IPBA – CIC Construction Conference 2015

"Impact of Changing Statutory Regimes on the Construction Industry"

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SPEECH

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on

THE POWERS OF THE COMPETITION TRIBUNAL

Let me first of all thank the organisers for inviting me to this conference. It is a pleasure for me to be able to address practitioners in the construction industry on the role of the Competition Tribunal. The theme of the Conference - "Impact of Changing Statutory Regimes" – is clearly very apt and timely since the Competition Ordinance will come into force in just a little over three months from now. The particular impact that I would like to talk about this afternoon is the powers of the Tribunal to make orders for contraventions of the competition law.

The Ordinance contains two principal substantive rules on economic activities that apply to all industries – one dealing with agreements between undertakings and the other unilateral conduct that amounts to abuse of market power. Of greater relevance perhaps to the construction industry is the first conduct rule, which broadly speaking prohibits anti-competitive agreements, concerted practices and decisions of trade associations.

In particular, the Ordinance specifies four types of activities which it labels "serious anti-competitive conduct", namely:

(a) price-fixing;
(b) market sharing;
(c) fixing or limiting production or supply; and
(d) bid-rigging.

The common features of agreements involving these instances of serious anti-competitive conduct are that they involve more than one undertakings or economic entities who are, or are supposed to be, competitors with each other. These agreements are commonly known as cartels.

These are not the only types of conduct prohibited by the Ordinance but the experience of overseas jurisdictions has shown that the construction industry is a fertile ground for cartels, perhaps because demand is relatively speaking inelastic in this market and there is a large measure of homogeneity in the products.

For example, in 2009, the Office of Fair Trading in the UK imposed fines totalling £129.2 million on 103 construction firms in England which it found had colluded with competitors on building contracts. The OFT concluded that the firms engaged in illegal anti-competitive bid-rigging activities on 199 tenders from 2000 to 2006, mostly in the form of "cover pricing", which, incidentally, has been condemned in the UK as being contrary to their "Chapter I prohibition" – broadly the equivalent of the first conduct rule under our Ordinance.[1]

If there is one area which is relatively clear in competition law, it is that cartels are virtually universally condemned by regulators worldwide. Cartels have in fact long been viewed as a serious crime in the US, punishable with custodial sentence, ever since the Sherman Act enacted some 125 years ago. The same type of conduct which in our Ordinance is called "serious anti-competitive conduct" has been criminalised in the UK since 2003.[2]

[1] *Apex Asphalt v OFT* [2005] CAT 11; *Makers UK Ltd v OFT* [2007] CAT 11.

[2] since June 2003 when the relevant provisions in the Enterprise Act 2002 came into force; see the types of conduct referred to in s. 188(2) of the Enterprise Act 2002

In Hong Kong, as you may know, cartels are not as such made a criminal offence by the Competition Ordinance.[3] But this of course does not mean the law is without teeth.

Under the judicial enforcement model that Hong Kong has adopted in its Competition Ordinance, it is for the Competition Commission to receive complaints, investigate and where appropriate bring enforcement proceedings in the Competition Tribunal.

The powers to decide whether contraventions have occurred, and if so to mete out punishment and make other orders are vested in the Tribunal which is staffed by judges who are impartial and independent from the Government as well as the Commission.

There are a number of orders that the Tribunal can make where the Commission has proved a contravention of the conduct rules. It is to these powers that I now turn.

By far the more important weapon is the power to impose a pecuniary penalty. The Tribunal can, on the application of the Commission, impose a pecuniary penalty on a person who has contravened or been involved in a contravention of a competition rule.[4] The use of a fine as punishment follows general international practice.

You may have read about the staggering amounts of fines ordered by the European Commission and in the US against major companies for infringements of competition law.

In Hong Kong, the maximum amount of pecuniary penalty the Tribunal may impose for a single contravention is 10% of the undertaking's local turnover – i.e. total gross revenues obtained in Hong Kong – for each year of infringement, up to a maximum of three years with the highest turnover.[5]

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3 As to potential criminal liability for conspiracy to defraud, see *HKSAR v Chan Wai Yip* (2010) 13 HKCFAR 842; *Norris v The Government of the United States* [2008] UKHL 16.

4 s. 93(1)

5 s. 93(3)

The Ordinance requires that four factors must be taken into account in setting the fine, namely:

(a) the nature and extent of the conduct that constitutes the contravention
(b) the loss or damage caused (if any)
(c) the circumstance in which the conduct took place, and
(d) any previous contravention of the Ordinance by the same person.

Within the upper limit, and subject to taking into account the four matters I have just mentioned, the Ordinance provides, helpfully, that the Tribunal can order "any amount it considers appropriate".[6]

How then will the Tribunal set the pecuniary penalty? When an actual case arises for determination, it is, I think, likely that the Tribunal will make reference to practices in overseas jurisdictions as well as have regard to general sentencing principles. But the Tribunal will I think have to wait for a real case and hear arguments before it can lay down any principle. It is not the practice of the Hong Kong courts, in general, to issue sentencing guidelines in a vacuum and outside the context of adjudication of a specific case.

There is certainly no lack of materials internationally to shed light on the setting of fines. In certain jurisdictions where the fines are determined and imposed by an administrative enforcement agency, such as the EU, guidelines for setting fines have been published. In some other countries where competition law is enforced by the courts in the first instance, such as the US, sentencing guidelines are available.

There is also an enormous amount of academic writing on the subject. One approach that has been mentioned in the literature[7] is an economic deterrence approach. The idea is simple enough: make sure that cartels don't pay. It proceeds on the basis that the decision whether or not to form or take part in a cartel is the result of a cold, economic calculus:

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6 s. 93(1)

7 See e.g. William M Landes, *Optimal Sanctions for Antitrust Violations* (1983) 50 The University of Chicago Law Review 652; W P J Wils, *Optimal Antitrust Fines: Theory and Practice* (2006) 29 World Competition 183.

people do it because their expected gain is greater than their expected loss. In order to deter businesses from engaging in a cartel, therefore, the fine – discounted by the probability of the cartel being detected and punished – must exceed the amount that the business expects to gain from taking part in the cartel. To take a simplistic example, if a businessman thinks he will gain a total extra profit from cartel overcharge of $10 million, and there is a one-in-five chance of the cartel being found out and punished, then the fine should be fixed at at least five times the expected gain, i.e. $50 million, in order for deterrence to work. For good measure, you may even need to factor in an interest element to reflect the differential in the time of receipt of the expected gain and the time of payment of the fine.

This approach focuses on the profit made from the contravention and the perceived likelihood of being caught. These two things are not among the four factors mentioned in the Ordinance, but there is nothing to prevent them from being taken into account by the Tribunal.

While this economic deterrence approach may be a useful thing to bear in mind, there are a number of complications for its application in Hong Kong.

First, since a cross-sector competition law will only be coming into operation for the first time in Hong Kong, there is little data for businesses to form a view on how likely the Commission will find out what they have done, and go after them, or on the "conviction rate" in the Tribunal. This is an area where statistics from overseas jurisdictions may not be readily indicative of the local situation. It did cross my mind that perhaps I could start here and ask the audience to "rate" the likelihood of detection and punishment of cartel, but perhaps I should leave that to the Commission since one of its statutory functions is to promote research into various aspects of competition law in Hong Kong.

Then there is the perhaps universal tendency for people to underestimate the probability of bad things happening to themselves – i.e. "optimistic bias, commonly known as "wishful thinking", leading to under-deterrence. Adjustments to the amount of penalty can be made for this kind of bias, but there are limits.

Don't forget there is a cap in the Ordinance on the amount of penalty at 10% of an undertaking's Hong Kong turnover for three years. If a business can expect to gain just an extra profit of 2% of turnover by taking part in a cartel, then you need to have an overall detection and conviction rate of better than one-in-five, and an enforcement speed of less than three years, in order to achieve optimal deterrent effect according to this theory.

More fundamentally, one can legitimately question whether a pecuniary penalty should just be treated as a parameter fixed for the purposes of the dispassionate, utilitarian calculus of whether to take a gamble. It is perhaps also something more, with a moral dimension and retributive purpose, a penalty determined in the interests of justice. As such, it ought to accord with a common sense notion of what is a fitting and proportionate penalty for a particular infringement of the law.

The matter is further complicated in Hong Kong by the fact that the pecuniary penalty on the undertaking concerned is not the only relief that the Tribunal can give.

While the competition rules are targeted at "undertakings", a concept defined in terms of entities engaged in economic activity, the sanction of pecuniary penalty is directed at "persons" since legal liability and responsibility has to be precisely defined with reference to legal personality.

The Tribunal may, on application by the Commission, order a pecuniary penalty against not only a person who has himself contravened a competition rule, but also a person who has been involved in a contravention of a competition rule.

Who is a person "involved" in a contravention of a competition rule? In addition to someone who has aided and abetted, counselled or procured another person to contravene the rule, or conspired with another person to contravene the rule, it includes a person who "is in any way, directly or indirectly, knowingly concerned in or a party to the contravention of the

rule".[8] Aiding, abetting and conspiring are perhaps easier to understand, containing, as they do at least superficially, concepts that are familiar to criminal law and the law of torts. But what is being "knowingly concerned in" a contravention?

This definition of a person involved is almost identical to the equivalent definition of a default relating to a contravention of the Companies Ordinance found in s. 728(5) of the Companies Ordinance (Cap. 622)[9], the section that provides for the power of the court to grant injunctions to prevent contravention of company law. Similar variants of the formula exist in s. 213(1) of the Securities and Futures Ordinance (Cap. 571). In *Securities and Investments Board v Pantell SA (No. 2)*,[10] in the context of section 6(2) of the (UK) Financial Services Act 1986, Steyn LJ said of the phrase "knowingly concerned": "proof of actual knowledge is essential but not enough. Mere passive knowledge will not be sufficient: actual involvement in the contravention must be established".[11]

Whether an individual officer or employee of an undertaking who has contravened a conduct rule can and should be found to be a person involved in the contravention, and therefore fined, remains to be considered when the law comes into effect. The Ordinance specifically provides that no officer or employee can be indemnified by the company or employer against his own liability for paying a pecuniary penalty.[12]

The question whether the human beings who are the actual actors and decision-makers in the undertakings concerned will personally be subject to a pecuniary penalty will obviously have great significance in terms of deterrence. Whether a concurrent pecuniary penalty is imposed may also affect the computation of the amount of the penalty.

Another element in the Hong Kong statutory regime is the orders other than pecuniary penalty that the Tribunal can in principle impose. These are orders that the Tribunal can make either on application or "of its own

8 S. 91
9 formerly s. 350B(1) of the Companies Ordinance (Cap. 32)
10 [1993] Ch 256
11 p 283G
12 Ss. 168 & 169

motion".[13] One of the possible orders is "an order requiring any person to pay to the Government or to any other specified person … an amount not exceeding the amount of any profit gained or loss avoided by that person as a result of the contravention".[14] Clearly, if an order for disgorgement of cartel profit is made in addition to a penalty, there is likely to be an impact on the amount of penalty ordered.

As I have stated earlier, in contrast to the US and the UK, cartel arrangements have not been criminalised. That means none of the individuals involved in a cartel will face imprisonment (unless they are prosecuted in the criminal courts for conspiracy to defraud). In substitute, there is a power for the Tribunal, on application by the Commission, to make an order disqualifying a person involved from being a director or taking part in the management of a company.

The maximum period of disqualification, however, somewhat surprisingly, is only 5 years.[15] In other contexts such as disqualification of directors arising from an insolvency or breach of the law regulating the financial market, legislation has generally provided for a longer maximum period of disqualification, such as 15 years,[16] and case law has divided that into three brackets of five years each with the lowest bracket of 2 to 5 years reserved for "relatively not very serious" cases.[17] Under the Competition Ordinance, with the maximum disqualification period being 5 years, the existing jurisprudence on the length of directors' disqualification cannot be directly applied. Nevertheless, the prospect of being excluded from any management position in a company for 5 years may be a deterrent that can be taken into account in determining the overall response towards a particular contravention.

Finally, to complete the picture, there is also the potential liability for damages that the Tribunal can award in follow-on actions brought by

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[13] S. 94(1)

[14] Schedule 3, s. 1(p)

[15] S. 101(2) of the Ordinance

[16] S. 168E(3) of the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32); s. 214(2)(d) of the Securities and Futures Ordinance (Cap. 571)

[17] *In re Sevenoaks Stationers (Retail) Ltd* [1991] Ch 164; *Re Well Bond Group Ltd* [2008] 5 HKLRD 147; *Official Receiver v Chan Kin Hang Danvil* (CACV 202/2011, 8 June 2012).

private parties. The difficulty, however, is that since these are follow-on actions, by definition they can only be brought after the Tribunal has dealt with the enforcement proceedings in the first place. When fixing the pecuniary penalty in the enforcement proceedings brought by the Commission, it is unlikely that the Tribunal will know whether there will be any private follow-on actions or the amount of damages claimed. Whether and how these private claims are to be taken into account in fixing the pecuniary penalty or other orders at the earlier stage will have to be carefully considered when the cases arise.

So these are some thoughts on what in one sense may be "the bottom line". Obviously the Tribunal can only decide disputed questions when they arise in real cases thereby laying down principles and giving guidance on the law. But it will serve us well to think about these questions in advance.

I wish you all a rewarding afternoon in your discussions of the impact of the Competition Ordinance on the construction industry.