive Scheme would reduce the buffer available to the HKMC and its reinsurers to withstand the risk of increased default losses which may be caused by adverse selection by the participating banks.
- (c) As HKMC is required to operate on prudent commercial principles, we believe it is legitimate for it to take appropriate risk management measures to control its risk of business.

- (d) Notwithstanding the above, the HKMC has subsequently provided a “let-out” to the exclusivity requirement. This would apply if the participating bank concerned can design a mechanism, to the satisfaction of the HKMC, that can ensure fair and equitable allocation of mortgage insurance applications amongst its insurers, including the HKMC, which would avoid the adverse selection of applications in favour of one insurer or prejudicial to the others. The HKMC has devised a computerized system for random allocation of MIP applications amongst its 4 reinsurers, so it believes that it should not be difficult for banks to come up with a similar system. This proposal should help to address the concerns of market participants about the potential effect of the exclusivity clause on market accessibility and contestability.

Case 3 : Removal of Ocean Park from the standard itinerary by 18 inbound travel agents

11. The Consumer Council wrote to the Commissioner for Tourism in July 2003 concerning a collective decision by 18 Hong Kong inbound travel agents, who compete with each other for the supply of package tours to Mainland tourists, not to include Ocean Park (OP) in their fixed itinerary but make it an optional tour. The Council considered that there was prima facie evidence of the 18 inbound travel agents having engaged in a restrictive business practice.

12. The Tourism Commission (TC) requested the Travel

Industry Council of Hong Kong (TIC), a self-regulatory body of the travel trade industry, to look into the case. The TIC confirmed that the group did remove the OP from their standard itinerary. The travel agents concerned said that they felt they had to do something to remain cost competitive in the market in the light of impact of SARS on the travel industry. As a result of the TIC intervention, the travel agents concerned have reinstated OP as a standard item in their itineraries.

13. The TC considers that the inbound tour market in Hong Kong is highly open and competitive and any anti-competitive practice cannot be sustained. According to the trade, there are over 350 active travel agents involved in the inbound travel businesses offering a wide variety of itineraries for consumers. Many itineraries include OP as a standard item. The TC believes that the impact of the action by the group of 18 inbound travel agents on market efficiency and free trade has not been significant. More importantly, the action taken by the TIC has demonstrated to those involved and the travel trade as a whole that such action is not acceptable.

14. Nevertheless, the present case highlights the need to heighten awareness of fair competition among members of the travel trade. In addition to its general Code of Conduct which uphold the spirit of fair trading, the TIC has reminded members of the Government's *Statement on Competition Policy* and will continue to require members to be mindful of anti-competitive practices and draw their attention to the *Guidelines to Maintain a Competitive Environment and Define and Tackle Anti-Competitive Practices*.

III. Studies initiated by the Competition Policy Advisory Group

Competition in the asphalt market

15. Members of the Competition Policy Advisory Group discussed the report in the 20 June 2003 issue of the Hong Kong Economic Times on the judicial review (JR) application filed by four asphalt companies against the Town Planning Board (TPB)'s decision on 4 April 2003 to approve an application under section 16 of the Town Planning Ordinance (TPO) for a temporary asphalt production plant at a site zoned "Agriculture" at Man Kam To Road, Sha Ling. Members were concerned that the action of the asphalt companies smacked of anti-competitive collusive action and requested that the Environment, Transport and Works Bureau (ETWB) conduct a study on the competition aspect of the asphalt supply market

16. Asphalt is mainly used for road works in Hong Kong. The major raw materials used for the production of asphalt include bitumen, aggregates and additives. Bitumen is a petroleum by-product manufactured by the refinery processes, and Shell Hong Kong Limited was the sole supplier of bitumen for road works in Hong Kong. Aggregates are usually obtained from quarries in Hong Kong or the Mainland, whilst additives are proprietary products purchased by the asphalt suppliers from relevant sources.

17. Asphalt is manufactured by mixing aggregates with bitumen and additives to specified proportions at a high temperature around 165°C.

Asphalt is then transported to site in well-insulated dump trucks and must be placed within a few hours before the asphalt drops in temperature and hardens.

18. The local industry consumed about 1 million tonnes of asphalt each year, and most of it was used for public road works. There are currently four suppliers approved by the ETWB to supply asphalt for public work, and each has a varying market share.

19. The asphalt market is not closed: suppliers are free to enter or leave the market as they wish. The Government imposes no regulatory obstacles to market entry other than administrative measures necessary to safeguard the quality of asphalt produced, and to ensure that the relevant environmental and public safety requirements are met. An asphalt supplier has to be included in the ETWB list of “Approved Suppliers of Materials and Specialist Contractors for Public Works” under the category of “Supply of Bituminous Pavement Materials and Construction of Special Bituminous Surfacing” in order to supply asphalt for public works. The application procedures and information to be submitted are described in detail in the Contractor Management Handbook available at the ETWB website.

Demand and price trends

20. The annual demand for asphalt in Hong Kong remained fairly stable over the last 3 years (2000-2002), increasing slightly from about 1.11 million tonnes in 2000 to about 1.27 million tonnes in 2002. The demand in 2003 was estimated to be around 1.2 million tonnes.

21. In order to gain an indication of the price trends, ETWB randomly selected nine major road works contracts awarded between 2000 and 2002 for analysis. The analysis focused on the trend of tendered rates for laying asphalt including both the material and labour costs. Between 2000 and 2002, the relevant tender rates dropped by about 5% on average, reflecting possibly lower labour costs. During the same period, the price of aggregates remained fairly stable, while the price of bitumen rose by about 30% between end-2001 and early 2003 due to higher oil prices.

Competition in the asphalt supply market

22. Based on its study of the asphalt market and the demand and pricing trends of asphalt, ETWB could not find any evidence of anti-competitive practices in the asphalt supply market. Apart from government regulations intended to safeguard the quality of asphalt produced and to ensure compliance with relevant environmental and public safety requirements, there was no barrier to market entry. The varying market shares among the suppliers indicate competition did exist. There was also a range of asphalt prices (depending on mix requirements and quantities ordered), and the increased price of bitumen, which should theoretically affect the price of asphalt, was not reflected in the tender price for road works contracts. There had not been any complaint from the government road works contractors of restrictive practices such as price-fixing, bid-rigging or market allocation etc. by the asphalt suppliers.

Guidelines to maintain a competitive environment and define and tackle anti-competitive practices

Introduction

The *Statement on Competition Policy* ("the policy statement") promulgates the Government's sector-specific approach to competition. It stipulates, inter alia, that the determining factor of whether a business is anti-competitive is not the scale of operation or share of the market per se but whether a business or practice is limiting market accessibility or contestability and impairing economic efficiency or free trade to the detriment of the overall interest of Hong Kong. To facilitate implementation of this policy statement, the following guidelines (with specific pointers) are developed to –

- (a) assess Hong Kong's overall competitive environment;
- (b) define and tackle anti-competitive practices; and
- (c) ensure consistent application of our competition policy across sectors.

Guidelines

1st Pointer: *Assessing the overall competitive environment*

2. This pointer assesses whether the economy is competitive. By meeting certain criteria, the overall business environment of Hong Kong would be deemed conducive to competition and free trade. The essential elements to assess the overall competitive environment are:

- (a) a stable and effective political environment;
- (b) a regime based on the rule of law;
- (c) a free and open macroeconomic environment;
- (d) abundant market opportunities;
- (e) positive policy towards private enterprise and competition;
- (f) positive policy towards foreign investment;
- (g) no foreign trade and exchange controls;

- (h) a transparent investment and tax regime;
- (i) easy access to financing;
- (j) a sophisticated labour market;
- (k) transparent and fair labour and immigration policies;
- (l) a strong physical infrastructure; and
- (m) free flow of information.

3. The key to competitiveness in a market is the high degree of easiness of entry and exit. When entry and exit barriers virtually do not exist, the incumbent firms will maintain prices close to the competition level. While competition could still exist and may even be intense with few participants in the market, the prevalence of numerous small and medium enterprises could be an illustration of the pro-competition attributes of the business environment in Hong Kong.

2nd Pointer: Measuring the effects of restrictive practices on the market

4. This pointer measures the **effects** of restrictive practices on the market to show whether the practices require Government action. A three-step broad economic test is provided under the policy statement as the means to determine whether the Government will take action against market conduct:

- (a) **Step 1** – when such market conduct limits market accessibility;
- (b) **Step 2** – impair economic efficiency or free trade; and
- (c) **Step 3** – to the detriment of the overall interest of Hong Kong.

5. For **Steps 1 & 2** of the test, the following factors can be used to determine whether competition in particular sectors has been, or likely to be, prevented or lessened substantially –

- (a) the extent to which foreign products or foreign competitors provide or are likely to provide effective competition to the businesses of the existing market participants;
- (b) the extent to which acceptable substitutes for products/services supplied by the existing market participants are or are likely to be available;

- (c) restrictive government measures, including
 - (i) cumbersome government or public sector systems or measures;
 - (ii) tariff and non-tariff barriers to international trade by governments; and
 - (iii) government's regulatory control over entry;
- (d) any barriers to entry into a market, including
 - (i) **economic barriers** such as the (investment) cost of entry;
 - (ii) **structural barriers** such as sunk costs that reduce the ability to exit, the need to achieve economies of scale, the need to overcome brand loyalty of existing products; and
 - (iii) **strategic barriers** such as behaviour of incumbents that pose a credible threat to successful entry, the pre-emption of facilities by which an incumbent over-invests in capacity in order to threaten a price war if entry actually occurs, and the artificial creation of new brands and products in order to limit the possibility of imitation;
- (e) the extent to which effective competition remains or would remain in a market that is or would be affected by actions or proposed actions by existing or potential market participants;
- (f) any likelihood that actions or proposed actions by existing or potential market participants will or would result in the removal of a vigorous and effective competitor;
- (g) the nature and extent of change and innovation in a relevant market; and
- (h) any other factor that is relevant to competition in a market that is or would be affected by actions or proposed actions by existing or potential market participants.

6. There are circumstances where free competition may not be practicable or may not be the best solution, such as in situations where:

- (a) one firm can produce at lower average costs than could more than one;
- (b) there is a need for prudent supervision;

- (c) there is a need to protect the long-term interest of consumers; or
- (d) there is a need to provide incentives for innovation.

7. In the cases mentioned in paragraph 6, a qualitative assessment of the balance between a justified monopolistic situation on the one hand and the benefits of quality services and fair prices on the other is required. This would apply to **Step 3** of the test, which aims to determine market conducts that may be to the detriment of the overall interest of Hong Kong. The following public policy considerations are relevant:

- (a) the need for prudential supervision in the sector;
- (b) the need to maintain service reliability;
- (c) the need to meet social service commitments;
- (d) safety needs; and
- (e) other public interest considerations.

3rd Pointer: Specific activities that restrict competition

8. This pointer helps detect specific instances of anti-competitive practices and abuse of market position.

Anti-competitive practices

9. The following is a non-exhaustive list of examples of **anti-competitive practices**:

- (a) price-fixing intended to distort the normal operation of the market, increase the cost for purchasers, and have the effect of impairing economic efficiency or free trade;
- (b) actions preventing or restricting the supply of goods or services to competitors, and have the effect of impairing economic efficiency or free trade;
- (c) agreements to share any market sector between participants on agreed geographic or customer lines, and have the effect of impairing economic efficiency or free trade;

- (d) unfair or discriminatory standards among members of a trade or professional body intended to deny newcomers a chance to enter or contest in the market, and have the effect of impairing economic efficiency or free trade;
- (e) joint boycotts intended to distort the normal operation of the market, deprive supply or choice to the targets of the boycott, and have the effect of impairing economic efficiency or free trade; and
- (f) bid-rigging,[§] market allocation, sales and production quotas intended to distort the normal operation of the market, increase the cost for and reduce the choice and availability to purchasers, and have the effect of impairing economic efficiency or free trade.

Abuse of market position

10. Generally speaking, in considering whether a company is **dominant**, the Government shall take into account relevant matters including, but not limited to –

- (a) the market share of the company;
- (b) the company's power to make pricing and other decisions;
- (c) any barriers to entry to competitors into the relevant market; and
- (d) the degree of product differentiation and sales promotion.

11. A company who is in a dominant position would be deemed to have **abused** its position if it has engaged in a conduct which has the purpose or effect of preventing or substantially restricting competition in a market. As illustrative examples, the conducts to be taken into account in considering an **abuse of dominant market position** include:

- (a) predatory pricing – a deliberate strategy, usually by a dominant firm, to drive competitors out of the market by setting very low prices or selling below the firm's incremental costs of producing the output. Once the predator has successfully driven out existing competitors and deterred entry of new firms, it can raise prices and earn higher profits;
- (b) setting retail price minimums for products or services where there are no ready substitutes;

[§] Certain bid rigging activities, as far as public bodies are concerned, are criminal offences under the Prevention of Bribery Ordinance.

- (c) price discrimination, except to the extent that the discrimination only makes reasonable allowance for differences in the costs or likely costs of supplying the goods or services;
- (d) conditioning the supply of specified products or services to the purchase of other specified products or services or to the acceptance of certain restrictions other than to achieve assurance of quality, safety, adequate service or other justified purposes;^{**} and
- (e) making conclusion of contracts subject to acceptance by other parties of terms or conditions which are harsh or unrelated to the subject of the contract.

Mechanism for initiating action against anti-competitive practices and appeal

12. As mentioned in the policy statement, the Government is committed to pro-actively nurture and sustain competition for the purpose of enhancing economic efficiency and free trade. The Competition Policy Advisory Group (COMPAG) chaired by the Financial Secretary –

- (a) directs **all government entities (including all statutory bodies)** to adhere to the policy statement and the above guidelines; and
- (b) calls upon **all businesses** to abide by the policy statement and this set of guidelines and cease existing, and refrain from introducing, restrictive practices that impair economic efficiency or free trade.

13. The following mechanism deals with action against anti-competitive practices and appeals against such actions^{††}:

- (a) **complaints** – alleged restrictive practices in the public and private sectors may be referred to the concerned policy bureau or government department for consideration. Separately, the COMPAG Secretariat will keep track of all referrals and bring these to

^{**} It is necessary to take into account the commercial practice of “cross-selling”, particularly when in the form of bundled products/services which are typically offered to increase the attractiveness of the individual products/services. Very often these service/product packages address customers’ preferences as well as lower the cost of servicing to the benefit of the customers.

^{††} The mechanism for complaints against restrictive practices and appeals in this set of guidelines is in reference to the work of the COMPAG in general. It shall be without prejudice to the action of statutory bodies like the Telecommunications Authority and the Broadcasting Authority which work to sector-specific competition laws.

the attention of COMPAG should there be substantial policy or systemic implications;

- (b) **initiating action** – where justified, the Government will take administrative or legal steps as appropriate to remove anti-competitive practices if necessary; and
- (c) **appeals** – all parties subject to action against anti-competitive practices by the Government may appeal to the COMPAG for review of the action concerned;
- (d) Bureaux/departments are expected to implement the recommendations of the COMPAG. In general, the implementation of recommendations by the COMPAG is subject to judicial review or appeal mechanisms built into certain specific laws (e.g. Administrative Appeal Board Ordinance and applicable laws regulating specific sectors).

COMPAG Secretariat
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