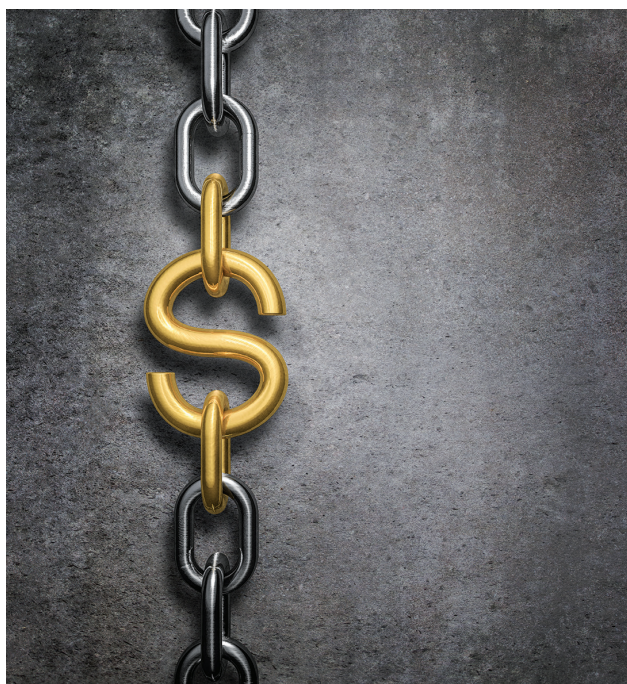


Hong Kong Competition Law Series: Part 9

2015 - THE YEAR OF COMPETITION IN HONG KONG

Resale Price Maintenance

Resale Price Maintenance (RPM) is a type of vertical price restriction where an upstream supplier requires an independent reseller to resell at a fixed or minimum resale price. RPM is called a “vertical” agreement because it is an agreement between businesses operating at different levels of the supply chain.



An RPM is typically enforced by one or more of the following mechanisms:

- The supplier punishes non-compliant resellers by threatening to stop supplying the product; or
- The supplier provides incentives for observing the fixed resale price.

WHY MAINTAIN RESALE PRICES?

Suppliers may impose RPM as part of a wholesale price-fixing arrangement. Setting the resale price reduces incentives for individual resellers to undercut each other to gain market share at the distribution/retail level, and facilitates enforcement of a cartel.

RPM may also originate from resellers who may wish to use RPM to disguise/enforce a price fixing arrangement.

On the other hand, there may be business justifications for implementing RPM within a single-brand distribution or retail network, such as:

- To promote consumer interest in a new product;
- To encourage retailers to invest in customer service and enhance the retail experience, thereby increasing the competitiveness of the brand compared to other brands;
- To improve after-sales and maintenance services;
- To prevent discount or non-prestige distributors or retailers from free-riding on the benefits of investment made by the supplier or other distributors or retailers of the same brand; and
- To strengthen inter-brand competition in a franchise system.

As the nature of these justifications suggests, RPM is usually more likely to give rise to efficiencies where the distribution or sale of the product requires product-specific investment, e.g., at the inception of a new product, within a franchised distribution network, or in relation to luxury or complex products.

WHAT ARE THE HARMS OF RPM?

RPM may restrict competition in the following ways:

At the supplier level...	<ul style="list-style-type: none">• A broad RPM arrangement may increase price transparency in the market and facilitate coordination between competing suppliers.• Where RPM is implemented by a supplier with market power to protect the profit margin of resellers, smaller suppliers may be excluded from the market by reason that the resellers do not have incentive to deal with other suppliers outside of the RPM arrangement.
At the distributor/ retailer level...	<ul style="list-style-type: none">• RPM restricts the ability of resellers to compete on price.• RPM may restrict market entry at the distributor/retail level and hinder the emergence of innovative distribution/retail business models.• RPM may be requested by resellers to facilitate coordination in pricing.

Competition law treatment of RPM has traditionally been strict. Recently however, competition authorities and courts in many mature competition law jurisdictions are increasingly receptive to efficiency justifications for RPM. Ultimately whether an RPM arrangement is justifiable will depend on the context of the restriction and must be analysed on a case by case basis.

WHAT ABOUT RECOMMENDED PRICES OR MAXIMUM PRICES?

It *may* be permissible to give non-binding price recommendations, or suggest a maximum resale price, but problems may arise when:

- a. Despite not being mandatory, the recommended or maximum prices serve as a “focal point” for reseller pricing; or
- b. The supplier enforces recommended or maximum prices as if they are a fixed or minimum retail price.

The risk of anticompetitive effects arising from a vertical pricing restriction increases with market

power. In determining whether a restriction is anti-competitive, it would be necessary to examine the actual and potential effects of the restriction on the relevant market.

Next week

In the coming few weeks, we will look at different forms of distribution agreements. Next week, we will start the discussion with exclusive distribution, followed by selective distribution and franchise arrangements.

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