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**ROUNDTABLE ON FIDELITY REBATES**

**Note by Ukraine**

**15 – 17 June**

*This document reproduces a written contribution from XXX submitted for item 6 of the 125th OECD Competition committee on 15-17 June 2016.*

*More documents related to this discussion can be found at [www.oecd.org/daf/competition/fidelity-rebates.htm](http://www.oecd.org/daf/competition/fidelity-rebates.htm)*

Please contact Mr. Chris Pike if you have any questions regarding this document [Email: [Chris.Pike@oecd.org](mailto:Chris.Pike@oecd.org)]

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**WRITTEN CONTRIBUTION ON “FIDELITY REBATES”  
FROM THE ANTIMONOPOLY COMMITTEE OF UKRAINE**

**1. Introduction**

1. The Antimonopoly Committee of Ukraine (hereinafter – the AMCU) handles a number of cases on violations of competition laws in the form of anticompetitive concerted actions by foreign pharmaceutical companies (or their subsidiaries) and wholesale domestic distributors of medicines.

2. These cases were opened by the AMCU on its own initiative after having investigated the markets of medicines taking into account the social importance of these markets and a significant proportion of public procurement in this sphere.

**2. Sector Enquiry Into Medicines**

3. It was discovered by the AMCU that majority of foreign pharmaceutical companies supply medicines in Ukraine through their exclusive importers which are usually in relationships of control (importers).

4. At the same time, each foreign pharmaceutical company has the part of medicines prices on which are regulated by the state according to the legislation of Ukraine by establishing of maximum wholesale and retail trade margins.

5. Whereas, importers distribute medicines in Ukraine through a rather limited range of wholesale distributors which usually buy a wide range of medicines by wholesale and then sale these medicines to pharmacies, hospitals and other entities.

6. Thus, foreign pharmaceutical companies use in Ukraine following restrictions in relationships with Ukrainian distributors:

- a ban on the export of goods from Ukraine;
- obligation to prevent third parties in exporting goods outside Ukraine;
- an obligation to report and the establishing of payment conditions that provides a comprehensive control over the flow of goods in the market of medicines.

7. As foreign pharmaceutical companies often produce and sell unique medicines in the markets of Ukraine that can not be replaced, there are signs of these companies’ market power.

8. Given the ability to affect the turnover of certain medicines due to the abovementioned uniqueness, producers of medicines or their exclusive representatives (importers) actually control the value and selling of goods in the market.

9. At the same time, distributors voluntarily comply to such restrictions and help pharmaceutical companies to control commodity markets. In turn they gain the assistance to evade the government regulation of prices and additional income as the result of actual allocation of markets or sources on the territorial principle, range of products, buyers or consumers.

10. The highly important fact is that the most common tool to establish the control and to evade government regulation is specific discounts that suppliers provide to distributors.

11. As the rule, payment for delivered goods is carried out by prepayment or deferred payment which is envisaged by a contract.

12. At the same time, the cost of previously received and already sold goods can be adjusted (reduced) in the future periods at the amount of discount that is provided by additions to the contract. The terms for granting such discounts are:

- carrying out the payment for goods pursuant to the contract;
- selling of medicines through tender procurement;
- distributors adhere the plans for acquisition / sale of medicines established by supplier;
- maintaining of stocks;
- providing detailed reports on volume of sales in channels of distribution by distributor;
- selling of specific medicines to specific consumer, etc.

13. Hence, on the one hand distributor pays for the received from importer goods, on the other hand importer returns the excessively paid costs (including discounts provided after the sale of medicines) in the form of discounts, bonuses, financial aid, etc.

### **3. The Impact of Fidelity Rebates**

14. The abovementioned leads to dual pricing when there are two types of prices:

- *nominal price*, which is specified in the contract. This type of price is the basis for the calculation of custom duties and trade margins. The price for medicines for final consumers depends on this nominal price. And what is more, on the basis of nominal price a government regulator assesses the compliance with the legislative provisions in terms of government regulation of prices;
- *real price*, which is less than the nominal and actually paid by the distributor to the supplier (including discounts provided after the selling of medicines).

15. The AMCU has also found that one pharmaceutical company set the same rate (as a percentage) of rebates for achieving of very different amounts of purchase for all of the distributors.

16. Moreover, the mentioned opaque pricing system that has been existing for years doesn't actually stimulate sales of medicines and does not enhance competition between distributors. On the contrary, it allows distributors to receive a concealed income as the result of restriction of competition in the market.

17. The case papers show that the discounts received by distributors do not lead to a price decreasing for consumers and final users.

18. On the contrary, suppliers provide additional discounts to Ukrainian distributors for medicines sold in the process of public procurement.

19. Due to tacit collusion of suppliers, distributors sell medicines through public procurement procedure for prices which are higher than prices for selling these medicines to pharmacies.

20. The AMCU discovered that the existence of such opaque terms of payment in conjunction with restrictions on re-export and excessive reporting restraints parallel import of medicines in Ukraine and causes the hidden increase of profitability of certain distribution market participants, which gives them additional unjustified competitive advantages. Also this business tradition leads to price manipulation in terms of government regulation that provides unreasonable competitive advantages. Thus, the investigation materials showcase that pharmaceutical companies provided to:

- Distributor 1 – a discount for selling of certain medicines at a rate of 15%;
- Distributor 2 – an additional discount that gives a distributor the right to exclusively distribute medicines to health care facilities in one of the regions of Ukraine;
- Distributor 3 - an additional discount for selling medicines through tenders to 27 medical facilities for special prices that are lower at 30-50 percent compared to the price of purchase of other distributors;
- also some specific discounts (from 10% to 28%) were granted to some distributors for the sale of medicines through public procurement of some medicines.

21. An additional argument against these concerted actions of foreign pharmaceutical companies and Ukrainian distributors is a negative impact on competition in the market. This is evidenced by market study and investigative materials, including:

- the market is developing not in intensive way when there is a growth of a market in physical units due to price competition. On the contrary, recently Ukraine has witnessed a market growth in terms of value indicators in conjunction with reducing of quantitative indicators;
- also, there is a decline in the number of Ukrainian distributors and increase of the concentration rate in these markets.

22. Also the AMCU found that the use of discounts by a company and distributors can serve as a mechanism for allocation of markets on a territorial basis or product selection, in terms of customers or users.

23. Hence, the terms of contracts between producers, their representatives and distributors have anticompetitive effect.

24. Furthermore, both sides of this relationship obtain benefits from this cooperation due to infringement of interests of final consumers and government.

25. Taking into account the abovementioned facts, the AMCU assesses these actions as anticompetitive concerted actions.

26. Apparently, in the process of investigation of the mentioned cases the AMCU considers the practice of discounts in combination with exclusive distributing and other types of vertical restraints.

#### **4. Context on Fidelity Rebates Investigations**

27. As of today, in consideration of these cases the AMCU considers the practice of providing discounts in conjunction with other terms of the contracts aimed at the establishing of vertical restraints.

28. According to the assessment of the AMCU, the consideration of these issues should cause enhancing of competition in the market as a result of the elimination of unreasonable restrictions of parallel imports and prevent unjustified price increasing.

29. The Ukrainian legislation on protection of economic competition does not contain provisions that would directly assess any discounts as a negative impact on competition. Today the AMCU doesn't have any practice of presuming the existence of such discounts that have either pro-competitive or anti-competitive effect.

30. The process of assessment of how such discounts comply with the competition laws is based on the need to assess the impact of these discounts on competition.

31. In the process of such assessment following factors are taking into account:

1. characteristics of market and its products (presence or absence of substitutes or complements, product life cycle, availability of patent protection, etc.);
2. the structure of the market participants, the level of market power of entities that are about to provide or receive a discount;
3. the matter of concerted actions between the market participants, the presence or absence of additional to discounts obligations between counterparties involved (exclusive dealership, excessive control over the flow of goods, restrictions of pricing, etc.);
4. the impact of the actions on the markets. In the process of consideration of the abovementioned cases, the AMCU applied the theories of harm such as inflation of costs of a competitor; liberalization of the incentives for competition.