

## Renovation cartels – a word of caution

September 2020

Hong Kong people may be well aware of complaints about renovation cartels in the market for some time, even before Hong Kong had its competition law. With the enforcement of competition law, it is hoped that such anti-competitive behavior will be addressed.

Two recent Hong Kong Competition Tribunal decisions have given helpful guidance on what would happen if contractors involve themselves in anti-competitive behavior and the approach the Competition Tribunal will take when considering settlements between the parties and the penalties to be imposed for such anti-competitive behaviour.

In *Competition Commission v. Kam Kwong Engineering Co. Ltd.* [2020] HKCT 3, the Honorable Mr. Justice Jonathan Harris approved a consensual application by the Hong Kong Competition Commission and the first, second, and fourth respondents, to dispose of the proceedings following the parties' settlement. *Kam Kwong* was the second of three cases involving alleged cartel behavior in cases involving renovation in Hong Kong's public housing estates.

In the first such case, *Competition Commission v. W Hing Construction Co. Ltd. (No 3)*, [2020] HKCT 1, the Honorable Mr. Justice Godfrey Lam set out the approach to be adopted as regards the determination of penalties for proven anti-competitive behavior, an approach which has been adopted by the Commission in a recent policy announcement.

*Competition Commission v. Kam Kwong Engineering Co. Ltd.* [2020] HKCT 3

In *Kam Kwong*, the Commission brought proceedings against three construction firms, Kam Kwong Engineering Company Limited, Goldfield N&W Construction Company Limited, Pacific View Engineering Limited, and two individuals, Chan Kam-shui (a director of Kam Kwong) and Lam Po-wong (a representative of Pacific View), alleging they had contravened (or had been involved in contravening) the First Conduct Rule pursuant to section 6 of the Competition Ordinance, (Cap.619) in relation to renovation services on a public housing estate at King Tai Court, San Po Kong, Kowloon.

The Commission highlighted the alleged allocation of floors and units between firms (i.e., market sharing) and coordination of pricing of a basic redecoration package (price fixing), both contraventions of the First Conduct Rule under section 6 of the Ordinance. The contractors involved were licensed under the Hong Kong Housing Authority's Decoration Contractor System.

The contractors were alleged to have entered into an arrangement to allocate potential customers from the estate between themselves by reference to the owners' unit and floor number (the

allocation arrangement). The contractors also exchanged and coordinated the content and price of the standard decoration package on offer to the unit owners, producing a series of leaflets in Chinese promoting identical prices and offerings (the pricing agreement).

The first, second, and fourth respondents admitted liability and agreed a statement of facts with the Commission which was put before the Tribunal.

### **The judgment**

Harris J noted that the application was the first of its kind for the disposal of proceedings against respondents by consent. Harris J concluded that the appropriate way to proceed was by the adopting a procedure used in the context of directors' disqualification proceedings under the Companies Ordinance, Cap 622 and known as the Carecraft procedure, taking its name from the case of *Re Carecraft Construction Co. Ltd.* [1994] 1 WLR 172.

The court held, by virtue of the allocation agreement and/or the pricing agreement, the first and second respondents gave effect to an agreement and/or engaged in a concerted practice with the object of preventing, restricting, or distorting competition in Hong Kong in contravention of the First Conduct Rule. The fourth respondent individual was "involved" in the contravention within the meaning of section 91 of the Ordinance in that he (i) aided, abetted, counselled, or procured the contravention.

The allocation agreement and the pricing agreement represented serious anti-competitive conduct. The court entered judgment for liability against the first, second, and fourth respondents and a declaration that the first and second respondent had contravened the First Conduct Rule and that the fourth respondent was involved in such contravention.<sup>1</sup>

Proceedings were adjourned to a further hearing for the determination of other relief sought by the Commission and for a ruling on costs.

### **Mitigating or aggravating?**

At the further hearing, which took place on 7 August 2020, Harris J was asked to consider whether the level of fine to be levied on Goldfield N&W Construction should be reduced as the infringing activities were carried out by its subcontractor.

Harris J reportedly told counsel for Goldfield that he had "great difficulty" in agreeing with the company's claim that it deserved a one-third discount because the infringing activities were carried out by its subcontractor. The Commission had proposed fines of HK\$1.7 million for Goldfield and HK\$398,000 for Kam Kwong.

Counsel for Goldfield argued that the company's only mistake had been to subcontract the project to a third party who had engaged in the concerted practice and that the company had no knowledge of, and had not itself benefited from, the subletting.

Counsel claimed Goldfield had suffered additional punishments, such as being delisted from the Housing Authority's reference list for decoration contractors and having all its construction work terminated for a period of time. For its part, the Commission has argued for a 25 percent increase on the basic fine, arguing that the prevalence of conduct should be taken into account as an aggravating factor.

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<sup>1</sup> The ruling did not affect the third and fifth respondents, Pacific View Engineering Limited, and Lam Po-wong, who were not party to the settlement agreement with the Commission and whose case was due to proceed to full trial in September 2020. Shortly after the ruling, however, the respondents said they had also decided to settle with the Commission.

Rather than accept the "sub-contracting" defence as a mitigating factor, Harris J described it as "almost an aggravating factor." Harris J criticised Goldfield for failing to supervise the work of its subcontractor, carried out under licence from Goldfield. Goldfield's contract with the Housing Authority prohibited the company from subletting the licence. Harris J also remarked that granting a reduction could diminish the deterrent effect of the penalty, which he said was intended to discourage a cavalier attitude amongst contractors. In contrast, in the first decision on fines in a cartel case (discussed below), the fact that some of the respondents were acting through a subcontractor and therefore did not participate directly in the renovation project was considered a mitigating factor for those respondents.

A decision is awaited.

### **Four steps**

The way fines should be calculated was set out in the first cartel case, in *Competition Commission v. W Hing Construction Co. Ltd. (No 3)*, [2020] HKCT 1. In one of its first major rulings, the Competition Tribunal ruled in May of last year against 10 decorating contractors for serious anti-competitive conduct by allocating refurbishment work amongst themselves and for price-fixing, while undertaking work at a public housing estate in Kwun Tong.

The Tribunal found that the contractors had made an agreement amongst themselves whereby they would each take four floors in each of three buildings in the estate and would agree not to actively seek businesses on floors allocated to the others. They also came to an arrangement as to the prices they would charge, with the prices printed on a joint flyer that was distributed to tenants.

Having found the respondents had contravened the First Conduct Rule, the Tribunal went on to determine the appropriate level of fines to be imposed on each of them.

In the decision of 29 April 2020, Lam J held there were four main steps in determining the pecuniary penalty to be imposed under the Ordinance – (i) determining the base amount (step one), (ii) making adjustments for aggravating, mitigating and other factors (step two); applying the statutory cap (step three), and (iv) applying reduction for cooperation and considering any plea of inability to pay (step four).

The Tribunal said that generally, it should follow the approach in civil proceedings of allowing the costs of the proceedings to follow the event. Given that this was one of the Tribunal's first cases – and that more costs would have been incurred because of the novelty of the law than might otherwise have been the case – Lam J considered it appropriate for there to be a general reduction, by 20 percent, of the costs payable by the respondents to the Commission.

The court awarded costs of between HK\$145,000 and HK\$740,000 against each of the ten respondents, as well as an order for payment of 80 percent of the commission's costs of the proceedings.

In line with the four-step approach of the Tribunal in this decision, the Commission shortly afterwards issued its Policy on Recommended Penalties which sets out a four-step approach to the formulation of recommended pecuniary penalties (available [here](#)).

### **Three in a row**

In the third renovation cartel case to come before the courts, *Competition Commission v. Fungs E&M Engineering Co. Ltd.* [2020] HKCT 4, the Honorable Madam Justice Queeny Au-Yeung was asked by counsel for a respondent to join an individual as an additional defendant. As with the

other cases, the case involves an allegation of allocating customers and fixing prices for the renovation of a public housing estate in Kwun Tong.

Counsel for the first respondent argued that, in the event contravention was established, an individual who was not among those charged should be held responsible for the contravention.

Queeny Au-Yeung J said that enforcement proceedings instituted by the Commission should not be conflated with private litigation. The prosecutorial prerogative lies with the Commission and no one else. The Tribunal should not usurp the Commission's powers to decide who to sue.

On 26 August 2020, counsel for Fungs told the Tribunal the company was ready to reach a statement of agreed facts with the Competition Commission, as a prelude to settlement.

### **Under construction**

The law in this area is novel and is presently under construction. The process has also been instructional for the Commission itself, which was told in July 2020 that it could not seek permission to appeal on the issue of costs in *W. Hing* because the time limit for the request had passed. The time limit for filing the request to appeal on costs is 14 days within date of judgment.

A particular area of concern arising from the recent cases, is the degree to which subcontractors should be supervised to ensure that they are not engaged in anti-competitive practices. It should not be assumed that, "see no evil, hear no evil" can be the watchword. In brief:

- Contractors should be particularly aware of the dangers of contravening the First Conduct Rule.
- The First Conduct Rule prevents businesses from making or giving effect to an agreement, engaging in a concerted practice, or making, or giving effect to a decision of an association, if the object or effect is to harm competition in Hong Kong.
- The aspects of this that most concern construction – given their prevalence in the industry is price fixing, market sharing, and bid rigging.
- Contractors should be mindful not to engage in any activity that may be seen as a contravention. This includes coming to any agreement as to the allocation of units, organizing joint promotions, or printing or distributing leaflets to be given to end users that may show identical or substantially similar pricing or offers.
- They should also be mindful that notes of meetings, conversations, instant messages and so on, will all be discoverable should the Commission pursue an investigation.
- Contractors should be particularly careful to monitor the activities of subcontractors. They should ensure that subcontractors understand the requirements of the First Conduct Rule and should conduct spot monitoring at sites to satisfy themselves that no infringing activities are taking place.

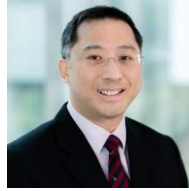
At the very least, contractors should make sure they are fully familiar with the requirements of the Ordinance and the range of helpful guidance produced by the Commission and which is available [here](#).

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