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PROHIBITION OF UNFAIR RETAIL PRACTICE – LET'S GET TO THE NITTY-GRITTY!

The unfair retail regulation nicely wrapped just like a Christmas gift under a Christmas tree will be shortly presented to the retailers and suppliers of Latvia.

Namely, on 1 January 2016, the Unfair Retail Practice Prohibition Law (the **Law**) will come into effect, and thus the contradictory regulation prescribing for the prohibition of abuse of dominant position in retail will be deleted from the Competition Law (the **CL**). There are essential changes directly in respect of the retailers of food products, since the prohibited activities will be applicable to all retailers of food irrespective of their actual market power.

The new Law will be applicable to approximately 2,000 food retail companies in Latvia, including 12 food product retail chains and unions, as well as to the largest non-food product retailers.¹

Thus the changes caused by the Law will be less felt by the largest retail chains that have already been subject to the prohibition of abuse of dominant position in retail (Rimi and Maxima). It is expected that more attention will be paid to the unions of retailers that have already been subject to the market supervision by the Competition Council (the **CC**) after establishment of certain potential non-compliance with the Law during their activities from 2007 to 2014.²

Likewise the CC has prepared and delivered for public discussion the draft Guidelines for the Unfair Retail Practice Prohibition Law (the **Draft Guidelines**).³

Currently, amendments to Cabinet Regulation No. 796 "Procedures for the Determination of Fines for the Violations Provided for in Article 11(1) and Article 13 of the Competition Law" adopted on 29 September 2008 have been submitted to the Meeting of the State Secretaries, and they will govern the procedure for calculation of fines for the breach of the Law.

Meanwhile, the European Commission has also evaluated the relationship of the retailers and suppliers (the so-called B2B or business-to business relationship) from the competition law perspective. Similar regulations are being developed in other Member States as well, and there have

been proposals for regulation of the relationship between suppliers and retailers on the EU level.⁴

In general, the Latvian regulation, the general trend in other Member States of the EU and the approach of the European Commission are aimed at fair regulation of such relationship between a retailer and a supplier that has been separated from the "classical" norms of the competition law (similar to the approach to the consumer right protection). In its essence that regulation is a part of the commercial law, the creation whereof has been based on the competition and consumer protection goals.

The Competition Council tried to clarify the current reaction of the involved parties with respect to the contents of that Christmas gift in the conference on fair cooperation of retailers and suppliers organised on 27 November 2015, where various opinions of all the interested parties were represented in the presentations.

However, the overall state of mind at the conference witnessed of the incomprehension of the new regulation and a lot of uncertainty. Given such background, the structure of the conference establishing as if two fronts – suppliers vs retailers – did not ensure comfortable environment disclosing the actual problems the parties face in practice with respect to the new regulation. The Law is definitely perceived very cautiously and to some extent also as an encumbrance for both parties.

Although the Law will come into effect as from 1 January 2016, suppliers and retailers have been actively working at the incorporation of the regulation into their agreements and in practice for quite a period of time. It turned out to be at least as hard as expected. On the one hand the retailers are significantly restricted in their commercial activity, which fact will make them less flexible in respect of any transactions with suppliers – the supplies will be standardized, and any variations will be limited, the assessment thereof will take additional time, etc. On the other hand, the suppliers expect practical difficulties in the practical application of the norms of the Law in

¹ Annotation, available at: <http://titania.saeima.lv/LIVS11/saeimalivs11.nsf/0/6AF59FDD1FD653EDC2257C66003BD8FB?OpenDocument>.

² Final Report of the CC market supervision "Retail of Daily Consumer Goods: Procurement Groups (period of analysis 2007-2014)"

³ The draft Guidelines, available at: <http://kp.gov.lv/documents/e29b1a97d1968e9f4c2da956c7486ce72552efb5>

⁴ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions „Tackling unfair trading practices in the business-to-business food supply chain”. Available at: http://ec.europa.eu/internal_market/retail/docs/140715-communication_en.pdf. See also: http://ec.europa.eu/internal_market/retail/docs/140711-study-utp-legal-framework_en.pdf; Green Paper on Unfair Trading Practices in the Business-to-Business Food and Non-food Supply Chain in Europe /* COM/2013/037 final - 2012/ () */, available at: <http://eur-lex.europa.eu/legal-content/LV/TXT/?uri=CELEX:52013DC0037>; Opinion of the Competition Council: http://ec.europa.eu/internal_market/consultations/2013/unfair-trading-practices/docs/contributions/public-authorities/latvia-competition-council_lv.pdf.

negotiations with the retailers, since the critical role is still played by the purchasing power of a retailer against the supplier and the fear of suppliers of later sanctions, either direct or indirect, against the supplier, if it objects against unfair terms or addresses the CC. It already turned out during the conference that the new regulation does not currently prevent the endeavours of a retailer from including a set of terms in the new agreements that are flatly contradictory to the Law.

RETAILERS SUBJECT TO REGULATION

If previously the limitations prescribed in Article 13 of the CL were attributable solely to such a retailer that had the dominant position in retail, then the Law is applicable to all food product retailers without exception, as well as to retailers having substantial influence on the non-food product trading.

A food product retailer is a performer of operational activity selling food products in retail at its permanent place of trading, or a union of performers of operational activity selling food products.

A retailer having substantial influence in the non-food product trading is a performer of operational activity that, considering its purchasing power during a sufficiently long period of time and the dependence of suppliers in the relevant market, is able to apply or impose, either directly or indirectly, unfair and unjustified terms, conditions or payments on the suppliers, and is able to delay, restrict or distort competition in retail in any relevant non-food product market within the territory of Latvia. Namely, only the largest non-food retailers actually correspond to that definition rather than any retailer, as it is in the case of food retail.

WHAT ACTIVITIES ARE PROHIBITED TO THOSE RETAILERS?

As a general provision (general clause) the Law prescribes that a retailer is prohibited to perform activities, which contradict to the decent operational activity practice and which impose the retailer activity risk on the suppliers, determine additional obligations or limit the possibility to freely operate in the market.

Moreover, the new Law (Article 6) prescribes particular requirements that one is prohibited to impose on a supplier in the food product retail. Likewise, the Law (Article 7) prescribes particular requirements that one is prohibited to impose on a supplier in the non-food product retail. The Law separately specifies the provision that it is prohibited to determine unfair and unjustifiably long periods for payments for the supplied products (Article 8).

It is not prima facie clear from the wording of the particular norms, whether, in case the parties intend to freely agree on such terms, it will be deemed that the retailer has

proposed/determined such requirements. Concurrently, analogous to the conclusions of the Supreme Court on the regulation of the dominant position in retail, the fact that the particular supplier (contractual party) does not consider that its rights have been infringed shall have no significance from the perspective of the Law, since it has not been prescribed by the law that a mandatory application of the injured party is required for the activities to be performed by the CC.⁵ The summary of the Law also states that the supplier's agreement to the terms of the agreement does not necessarily mean that those terms are fair and justified. It may be additionally explained also by the fact that it is not possible for a retailer to assess the risk, that a supplier may, at any moment, argue that the retailer has imposed such requirements on the supplier by using its purchasing power. Therefore, although the regulation of the Law has been intended as the limitation of the retailer's rights, in fact it means that the parties will not be able to freely agree on the particular terms, even if the supplier is interested in such terms.

Thus, in its essence the particular regulation protects not only the supplier within its relationship with the retailer, but indirectly also the small suppliers in their competition with more powerful suppliers that might have an objective interest and the necessary resources for payments for the shelf spaces, additional discounts, etc.

The Law explicitly prescribes that it is prohibited to impose the following requirements on the supplier in the food product retail:

1. To directly or indirectly pay for or otherwise compensate the conclusion of the agreement.
Not only a single payment, but any other bonuses, incl., in the form of further discounts, unilateral request of marketing payments in monetary terms, price reduction or supply of free products, etc., which in their essence are the "entry fee".
2. To directly or indirectly pay for the location of products in the retail place, including for placement of products on the store shelves, save the case when the retailer and the supplier have made a written agreement that prescribes for a fee for additional placement of products in special places.
The prohibition applies to the permanent places for placement of products: Not only a single payment, but any other bonuses, incl., in the form of further discounts, unilateral request of marketing payments in monetary terms, price reduction or supply of free products, etc., which in their essence are the "shelf fee".
Direct payments observed in practice – the supplier undertakes to make a payment to the purchaser for

⁵ The rulings are available at:
http://www.kp.gov.lv/files/pdf/2011_e02-4.pdf,
https://www.tiesas.lv/files/AL/2012/09_2012/24_09_2012/AL_2409_apg_AA43-0017-12_16.pdf

the input of each new product in the database or a payment for each case of change in the prices for the supplied products. Indirect payments / bonuses – the retailer uses the inventory (pallets, boxes, freezers, etc.) owned by the supplier free of charge for placement, transportation of the products of another supplier or forces on the supplier an unjustified proportion of pallets to be written down, i.e., non-returnable, etc.

3. To compensate the unearned profit of the retailer from the sale of the products supplied by the supplier.
E.g., in cases when the products are sold at cost close to their date of expiry.
4. To compensate the expenses of the retailer related to equipping of new stores or updating of the old stores, including making unfair and unjustified payments for the supply of products to the retail point to be opened.
5. To purchase products, services or property from a third party specified by the retailer, save the case, when there is an objective substantiation for that and a separate written agreement has been concluded regarding purchase of those products or services.
6. To ensure the lowest price thus limiting the supplier's freedom to agree on a lower price with another retailer.

Inter alia, the obligation to specify to the retailer the prices applied by the supplier to the relationship with other retailers may indicate of such a restriction.

7. To change the product specifications, including the assortment, if the supplier has not been notified thereof by the deadline specified in the agreement, which shall not be less than 10 days.
8. To accept the return of unsold food products, save low-quality products and new food products unknown to consumers, the supply or the increase in the volume of supply whereof has been initiated by the supplier.

E.g., as the result of inexpedient forecasts of market trends or erroneous planning, the ordered and unsold products are delivered back without compensation of loss incurred by the suppliers from such return of products.

Such provisions that entitle the retailer to unilaterally return the previously ordered products at its own discretion, including the provisions:

- on the return of products at any moment, e.g., during the period of validity, close to the date of expiry or after the date of expiry;
- on the return of products after the product sales promotion events (campaigns);
- on the return of products due to the optimisation of the product assortment;
- on the return of products due to the reduction in the demand for the products;
- on the return of seasonal products;
- as well as on the terms that in their essence replace the return of products, e.g., by

prescribing that the retailer shall pay a certain fee for the failure to return the products.

In any case, the return of ordered products that have lost their quality by the fault of the retailer shall be considered unfair and unjustified.⁶

9. To directly or indirectly pay to the retailer for the sales promotion events or otherwise compensate all the expenses for such events or any part thereof, save the case, when the retailer and the supplier have made a written agreement on the sales promotion activities.
10. To compensate the expenses related to review of the consumer complaints, save the case, when the justified complaints of consumers follow from the circumstances, which are the responsibility of the supplier.
11. To determine unfair and unjustified sanctions for the breach of the contractual terms.
12. To make payments (apply discounts) to the retailer that are unfair, unjustified or not prescribed in the agreement, save the case when the retailer and the supplier have agreed on the volume discount (the discount applied depending on the volume of ordered products) or a campaign discount (the discount applied for the sales promotion of products during a limited and specified period of time).
In order to identify the hidden payment, the terms of the previous agreement will most probably serve as the basis and the costs will be compared.
13. To compensate the retailer's expenses related to the retailer's expenses for the logistics services, save the case when the retailer and the supplier have made a written agreement on the distribution of products.
14. To compensate the retailer's expenses related to the expenses for administration thereof.
15. To determine unfair and unjustifiably long periods for payment for the supplied products.
 - a) The time period for payment for fresh vegetables and berries supplied by the producer or the cooperative company of producers, the supply whereof shall be performed at least three times per week, shall be unfair and unjustifiably long, if it exceeds 20 days as from the day of supply of the products, save the case when an agreement has been made with the supplier on another payment deadline, so far that it does not contradict the provisions of paragraph one of this clause.
 - b) The time period for payment for the supplied food products, the validity period whereof is not longer than 25 days, shall be unfair and unjustifiably long, if it exceeds 30 days as from the date of supply of the products.

⁶ For more information please refer to Guidelines to application of Article 13(2) of the Competition Law, available at: <http://www.kp.gov.lv/documents/9d396409afc09362cc57c6bad6b258f1c731c15b>.

16. To apply the campaign discount to the products not sold during the sales promotion, save the case when the retailer and the supplier have made a written agreement on the application of the campaign discount to the products not sold during the sales promotion.
17. Fail to accept from the supplier the food products that may be used for at least two thirds of the validity period determined for them, if such period exceeds 30 days.
18. To changes the order of food products two days prior to the supply of the products or later.

The new Law does not explicitly govern, whether it will be allowed to apply a fee for the promotion of a new product unknown to the consumers in the market. However, considering the general understanding and the currently valid regulation (Article 13(2) of the CL), a, objectively justified fee for the promotion of a new product unknown to the consumers in the market should not be considered unfair and unjustified. However, such a restriction required special assessment. The applicable payments shall be justified by a particular economic reasoning, and the actual risk undertaken by the retailer in such case shall be assessed.⁷

While in the non-food product retail it is prohibited to impose the following requirements on the supplier:

1. To directly or indirectly pay for or otherwise compensate the conclusion of an agreement, unless the payments are justified by the fact that the agreement is made with a new supplier that requires special assessment.
2. To directly or indirectly pay for the location of products in the retail place, including for placement of products on the store shelves, save the case when the retailer and the supplier have made a written agreement that prescribes for a fee for additional placement of products in special places.
3. To compensate the expenses of the retailer related to equipping of new stores or updating of the old stores, including making unfair and unjustified payments for the supply of products to the retail point to be opened.
4. To accept the return of unsold products, save low-quality products and new products unknown to consumers, the supply or the increase in the volume of supply whereof has been initiated by the supplier.
5. To determine unfair and unjustified sanctions for the breach of the contractual terms.
6. To determine unfair and unjustifiably long periods for payment for the supplied products.

Pursuant to the summary of the Law, the aforementioned list of prohibited activities is exhaustive.

⁷ For more information please refer to Guidelines to application of Article 13(2) of the Competition Law, available at: <http://www.kp.gov.lv/documents/9d396409afc09362cc57c6bad6b258f1c731c15b>.

WHO IS RESPONSIBLE FOR THE BREACH OF THE LAW?

The breach of the Law may be established by the CC and the court according to the procedure prescribed in the Civil Procedure Law. It has been additionally prescribed that persons are entitled to receive a respective compensation for the infringement of the interests protected by the Law (Article 4 of the Law).

The CC, at its own initiative, initiates an investigation case with respect to the breach of the Law. The suppliers are entitled to provide the information on the potential breach to the CC. Thus the supplier may not request initiation of a case of breach, and the CC does not have an administrative legal obligation to respond to the information provided by the supplier in any manner.

The supplier is a person selling products to the retailer, pursuant to the agreement made with the retailer (Article 1 of the Law). Thus, the information may be provided not only by the injured supplier, but also by its competitors that have signed an agreement with the particular retailer. It is concurrently clear that the potential competitors that do not have an agreement with the retailer, as well as any third party may submit the information to the CC, and it is expected that the CC will take such information into consideration.

If the CC establishes a breach in the activities of the retailer, it will adopt a decision on the establishment of breach, imposition of legal obligation and a fine of up to 0.2% of its net turnover for the preceding reporting year, but no less than EUR 70.

In its essence, the penalty for the breach of the Law may be imposed only on the retailer. The supplier that has agreed with the retailer on the terms incompliant with the Law shall not be directly held liable to the CC or any third party. In case of establishment of the breach, indirect risks and adverse consequences may be concurrently caused to the supplier. E.g., the supplier shall take account of the prohibition of the CC to apply the particular terms in future.

The retailer has an additional risk that, in case of establishment of the breach, the "injured party" may bring a claim to the court for compensation of loss incurred as the result of the unfair retail practice. E.g., irrespective of the fact that the supplier has agreed with the retailer on the payment for the shelf places, the supplier may, at a later stage (especially if the CC has established the breach and the supplier itself does not have to prove that), bring a claim to the court against the retailer regarding compensation of the payments made by the supplier.

Likewise, a competing supplier might bring a claim to the court against the retailer for the compensation of loss, if it has learned that its competitor agreed with the retailer to the contrary of the provisions of the Law.

From the practical perspective though, it should be taken into account that third parties have considerable difficulties in provision of adequately detailed information and evidence on the contractual obligations of the retailer and the supplier, as well as to prove the particular amount of loss incurred by the competitor.

The CC might objectively lack resources for investigation of large cases on the potential breach of the Law; therefore the priorities of the CC in review of the cases are important.

Currently the priorities of the CC are disclosed in the CC Case Prioritisation Strategy.⁸ It follows from the strategy that abuse of the dominant position in retail (which is analogous to the new Law) has been assigned a comparatively low priority and is subject to such qualifications as: horizontal cartel agreement or agreement containing limitation of goal, abuse of dominant position (excluding activity); abuse of dominant position; prohibited agreement after consequences.

It is expected that at the beginning of 2016 material amendments to the CL might be adopted that, inter alia, will contain the rights and principles of the CC for the prioritisation of cases. The main priorities to be assessed by the CC when initiating a case will be the most severe breach of the CL (cartels), as well as the breach having significant influence on the competition or the collective interest of consumers, maximum efficient use of financial resources assigned to the institution, the topicality of the respective market sector.⁹

Should you have additional questions or comments with respect to the above please do not hesitate contacting us. Likewise, we would appreciate you informing us on other topical issues in the competition area that you face in practice and that would be useful for inclusion in our future newsletters.

⁸ The strategy is available at:
<http://kp.gov.lv/documents/658e9dd72abcd62835ece1c26c14eb04a161acb0>

⁹ The summary is available at:
<http://titania.saeima.lv/LIVS12/SaeimaLIVS12.nsf/0/B079BC5404CC6F91C2257E500027E87B?OpenDocument>

Contacts:



Andra Rubene
Partner, Attorney at Law
andra.rubene@tgslegal.com
+371 67 88 9999



Māra Stabulniece
Senior Associate
mara.stabulniece@tgslegal.com
+371 67 88 9999



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