Introduction

On 17 May 2019, the Competition Tribunal (the “Tribunal”) handed down two decisions for the enforcements actions initiated by the Competition Commission (the “Commission”), comprising Competition Commission v Nutanix Hong Kong Limited and Others [2019] HKCT 2 and Competition Commission v W. Hing Construction Company Limited and Others [2019] HKCT 3. Both cases involved breach of the first conduct rule which prohibits any agreement that has an anti-competitive “object” or “effect”. This article is on the case of Competition Commission v W. Hing Construction Company Limited and Others. The prohibition is stipulated under s.6 of the Competition Ordinance (Cap. 619 of the Laws of Hong Kong), which provides:

“(1) An undertaking must not —

(a) make or give effect to an agreement;

(b) engage in a concerted practice; or

(c) as a member of an association of undertakings, make or give effect to a decision of the association,

if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong.

Background

This case concerned decoration works undertaken for the tenants of particular flats in three public housing buildings (the “Estate”). The Commission alleges that:-

1. between June and November 2016, 10 decoration contractors (the “Respondents”) approved by the Hong Kong Housing Authority (“HKHA”) under its decoration contractors registration system, made or gave effect to an agreement or engaged in a concerted practice among themselves, whereby each of them (a) would not actively seek business from tenants on floors allocated to other Respondents; (b) would not accept business from those tenants; and (c) would direct those tenants to the Respondents who had been allocated their floors (“Floor Allocation Arrangement”); and
2. the Respondents made or gave effect to an agreement or engaged in a concerted practice whereby (a) they jointly produced a promotional flyer where the package prices would be printed and which would be used by the Respondents for advertisement to the tenants; and (b) the package prices would be the prices used or offered by the Respondents for the basic packages in the first instance ("Package Price Arrangement").

It was contended that such actions contravened the first conduct rule of the Competition Ordinance in that they had the object of restricting competition, and the arrangements amounted to serious anti-competitive conduct in the form of market sharing and price fixing.

**Decision**

**Infringement of first conduct rule by object**

In relation to the first conduct principle, the Tribunal noted certain types of coordination between undertakings “can be regarded, by their very nature, as being harmful to the proper functioning of normal competition”. The sufficient degree of harm to competition revealed renders it unnecessary to examine their effects. To assess the degree of harm done, the content of the anti-competitive agreements, its objectives and the nature of the goods or services affected have to be considered. Furthermore, s.7 of the Competition Ordinance provides if an agreement has more than one object, it is sufficient if one of its objects is to restrict competition; and the object of restriction of competition may be found even if it can be ascertained by only inference.

The Tribunal held that the terms of the Floor Allocation Arrangement restricted competition by reason of its very object, as it directly prevented competition between the Respondents (the flats in the Estate were carved up by the floors, with each floor allocated to one and only one respondent). Noting that the Respondents enjoyed clear advantages over outside contractors in attracting the patronage of the tenants, e.g. they shared the use of a site office located conveniently within the Estate, and they were allowed to tout for decoration business within the precincts of the estate, it was plain that the respondents would be the closest competitors of one another. The actual pattern of allocation revealed that the Floor Allocation Arrangement was for benefiting the Respondents themselves.

In relation to the Package Price Arrangement, evidence shows that the package prices were reached by many Respondents as the final contract prices in a number of transactions. For tenants who did not bargain and simply agreed to pay the flyer price, the collusion among the Respondents removed the benefit of price competition. Furthermore, even though the package prices were only list prices subject to negotiations with the tenants, they acted as a starting or reference point for negotiations. Agreement on list prices also allowed the
Respondents to foresee with a reasonable degree of certainty what pricing policy will be pursued by their competitors. With no credible evidence of any legitimate objectives served by the Package Price Arrangement, the Tribunal held that it had the object of restricting competition in the Estate.

**The efficiency defence**

Several of the Respondents contended that the arrangement was not anti-competitive but would give efficiency in allocating the works amongst the Respondents, that they should not be held liable for contravening the first conduct rule because the arrangements were economically efficient within the scope of Schedule 1 to the Competition Ordinance. In order for the efficiency defence to apply, there are four conditions, namely: (i) the agreement generates efficiencies; (ii) it allows consumers a fair share of the resulting benefit; (iii) it does not impose restrictions that are not indispensable to the attainment of the objectives; and (iv) it does not afford the undertakings concerned the possibility of eliminating competition.

The Respondents contended that the Floor Allocation Arrangement allowed them to achieve better efficiency including savings in, among others, labour costs, raw material delivery costs, construction waste and debris clean up and disposal costs, and reduction of raw material wastage. Yet, in the Respondents’ hypothetical analysis, the Tribunal held that the purported degree of efficiency was exaggerated and there were inexplicable fallacies that could not be justified. For example, the Respondents alleged that there could be continuity of work for flats on the same floor, yet expert witness showed that some trades are by nature slower than others so that faster trades may have to wait for preceding slower trades to be completed before they can start; while some trades necessarily have to be carried out in priority to other trades (e.g. brickwork before plastering and painting). Despite having the Floor Allocation Agreement and use of detailed project management tools, there would still be downtime in decoration works within the same floor.

The elimination of rivalry between the Respondents, their closest competitors, conferred upon the Respondents an incentive and ability to raise prices. The tenants of the Estate were effectively deprived of any choice between appointed decorative contractors because only one of them would be prepared to take on work on any particular floor. The Respondents have failed to assess whether the costs saving said to have been passed on to the tenants are sufficient to compensate for the anti-competitive disadvantages mentioned and hence failed to satisfy the second condition.

To satisfy the third condition, the agreements and the individual restrictions flowing from it must be reasonably necessary for the attainment of efficiencies. In the current case, the Tribunal held that even if some form of agreement was necessary for achieving floor-based concentration of work, the Respondents have failed to substantiate that the extent and
intensity of restrictions imposed by the Floor Allocation Arrangement were reasonably necessary.

The Respondents also failed to satisfy the fourth condition, as the Floor Allocation Arrangement and Packaging Price Arrangement virtually removed all internal competition among all contracts that were subject to HKHA’s supervision and regulation. The low proportion of the flats within the Estate which the Respondents performed decorative works for does not automatically satisfy the fourth condition.

Hence, the Tribunal held that the Respondents have fallen short of satisfying the conditions of the efficiency defence.

**The sub-contractor defence**

Apart from raising the efficiency defence, the 1st Respondent and the 9th Respondent put forward the sub-contractor defence, in which they contend that they are not liable for any contravention of the first conduct rule on the ground that the renovation business in relation to the Estate was carried out by a separate undertaking.

Based on the facts of the case, it is a fact that the licence granted by the HKHA was to the 1st Respondent and the 9th Respondent. While they might have in effect purported to have given the sub-contractor the benefits of the contract, its obligations thereunder could not be assigned.

As a result, the Tribunal held that there was unity in the Respondents’ and sub-contractors’ conduct on the market, in which it was a joint exercise where the 1st Respondent and the 9th Respondent brought in its status as an appointed decorative contractor and the associated rights and took on responsibilities and obligations towards HKHA and the tenants, whilst the sub-contractors brought in workers, raw materials, site supervision and management. The 1st Respondent and the 9th Respondent may not rely on the sub-contractor defence to evade liability.

Accordingly, each of the 10 Respondents is a person or are persons who have contravened the first conduct rule.

**Conclusion**

As highlighted in the Tribunal’s decision, it is a recognised defence that by reason of the efficiencies generated one may be excluded from the first conduct rule, yet the hurdles to pass are high and companies should exercise caution prior to implementing arrangements that may obstruct competition in the respective market.
The Tribunal’s decision for the Commission is an important step forward for the enforcement against anti-competitive behaviour in Hong Kong, in particular under the first conduct rule. It reinforces the notion that the application of the Competition Ordinance is a powerful tool for the Commission in taking action against infringements of the conduct rules.

For enquiries, please contact our Litigation & Dispute Resolution Department:

E: competition@onc.hk   T: (852) 2810 1212
W: www.onc.hk           F: (852) 2804 6311

19th Floor, Three Exchange Square, 8 Connaught Place, Central, Hong Kong

Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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