Antitrust Legislation in Russia: Recent Trends, Achievements and Threats

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Need for competition policy in Russia

- Structural distortions inspired by specialization in international markets and/or inherited from Soviet economy:
  - High contribution to GDP by industries with high concentration (extracting activities – oil. gas, aluminum, copper, nickel etc)
  - High concentration in many markets which *could be* not so concentrated
    - In 2001 25% of General Directors of manufacturing companies indicated that they could not change the supplier of main input
  - High entry cost (including administrative procedures)
- Mental distortions inherited from planned economy and supported by recent development of political system
  - Secondary importance of freedom and competition in comparison with recent economic policy objectives

Need for tight antitrust enforcement in Russia as a transition economy

- In countries with poor institutions antitrust enforcement implies a risk of misuse
- Even under 'formal content' of rules harmonized with 'world best practice' , enforcement (including standards of proof) can differ much
- 'Decentralized globalization' (Geradin)
  - source of numerous errors (both Type I and Type II)
  - source of additional burden on business
  - not only multinationals those suffer from 'decentralized globalization' (Geradin) but also national business
- So, gains from tight antitrust enforcement in emerging market economies are not evident

Objectives of survey

- To show adverse development of 'European-style' antitrust norms in Russia
- Using three examples:
  - 'antitrust prohibitions' in relationships between suppliers and retail chains
  - antitrust prohibitions on parallel behavior of sellers and high prices in the market where incentives to collude are proven
  - antitrust prohibitions on variations in contract terms
- To show that weak interpretation of 'European-style' rules and low standards of proof not only lead to type I errors (false positives) but also can prevent competition
- To find common causes of adverse evolution of antitrust rules

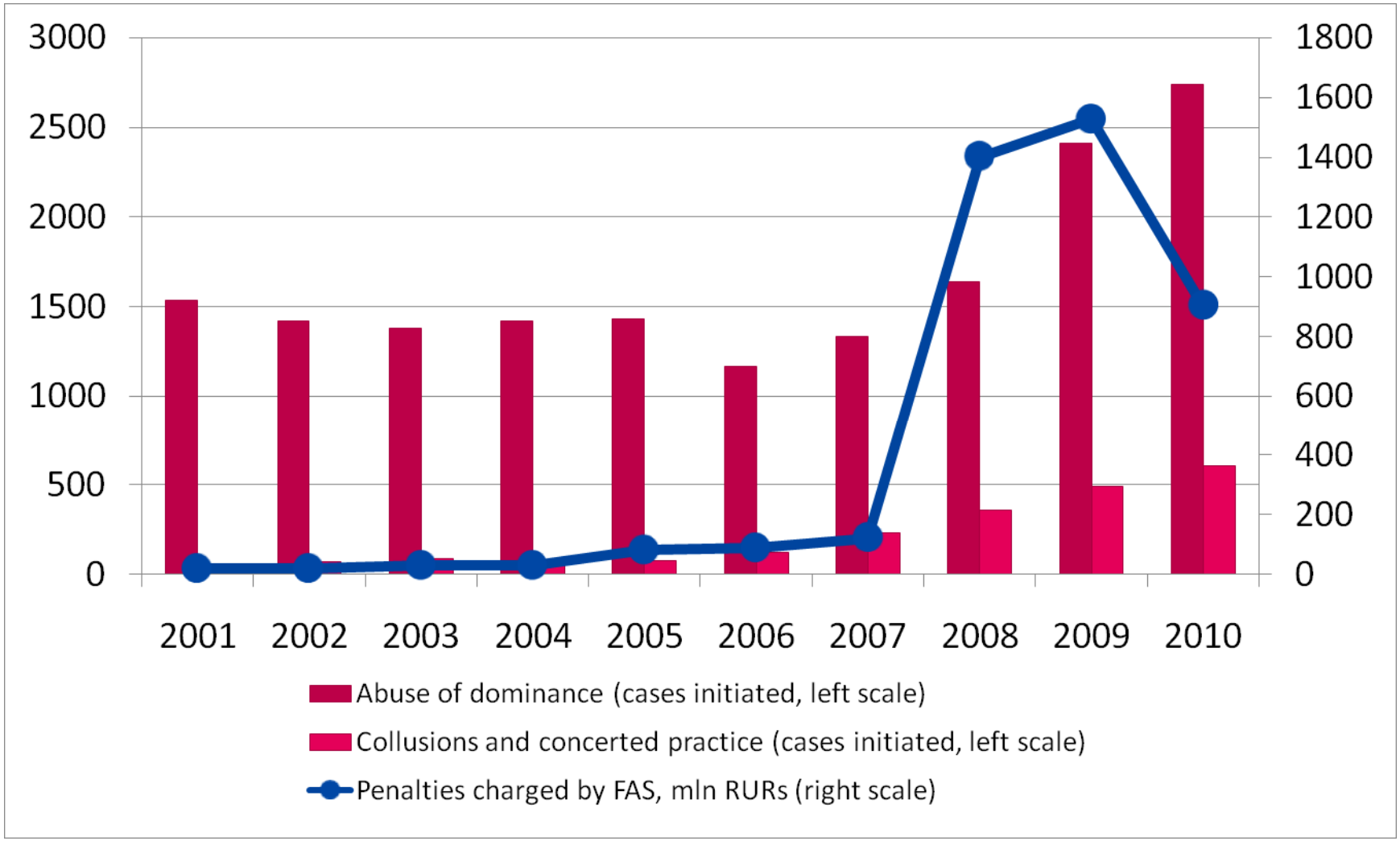
Plan of presentation

1. Recent development of antitrust policy in Russia: strengthening enforcement power vs. relatively weak norms
2. Danger of industry-specific antitrust rules: on the example of the Law "On the Fundamentals of State Regulation of Trading Activity in the Russian Federation" (Law On Trade)
3. Efforts to battle collusion: battling "something that seems like collusion"
4. 'Exploitative' abusive practices: on the example of *discrimination*
5. Search for explanation: why adverse evolution of rules takes place?

Russian antitrust: content of rules *vs* power of enforcement

- Russian antitrust authority is among the biggest in the world (central office + regional branches, about 2500 officers)
- Ten years ago Russian antitrust enforcement was a system of 'relatively good rules without enforcement'
- Fixed and very low threshold of sanctions for violations of competition rules (till 2007 – up to 0,5 mln RUR = 12 thous Euro)
- Effects of antitrust enforcement were low but cost of Type I errors also low
- Activity was skewed towards merger notification and cases against public authorities
- In 2007 *turnover penalties (*up to 15% of company turnover *on relevant market)* were introduced
- At the same time number of antitrust cases *against market participants* increases

Enforcement of antitrust rules: some statistical data



Increasing impact of antitrust on companies' behavior

- Deterrence effect increases
- Cost of Type I errors increases too
- Type I errors are not the only threat to effectiveness of antitrust legislation
- More dangerous is the threat of antitrust enforcement to competition

Example I: Law 'On Trade' (2009)

- The main goal according to the authors is to restrict market power of food retail chains
- Law includes three main types of provisions:
  - restriction of expansion of food retail chain by 25% in geographical market (defined as municipality)
  - **prohibition of certain types of terms in contracts between suppliers and food retail chains**
  - rules on price regulation of certain 'socially important' goods (minimum consumer basket)

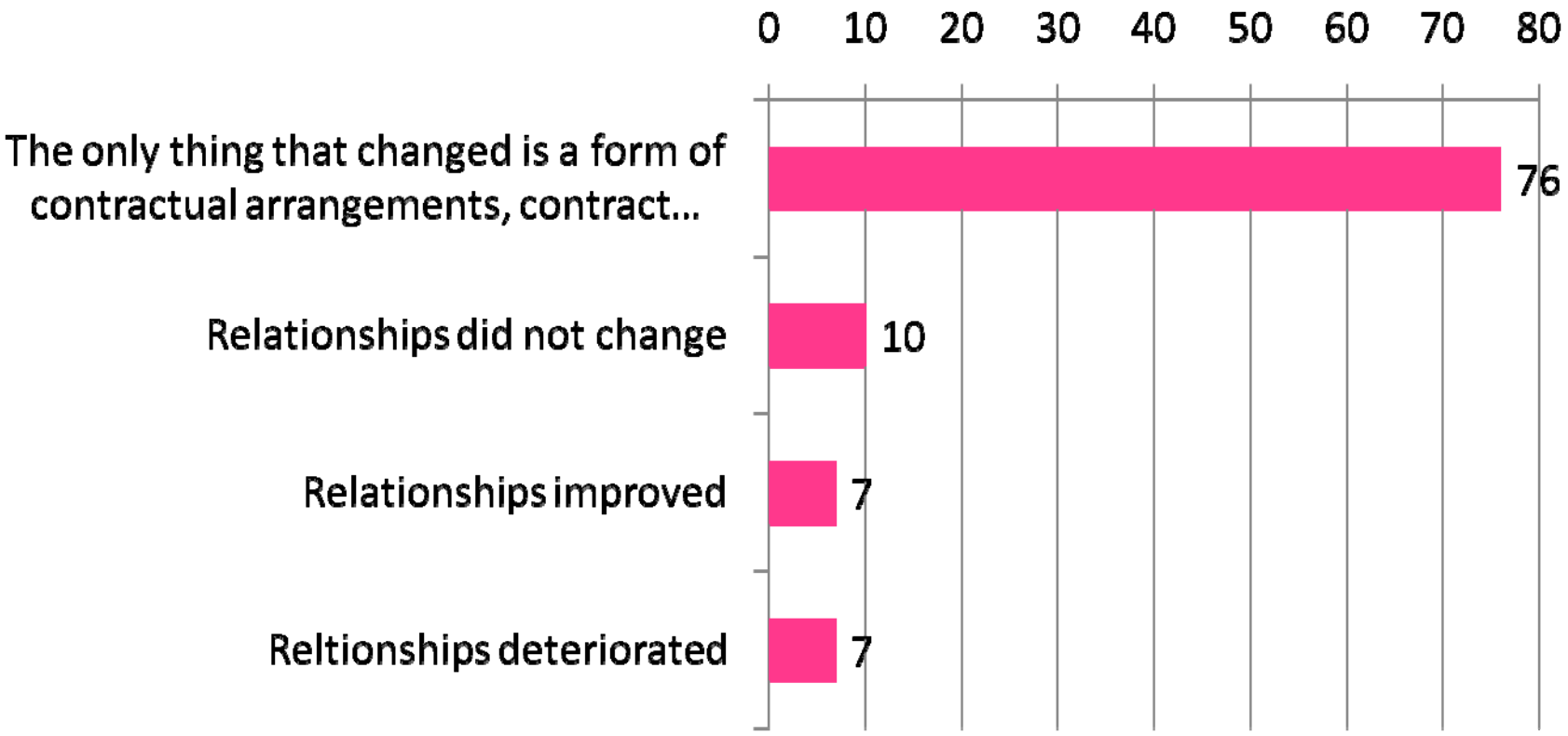
What and why is prohibited by Law 'On Trade' (for instance)

- To discriminate suppliers (according to Federal Antitrust Service – to vary terms of contract across suppliers)
- To request a quantity discount exceeding 10% of the wholesale price
- To return unsold products to suppliers
- To demand from suppliers information on terms of contracts with other retailers
- To include in contracts a most-favored nation clause

- It is evident that the goal of the norms is not to protect competition but to support food suppliers
- What are the effects of rules on conduct and performance of market participants and competition?

According to food suppliers, in 2010 impact of Law on contracting practice is minor

Do you think relationships between suppliers and food retail chains improved due to Law 'On Trade' adoption? (Ernst and Young company survey), % respondents



Possible adverse effects of provisions on contract arrangements

If I should follow the rule of universal terms of contract with incumbent/ supplier of branded product/ supplier of quality known by consumer (type I supplier) and new supplier/ supplier of non-branded product/ unknown quality (type II supplier), I have the following three options

	Effect for food retail chain	**Effect for competition**
'pay over the odds' to type II	decrease of profit	decrease of incentive to contract type II
vary terms of contract according to characteristics of suppliers	increase of the risk of antitrust prosecution	decrease of incentive to contract type II
employ 'shadow' contract term (pay-back) in order to vary contract terms	increase of monitoring cost	decrease of incentive to contract type II

Example II: concerted practice and excessive price of collectively dominant suppliers as tacit collusion

Concerted practice

(defined as conduct)

Standards of proof: *parallel behavior* (including 'price umbrella'),

market analysis is rare,

effect analysis – almost never

Excessive price of collectively dominant suppliers

(*defined* as market structure + performance)

Standards of proof:

1) market structure subject to a risk of collusion (high concentration, high entry cost, market transparency)

2) *'high monopolistic price'*

- Price exceeding the price of comparable competitive market (but standards of comparability are overstated)
- or price exceeding cost + 'normal' profit

Impact on provisions on concerted practice and excessive price of collectively dominant suppliers on competition

Concerted practice

- incentives for horizontal expansion on the markets with high share of large supplier and low share of competitors

Excessive price of collectively dominant suppliers

- reinforcement of price regulation in competitive (though imperfect) markets
- all inefficiencies which follow from price regulation
  - agency problem (overstatement of cost, no incentives for cost-saving)
  - ratchet effect etc/
- problems with interpretation 'necessary cost and necessary profit'
- decrease of incentives to enter the market

Example III: *discrimination* as a form of abuse of dominance

- *Discrimination* (as variation of contract terms) is illegal not because it restricts competition but because it harms counterparty (Supreme Court RF: to prove abuse of dominance it is enough to show that harm takes place)
- *This approach suggests that even discrimination increasing welfare can be considered as illegal*
- Standards of proof: not only the impact on competition but also equivalence of transaction is completely ignored
- *Example* I: vertical integrated oil companies where admitted guilty of discrimination (even not systematic) because of different price for independent downstream companies and their own subsidiaries
- *Example* II: a subsidiary of pharmaceutical company was admitted guilty for refusing to sign a contract with distributors, disagree on due diligence inspections

Impact of norms on *discrimination* on competition

- Risk of *strategic accuse* of discrimination is high since cost of complaint to Federal Antitrust Service is low, and all further investigations and litigations are financed by FAS
- Hierarchy as a form of transaction governance becomes preferable in comparison with market or hybrid transaction governance:
  - For vertical integrated company supplying to independent downstream buyer the risk to be accused of discrimination is higher than in the case it does not supply independent downstream market participants at all
  - For companies applying any criteria to select distributors the risk to be accused of discrimination is higher than in the case they develop their own distribution system
- Incentives for vertical and horizontal expansion increase
- Ceteris paribus deteriorating conditions for competition

Search of explanation: why antitrust provisions are applied for purposes alternative to protection of competition

- Objective-setting by Government RF:
  - Antitrust policy *should* protect public interests
  - Results of antitrust enforcement *should* be visible (low prices)
  - Priority of antitrust enforcement *should be* markets of public interest (*downstream oil markets, food and beverage markets, pharmaceutical markets)*
  - Externalities and long-term effects of antitrust enforcement on competition are underestimated
  - Type I errors are not a problem
- Structure of antimonopoly policy in Russia
  - Too many responsibilities (antitrust, sector-specific regulation, protection of consumers, control of investments in strategic enterprises, public procurement, state aid, agreements between government authorities and firms, unfair competition, advertising…)
  - Measures of competition policy are mixed with regulation measures
  - Protective and proactive competition policy are not divided enough

Conclusions

1. Strengthening enforcement power in Russian antitrust policy reveals the risks associated with poor understanding of rules in force
2. As a result, antitrust rules become a source of Type I errors and even restrictions of competition
3. 'Poor interpretation' of antitrust rules is not accidental: in many (if not all) cases it follows from the desire to achieve the goals of competition policy (or even other policy objectives) by applying antitrust prohibitions
4. That is, applying protective methods of competition policy even in cases when proactive competition policy (or no competition policy at all) is needed

Thank you for your attention