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HONG KONG COURT OF APPEAL DECISION ON CARTEL FINES IMPOSED ON ENTITIES WITHIN THE SAME UNDERTAKING

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SUMMARY

Competition Commission v W. Hing Construction & others [2022] HKCA 786 (judgment date: 2 June 2022) concerned an appeal from the first Hong Kong judgments concerning pecuniary penalties for contraventions of competition rules.

The Court of Appeal held that pecuniary penalties for contraventions of competition rules are to be assessed based on the economic activities and conduct of the undertakings who are answerable for the contraventions, and that the legal or natural persons (entities) constituting such undertakings jointly and severally are liable for the pecuniary penalties.

Accordingly, the Court of Appeal allowed the appeals by the Competition Commission (Commission) against two judgments in which the Competition Tribunal (Tribunal) reduced the pecuniary penalties ordered against the respondents in recognition of the respondents' limited participation in the anti-competitive conduct because they had passed down various obligations through subcontracting and partnership arrangements in return for a portion of the value of sales related to the contravention.

THE TWO CASES

The present appeal concerned two enforcement proceedings commenced by the Commission against renovation contractors who were licensed by the Hong Kong Housing Authority (Authority) to offer renovation services in newly completed public rental housing estates, under the Decoration Contractor System that expressly restricted the transfer/sub-letting of the license or subcontracting of the works without the Authority's prior written consent.

In each case, the Tribunal found that the respondents engaged in the serious anti-competitive conduct of allocating customers among themselves, and fixing the service packages and prices

offered for the different types of flats in the relevant housing estate.

In *Competition Commission v W. Hing Construction and others* [2020] HKCT 1, the Tribunal exercised for the first time its power to impose a pecuniary penalty, and laid down a four-step approach for determining pecuniary penalties. (For a detailed discussion of the judgment, please refer to our previous article) The four steps are:

Step 1 - To determine the base amount.

Step 2 - To make adjustments for aggravating, mitigating and other factors.

Step 3 - To apply the statutory cap.

Step 4 - To apply cooperation reduction and to consider any plea of inability to pay.

In the second step, the Tribunal in *W. Hing* gave a one-third reduction in favour of some of the respondents, who claimed to have subcontracted the renovation works in return for a lump sum payment, or to be salaried partners who did not receive any share of the profits from the renovation works carried out in the name of the partnership. The reductions were given in recognition of the respondents' limited participation in the anti-competitive conduct, and on the assumption that the respondents would be unable to recoup the pecuniary penalties from their subcontractors or partners.

Subsequently in *Competition Commission v Fungs E&M Engineering Company Limited and others* [2021] HKCT 1, the Tribunal applied the four-step approach, and further held that the Tribunal may give subcontracting reductions of appropriate percentages, up to 50% of the base amount determined in the first step.

The Commission appealed on the basis that the Tribunal erred in principle in giving subcontracting deductions.

COURT OF APPEAL'S RULING

The Court of Appeal ruled in favour of the Commission, holding as follows:

1. ENTITIES JOINTLY AND SEVERALLY ARE LIABLE FOR THE PECUNIARY PENALTY IMPOSED ON THE UNDERTAKING OF WHICH THEY FORM PART

The Court of Appeal referred to EU jurisprudence which established the principles (a) that competition rules are targeted at undertakings, (b) that the pecuniary penalty is to be imposed on the undertaking that contravenes the competition rule, and assessed with reference to the undertaking's economic activities and conduct, and (c) that the entities constituting the undertaking jointly and severally are liable for the pecuniary penalty.

The joint and several liability, the Court of Appeal explained, is a legal consequence flowing from the economic activities of the undertaking, as the economic unit that contravenes the competition rule. As such, there is no separate infringement by the individual entities constituting the undertaking, and it was wrong in principle to give reductions to respondents based on their individual roles in the undertaking.

The respondents attempted to distinguish EU jurisprudence by pointing out that the Hong Kong Competition Ordinance referred to the imposition of a pecuniary penalty on a "person" rather than an "undertaking". Rejecting the respondent's submissions, the Court of Appeal emphasised that "undertaking" is the key organising concept of the competition law in Hong Kong, and that word "person" was used in the Competition Ordinance because the competition law in Hong Kong was modelled not only upon the competition regimes in the EU and the UK in respect of the contravention of a competition rule by an undertaking, but also upon the competition regime in Australia regarding accessory liability.

The Court of Appeal further pointed out that, for the reasons above, (a) the relevant conduct to be considered at the second step of the four-step approach should be the conduct pertaining to the undertaking, rather than the individual entities, and (b) the principles concerning joint and several liability would not apply to respondents who were pursued under the accessory liability regime, rather than as primary contravener.

2. INABILITY TO RECOUP THE PECUNIARY PENALTY IS AN IRRELEVANT FACTOR FOR ASSESSING THE PECUNIARY PENALTY

Because it is an undertaking rather than its constituent entities that is answerable to competition law contraventions, and the liability of the constituent entities is joint and several, the internal relationships between the constituent entities of an undertaking are not relevant. Therefore, the Court of Appeal held that it was irrelevant to inquire into an entity's ability to recoup the pecuniary penalty from other entities in the same undertaking.

Also, the Court of Appeal took the view that the Commission is not required to identify and commence enforcement proceedings against all the entities to an undertaking. If a respondent wishes to seek a contribution or indemnity against another entity in the same undertaking in respect of the pecuniary penalty made or expected to be made against it, such a claim should be dealt with in subsequent proceedings or in third party proceedings.

Even if the inability to recoup the pecuniary penalty had been considered a relevant mitigating factor, the Court of Appeal held that the respondents would have the burden to adduce evidence to establish such inability and none of the respondents had discharged that burden.

3. IT IS IMPERMISSIBLE TO RELY ON AN UNLAWFUL CONDUCT AS A MITIGATING FACTOR

In *Fungs E&M*, the Commission submitted that the Tribunal should not give recognition to the subcontracting arrangements as a mitigating factor, on the basis that the subcontracting arrangements violated the express restriction against subcontracting under the Authority's Decorator Contractor System. The Tribunal had rejected the Commission's submissions, reasoning that it was not the Tribunal's role to penalise the contractors for breaching their licenses.

The Court of Appeal, however, accepted the Commission's submissions and held that (a) the respondent's subcontracting arrangements were against the public interest protected and served by the Authority's Decorator Contractor System and were contrary to public policy, (b) by operating under the licences, the respondents represented that they solely were responsible for the works, and (c) the respondents should not be allowed to rely on their own wrongs. For these reasons, it was wrong in principle to give recognition to the unlawful subcontracting arrangements as a mitigating factor.

KEY TAKEAWAYS

The appellate judgment recognises that the concept of an undertaking is fundamental to the competition law of Hong Kong, not only for determining the liability but also for assessing pecuniary penalties for competition law contraventions, and highlights that the Commission is free to take action against any entity in an undertaking for the undertaking's contraventions of competition rules.

The finding that entities in the same undertaking jointly and severally are liable for the pecuniary penalty means that an entity with limited role or participation in the contravention will be liable for the same penalty as the other entities in the same undertaking. As demonstrated in *W. Hing* and *Fungs E&M*, the respondent renovation contractors were liable for the infringements committed by their sub-contractors, in full and without deductions, although the contractors might have limited control, authority or influence over the sub-contractors.

The above has wider implications to businesses from compliance and business risk management perspectives. In particular, to ensure full compliance with competition law, businesses not only should monitor and regularly review their own procedures, practices and conduct, but also to take steps to ensure that entities in the same economic units as themselves are in compliance with competition law, for example, affiliates companies, principals/agents, firms/commercial agents, contractors/subcontractors, and suppliers/distributors. However, whether two or more entities will be considered to form a single undertaking will depend on the circumstances of each case.

As an additional protection, businesses may wish to consider including indemnification clauses in respect of the potential legal liabilities they may bear as a result of the conduct of their businesses partners.

Related insight:

- Hong Kong Competition Tribunal establishes four-step approach to assess pecuniary penalties for contraventions of competition rules in recent judgment (15 June 2020)

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