FARMER, BARON, TRADER, SUGAR: COMPETITION AND INDUSTRY REGULATION OF THE PHILIPPINE SUGAR SECTOR*

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I. INTRODUCTION

The Philippines is the eighth largest sugar producing country in the world, but it is not a major player in the international sugar trade because of higher production costs.[1] The industry is highly regulated with quantitative import/export restrictions and production quotas which impact sugar output, supply, and prices. There have been reports of anti-competitive conduct in the industry such as the presence of a cartel among sugar traders. It appears that the newly-formed Philippine Competition Commission (PCC) had similar concerns about anti-competitive practices in the sugar industry when it included the same in its 2019 priorities for market investigation.

If the competition concerns can be substantiated, we have a curious case of government regulations facilitating collusion and other anti-competitive conduct, or at least failing to thwart them. It can mean a confrontation between the PCC and the Sugar Regulatory Administration (SRA), and not to mention an old, but still strong, political class with ties to the industry.

This paper analyzes the *possible* competition issues in the sugar sector and the interface between sector-specific regulations and competition rules. To understand these competition issues, we take a brief overview of the structures and practices in the industry that have deep historical roots dating back to American colonial times (Part II). We analyze their anti-competitive effects within the industry itself, on consumers, and on the downstream manufacturing industry (Part III). The paper does not attempt to *conclusively*

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* *Cite as* Michael Ocampo, *Farmer, Baron, Trader, Sugar: Competition and Industry Regulation of the Philippine Sugar Sector*, 93 PHIL. L.J. 298, [page cited] (2020).

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[1] ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [hereinafter "OECD"], AGRICULTURAL POLICIES IN THE PHILIPPINES 90 (2017), *available at* https://read.oecd-ilibrary.org/agriculture-and-food/title-agricultural-policies-in-the-philippines_9789264269088-en#page92

prove anti-competitive behavior, which will require a thorough sector investigation. However, it identifies *possible* competition issues based on existing literature on competition and the sugar industries in the Philippines and other countries. To address these issues, we would need to know the competition law framework and its boundaries with sector regulations.

The paper summarizes the Philippine Competition Act's (PCA) key provisions, prohibited acts, and the PCC's powers vis-à-vis sector regulators (Part IV). Possible overlaps between competition and sector regulation are also discussed (Part V). Finally, in view of the competition framework and overlap with sector regulations, and the structural, behavioral, and regulatory constraints identified in the previous parts, the paper delves into approaches that a nascent competition authority could take and, at the same time, attempts to establish a strong competition framework (Part VI). It is proffered that the identified approaches avoid unnecessary conflicts with sector regulators as well as with the political landscape, which could clip the wings of competitiveness before it is able to even take flight.

II. THE PHILIPPINE SUGAR INDUSTRY

Brought into the country by Arab traders, sugar had been grown in the Philippines centuries before the Spanish colonization during the 16th century.[2] It did not become an important crop, however, until the late 18th century when Manila, the capital, opened to Western trade. The Spaniards saw sugar as a possible profitable export to replace the lost revenues from the Acapulco-Manila galleon trade of Chinese goods, which ended with Mexican independence in 1821.[3] By the mid-19th century, sugar was the leading export. This was further propelled by the British, who encouraged sugar cultivation in central Philippines to provide a profitable return cargo for British textile merchants.[4]

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[2] Peace and Equity Foundation, *A Primer on PEF's Priority Commodities: Industry Study on Cane Sugar* (2013), PEACE AND EQUITY FOUNDATION WEBSITE, *at* https://pef.ph/wp-content/uploads/2016/03/Industry-Study_Cane-Sugar.pdf (last visited July 30, 2019).

[3] MICHAEL BILLIG, BARONS, BROKERS, AND BUYERS: THE INSTITUTIONS AND CULTURE OF PHILIPPINE SUGAR 32-33 (2003).

[4] Michael Billig, *Syrup in the Wheels of Progress: The Inefficient Organization of the Philippine Sugar Industry,* 24 J. SE. ASIAN STUD. 122 (2003).

A. In the 20th Century

The U.S. acquired the Philippines after winning the 1898 Spanish-American War. The industry was then reshaped by American policies and economic interests, whose effects still linger today.

The U.S. gave preferential tariff rates for imported Philippine sugar. The 1909 Payne-Aldrich Act allowed the duty-free entry of 300,000 metric tons (MT). In 1913, the U.S. Congress removed the quantitative restriction.[5] These policies led to the boom years for Philippine sugar and the rise of "sugar barons," who gained economic and political power.

The industry radically changed from the 1910s to 1920s with the development of large centrifugal mills (i.e. a *central*), shifting sugar production from the small *hacienda*-based mills to large processing plants.[6] Sugar lands were divided into milling districts, with a central connected to the surrounding plantations (mostly by rail networks), leaving the planters with no choice but to engage with a monopsonist mill.[7] These mills first implemented the *planter-miller ("P-M") sharing system*: the mills transport and process the sugarcane in exchange for a share in the finished product instead of directly purchasing the sugarcane as raw material.[8]

With the Great Depression, demand glut and overproduction in the U.S., and the anticipated grant of Philippine independence, import controls on Philippine sugar came on the agenda. The Jones-Cortigan Act of 1934 and the Sugar Act of 1937 set import quotas for duty-free Philippine sugar.[9] Expectedly, sugar exports fell from 1,153,000 MT in 1934 to an average of 826,000 MT from 1935 to 1941.[10]

World War II (1941–1945) left a tattered industry when the Philippines became independent in 1946. As part of the U.S. post-war rehabilitation support, the 1946 Bell Trade Act allowed duty-free access of Philippine sugar until 1954, which was later extended to 1974 by the Laurel-Langley Act. Boon years followed from the 1950s to the early 1970s.[11] The

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[5] Peace and Equity Foundation, *supra* note 2.

[6] Billig, *supra* note 3.

[7] Billig, *supra* note 4.

[8] Billig, *supra* note 3.

[9] Billig, *supra* note 4.

[10] JOHN LARKIN, SUGAR AND THE ORIGINS OF MODERN PHILIPPINE SOCIETY 202 (1993).

[11] *Id.* Billig, *supra* note 4.

Philippines especially benefited from the Cuba embargo, imposed after the Fidel Castro-led revolution in 1958.[12]

To meet the U.S. quota, the Philippine government implemented the *sugar classification system*, allocating production for the U.S. and domestic markets, and a reserve supply to fill any shortfall in the U.S. quota.[13] With minor changes, the classification system is still used today as the Philippines continues to benefit from the U.S. Tariff-Rate quota, albeit with lower quota volumes and preferential instead of zero tariffs for in-quota exports.[14]

The end of duty-free entry in 1974 already spelled trouble, followed by the Marcos dictatorship which further ravaged the industry from 1975 to 1986. To supposedly thwart a trader's cartel, Marcos created a monopsony, the Philippine Exchange Company ("Philex")—later replaced by the Philippine Sugar Commission ("PHILSUCOM")—headed by Roberto Benedicto, a Marcos crony. Philex's initial foray into the sugar trade culminated in disaster. It speculated that sugar prices would rise in 1975 and kept much of the 1974 production in warehouses, only to see a worldwide price glut.[15] As described by one writer, "[p]eople in [the production hub of] Negros recall 1975-1978 as the years in which surplus sugar had to be stored in swimming pools, schools and churches."[16] Even when prices recovered in the 1980s, the rates paid by PHILSUCOM barely inched up. PHILSUCOM was used as a tool to divert industry profits to Marcos and his cronies.[17] The stifling of competition in sugar trading stunted the industry and caused mass job losses. Farmhands endured egregious poverty and hunger, with Negros being called the Ethiopia of the Philippines and becoming a hotbed of armed insurgency.

People power forced Marcos out in 1986. The succeeding Aquino administration dismantled the sugar trading monopsony and privatized government-owned mills;[18] however, the SRA, created by Aquino in 1986, retained import controls and sugar quotas.

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[12] Peace and Equity Foundation, *supra* note 2.

[13] Larkin, *supra* note 10, at 202-06.

[14] United States Department of Agriculture, *Sugar Imports Under Tariff-Rate Quotas (2019)*, UNITED STATES DEPARTMENT OF AGRICULTURE WEBSITE, *at* https://www.ers.usda.gov/topics/crops/sugar-sweeteners/trade/ (last visited Feb. 18, 2020).

[15] Billig, *supra* note 3; Billig, *supra* note 4.

[16] Billig, *supra* note 3, at 56.

[17] Billig, *supra* note 3; Billig, *supra* note 4.

[18] OECD, *supra* note 1.

B. The Industry Today

Today, sugar centrals operate within a mill district, a contiguous area where a sugar mill or other processing facilities and the plantations and farms adherent thereto operate.[19] The number and location of mills are largely determined by the source and amount of sugarcane supply. The mills must be near plantations because the sugarcane must be milled as soon as possible after harvest to avoid sucrose content losses.[20] New mills will not be constructed and existing mills will not expand capacity if sugarcane supply is low. In 2017, it was reported that the existing 27 mills were utilizing only 60% of its capacity[21] due mainly to limited sugarcane supply.[22]

During the milling season, planters deliver the harvested sugarcanes to the mill, which they select based on the distance from the plantation, capacity, efficiency (sugar recover rate and speed of milling), incentives (e.g. free hauling services, trucking subsidies), and the planters' share in the P-M sharing agreement.[23]

Juice extracted from the sugarcane is processed to produce raw sugar, which is shared between the planters and millers. The P-M sharing agreement is usually negotiated through sugar cane planters' associations.[24] In the absence of an agreement, a 1952 statute provides a default P-M share, ranging from ratios of 60-40 to 70-30, depending on the mill's preceding annual production.[25] Direct selling of sugarcane to the mills is not prohibited, but the P-M sharing system has been too entrenched that planters are not open to new arrangements. One attempt to directly purchase sugarcane failed. It faced

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[19] Rep. Act No. 10659 (2015) Rules & Regs., Rule 2.2.

[20] *In re* Proposed Acquisition by Universal Robina Corp. of Assets of Cent. Azucarera Don Pedro, Inc. and Roxas Holdings [hereinafter "*In re* Proposed Acquisition by URC of Assets of CADPI and RHI"], PCC Case No. M-2018-006 (Phil. Competition Comm'n Feb. 12, 2019); Billig, *supra* note 4.

[21] Jeffrey Albanese & Pia Ang, *Philippines Sugar Annual Situation and Outlook*, UNITED STATES DEPARTMENT OF AGRICULTURE WEBSITE, *available at* https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Sugar%20Annual_Manila_Philippines_4-6-2017.pdf (last visited July 29, 2019).

[22] SUGAR REGULATORY ADMINISTRATION [hereinafter, "SRA"], Sugarcane Industry Roadmap 2011-2016: Executive Summary, *available at* https://www.sra.gov.ph/wp-content/uploads/downloads/2012/12/SUGARCANE-INDUSTRY-ROADMAP_nov12-1.pdf (last visited July 29, 2019).

[23] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006, ¶¶ 35-36, 50-51.

[24] *Id.* ¶¶ 38-39.

[25] Rep. Act No. 809 (1952), § 1.

hostility from planters, with many boycotting the mill and refusing to send their cane for processing.[26]

Mills issue negotiable receipts ("*quedans*") to represent shares in the raw sugar, which are stored in government-registered warehouses.[27] *Quedans* are classified based on SRA apportionment of sugar for domestic, U.S., or other markets. Every crop year ("CY"), the SRA issues Sugar Order ("S.O.") No. 1, which sets the allocations.

There is a lucrative secondary market for *quedans*.[28] Some planters immediately sell their *quedans* to local traders, who subsequently sell them to large traders. Other planters hold on to their *quedans*, speculating when prices will go up. In major sugar-producing areas like Negros, there are weekly biddings for *quedans*, with the SRA publishing the bid prices on its website. The *quedans* accumulated by large traders are sold to wholesalers, distributors, and processors (e.g. food and beverage manufacturers), which withdraw the sugar from the warehouses.[29] Some millers also engage in trading, but generally, it is the network of traders and brokers that transport the sugar from the warehouses to the industrial users and consumers.[30] Because of the middlemen and their mark-ups, prices are pushed up before the sugar reaches the end-consumers. As one author said, there is "a frenzy of trading that affords inordinate profits."[31]

The industry is highly organized with associations at every level of the product chain: planting, processing, and trading. Some have more influence than others, with 90% of total sugar production coming from four planter federations and three miller associations.[32] Aside from the obvious bargaining and lobbying uses of these associations, there are statutes and regulations that incentivize their formation. The Sugarcane Industry Development Act of 2015, for example, aims "to promote the competitiveness of the sugarcane industry [...] and improve the incomes of farmers and farm workers, through improved productivity."[33] Under the law, technical assistance and extension

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[26] Billig, *supra* note 3.

[27] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006, ¶ 35.3.

[28] Albanese & Ang, *supra* note 21.

[29] Ryan Bedford & Pia Ang, *Philippines: Sugar Annual Situation and Outlook*, UNITED STATES DEPARTMENT OF AGRICULTURE WEBSITE, *available at* https://www.fas.usda.gov/data/philippines-sugar-annual-3 (last visited July 29, 2019).

[30] Billig, *supra* note 4.

[31] *Id.* at 122.

[32] Bedford & Ang, *supra* note 29.

[33] Rep. Act No. 10659 (2015), § 2.

services shall be planned and provided by government agencies and the mill district development councils,[34] which are registered corporations or cooperatives made up of representatives from the sugar mill, refinery, and planter's association in the milling district.[35] Also, under its charter, the SRA's three-member board should have one member representing the millers and another member representing the planters.[36] Expectedly, industry stakeholders organize themselves to strengthen their influence over the selection process. The existence of trade associations to promote safety and quality is not by itself problematic;[37] however, it is discussed in Part III how it can be a red flag for anti-competitive conduct.

C. Sector Regulations

Aside from Congress-passed legislation, regulations for the sugar industry are determined and implemented primarily by the SRA. As mentioned, the SRA was organized to end the failed government-controlled monopsony in trading.[38] However, this was not a radical liberalization of the industry, but merely a return to the pre-Marcos dictatorship status quo. Although the SRA's charter called for "free market forces [...] to prevail in the marketing of sugar," the "production of the same *should be regulated.*"[39] The SRA was tasked "to institute an orderly system in sugarcane production for the stable, sufficient and balanced production of sugar, for *local consumption, exportation, and strategic reserves.*"[40] Later, the Sugar Industry Development Act of 2015 also mandated that importers secure SRA's classification of the sugar prior to their release from customs warehouses.[41] Thus, through the sugar classification system, export and import controls remained.

The classification system institutes production quotas for market destinations or end-users of the sugar. This classification system is implemented through S.O. No. 1, which the SRA issues near the start of the crop year, usually in August. Table 1 shows the classification system used by the SRA in CY 2017-2018 and 2018-2019.[42]

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[34] § 5.

[35] Rep. Act No. 10659 (2015) Rules & Regs., r. 5.1.

[36] Exec. Order No. 18 (1986).

[37] Rep. Act No. 10667 (2015), § 48.

[38] Billig, *supra* note 3, at 220; Exec. Order No. 18 (1986), ¶¶ 2-3.

[39] Exec. Order No. 18 (1986). (Emphasis supplied.)

[40] Exec. Order No. 18 (1986). (Emphasis supplied.)

[41] Rep. Act No. 10659 (2015), § 9.

[42] SRA Sugar Order No. 1 (2017); SRA Sugar Order No. 3 (2017); SRA Sugar Order No. 4 (2017); SRA Sugar Order No. 4-A (2017); SRA Sugar Orders No. 1 (2018); SRA Sugar Order No. 2 (2018).

Sugar Classification	Market Destination
A	U.S. Market
B	Domestic Market
C	Reserve (can be converted to A or B by the SRA)
D	World Market (other than the U.S. market)
E	Food processors / manufacturers of sugar-based products for export
F	Ethanol producers

TABLE 1. Sugar Classification System.

The SRA can amend S.O. No. 1 after periodic assessments of sugar production and withdrawals from warehouses throughout the CY.

While the SRA does not craft tariff policies, tariffs on imports also bear on sugar prices and supply. The Philippines has historically maintained high tariffs for sugar imports. Under its World Trade Organization (WTO) minimum access volume commitments for sensitive agriculture products, the Philippines maintained import quotas and high tariffs on raw and refined sugar with in-quota and out-of-quota tariffs of 50% and 65%, respectively.[43] Minimum access is 5% of domestic consumption, which had been unchanged since 2004.[44] However, for countries in the ASEAN Free Trade Area ("AFTA"), the Philippines reduced tariffs from 38% in 2010 to 5% in 2015.[45]

Despite the lower tariffs for AFTA imports, SRA-imposed import controls keep most cheaper imports off the Philippine market. Since 2017, the SRA also tightened its grip over high fructose corn syrup ("HFCS") and other cheaper sugar substitutes that beverage manufacturers started to import

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[43] World Trade Organization, *Report by the Secretariat - World Trade Organization (Philippines - WT/TPR/S/149)*, WORLD TRADE ORGANIZATION WEBSITE, *available at* https://www.wto.org/english/tratop_e/tpr_e/s149-4_e.doc (last visited Mar. 4, 2020).

[44] OECD, *supra* note 1.

[45] Caesar Cororaton, Economic Impact Analysis of the Reduction in Sugar Tariffs Under the ASEAN Trade in Goods Agreement: The Case of the Philippine Sugar Sector (GII Working Paper No. 2013-1) (Sept. 2013), *available at* http://www.gii.ncr.vt.edu/docs/GII_WP2013-1.pdf (last visited July 29, 2019).

in large volumes in 2016. Fearing an oversupply of domestic sugar and a price slump, sugar planters and millers pushed for government regulations to tighten the HFCS supply.[46] In response to "complaints from sugar farmers, [...] millers and workers, that the unregulated importation of HFCS, displaces the use of locally-produced sugar and thereby negatively affects the [...] livelihood of industry workers, and impedes the [...] sugar industry[,]"[47] the SRA issued S.O. No. 3 (series 2016-2017) requiring import clearances for HFCS imports, which would then be classified into B, C or D categories. With S.O. No. 3, threats of and actual boycotts of products using HFCS,[48] and the 2018 excise taxes on sugary beverages wherein drinks using were taxed twice more than those using sugar, [49] beverage manufacturers halted HFCS importation.[50] HFCS imports dropped from its 340,000 MT average in CYs 2015-2016 and 2016-2017, to 125,000 MT and 3,000 MT in 2017-2018 and 2018-2019 respectively.[51]

Thus, even though the SRA does not have price-setting powers, it is able to regulate the domestic supply of sugar and affect prices through price classification and import/export regulations.

III. COMPETITION ISSUES

We need to restate a caveat. Except for structural barriers, which the PCC identified in a recent merger control case,[52] the competition issues and anti-competitive conduct described below are *not* conclusive findings. The goal of this paper is to identify *possible* anti-competitive conduct and constraints based on literature and provide *indicative* evidence of such conduct.

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[46] Eric Salta, *The Harrowing Price of High Fructose Corn Syrup*, F&B REPORT, May 21, 2018, *at* https://fnbreport.ph/features/agriculture/the-harrowing-price-of-high-fructose-corn-syrup-eric-20180521

[47] SRA Sugar Order No. 3 (2017), pmbl., ¶ 3.

[48] Carla Gomez, *6,000 Protest in Bacolod vs Coca-Cola's Shunning of PH Sugar*, PHIL. DAILY INQUIRER, Mar. 20, 2017, *available at* https://newsinfo.inquirer.net/882307/6000-protest-in-bacolod-vs-coca-colas-shunning-of-ph-sugar; Nanette Guadalquiver, *Coca-Cola Products Banned in 4-Day BacoLaodiat Festival,* PHIL. NEWS AGENCY, Feb. 15, 2018, *at* https://www.pna.gov.ph/articles/1025440

[49] Rep. Act No. 10963 (2018), § 47.

[50] Manolo Serapio Jr. & Enrico Dela Cruz, *Philippines Drinks Makers Shun China Corn Syrup Imports to Avoid Tax*, REUTERS, Jan. 30, 2018, *available at* https://www.reuters.com/article/philippines-sugar/philippines-drinks-makers-shun-china-corn-syrup-imports-to-avoid-tax-idUSL4N1PP1TW

[51] Bedford & Ang, *supra* note 29.

[52] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006.

This gives us a map of issues, which the PCC will likely face when it acts upon the issues surrounding the sugar industry.

A. Structural Barriers

The entry, or even the threat of entry, of a competitor or the expansion of existing competitors can constrain anti-competitive conduct. One must consider whether the entry or expansion is likely, timely, and sufficient in both scale and scope to assess whether such effective checks exist.

In sugar planting, entry or expansion is constrained by land and labor supplies. The SRA noted that sugar land conversion to commercial and industrial estates and declining workforce are major problems for the industry.[53] The laborers have been moving to sectors with higher productivity like construction and manufacturing. Mechanization may solve this problem, but government modernization support programs have had uneven results.

A new mill, which takes three to five years to build, costs approximately 1 billion pesos. Annual operating and maintenance costs range from 60 million to 100 million pesos. The competition authority found these costs to be highly insurmountable barriers to entry.[54] Moreover, a new entrant will face raw material constraints.[55] Existing mills are operating below capacity (60% average) partly due to the limited supply of sugarcane. Given the high entry costs and limited sources of raw material, sugar processing industries are characterized by oligopolistic, even monopolistic, markets.[56]

B. Possible Cartel Behavior

Economic literature tells us that cartels are not easy to organize and maintain because there are incentive problems which make cheating by members likely.[57] For collusion, especially tacit collusion, to be sustained, cartel members must have the ability to monitor each other's behavior and

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[53] SRA, *Sugarcane Roadmap 2020,* SRA WEBSITE, *at* https://www.sra.gov.ph/industry-update/roadmap/ (last visited July 29, 2019).

[54] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006, ¶ 113.

[55] *Id.* ¶¶ 115-16.

[56] Francisco Marcos, *Damages Claims in the Spanish Sugar Cartel,* 3 J. ANTITRUST ENF'T 205 (2015).

[57] Peter Grossman, *Introduction: What Do We Mean by Cartel Success?,* HOW CARTELS ENDURE AND HOW THEY FAIL: STUDIES OF INDUSTRIAL COLLUSION (Peter Grossman ed., 2004).

swiftly punish any deviant. Cheating must be too costly to outweigh its short-term benefits.[58] In other words, the short-term gains of cheating must be less than the expected future losses from detection, price war, the cartel's breakdown, and loss of supra-competitive prices.[59]

However, literature also tells us that certain products and markets are more susceptible to cartels than others. Homogenous goods like sugar are prone to collusion[60] since competition is not multi-dimensional. With little scope for product differentiation, competition is ultimately restricted to price, which is easily monitored by cartel members. Price deviation by cheating members can therefore be easily caught.[61] In particular, price monitoring is made easy through transparency due to production quotas[62] (undertakings have the means to estimate the available supply in the market), publicly available data on bid and wholesale prices that the SRA collects and publishes on its website, and information-sharing among the federations and industry association members.

The price inelasticity of sugar makes a cartel profitable,[63] especially when there is limited countervailing power of consumers (demand side). Even big industrial users seem to have limited countervailing power as shown by how they succumbed to sugar industry pressures when they tried to use cheaper sugar substitutes during the HFCS importation issue.

Structural barriers in processing and regulatory barriers in trading may also facilitate cartels by preventing competitors from entering the market.[64] The small number of mills in the production segment and the small number of big traders in this highly concentrated market may also facilitate a cartel because coordination becomes easier and less costly.[65] With less parties

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[58] MARC IVALDI ET AL., THE ECONOMICS OF TACIT COLLUSION (Mar. 2003), *available at* http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf (last visited July 29, 2019).

[59] Joseph Harrington Jr., Thoughts on Why Certain Markets Are More Susceptible to Collusion and Some Policy Suggestions for Dealing With Them (Oct. 6, 2015), *at* http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/GF/WD(2015)23&docLanguage=En (last visited July 19, 2019).

[60] Rafaelita Aldaba, *Why Cement Prices Remain High Despite Zero Tariff,* PHILIPPINE INSTITUTE FOR DEVELOPMENT STUDIES WEBSITE, *a*t https://www.pids.gov.ph/publications/4779 (last visited July 30, 2019).

[61] ALISON JONES & BRENDA SUFRIN, EU COMPETITION LAW: TEXT, CASES, AND MATERIALS (2016 ed.); Ivaldi et al., *supra* note 58.

[62] Marcos, *supra* note 56.

[63] *Id.*

[64] Jones & Sufrin, *supra* note 61; Ivaldi et al., *supra* note 58.

[65] Jones & Sufrin, *supra* note 61.

sharing the pie, the short-run incentive to cheat the cartel is reduced while the long-term benefit of keeping in line is strengthened. When there are many parties, the participants' shares are small, and undercutting the cartel price can potentially lead to capturing the entire market, so the incentive to cheat the cartel is higher.[66]

The level of interaction and relationships among participants in the farming, processing, and trading segments also raise red flags (e.g. the frequent interactions among traders during weekly biddings for *quedans*). Collusion is easier to sustain with frequent interaction and frequent adjustment of prices because members can react quickly when someone attempts to undercut the cartel. This is the logic behind some governments' procuring requirements (like with vaccines in bulk), which increases the stakes in each procurement and lessens the regularity of interaction among competing firms.[67] Sugar planters and workers claim that there is a cartel among traders keeping mill gate prices depressed while wholesale and retail prices remain high.[68] On the other hand, sugar planters and processors are "economically interdependent for sugar production, leading them to long-term links and contractual engagements among them,"[69] giving them strong incentives to act collectively to protect common interests.

Moreover, we already noted that the industry is highly organized across all segments along the production chain. Well-organized trade associations also make collusion likely since the collection and circulation of data on production and prices can be done within these groups.[70] In an uncovered Spanish sugar cartel, the enforcement of collusion was made possible by constant exchange of detailed production and sales forecast by industry players.[71]

Indeed, sugar cartels are not novel. Anti-competitive behavior had been reported in the U.S., Colombia, India, Kenya, South Korea, Pakistan, South Africa, and Zimbabwe.[72] In their survey of cartel prosecutions from

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[66] Ivaldi et al., *supra* note 58.

[67] *Id.*

[68] Modesto Sa-Onoy, *Sugar Industry Future*, VISAYAN DAILY STAR, Nov. 15, 2017, *available at* http://visayandailystar.com/2017/November/15/tightrope.htm; Louise Maureen Simeon, *Senate Urged to Probe High Sugar Prices*, PHILSTAR, Apr. 28 2019, *available at* https://www.philstar.com/business/2019/04/28/1913087/senate-urged-probe-high-sugar-prices#c8GP4kxmjlTTZcTe.99

[69] Marcos, *supra* note 56, at 207.

[70] MICHAEL UTTON, CARTELS AND ECONOMIC COLLUSION: THE PERSISTENCE OF CORPORATE CONSPIRACIES (2011).

[71] Marcos, *supra* note 56.

[72] *Id.*

1995 to 2013 in selected developing countries, Ivaldi et al. noted cartels in sugarcane remuneration rates (Colombia) and the sale of sugar (Ukraine, Kenya, South Africa).[73]

C. Sector Regulations

To recall, key sector regulations include the *P-M sharing system* (sugar planting and processing), *sugar classification* (sugar production and trading), *trading licenses* (domestic trade and distribution), and *import and export licenses* (international trade).

The *P-M sharing system*, aside from strengthening economic interdependence that may be conducive for collusion, has been identified as a culprit for the industry's low level of innovation. Fixed revenue sharing between planters and millers discourages the latter from making capital investment to achieve higher extraction rates and capacity.[74] The sharing system "taxes" efficiency gains with most of the return on investment ("ROI") accruing to the planters rather than the millers.[75] Studies conducted by the World Bank and a committee convened by the SRA in 1986 and 1991 recommended a shift to direct purchase of sugarcane, but planters' "cultural inertia" and strong-held views about the sharing system's supposed benefits meant that the idea was dead in the water.[76]

The *sugar classification system* "serves the dual purpose of apportioning sugar to different markets and maintaining price stability within crop years."[77] It is through this system that the SRA balances "the interests of producers, traders and consumers, and it is the nature of this balance that generates most of the controversy."[78] The controversy has to do with *quedan* and trading speculation, which is heightened by the allocations made in S.O. No. 1, the timing of its amendments, and the resulting sugar conversion.[79] For instance, in CY 2017-2018, S.O. No. 1 (August 2017) had the following allocation: 10% (A), 80% (B), and 10% (D). Five months later, this was amended to 6% (A),

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[73] Marc Ivaldi, Frederic Jenny & Aleksandra Khimich, *Cartel Damages to the Economy: An Assessment for Developing Countries*, *in* COMPETITION LAW ENFORCEMENT IN THE BRICS AND IN DEVELOPING COUNTRIES (Frederic Jenny & Yannis Katsoulacos eds., 2016).

[74] Donald Larson & Brent Borell, *Sugar Policy and Reform*, WORLD BANK E-LIBRARY, *available at* https://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-2602 (last visited July 29, 2019).

[75] OECD, *supra* note 1; Larson & Borell, *supra* note 74.

[76] Billig, *supra* note 3, at 125-26.

[77] *Id.* at 103.

[78] Billig, *supra* note 4, at 132.

[79] *Id.*

93% (B), and 1% (D) due to lower production caused by unfavorable weather. Just two months after, the SRA again changed the allocation to 6% (A) and 94% (B).[80] Those who acquired the A and D *quedans* before the amendments could therefore convert their *quedans* to B sugar, which meant a windfall if one were to consider that the average mill site price of B sugar in CY 2017-2018 was higher by 34% and 125% compared to A and D sugar.[81]

B sugar had been priced higher than A and D on average by 42% and 112% during CY 2014-2019.[82] Meanwhile, prices for A sugar intended for the U.S. market have gone down because of the unlimited entry of Mexican sugar under the North Atlantic Free Trade Agreement.[83] Thus, higher profits can be reaped when conversions happen. Also, the increase in domestic supply resulting from the conversion to B sugar does not always translate to lower prices for consumers.

SRA also regulates domestic trading by requiring traders to secure licenses. 2019 recorded 234 licensed domestic traders, including food processors like Universal Robina, Del Monte, and Coca-Cola, which engage in direct trade that is likely to maintain a steady input supply at lower costs.[84] Industrial users require big volumes of sugar, but *quedans* pass through the hands of various traders before a sufficient volume can be consolidated. This drives up prices before the sugar reach industrial end-users.

Sugar tariffs have decreased, at least for imports from the ASEAN Free Trade Area, but import controls have limited the entry of cheaper sugar and substitutes. International traders must also register with the SRA and secure clearances every time they import. In 2019, there were 80 licensed international traders, including food manufacturers licensed as traders who use their imports for their own production and therefore do not affect the domestic supply for other consumers.

There are also quantitative restrictions on imports. For instance, due to inflation concerns in 2018, wherein an uptick in the food and beverages

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[80] SRA Sugar Order No. 1 (2017); SRA Sugar Order No. 1-A (2017); SRA Sugar Order No. 1-B (2017).

[81] SRA, Monthly Average Millsite Prices of Raw Sugar and Molasses - Crop Year 2017-2018 (2018), *at* https://www.sra.gov.ph/wpcontent/uploads/downloads/2018/11/Monthly-Ave-Millsite-Price-2013-2018.pdf (last visited Mar. 9, 2020).

[82] SRA, Monthly Average Millsite Prices of Raw Sugar and Molasses - Crop Year 2016-2017 (2018), *at* https://www.sra.gov.ph/wp-content/uploads/downloads/2018/08/Mo-Ave-Millsite-Price-2012-2017.pdf (last visited Mar. 9, 2020).

[83] SRA, *supra* note 53.

[84] SRA, Listing of Registered Sugar Traders (International), Crop Year 2018-2019.

price indices contributed to the unusually high inflation of above 6%, the SRA approved the importation of 150,000 MT of raw or refined sugar.[85] Each eligible trader could apply to import 2,500 to 15,000 MT of the raw or refined sugar,[86] the allocations of which were to be awarded on a first-come, first-serve basis.[87] The small number of traders who could secure the licenses and the known allocation of sugar volumes creates transparency in the market which can result in pricing decisions not favorable to consumers. Indeed, "[s]trong protectionist regulatory measures in sugar industries across the world have left narrow room for business competition."[88]

D. Effects on Consumers and Downstream Manufacturers

It bears stressing that import controls and domestic market quotas have raised prices. Except for periods of abnormally high world prices, government policies have contributed in keeping domestic sugar prices above world prices.[89] From 2007 to 2011, the average domestic price of sugar was 100% higher than world prices.[90] According to food manufacturers, as of 2018, domestic sugar remains to be twice as expensive as imported sugar[91] despite government subsidies to the industry. Indeed, the high cost of sugar is borne by Filipinos: *first*, as consumers, and *second*, as taxpayers. The Organization for Economic Co-operation and Development (OECD) estimated that taxpayer and consumer transfers to the sugarcane producers from 2012 to 2014 were slightly more than one-third of gross farm receipts.[92]

High sugar prices have dragged down the downstream manufacturing industries, especially in the food and beverage industry where sugar is the main input.[93] The high cost of sugar inputs have prevented manufacturers from producing cheaper consumer goods and competing in international markets. A government economic manager noted how costly sugar inputs negatively

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[85] SRA Sugar Order No. 2 (2018), § 2.

[86] § 4.

[87] § 4.

[88] Marcos, *supra* note 56.

[89] Rigoberto Lopez, *Political Economy of Pricing Policies: The Case of Philippine Sugar*, 32 THE DEVELOPING ECONOMIES 155 (1994).

[90] Cororaton, *supra* note 45.

[91] Rudy Romero, *Sugar Importation is about Price, Not Supply*, MANILA STANDARD, July 31, 2013, *available at* http://manilastandard.net/opinion/columns/business-class-by-rudy-romero/271790/sugar-importation-is-about-price-not-supply.html

[92] OECD, *supra* note 1.

[93] Marcos, *supra* note 56.

impact potential exports.[94] With similar concerns, the National Economic and Development Authority (NEDA) launched a study on sugar importation and related regulations. The planning secretary said that his office was evaluating the removal of non-tariff, quantitative barriers, and allowing industrial users to import directly and cut intermediary transaction costs.[95] Such changes augur well for the overall economy because the food and beverage industry accounts for over half of the total manufacturing output.[96]

IV. COMPETITION LAW IN THE PHILIPPINES

Before the 2015 Philippine Competition Act (PCA), competition rules had been scattered in about 30 different laws (e.g. criminal, consumer protection, and sector-specific statutes) with outdated, hardly-enforced provisions.[97] Article 186 of the Revised Penal Code (RPC) prohibited monopolies and combinations in restraint of trade. Adopted in 1932 during the American colonial rule, Article 186 was influenced by the U.S. Sherman Act. However, unlike U.S. courts, which could expound and give meat to the Sherman Act in a common law fashion, Philippine courts operated under a civil law tradition in criminal law, which could have had a restraining effect on its enforcement. Other obstacles to the penal provision's effective implementation included the high burden of proof beyond reasonable doubt of *knowingly* committing the illegal acts, general unawareness about competition law, and the absence of a dedicated competition agency with independence, competence, and resources to enforce it.[98]

The need for a comprehensive competition legislation became pressing as the economy grew and became more integrated with international production and supply chains,[99] firms and domestic conglomerates increased their market power, and markets remained concentrated in many sectors of

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[94] Aika Rey, *Gov't to Deregulate Sugar Imports in 2019*, RAPPLER, Jan. 16, 2019, *at* https://www.rappler.com/business/221092-government-to-deregulate-sugar-imports-2019

[95] Ben De Vera, *NEDA: Liberalization of Sugar Industry Next*, PHIL. DAILY INQUIRER, Jan. 28, 2019, *available at* https://business.inquirer.net/264239/neda-liberalization-of-sugar-industry-next?

[96] OECD, *supra* note 1, at 6.

[97] Erlinda Medalla, *Understanding the New Philippine Competition Act*, PHILIPPINE INSTITUTE FOR DEVELOPMENT STUDIES WEBSITE, *available at* https://www.pids.gov.ph/publications/5802 (last visited July 30 2019).

[98] Mel Marquis, *Competition Law in the Philippines: Economic, Legal, and Institutional Context*, 6 J. ANTITRUST ENF'T 79 (2018).

[99] Erlinda Medalla, *Philippine Competition Policy in Perspective*, PHILIPPINE INSTITUTE FOR DEVELOPMENT STUDIES WEBSITE, *at* https://www.pids.gov.ph/publications/2217 (last visited July 30, 2019).

the economy.[100] Despite the liberalization of key sectors, reforms needed "to be reinforced by measures that safeguard competition."[101]

As the PCA's main implementor, the PCC, an independent, quasi-judicial body, has the power to conduct investigations, hear and decide on administrative cases involving anti-competitive conduct, and review mergers and acquisitions ("M&As"). It can likewise impose fines and structural and behavioral remedies.[102] The Department of Justice (DOJ) has jurisdiction over criminal prosecutions that will be filed in regular courts.[103]

A. Hardcore Cartel and Anti-Competitive Agreements

The PCA prohibits three categories of anti-competitive agreements "between and among competitors."[104] Category 1, expressed in Section 14(a) of the PCA, includes the fixing of prices and other terms of trade and bid manipulations which are prohibited *per se*. This means that anti-competitive effects need not be proven for liability to attach. Under Section 14(b), Category 2 involves agreements that have "the object or effect of substantially preventing, restricting or lessening competition" such as market sharing, limiting production, markets, technical development, or investment, which means that the burden of proof for prosecuting market-sharing cartels is higher than price-fixing cartels.[105] Category 3 are agreements *not* in the two preceding categories and which the object or effect substantially prevents competition. Under Section 14(c), these can be justified by economic, technical, or dynamic efficiencies, unlike Categories 1 and 2.

Under Section 35, the PCA empowers the PCC to implement a leniency program covering Section 14(a) and 14(b) violations. Immunity from, or reduction of, administrative penalties can be given to a party that first comes forward with information about illegal conduct, subject to conditions like *not* being a leader or instigator of the cartel and giving full cooperation and disclosure. Leniency can also include immunity from follow-on suits by third parties affected by the illegal conduct. Criminal liability can also be excused under a separate DOJ leniency program.

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[100] WORLD BANK GROUP, FOSTERING COMPETITION IN THE PHILIPPINES: THE CHALLENGE OF RESTRICTIVE REGULATIONS (2018).

[101] Rep. Act. No. 10667 (2015), pmbl.

[102] § 12.

[103] § 31.

[104] § 14.

[105] Marquis, *supra* note 98.

B. Abuse of Dominance

In Section 15, the PCA prohibits abuse of dominance by "one or more entities" engaging in conduct that would substantially restrict competition, including predatory pricing, imposing barriers to entry, price and terms and conditions ("T&C") discrimination, exclusivity agreements, preferential discounts or rebates, and terms that impose restrictions on the contracting party, tie-ins, and unfair pricing.[106]

Section 15 provides a system of exceptions and defenses. For example, prices that develop in the market "due to superior product and processes or legal rights or laws" shall not be considered unfair prices.[107] Price and T&C prohibitions under Section 15(d) excludes socialized pricing for marginalized sectors, prices and terms in response to a competitor's pricing, and changes in the latter's facilities or services and changing market conditions. In all cases, the accused can argue legitimate acquisition of dominance or raise efficiency defenses.[108]

C. Merger Control

In Section 21, the PCA requires mandatory notification when the transaction meets the minimum thresholds for the size of the entity or person (5.6 billion pesos) and size of the transaction (2.2 billion pesos).[109]

Under Section 20, M&As that substantially restrict competition in the relevant market may be prohibited. Entities may raise efficiency defenses[110] or prove that a party to the M&A is faced with an actual or imminent financial failure and the agreement is the least anti-competitive means to avert it.[111]

The PCC recently prohibited a transaction involving the acquisition of the Centro Azucarera de Don Pedro ("Don Pedro") mill in the province of Batangas by Universal Robina Corporation ("URC"). URC is a vertically integrated food and beverage manufacturing firm which owns several sugar mills, including a smaller mill in Balayan, Batangas that competes with Don Pedro in the market for sugar milling (for planters) and refining services and

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[106] § 15.

[107] § 15(h).

[108] § 15.

[109] Rep. Act No. 10659 (2015) Rules & Regs., Rule 3, § 3.; PCC Res. No. 03-2019 (2019), adjusting the Merger Notification Threshold.

[110] Rep. Act. No. 10667 (2015), § 21(a).

[111] § 21(b).

for the production of raw and refined sugar and molasses.[112] The PCC found that the transaction was a "merger to monopoly," which would combine the only existing rivals and "translate not only to a lessening of competition but a total elimination of competition in the relevant market."[113] It would lead to a unilateral decrease in the planter's share in the P-M sharing agreements,[114] sugar recovery rates, [115] and incentives for planters (e.g. transportation subsidies for hauling the sugarcane to the mill).[116] In the absence of substitute mills (since the sugarcane cannot be transported to mills outside Batangas without losing too much sucrose and while bioethanol mills nearby are not viable alternatives),[117] and in view of the structural barriers to entry,[118] there would be no actual or potential competitive pressure to mitigate the merger's anti-competitive effects.

The PCC rejected the efficiency defenses put forward—economies of scale and lower production costs post-merger, increase in capacity utilization due to consolidation in view of insufficient raw materials (sugar cane), and more efficient milling schedules post-merger—because the parties failed to provide detailed and verifiable evidence that the efficiencies would materialize.[119]

The competition authority's rejection of the merger goes against the stand of the sector regulator. In *Sugarcane Roadmap 2020*, the SRA identified mergers of sugar mills by leading investors as one of the industry's strengths.[120] The favorable view towards consolidation is likely due to limited cane supply (raw materials), which cause mills within the same or adjacent districts to operate below capacity.

V. COMPETITION AND SECTOR REGULATION: BOUNDARIES AND OVERLAPS

What happens in cases of conflicting views between the competition authority and the SRA, like in the case of mill mergers? What if the sector

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[112] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006, ¶¶ 21-33.

[113] *Id.* ¶ 63.

[114] *Id.* ¶¶ 65-84.

[115] *Id.* ¶¶ 85-97.

[116] *Id.* ¶¶ 98-103.

[117] *Id.* ¶¶ 117-121.

[118] *Id.* ¶¶ 104-116; *see supra* Part III.A.

[119] *Id.* ¶¶ 122-129.

[120] SRA, *supra* note 53.

regulations themselves are found to facilitate or directly result in anti-competitive conduct?

Philippine legislators appear to have anticipated these kinds of conflicts. Section 32 of the PCA states that:

> [The c]ommission shall have *original and primary jurisdiction* in the enforcement and regulation of all competition issues. The Commission *shall still have jurisdiction if the issue involves both competition and noncompetition issues*, but the concerned sector regulator shall be consulted and afforded reasonable opportunity to submit its own opinion and recommendation on the matter before the Commission makes a decision on the case.[121]

The term "noncompetition" is quite vague. But if one reads the provisions of the PCA together, one can deduce that "noncompetition" refers to sectoral regulatory issues. Even then, sectoral issues (e.g. sugar quotas) cannot really be disassociated from competition issues involving price and production.

However, despite this vagueness, it is submitted that it can be interpreted in a way that is not unfamiliar to jurisdictions like the European Union (EU). *First*, the competition authority has original and primary jurisdiction over cartels and anti-competitive agreements, abuse of dominance, and merger control. This does not mean that sector regulators cannot do their own investigations into anti-competitive conduct within their sectors, but administrative proceedings against erring entities will have to be submitted to the PCC. *Second*, anti-competitive conduct that is covered by sector regulation and even sanctioned by it does not have immunity from liability under competition law. Thus, SRA-approved sugar and import quotas and clearances will not excuse any anti-competitive agreement and abuse of dominance. Only in instances when sector regulation leaves no recourse for an entity but to commit an anti-competitive conduct will it have immunity from prosecution.

A. Defining Boundaries

The prospect of the PCC finding competition violations despite the presence of sector regulations brings us to the classic regulation versus competition debate, raising concerns that the competition authority will be wading into areas outside of its purview and expertise.

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[121] Rep. Act. No. 10667 (2015), § 32. (Emphasis supplied.)

Good fences make good neighbors. *Conceptually*, the boundary between competition law and industry-specific regulation can be drawn. Although both regimes are tools to address market failures, their respective spheres are supposed to be distinguishable, thereby avoiding conflict between the two.

Regulation is understood to work better in cases where there are structural barriers to competition.[122] In other words, "sector regulation should be put in place only where competition law is unable to deal with market failures,"[123] when there are *natural monopolies* or *externalities* (e.g. industrial pollution), and when regulation is needed for the provision of *public goods* to address free-riding. But regulation is not an animal that sticks to these habitats. Regulation exists even when there is a functioning market or where the market mechanism has been reintroduced, such as the removal of state monopoly in sugar trading. In these situations, regulation and antitrust law are two policy levers that exist side by side, which create some expected tensions. Still, arguably, certain distinctions between competition law and regulation can provide guidance in determining which policy lever should be pulled down.

First, regulation acts *ex ante* in the form of pre-defined rules for price setting, entry, investment, and profit, while competition law acts *ex post* (except in the case of merger control).[124] Competition law acts *ex post* to address *individual* cases of anti-competitive conduct unlike regulation, which alters the structure of the market itself.[125]

Second, sector regulatory agencies often possess more information and know-how compared to anti-trust agencies with respect to industries being investigated for anti-competitive conduct.[126] This suggests that antitrust rules may be appropriate when detailed regulation is *not* critical, while regulation is needed when more resources and complex analyses are needed, like in price-setting and access policies.[127]

Third, regulatory agencies have more enforcement tools and resources (e.g. bigger bureaucracy dedicated to narrower concerns) compared to competition authorities, which mostly rely on fines and prohibitions to check

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[122] NIAMH DUNNE, COMPETITION LAW AND ECONOMIC REGULATION (2015).

[123] Jones & Sufrin, *supra* note 61.

[124] Marcel Canoy, Patrick Rey & Eric van Damme, *Dominance and Monopolization, in* THE INTERNATIONAL HANDBOOK OF COMPETITION (Manfred Neuman & Jurgen Weigand eds., 2004).

[125] Dunne, *supra* note 122.

[126] Jones & Sufrin, *supra* note 61.

[127] Canoy et al., *supra* note 124.

anti-competitive conduct. Hence, regulation is better equipped to address problems that require close and constant monitoring (e.g. production, prices).

However, in the real world, problems and solutions do not always fit into neat categories. Often, we are left with second-best solutions. Competition authorities may have to come in when the sector regulators fail to address market failures, with competition law serving as a residual regulatory framework to protect market mechanisms. It will be useful to remember that except in natural monopolies, for public goods and externalities where regulation serves as *the* market mechanism, generally what regulation does is to reintroduce market mechanism or restructure the market. *There is a market*, and the market mechanism that the regulatory framework creates must be protected against the undertakings' natural tendencies—that is, to seek market power and maximize profit—which regulators may be unable to keep in check. In the sugar industry, statutorily-sanctioned regulatory capture is an added concern, which supports a greater role for the competition authority. Competition law can provide a stop-gap measure to protect the market while regulation shapes up.

B. Promoting Competition?

The PCC's engagement in regulatory issues may not be controversial, at least from a jurisdictional point of view. Under the PCA, "where appropriate, the [PCC] and the sector regulators shall work together to issue rules and regulations to promote competition, protect consumers, and prevent abuse of market powers by dominant players."[128] Even without veto power over anti-competitive regulations, the PCC has other means to shape and align regulations with competition law.

Moreover, the PCC has other powers and functions, which allows it to make a meaningful impact on policies to *promote*, and not just *protect* competition. It can do so directly by intervening in the proceedings of quasi-legislative and quasi-judicial bodies, which require some degree of consideration for competition law.[129] It is also tasked to assist the NEDA in developing a national competition policy in consultation with relevant agencies and sectors.[130] Meanwhile, indirect means of influencing regulations include the issuance of advisory opinions; the submission of "annual and special reports to Congress, including proposed legislation for the regulation

[128] Rep. Act. No. 10667 (2015), § 32.
[129] § 12(n).
[130] § 12(o).

of commerce, trade or industry";[131] and the advocating for pro-competitive policies of the government by "advising the Executive Branch on the competitive implications of government actions, policies and programs"[132] and "reviewing economic and administrative regulations, [on its own] or upon request, as to whether or not they adversely affect relevant market competition, and advising the concerned agencies against such regulations."[133]

It can also shape the mindsets of sector regulators by sharing best practices and building capacity in other competition-related bodies.[134] Finally, the foregoing functions and powers can be strengthened with information gathered through market monitoring and studies of anti-competitive conduct and agreements.[135] Thus, the PCC has power to do competition impact assessments of regulations and policies *ex post* (for existing regulations) and *ex ante* (for proposed regulations).[136]

VI. ADDRESSING THE COMPETITION ISSUES

Given the powers of the PCC and the possible conflict between competition and sector regulations, what approaches can the PCC take to address the competition issues in the industry?

A. Investigations of Anti-Competitive Conduct and Merger Control

Aldaba and Sy propose a cooperative approach, with regulators taking the lead in economic (price setting and consumer protection) and technical (quality, safety, environmental concerns) issues given their area of expertise, while the competition authority takes the lead in abuses of dominance, cartel investigations, and merger review.[137] It is the most uncontroversial approach since the PCA gives the PCC *original and exclusive jurisdiction* over these three areas. Moreover, the PCA, as discussed, appears to allow PCC's intervention

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[131] § 12(k).

[132] § 12(r).

[133] § 12(r).

[134] § 12(q).

[135] §§ 12(*l*)-(m).

[136] *See* Nicoletta Rangone, *New Frontiers for Competition Advocacy and Potential Role of Competition Impact Assessment, in* COMPETITION LAW AS REGULATION (Josef Drexl & Fabian di Porto eds., 2015).

[137] Rafaelita Aldaba & Geronimo Sy, Designing a Cooperation Framework for Philippine Competition and Regulatory Agencies (Discussion Paper Series No. 2014-31) (June 2014), *available at* https://dirp3.pids.gov.ph/webportal/CDN/PUBLICATIONS/pidsdps1431.pdf (last visited July 29, 2019).

when sector regulation leaves room for autonomous cartel and abuse of dominance behavior. A strong foray into these three areas does not run the risk of colliding with the jurisdiction of the sector regulator and being hampered by court injunctions. The PCC must avoid litigation at a stage where courts are still unfamiliar with the extent of the competition authority's powers as well as relevant competition law concepts in order to evade unfavorable precedents that may hamstring its investigations for years to come.

In the *Don Pedro-URC* case, the PCC already used merger control to protect the level of competition existing in the sugarcane milling market.[138] As the market is already characterized by oligopolistic regional markets, merger control is a viable tool to protect the already restricted level of competition. However, the *Don Pedro-URC* precedent (wherein the transaction would have resulted in a monopoly) may be difficult to re-apply where multiple mills operate within the same geographical and product markets, and consolidation may only result in the retention of the market's oligopolistic character. Moreover, merger control may run into a difficult conundrum, assuming policies like import controls and quota systems are found to facilitate anti-competitive conduct and there is a push to change them. To compete with cheaper sugar imports, local firms may need to improve their scale in production, sales and distribution, and research and development ("R&D"), which can be achieved with M&As.[139] Consolidation may also be needed if sugarcane production does not increase. With mills operating under capacity, limiting the number of entities competing for the limited sugarcane (a raw material without substitutes) may be a rationale step. Merger control cannot be disentangled from sectoral issues as neatly as we may want.

With respect to anti-competitive agreements, especially horizontal arrangements or collective dominance in trading, and possibly in processing, red flags—entry barriers, market concentration, product homogeneity, and well-organized trade associations—support further investigation.[140] The PCC will also likely evaluate the cost variation in each segment of the production and supply chain. If the major firms within a market share similar cost structures, it will be easier to agree on a price level.[141] Aside from this structural approach to screening for collusion, the PCA may screen for behavioral indicators as well. These include low-price variability, stability in

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[138] *In re* Proposed Acquisition by URC of Assets of CADPI and RHI, PCC Case No. M-2018-006, ¶¶ 63.

[139] Paul Cook, *Competition and Its Regulation,* 73 ANNALS PUB. & COOPERATIVE ECON. 541 (2002).

[140] Utton, *supra* note 70.

[141] *Id.*

market shares, and lack of linkages between prices and costs. In a sugar cartel case, Spain's competition tribunal found that the movement in sugar prices in 1995 and 1996 did not reflect changes in production and input costs;[142] combining structural and behavioral checks will lessen the chances of false positives.[143]

There are other areas that the competition literature on Philippine sugar seem to gloss over. One is the low capacity utilization rate of mills, which has been blamed on lack of raw material (i.e. sugarcane). The SRA and the Department of Agriculture support this assessment.[144] But there is a possibility that the low capacity utilization rate of mills may be due to agreements that limit production, especially when we consider the economic interdependence between planters and millers and their common interest in avoiding an oversupply of sugar and low prices. Literature has also not delved into vertical arrangements and vertical integration in milling and trading. Sometimes, there is even integration in all three segments (planting, milling, and trading) as some millers have trading licenses and plantations as well. We do not know how these arrangements have affected the market. It will be remiss for any competition investigation *not* to look into these possible horizontal and vertical anti-competitive conduct within the industry.

However, a lot more information is needed to pursue cartel or abuse of dominance prosecutions. There are numerous red flags in this regard, but securing the evidence to support prosecution is a big mountain to climb. Competition issues "cannot be resolved without nuanced and detailed understanding of the industry or market involved."[145] Considering the PCA's limited knowledge and technical know-how about the industry, it is sensible to conduct a market inquiry first before it investigates specific illegal acts or advocates for policy changes.

In the meantime, merger control can be utilized to protect current competition levels. Indeed, merger control has the advantage of not having to prove actual collusion and meeting of the minds between parties.[146] Merger inquiry will also be less complex, considering the inquiry is not industry-wide. An industry-wide inquiry will likely be the scope of cartel and abuse of

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[142] Marcos, *supra* note 56.

[143] Harrington Jr., *supra* note 59.

[144] SRA, *supra* note 53.

[145] Adi Ayal, *Anti-Anti Regulation: The Supplanting of Industry Regulators with Competition Agencies and How Antitrust Suffers as a Result, in* COMPETITION LAW AS REGULATION 39 (Josef Drexl & Fabiana Di Porto eds., 2015).

[146] MARILENA FILIPPELLI, COLLECTIVE DOMINANCE AND COLLUSION: PARALLELISM IN EU AND US COMPETITION LAW (2013).

dominance inquiries due to interlinked industry practices and policy issues that apparently have adverse effects on competition.

B. Market Inquiry and Competition Impact Assessment

Considering how the competition issues in the industry are linked closely with industry regulations, it makes sense to do a hybrid inquiry: market inquiry ("MI") plus competition impact assessment ("IA"). As discussed, the PCA gives the PCC authority to conduct market inquiries, studies of anti-competitive conduct and agreements, and review economic and administrative regulations to determine how they impact competition. The emphasis of the statutory cover for these activities is for steering clear of court injunctions.

The hybrid inquiry allows the PCA to use a "broad prism," gathering not only evidence of *suspected* illegal conduct but also illegal conduct that may be lurking in the shadows with more participants being identified than in a typical enforcement case.[147] Aside from possibly uncovering anti-competitive activities, it may also lead to more in-depth recommendations for structural, behavioral, and regulatory changes.[148]

Moreover, the inquiry's results may have a chilling effect for some entities to cease their anti-competitive conduct even before the PCC takes corrective measures. The information uncovered by the competition authorities may also cause real pressure for some participants to get ahead of the game, report wrongdoing, and partake of the leniency program.

If the results of the inquiry call for the PCC to proceed with prosecution, the data and information gathered may enable the PCC to meet the evidentiary threshold to prove anti-competitive agreements or conduct. Note that the PCA requires the PCC to determine whether such agreements or acts have been committed using "a broad and forward-looking perspective,"[149] that is to say, it must consider not just static efficiency and consumer welfare, but also dynamic efficiency, parties' past behavior, existing market conditions, legal requirements (i.e. regulations), and "future market developments."[150]

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[147] Tamar Indig & Michael Gal, *New Powers - New Vulnerabilities? A Critical Analysis of Market Inquiries Performed by Competition Authorities, in* COMPETITION LAW AS REGULATION 39 (Josef Drexl & Fabiana Di Porto eds., 2015).

[148] *Id.*

[149] Rep. Act. No. 10667 (2015), § 26.

[150] § 26.

Intensive data and information gathering is especially critical because, as discussed, the highly concentrated sugar industry may be suffering from oligopolistic coordination—the Achilles heel of competition law.[151] There are few successful antitrust proceedings against such coordination, often involving parallel or tacit collusion. It "remains extremely difficult to demonstrate that parallelism embeds a deliberate choice of following a common course of action."[152] Many EU decisions—like the *Suiker Unie* (European Sugar Cartel) case—ruled that entities are not prohibited for intelligently anticipating the conduct of their competitors.[153] Thus, the PCC should maximize the use of the hybrid inquiry to bolster its proof that parallel conduct, if indeed present, cannot be explained otherwise than by concentration.[154]

C. Changes to Policies and Regulations

The hybrid MI and IA inquiry will also support policy or regulatory recommendations. Therefore, the PCC must be strategic in the conduct of the inquiry and use it as an opportunity to coordinate with the SRA as the sector regulator.. Involving them in the inquiry may increase the chances of arriving at a shared ownership of recommendations. However, even if the remedies proposed at the end of the process may not be acceptable to the sector regulator, coordination during the inquiry will at least reduce information gathering costs[155] and may insulate the PCC from industry and political pressures, at least for a time.

Moreover, the inquiry should endeavor to understand all points of view coming from the industry and "weigh all conflicting considerations"[156] to ensure nuanced policy recommendations, which may succeed in at least gaining the support of some industry stakeholders. The PCC cannot insist on solely using the competition framework in proposing policy changes. Sound competition is only one of the public interests considered in the rule-making process and it may not be the most important in the gamut of considerations.[157] For instance, the PCC cannot turn a blind eye to social policy considerations, including the plight of small planters. Nor can it just insist on the removal of all anti-competitive regulations in the Philippine sugar industry without considering whether the industry will be put at a

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[151] Indig & Gal, *supra* note 147, at 103.
[152] Filippelli, *supra* note 146, at xii.
[153] Joined Cases 40/73 etc., Suiker Unie v. Comm'n, 1975 E.C.R. 1663.
[154] *See* Cases C-89, Ahlstrom Oy v. Comm'n, 1993 E.C.R. I-1307.
[155] Indig & Gal, *supra* note 147.
[156] *Id.* at 99.
[157] Rangone, *supra* note 136.

disadvantage compared to other countries' sugar industries, which also receive government subsidies and are supported by production quotas, trade controls, and other state regulations.[158]

It is accurate to say that the foregoing approach calls for the PCC to tread carefully when tackling anti-competitive policies and regulations. A young competition authority needs to minimize direct confrontation with the political and economic establishments while it establishes its reputation and legitimacy. Indeed, the PCC can suffer setbacks if it adopts an overly aggressive approach against anti-competitive sugar regulations. The competition authority may be forced to devote a substantial share of its finite resources to battle it out with both regulators and industry players, which will also distract it from more central competition priorities.[159] The government may "retaliate by, for example, limiting the competition agency's jurisdiction, power or budget."[160]

This prudent approach, which also recognizes the conceptual boundaries between regulation and competition, should not, however, result in a cop out. If the MI and IA inquiry clearly connects anti-competitive conduct with sugar industry regulations, the PCC should not shirk from its responsibility of raising those concerns through the appropriate channels (e.g. reports to Congress, inputs to the national competition policy, public reports). State measures that weaken the competition process have already been neglected for far too long "even though excessive state restraints can be the most significant competition problem faced, and for developing countries [like the Philippines], one of the most significant impediments to development."[161] The PCC cannot focus on private illegal conduct while turning a blind eye to the regulatory mechanisms that make such conduct possible in the first place.

> Protecting competition by focusing solely on private restraints is like trying to stop the water flow at a fork in a stream by blocking only one channel. A system that sends private price fixers to jail, but makes government regulation to fix prices legal, has not

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[158] *See* Suresh Gawali, *Distortions in World Sugar Trade,* 38 ECON. & PO. WEEKLY 4513 (2003).

[159] Eleanor Fox & Deborah Healey, *When the State Harms Competition: The Role for Competition Law*, NELLCO LAW LIBRARY, *available at* https://lsr.nellco.org/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1340&context=nyu_lewp (last visited July 29, 2019).

[160] *Id.* at 50.

[161] *Id.* at 40.

> completely addressed the competitive problem. It has simply dictated the form that the problem will take.[162]

D. Advocacies and Changing Mindsets

If the PCC does tackle regulatory issues and push for changes in sugar regulations, it should not neglect the advocacy component. This is integral to any successful policy reform.

Advocacy is needed not only to convince the stakeholders in the sugar industry itself of the wisdom of the policy changes, especially since some industry actors are already open to such proposals because they believe that the industry should modernize, adopt policies that reward efficiency, and compete with other countries' sugar industries.[163] Rather, the advocacy should also aim at gaining wider public support by framing the issue using consumer welfare, economic development through development of the downstream manufacturing sector, and other broad considerations.

At the very least, the advocacy should succeed in convincing other government agencies, if not the sector regulator itself, to support the policy reforms. This may not be too difficult a task because we already noted that economic and planning agencies have expressed support for removing anti-competitive regulations in the industry. It is important to get more government agencies in the fold as it will disperse the targets of lobbyists and political forces, thereby lessening the chances of regulatory capture of the competition authority.

VII. CONCLUDING REMARKS

The PCC has chosen to fight a giant when it decided to include the sugar industry in its investigation priorities. It is an industry that is steeped with age-old practices, structures, and government regulations which appear to have anti-competitive hues. It is likely that addressing the industry's competition woes will require the PCC to struggle with a captured sector regulator and an industry that has produced a political class, which still possesses substantial influence today and can flex its muscles to frustrate pro-competition reforms.

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[162] Timothy Muris, *Principles for a Successful Competition Agency*, 72 U. CHI. L. REV. 165, 170 (2005).

[163] Billig, *supra* note 3.

This paper asks what approaches the PCC can adopt given the regulatory milieu as well as the economic, even politico-historical, context of the sugar industry. Four considerations guided the response to this question: (i) conceptual and jurisdictional or legal boundaries between the PCC and the sector regulator; (ii) technical capacity, knowledge and resources needed to address the competition issues; (iii) the fact that the PCC is a young institution still trying to find its bearings and establish its legitimacy within the governmental framework and the public's eye; and (iv) avoidance of political capture of the competition authority and political backlash against competition law.

Time will tell if the PCC's boldness in deciding to tackle this juggernaut at an early stage of its existence will be rewarded, and whether the country and Filipino consumers will be better off by it. Indeed, this story will be fascinating to watch as it unfolds.

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