

Competition issues for distribution and supply agreements in Hong Kong

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Practice notes

A Practice Note outlining the key antitrust and competition issues that can arise in relation to distribution and supply agreements in Hong Kong. This includes a discussion of the antitrust and competition risks associated with common price-related terms, geographic and territorial restrictions, customer restrictions, sales channel restrictions, exclusivity, tying and bundling, and other considerations for dealing with competitors in a distribution context.

In brief

The principal competition legislation in Hong Kong is the Competition Ordinance (Cap 619) which came into full effect on 14 December 2015. The Competition Ordinance prohibits businesses (undertakings) from entering into agreements with other undertakings that prevent, restrict or distort competition in Hong Kong. It also prohibits businesses with a significant degree of market power from abusing their market power in a way which prevents, restricts or distorts competition in Hong Kong.

The Hong Kong Competition Commission ("**Commission**") and the Competition Tribunal ("**Tribunal**") are primarily responsible for competition law enforcement in Hong Kong. The Commission has broad powers to investigate and bring proceedings relating to alleged breaches of the Competition Ordinance. The Tribunal is a specialist division within the Hong Kong High Court. It has primary responsibility to hear competition cases and issue decisions on breaches, penalties and other relief. Tribunal decisions can be appealed to the Court of Appeal and Court of Final Appeal.

This Note includes:

- A description of the regulatory framework for challenging vertical distribution agreements in Hong Kong
- A discussion of the antitrust and competition risks in distribution agreements

While contested vertical-agreement-related cases have been relatively uncommon in Hong Kong, parties should still carefully consider competition law risks when concluding these agreements.

Regulatory framework

The relevant substantive provisions of the Competition Ordinance are the First and Second Conduct Rules (collectively, "**Conduct Rules**").

The Conduct Rules apply to agreements and conduct which cause harm to competition in Hong Kong. Under Section 8 and Section 23 of the Competition Ordinance, the Conduct Rules apply even if the conduct occurs outside of Hong Kong, or if any party to such conduct is outside of Hong Kong.

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First Conduct Rule

The First Conduct Rule prohibits undertakings from making, giving effect to, or engaging in agreements, concerted practices or decisions with the object or effect of preventing, restricting or distorting competition in Hong Kong (Section 6(1), Competition Ordinance). It governs arrangements between competitors, and has been interpreted by the Tribunal to also apply to undertakings at different levels of the distribution and supply chain (*Competition Commission v. Nutanix Hong Kong and Others* [2019] HKCT 2, paragraph 40).

The First Conduct Rule applies to all forms of written and unwritten agreements, arrangements and understandings. It also applies to arrangements that are nonbinding or not legally enforceable.

Hong Kong distinguishes between anti-competitive agreements that constitute serious anti-competitive conduct (SAC) under the First Conduct Rule and other conduct that may breach the First Conduct Rule. SAC is defined under Section 2 of the Competition Ordinance as consisting of the following types of agreement:

- Price fixing
- Market sharing
- Output restrictions
- Bid rigging

If the Commission has reasonable cause to believe that a breach of the First Conduct Rule involves SAC, it can commence enforcement proceedings or issue an infringement notice. If the Commission does not reasonably believe that the breach involves SAC, it must issue a warning notice to the companies involved before commencing enforcement proceedings or issuing an infringement notice (Section 82, Competition Ordinance).

The Legislative Council warning notice mechanism was introduced in response to concerns of the business sector, particularly small and medium enterprises, about inadvertently breaching competition law for 'non-hardcore anti-competitive activities'. A warning notice gives an undertaking a limited period to remedy its conduct without being subjected to enforcement proceedings. It also "limits their exposure to sanctions to the period starting from the commencement of the period prescribed in the warning notice" (Section 82(5), Competition Ordinance; *Competition Commission v. Nutanix Hong Kong and Others* [2019] HKCT 2, paras. 468-469). To date, the Commission has not issued any warning notices.

The Tribunal has held that the relevant time for ascertaining whether there is reasonable cause to suspect SAC is before the Commission commences enforcement proceedings (*Competition Commission v. Nutanix Hong Kong and Others* [2019] HKCT 2, paras. 464-467). If the Commission reasonably believes that an infringement of the First Conduct Rule constitutes SAC and commences enforcement proceedings, these proceedings will not necessarily fail if the Tribunal later finds there was a breach but no SAC.

Whilst the definition of SAC in the Competition Ordinance does not expressly refer to agreements between competitors, vertical agreements (except resale price maintenance) are unlikely to constitute SAC. As yet, there is no case law on this question.

Second Conduct Rule

The Second Conduct Rule prohibits undertakings (such as a supplier) with a substantial degree of market power from abusing that power by engaging in conduct which has the object or effect of preventing, restricting or distorting competition in Hong Kong (Section 21(1), Competition Ordinance).

Substantial degree of market power

An undertaking is more likely to have a substantial degree of market power if it has a high market share. Neither the Competition Ordinance nor the Guidelines specify a market share safe harbour (below which significant market power will not arise) or threshold (over which a substantial degree of market power might be presumed).

Under the Second Conduct Rule Guidelines ([Guideline on the Second Conduct Rule](#), July 2015), the Commission considers the following factors when determining whether an undertaking has a substantial degree of market power:

- **Market concentration.** This factor can be used to assess the relative positions of market participants to the position of the undertaking in question.



- **Potential entry into the market by new players, or expansion by existing players.** To the extent that entry or expansion is likely to occur in the event that prices in the market increase, this will constrain the ability of the existing player to raise its prices.
- **Countervailing buyer power.** If a supplier faces a credible threat that the undertaking's customers or buyers could bypass it in favour of other suppliers, it will be less likely to have significant market power.

The Second Conduct Rule Guidelines state that market shares can be unreliable in particular scenarios, for example:

- **Bidding markets.** To the extent that market shares fluctuate significantly as a result of tenders, a high market share may not reflect long-term market power, therefore, it may be more appropriate to look at market shares over an extended period.
- **Innovative markets.** In markets characterised by rapid technological change, a high market share based on a current product offering may not last. For example, in some consumer electronics markets, frequent launches of new and improved products result in fluctuating market shares.

Abuse

Abusive conduct is an open category. As guidance, the Commission provides the following nonexhaustive list of abusive conduct under the Second Conduct Rule:

- Predatory pricing
- Tying and bundling
- Margin squeeze
- Refusals to deal
- Exclusive dealing

Guidelines

The Commission has issued Guidelines under the Competition Ordinance that are relevant to distribution agreements. These include:

- [Guideline on the First Conduct Rule](#) (July 2015) (First Conduct Rule Guidelines)
- [Guideline on the Second Conduct Rule](#) (July 2015) (Second Conduct Rule Guidelines)

The First and Second Conduct Rule Guidelines do not have force of law in Hong Kong. If the Tribunal (or another court in Hong Kong) finds that a guideline is relevant to determining a matter that is in issue, that guideline is admissible as evidence. Any party to the proceedings can rely on proof that a person did or did not contravene the guideline as tending to establish or negate the matter (Section 35, Competition Ordinance).

Sanctions

If the Commission finds that the undertaking has contravened or been involved in a contravention of a competition rule, the Commission can ask the Tribunal to impose a financial penalty. The maximum penalty is 10% of the undertaking's annual turnover obtained in Hong Kong for each year of infringement, for up to three years. If the infringement period exceeds three years, the Tribunal can base the penalty on the three years with the highest turnover. It can also impose a fine on a person (including individuals such as employees or directors) involved in the contravention of a competition rule (Section 93, Competition Ordinance).

The Tribunal may also impose nonfinancial sanctions, such as:

- Prohibiting a person from making or giving effect to an agreement
- Requiring the parties to an agreement to modify or terminate that agreement
- Declaring agreements void or voidable

(Section 95, Competition Ordinance)



Private rights of action

There are no stand-alone private rights of action in Hong Kong (sections 108 and 110 of the Competition Ordinance; *Loyal Profit International Development Ltd v. Travel Industry Council of Hong Kong* [2016] HCMP 256/2016). However, competition law can be invoked as a defence to civil actions (see, for example, *Taching Petroleum Company, Limited v. Meyer Aluminium Limited* [2018] HKCFI 1074, where the defendant to a claim for the price of goods sold and delivered raised a defence based on the suppliers' alleged contravention of the First Conduct Rule).

Persons that have suffered loss or damage due to anti-competitive conduct can bring follow-on claims against the infringing party in the Tribunal for damages and other relief (Section 110, Competition Ordinance).

Price-related terms

Setting resale prices (resale price maintenance)

Resale price maintenance (RPM) occurs when a supplier sets a fixed or minimum resale price for the buyer to resell its product. This includes indirect measures, such as pressuring or threatening a distributor to adhere to a given resale price, for example:

- Fixing the distributor's margin or the maximum level of discount that it can grant
- Using threats, intimidation, warnings or penalties
- Delaying or suspending deliveries, or refusing to deal as a result of a distributor discounting below a supplier's desired resale price

(Paragraph 6.73, First Conduct Rule Guidelines)

To date, Hong Kong courts have not considered whether or in what circumstances RPM contravenes the First Conduct Rule.

The First Conduct Rule Guidelines set out the Commission's views on RPM. The Commission considers that RPM is likely to contravene the First Conduct Rule, unless there is a sufficient efficiency justification for the arrangement. In some cases, the Commission may treat RPM as a restriction of competition by object, meaning presumed illegal even without evidence of an anti-competitive effect. The Commission may consider RPM to be a restriction of competition by object if, for instance:

- There is evidence that a supplier implemented RPM under pressure from a distributor who sought to limit competition from other distributors at the resale level.
- A supplier implements RPM solely to foreclose competing suppliers.

If neither of these situations exist, counsel should still assess the arrangement for potential anti-competitive effects. For example, the Commission would consider that RPM does not have the object of harming competition if RPM is required in a franchise distribution system (or other uniform model distribution system) for the purposes of organizing a coordinated price campaign. In such cases, the Commission assesses whether the arrangement harms competition (paragraph 6.77, First Conduct Rule Guidelines).

The Commission also considers that RPM amounts to SAC in some instances by being a form of price-fixing. The First Conduct Rule Guidelines provide one example: RPM is imposed by a supplier under pressure from a distributor to limit price competition from other distributors (Hypothetical Example 16, First Conduct Rule Guidelines). This interpretation has yet to be tested in the Hong Kong courts.

Suggesting retail prices without an agreement

Suggested resale prices are generally permissible if they are genuine recommendations and do not amount to de facto fixed or minimum resale prices. Resellers must be free to accept, reject or modify suggested prices. Practically, a supplier must not coerce a reseller into selling at the suggested resale price, for instance, by terminating the reseller or limiting supplies if the reseller sells at a discount.

Under the First Conduct Rule Guidelines, suggested retail prices (without any other agreement) can create competition concerns if they:

- Establish a convention for distributor pricing, so that distributors generally follow the suggested price



- Soften competition between suppliers
- Facilitate coordination between suppliers

An important factor in the analysis is the market position of the supplier: The higher the supplier's market power, the higher the likelihood that the conduct harms competition (paragraph 6.80, First Conduct Rule Guidelines).

When combined with other measures, suggested resale price arrangements could be construed as RPM. For instance, the Commission may view the following supplier practices as RPM, considering all available facts:

- Using a price monitoring system
- Requesting that distributors report members of the distribution network who deviate from the suggested resale price
- Implementing other measures which disincentivise the distributor from lowering the resale price

(Paragraph 6.81, First Conduct Rule Guidelines)

Setting minimum advertised prices

Suppliers should be cautious when implementing a minimum advertised price (MAP) policy which prevents or limits the ability of a reseller to advertise lower prices. The Commission is likely to consider this RPM.

Although the First Conduct Rule Guidelines do not explicitly address MAPs, overseas precedents are likely to be persuasive in Hong Kong. Competition authorities such as the European Commission and the UK Competition & Markets Authority (UKCMA) have found that MAPs constitute RPM. UKCMA has found that MAP policies prevented resellers from deciding the resale price by restricting the price at which the seller could advertise the products online. It held that there was a clear link between the advertised price and resale price when products were purchased online (CMA Case CE/9856-14, 17 July 2020).

Most favoured nations pricing

The Commission has considered most favoured nation (MFN) clauses (also known as parity clauses) in the context of online hotel bookings. The First Conduct Rule Guidelines do not address MFN clauses.

In May 2020, the Commission accepted commitments by three online travel agents (OTAs), which serve as channels through which hotels and other accommodation providers advertise and sell accommodation. In this case, the contracts between the OTAs and accommodation providers in Hong Kong contained at least one of the following parity clauses:

- Wide price parity. The accommodation provider must always give the OTA the same or a better price as those it offers across all other sales or distribution channels.
- Wide conditions parity. The accommodation provider must always give the OTA the same or better terms and conditions as those it offers across all other sales or distribution channels.
- Room availability parity. The accommodation provider must always give the OTA the same or better room availability as those it offers across all other sales or distribution channels.

The Commission expressed concerns that these parity clauses could soften competition among OTAs and hinder entry and expansion of new or smaller OTAs. This would deprive consumers of the benefits of effective competition (such as lower and more varied room rates) in contravention of the First Conduct Rule.

Notably, the Commission distinguished wide price parity and narrow price parity in this case. Narrow price parity clauses require that accommodation providers always give OTAs the same or a better price as the price offered by the accommodation provider through its direct online sales channels. The Commission considered that narrow price parity clauses may give rise to pro-competitive benefits by addressing potential free-riding by the accommodation provider.

Offering different prices to competing customers (price discrimination)

Generally, undertakings are free to determine the pricing policies for their products, including by offering different prices to customers who are in competition with each other.

In some jurisdictions, price discrimination has been found to raise competition law concerns in very limited scenarios. Typically, this is where:

- The supplier has substantial market power.



- The discrimination is reasonably likely to lead to undertakings being excluded from a market.
- There is no objective justification for the discriminatory treatment.

The Second Conduct Rule Guidelines do not address when, if ever, price discrimination can constitute abuse of substantial market power under the Second Conduct Rule. Price discrimination is unlikely to be an enforcement priority for the Commission.

Territorial and customer restrictions

Territorial and customer restrictions limit the ability of a distributor to sell products within a particular territory or to a particular customer group.

These restrictions are subject to an effects assessment. The Commission has stated that it will assess how they affect intrabrand and interbrand competition, the extent of such restrictions, and if they are common in the relevant markets (paragraph 6.86, First Conduct Rule Guidelines).

This is different from the approach taken in the EU, which generally treats these restrictions as anti-competitive by object, with limited exceptions (for example, preventing a distributor from making 'active' sales into a territory exclusively reserved to the supplier, or allocated to another distributor). The EU approach principally arises from the EU single market, and the role EU competition law has played in promoting this concept and in removing obstacles to cross-border trade. This dynamic does not exist in Hong Kong (or in Asia more broadly). To date, there has been no published enforcement action taken against territorial or customer group restrictions.

Exclusivity

Exclusivity arrangements can arise in the following circumstances:

- A supplier requires or induces its distributors to only purchase the supplier's products (exclusive purchasing).
- A supplier requires or induces its distributors not to sell products that compete with the supplier's products (noncompete).

Exclusivity arrangements can be assessed under both Conduct Rules. They are commonly used in commercial arrangements and in most cases will not be perceived as harmful to competition (paragraph 5.23, Second Conduct Rule Guidelines). Such restrictions are subject to an effects assessment; in each case, consideration must be given to the commercial rationale (the efficiencies) of such arrangements and any possible anticompetitive effects.

An exclusivity agreement will not raise competition concerns unless:

- One of the parties to the agreement has a substantial degree of market power.
- The restriction may foreclose competition.

The Second Conduct Rule sets out a nonexhaustive list of conduct that would constitute an abuse of market power, which includes exclusive dealing.

When assessing whether the exclusivity arrangement raises concerns, the Commission will consider how intrabrand and interbrand competition is affected, the extent of such restrictions, and if they are common in the relevant markets.

Exclusive purchasing

Exclusive purchase obligations are subject to an effects assessment. Counsel should consider the commercial rationale (the efficiencies) of these arrangements and any possible anti-competitive effects.

An exclusive purchasing obligation requires a customer to purchase a particular product exclusively, or to a large extent, from an undertaking with a substantial degree of market power. Other obligations, such as stocking requirements, may have the same effect as exclusive purchasing though they do not, strictly speaking, entail exclusivity.

Exclusive purchasing agreements are subject to an effects-based analysis under both the First and Second Conduct Rules. The Commission will have concerns if all of the following apply:



- An undertaking with a substantial degree of market power has imposed exclusive purchasing obligations on many of its customers.
- Consumers, as a whole, are unlikely to derive a benefit.
- The relevant obligations, as a whole, have the effect of preventing the entry or expansion of competing undertakings. For example, if the exclusive purchasing locks up a significant part of the relevant market.

Noncompete and single branding obligations

Some distribution agreements contain noncompete obligations that prevent distributors from entering into agreements to distribute certain products other than the supplier's products, either directly or indirectly.

Noncompete obligations are briefly mentioned in the First Conduct Rule Guidelines but are not discussed in any detail (Hypothetical Example 19 under § 6.89 and paragraph §6.118, First Conduct Rule Guidelines).

The Commission is likely to apply an effects-based analysis to noncompete obligations, by analogy with the guidance in other jurisdictions such as the EU. The Commission is likely to have concerns only if:

- One or both parties to the noncompete agreement have substantial degree of market power.
- The noncompete is for an extended duration (five years or longer, by analogy with the guidance in the EU).
- The relevant obligations, as a whole, have the effect of preventing the entry or expansion of competing undertakings. For example if the exclusive purchasing locks up a significant part of the relevant market.

Sales channel restrictions

Restricting online sales

Online sales restrictions that contain the following features are subject to an effects assessment:

- A prohibition on bricks-and-mortar retailers from also selling products online
- A refusal by suppliers to distribute products through retailers with only an online presence

It is not expected that these restraints will generally raise concerns. The Commission has not issued guidance or made any decisions on such restrictions.

The Conduct Rule Guidelines state that a lack of online sales restrictions may alleviate any concerns around a restriction of intrabrand competition due to, for instance, an exclusivity arrangement (Hypothetical Example 19, First Conduct Rule Guidelines).

Setting other criteria for downstream resellers (selective distribution)

Businesses commonly sell their products to end consumers through a network of authorised retailers chosen according to particular criteria. According to the Commission's Guidelines, such a selective distribution system is not problematic if:

- The nature of the product legitimately justifies selective distribution, for example, to preserve product quality and brand image or to ensure appropriate use of the product.
- It is based on non-discriminatory, purely qualitative criteria.
- The criteria do not go beyond what is necessary.

If these features are not present, the Commission may assess a selective distribution system for potential anticompetitive effects.

Selective distribution is more likely to raise concern if interbrand competition is limited and if the supplier has market power. The Commission recognises greater risk of the anti-competitive foreclosure of certain types of retailers (such as price discounters) and collusion between major competing suppliers if:

- The number of authorised retailers is small.
- All major competing suppliers in the market have set up a similar selective distribution system.



Since the Competition Ordinance was enacted in December 2015, there have been no publicly known investigations into brand owners for selective distribution in Hong Kong. As with territorial and customer restraints, there is no policy objective in Hong Kong to facilitate cross-border trade as there is in the EU. Consequentially, we do not expect selective distribution systems to be an enforcement priority for the Commission.

Tying and bundling

Tying refers to the offering of two separate products together, without one being offered separately. Bundling refers to offering two products at a discount (that is, the bundle price is below the price of purchasing both products separately). Both are ubiquitous commercial practices that are usually pro-competitive.

Competition law considers that an undertaking with a substantial degree of market power could use tying or bundling to leverage market power in the market for one of the products (the tying market) to foreclose competitors in the market for the other product (the tied market). The Second Conduct Rule Guidelines set out a nonexhaustive list of conduct that would constitute an abuse of market power, which includes tying and bundling.

When assessing tying or bundling, the following factors are relevant:

- Separate products, that is, whether the tied and tying product are genuinely distinct products, for which there is separate demand
- Anti-competitive effects, in particular, the foreclosure of competitors for the tied product or one of the bundled products. Anti-competitive effects are unlikely to arise if competitors can profitably offer both tying and tied products or the bundled products.

Considerations in dealings with competitors

Cooperating with competitors

Common types of cooperative arrangements (joint ventures) between undertakings (including between competitors) include joint production arrangements, joint buying arrangements, joint selling, distribution and marketing arrangements, and joint research and development (R&D) ventures.

Mergers are excluded from the application of the Conduct Rules (Section 4, Schedule 1, Competition Ordinance). A joint venture is excluded from the application of the Conduct Rules if it amounts to a merger, as defined in the Competition Ordinance, that is, when the joint venture is created "to perform, on a lasting basis, all the functions of an autonomous economic entity" (Section 3(4), Schedule 7, Competition Ordinance).

Potential issues – by object

Sales-related joint ventures can give rise to concerns under the First Conduct Rule if they lead to price fixing, output restriction, market sharing or the exchange of competitively sensitive information (such as pricing, volume, or marketing plans).

For instance, agreements between competitors which are limited to the joint selling of products can serve as a vehicle for price fixing and restricting the output of the parties concerned, hence these agreements are likely to have the object of harming competition.

Similarly, reciprocal distribution agreements between competitors that aim to limit competition between them by allocating markets can be considered to have the object of harming competition.

The above examples may be considered SAC.

Potential anti-competitive effects

Where sales-related joint ventures between competitors do not have the object of harming competition, the relevant arrangements would nevertheless be assessed for potential anti-competitive effects under the First Conduct Rule.

Examples of potential anti-competitive effects that may arise in sales-related joint ventures include the following:

- An increase in parties' commonality of variable costs



- An exchange of competitively sensitive information which goes beyond what might be necessary for the implementation of the joint venture or collaboration
- In the case of distribution agreements, undermining the incentive of one party to enter the market of another

Even if the Commission considers joint ventures or collaborations to have anti-competitive effects, they might be justified under the efficiencies exemption if, for example, they produce significant cost savings and synergies, economics of scale or scope, or improvements in product range or quality.

Refusal to deal with a competitor

In most circumstances, an undertaking is free to choose with whom it will or will not do business, including whether it will deal with a competitor. An undertaking might not wish to enter a trading relationship with another party, including a competitor, for various legitimate commercial reasons.

Refusals to deal with a competitor may be challenged in the following circumstances.

Group boycott

The Commission may consider an agreement or concerted practice amongst two or more competitors not to do business with another actual or potential competitor to be an anti-competitive group boycott with the object of harming competition.

Abuse of dominance

The Second Conduct Rule prohibits an undertaking that has a substantial degree of market power to abuse that power by engaging in conduct with the object or effect of preventing, restricting or distorting competition in Hong Kong. Conduct that may constitute an abuse of substantial market power includes refusal to deal.

In very limited or exceptional circumstances, a refusal to deal by a supplier with a substantial degree of market power may be considered by the Commission to be abusive. Competition concerns are more likely when the supplier also competes in the downstream market with the party with whom it refuses to deal.

A supplier refusing to supply an input to its competitor is also a refusal to deal. This includes a situation in which a supplier is willing to supply the input, but only on objectively unreasonable terms, such as undue delaying, degrading the supply of the relevant input or imposing an excessive price for the input. In assessing whether a refusal to deal contravenes the Second Conduct Rule, the Commission considers the following points:

- Whether the relevant input is indispensable for the competitor to operate in the downstream market
- Whether the competitor in the downstream market can duplicate the relevant input at a reasonable cost
- Whether it is technically and economically feasible for the supplier to provide the input in question to its competitor
- Whether there are any previous dealings between the supplier and its competitor (termination of an existing supply arrangement is more likely to be abusive)
- The terms and conditions under which the relevant inputs are generally supplied
- Whether the supplier has any legitimate objectives in refusing to deal with its competitor (such as objectively insufficient creditworthiness) and, if so, whether their conduct is indispensable and proportionate to those objectives

(Paragraphs 4.4, 5.19, and 5.20, Second Conduct Rule Guidelines)

Selling to a downstream entity that is also a competitor (dual distribution)

Some competition regulators (for example, the European Commission) now focus on perceived competition between suppliers' direct-to-consumer retail and traditional distribution channels, asking whether these relationships should be subject to competition law scrutiny. This is known as dual distribution. When selling directly to end customers, the supplier acts as a competitor to its independent retailers or distributors.

There is no guidance or precedent in Hong Kong regarding the sharing of data between distributors and suppliers in the context of dual distribution. The Commission has provided some guidance on the exchange of commercially sensitive information between competitors.



Accordingly, any discussions between the supplier and its distributors or retailers should be limited to the supplier-distributor relationship. In particular, the supplier and its distributors or retailers should not exchange competitively sensitive information pertaining to their other activities, such as pricing, volumes or commercial strategy.

To minimise risk, suppliers should consider creating an information barrier or setting up clean teams to keep direct sales and traditional distribution channels operationally separate. This helps to avoid:

- Sharing competitively sensitive information about its direct sales channel with its independent distributor or retailers
- Aligning pricing under the separate channels

For example, the team responsible for the traditional distribution channel should not share pricing or point of sale information provided by its distributors with the team responsible for direct sales to end customers, or vice versa.

The potential competition theory of harm raised by competition regulators in dual distribution is that alignment of pricing between a supplier's sales channel and their independent retailers or distributors results in loss of intrabrand competition. From an economic perspective, this should only be a potential concern where there is a lack of interbrand competition. To date, competition regulators in Asia Pacific (including Hong Kong) have not taken enforcement action against dual distribution. An exception is the Australian Competition & Consumer Commission (ACCC) which has investigated agreements between airlines' direct sales channels and third-party agents. The High Court of Australia concluded that the two channels were competitors (*ACCC v. Australian and New Zealand Banking Group Limited* [2013] FCA 1206; *ACCC v. Flight Centre Limited (No 2)* [2013] FCA 1313).

Agency considerations

Suppliers commonly use third-party distributors for their products. If the third party is an independent and separate undertaking, the First Conduct Rule applies.

The First Conduct Rule does not apply to agreements between a principal and a genuine agent (that is, genuine agency agreements). The third party is merely acting as a distribution agent for the supplier so it is not considered a separate undertaking.

To determine if a third party is a genuine agent, the Commission looks at the substance of the arrangements, rather than their labels. The relevant factors are:

- The level of control exercised by the supplier over the third party
- The level of financial or commercial risk borne by the third party

A distributor acts as a genuine agent of the supplier if it bears no risk, or only insignificant risk, in the contracts it concludes on behalf of the supplier. For example, if:

- Title to the contract products is not transferred to the distributor.
- The distributor does not bear any, or bears only an insignificant portion, of the risks and costs related to the contracted products.

If the third party bears several risks and costs relating to the sale of the products under contract (such as the cost of advertising, logistics and installation services, responsibility for product warranty risks towards customers, and the risk of dead stock), this suggests that it is not a genuine agent.

The First Conduct Rule does not apply to restrictions imposed in the distribution agreement relating to contracts concluded on behalf of the supplier. This includes:

- Customer and territorial restrictions
- Resale prices at which the distributor can sell the contract products
- Conditions at which the distributor can sell the contract products

The First Conduct Rule does apply to aspects of the supplier-distributor relationship that do not relate to the sale of the contract products (such as an exclusive agency provision).



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