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Navigating Russia's Trade Regime

1. INTRODUCTION AND SCOPE OF THE TRADE LAW

Since shortly after the introduction of Russia's Federal Law No. 135-FZ "On the Protection of Competition" (the "**Competition Law**") in October 2006, the Federal Antimonopoly Service "**FAS**") has been emphasizing the need for additional regulation of the trade sector. In particular, FAS has pointed to the many Russian and foreign retail chains whose market shares typically fall short of market dominance but whose market position is significantly stronger than that of their suppliers, which in FAS' view has resulted in questionable business practices and vertical dependencies within distribution chains. After a long-lasting dispute about the necessity of sector-specific regulation and heated debate over the details of specific restrictions, the Federal Law "On Principles of State Regulation of Trade Activity in the Russian Federation" (the "**Trade Law**") was adopted at the end of 2009. The Trade Law entered into force on 1 February 2010.

The Trade Law applies to all types of wholesale trade activities carried out in the Russian Federation, and trade in food products in particular. The Trade Law is based on the general principle of freedom of trade, which means that undertakings are free to determine themselves the type of trade (wholesale and/or retail), form of trade (sale out of premises or outlets, distance selling, etc.), scope of promotion and advertising activities, terms and conditions of their contractual relationships, etc. Such freedom of trade is, however, restricted by certain limitations, set forth in the Trade Law, which are discussed in more detail below.

The Trade Law does *not* apply to areas that are specifically regulated with separate regimes. Excluded from the scope of the Trade Law are, therefore, any

- cross-border trade, whether by way of import or export;
- retail trade to end customers;
- trade at commodity exchanges; and
- trade in securities, real estate and production assets, including electric power, heat and other energy resources.

The restrictions regulated by the Trade Law affect any trade activity, and contractual relationships in particular. Most of the restrictions apply to agreements involving any vertical arrangement between producers, distributors, wholesalers and/or retailers. The restrictions are effective from the date the Trade Law came into force, i.e. from 1 February 2010. As for agreements entered into before this date, the Trade Law permitted an interim period of 180 days within which existing agreements had to be brought into line with the new rules, i.e. on or before 30 July 2010.

The Trade Law introduced a new system of trade registers in which all undertakings engaging in trade activities (except manufacturers) within a particular region are recorded. The trade registers are to be kept by regional authorities and they are mainly for statistical purposes. It is important to note that registration with a regional trade register is *not* a legal prerequisite that must be met in order to carry out trade activities in any particular region.

Key Issues

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2. SUPPLY OF FOOD PRODUCTS

2.1 General restrictions applying to all supplies of food products

The Trade Law contains a set of restrictions that generally apply to any agreement for the supply of food products. Food products include (i) food, (ii) bottled water, (iii) all types of beverages (alcoholic and non-alcoholic), (iv) chewing gum, (v) food supplements, and (vi) biologically active supplements. With respect to such agreements, the main restrictions can be summarised as follows.

(i) Discounts and bonuses

The Trade Law requires that agreements for the supply of food products must not provide for any type of discounts (bonuses) to purchasers other than those permitted by the Trade Law. As for permissible discounts, the Trade Law only envisages one type of discount for agreements to supply food products, namely if such discount is pegged to the purchase of specific volumes of products (a "**volume bonus**"). The Trade Law states that such volume bonus must "be included in the overall price under the agreement but cannot affect the price of the goods". This provision is somewhat ambiguous but is understood to mean that the volume bonus must take the form of a retro-bonus. In other words, the purchaser pays the normal price of the products, which is not as such affected by the volume bonus, and the supplier pays the bonus solely in light of certain purchase volumes having been exceeded. Moreover, the volume bonus must not be reflected by the purchaser in its price for products when reselling them within the distribution chain.

The Trade Law requires that the volume bonus must not exceed 10% of the price of the products. The question of how to correctly calculate this 10% threshold remains, however, open. For example, it is unclear whether the threshold should be based on the price of all products purchased under a specific agreement or on the price of products purchased as a particular consignment. While there appear to be stronger arguments in support of the latter interpretation, it remains to be seen how the provisions will be applied by the authorities and the courts.

Finally, volume bonuses are not permitted in relation to so-called "socially important" food products. These are products included on an official list that is to be kept by the federal government but which has yet to be adopted.

(ii) Promotional activities

The Trade Law requires that agreements for the supply of food products must not regulate promotional activities by traders. Promotional activities of any kind (advertising, marketing, merchandising, etc.) may only be agreed on the basis of separate services agreements between suppliers and purchasers. In addition, it is prohibited for traders to require that such services agreements be entered into as a prerequisite to purchasing food products under supply agreements.

In light of the above rules, one may expect that many market participants will continue to apply various types of discounts that they used in the past by incorporating them into the structure of separate services agreements. The effectiveness of the rules will, therefore, largely depend on how FAS and the courts will scrutinize these services agreements.

(iii) Assignment

The Trade Law prohibits that agreements to supply food products contain restrictions on assignments to third parties or any sanctions essentially having the same effect.

(iv) Payment periods

The Trade Law prescribes mandatory time limits for purchasers of food products to fulfil their payment obligations. These time limits depend on the expiry date of the food product in question, i.e.:

- if a food product should be used within 10 days, payment must be made no more than 10 business days after the date of delivery;
- if a food product should be used within 10 to 30 days, payment must be made no more than 30 calendar days after the date of delivery;
- if the expiry date of a food product is more than 30 days, payment must be made no more than 45 calendar days after the date of delivery.

The Trade Law does not, however, specify sanctions in the event that the above time periods are not met; rather, it is for the parties to agree on contractual penalties.

2.2 Special restrictions for the supply of food products to retail chains

Retail chains have long been under the scrutiny of FAS, which has been dissatisfied with numerous trade practices used particularly in relation to suppliers of food products. Suppliers often find themselves in a significantly weaker position than large retail chains, and FAS has repeatedly criticised various retail chains for imposing unfavourable terms on their suppliers and employing unfair trade practices. Market studies, however, show that there are few cases were retail chains have a market share of more than 35 percent, which was the minimum level for an undertaking to be deemed to hold a dominant market position. As a consequence, retail chains could not be held to be abusing a dominant position, and FAS found itself unable to intervene.

In 2008, FAS proposed decreasing the minimum level for market dominance by retail chains from 35 percent to 15 percent. In the course of 2009, FAS attempted to get a better grip on the sector by intensifying investigations into concerted practices by retail chains and broadly applying the concept of coordination. FAS

also adjusted its merger control practice for the retail sector and developed a set of conditions banning unfair trade practices that became a standard part of merger control decisions. Finally, in August 2009, the Competition Law was amended to abolish the strict minimum dominance threshold of 35 percent, thereby permitting FAS to consider undertakings with smaller market shares as dominant, subject to certain market conditions being met.

However, notwithstanding the legislative and administrative developments in 2008 and 2009, it was decided to introduce restrictions that would apply irrespective of the parties' market shares. As a result, the Trade Law sets out specific rules applicable to agreements for the supply of food products by retail chains. In this context a retail chain means more than one retail outlet managed or franchised by the same entity or group. As regards such supply agreements for food products of retail chains, the Trade Law prohibits:

(i) discriminatory provisions;

(ii) violation of any applicable price regulation rules;

(iii) wholesale trade in the form of commission contracts or other agreements containing similar commission elements;

(iv) forcing suppliers to accept:

- prohibitions to enter into supply agreements with other purchasers (which bans exclusive supply arrangements);
- sanctions for not supplying food products on better terms than those applied to third parties (which bans most-favoured-customer clauses);
- obligations to provide information about agreements with other parties (which bans requests to disclose third-party arrangements);
- entry bonuses (which outlaws financial obligations payable solely to be permitted to start supplies);
- obligations to pay merely for the change of the retailer's assortment;
- obligations to decrease its product prices to the level of a minimum retail price (including the retailer's margin) as charged by other retailers;
- obligations to compensate the retailer for costs incurred after delivery, e.g. as a result of loss of or damage to the food products, except in cases where the supplier can be held liable for such loss or damage;
- obligations to compensate the retailer for costs that are not connected to the implementation of the supply agreement or subsequent sale;
- arrangements on returning products that have not been sold by the retailer within a certain period of time; and
- any other terms that may have the same effect as the arrangements described above.

3. EXPANSION OF RETAIL CHAINS

The Trade Law sets out a special prohibition applicable only to retail chains that sell more than 25 percent of the total annual sales of food products in a Russian region or a municipal or city district. Such retail chains are prohibited to acquire or lease additional trade facilities, including through commissioning and operating new trade facilities.

The purpose of this prohibition is to prevent uncontrolled growth of retail chains outside the scope of merger control by expanding into new trade facilities. The prohibition has been heavily criticised by economists, as it restricts organic growth of retail chains and does not provide clear methods of calculating total sales of food products. Despite the criticism, the prohibition was included in the Trade Law on the condition that the government should adopt a clear methodology for calculating the market shares of retail chains.

In January 2010, FAS published a draft methodology suggesting that market shares should be calculated on the basis of statistical data collected by the Federal State Statistics Service from the retailers themselves. It remains unclear, however, how the Federal State Statistics Service will verify the data provided by undertakings, particularly if undertakings choose not to provide any data whatsoever. As a positive sign of legal transparency, it is planned that market share allocations will be published on official websites, which means that undertakings should be able to verify the calculation of their market shares and, if incorrect, challenge them in court.

4. RELATIONSHIP BETWEEN THE TRADE LAW AND THE COMPETITION LAW

The Trade Law contains sector-specific rules. In addition, the general rules of the Competition Law continue to apply to the trade sector without any changes. In particular, supply agreements for food products must comply with the general rules applicable to any other vertical agreement, which may result in problematic assessments.

In particular, the Competition Law provides for a *de minimis* rule exempting vertical agreements from antimonopoly restrictions if the market shares of both parties are below 20 percent in all of their markets. In this regard, the question of whether the Competition

Law or the Trade Law takes priority remains unclear, as the Trade Law does not provide for any similar *de minimis* exemption. One may, however, expect that FAS will consider the Trade Law as being in supplementary to the Competition Law, meaning that its restrictions should apply irrespective of any exemptions applicable under the Competition Law.

In practice, this means that supply agreements will have to be reviewed according to a 3-step test. Firstly, any supply agreement must comply with the restrictions of the Trade Law. Secondly, subject to the *de minimis* exemption, supply agreements must comply with the rules for vertical agreements under the Competition Law. Thirdly, where a party may be considered to enjoy a market-dominating position, the Competition Law's prohibitions on abuse of dominance must be observed.

5. SANCTIONS

In January 2010, FAS published draft amendments to the Federal Administrative Offences Code providing for fines for specific violations of the Trade Law. The proposed fines are administrative in nature and comprise fixed amounts of up to a maximum of RUB 1,000,000 (approximately EUR 24,000) per violation. In addition, the draft amendments provide for personal liability of decision-makers with administrative fines of up to a maximum of RUB 50,000 (approximately EUR 1,200) and, in exceptional cases, disqualification of up to a maximum period of three years.

Unlike in cases of violation of the Competition Law, there will be no sanctions pegged to the annual turnover of the breaching undertaking. This system has been welcomed by the business community as offering full legal transparency. At the same time, the fines appear to be low, which leaves open to question the effectiveness of the regime.

6. OUTLOOK

Following the August 2009 amendments to the Competition Law, it is arguable whether or not the introduction of additional restrictions for the trade sector was indeed necessary. In addition, the Trade Law establishes various restrictions, the precise implementation of which remains unclear to date, e.g. the provisions prohibiting expansion of large retail chains by acquiring or leasing additional retail premises. In any event, one may expect that FAS will intensify investigations into the trade sector in the course of 2011. Even if sanctions for violations of the Trade Law may be low, investigations may also result in disputes about alleged breaches of the Competition Law, whether through illegal coordination or abuse of a dominant position. One may also expect that FAS will need to deal with a wave of complaints by suppliers. Market players will therefore have to be careful when amending their existing supply agreements and entering into new supply agreements to avoid unnecessary disputes with counterparties and with FAS.