

Distribution Q&A: Hong Kong

by Frank Voon, Elsa Mak and Joey Liu, K&L Gates

Status: **Law stated as at 28-Feb-2021** | Jurisdiction: **Hong Kong - PRC**

This document is published by Practical Law and can be found at: uk.practicallaw.tr.com/w-030-3897
Request a free trial and demonstration at: uk.practicallaw.tr.com/about/freetrial

Hong Kong-specific information concerning key local and commercial issues that arise when appointing a distributor.

This Q&A provides country-specific commentary on [Practice note, Distribution: Cross-border overview](#).

Regulation and legal formalities

1. Is distribution specifically regulated by national law? Are there any special rules or definitions applicable to:

- Exclusive distribution?
- Sole distribution?
- Non-exclusive distribution?
- Selective distribution?
- Is any legislation pending, which is likely to affect distributions?
- Are there any formalities that a supplier must comply with when setting up a distribution network, for example, any registration or disclosure requirements?

A distribution arrangement in Hong Kong, or governed by Hong Kong law, is subject to common law, Hong Kong case law, and certain Hong Kong legislation, such as:

- The legislation regulating contracts, which includes but is not limited to:
 - the Contracts (Rights of Third Parties) Ordinance (Cap. 623), on the regulation of enforcement of contractual terms by third parties;
 - the Control of Exemption Clauses Ordinance (Cap. 71), on the regulation of exemption clauses;
 - the Unconscionable Contracts Ordinance (Cap. 458), on the regulation of unfair terms.
- The legislation regulating the contracting parties or the underlying arrangement, which include but are not limited to:
 - the Competition Ordinance (Cap. 619), on prohibition of anti-competitive conduct by businesses (the Competition Ordinance) (see Question 3);

- the Food Safety Ordinance (Cap. 612), on registration of food importation or distribution business;
- the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330), on registration of a business which imports and/or distributes motor vehicles;
- the Newspapers Registration and Distribution Regulations (Cap. 268B), on licensing of a business which distributes newspapers;
- the Pharmacy and Poisons Regulations (Cap. 138A), on wholesale dealer licensing for the wholesale and/or import or export of poisons and/or pharmaceutical products;
- the Prevention of Bribery Ordinance (Cap. 201), on prohibition of parties from engaging in corrupt conduct or other offences relating to bribery established under the ordinance; and
- the Personal Data (Privacy) Ordinance (Cap. 486), on compliance of parties (as data users) with the data protection principles on the collection, handling and use of personal data.

At the time of writing, there is no known pending legislation in Hong Kong that would specifically govern a distribution arrangement in Hong Kong.

Subject to the intention of the parties and the underlying contractual terms, the common understanding in Hong Kong is that:

- An “exclusive distribution” means a distribution arrangement for a specific product, territory and duration that is exclusive of all other persons, including the supplier.
- A “sole distribution” is similar to an exclusive distribution, except that the supplier can itself distribute the specific product for that territory and duration.

- A “selective distribution” means a number of distributors appointed concurrently for the same product and territory, provided that they comply with certain rules and parameters set by the supplier.

The Competition Commission of Hong Kong has also provided interpretations of certain commercial arrangements, such as exclusive distribution and selective distribution, in its published guidelines (see Question 3).

As a general note, a supplier entering into a distribution arrangement in, or involving, Hong Kong should carefully consider and review matters of Hong Kong law that relate to:

- The registration and licensing formalities that may apply to the business and/or the particular product that is the subject of distribution.
- The contractual terms that would govern the distribution arrangement and how various legislation would impact on the terms of the contract.
- The tax considerations underlying the distribution structure and terms.

2. Are there any laws, regulations or case law which apply to agency relationships that might be interpreted in such a way as to apply to a distributor relationship as well?

Hong Kong laws do not pre-determine or otherwise deem a relationship between a supplier and a distributor as one of principal and agent. Whether or not the distributor is an agent of the supplier and has the right to contract with third parties in the name of the principal will depend on the substance of the relationship and the surrounding facts.

It is necessary to refer to the general principles of agency law, including an examination of whether there is any manifestation of assent (express or implied) between the relevant parties to the conferral of authority in the acts in question (*Bright Gold Ltd v Mega Well Development Ltd (No 2)* [2020] 5 HKC 614). The designation of authority can be by way of actual authority (either express or implied) or apparent authority. The court in *Bright Gold* also cited and considered the following to be the usual characteristics of agency relationship:

- Whether the agent has the authority to affect the principal’s relationship with third parties.
- Whether the agent owes a fiduciary duty to the principal.
- Whether the principal has the ability to exercise a degree of control over the agent.

In practice, a supplier will be cautious about providing any agent authority to the distributor, outside the right of distribution, and it is therefore customary for a distribution agreement:

- To contain provisions that clearly disclaim any agency relationship.
- To ensure that the distributor does not have the authority to contract with third parties on behalf of the supplier.

Competition law

3. Are there any national laws or regulations that would affect the following business practices:

- Grant of exclusive territory?
- Tied selling?
- Territorial restrictions?
- Customer restrictions?
- Resale price maintenance?
- Minimum purchase targets?
- Imposition by the supplier of restrictions on the sources of supply to distributors?
- Refusal to deal?

The Competition Ordinance has implications for the business practices under a distribution arrangement. Under the Competition Ordinance, and the guidelines published by the Competition Commission from time to time (individually, Guideline and collectively, the Guidelines):

- **First conduct rule.** Any conduct or agreement with the object or effect of preventing, restricting or distorting competition in Hong Kong is prohibited.
- **The second conduct rule.** Any business with a substantial degree of market power abusing that market power by engaging in conduct that has the object or effect of preventing, restricting or distorting competition in Hong Kong is prohibited.

An assessment of whether a business practice or agreement falls under the first conduct rule or the second conduct rule would require an analysis of its effects or likely effects on competition in the relevant market in Hong Kong on a case-by-case basis.

The Guidelines are often observed, even though they are not legally binding.

Exclusive distribution and customer restriction

The Guidelines:

- Set out the concept of “exclusive distribution” as one where a supplier appoints the distributor as its only distributor to sell its products on an exclusive basis in a particular territory.
- Define the concept of “exclusive customer allocation” as one where a supplier can restrict the distribution of the products by the distributor on an exclusive basis to a particular group of customers (that is, a typical customer restriction concept).

Whether such exclusive arrangements are prohibited will depend on whether they create anti-competitive effects in the relevant market (in particular, in breach of the first conduct rule). An assessment of the effects includes an evaluation of:

- How intra-brand and inter-brand competition are affected.
- The extent of the territorial and/or customer sales limitations.
- Whether exclusive distributorships are common practice in the markets impacted by the agreements under consideration.

(Paragraphs 6.85-6.89, Guideline on the first conduct rule.)

Separately, the Guideline on the first conduct rule also provides for “selective distribution”, in that a supplier can choose to appoint a selected group of authorised distributors, chosen on the basis of particular criteria, to sell the supplier’s products in a given territory. Under the “selective distribution” arrangement, the supplier often prohibits the authorised retailers from reselling the products to non-authorised retailers.

For a selective distribution arrangement where selection is based on purely qualitative criteria to fall outside the scope of the first conduct rule, it will have to meet the following criteria:

- The product needs a selective distribution network to preserve its quality and to ensure proper use.
- The authorised distributors are selected on the basis of non-discriminatory qualitative criteria relating to their technical ability to handle the product or their suitability to protect the product’s brand image.
- The selection criteria do not go beyond what is necessary for the particular product.

(Paragraphs 6.121-6.127, Guideline on the first conduct rule.)

Tied selling

Under the Guidelines, “tying” occurs where the sale of a product or service is conditional on another product or service also being purchased, and is a type of conduct that the Competition Commission may, in appropriate circumstances, consider an abuse of a substantial degree of market power in violation of the second conduct rule. When assessing the tying conduct, the Competition Commission will consider whether the tying and the tied products are distinct products and, if so, whether the conduct has an anti-competitive effect (for example, whether anti-competitive foreclosure will result).

(Paragraphs 5.8-5.12, Guideline on the second conduct rule.)

Resale price maintenance

Under the Guidelines, resale price maintenance occurs when a supplier establishes a fixed or minimum resale price to be observed by the distributor when it resells the product.

This can also occur indirectly when the supplier fixes the distributor’s margin or the maximum level of discount the distributor can grant. 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 otherwise link the prescribed resale price to the resale price of competitors.

Whether or not these arrangements have the object of harming competition, thereby breaching the first conduct rule, will turn on a consideration of:

- The content of the agreement.
- The manner in which such an arrangement is implemented by the parties.
- The circumstances of the case.

When a supplier merely recommends a resale price to a distributor, or requires a reseller to respect a maximum resale price, the agreement will not, on its face, be considered as having the object of harming competition (*paragraph 6.78, Guideline on the first conduct rule*). Nonetheless, it is still necessary to consider if it has any competitive effects (taking into account the market position of the supplier) and to consider whether other measures that might be in place, such as the supplier’s right to recourse if the “recommended” resale price is not followed, might render such an arrangement, in effect, a fixed- or minimum-price agreement.

(Paragraphs 6.71-6.77, Guideline on the first conduct rule.)

Minimum purchase targets, supply restrictions and refusal to deal

The Competition Commission considers “exclusive dealing” as a broad category of conduct which covers exclusive purchasing obligation and conditional rebates. See Question 6 and Question 7 for discussion on the imposition of minimum purchase targets and restriction on sources of supply by the supplier (the imposition of exclusive purchase obligations).

According to the relevant Guideline, a “refusal to deal” occurs when a supplier with a substantial degree of market power refuses to supply to another distributor or reseller, or is willing to supply only on objectively unreasonable terms.

In general, it is recognised that the parties are free to decide with whom they will or will not do business with. However, competition concerns may arise when a supplier with a substantial degree of market power competes in the downstream market with a distributor or reseller in that market with whom it refuses to deal, especially if the product

- Is indispensable for the distributor or reseller operating in the downstream market.
- Cannot be duplicated or can only be duplicated at an unreasonable cost.

In assessing whether a refusal to deal is a contravention of the second conduct rule, the Competition Commission may consider the following:

- Whether or not it is technically and economically feasible for the undertaking with a substantial degree of market power to provide the product in question.
- The history of dealing between the supplier and the distributor.
- The terms and conditions under which the products in question are generally supplied or are supplied in other contexts.

(Paragraphs 5.16-5.22, Guideline on the second conduct rule.)

The Competition Ordinance provides certain exemptions from anti-competitive conduct, to be assessed on a case-by-case basis, which may include but do not limited to the following for the first conduct rule:

- Agreements which harm competition but which may also enhance overall economic efficiency.
- Agreements of lesser significance, meaning:
 - an agreement between entities in any calendar year, if the combined turnover of the entities for the turnover period does not exceed HKD200 million;

- a concerted practice engaged in by the entities in any calendar year, if the combined turnover of such entities for the turnover period does not exceed HKD200 million; or
- a decision of an association of entities in any calendar year, if the turnover of the association for the turnover period does not exceed HKD200 million.

There are also certain exclusions of the application of the second conduct rule (see Schedule 1 to the Competition Ordinance, the Annex of the Guideline on the first conduct rule and the Annex of the Guideline on the second conduct rule).

4. Is there specific competition or anti-trust law regulation of exclusive and selective distribution? Describe briefly.

See Question 3.

5. Are there any national provisions relating to the imposition of minimum or maximum prices?

See Question 3.

6. Can a supplier impose minimum purchase obligations or targets on a distributor?

Yes, provided that such an arrangement complies with the Competition Ordinance. For example, if a minimum purchase requirement is imposed on a distributor by the supplier and, in return, the distributor is given additional benefits based on the quantity purchased, this may constitute “conditional rebates” and a type of “exclusive dealing” recognised by the Competition Commission, which may in turn contravene the second conduct rule if the supplier has a substantial degree of market power, among other things (see Question 3).

7. Can a supplier impose exclusive purchase obligations on a distributor?

Yes, provided that such an arrangement complies with the Competition Ordinance. An exclusive purchasing obligation usually requires a distributor to purchase a particular product exclusively (or to a large extent) from the supplier. The Competition Commission may consider this to be a type of “exclusive dealing” and have concerns regarding its anti-competitive effect where:

- The supplier has a substantial degree of market power and has imposed the requirement on many other distributors, thereby abusing its market power.

- It is likely that these distributors as a whole will not derive any benefits from the arrangement.
- The exclusive purchase obligations as a whole have the effect of preventing the entry or expansion of competing businesses, for example, the exclusive purchasing locks up a significant part of the relevant market.

(See Question 3.)

8. Are there any laws or regulations relating to restrictive covenants or covenants not to compete during the distribution agreement? To what extent is it possible to continue the restrictions after the agreement has expired? In particular, to what extent does the geographical extent and or the length of time of the restriction affect its enforceability?

Restrictive covenants or covenants not to compete are governed by the common law doctrine of restraint of trade, and they are enforceable if the relevant covenant goes no further than is reasonable to provide adequate protection to the party in whose favour it was imposed, while also not being injurious to the public (*Esso Petroleum Co Ltd v Harper's Garage (Stowaport) Ltd* [1968] AC 269; *Oriental Machinery Ltd v Choi Kin On* [2003] 3 HKC 398 (CFI)).

The enforceability of these restrictions under Hong Kong law depends on the reasonableness of their scope, including territory and duration. For example, a post-termination non-compete clause should only prevent a distributor from distributing particular products within the contracted territories which specifically compete with the contracted products for a reasonable period of time following termination of the distribution agreement.

Even if a non-compete or restraint of trade provision is enforceable under common law, its lawfulness must also be assessed under the Competition Ordinance, for example, determining whether or not it will foreclose a competitor's access to the relevant market (see Question 3 and Question 7). If the supplier has a substantial degree of market power, the prohibition of the abuse of a dominant market position may also apply, and this is to be assessed on a case-by-case basis (see Question 3).

9. Is the supplier free to impose on the distributor an obligation to buy and keep a full stock of each of the products comprised in the range of products which are the subject of the distribution agreement?

Stocking requirements imposed by the supplier may have the same effect as an exclusive purchasing obligation even though, strictly speaking, they do not entail exclusivity (see Question 7 for a discussion of the competition law considerations that may apply in this scenario).

10. Where a distribution network involves trading online how is this regulated?

There are no known Hong Kong laws that specifically govern online business trading between suppliers and distributors. However, the Electronic Transactions Ordinance (Cap. 553) may be relevant to online business activities, as it:

- Recognises contracts in digital form and other electronic records as having legal effect.
- Regulates the use of electronic and digital signatures.

Intellectual property

11. Does a distributor enjoy an implied licence to use the supplier's intellectual property rights in performance of its obligations under the distribution agreement?

There is no Hong Kong legislation that imposes or implies a licence to use the supplier's intellectual property rights solely by virtue of parties entering into a distribution agreement.

If a licence is contemplated over the use of the supplier's intellectual property, an express licence should be included, so that the parties are clear as to the scope of the licence and the rights and obligations of the distributor with respect to intellectual property.

12. Is registration of intellectual property licences possible? Does this give any added protection?

Yes, registration with the Intellectual Property Department of Hong Kong is possible in respect of a licence regarding a trade mark, patent or design. Generally, the effect of registration is that:

- The licence will be effective against a third party that subsequently acquires a conflicting interest in the intellectual property right without knowledge or notice of the licence.
- The licensee may be able to take advantage of certain statutory provisions which grant them certain rights (such as the right to call for or bring about

infringement proceedings as stipulated in the Trade Marks Ordinance) and remedies in the event of infringements.

13. If the supplier is based abroad, does the distributor need to be registered as owner or user of the trade mark to be able to import goods bearing the trade mark?

Generally, no, unless the Hong Kong customs authority imposes a requirement. However, a supplier should consider registering its trade mark in Hong Kong, so as to provide its trade mark with the relevant protection (see Question 12).

14. Does the distributor become entitled to any rights in a trade mark (or any other intellectual property right) by virtue of selling the trade-marked products in its territory?

Yes, depending on the circumstance, there is a risk that, unless otherwise provided in the distribution agreement, goodwill in the name or mark applied to the goods may be acquired by the distributor or be jointly owned by both the supplier and the distributor over a period of substantive use of the mark or control over the sale of products.

The distributor may also acquire unregistered trade mark rights that could prevent the supplier enforcing a trade mark infringement action against the distributor for use of the mark for the registered goods/services before the date of the supplier's trade mark registration.

The supplier should apply to register the trade mark from the outset, and incorporate terms in the distribution agreement acknowledging that the supplier is the owner of all intellectual property rights (including trade marks) and that there is no assignment of any intellectual property rights (including trade marks) to the distributor.

15. Are there any competition law or anti-trust implications of licensing intellectual property rights?

The Competition Ordinance and Guidelines will also apply to a licensing of intellectual property rights (see Question 3). Provisions in the context of licensing intellectual property rights, such as exclusivity, non-compete and/or price fixing, can give rise to competition law concerns.

16. Can the supplier impose restrictions on the use of the supplier's confidential information by a distributor either during or after the expiration of the distribution agreement?

Yes, the supplier can impose restrictions on the use of the supplier's confidential information by the distributor during or after expiration of the distribution agreement. The scope of such restrictions, however, would be subject to the common law doctrine of restraint of trade (see Question 8) and competition law (see Question 3).

Employment law

17. Is there a risk that distributors may be treated as employees of the supplier?

In a typical distribution agreement for the sale and resale of goods between corporate entities, this risk is very low. However, whether there is an actual employment relationship (as opposed to an independent contractor relationship) is a question of fact and will depend on the nature and substance of the relationship. Some factors suggested by the Labour Department of Hong Kong for assessing this relationship that may be considered would include, but are not limited to:

- How much control the supplier has over the distributor's work procedures, working time and work method.
- Whether the supplier provides the distributor with the relevant work equipment, tools and materials.
- Whether the distributor carries on business on its own account, with investment and management responsibilities.
- The degree of financial risk undertaken by the distributor when compared to that undertaken by the supplier.
- How responsibilities for insurance and tax are allocated.

([Hong Kong Labour Department FAQs on the Employment Ordinance, Cap. 57.](#))

18. Could employment liabilities of an outgoing distributor be transferred to a new distributor or to the supplier itself?

There is no automatic transfer of employees or employment liabilities from an outgoing distributor to a new distributor appointed by the supplier, nor is there such an automatic transfer where the supplier assumes the distribution. However, the parties may agree

contractually to the transfer of employees, or allocation of employer responsibilities.

If a change of distributor constitutes a transfer or sale of a business by the outgoing distributor, the Transfer of Business (Protection of Creditors) Ordinance (Cap. 49) may apply.

Where a business is transferred from, or sold by, the distributor to the supplier, the purchaser (that is, the supplier) will be liable for all the debts and obligations arising out of the carrying on of business by the seller (that is, the distributor), unless the procedures prescribed in the aforementioned ordinance are followed.

Tax

19. Will a foreign supplier who appoints a distributor directly in the national territory be regarded as carrying on business for tax purposes in that territory?

In an ordinary distribution business model, if the Hong Kong distributor is not affiliated with the foreign supplier, then the Hong Kong distributor is treated as an independent entity and the foreign supplier is unlikely to be regarded as having a permanent establishment in Hong Kong which would render the profits attributable to the permanent establishment to be subject to Hong Kong profits tax (if such profits arise in or derive from Hong Kong).

Factors that may result in a foreign supplier having a permanent establishment in Hong Kong can be found in *Advance Ruling Case No. 66, Inland Revenue Department*.

20. Are any withholding or other taxes levied in the territory on remittance monies? When and by whom are they payable?

The remittance of funds by a Hong Kong distributor to a non-resident supplier would not ordinarily give rise to withholding tax obligations in Hong Kong.

However, a Hong Kong distributor may have to withhold a tax amount for royalty payments made to a non-resident supplier for the use of certain intellectual property. This will usually arise at the time of payment of the principal amount to the non-resident supplier (*sections 15 and 20B, Inland Revenue Ordinance (Cap. 112)*).

21. Will there be any difficulties in a domestic distributor making payment to a foreign supplier, either in local currency or in the currency of the supplier's country? Are there any exchange controls in operation?

Hong Kong uses a linked exchange rate system, and trading since May 2005, has been in the range of USD1: HKD7.75 to 7.85. Under this system, Hong Kong dollars are freely convertible into other currencies that are not themselves subject to foreign exchange controls. However, a payee country may have foreign exchange controls in place that may affect payment by a Hong Kong distributor to a foreign supplier in that payee country.

Product liability

22. To what extent is it possible to exclude liability as between the distributor and supplier for the supply of defective goods or services? To what extent can a distributor be indemnified against product liability claims?

Parties to a distribution agreement are generally free to agree to exclude liability for defective goods or services or to require one party to provide indemnities to the other for liabilities arising from those defects.

As a result, a distributor can request the inclusion in the agreement of an indemnity clause specifying that the supplier will indemnify losses suffered by the distributor from any product liability claims. However, there are exceptions to this, such as:

- Liability for death or personal injury caused by negligence cannot be contractually excluded or restricted (*Control of Exemption Clauses Ordinance (Cap. 71)*).
- Liability for other loss or damage resulting from negligence can only be excluded or restricted where the term satisfies the requirement of reasonableness (*Control of Exemption Clauses Ordinance (Cap. 71)*).
- Liability for breach of a supplier's implied undertaking as to title of the goods cannot be contractually excluded or restricted (*Control of Exemption Clauses Ordinance (Cap. 71)*).
- As against a person not dealing as a consumer (defined under section 4 of the Control of Exemption Clauses Ordinance (Cap. 71)) (for example, a supplier or distributor contracting in the course of a business), liability under warranties implied by the Sale of Goods Ordinance (Cap. 26) regarding conformity of goods with description or sample, or as to their quality or fitness for a particular purpose, can only be contractually excluded or limited insofar as the term is reasonable. In determining reasonableness, the court or arbitrator shall have regard to matters such as the relative strength of the bargaining positions of the parties, as specified in Schedule 2 to the Control of Exemption Clauses Ordinance (Cap. 71).

The distribution agreement

23. Are any particular formalities required in relation to distribution agreements?

No particular formalities are required. General principles of contract law will apply, and certain Hong Kong legislation relating to contract and contracting parties would apply (see Question 1). It is advisable for evidentiary reasons to have a properly drafted written agreement that clearly defines the parties' rights and obligations. A valid contract in Hong Kong would contain the following elements:

- Offer.
- Acceptance.
- Intention to create legal relations.
- Consideration.
- Capacity (the authority or ability to make contracts).

For general contract execution requirements, see Question 44.

24. Is it possible to incorporate the supplier's standard conditions of sale into the distribution agreement? What do such standard conditions normally cover?

Yes, this is a relatively common practice in Hong Kong, and the standard conditions of sale can be contractually incorporated by reference. Standard conditions would usually cover the following:

- Nature and scope of distributorship.
- Description and specification of goods.
- Price and payment.
- Orders and inventory.
- Time, place and manner of delivery of goods.
- Training and provision of sales support.
- Insurance obligations.
- When risk and title will pass.
- Consequences of any defects in the goods (including repair, replacement and limitation of liability).
- Indemnity obligations.
- Cancellation rights in connection with any orders for goods.
- Intellectual property rights, ownership and licensing arrangements.
- Termination rights.

25. Does national law impose any obligations on the supplier or the distributor? Are there any obligations of either party which are typical due to local custom?

The Sale of Goods Ordinance (Cap. 26) provides that certain terms are implied into the sale of goods transaction regarding:

- Title.
- Description.
- Quality.
- Fitness.
- Sample.

(See Question 22 and Question 26.)

There are also statutes governing general contract terms (see Question 1). Certain product-specific legislation may also apply:

- The Consumer Goods Safety Ordinance (Cap. 456), which regulates the safety of the consumer goods supplied for private use or consumption by manufacturers, importers and suppliers.
- The Toys and Children's Products Safety Ordinance (Cap. 424), which regulates the safety of toys and children's products.
- The Pharmacy and Poisons Ordinance (Cap. 138), which regulates the sale, import, export and possession of pharmaceutical products and poisons.
- The Dangerous Goods Ordinance (Cap. 295), which (together with its subsidiary regulations) provides for the control of different types of dangerous goods in accordance with their inherent characteristics.

Also potentially relevant are:

- General import and export regulations; for example, the Import and Export Ordinance (Cap. 60).
- Legislation prohibiting false trade descriptions and misleading or incomplete information; for example, the Trade Descriptions Ordinance (Cap. 362).
- The common law tort of negligence, which will apply to create civil liability if losses are a reasonably foreseeable consequence of the supplier and/or distributor taking less than reasonable care.

26. Are any terms implied by law as to the supplier's title to the goods? Is any specific wording necessary and do buyers normally impose a higher standard than is implied by law?

Yes, it is an implied term of a sale of goods contract that:

- The seller has the right to sell the goods.
- The goods are free from undisclosed charges and encumbrances.

(Section 14(1)(a), *Sale of Goods Ordinance (Cap. 26)*.)

The parties cannot exclude or restrict liability for breach of these implied terms, and any attempt to do so will be void (section 11(1), *Control of Exemption Clauses Ordinance*) (see Question 22).

No specific wordings need to be included in the contract for the implied condition and warranty to apply.

27. What term is commonly agreed for a distributorship? Does national law regulate the length of notice periods?

There is no legally prescribed term for (or notice period for termination of) a distribution agreement. These are matters to be agreed contractually and commercially between the parties.

28. What events will be regarded in law as justifying termination of the distribution agreement? Do any statutory obligations arise on termination? What provision is usually made in the agreement for termination?

The parties can contractually agree on the grounds on which any party can terminate the distribution agreement. In addition, common law rights of termination may be relied on. For example, a party can rescind the contract where:

- The breach of the other party goes to the root of the contract.
- The other party declares an unequivocal intention to abandon performance of the contract.
- The breach of the other party will substantially deprive it of the whole of the benefit which it bargained for from the contract.

Common grounds for termination in a distribution agreement include:

- Change in control.
- Non-compliance with law.
- Liquidation or insolvency.
- Bribery or criminal conduct.
- Breach of certain material provisions, such as the payment obligation, or obligation to meet minimum purchase commitments.

The right to terminate is commonly expressed in a contract to be without effect on other rights, remedies, obligations or liabilities to which parties may be entitled or which may have accrued up to the date of termination, including the right to claim for breach of contract.

There is no specific Hong Kong legislation which imposes obligations that would arise automatically on the termination of a distribution agreement. Instead, the consequences are normally expressly set out in the agreement, including:

- The supplier's right or obligation to buy back or dispose of remaining stocks of products.
- The distributor's obligation to return confidential information or other marketing or promotional materials, or unused packaging.
- The distributor's obligation to assist with transitional arrangements.
- The cessation of use of the supplier's intellectual property rights.

29. What rights does the distributor have to compensation on termination of the distribution agreement or discontinuation of supply of the products? How is compensation for termination / discontinuation of supply calculated?

The distributor's right to compensation on termination or on discontinuation of supply, and the method of its calculation, are matters to be agreed contractually by the supplier and the distributor.

The parties can also agree on liquidated damages. However, note that liquidated damages may constitute a penalty, and become unenforceable, if the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract (*Cavendish Square Holding BV v Makdessi* [2016] AC 1172; *Chan Cham Pong Cedric v Too Ka Man & Anor* [2019] HKDC 917; [2019] HKCU 2827).

30. Where the distributor holds stock or money or other property belonging to the supplier, can the supplier assert its rights of ownership against third parties:

- In the event of insolvency of the distributor?
- In the event that the distributor has dishonestly disposed of them to third parties?

Following the termination of a distribution agreement, any payment due to the supplier will generally become actionable as a debt. This is on the assumption that the distributor has taken title of the products and it therefore becomes difficult for the supplier to establish a proprietary claim for them.

However, if a distribution agreement contains a properly drafted retention of title provision to the effect that, if the purchase price is not paid, the goods will remain the property of the supplier until full payment is made, then the supplier may be able to repossess the unpaid goods that are still in the possession of the distributor. In addition, in the event of the distributor's insolvency, the supplier may be able to rely on this clause to ensure that the goods do not form part of the distributor's general assets to be distributed during the insolvency proceedings, at least as long as the goods remain in the form in which they were sold.

In any event, the supplier's claim over any title to the goods may be lost where the goods are sold to a third-party good faith purchaser for value without notice.

31. What limitations and exclusions of liability might be appropriate (see [Standard document, Distribution agreement: Cross-border: clause 14](#))?

Limitation and exclusion of liability are matters to be agreed contractually by the parties, subject to certain restrictions imposed by law (see Question 22). A supplier may attempt to seek the following limitations and exclusions of liability:

- Setting a cap on the total liability.
- Excluding liability for loss of goodwill, profit, revenue or anticipated savings.
- Excluding any indirect or secondary losses.
- Excluding insurable losses (such as damage to property).

32. Could any terms be implied under local law which regulate the supplier's ability to increase prices to the distributor during the term of the agreement (see [Standard document, Distribution agreement: Cross-border: clause 6.2](#))?

No such terms are implied under Hong Kong law. The supplier is free to increase prices during the term of the distribution agreement if that is expressly provided for in the agreement. Otherwise, the supplier is contractually bound to supply at the agreed prices.

33. Are bank or parent company guarantees, letters of credit or other forms of security common practice in your jurisdiction (see [Standard document, Distribution agreement: Cross-border: clause 6.4](#))?

It is not uncommon for the supplier to require a parent company guarantee or security from the distributor for the performance of its obligations under the distribution agreement. This is subject to the bargaining position of the parties, with details to be contractually agreed. Payment by way of a letter of credit is common in Hong Kong.

34. Would it be permissible to include a clause (referred to as a retention of title clause in common law jurisdictions) to ensure the supplier retains ownership (title) of the products until payment has been received from the buyer (see [Standard document, Distribution agreement: Cross-border: clause 6.4](#))?

Yes, this is permissible and also recognised under Hong Kong law (see Question 30).

35. Are there any local laws, rules or practices in relation to set-off (see [Standard document, Distribution agreement: Cross-border: clause 33](#))?

There are various forms of set-off in Hong Kong, such as:

- Legal set-off in legal proceedings is available where the two countering claims are for liquidated sums.
- Equitable set-off is available where either or both of the claims may be for an unliquidated sum.

Parties are also free to expressly stipulate in a distribution agreement what rights of set-off will apply (for example, whether set-off is permitted, how this right is to be exercised, and whether the right of set-off is bilateral or unilateral).

36. Will any customs duties be payable under the agreement for any products that are received by a distributor in your jurisdiction? Would the supplier or the distributor typically be responsible for paying any customs duties?

Importation of goods into Hong Kong is generally duty-free, except for certain types of goods, including:

- Motor vehicles.
- Liquor (of a certain alcohol concentration).
- Tobacco.
- Hydrocarbon oil.
- Methyl alcohol.

The person importing the goods (usually the distributor) will usually be responsible for paying the relevant duties (if any), although parties are free to agree on the allocation of that responsibility between them.

37. Are there any compliance obligations on either party under your local laws?

Distribution agreements are subject to a variety of statutory, regulatory and common law requirements in Hong Kong, as mentioned throughout these Q&As. In particular, the general principles of contract law and competition law principles apply (see Question 1 and Question 3).

38. Should the distributor be solely responsible for compliance with import licensing laws (see [Standard document, Distribution agreement: Cross-border: clause 9.3](#))?

This is subject to agreement, but ordinarily the distributor will take responsibility for complying with the import licensing laws given the locality and access to local resources. This obligation tends to encompass the obtaining of the relevant import licence from the relevant authority. For example, an import licence is required from the Trade and Industry Department for importing strategic commodities and rice (*Import and Export Ordinance (Cap. 60)*; *Import and Export (Strategic Commodities) Regulations (Cap. 60G)*; *Reserved Commodities (Control of Imports, Exports and Reserve Stocks) Regulations (Cap. 296A)*).

39. Is the supplier, distributor or both parties responsible for ensuring products can be sold in the defined territory: (i) before the start of the start if the agreement; and (ii) during the term of the agreement (see [Standard document, Distribution agreement: Cross-border: clause 9.5](#))?

The supplier and the distributor tend to share the responsibility for ensuring that the products can be sold in Hong Kong before the term of the agreement commences.

During the term of the agreement, as the distributor has on-the-ground advantage and has the contractual obligation to distribute, this obligation tends to shift contractually to the distributor and also includes the distributor ensuring that the relevant import (if applicable) or distribution licences having been obtained in order to legally import (if applicable) and distribute such goods locally.

However, depending on the circumstances, there may be particular requirements regarding the product itself (such as its characteristics, design and specifications) which may have to be satisfied before it can be distributed and sold in Hong Kong, and that would usually be a matter to be controlled by the supplier.

Although the respective obligations of the distributor and supplier can be, and often are, allocated by contract, each party should carefully assess this in view of its responsibilities and the possible ramifications that may arise from non-compliance.

40. Would it be common practice in your jurisdiction for a supplier to include a clause / clauses stating that it makes no warranty or representation: (i) as to the validity or enforceability of trade marks; or (ii) as to whether the trade marks infringe any third party intellectual property rights (see [Standard document, Distribution agreement: Cross-border: clause 12.5](#))?

It is common for a supplier to request the inclusion of such a warranty or representation, and these are at times accepted by the distributor. It is more often the case that diligence over the trade marks and intellectual property rights will be conducted so as to identify any potential infringement risks before the parties conclude a distribution arrangement (see also Question 12).

41. In your jurisdiction, to what extent can a distributor incur personal liability to a customer?

If the distributor has sold the goods directly to the customer in the course of business, then the distributor may be directly liable to the customer in respect of matters such as:

- The goods not being of merchantable quality (*Sale of Goods Ordinance (Cap. 26)*).
- Any false trade descriptions or misrepresentations (*Trade Descriptions Ordinance (Cap. 362)*).

- The goods not complying with the general safety requirement (*Consumer Goods Safety Ordinance (Cap. 456)*).

A distributor often takes out insurance to cover these risks and/or includes a back-to-back contractual arrangement with the supplier, such as a refund of goods that are not of merchantable quality.

42. Does the law in your jurisdiction dictate which governing law and jurisdiction will apply to the distribution agreement (see [Standard document, Distribution agreement: Cross-border: clauses 35 and 36](#))?

No, these are matters to be contractually agreed between the parties. Hong Kong has an advanced and well-established legal system. Accordingly, the use of Hong Kong law as governing law and Hong Kong courts (or an arbitral tribunal) as a jurisdiction have their appeal.

43. Does the agreement need to be in a language other than English for it to be valid and enforceable (see [Standard document, Distribution agreement: Cross-border: clause 37](#))?

No, there is no such requirement; it is common for the distribution agreement to be in English, Chinese or another language, depending on the contracting parties' requirements.

44. How does this agreement need to be executed to ensure that it is valid and enforceable? Does it need to be registered with any authority in your jurisdiction?

Execution by a Hong Kong company must comply with the company's articles of association and/or the Companies Ordinance (Cap. 622). A Hong Kong company can:

- Execute a document under its common seal.
- Have the document signed by:
 - the sole director (if the company has only one director); or
 - by two directors or one director and the company secretary of the company (if the company has two or more directors).

Additional requirements would apply if the agreement is executed as a deed.

There are also no requirements for a distribution agreement to be registered with a Hong Kong regulatory authority to be valid and effective.

For a foreign supplier, the validity of execution by the foreign supplier will be governed by the laws of domicile of the foreign supplier.

45. Are there any clauses in [Standard document, Distribution agreement: Cross-border](#) that would not be legally enforceable or not standard practice in your jurisdiction?

In addition to our comments throughout this Q&A, in relation [Standard document, Distribution agreement: Cross-border: clause 24](#), it is not the Hong Kong courts' general practice to assist parties in modifying the contract terms to render it valid, legal and enforceable.

While the courts have the power to sever a clause from an agreement, the courts will only do so taking into account factors such as:

- Whether the remaining terms continue to be supported by adequate consideration.
- The "blue pencil" test (that is, whether part of a clause could be deleted without having to modify the rest and without it affecting the "character" of the contract).

In relation to [Standard document, Distribution agreement: Cross-border: clause 34](#), depending on the actual percentage and amount of interest to be paid for the overdue amount, there may be a risk that the interest may be regarded as a penalty by the court and therefore not legally enforceable (see Question 29 for a discussion of penalties).

46. Are there any other clauses that would be usual to see in a distribution agreement and/or that are standard practice in your jurisdiction?

No. The standard form agreement looks fairly comprehensive in terms of its coverage of matters that are generally addressed in distribution agreements.

Brexit

47. From the point of view of your jurisdiction, what points do you anticipate might arise in relation to a distribution agreement which either: (i) contains an express choice of English law as the governing law; or (ii) has a UK-incorporated supplier or distributor as a party and is governed by the laws of your jurisdiction, if, during the life of the agreement, the UK were to cease to be a member of the European Union?

At the date of publication, the implications of Brexit on distribution arrangements are still unclear. From a Hong Kong law perspective, there is currently no pending legislation that might affect distributions in light of Brexit.

48. In relation to any points identified in Question 47, would you recommend that any adjustment should be made now to the [Standard document, Distribution agreement: Cross-border](#) if it were to be used as an agreement governed by the law of your jurisdiction, in order to address those points in advance?

See Question 47. Whether or not adjustments to the standard document would have to be made depends largely on the issues arising from Brexit, which are still unclear at the time of writing.

Contributor details

Frank Voon, Partner

K&L Gates

E frank.voon@klgates.com

Areas of Practice: Corporate M&A.

Elsa Mak, Counsel

K&L Gates

E elsa.mak@klgates.com

Areas of Practice: Corporate M&A.

Joey Liu, Associate

K&L Gates

E joey.liu@klgates.com

Areas of Practice: Corporate M&A.

Legal solutions from Thomson Reuters

Thomson Reuters is the world's leading source of news and information for professional markets. Our customers rely on us to deliver the intelligence, technology and expertise they need to find trusted answers. The business has operated in more than 100 countries for more than 100 years. For more information, visit www.thomsonreuters.com