Ukraine

Competition in Ukraine: Feel the 2017 progress

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Ukrainian competition laws and regulatory practice continue to go through the active reform phase and 2017 turned out to be just as busy as 2016, primarily in the sphere of merger control reform. The Antimonopoly Committee of Ukraine (AMC) continues to be the driver of these reforms, implementing best international practices. Most of these reforms have received a warm welcome from the business and professional communities, yet the increase in the average level of fines and constant attempts to test the limits of its jurisdiction combine to make the AMC one of the most powerful governmental agencies, creating concerns for larger businesses regarding compliance risks.

Legislative developments
One of the major novelties for Ukrainian competition lawyers is the introduction of state aid regulations. On 2 August 2017, the Law of Ukraine “On State Aid to Undertakings” (the State Aid Law) entered into force. While the State Aid Law dates back in 2014, giving sufficient time for businesses and the government to become acquainted with the new requirements, it is fair to say that general awareness about state aid legislation, or even a basic understanding of its principles, remains low. This will likely change when enforcement kicks in and the first cases appear on recalling state aid due to misconduct.

When it comes to secondary legislation, the most notable development is the adoption by the AMC in October 2017 of the Vertical Block Exemption Regulation (the Vertical Regulation). This Ukrainian Vertical Regulation is heavily influenced by the Commission Regulation (EU) No 330/2010, providing useful guidance on (i) a block exemption for certain categories of vertical agreements where the absence of an anticompetitive effect may be predicted; and (ii) a list of hardcore and other restrictions falling beyond the scope of the block exemption. More developments are expected in the near future.

In November 2017, a draft law amending procedural rules of case investigation passed a first reading in the Parliament of Ukraine. Among many improvements, this draft law introduces clear deadlines for investigations conducted by the AMC, extends and ensures procedural rights of all parties, improves regulation of the leniency programme, introduces settlement procedures in cartel cases, and provides for other long-awaited changes that shall ensure due process in the AMC’s investigations.

Finally, in November 2017 the Parliament of Ukraine adopted a law allowing the AMC to deny merger clearance of transactions involving undertakings featured in the sanctions list. The ambiguous wording of this law raises a lot of issues with applicability to clearances granted and transactions implemented earlier, which will have to be resolved through administrative practice and judicial interpretation.

Hard-hitting precedent: To rebate or not
Throughout 2017, the AMC closely scrutinized various socially important markets. One of the most noticeable investigations concern the pharmaceuticals market. This probe dates back to 2012, focusing on vertical agreements between pharma producers and their distributors. The first fines imposed in 2016 on Alcon and Servier, together with their distributors, were relatively small.

However, on 14 November 2017, the AMC adopted a practice-breaking decision imposing a fine of EUR 2.2 million on Sanofi-Aventis Ukraine (SAU), a subsidiary of French pharma producer Sanofi. Two of its local distributors, Limited Liability Company BADM (BADM) and Limited Liability Company Optima-Pharm Ltd (Optima-Pharm), also received fines of EUR 0.9 million and EUR 1.3 million respectively. This is perhaps the most controversial decision of the AMC in 2017, which demonstrates new approaches and deserves a more detailed look.

Alleged violation
The investigation concerns 2011, when SAU introduced a uniform rebate system for all
distributors, with BaDM and Optima-Pharm being the largest among the 10 distributors used by SAU, encouraging them to increase purchase volume and rewarding them for meeting certain targets (volumes, prepayment, stock maintenance, etc.). Similar distribution models were used by other pharmaceutical producers and are also common in other industries.

After five years of investigation, the AMC concluded that the distribution agreements between SAU and each of the distributors resulted in (i) price-setting mechanisms that restrict competition on the markets of Sanofi’s pharmaceuticals from cheaper substitutes (market foreclosure); (ii) division of markets according to assortment of goods; and (iii) securing price increase for Sanofi’s pharmaceuticals sold through state procurement, which may lead to limitation of competition.

Among the three allegations, market foreclosure is the most interesting one, as it is missing in the cases of Alcon and Servier prosecuted by the AMC in 2016, despite the very similar factual pattern. This is the first case where the AMC used economic analysis to substantiate and develop the “theory of harm”. In essence, the allegation is that SAU sold expensive (compared to local substitutes) branded generic pharmaceuticals in high volumes and used rebates to incentivise the distributors to maintain the status quo. The AMC also argued that in SAU’s distribution model, rebate points could be earned from all sales, but discounts were applied to products where there was high competition, effectively cross-subsidizing them, while the distributors did not pass on these discounts to their customers, i.e. pharmacies. The AMC ignored the arguments of the parties that there was no evidence of any actual restrictions of competition and no deficit of competing products, because distributors merely responded to demand from consumers and could only sell as much as consumers were willing to buy.

Market definition
In its market analysis, the AMC relied on a very narrow market definition, looking only at substitutes with the same international non-proprietary name (INN), form, and dosage, while completely ignoring substitutability of many pharmaceuticals based on medical protocols or consumer preferences in the case of OTC products. Even the same product with different dosage (e.g. 100 mg and 200 mg) went into two product markets in the AMC probe.

Interestingly, even under the narrowest market definition, there were many product markets on which SAU’s market share was small (below 30%, and in some cases even below 5%). However, even in these cases, the AMC did not apply the relevant block exemption permitting vertical conduct and, thus, did not exclude these highly competitive markets from its analysis.

Qualification of violation
It is widely known that rebates and discounts are often investigated by competition authorities within the context of abuse of market power, rather than concerted practices. The EC attempted to shed more light on the lawful application of rebates and discounts in its Guidance on the Commission’s enforcement priorities in applying Article [102 TFEU] to abusive exclusionary conduct by dominant undertakings in paragraphs 37 to 45 explaining the circumstances where consumer harm may occur. Violation of these rules may lead to severe prosecution, such as in the Intel case, where a record EUR 1.06 billion fine was imposed for violating Article 102 of the Treaty on the Functioning of the European Union. Even though the use of rebates based on identical terms for all distributors was unilateral conduct of SAU, the AMC decided to qualify such conduct as “concerted practices” between SAU and its distributors, the analogy of EU’s Article 101 of the TFEU, because the distributors allegedly benefited from the system by maintaining high prices and keeping a large portion of the resultant profits.

Absence of anticompetitive effects ignored by the AMC
When substantiating the violation, the AMC did not try to show any anticompetitive effects of the alleged “anticompetitive concerted practices” and even ignored any evidence to the contrary. Initially, the AMC assumed that, due to the introduction of rebates, the assortment (i.e. number of SKUs) or volumes of sales of competing products decreased. However, in the face of evidence to the contrary submitted by the parties, in its decision the AMC merely stated that the respective actions “may lead to limitation of competition”, without going into actual effects. Given that no negative effects were identified by the AMC five years after the alleged violation, there are serious doubts over whether such conduct really had any impact on competition and could be qualified as “concerted practices” to begin with.

The allegation related to increase of prices in state procurement tenders is also highly controversial. Given that (i) SAU did not participate in any state tenders, (ii) did not distinguish its pricing policy depending on further resale of its products to the public or private sector by the distributors, and (iii) did not influence the pricing policy of its distributors, it is quite difficult to imagine how SAU could influence the prices offered by distributors during a tender, which is a competitive process by definition, and given that no evidence of distortion of any tender was demonstrated.

Lessons from the Sanofi case
The Sanofi case clearly shows that vertical relations present a new risk zone for multinational companies in Ukraine, which was previously underestimated. Even though not all rebates are illegal, off-invoice provision of discounts based on bonus schemes, in the opinion of the AMC, may limit competition from other products. Therefore, any sophisticated commercial conditions other than on-invoice discounts may also come under the scrutiny of the competition agency. Moreover, the low standard of proof and the quality of evidence and economic analysis used by the AMC to support its decision demonstrates a significant increase of prosecution risk, even for companies that adhere to the highest standards in competition law compliance.

Picture the future
The reform of Ukrainian competition laws launched in 2015 is clearly not finished. It is a pleasure to see the increased initiative of the AMC to tackle many issues that were neglected for many years. For example, businesses often need guidance on the approaches to market definition that the AMC uses. This issue is set for clarification in 2018. Some fine-tuning of merger control laws is also on the agenda, including removal of the seller from the calculation of turnover and assets as recommended by the OECD in the most recent peer review. Overall, Ukrainian competition laws are becoming more and more aligned with the best practices of other European countries and this should increase the predictability of law enforcement for businesses operating in Ukraine.