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SPITZBERG ELEVATORS CORPORATION: responding to antitrust legislation

Ken Mark wrote this case under the supervision of Professor Brian Pinkham solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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Justine Lim, a legal associate with Spitzberg Elevators Corporation (SEC), a U.S. corporation operating in Hong Kong, was meeting with her manager, Alfred Cheng, head of the legal department. “What are the advantages and the disadvantages to being proactive or reactive to impending legislation?” asked Cheng. He was referring to Hong Kong’s Competition Ordinance (the Ordinance), passed by the Hong Kong Legislative Council in June 2012. The Competition Ordinance was on track to become the new law on December 14, 2015.

“It’s April 15, 2015, and we have eight months before the law could come into effect,” Cheng continued. “First, we are preparing to bid on five of the 11 available commercial contracts in 2015. Delivering on these five contracts will require us to manage multiple suppliers. Our key competitors may be bidding on the same contracts, but they will be more focused on the remaining six contracts,” said Cheng. He continued:

There is the perception we are the dominant player and our strategy of offering bundle discounts will have outsized influence on the market. Second, there is a competitive elevator services company—Blue Cirrus Technology [BCT]—that we’re interested in buying. Purchasing this company will allow us to increase our market share in elevator technology to 95 per cent of the market. We were intending to buy BCT in 2016. Should we move up our purchase date to sometime in 2015?

Lim listened carefully and took notes. What might be considered anti-competitive behaviour in other countries continued to be allowed by law in Hong Kong, at least for the next few months. Being proactive or reactive to the impending legislation had both advantages and disadvantages. Over the next few days, Lim needed to craft an analysis for Cheng’s review.

The Hong Kong Competition Commission[[1]](#footnote-1)

Established in June 2012, the Hong Kong Competition Commission (the Commission) was an independent statutory body whose objective was to monitor and stop conduct that prevented, restricted, or distorted competition, and to prohibit mergers that substantially reduced competition in Hong Kong. The Commission was tasked with investigating conduct that might contravene the competition rules of the Ordinance and enforcing the provisions of the Ordinance; promoting public understanding of the value of competition and the Ordinance’s promotion of competition; promoting the adoption by undertakings carrying on business in Hong Kong of appropriate internal controls and risk management systems and ensuring their compliance with the Ordinance; advising the government on competition matters in Hong Kong and outside Hong Kong; conducting market studies into matters affecting competition in markets in Hong Kong; and promoting research into and the development of skills in relation to the legal, economic, and policy aspects of competition law in Hong Kong.

The primary source of competition law in Hong Kong was the Competition Ordinance (Cap 619) and its related subsidiary legislation such as Competition (Disapplication of Provisions) Regulations (Cap 619B), which excluded entities related to Hong Kong Exchanges and Clearing Limited. The Commission provided guidance to firms through detailed guidelines and policy documents.

The Competition Ordinance (Cap 619)—The Impending Legislation

The Ordinance was passed by Hong Kong’s Legislative Council in June 2012, and was set to commence full operation on December 14, 2015.

The Ordinance prohibited restrictions on competition in Hong Kong through three competition rules. The First Conduct Rule prohibited anti-competitive agreements. The Second Conduct Rule prohibited abuse of market power. The Merger Rule prohibited anti-competitive mergers and acquisitions.

The First Conduct Rule and the Second Conduct Rule would apply to the entire Hong Kong economy and were the focus of Lim’s analysis. She looked at the Guideline on the First Conduct Rule and noted that her firm would be in violation of this rule once it was in force, especially on the issue of “price fixing and market sharing.” On the Second Conduct Rule, she noted that SEC might be in violation on the issue of “tying and bundling and exclusive dealing.” She looked at the relevant guidelines on these issues. According to the Commission:

Price fixing is when competitors agree on pricing rather than competing against each other. This includes agreeing to prices, a formula to calculate prices/margin or elements of a price such as discounts, rebates, promotions or credit terms. Price fixing can occur verbally or in writing—agreement can be by a “wink and a nod,” made over a drink, price fixing can occur at an association meeting or at a social occasion.

In a competitive market, each competitor should make price decisions independently. Anything that removes price uncertainty between competitors risks being a form of price fixing which hurts consumers and other businesses. Price fixing increases prices and reduce quality of the products sold. Under the Competition Ordinance, it is a serious anti-competitive conduct.[[2]](#footnote-2)

On the issue of tying and bundling, Lim noted the following guidance from the Commission:

Tying occurs when a supplier makes the sale of one product (the tying product) conditional upon the purchase of another (the tied product) from the supplier (i.e. the tying product is not sold separately). Bundling refers to situations where a package of two or more products is offered at a discount. Tying and bundling are common commercial practices and rarely raise competition concerns. However, in limited cases an undertaking with a substantial degree of market power can harm competition through tying or bundling. For example, in the context of bundling, an undertaking with a substantial degree of market power in the market for one of the products that forms part of the bundle may use bundling to harm competitors in the markets for the other products that are part of the same bundle. This may give rise to foreclosure in the latter markets, leading potentially to higher prices for consumers.[[3]](#footnote-3)

Spitzberg Elevators Corporation

Founded in 1967 in Columbus, Ohio, SEC was a manufacturer, prime contractor, and integrator in commercial and residential people-transport systems—elevators and escalators. Its signature products included rapid, high-capacity elevators designed to reduce travel time in tall buildings, and long moving walkways designed for airport terminals. SEC’s products included a significant amount of information technology and engineering work, most of which it performed in-house. SEC sourced key pieces—such as control modules and software—from local and international suppliers. It worked with clients to design, engineer, and install these transport systems.

From a base in North America, SEC’s customers included North American airlines; Asia-based airlines, especially those headquartered in Hong Kong; and the Hong Kong International Airport.

In Hong Kong, SEC was the market leader with a 60 per cent share. It competed with Ludwig Systems—based in Germany, which had a 20 per cent share, and Coolidge Elevators, which held the remaining 20 per cent of the market.

SEC’s business strategy was customer-focused and aimed to increase shareholder value by strengthening its market positions in elevator systems, sensor systems, and communication systems as a result of leveraging strong customer relationships and pursuing adjacent market opportunities, including international sales. It intended to win market share through innovative and affordable solutions, collaboration across SEC’s business units, and demonstrated past performance that addressed customer imperatives. It worked closely with major U.S. and European elevator products and services providers to deliver solutions to customers.

In 2015, SEC focused on products and systems in its core elevators market. Financially, its emphasis was on growing its sales, operating income, earnings per share, cash flow, and operating margin. Its goal of disciplined growth involved a flexible and balanced combination of organic growth, cost reductions, and select business acquisitions and divestitures, enabling it to grow the company and also return cash to shareholders in a balanced and disciplined manner. SEC’s strategy had two key elements: maintaining an agile culture of excellence, integrity, and accountability; and strengthening and expanding its market positions and unique capabilities.

Maintaining an Agile Culture of Excellence, Integrity, and Accountability

A key part of SEC’s strategy was its agile, accountable, and results-driven culture that focused on meeting customers’ needs and achieving strategic goals and growth objectives. SEC provided creative, innovative, and affordable solutions and ideas in an environment that fostered teamwork and collaboration across its business units. The company focused on adhering to local laws and business practices.

Strengthening and Expanding Its Market Positions and Unique Capabilities

SEC intended to use its existing prime contractor and supplier positions and internal investments to increase market share, grow sales organically, and continue to build strong businesses with durable key differentiators that had a number-one or number-two market position. It intended to expand its role in select business areas where it had domain expertise, including rapid, high-capacity elevators and travelators (i.e., moving walkways). SEC worked with suppliers, leveraging its customer relationships through a variety of platforms. As an independent supplier of a range of customized products, subsystems, and systems, SEC’s growth would partially be driven by expanding its share of existing programs and by participating in new programs.

SEC intended to pursue select new business opportunities and to expand its content on select platforms through teaming arrangements with other prime contractors and platform original equipment manufacturers (OEMs). It planned to achieve leading market share in each area in which it competed, maintaining its diversified and broad business mix with limited reliance on any single-contract, follow-on, or new business opportunity. SEC intended to continue to supplement organic sales growth by acquiring, on a select basis, businesses that provided attractive returns on investment and added new products, technologies, programs, and contracts, or provided access to select international and/or commercial customers.

The Potential Issues

SEC was preparing to bid on five of the 11 elevator contracts in Hong Kong, with each contract representing a single, new building. Developing the products for these contracts would mean coordinating products from approximately 30 suppliers. Equipment purchases would include both materials for the elevators and the spare parts necessary for maintenance of the elevators over a 30-year contract. Lim noted that five real estate companies, through their subsidiaries, owned all 11 buildings for which the elevator contracts were being issued. For example, contracts 1–5 were for buildings owned by Hong Kong Gateway Group.

“One of SEC’s key selling advantages has been our ability to offer multiple contract discounts,” said Lim. He continued:

We’re specifically targeting five of the 11 contracts—by the Hong Kong Gateway Group—because these five are being bid out by one single real estate firm. We’re planning to offer them a 15 per cent discount on the contract should we win all five orders. I note that none of our competitors is in a position to bid on the complete set of five contracts. Due to their product range limitations, each would be able to bid on three of the five, at most.

Lim imagined that, by declining to receiving information on the request for quote proposals for the remaining six contracts, SEC’s two competitors would be targeting and prioritizing those contracts.

SEC’s offer included a 30-year maintenance package for parts, software, and services. The following typical contract clause was similar to that being drafted for the Hong Kong Gateway Group proposal:

Full comprehensive service and repair coverage shall be included under the terms of this Agreement when equipment and/or component systems represented herein are modernized, modified or upgraded by the Contractor. If new maintenance pricing is included as part of an Owner specified modernization, modification or upgrading project, such pricing shall supersede and become a part of this Agreement. Changes in equipment necessitating continuing full maintenance coverage may be initiated by the Owner under a separate voluntary extra cost upgrading agreement with or without the Contractor’s permission or direct authorization and involvement before the work is performed.[[4]](#footnote-4)

At the time, SEC’s in-house software accounted for 60 per cent of the market for elevator technology in Hong Kong. Its remaining competitors relied on software from BCT, and from a few Taiwanese firms. SEC had an opportunity to buy BCT for US$5 million, with the transaction closing September 30, 2015. Owning BCT would increase SEC’s market share for elevator technology to 95 per cent. “This isn’t disallowed at the moment because the segment for people and equipment transport is much larger than just elevators alone,” said Lim. “One might include conveyor belts at factories and other transportation systems that move product, not people. If we take this broader look at the market, our market share would only be 35 per cent following the purchase of BCT.”

Making a Decision

“We believe that the legislation will be in force by December 14, 2015,” said Lim. “But this could change and there will be a period of monitoring and adjustment. Should we be proactive and change the way we are doing things or should we play by the rules until they are changed?” Lim, who had worked for an American firm in Texas prior to joining SEC, was cognizant that SEC’s managerial staff, who were primarily born and educated in Hong Kong, could look at the situation differently than SEC’s staff from other countries. She looked at some information about how different work cultures dealt with similar issues, such as whether they attended to multiple items at one time, focused on one item at a time, or reacted to issues (see Exhibit 1). Lim pondered three main issues.

First, legal counsel had historically been reactive to new regulations, as the company adhered to new regulations only as they were issued. Could SEC benefit from being proactive? Two additional points to consider were that SEC was a U.S. corporation operating in Hong Kong; and SEC competed with French and German firms, all of which had also been reactive to legislation.

Second, if the company decided to be proactive, could SEC implement the changes before the year was up? How would it implement the changes that quickly?

Third, should SEC forgo the opportunity to bid on the five requests for proposals in 2015? Would SEC’s competitors also be proactive or would they continue to be reactive? Should SEC delay the purchase of BCT, or should it proceed with the purchase?

Exhibit 1: CROSS-Cultural classifications

**Multi-Active**

* Most prevalent countries: Italy, Spain, Brazil, Venezuela, Mexico, Colombia, Peru, and Bolivia.
* Traits in people: talkative, impulsive, placing importance on relationships and feelings, and taking on multiple tasks at once.
* Relationships and connections are more important than products.
* Often late with delivery times and in paying. Procrastination is common and unpunctuality is frequent.

**Linear-Active**

* Most prevalent countries: Germany, Switzerland, Luxembourg, the United Kingdom, and the United States.
* Traits in people: task-oriented, highly organized, preferring direct discussion and working with facts from reliable sources. They are to the point, do not shy away from confrontation, and emphasize logic over emotion.
* Focused on meeting deadlines and being punctual, are process-oriented and rational.

**Reactive**

* Most prevalent countries: Vietnam, China, Japan, Taiwan, and Hong Kong.
* Traits in people: listening before reacting. They concentrate on what others are saying and are focused. They are silent while considering how to respond, showing respect for the other party’s remarks. They are not known to voice strong opinions and are likely to ask questions in an attempt to avoid misunderstanding.
* Reactive cultures tend to consider many strategies before selecting one that has the least impact on all parties.
* Typically introverted and preferring non-verbal communication, they do not tend to participate in small talk, and they typically avoid eye contact.

Source: Richard Lewis Communications, “Cultural Classification: Multi-Active,” n.d., accessed April 3, 2017, https://www.crossculture.com/about-us/the-model/multi-active/; Richard Lewis Communications, “Linear-Active,” n.d., accessed April 3, 2017, https://www.crossculture.com/about-us/the-model/linear-active/; Richard Lewis Communications, “Reactive,” n.d., accessed April 3, 2017, https://www.crossculture.com/cultureactive/.

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2. Competition Commission (Hong Kong), “Price Fixing,” 2015, accessed January 3, 2017, https://www.compcomm.hk/en/media/reports\_publications/usefulresources\_competition\_1.html. [↑](#footnote-ref-2)
3. Competition Commission (Hong Kong), “Competition and Anti-Competitive Practices,” 2015, accessed January 3, 2017, https://www.compcomm.hk/en/practices/what\_is\_comp/tying\_bundling.html. [↑](#footnote-ref-3)
4. St. Cloud State University, “Maintenance of Elevators Equipment Coverage,” item 2.15 A, in *Request for Proposal: Elevator Maintenance Services*, 24, June 23, 2014, accessed April 3, 2017, https://www.stcloudstate.edu/businessservices/purchasing/bids/documents/ElevatorMaintenanceServicesRFPJune202014FINAL.pdf. [↑](#footnote-ref-4)