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ROUNDTABLE ON CHANGES IN INSTITUTIONAL DESIGN OF COMPETITION AUTHORITIES

-- Note by Latvia --

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More documents related to this discussion can be found at <http://www.oecd.org/daf/competition>.

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1. Competition rules are rooted in economic principles and reflect economic structures, economic behaviour and economic effect. Economics are at the centre of competition policy and only considerations related to competition and economics should be taken into account, when investigating infringements and assessing market concentrations. Such commitment requires an objective, impartial enforcement undistorted by powerful interest groups, which often seek to influence government. By establishing competition authorities as independent state institutions, government makes a credible commitment not to interfere with competition enforcement and lets the market know, that there is no point to exert pressure on the executive branch in order to shape competition enforcement.¹

2. Independence of a competition authority can be assessed through four aspects – institutional, functional, personal and financial independence. The integrity and effective operation of the authority is secured when all four aspects of the independence are present. Just like the four sides of a fence around home, if independence structure is missing one aspect or has holes, it is only a question of time before the integrity and effective operation the authority is compromised. Independent status is fully compatible with holding competition authorities accountable for their decisions and enforcement priorities, which is important for enhancing confidence and trust placed in proper execution of their mandate.

3. The main objective of the competition authority is to protect free and undistorted competition on the market. Delegation of additional functions should not undermine attainment of this primary objective, by taking away resources, both personnel and financial, which are reserved for competition enforcement.

1. Multifunction competition authorities

4. Latvian Competition Council may be considered as a bi-functional authority, as besides principal objective of competition enforcement, CC is also responsible for abuse of significant market power regulation in the food and non-food retail sectors *vis-à-vis* suppliers (dominant position in retail trade).

5. Since 2002 Latvia has seen rapid growth and expansion of retail chains. Early on RIMI and Maxima emerged as market leaders, together accounting for ~60% of the market. Overall there are 12 retail chains as well as independent shops. In 2005 it was becoming increasingly evident, that large food retail chains were abusing their market power, albeit it being below classical dominance level, *vis-à-vis* their suppliers by imposing unfair trading conditions. In essence retail chains were successful at shifting costs of the retail risk to suppliers. For example – retailers were able to return back any amount of ordered goods in case the goods did not sell in accordance with the expectations of a retailer or simply because it was over-ordered. Retailers used elaborate schemes of bonuses and additional payments, even not negotiated in advance, to extract monetary benefits from their suppliers. Suppliers also experienced losses due to late payments and often disproportionately imposed sanctions. This increased suppliers and producers costs, which disallowed normal planning and growth of the production and innovation. Retail trade accounted for a large proportion of suppliers' turnover, which was difficult to substitute with other sales channels.

¹ See also: The Importance of the Independence of a Competition Authority. Rimantas Stanikunas (former Chairman of the Competition Council of the Republic of Lithuania) http://kt.gov.lt/en/index.php?show=cases_other&other_doc=other_20040615

Therefore a large number of suppliers found themselves economically dependent from their supplies to retailers, which in turn was further exploited by the retailers.

6. Above mentioned unfair practices across the retail sector signalled of an unbalanced market structure, with a few large and powerful retailers and many relatively small suppliers and producers. Such market structure did not raise concerns under the classical dominance, as retail market and procurement market was sufficiently competitive, although concentrated. Legislator opted to draft an Unfair trading practice law in food retail sector. However, the draft law meet with strong opposition of the retail lobby. An easier and quicker option was to introduce a separate section under the classical dominance provision in the Latvian Competition Act in 2008. The aim of the legislator was to protect suppliers and producers from the market power of big retail chains.

7. Dominant position in the retail trade is a different from the classical state of dominance. The latter is characterised by an ability to act independently on the market from its competitors, clients, suppliers or customers. Retailer, which holds a dominant position in the retail trade enjoys sufficient market power to act independently from its suppliers, however, it is still constrained by competitors and is actively competing for its customers. Dominant position in retail trade is characterised by buyer power and economic dependence of suppliers. More than one undertaking may hold dominant position in the retail trade.

8. Dominant position in retail trade has a separate set of prohibited conducts². Unlike classical dominant position, the list is exhaustive. Retailer, holding dominant position in the retail trade, does not have a universal obligation to deal. Retailer can freely choose what products to buy, however, once it procures a product, it has to observe restrictions stipulated in Article 13(2) of the Competition Act. Dominant position in retail trade is viewed and applied by the CC as provisions of unfair competition.

² Article 13(2) of the Competition Act states: *A market participant or several market participants are in a dominant position in retail trade if, considering their buying power for a sufficient period of time and the suppliers' dependency in the relevant market, they have the capacity of directly or indirectly applying or imposing unfair and unjustified provisions, conditions or payments upon suppliers and may hinder, restrict or distort competition in any relevant market in the territory of Latvia. Any market participant who is in a dominant position in retail trade is prohibited from abusing such dominant position in the territory of Latvia. Abuse of a dominant position in retail trade occurs as:*

1) application or imposition of unfair and unjustified provisions concerning return of products, unless the returned product is of poor quality or is a product, including a new product, unknown to consumer, delivery or increase in the amount of delivery of which is initiated by the supplier;

2) application or imposition of unfair and unjustified payments, discounts for the delivery of products, the presence of the delivered product at a retail outlet, including for the placement of products on shelves of shops, and for the promotion measures of the trade. Objectively justified payment for the promotion of a new product, unknown to the consumer, in the market shall not be considered as unfair and unjustified;

3) application or imposition of unfair and unjustified payments for entering into a contract, unless such payments are justified by the fact of entering into a contract with a new supplier who therefore needs a special evaluation;

4) application or imposition of unfair and unjustified payments for the delivery of products to a soon to be opened retail outlet;

5) application or imposition of unfair and unjustifiably lengthy settlement periods for the delivered products. The settlement period for the delivered food products, the term of validity of which is not longer than 20 days, shall be unfair and unjustifiably lengthy, if it exceeds 30 days from the day of delivery of products; and

6) application or imposition of unfair and unjustified fines for violating the provisions of a transaction.

9. Since 2008 the CC has had 6 cases initiated – 4 ex officio and 2 on complaints. In 3 cases infringement was established and fine imposed – both largest food retailers and the largest non-food retailer have been fined for infringing Article 13(2) of the Competition Act. The CC has evidenced overall improvements of trading conditions, i.e., suppliers have much more clearer supply conditions in their agreements regarding price, additional payments, return goods, etc. Application of unjustified and disproportional sanctions has significantly reduced.

10. In 2010 the CC conducted a survey of suppliers to inform about trends within the retail markets and whether there are any improvements in relationship between retailers and suppliers. Answers indicated that smaller retail chains are still applying unfair practices, just like the large ones before introduction of the regulation. This problem is going to be solved by the draft Unfair Trading Practice Law, prohibiting abuse of certain actions by all retail chains. New draft law has been submitted to the Parliament by the Cabinet of Ministers and is expected to be adopted in 2015.

11. The CC initiated neither the provision, nor its inclusion in the Competition Act. Initially the CC recommended the Ministry of Economics to include unfair trading conditions in a separate unfair trade practice law, which would include provisions prohibiting largest retailers to abuse their buyer power vis-à-vis suppliers. Due to opposition from retail sector lobby legislator opted to introduce only an additional section in the Competition Act as specific regulation for an abuse of dominant position in the retail trade.

12. Practical application of the Article 13(2) of the Competition Act has been very complicated (establishing dominant position in the retail trade is difficult and resource intensive). No formal calculations of resources allocations are available. However, taking into account, that: (i) over 2010-2013 CC adopted 155 decisions, 6 of them concerned below-dominance in retail sector; (ii) practice showed, that investigation of these cases took twice the burden of proof compared to regular anti-trust and cartel case; it would be fair to conclude CC has spent on average 8% of its resources on below-dominance cases.

2. Independence from government

13. Competition rules apply universally to economic activity and require equal enforcement according to economic principles. Each sector of the economy and market player is viewed objectively and no political or private interest group should have direct or indirect influence on decision making process.

14. The CC ensures enforcement of national and the EU competition rules in all sectors of the national economy, as it investigates alleged abuse of dominant position and prohibited agreements, as well as ensures merger control to prevent excessive market concentration or formation of monopolies. Pursuant Article 5 of the Council Regulation 1/2003³, the CC is entitled to implement EU competition law, as defined in the Articles 101 and 102 of the TFEU. Member States are responsible for effective implementation of EU competition law⁴. In compliance with the TFEU and the EU Court's case law, the CC is obliged to disapply national law which is conflicting EU competition rules.

15. As for now, the CC is a governmental institution of direct administration and it is subordinated to the Ministry of Economics. Subordination is conducted in the form of supervision. Supervision is restricted, as decisions of the CC can only be examined by the Court. Article 8(2) of the Competition Act stipulates that decisions adopted by the CC shall be directly subject to a judicial review.

³ Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty

⁴ Case C-429/07 *Inspecteur van de Belastingdienst v X BV*, Para 37.-38.

16. Article 8(6) of the Competition Act ensures formal functional independence. CC adopts its decisions impartially and does not seek nor is required to seek any prior consultation or approval of the government or any other public or private body/party. Article 8(6) of the Competition Act concisely states, that *directions regarding the commencement of an investigation of a case in a particular case, as well as regarding the manner in which the investigation shall be conducted or a decision taken, may not be given to the Chair and members of the Competition Council by the Cabinet, the Minister for Economics or other persons*. Functional independence extends to all decisions adopted by the CC.

17. Functional independence is formulated in the form of a negative definition, stating, that no party or body can influence CC's decisions. The Law does not state, that decisions are formally taken independently. Besides functional independence, provisions, which would suggest or strengthen institutional, personal or financial independence from the governmental or political influence, are lacking.

18. Subordination to the executive branch holds an inherent conflict of interests with the function to impartially and independently ensure fair competition in accordance with the Competition Act and the TFEU in regard of the actions of state owned enterprises. Competition rules and enforcement is solely based on objective economic principles, to ensure level playing field for all market participants in accordance the Competition Act and the TFEU, regardless of their legal form or the source of their funding, whether it is state, municipal or private. NCAs should have sufficient powers to challenge laws and governmental and municipal acts before the Court, if they infringe competition rules and are discriminatory. To avoid conflict of interest, NCA should be appropriately distanced from the government and isolated from the political influence.

19. Since the end of 2012 CC has advocated for its independence from the governmental branch. CC focuses on strengthening its functional independence, introducing institutional separation from the ministerial subordination, involving both the legislature and the government in appointing management of the CC, exiting unified wage grid similarly as the rest of the independent institutions in Latvia, and having higher autonomy in setting its budget. The CC has also started drafting the amendments to the Competition Act addressing independence of the authority. Plans for a full independence have been discussed with the Ministry of Economics. There are reservations regarding sufficient political will to successfully advocate for the full independence of the CC. Draft reforms plan to address: (i) institutional separation from the Ministry of Economics; (ii) positive definition of a functional independence, stating in clear terms that the CC adopts its decisions independently⁵; (iii) personal independence, making appointment of the members of the CC dependent from both Government and Parliament, as well as limiting dismissal of the members of the Council to *cause majeure* cases; as well as (iv) financial independence.

20. Accountability is fully compatible with the independent status of a competition authority. Supervision by the Ministry of Economics requires the CC to submit quarterly reports of its activities as well as expenditures. The CC is also required to submit to the minister of economics plan of its activities for the coming year. CC also accounts by way of an annual public report regarding its operation and expenditure of the budget resources. This report is available on the website of the CC.

21. Proposed amendments to the Competition Act will limit universal obligation to act upon any complaint and will allow the CC to prioritise cases, which it pursues. Prioritisation will require open and transparent dialog with stakeholders, taking place annually. Dialog will allow to have a better understanding about the current situation on the markets and possible competition restrictions the CC should focus its resources on. Dialog will also help to explain and justify to the market CC's enforcement priorities.

⁵ Currently Article 8(6) of the Competition Act stipulates only a negative definition of the functional independence. Namely, that any party is precluded to give instructions to the Council on execution of its powers.