CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
September 2015 (2)

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I. INTRODUCTION

The treatment of resale price maintenance ("RPM") under Hong Kong's soon-to-be operational competition regime is a hot topic in the region.

RPM, the practice under which a manufacturer/supplier establishes fixed or minimum (or, in certain circumstances, maximum or recommended) resale prices that a distributor/retailer must observe when reselling the contract goods or services,[2] is reported to be commonplace in Hong Kong. RPM can be achieved directly (for example, via a clause in a distribution agreement) or indirectly (for example, by fixing the level of discounts which a distributor may grant from a particular price level, applying penalties for failure to adhere to a prescribed resale price, and/or tying rebates or other benefits to adherence to a recommended resale price).

RPM is a subject that has engendered significant debate in recent years and has been subject to considerable scrutiny from competition authorities globally. However, the treatment of RPM and the level of enforcement activity do vary from jurisdiction to jurisdiction. In Taiwan, for example, RPM was considered to be *per se* illegal and has been the subject of extensive enforcement action in recent years.[3] This hard-line stance can also be seen at the EU level, where RPM remains presumptively problematic (albeit with little enforcement activity by the EU Commission itself). At the other end of the spectrum, Singapore's competition law contains a broadly worded exemption from the prohibition on anticompetitive agreements for vertical arrangements including RPM (albeit that this exemption is not absolute). Many other jurisdictions, such as the United States (at least at the federal level), adopt a "middle-ground" by subjecting RPM arrangements to a "rule of reason" effects-based assessment.

Hong Kong currently stands out as possibly the most developed economy in the world not

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[2] A related practice common in the e-commerce world is the imposition of internet minimum advertised prices ("IMAPs"), whereby the supplier of a product/service imposes restrictions on what prices a distributor/retailer can display on online channels. While such IMAPs in theory may not involve an actual restriction on the ultimate sales price, in practice such provisions may restrict competition in the same manner as outright RPM.

[3] With fines being imposed across a variety of industries, from pet nutrition to board games to mobile phones. The Taiwanese rules were, however, amended in 2015 to provide that RPM can be permissible where there are "justifiable reasons" (stated to include consideration of factors such as the enhancement of pre-sales services and the prevention of free-riding). It remains to be seen how willing the competition authority will be to conduct "rule of reason" type assessments and accept these justifications in practice.

yet to have a comprehensive competition law in force.[4] Barring any last-minute legislative delays, this is expected to change on December 14, 2015 when the Hong Kong Competition Ordinance ("Ordinance"), which has been on the statute books for over three years, comes into full force.

Considerable interest has surrounded the treatment of RPM under the Ordinance's prohibition on anticompetitive agreements (the First Conduct Rule) and the accompanying guidelines including the Guideline on the First Conduct Rule ("Guideline")[5] issued by the Hong Kong Competition Commission ("HKCC"). During its consultations on earlier drafts of the Guideline, the Commission received numerous submissions expressing views on the appropriate treatment of RPM under the Guideline and the Commission has also apparently received a number of queries and complaints regarding RPM ahead of full implementation of the Ordinance.

The level of debate is broadly reflective of the multitude of views that exist among competition authorities, businesses, and legal/economic practitioners regarding RPM. It also demonstrates the importance of RPM in a small economy such as Hong Kong, which has a substantial focus on retail and distribution.

The purpose of this article is to outline the Commission's stated approach to the assessment of RPM practices and to assess where the Hong Kong regime (as reflected in the Guideline) would appear to sit on the worldwide spectrum of RPM enforcement. It also considers the practical implications of this approach for Hong Kong businesses, and businesses that operate regionally in Asia Pacific.

II. THE POLICY BACKGROUND: WHY IS THERE SUCH A DEBATE ABOUT RPM?

The appropriate treatment of RPM under competition law provokes strong, and divergent, viewpoints. Certain businesses, for example some suppliers of branded goods, will argue vehemently that control over their supply chain via RPM is necessary to maintain a quality image or to ensure that resellers invest adequately in promotional activities or customer services. Some resellers may maintain RPM is necessary in order to ensure they have sufficient margin to make such investments/to prevent undercutting by other resellers "free-riding" on these investments. Other businesses, for example some resellers (often online "e-tailers") with a low-cost, low-price business model, will argue that RPM, when practiced by suppliers, hinders their entry or expansion, and will be quick to challenge such behavior as anticompetitive. [6]

In terms of competition policy and economics, some divergence of viewpoints is inevitable given that vertical agreements, including RPM, can have both pro-competitive and anticompetitive effects. Much has been written on this topic, but a brief summary follows.

RPM may harm competition at the supply level, for example, by facilitating collusion through increased pricing transparency (at least where RPM is widespread) or hindering access

[4] The current regime applies only in the telecommunications sector.

[5] *See, Guideline on the First Conduct Rule*, published by the HKCC and the Hong Kong Communications Authority on July 27, 2015, *available at* http://www.compcomm.hk/en/guidelines.html.

[6] The Office of Fair Trading, the U.K.'s legacy competition authority, has, for example, noted that RPM was its "most complained about" practice.

to distributors by smaller suppliers. At the distribution/retail level RPM may again facilitate collusion between downstream competitors, and is likely to reduce intra-brand competition as resellers can no longer compete on price, and new entrants may be prevented/hindered by an inability to gain market share by undercutting on price. This is likely to lead to higher prices for consumers.

It is generally recognized, however, that RPM can potentially give rise to pro-competitive effects. RPM may promote competition on non-price aspects that may be important to customers. In particular, it may promote inter-brand competition by providing signals as to quality certification, or may reduce free-riding by other distributors in respect of, for example, pre-sales services (thus maintaining incentives for resellers to offer these services). Such arguments are often put forward in relation to hi-tech, complex or "experience" products, with a common example being a customer testing such a product (such as a home cinema system) and receiving advice from sales staff in the expensive bricks and mortar show room of a high-end retailer, only to actually purchase the product from a cut-price e-tailer not offering these services.

While recognizing the validity of these arguments, competition authorities in some jurisdictions can be reluctant to accept their application to particular facts, given that there may be other methods to secure the same outcome (such as by securing contractual commitments to pre-sales services). The resulting uncertainty has the potentially negative impact that, due to concern about compliance with competition law, businesses adopt a cautious approach and do not enter into arrangements that may in fact be overall pro-competitive.

In light of the above, there has been continued debate in mature competition law regimes as to how to appropriately categorize RPM in terms of a competition authority's enforcement framework. This debate has focused, in particular, on two questions: (1) whether RPM is regarded as presumptively legal or illegal and (2) who bears the burden of proof. This debate reflects the fact that the practice may have different overall effects on competition depending on the factual circumstances. Further, there is concern about providing sufficient legal certainty to businesses.

This policy issue was considered carefully by the EU Commission at the time at which it issued a new version of its guidelines on vertical agreements in 2010,[7] in which it, largely, maintained its anti-RPM stance (see further below). In contrast, other regimes, such as the United States and Brazil, have recognized the potential pro-competitive effects of RPM by shifting in recent years from applying an assessment standard that categorizes RPM as *per se* problematic to a "rule of reason" effects-based approach.

It is against this background that the debate in Hong Kong occurred; the approach ultimately adopted by the Commission within its Guideline is discussed below, but of course the impact on Hong Kong markets will depend on how the Commission applies this Guideline to individual cases and whether the Hong Kong Competition Tribunal ("Tribunal") endorses the approach of the Commission.

In respect of the wider policy picture and the likely enforcement priorities of the Hong

[7] *See,* http://ec.europa.eu/competition/antitrust/legislation/vertical.html.

Kong authorities in practice, while there remains considerable enforcement of classic RPM worldwide,[8] recent enforcement attention in a number of jurisdictions with established competition law regimes has focused on more complex forms of RPM where the RPM is ancillary to, or supportive of other forms of, potentially anticompetitive behavior. Topical examples include RPM related to "most favored nation" ("MFN") clauses or "best price guarantee"/"price parity" provisions, where a supplier may need to impose RPM on some resellers/platforms in order to meet an MFN or best price guarantee obligation to another reseller/platform.[9]

It is likely, however, that in Hong Kong both businesses and the Commission will need to first get to grips with straightforward RPM. They will also need to grapple with the separate, but related, prior question of when the setting of resale prices by a supplier amounts to an agreement or concerted practice between independent undertakings within the meaning of the Ordinance. This depends on whether the supplier and the distributor should be regarded as separate entities in competition law terms, or whether the distributor is acting as a "genuine agent" of the supplier simply entering into contracts on its behalf and should be treated as part of the same undertaking, such that the supplier setting prices would not fall within the scope of the First Conduct Rule at all.

III. RPM UNDER THE ORDINANCE

As is the case in many other jurisdictions, the First Conduct Rule prohibition on anticompetitive agreements does not refer specifically to either vertical agreements (between undertakings at different levels of the supply chain, such as RPM) or horizontal agreements (between competitors). Instead, it applies to any agreement or concerted practice that has the object or effect of preventing, restricting, or distorting competition in Hong Kong.[10] However, absent a specific exclusion for vertical agreements, it is clear that these agreements can fall within the prohibition, a position that has been confirmed by the Commission within its Guideline.[11]

Again, the definition of agreements constituting "serious anti-competitive conduct" ("SAC") under the Ordinance[12] does not specifically refer to vertical or horizontal agreements. This definition lists classic horizontal agreements, such as bid-rigging and market-sharing. Importantly for these purposes, however, the list includes conduct involving "fixing, maintaining,

[8] In particular by national competition authorities (such as in Germany and the United Kingdom) in Europe, but also by competition authorities in Asia Pacific, both in established regimes (such as Australia) and within relatively new regimes (such as China and Malaysia).

[9] *See* for example the various investigations across Europe, and most recently in Australia, into the arrangements between online travel agents and hotels in relation to room rates, and the investigations by the German and U.K. competition authorities into Amazon's terms and conditions for resellers on its Marketplace platform.

[10] Unless the agreement/concerted practice can be justified on efficiency grounds on the basis of the criteria set out in Section 1 of Schedule 1 to the Ordinance.

[11] *See* Guideline, *supra* note 5, at ¶ 6.1.

[12] Categorization of conduct as SAC is very significant as this has important procedural consequences. These include the fact that the "Agreements of lesser significance" provisions within Section 5 of Schedule 1 to the Ordinance excluding certain *de minimis* agreements from the First Conduct Rule do not apply to SAC, and that there is no requirement in the case of SAC for the Commission to issue a "warning notice" before bringing infringement proceedings before the Tribunal.

increasing or controlling the price for the supply of goods or services" which, absent any statutory limitation of SAC to agreements between competitors, may be interpreted to include RPM, aka vertical price-fixing. The Commission adopts this interpretation within its Guideline, stating that in some circumstances RPM may amount to SAC (see further below). [13]

IV. RPM UNDER THE GUIDELINE

A. Background to the Guideline

Following two rounds of draft guidelines and an extensive consultation process, on July 27, 2015 the final versions of the Commission's suite of guidelines on the Ordinance were published, including the Guideline on the First Conduct Rule.[14]

While the Tribunal will be the ultimate arbiter of the meaning and application of the Ordinance, the guidelines set out the general approach which the Commission intends to apply, and, as such, are an invaluable resource for businesses.

B. Assessment of RPM Under the Guideline[15]

As noted above, there was considerable debate during the gestation of the Guideline as to how the Commission should approach RPM. The Commission appears to have initially considered whether to adopt some form of exemption for vertical agreements, and potentially RPM, under the Ordinance.[16] Conversely, it also appeared to take the view in an earlier version of the Guideline that it considered RPM to have the "object" of harming competition.[17]

In the final Guideline it has adopted an apparent compromise position, taking the view that "RPM arrangements have an inherent potential to harm competition in Hong Kong"[18] and therefore a "light touch" approach is not warranted. It has, however, recognized that "in certain cases RPM arrangements may be made for a pro-competitive purpose" and therefore would not automatically infringe the First Conduct Rule in all cases.

Within the final Guideline the Commission is therefore clear that RPM constituting fixed- or minimum-resale prices (whether set directly or indirectly) may infringe the First Conduct Rule. However, whether such RPM infringes the Ordinance in an individual case is less clear because, although the Guideline contains some useful insights into the Commission's likely approach to the assessment of RPM, the Commission has adopted an enforcement framework that allows it considerable leeway in its assessment. In summary:

- RPM "may" be regarded as having the "object" of restricting competition, and can therefore be regarded as problematic without any requirement for the Commission to

[13] *See* Guideline, *supra* note 5, at ¶¶ 5.5-5.6.

[14] *See* http://www.compcomm.hk/en/guidelines.html.

[15] *See* Guideline, *supra* note 5, at ¶¶ 6.71-6.84.

[16] "Some competition authorities…provide exemptions to smaller firms engaging in [RPM]," *see*, *Getting prepared for the full implementation of the Competition Ordinance*, Competition Commission (May 2014), *available at* http://compcomm.hk/en/pdf/consultations-en.pdf.

[17] *See* ¶¶ 3.7 and 5.6 of the October 2014 Draft Guideline to the First Conduct Rule.

[18] Competition Commission, *Guide to the Revised Draft Guidelines Issued under the Competition Ordinance*, ¶44 (March 2015), *available at* http://www.compcomm.hk/en/pdf/consultations/2015/Guide_e_0329.pdf

establish it has actually affected competition on the market.

- Not all RPM will, however, automatically be regarded as having the object of restricting competition; this depends on the content of the agreement establishing the RPM, the way the arrangement is implemented, and the relevant context.
- RPM may, in some circumstances, amount to SAC.
- If RPM does not have the object of harming competition, the Commission will assess whether it nevertheless has the effect of restricting competition.
- Even where the RPM is found to have the object or effect of restricting competition, and therefore in principle infringes the First Conduct Rule, it is open to the parties to put forward evidence of economic efficiencies such to justify the arrangement under Section 1 of Schedule 1 to the Ordinance.

The Guideline does not articulate in detail when RPM will be regarded as having the object of restricting competition, or provide any safe harbors where no object can be assumed. It does, however, give examples of where the Commission will, or is likely to, find RPM to constitute an object infringement,[19] and include a description of the Commission's likely assessment of a number of hypothetical factual scenarios. The Guideline also provides some hypothetical examples where RPM "possibly" would not constitute an object infringement (for example where utilized in a franchise distribution system for the purposes of organizing a short-term coordinated promotional price campaign), and as to the likely effects assessment in these cases.

The Guideline contains even less commentary on when RPM will be regarded as sufficiently serious to constitute SAC, although again the Commission provides some hypothetical examples where RPM is likely to be regarded as SAC. In relation to efficiency defenses, the Commission does give some examples of where such arguments may be made, for example to avoid a free-rider problem, but makes it clear that compelling evidence would be required in order for these to be accepted.

In relation to recommended or maximum prices, the Guideline unsurprisingly provides that where in reality these operate as fixed or minimum prices, these will be assessed in the same manner as fixed or minimum RPM. Where there are genuine recommended or maximum prices, these will not be regarded as having the object of restricting competition, but will be subject to an effects analysis; considering, for example, whether they serve to establish a "focal point" for distributor pricing and whether the supplier has market power.

C. Agency vs. Distribution

Finally, the Guideline includes guidance on the related question of whether a distributor is to be regarded as a separate independent undertaking (such that the First Conduct Rule would apply to pricing restrictions and other aspects of the agreements between the supplier and

[19] For example where there is evidence that the RPM was implemented by a supplier in response to pressure from a distributor seeking to limit competition from its competitors, or if the RPM is implemented by a supplier solely to foreclose competing suppliers.

distributor) or as a true agent (in which case the First Conduct Rule would not apply to restrictions imposed on the agent in so far as they relate to the contracts concluded on behalf of the supplier). As per the approach in the European Union, the question of whether the agent is a true agent is stated to depend on the extent to which the agent bears risks in relation to the contracts concluded on behalf of the supplier, with the Guideline setting out examples of costs and risks to be taken into account.[20] Although this guidance is useful, these assessments are inherently difficult in practice, in particular at this stage, in the absence of any decisional practice from the Commission/Tribunal.

D. Conclusion on the Guideline

Overall, while the recognition within the final Guideline that not all RPM has the object of restricting competition is welcome, and the Guideline contains some helpful examples, the guidance is carefully caveated and the Commission retains considerable flexibility as to assessment in individual cases. The examples provided of conduct that is unlikely to infringe the First Conduct Rule (at least by object) are narrowly drawn, and there is very limited explanation of the type of RPM conduct that could be considered SAC.

It is clear that the Commission has given some consideration to this issue, in light of changes made between the various iterations of the Guideline and based on public statements by Commission officials. The Commission will likely have deliberated on the various submissions it received during the consultation process, some of which advocated a more lenient treatment of RPM under the Guideline. It will also have considered the approaches to RPM that are adopted in established competition law jurisdictions worldwide while taking into account the specific characteristics of the Hong Kong economy.

However, the compromise position reached in the Guideline provides relatively little in terms of legal certainty as to the circumstances in which RPM may be acceptable.

Further guidance may be provided in due course by the decisional practice of the Commission and the Tribunal, but in the meantime businesses will have to tread very carefully in this area.

V. HOW DOES THE APPROACH IN HONG KONG COMPARE TO OTHER JURISDICTIONS?

As can be seen from the above, the Commission has sought to reach a balance between retaining its ability to categorize RPM arrangements as object infringements—and even SAC—and recognizing that in some cases RPM may be unproblematic or in fact pro-competitive. In this sense the proposed approach in Hong Kong, at least on paper, is not as strict as in those jurisdictions, such as Australia, Japan, and (previously) Taiwan, where RPM is assessed under a *per se* standard and assumed to be problematic.

The Commission also appears to be taking a more flexible approach than that of the EU Commission, which presumes all RPM to have the object of restricting competition and that it is unlikely that the conduct can be justified on efficiency grounds—the burden of proof then

[20] *See* Guideline, *supra* note 5, at ¶¶ 2.11-2.17.

switching to the parties to demonstrate such justification.

However, the approach is stricter than in those jurisdictions that carry out an effects-analysis in all cases under a rule of reason standard (such as the United States at a federal level, and, potentially, Indonesia), and those that provide safe harbors for vertical agreements that extend to RPM (such as Singapore). If RPM enforcement is viewed as a continuum in which *per se* approaches are plotted to the left and exemptions for all vertical agreements to the right, then based on its theoretical framework Hong Kong will sit to the center-left of this line.

How the Hong Kong approach fits on the continuum in practice will of course depend on how the guidance is actually applied, and whether RPM is taken up as an enforcement priority by the Commission. Indeed, it will be very interesting to see how, and to what extent, RPM is reflected in the Commission's forthcoming statement of its enforcement priorities.

However, it is clear that the Guideline adds yet another nuance to the already patchwork nature of RPM enforcement within Asia Pacific (as well as globally). Even looking more narrowly at Greater China, approaches differ from jurisdiction to jurisdiction and even within jurisdictions, with the approach in Mainland China arguably diverging between the more hard-line "restriction by object" stance which appears to be being taken by the National Development and Reform Commission,[21] and the judicial approach (to date) making it clear that an anticompetitive effect must be demonstrated and therefore that a rule of reason assessment is required.[22]

This variety of approaches presents challenges for companies doing business in the region, meaning that identical distribution arrangements cannot be used on a pan-Asia Pacific basis unless an approach is taken which applies the strictest legal position across all jurisdictions. However, this may be an unnecessarily restrictive approach to take in respect of some jurisdictions that adopt a more permissive approach to RPM.

VI. IMPLICATIONS OF THE APPROACH TO RPM FOR HONG KONG BUSINESSES

So where does this leave Hong Kong businesses (and overseas companies doing business in Hong Kong) assessing their distribution arrangements?

Given the lack of certainty arising from the compromise approach adopted within the Guideline, and the real risk of RPM practices being found to constitute SAC (with the consequences that follow), a prudent approach, at least until some decisional practice exists, would be to assume that the imposition of fixed or minimum resale prices will infringe the First Conduct Rule and therefore need to be avoided unless very clear exceptional circumstances—verified by a careful legal and economic assessment—apply. Potential examples may include where this relates to a short-term promotion for a new product or there is a real free-riding problem that cannot readily be resolved through other solutions (such as service requirements).

Businesses will need to take care to ensure not only that their written contractual

[21] With significant enforcement activity occurring in a variety of sectors, including premium liquor, baby formula, contact lenses, and automotive distribution, at both a national and regional level (*see* most recently the fines imposed by the Guangdong Development and Reform Commission on Dongfeng-Nissan).

[22] *See* the 2013 Shanghai High People's Court ruling in *Rainbow v Johnson & Johnson*.

arrangements preserve resale pricing freedom for distributors/retailers, but also that this freedom is available in practice. For example, rebates or other rewards/incentives must not be linked to resale pricing, discounting should not be subject to pre-approval processes, and termination or reduction of supply must not be linked to resale prices in any way (with genuine reasons for cessation or changes to supply arrangements being documented carefully).

Finally, although one method for retaining control over resale pricing while remaining in compliance with competition law is to move from a distribution to an agency model, businesses will need to be alive to the fact that just because a reseller is labeled an "agent," this does not mean it will be regarded as such under the Ordinance, and therefore a careful assessment of the reality of the relationship will need to be carried out.

As with other aspects of the Ordinance, businesses need to assess carefully their practices (including any global or pan-regional distribution agreements applying to Hong Kong that currently provide for resale price-fixing) now to determine whether any changes need to be made prior to the entry into force of the Ordinance in December, and to ensure that clear compliance policies, procedures, and training are in place.