

Competition Law Guidance Note (Twelfth Issue) – Guidance Note on Resale Price Maintenance (RPM)

The governance professional may know that in the past year, the Hong Kong Competition Commission (**Commission**) has stepped up its fight against suppliers setting fixed or minimum resale prices for distributors – also known as resale price maintenance (**RPM**). In September 2022, the Commission lodged enforcement proceedings against a supplier of monosodium glutamate (**MSG**) that had allegedly been imposing minimum resale prices on two distributors. This focus on 'vertical' relationships along the supply chain was a break from the Commission's previous enforcement focus on cartels, i.e. competitors harming competition at the same level of the supply chain.

The Commission 'doubled down' its efforts with a city-wide campaign advocating against RPM in June 2023, which included a new educational brochure on the topic (**RPM Brochure**). This guidance note discusses the key takeaways from the RPM Brochure and highlights what businesses in Hong Kong as well as governance professionals, as their trusted advisers, need to know about RPM in Hong Kong.



Source: Competition Commission website (accessed on 26 July 2023)

Gratitude is expressed to Natalie Yeung, Partner, Slaughter and May as the author of this guidance note with input from Alexander Lee, Counsel and Adam Janmohamed, Registered Foreign Lawyer. The Institute's Competition Law Interest Group members are David Simmonds FCG HKFCG (Chairman), Adelaide Luke, Alastair Mordaunt, Brian Kennelly KC, Mike Thomas and Natalie Yeung. Mrs April Chan FCG HKFCG, Institute Past President, is Chairman of the Institute's Technical Consultation Panel with oversight of the Institute's Interest Groups. Mohan Datwani FCG HKFCG(PE), Institute Deputy Chief Executive, also serves as Secretary to the Institute's Interest Groups. If you have any comments and/or suggestions relating to the Institute's thought leadership, please contact: mohan.datwani@hkcgi.org.hk.

What is resale price maintenance (RPM)?

Resale price maintenance (RPM) occurs when suppliers require their distributors (including retailers) to sell their products at a certain price (i.e. fixing the resale price) or not to sell them below a certain price (i.e. setting a minimum resale price).

Suppliers may conduct RPM by directly setting a fixed or minimum price for resale from which no reduction or discounts can be offered; or indirectly, for instance by fixing the distributors' margin or the maximum level of discount the distributor can grant from a set price level.

To achieve the above, suppliers may incentivise distributors, or may equally pressure them by using

threats, intimidation, warnings, penalties, delays in or the outright suspension of the supply of products.

By limiting the ability of distributors to compete with each other on price, RPM arrangements may result in harm to competition and ultimately consumers. Such arrangements may contravene the Ordinance in certain circumstances.

RPM can be initiated by a supplier or its distributors. In some cases, a distributor may pressure its supplier to implement RPM in order to limit price competition at the distributor level.

Commission's RPM Brochure

A new approach or maintenance of the *status quo*?

Whilst the RPM Brochure falls short of adopting a *per se* approach towards RPM (for example, it states that RPM '*may* contravene the [Competition] Ordinance *in certain circumstances*'), it sets out a tough stance on RPM with a lot of emphasis on the potential harm to competition that may arise from fixed or minimum resale prices. It also makes it clear that there is a requirement for parties to strictly prove their agreement satisfies all four conditions of the statutory exclusion for economic efficiencies if they wish to benefit from the exclusion. These conditions are:

- The agreement contributes to improving production or distribution, or promoting technical or economic progress.
- Consumers receive a fair share of the efficiencies.
- The agreement does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the relevant efficiencies, and

- The agreement does not allow the undertakings the possibility of eliminating competition in respect of a substantial part of the goods or services in question.

However, upon closer examination, the stance in the RPM Brochure is neither more hostile nor more favourable to vertical restraints when compared to the Commission's Guideline on the First Conduct Rule (**FCR Guideline**) published in 2015. The RPM Brochure broadly reflects the points already set out in the FCR Guideline, albeit (and understandably) with greater emphasis on discouraging RPM practices to support the Commission's advocacy on promoting compliance more generally. The RPM Brochure also reworks the FCR Guideline's hypothetical examples on RPM, and includes a specific reference to the application of RPM to e-commerce, which will aid in raising awareness and educating the public on the subject.

The latest position on RPM in Hong Kong

The Commission's principles for analysing RPM in the RPM Brochure generally remain the same as those identified in the FCR Guideline. The key takeaways from the Commission's RPM Brochure can be summarised as follows:

- **No warning before RPM enforcement:** As the Commission's position is that RPM can be a form of 'serious anti-competitive conduct', it can take enforcement action against unlawful RPM in the same manner as cartel cases, i.e. small and medium businesses may not benefit from the statutory 'agreements of lesser significance' exclusion, and enforcement proceedings in the Tribunal can be lodged without a prior Warning Notice.
- **Not all RPM arrangements are outright prohibited:** The Commission remains committed to analysing whether the RPM arrangement has the 'object' or 'effect' of harming competition and whether the economic efficiency exclusion applies in the circumstances.
- **High-risk 'object' scenarios for RPM:** The RPM Brochure outlines several scenarios where RPM arrangements would be deemed as having the 'object' of harming competition (which would make it easier for the Commission to bring enforcement proceedings before the Tribunal), and these are discussed further below.
- **Assessing RPM for harmful effects:** The Commission reiterated its approach to analysing RPM by effects if the RPM arrangement does not have the 'object' of harming competition. The RPM Brochure further specifies that, in the context of assessing the 'effects' of RPM, it will consider: (a) the market power of the parties involved, (b) the impact on the competitive process, and (c) the market conditions in the absence of RPM.
- **Recommended and maximum resale prices are lawful if they are genuine:** While it remains generally lawful for suppliers to recommend resale prices or set maximum resale prices, the RPM Brochure emphasises vigilance against scenarios where downstream price competition is restricted in practice (e.g. if recommended

prices serve as a 'focal point' for downstream pricing, or if resellers are effectively required to follow recommended prices via price monitoring mechanisms or incentive arrangements).

- **Strict proof required for economic efficiencies:** The RPM Brochure includes a stern reminder that all four limbs of the statutory economic efficiency exclusion must be satisfied if economic efficiencies are to be claimed. However, the RPM Brochure mentions only two examples of efficiencies, namely where: (a) RPM is set for a short period of time to introduce a new product, and (b) RPM is used to prevent discount resellers from free riding the benefit of investments made by other resellers.

Helpful guidance for vertical price restrictions

The RPM Brochure includes a 'practical tips' section for suppliers and distributors wishing to avoid engaging in RPM. The governance professional should study these. However, these practical tips are not exhaustive. It, therefore, remains important to understand that determining the legality of RPM arrangements may not be a clear-cut exercise and may require complex economic analysis of factors beyond those mentioned in the RPM Brochure.

That said, the 'object' scenarios set out in the RPM Brochure should help parties wishing to distinguish higher-risk scenarios from those that are lower risk, i.e. higher-risk scenarios include where fixed or minimum resale prices:

- Are implemented to foreclose competing suppliers or in response to pressure from a distributor/reseller seeking to limit competition at the downstream level
- Are clearly used for the sole purpose of restricting price competition

- Involve a supplier or distributor/reseller with a significant market share (i.e. weak competition between different brands of similar products or different resale channels)
- Are set on products that are unlikely to require investment by distributors/resellers (e.g. in terms of training sales staff or providing after-sales services)
- Do not create any apparent pro-competitive efficiencies that satisfy the economic efficiency exclusion, and
- Are not related to introducing a new product into the market or part of a coordinated price campaign for a franchise distributor system.

In view of the Commission's enforcement approach set out in the RPM Brochure, it would be prudent for Hong Kong businesses, particularly those with higher market shares, to steer away from the above higher-risk scenarios when implementing or responding to vertical price restraints, whether fixed or minimum resale prices or recommended or maximum resale prices. If in doubt, seeking legal advice would be sensible, as recommended in the RPM Brochure.

More RPM cases to come?

Overall the RPM Brochure is a welcome addition to the Commission's growing library of educational material. It presents a fair summary of RPM analysis under the local statutory framework. The RPM Brochure also reaffirms the Commission's commitment to broadly align its enforcement approach with internationally accepted best practices. However, it falls short of providing further legal certainty on the issue, which is understandable pending the Tribunal's first decision on RPM (the MSG case mentioned at the outset).

While cartel enforcement will likely continue to be an enforcement priority of the Commission, this latest RPM campaign by the Commission may result in more RPM complaints, which could lead to more investigations and enforcement cases on RPM in the future. It also serves as a reminder of the Commission's willingness to investigate all kinds of anti-competitive behaviour and that governance professionals should keep up to date with competition law developments so as to ensure compliance.