

HIGHLIGHTS

ANTI-COMPETITION PROVISIONS IN DISTRIBUTOR AGREEMENTS

Legal Regulations

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During the conclusion of distribution agreements that govern relations between suppliers and distributors, specifically terms and conditions of delivery and subsequent resale, the parties would normally be guided by the provisions of the Ukrainian Commercial and Civil Codes and/or rules of international law, if such an agreement is made by and between a resident and a non-resident. Quite often, suppliers wish to limit distributors' supply and acquisition of goods, implementation of intellectual property rights, fixing of resale prices, mutual relations with competitors, etc., and ignore the Ukrainian antimonopoly law, which failure may, in certain cases, result in penalties imposed by the market regulator - Antimonopoly Committee of Ukraine (*hereinafter* - AMC). In this article we are going to discuss specific provisions that may trigger AMC penalties.

The first thing to be kept in mind is that distributor agreements are based on freedom of contract - a key civil-law principle in the Ukrainian Civil Code implying that the parties act freely while entering into a contract, selecting a contracting party, contract type or contract provisions. However, freedom of contract is limited by the law. The parties should consider such restrictions as mandatory compliance with civil law, other legislation acts, business customs, and must act reasonably and justly. Also, whenever a contract involves a foreign subject of business activity, according to the Law of Ukraine "On Foreign-Economic Activities" the parties have the right to use known international customs, rules, etc., unless same are forbidden expressly and exclusively by the laws of Ukraine. Therefore, while entering into the distributor agreements with Ukrainian residents Ukrainian and foreign companies should take into account, among other provisions, the rules of the Ukrainian antimonopoly law.

According to the Ukrainian antimonopoly law, the distributor agreement between a supplier and a distributor is treated as coordinated acts, specifically vertical coordinated acts, which means that the subjects of business activity the participants of which are involved in the coordinated acts do not and, under the existing conditions, cannot be competitors on the same commodity market, and at the same time have or may have purchase-and-sale (e.g. "seller" - "buyer" or "supplier" - "consumer") relations on the relevant commodity markets.

Article 30 of the Ukrainian Commercial Code says that unlawful agreements between subjects of business activity include those aimed at fixing or maintaining monopoly prices, discounts, mark-ups/surcharges, market sharing based on territory, sales or purchases of goods, product range or consumer type, eliminating sellers/buyers from the market or restricting their access thereto, etc.

The provisions of the Commercial Code are stated in more detail in Article 6 of the Law of Ukraine "On Protecting Economic Competition" where the following contract

terms and conditions are treated as being anticompetitive (i.e. such that may result in non-admission, elimination or restriction of competition):

- fixing prices or other terms and conditions for buying or selling goods;
- restriction of production, commodity markets, technical and technological developments, investments or control over same;
- market or supply sources sharing based on territory, product range, sales or purchases, sellers, buyers or consumers or other criteria;
- elimination of other subjects of business activity, buyers, sellers from the market (market abandoning) or restriction of their access thereto.

The anticompetitive acts also mean different conditions being used in identical agreements with other subjects of business activity so that the latter find themselves in disadvantageous position in competition; conclusion of agreements on the condition that other subjects of business activity assume additional obligations which by their substance or according to trade or other fair business customs have nothing to do with the subject matter of these agreements, etc. It should be noted that the list of the anticompetitive coordinated acts is not exhaustive: the anticompetitive coordinated acts may also mean similar acts or omissions by subjects of business activity on a commodity market that have resulted or may result in non-admission, elimination or restriction of competition in case a commodity market situation analysis shows there are no objective reasons for such acts or omissions.

The anticompetitive coordinated acts are forbidden and are penalized by fines of up to 10% of the income (revenue) derived by a subject of business activity from sales (of goods, works, services) in the most recent accounting year before the year in which the fine is imposed.

The most common so-called "anticompetitive provisions" of the distributor agreements are:

- a system of selective delivery of goods by a supplier in the form of restriction of supplies to a territory, specific distributors;
- granting a distributor the exclusive right to distribute products;
- assumption by a distributor of the obligation not to purchase similar goods from other suppliers;
- a selective system of discounts;
- fixing resale price;
- supplier's restriction concerning the conclusion by a distributor of a subsequent agreement with a second-level distributor, including conclusion without the supplier's prior approval;
- specific conditions for the purchase of goods not related to the subject matter of the agreement, etc.

However, not all of the "anticompetitive" coordinated acts are unlawful.

Firstly, subjects of business activity may request, in accordance with the established procedure, prior approval of the AMC for such acts. The AMC may approve the coordinated acts that were identified as "anticompetitive", if the parties involved prove that the acts improve production, purchase or sale of goods; economic development; optimize exports or imports; development and use of standardized specifications or standards of goods, etc. In some cases, the Cabinet of Ministers of Ukraine may allow the coordinated acts that were not approved by the AMC if the parties involved prove that positive effects in public interests prevail over negative consequences of restricted competition.

Secondly, there are exceptions from the aforementioned rules which will be discussed below.

If there are doubts concerning the exceptions discussed below, companies may request from the AMC its preliminary opinion with respect to the coordinated acts. It should be noted that the scope of the information to be submitted with the preliminary opinion request is substantial, and after all of the information required by the law is submitted a company may be subject to "special supervision treatment" by the AMC.

(a) Exceptions for small-scale and average-scale entrepreneurs

Coordinated acts of small-scale or average-scale entrepreneurs (i.e. the subjects of business activity incomes or cost of assets of which in the most recent fiscal year is not in excess of 500 thousand Euros) in joint acquisition of goods that do not result in an essential restriction of competition are not anticompetitive acts.

(b) Exceptions concerning supply and use of goods

Article 8 of the Law of Ukraine "On Protecting Economic Competition" stipulates that the coordinated acts of supply or use of goods, if one party to the coordinated acts establishes for the other party restrictions concerning:

- the use of the goods it delivers or the goods of other suppliers;
 - purchases from other subjects of business activity or sales to other subjects of business activity/consumers of other goods;
 - the purchase of the goods which by their nature or according to trade or other fair business customs do not belong to the subject matter of the agreement;
 - formation of prices or other provisions of a contract for the sale of delivered goods to other subjects of business activity or consumers
- are not anticompetitive acts, i.e. are allowed.

However, the Article goes on to say that those coordinated acts are not covered by the aforementioned exceptions if the coordinated acts result in an essential restriction of competition on the entire market or within a considerable portion thereof, monopolization of markets; restriction of access to the market by other subjects of business activity; an economically unreasonable rise of prices or product deficit. The AMC have not issued any clarifications concerning the application of the provisions of this Article, which means that the AMC will be making specific decisions in specific cases concerning compliance with the effective rules, and the entity's independent decisions concerning the availability/lack of such competition restriction criteria can be risky.

The AMC are developing "Standard Requirements Concerning Coordinated Acts of Subjects of Business Activity in Supply and Use of Goods Compliance with Which Allows These Coordinated Acts Without the Approval of the AMC Offices" that will be applicable to distributor agreements, but before they are adopted we would recommend that the rules discussed in this section be applied cautiously.

(c) Exceptions under the "Standard Requirements Concerning Coordinated Acts of Subjects of Business Activity for General Exemption From the Prior AMC Office Approval of the Coordinated Acts of Subjects of Business Activity", approved by AMC Order No. 27-r dated 12.02.2002.

Vertical coordinated acts are permitted and the approval is not required when:

- Aggregate share of all the parties involved in the acts on the relevant commodity market in Ukraine (i.e. on the market where the coordinated acts occur and adjacent markets) is less than 5%, or
- Aggregate market share of the parties involved in the acts on the relevant market in Ukraine is not in excess of 20%, if neither party is a monopolist, has no

prevailing rights or powers granted by public or local authorities, monopoly entities, etc., and when the assets or product sales of the parties involved in the vertical coordinated acts (taking into account control relations) do not exceed the following limits:

- aggregate cost of the assets or aggregate product sales of all subjects of business activity the corporate structures of which include the parties involved in the coordinated acts in the most recent fiscal year, including abroad, is more than the equivalent of 12 million Euros according to the National Bank of Ukraine exchange rate that was effective on the last day of the fiscal year, and:
- cost (aggregate cost) of the assets or product sales (aggregate sales), including abroad, of at least two subjects of business activity the corporate structures of which include the parties involved in the coordinated acts is more than the equivalent of 1 million Euros according to the National Bank of Ukraine exchange rate that was effective on the last day of the fiscal year with each one of them, and
- cost (aggregate cost) of the assets or product sales (aggregate sales) in Ukraine of at least one subject of business activity the corporate structure of which includes the parties involved in the coordinated acts is more than the equivalent of 1 million Euros according to the National Bank of Ukraine exchange rate that was effective on the last day of the fiscal year.

(d) Exceptions concerning the use of intellectual property rights

Distributor agreement provisions concerning the assignment of intellectual property rights or the use of an intellectual property item are not anticompetitive to the extent they limit the business activities of the contract party that assumes the right, unless the restrictions are beyond the legitimate rights of the holder of the intellectual property rights, i.e., the timeframe and territory covered by the authorization to use the intellectual property item, as well as activity type, usage area, minimal production output.

Summing it up, I would like to add that in the last years the AMC have been interested in distributor agreement provisions, primarily with respect to socially significant markets (pharmaceuticals, medical items, foodstuffs, etc.), and we advise the companies to harmonize their agreements with the effective provisions of the antimonopoly law.