SLAUGHTER AND MAY/

CLIENT BRIEFING

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SUB-CONTRACTOR DISCOUNT FOR CARTEL FINES OVERTURNED IN HONG KONG

While sub-contracting is part of everyday business in many industries, few are aware that sub-contracting is not a defence in competition law. This was reinforced in a recent appeal holding that sub-contracting is not even a mitigating factor in reducing cartel fines. Interestingly, the principles enunciated by the Hong Kong Court of Appeal may have wider applications to other day-to-day business relationships (e.g. distributors, agents, subsidiaries). This briefing looks at this first appeal on cartel fines in Hong Kong and discusses its potential implications, particularly on competition compliance.

The Commission's appeal against the reduction of cartel fines

The cases under appeal concerned the 1st and 3rd Decorators Cartel cases, in which decoration contractors and sub-contractors were found to have fixed prices and shared customers at new public housing estate projects. In fixing the amount of pecuniary penalties in these cases (see our briefings **here** and **here**), the Competition Tribunal (**Tribunal**) gave a reduction of fines to contractors that lent their Housing Authority licences to sub-contractors, partly to account for the fact that the contractors had no direct participation in cartels in question. The Competition Commission (**Commission**) appealed to set aside the sub-contractor discount in both cases.

The Court of Appeal (**[2022] HKCA 786**) allowed the Commission's appeals against the pecuniary penalty reductions in both cases, holding that:

- **Pecuniary penalty reductions should not be given to reflect the role or extent of participation by entities (e.g. lesser involvement by a contractor) within an undertaking.** The Hong Kong competition rules, similar to the EU and UK rules, apply to 'undertakings', i.e. the economic unit that may consist of one or more natural or legal persons. Under the EU and UK rules, liability for competition infringements typically attaches to the undertaking as a whole. The appellate court reasoned that pecuniary penalties in Hong Kong should similarly be determined with reference to the conduct and economic activities of the undertaking, not the individuals or legal entities within that economic unit. As such, there should neither be separate contraventions by each entity within the same undertaking, nor allocation of responsibilities reflecting the entities' extent of participation in the contravention.

- **Natural or legal persons forming the same economic unit are jointly and severally liable for the undertaking's contravention of competition law.** According to the Court of Appeal, joint and several liability is a legal consequence that follows when the competition law contravention is committed by an undertaking made up of one or more natural or legal persons. The appellate court recognised that joint and several liability is an effective legal device for the Commission to recover fines and deter undertakings from anti-competitive conduct. It would be highly onerous if the Commission must bring an action against *all* entities within an undertaking to recover 100% of the fine against that undertaking.

- **When determining pecuniary penalties, the Tribunal should not inquire into the apportionment of penalty among the entities within the same undertaking.** Once the fines have been paid by one or more of those held jointly and severally liable, the Commission would cease to have a role in the matter. The entities may nonetheless apportion responsibility as to the penalty in subsequent indemnity or contribution hearings in which the Commission has no interest.

- **Contractors should not be allowed to rely on their unlawful conduct as mitigation of a penalty.** The Tribunal recognized the sub-contracting relationship as a mitigating factor for the contractors in the 3rd Decorators Cartel case. The appellate court disagreed. The Court of Appeal considered it was against public interest and contrary to public policy to do so, as the sub-contracting arrangements were in breach of the Housing Authority licensing

terms that expressly restricted contractors from sub-contracting their responsibilities. In particular, the fact that the contractors had no knowledge of the anti-competitive conduct committed by the sub-contractors is not relevant.

- **The ability of an entity to recoup penalties from other entities within the undertaking is not a relevant factor for pecuniary penalties**. The Commission has no obligation to disprove any alleged inability to recoup the penalties. Instead, it is for the relevant party to present proper evidence of any alleged inability, and such evidence was not presented to the Tribunal by the respondents in the 1st and 3rd Decorators Cartel cases.

By overturning the pecuniary penalty reductions, the Court of Appeal almost doubled the fines against five contractors in the 1st and 3rd Decorators Cartel cases. Separately, the Commission's appeal on costs in the 3rd Decorators Cartel case was dismissed, as the Court of Appeal was not satisfied that the Tribunal was plainly wrong in granting a certificate of costs for two counsel, instead of the three counsel actually engaged by the Commission.

Key takeaways

The Court of Appeal's ruling is significant for several reasons:

- **Compliance efforts may need to be extended to unaffiliated business partners.** While the contractors in the 1st and 3rd Decorators Cartel cases may not have considered themselves as having authority or responsibility over the actions of their sub-contractors, the Court of Appeal had no sympathy in holding them fully liable for their sub-contractors' contraventions of the competition rules. The same may apply to other commercial relationships where one party has some control/influence over a third party (e.g. suppliers and distributors; principals and agents; and by extension, parents and subsidiary companies). Businesses looking to minimise competition law risk may have to extend their compliance efforts to external business partners (e.g. competition compliance clauses in agreements with business partners, competition law training for the business partner's employees).

- **Sub-contracting is not a shield or mitigating factor to competition law liability.** The Court of Appeal has made it clear that no penalty discounts will be given simply because it was a party's sub-contractor that entered into anti-competitive agreements. Pecuniary penalties will be assessed in respect of the entire economic unit, not the individual entity's role within the economic unit. The Tribunal will not be concerned with the internal relationship of those held to be jointly and severally liable. The Court of Appeal added that there is no injustice or procedural unfairness in holding an entity within an undertaking responsible for the whole of the contravention by the undertaking.

- **The appellate court's ruling is broadly aligned with the EU position in respect of the determination and apportionment of fines.** The Tribunal has considerable discretion in imposing pecuniary penalties under the Competition Ordinance. Despite the respondents' arguments that the determination of pecuniary penalties should be a 'localised affair' (similar to criminal sentencing), the Court of Appeal held that the concept of an undertaking lies at the heart of the competition law in Hong Kong, and such concept is derived from EU jurisprudence. By adopting the EU position, the Court of Appeal did not take the opportunity to lay down a Hong Kong-specific approach in determining pecuniary penalties for competition law contraventions.

Conclusion

While it is unclear whether the respondents will be further appealing the Court of Appeal's judgment, it seems to have paved the way for the Commission to bring enforcement proceedings against parent companies as a result of anti-competitive activities carried out by their subsidiaries. This is reflected in the Commission's latest **press release** on its enforcement action against the Air-conditioning Cartel, which was released shortly after the handing down of the appellate court's judgment. It remains to be seen whether the Hong Kong jurisprudence will continue to follow EU case law in this regard, although the direction of travel in this judgment would suggest that this is likely to be the case.

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