Treatment of Resale Price Maintenance in Hong Kong

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I. INTRODUCTION

Three years after its enactment, the Competition Ordinance of Hong Kong ("Ordinance") is set to come into force on December 14, 2015. This article reviews the conceptually framework which the Hong Kong Competition Commission ("HKCC") will be adopting in assessing resale price maintenance ("RPM"), one of the issues at the center of interest in Hong Kong before and after the enactment of the Ordinance.

Emphases will be on the theories of harms, recognized pro-competitive effects of RPM, and the role of intra-brand competition relative to inter-brand competition, as contained in the official guidelines published in July 2015. This article also provides some historical background regarding the occurrence of, and various views about, RPM in Hong Kong in order to fully understand its seemingly "near per se illegal" treatment of RPM.

II. HISTORICAL BACKGROUND

RPM has received great attention in Hong Kong since the mid-1990s when Hong Kong first started discussing introducing competition law, as initiated by the Hong Kong Consumer Council.

In 1996, the Consumer Council received two complaints, one of which was from Carrefour, a French supermarket chain. Carrefour had just entered the Hong Kong supermarket sector, which was highly concentrated with the two local supermarket chains occupying as much as 70 percent of the market. To attract customers, Carrefour adopted an aggressive pricing policy where each week a significant number of products were for sale at below the recommended resale price (recommended discounted price in some cases). This led to complaints by suppliers to Carrefour and threats that supplies would be withheld until Carrefour returned to the agreed price level. In some cases these threats were carried out.

Carrefour supplied the Consumer Council with the names of 22 companies that it claimed had put pressure on it to return to recommended prices. Seven of the 22 companies contacted by the Consumer Council confirmed having told Carrefour that they would take action to enforce RPM.2

In another complaint, a discounted chain retailer, Pricerite, sold mattresses from several suppliers below the recommended resale price, which led a supplier to immediately withhold supplies, as well as refuse to deliver to customers who had purchased the under-priced mattresses during the promotion period. In its response to the enquiry from the Consumer Council, the

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supplier, which had a network of around 1,000 retail stores in Hong Kong, justified its three-year-old RPM policy as a strategic initiative to enhance sales and sales service. The supplier also restructured its retail network and selected 120 out of the 1,000 outlets to operate as exclusive distributors.

Based on its inquiries with the relevant parties, the Consumer Council concluded in its research report that “RPM exists in Hong Kong. … This evidence of the existence of RPM provides support for the recommendations made by the Council that Hong Kong should enact a comprehensive Competition Law and establish a Competition Authority to enforce it.”

In November 2011, the Competition Policy Advisory Group ("COMPAG") of Hong Kong received two complaints, alleging that the following practices of some supermarket chains and retail chain stores with market power were anticompetitive:

- Certain supermarket chains were alleged to have pressured a soft drinks supplier not to supply soft drinks to a local retailer who had refused to comply with the recommended price for a particular soft drink set by the supplier.
- A supermarket chain was alleged to have pressured a supplier not to supply instant noodles of a particular brand to a local retailer if the retailer refused to comply with the recommended price for the product set by the supplier.
- Certain retail chain stores were alleged to have pressured a supplier of electrical appliances to request a local retailer (to which the supplier supplied products) to increase the price of some of the electrical appliances to the level of the recommended prices set by the supplier.

While none of the three cases were prosecuted due to insufficient information and evidence at the time of the complaints—when Hong Kong had not yet established a general competition law—these cases seem to have influenced greatly the attention and position of the HKCC toward RPM, as we shall see below.

III. RPM UNDER THE COMPETITION ORDINANCE: THE FIRST CONDUCT RULE

After more than a decade-long debate and two rounds of public consultation, Hong Kong enacted the Ordinance in 2012. The First Conduct Rule of the Ordinance prohibits anticompetitive agreements and concerted practices and decisions having the object or effect of preventing, restricting, or distorting competition in Hong Kong. It applies to both horizontal and vertical agreements.

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3 Supra note 2.
4 Chaired by the Financial Secretary of Hong Kong, COMPAG was established in December 1997 to provide a high-level and dedicated forum to review competition-related issues in Hong Kong. It promulgated a Statement on Competition Policy in May 1998 to provide an overarching policy framework to guide sector-specific efforts to promote competition. COMPAG gives advice to government bureaux and departments in reviewing policies and practices from the competition standpoint, and in proposing new initiatives to promote competition in different sectors.
In July 2015, the HKCC published its Guideline on the First Conduct Rule (“Guideline”), along with five other guidelines on (i) the Second Conduct Rule, (ii) mergers, (iii) complaints, (iv) investigations, and (v) exclusions and exemptions. The HKCC is of the view that while generally less harmful to competition as compared to horizontal agreements, some vertical agreements may, nonetheless, cause harm to competition.

The Guideline defines RPM in the following way: RPM occurs whenever a supplier establishes a fixed or minimum resale price to be observed by the distributor when it resells the product affected by the RPM obligation. The Guideline also makes a distinction between direct RPM and indirect RPM. RPM can be achieved indirectly, for instance, by fixing the distributor’s margin or the maximum level of discount the distributor can grant from a prescribed price level. The supplier might also make the grant of rebates or the reimbursement of promotional costs subject to the observance of a given price level by the distributor, or link the prescribed resale price to the resale price of competitors. The supplier might equally use threats, intimidation, warnings, penalties, delays in, or the outright suspension of, deliveries to achieve RPM. While having no legal binding effect, the Guideline sets out how the HKCC intends to interpret and give effect to the First Conduct Rule.

Schedule I to the Ordinance contains a general exclusion for agreements of lesser significance. Pursuant to that provision, the First Conduct Rule does not apply to an agreement between undertakings (or a concerted practice engaged in by undertakings) in any calendar year if the combined turnover of the undertakings does not exceed HK$200 million (approximately U.S. $25.8 million). Here turnover means the total gross revenues of an undertaking, whether obtained in or outside Hong Kong.

However, this general exclusion rule is not available to agreements that are deemed to concern “serious anti-competitive conduct.” The list of “serious anti-competitive conduct” includes price-fixing, market-sharing, production/sales quota, bid-rigging, and RPM in some cases, as we shall see below.

There is also a general exclusion for agreements enhancing overall economic efficiency in Schedule 1 to the Ordinance.

A. The Theories of Competition Harms about RPM

The Guideline (paragraph 6.72) states that RPM can restrict competition in a number of ways:

i. RPM facilitates coordination between competing suppliers through enhanced price transparency in the market.

ii. RPM undermines suppliers’ incentives to lower prices to distributors and distributors’ incentives to negotiate lower wholesale prices.

iii. RPM limits “intra-brand” price competition by restricting the ability of distributors to offer lower sales prices for the affected brand as compared with prices offered by competing distributors of the same brand. This will be a particular concern where there are strong or well-organized distributors operating in a market. RPM facilitates coordination between distributors on the downstream market affected by the RPM.
iv. RPM prevents the emergence of new market participants at the distributor level and will generally hinder the expansion of distribution models based on low prices (for example, the emergence of discounter distributors).

v. Where RPM is implemented by a supplier with market power, this may have the effect of excluding smaller suppliers from the market. Distributors are incentivized to only promote the product affected by the RPM causing harm to consumers.

Theory (i) and the second part of theory (iii) above are the conventional concerns over RPM—that they can be used by upstream suppliers to facilitate upstream collusion or by downstream distributors—which are recognized and accepted by most antitrust jurisdictions in the world. The HKCC further adds that, in those contexts, it may have particular concern where RPM is employed by multiple suppliers in the market, RPM is otherwise common, or where there is evidence that the RPM conduct is distributor driven.

Regarding theory (iii), the Guideline clarifies that the HKCC interprets the First Conduct Rule as prohibiting not only restrictions on inter-brand competition but also restrictions on intra-brand competition (footnote 38). This position is reflected in other parts of the Guideline as well. When evaluating agreements on exclusive distribution and exclusive customer allocation, the HKCC will assess how intra-brand and inter-brand competition is affected (paragraph 6.86).

One may try to make sense of the emphasis on intra-brand competition, as well as inter-brand competition, in the following way. In a small economy like that of Hong Kong, where downstream retailing markets tend to be concentrated due to geographic constraints, perhaps the need to protect intra-brand competition becomes greater compared to large economies where protection of inter-brand competition is perhaps more important.6

Theory (iv) above, namely that RPM may be used to deter entry at the resale level, can be understood to reflect the concerns in the real RPM cases in Hong Kong whereby larger supermarkets pressured suppliers to impose RPM on new/discounted retailers.

Theory (v), namely that larger suppliers may use RPM to reduce retailer incentives to carry competing products, particularly from smaller rivals or new entrants, is also a sensible one. This theory of competition harm was discussed in the Leegin case where the U.S. Supreme Court noted a series of potential sources of competitive harm, including that a manufacturer with market power, by comparison, might use resale price maintenance to give retailers an incentive not to sell the products of smaller rivals or new entrants.7

This competition concern has been confirmed in a formalized equilibrium analysis by Asker & Bar-Isaac who developed a game-theoretical model which predicts that RPM, slotting fees, loyalty rebates, and other related vertical practices can allow an incumbent manufacturer to transfer profits to retailers.8 If these retailers were to accommodate entry, upstream competition

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could lead to lower industry profits and the breakdown of these profit transfers. Thus, in equilibrium, retailers can internalize the effect of accommodating entry on the incumbent’s profits. Consequently, if entry requires downstream accommodation, entry can be deterred. The HKCC is to be applauded for having incorporated the most up-to-date insight and development in industrial economics into the Guideline.

**B. “Near Per Se Illegal Approach” Toward RPM**

From the published Guideline and earlier statements of the HKCC about its draft guidelines, it appears that HKCC has adopted a “near per se illegal approach” toward RPM.

The HKCC initially viewed RPM as *per se* illegal, based on the above five theories of harms on competition. The Draft Guideline on the First Conduct Rule, published on October 9, 2014, stated, “where an agreement involves direct or indirect RPM, the Commission takes the view that the arrangement has the object of harming competition” (paragraph 6.64). During the public consultation period, the HKCC received 64 submissions from the business sector, trade associations, political parties, and public organizations etc., expressing views towards the published draft guidelines. A majority of the submissions were about the Draft Guideline on the First Conduct Rule, centering on such issues as RPM, information exchange among competitors, and collective bargaining.

The HKCC’s position toward RPM has changed somewhat, as reflected in the Revised Guidelines on the First Conduct Rule, published on March 30, 2015. There, the HKCC stipulated that RPM is harmful to competition, although the practice may not always have the object of harming competition. Depending on the content of the agreement, its implementation, and the relevant context, an RPM arrangement may be assessed on the basis of its effects.

In its press release on the revised guidelines, the HKCC stated that it “maintains its view that RPM arrangements have an inherent potential to harm competition in Hong Kong. The Commission considers that RPM may have the object of harming competition and there may be circumstances when it amounts to Serious Anti-competitive Conduct.” The revised guidelines contain additional examples of situations where RPM arrangements will be assessed as having the object of harming competition and/or where they might amount to "serious anti-competitive conduct."

In the final version of the Guideline published on July 27, 2015, the HKCC maintains that “for the reasons set out in paragraph 6.72 of this Guideline, where an agreement involves direct or indirect RPM, the Commission takes the view that the arrangement may have the object of harming competition.” However, whether this is in fact the case turns on a consideration of the content of the agreement establishing the RPM, the way the arrangement is implemented by the parties, and the relevant context. If an RPM agreement does not have the object of harming competition, the HKCC will assess whether the RPM causes harm to competition by way of its effects.

The Guideline recognizes that vertical price restrictions, including RPM, may sometimes lead to efficiencies. While efficiencies must be assessed on a case-by-case basis, the Guideline provides one scenario where RPM can improve upon efficiency. In particular, the Guideline states that the RPM may help address the so-called free riding problems at the distribution level
where the extra margin guaranteed by the RPM structure encourages parties to provide certain sales services for the benefit of consumers. The Guideline further elaborates that this efficiency may have some relevance in the case of “experience” goods or complex products.

While this recognition of a possible pro-competitive effect of RPM is in line with the development of modern industrial economics and international best practice, the HKCC emphasizes that “the Commission would expect to see compelling evidence of an actual free rider problem.”

**C. RPM as Serious Anticompetitive Conduct**

The Guideline provides an example of RPM having the object of harming competition. “For example, RPM will be considered as having the object of harming competition if there is evidence that the RPM was implemented by a supplier in response to pressure from a distributor seeking to limit competition from competitors of the distributor at the resale level.” This situation is illustrated in more detail in Hypothetic Example 16 of the Guideline:

HomeStore is the owner of a wide number of household goods shops across Hong Kong. HomeStore is a significant customer of CleanUpCo for a number of daily use products which are widely available in supermarkets, convenience stores, specialist stores and smaller shops.

HomeStore is concerned that its competitors, including other large chain stores and smaller independent stores, are offering CleanUpCo’s products at a lower price than HomeStore. HomeStore is concerned that its competitors’ pricing decisions will impact on the profitability of a number of important business lines in its stores. HomeStore therefore pressures CleanUpCo to require its customers to sell CleanUpCo products across Hong Kong at a fixed retail price determined by CleanUpCo. As HomeStore is a significant customer of CleanUpCo, CleanUpCo implements the RPM policy.

The HKCC would view this arrangement as having the object of harming competition. The Guideline explains its reasoning behind this view as follows: “HomeStore’s insistence on CleanUpCo introducing a fixed retail price across Hong Kong has an inherent ability to harm competition. In this scenario, the purpose of the arrangement is merely to protect HomeStore from the competitive pricing of its competitors.” In addition, the Guideline further elaborates that there would be unlikely to be sufficient justifications for the RPM practice to satisfy the terms of the general exclusion for agreements enhancing overall economic efficiency.

This example is almost identical in nature to the RPM complaints received by the COMPAG in 2012 as mentioned earlier. The Guideline in this part clearly targets the type of RPM that has been observed in Hong Kong’s supermarket sector.

The Guideline further states that “[t]he Commission would also consider the RPM in the example to be Serious Anti-Competitive Conduct under the Ordinance,” making it join the category of hard-core cartel agreements (price-fixing, market division, production/sales quota, and bid-rigging). This classification has strong implication because the general exclusion for agreements of lesser significance as mentioned earlier does not apply to agreements considered to be "serious anti-competitive conduct" under the Ordinance.
IV. CONCLUSION

RPM has been common in Hong Kong and received great attention both before and after Hong Kong enacted the Competition Ordinance in 2012. The HKCC’s position toward RPM, and its theories of harms as spelled out in the Guideline on the First Conduct Rule, are generally in line with both insight from modern industrial economics and international best practices. While recognizing the possible pro-competitive effect of RPM, however, the HKCC seems to have adopted a “near per se illegal approach” toward RPM by requiring “compelling evidence of an actual free-rider problem” in an RPM defense. The HKCC also emphasizes the need to protect both intra-brand competition and inter-brand competition.

Given the high attention received by RPM in Hong Kong historically and the fact that the retailing industry (not including the upstream markets) amounts to about 4 percent of Hong Kong’s total employment, and about 10 percent of its GDP, one would not be surprised to see immediate enforcement action against RPM after the Ordinance comes into force in December 2015.