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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ROUNDTABLE ON COMPETITION ON THE MERITS

-- Note by Lithuania --

This note is submitted by the Delegation of Lithuania to the Competition Committee FOR DISCUSSION at its forthcoming meeting (1-2 June 2005).

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1. The Law on Competition of the Republic of Lithuania prohibits abuse of a dominant position. The prohibition can be found in the Article 9 of the law and it is very similar to the Article 82 of the EC Treaty:

Article 9. Prohibition to Abuse a Dominant Position

It shall be prohibited to abuse a dominant position within the relevant market by carrying out actions which restrict or may restrict competition, limit without justification the possibilities of other undertakings to act in the market, or violate the interests of consumers, including:

1. direct or indirect imposition of unfair prices or other purchase or selling conditions;
2. limitation of trade, production or technical development to the prejudice of consumers;
3. application of dissimilar (discriminating) conditions to equivalent transactions with certain undertakings, thereby placing them at a competitive disadvantage;
4. making the conclusion of contract subject to acceptance by the other party of supplementary obligations which, by their commercial nature or usage, have no connection with the subject of such contract.

2. Despite the fact that substantive norms concerning the prohibition of the abuse of a dominant position are very similar, the national case law in Lithuania is much less developed and at this time the Competition Council is much less constrained by the national case law than competition authorities in some other countries. Nevertheless, the Competition Council and the national courts usually take into account the EU case law even when only national law is applicable. Article 1 of the Law on Competition states that “[t]his Law seeks for the harmonisation of the Lithuanian and the European Union law regulating competition relations.” Although the exact meaning of this statement could be interpreted differently the present consensus is that the Competition Council and the national courts should always pay attention to the EU case law.

3. So far the approach taken by the Competition Council when investigating the cases of the abuse of dominance used to be very similar to the one applied by the Commission. Therefore many critical remarks and conclusions presented by John Vickers¹ and Alberto Heimler² with respect to the principles determining the types of conduct by a dominant firm that fall outside of the acceptable area (competition of the merits) apply not only to the cases decided by the European Commission but also to the ones decided by the Competition Council.

4. Nevertheless, the extent of the obligation to take the EU case law into account is ambiguous. The Competition Council agrees that a dominant firm “has a special responsibility not to allow its conduct to impair undistorted competition”³, according to the principle formulated by the ECJ in *Michelin v Commission*. However, the Competition Council also tries to pay the utmost attention to the principle that a

¹ John Vickers, “Abuse of Market Power,” Speech to the 31st conference of the European Association for Research in Industrial Economics, Berlin (3 September 2004), available at www.ofc.gov.uk/NR/rdonlyres/948B9FAF-B83C-49F5-B0FA-B25214DE6199/0/spe0304.pdf

² Alberto Heimler, “Pricing Below Cost and Loyalty Discounts: Are They Restrictive and If So When?,” monograph (2004), available online at <http://ssrn.com/abstract=634723>.

³ Case 322/81 [1983] ECR 3461, [1985] 1 CMRL 282.

dominant firm which “defeats” a competitor because of its superior economic efficiency should not be condemned⁴.

5. The Competition Council of the Republic of Lithuania completely agrees that a notion of “competition on the merits” should be given a more precise meaning. A test of an equally efficient competitor and/or consumer welfare test should be the guiding principles when deciding which type of competition is on the merits and which is not. The rest of this contribution to the roundtable will be based on the case study of the particular investigation conducted last year.

1. The investigation concerning possible violation of Article 9 of the Law on Competition by the leading brewery *UAB Svyturys-Utenos alus*

6. In 2003 the Competition Council opened the investigation concerning possible infringement of Article 9 of the Law on Competition by the leading brewery *UAB Svyturys-Utenos alus* after having received complaints from the rival breweries, that is *AB Kalnapilio-Tauro grupe*, *AB Gubernija*, *AB Ragutis* and one of the leading retail chains *UAB Norfos mazmena*. The alleged violator of the law was and still is the leader among the breweries in Lithuania. According to the research conducted by ACNielsen in Lithuania in 2004, 96% respondents think that the beer produced by *UAB Svyturys-Utenos alus* is the best local beer. In the segment of premium beer sold in hotels, restaurants, and cafes (further – HoReCa) *UAB Svyturys-Utenos alus* had 74% share in 2003. *UAB Svyturys-Utenos alus* share in the overall beer sales was slightly less than 40% in the same year.

7. Rival breweries claimed that the *UAB Svyturys-Utenos alus* offered supply contracts with loyalty discounts for the participants of HoReCa market that resulted in exclusionary effects. They alleged that because of such contracts *UAB Svyturys-Utenos alus* was able to strengthen its dominant position, inflict harm on competitors and reduce consumers’ choice.

8. During the investigation the Competition Council thoroughly examined the supply contracts and the overall market situation. It turned out that *UAB Svyturys-Utenos alus* indeed offered discounts to HoReCa participants in the contracts concerning sales promotion and advertising services. A typical contract contained a clause that a buyer of beer who accepted obligation to perform sales promotion and advertising services could receive an advance payment for those services from *UAB Svyturys-Utenos alus*. The final settlement concerning the payment for the services provided would be calculated on the basis of the total volume of beer purchased by the retailer from *UAB Svyturys-Utenos alus*. The brewery and the buyer agreed to calculate the monthly payment M_i for actually performed services according to the formula $M_i = d(V)V$, where V = volume of beer purchased during the month (in thousands of litres), $d(V)$ = payment rate that depends on V . From the table we can see that the payment rate schedule could be approximated by $d(V) = 100V$ as long as $V \leq 5$.

V , in thousand litres	$1 < V \leq 1.5$	$1.5 < V \leq 2$	$2 < V \leq 2.5$...	$4.5 < V \leq 5$	$V > 5$
d , LTL	100	150	200	...	450	500

⁴ “Article 86 covers practices that are likely to affect the structure of a market where, as a direct result of the presence of the undertaking in question, competition has already been weakened and which, through recourse to methods different from those governing normal competition in products or services based on trader’s performance, have the effect of hindering the maintenance or development of the level of competition still existing on the market.” Case 322/81 [1983] ECR 3461, [1985] 1 CMRL 282 at para 70.

9. At the end of the contract the parties agreed to settle their claims according to the formula:

$S = \sum_{i=1}^T M_i - A$, where $T \equiv$ contract duration, $A \equiv$ advance payment. When $S < 0$, the buyer had to pay the brewery $F = 2(A - \sum_{i=1}^T M_i)$ or to agree with the contract extension.

10. It is easy to see that when a retailer doesn't sign an agreement on sales promotion and advertising services he pays pV for V volume of beer, where $p \equiv$ constant price of a thousand litres. When a retailer signs an agreement but does not receive an advance payment for the alleged services, he pays an average monthly payment $pV - d(V)V = [p - d(V)]V$, where $V =$ average monthly volume of beer. In such a case $d(V)$ is just a quantity discount because it is related only to the bought volume of beer and doesn't depend on actually performed advertising or sales promotion services⁵. The effective purchase price of beer was $p - d(V)$ and it declined with the volume, therefore it was a clear case of non-linear pricing.

11. When a retailer not only signs an agreement but also accepts an advance payment and fulfills his contractual obligation he pays in a year $12pV + A - 12d(V)V - A = 12[p - d(V)]V$, where $V \equiv$ average monthly volume of beer. It is important that he can receive discounts only in some period T_0 when $\sum_{i=1}^{T_0} M_i - A$ becomes positive. When a retailer is able to reach only such level of annual purchases that $\sum_{i=1}^T M_i - A$ is negative, he has to pay a fine $F = 2(A - \sum_{i=1}^T M_i)$. Therefore in a year he pays $12pV + 2(A - 12d(V)V) - A = A + 12[p - 2d(V)]V$ or he has to agree on the contract extension with the remaining liability F . Thus the effective monthly purchase price when a retailer had to pay a fine was $\frac{A}{12V} + p - 2d(V)$.

12. Assuming that $d(V) = 100V$, the effective price for all retailers fulfilling contractual obligations is $p - 100V$ but doesn't fall below $p - 500$ for those exceeding $V = 5$. It is also possible to calculate a break-even volume⁶ $V_0 \approx 0.029\sqrt{A}$ for a retailer who accepts an advance payment. A retailer with a very small capacity, for example $V = 1.1$, would be induced to make all his purchases from the brewery if he accepted an advance payment⁷ of 1452 LTL or 420 EUR. When such a capacity constrained retailer fails to purchase V_0 by an arbitrary small amount he has to pay the effective purchase price $p - 100$. However, when he purchases only $V_0/2$, he has to pay the effective price $p + 110$.

13. The above analysis allowed to conclude that the offered contracts had the built in loyalty inducing incentive structure. However, the Competition Council examined a large number of contracts and found only an insignificant number of signed contracts with advance payments. There were no cases that a retailer had to pay a fine during the investigated period. The Competition Council concluded that the contracts had an abstract ability to create a lock-in effect for a retailer who accepted an advance payment

⁵ HoReCa participants actually performed some sales promotion and advertising services. However, they consisted mostly of informing customers about a possibility to participate in a lottery when buying a particular brand of beer. A winner could receive a prize ranging from a free beer to a trip to some important sports competition. Nevertheless, the discounts were directly determined by the volume of the purchases and not by the efforts of sales personnel.

⁶ A break-even volume can be found from the condition $A - 12 \cdot 100V \cdot V = A - 1200V^2 = 0$.

⁷ $A = 1200 \cdot 1.1^2 = 1452$

and constrain his abilities to change a supplier. However, there was no ground to believe that they had any significant effect on competition. In 2003 *UAB Svyturys-Utenos alus* sold only 4.45% of all its beer in the HoReCa market through the retailers that accepted advance payments. Absolute majority of HoReCa participants stated that they prefer to buy *UAB Svyturys-Utenos alus* production because of the preferences of the customers. Finally, the Competition Council took into account the fact that the market share of the alleged violator of the law significantly declined during the investigated period.

14. Nevertheless, the question remained whether the quantity discounts were objectively justified by the cost savings or by provision of actual services by the retailer. The quantity discounts also could have been simply a loyalty-inducing instrument. It was obvious that discounts offered by *UAB Svyturys-Utenos alus* were not individualized target discounts. However, they would have been if advance payments had been individually *imposed* on each retailer. In the analysis of the discounts the Competition Council decided that an equally efficient competitor should be able to match the offer made by *UAB Svyturys-Utenos alus*. The situation in the Lithuanian beer market could be characterised as an oligopoly, however, effectively competitive. The market is growing, though prices are not. Shares of the major market players are not stable. The main competitor of *UAB Svyturys-Utenos alus* is of similar productive capacity and doesn't fall behind in technological innovations. Without going into a deep economic analysis the Competition Council concluded that at least the main rival was able offer comparable quantity discounts and that the benefit of such aggressive pricing was passed to the final consumers.

15. Therefore the only competitive concern was the penalty payment that a retailer had to pay to the brewery when he accepted the advance payment but failed to reach a break-even volume of purchases. During the investigation phase the Competition Council raised its concerns and the investigated party agreed to modify the contracts and waived the claims for the penalty payments imposed upon retailers. *UAB Svyturys-Utenos alus* also assumed an obligation to refrain from imposing such conditions in the future. The Competition Council also took into account that investigation did not find any significant anticompetitive effect of such clauses but only an abstract possibility and decided to terminate the investigation. One of the rival companies that submitted the original complaint appealed the decision of the Competition Council to the Court. At present time only some procedural questions but not the substance are being investigated.