



DISTRIBUTION CONTRACT UNDER RUSSIAN LAW: ANTITRUST RESTRICTIONS



Russian civil law does not specifically provide such type of agreement such as a distribution contract. The contract, however, has become widely used in commercial practice as an instrument for regulating relations between producers/wholesale suppliers of goods and wholesale purchasers under the general principle of freedom of contract enshrined in Article 421 of the Civil Code of the Russian Federation (hereinafter - the 'Civil Code').

Under a distribution contract, the distributor undertakes to purchase goods from the supplier and to arrange marketing, promotion and distribution of them within a particular territory (which is the principal obligation of a distributor under the international standards, in particular, the ICC Model Distributorship Contract. Sole Importer-Distributor. Publication No. 518, 1996; the ICC Model Distributorship Contract. Sole Importer-Distributor. Publication No. 646E), while the supplier undertakes not to supply the goods for sale to this territory on its own or through third parties, including not to sell the goods to third parties for distribution in the territory.

Thus, a distribution contract can be referred to the contracts of a mixed nature, i.e. contracts incorporating features of different contracts specified by the Civil Code such as sale-and-purchase agreement, supply agreement, transportation contract, agency contract, franchise agreement.

Depending on the rights and obligations specified in the distribution contract the court when considering disputes arising therefrom may qualify the contract as:

1. a contract for organisation of relationships on products supply with the consumers search service (Decision of the Praesidium of the Highest Arbitration Court (the HAC), dated 18 May 1999, No. 7073/98 on the case No. A40-9311/98-55-54);
2. an agency agreement (Decision of the North Caucasus FAC, dated 19 April 2005, No. F08-1395/2005);
3. a combined supply and agency agreement (Decision of the Povolzhsky FAC, dated 25 January 2005, No. A55-6685/2004-42);
4. a mixed contract incorporating elements of a supply agreement and service agreement, while not meeting the criteria of an agency agreement (Decision of the Ural FAC, dated 17 October 2002, on the case No. F09-2547/02-GC);
5. a contract governed by Chapter 30 of the Civil Code regarding a sale-and-purchase agreement (Decision of the Ural FAC, dated 2 May 2006, No. F09-3252/06-C3 in the case No. A50-19308/2005).

Based on Article 429.1 of the Civil Code, as effective from 1 June 2015, a distribution contract may be also structured as a framework agreement providing for general terms and conditions of binding relations between the parties which can be specified in supplement agreements, purchase orders or otherwise.

In addition to the complex nature of the parties' obligations, a specific feature of a distribution contract is its long term - from one year and more.

Given this specific nature of the relations between the manufacturer/supplier and distributor, when the latter is not just an ordinary reseller of goods but is also granted with the right to use trademarks, trade names and/or other brand identity for promotion purposes, and in some cases represents a supplier to third parties, including ultimate purchasers, and also based on the position held by a party to the distribution contract at the corresponding commodity market, there is usually a need to provide in the contract for certain restrictions on the distributor and/or supplier.

In this case the parties to a distribution contract need to understand what conditions can be included so that in the event of any dispute such conditions are not deemed unenforceable by courts due to the fact that they violate imperative provisions of Russian laws. Moreover, this will allow to the parties to avoid liability including significant 'turnover-based' fines for violations of prohibitions and restrictions of antitrust laws.

Under the Federal Law No. 135-FZ dated 26 July 2006 'On Protection of Competition' (hereinafter - the 'Competition Law') a distribution contract is a "vertical" agreement, i.e. an agreement between the seller and the purchaser of goods and as a general rule may not

include conditions (Article 11.2 of the Competition Law) which:

- 1) result or may result in fixing of the goods resale price – except for the case when a seller establishes a maximum resale price for the purchaser (since such a condition is deemed established for the benefit of ultimate consumers);
- 2) provide for the obligation of the purchaser not to sell the goods of the seller's competitor. However, this restriction does not apply when under the contract the purchaser is granted the right to sell the goods under the trademark or other brand identity of the seller or manufacturer (such agreements include not only license agreements but also dealer standards and dealer agreements under which the dealer has the right to use the trade name of a legal entity - see the decision of the Moscow district Federal arbitration court (FAC) dated 29 April 2014 on the case No. A40-79104/12).

Under Article 12 of the Competition Law, the above restrictions do not apply to:

- a. 'vertical' agreements made in writing (except for those concluded between financial institutions), which are franchise agreements that meet the requirements of the Chapter 54 of the Civil Code; and
- b. 'vertical' agreements between entities where the share of any party at any commodity market does not exceed 20%.

A commodity market is the area of circulation of the goods (including goods of foreign origin) non-replaceable with another product or of substitute goods within the boundaries of which (including geographic) the purchaser may buy goods based on economic, technical or other opportunities or advisability while the opportunity or advisability is not available beyond the boundaries of such an area.

Geographical and product boundaries of the commodity market, as well as the shares of the parties to the contract are determined by the Federal Antimonopoly Service of the Russian Federation (FAS Russia) in accordance with the Procedure for analysing of the state of competition on the commodity market (approved by the Order of FAS Russia No. 220 dated 28 April 2010).

If the supplier and distributor are competitors, i.e. they sell goods at the same commodity market, a distribution contract between them also may not contain provisions which lead or may lead to:

- 1) establishment or maintenance of prices (tariffs), discounts, markups (surcharges) and(or) margins;
- 2) increase, decrease or maintenance of prices at tenders;
- 3) division of the commodity market by the territorial principle, volume of sales or purchase of goods, assortment of goods for sale, or composition of sellers or purchasers (customers);
- 4) reduction in or termination of goods production;
- 5) refusal from entering into agreements with certain sellers or purchasers (customers).

Such agreements are deemed cartels and prohibited per se under Article 11.1 of the Competition Law, that is, FAS of Russia needs only to prove the fact of entering into an agreement without proving that the agreement leads or may lead to the restriction of competition as well as the fact of the agreement performance by the parties (Decision of the HAC Praesidium No. 9966/10 dated 21 December 2010).

Thereat, one also needs to take into account the following positions of Russian law enforcement bodies:

- a manufacturer engaged in the sale of its own products and distributor engaged in the sale of the same products are not deemed competitors (Decision of the HAC Praesidium No. 5-15/1-2 dated 23 May 2012);
- the sale of similar goods at the same market is a sufficient ground to deem the relevant entities competitors (Decision of FAS of Russia dated 31 May 2012 on the case No. 111/132-11 on violation of the antitrust laws. However, if the direct supplies were ad hoc, the FAS Russia does not consider the supplier and distributor as competitors).

A distribution contract (except for the contract being deemed a cartel) may be deemed valid under Article 13 of the Competition Law provided that:

- a. it does not create an opportunity for certain persons to eliminate competition at the relevant market;
- b. it does not provide for restrictions on the parties or third parties which do not meet the objectives of the contract; and
- c. it results or may result in:
 - improvement of production, sale of goods or facilitation of technical and economic progress, or increase the competitiveness of Russian products at the global market;
 - the purchaser's benefits commensurate to benefits obtained by business entities as a result of actions (omission), agreements and concerted acts, transactions.

The criteria to be met by a distribution contract to be deemed valid under the Article 13 are established by the Decision of the Government of the Russian Federation No. 583 dated 16 July 2009 (as effective until 1 July 2019).

- a) a seller sells the goods to two or more purchasers and holds the market share of the goods at least 35%, or sells the goods under the agreement to a sole purchaser whose market share is less than 35%;
- b) the purchaser and seller do not compete with each other or compete in the commodity market where the purchaser purchases the goods for resale thereof;
- c) the purchaser does not produce goods being substitute in respect to the goods constituting the subject of the agreement.

Even if the abovementioned criteria are met a distribution contract may not provide for, inter alia:

- a) refusal by the purchaser to sell the goods within the territory stipulated by the contract and(or) to a certain category of consumers, except for the ban to the purchaser (save for the retailers) to advertise and sell goods in the territory which is an exclusive under the agreement between the seller and another purchaser, as well as in the territory where under the contract the goods are sold by the seller;
- b) restriction of the seller's right to sell to retail customers the goods being spare parts or components of goods manufactured by the purchaser and which meet the requirements of the technical regulations, as well as to sell the goods to special repair or maintenance companies;
- c) ban on the purchaser to produce, purchase and(or) sell goods being substitute with respect to the goods which it purchases or may purchase under the contract (hereinafter - the 'substitute goods'), except when such conditions are established for a period no more than 3 years after the date of the contract (provided that the purchaser is not a retail company, and previous agreements between the purchaser and seller did not provide for such conditions);
- d) ban to sell the substitute goods on a land plot and(or) in premises transferred to the purchaser by the seller on any legal basis.

FAS of Russia while considering cases on violation of antitrust laws by entering into agreements restricting competition must establish the following circumstances (in accordance with p. 7 of the Decision of the HAC Plenum No. 30 dated 30 June 2008 and the arbitration practice, in particular, Decision of the Moscow district Arbitration Court dated 19 November 2014 on the case No. A40-75519/13-152-731)):

- fact of entering into a prohibited 'vertical' agreement and participating of the parties therein;
- absence of grounds for the recognition of the 'vertical' agreement as valid in accordance with Article 12 or Article 13 of the Competition Law; and
- impact of the 'vertical' agreement on restriction of competition at the relevant commodity market.

Territorial Restriction

Prior to 5 January 2012 Article 11.1 of the Competition Law prohibited agreements or concerted acts of all business entities (not just competitors) at the commodity market where such agreements or concerted acts lead or may lead, inter alia, to the division of the commodity market by territory, volume of sales or purchases, range of sold goods, or composition of sellers or purchasers (customers).

However, from 1 January 2010 the said restrictions do not apply to 'vertical' agreements. In this connection, the courts render decisions that a distribution contract may include provisions on territorial restrictions, in particular, the distributor's obligation to sell the commodity within the territory specified by the contract and penalties for violation of such obligation, provided that the supplier and distributor do not compete at the same commodity market and share of any of them at the relevant market does not exceed 20% (HAC Ruling, dated 26 February 2010, No. VAS-2119/10 on the case No. A56 -43093/2007, Decision of the Ural district FAC, dated 15 July 2010, No. F09-9540/09-C5).

If the distribution contract meets the criteria provided for by the General Exceptions for agreements between purchasers and sellers, it may also specify the territory within which the distributor has the exclusive right to sell the goods but it must provide for a waiver by the distributor to enter into agreements with sellers of substitute goods which specify a geographically identical or overlapping territory.

In the event the distribution contract is qualified by the court as an agency agreement the court may deem such a contract not a 'vertical' agreement under Article 4 p.19 of the Competition Law and apply Article 1007 p.7 of the Civil Code which provides for nullity of the conditions under which an agent may sell goods, works or services exclusively to a certain category of purchasers (customers) or exclusively to purchasers (customers) located or residing in the territory specified by the contract (see Decision of the North Caucasus FAC, dated 19 April 2005, on the case No. F08-1395/2005, Decision of the Fifth AAC, dated 2 November 2011, on the case No. A51-8679/2011, Decision of the Nineteenth AAC, dated 30 July 2010 on the case No. A14-8178/2009/268/29, and Decision of the Third AAC, dated 26 July 2010, on the case No. A33-18245/2009).

Sale Price Restriction. Recommended Prices

Terms and conditions of distribution contracts that lead to the establishment or maintenance of prices (tariffs), discounts, markups (surcharges) margins were absolutely prohibited by Article 11.1 of the Competition Law until 1 January 2010. The 'second antitrust package' amendments removed 'vertical' agreements (except for the cases, where such agreements are concluded between competing seller and purchaser) from this prohibition. At the same time, a ban was imposed on inclusion into the 'vertical' agreements the conditions that lead or may lead to the establishment of the goods resale price, including conditions on recommended prices if a failure to comply therewith entails penalties, reduction in discounts, purchases or, as opposite, compliance therewith results in bonuses, etc.

Starting from 5 January 2012 distribution contracts between a supplier and a distributor where the share of each at the same commodity market exceeds 20% may not include conditions which lead or may lead to the establishment of the goods resale price except where the seller establishes the maximum resale price for the purchaser (Article 11.2 of the Competition Law).

One of the recent cases initiated by FAS Russia for violation of the above ban is a case against Unified Trading Company OAO (UTC), a mediator in the sale of products of the sole producer of baking soda in Russia - Soda OAO (almost 100% of baking soda in Russia) that held the share in the commodity market of baking soda of at least 90% and from December 2010 to April 2011 inclusive provided in its distribution contracts that a distributor must follow the pricing policy of the Company (UTC), in particular: to establish a markup in December in accordance with market conditions. Where the distributor departs from the pricing policy of the Company,

the Company could at its discretion apply sanctions, including warning and termination of the Agreement.

Under the Decision of FAS Russia No. 1 11/111-12, dated 4 April 2013, UTC OAO and its distributors were recognised as violators of Article 11.2.1 of the Competition Law due to entering into the banned 'vertical' agreement which resulted in the establishment of the minimum resale price and the administrative fines under Article 14.32 of the Administrative Code were imposed on them. However the Moscow Arbitration Court abrogated this decision due to the lack of evidence provided by FAS Russia and the courts of appeal and cassation affirmed this decision. (Decision of the Moscow Arbitration Court dated 19 November 2014 on the case No. A40-75519/13-152-731).

Another significant case is the case against Vyazma Machine Building Plant OAO (VMZ) and 29 its dealers that in 2010 - 2012 entered into 'vertical' agreements for the supply of industrial washing machines and washer-extractors to prevent competition between dealers in the assigned regions and the establishment of minimum resale price of the specified VMZ products. 'Dealer's Obligation' section of all dealer contracts contained the following conditions:

- dealer's selling price shall be higher than the price given in the seller's price list by the amount of the transportation costs;
- price reduction as compared with the price given by the building plant is only allowed if there is competition with suppliers of imported equipment and with obligatory preliminary agreement with the seller.

In case of violation of these conditions VMZ could unilaterally amend the terms of the contract and reduce the discount rate for the next supply; in case of a repeated violation VMZ was entitled to terminate the dealer contract unilaterally.

According to the decision of FAS Russia on the case No. 1-11-116/00-22-12 dated 10 September 2013, compliance with these terms and conditions of the dealer contracts could lead to the establishment of a minimum goods resale price. Upon the results of the market analysis it was established that in 2010 and 2011 VMZ was the sole manufacturer of regular industrial washing machines of Russian origin in the territory of Russia and therefore had the decisive influence on the general conditions of circulation of certain goods at the relevant commodity markets. Therefore, the dealer contracts were deemed invalid in accordance with Article 12.2 of the Competition Law, VMZ and its dealers were declared violators of Article 11.2.1 and Article 11.4 of the Competition Law. The Moscow Arbitration Court and the Ninth Arbitration Appeal Court upheld the decision of FAS Russia (Decision dated 1 October 2014 and Decision dated 26 March 2015 on the case No. A40-181711/2013).

Please also note that according to the General Exemptions for agreements between purchasers and sellers, a distribution contract cannot contain conditions restricting the purchaser in determining the goods resale price, including the provision on the minimum resale price or fixed resale price of goods, if:

- a supplier sells the goods to two or more purchasers and holds the share at the relevant market less than 35%; or
- the distribution contract provides for exclusive supplies of the goods to a sole distributor, whose share at the relevant commodity market is less than 35% and the parties to the distribution contract do not compete.

Restriction to Enter into Similar Agreements with Other Counterparties. Exclusivity

Prior to 1 January 2010, Article 11.1 of the Competition Law prohibited agreements of any business entities at the commodity market, which lead or may lead, inter alia, to economically or technologically unjustified refusal from entering into agreements with certain sellers or purchasers (customers), unless such a refusal is expressly provided for by federal laws, regulatory legal acts of the President and the Government of the Russian Federation.

In this respect, conditions of distribution contracts which expressly prohibited, including under

the threat of penalties, the supplier from entering into similar contracts with other distributors were deemed invalid by the courts (in particular, Decision of the Central district FAC, dated 28 January 2011 on the case No. A14-7143/2010/207/22, and dated 4 February 2011 on the case No. A14-8178/2009/268/29).

From 1 January 2010 the said prohibition became no longer applicable to the 'vertical' agreements. However, it was established that such agreements, except for 'permitted' 'vertical' agreements (franchise contracts and the agreements any party to which holds the share at any commodity market no more than 20%) may not obligate purchasers not to sell the goods of a business entity - competitor of the seller, unless such agreements are agreements for organisation of sales of the goods by a purchaser under a trade mark or trade name of the seller or manufacturer (Article 11.2 of the Competition Law).

Exclusivity terms under which the supplier undertakes to sell the goods to the sole distributor, or the distributor undertakes to purchase goods from the sole supplier, are not expressly prohibited by Russian law provided that the supplier and distributor are not competitors and none of them has a dominant position. Otherwise such terms may be qualified as a refusal to enter into contracts with certain sellers or purchasers (customers) in accordance with Article 11.1 of the Competition Law, or economically or technologically unjustified refusal or evasion from entering into contracts with certain purchasers (customers) under Article 10.1 of the Competition Law.

An example of an unacceptable exclusivity condition is the provision under which the distributor is granted with the exclusive rights to buy any goods from the supplier that holds 100% share in a particular commodity market, and the supplier undertakes not to sell these goods in the territory specified by the contracts without the distributor's prior consent (the Decision of the HAC Praesidium No. 6577/11 dated 29 November 2011).

In practice FAS of Russia considers exclusivity terms and conditions as violating the Competition Law if they result or may result in restriction of competition, in particular, prevent other business entities from accessing the commodity market (Decision of FAS Russia on the administrative case No. ЧО 06-07/2009-99А; Decision dated 26 September 2012 on the case No. 1 11/227-11; Decision dated 17 September 2009 on the case No. 1 11/120-09).

The provision obliging the purchaser (distributor) not to produce, purchase and resell the goods of the seller's competitors after the expiration of the contract (ex post non-competition) may be deemed permissible upon decision of FAS of Russia (see http://fas.gov.ru/fas-in-press/fas-in-press_39752.html) based on the following circumstances:

- whether this obligation refers to substitute goods being the subject of the contract;
- whether this obligation is limited to the territory or rooms where the purchaser sold the goods during the contract term;
- whether it is required to protect production secrets (know-how), patent rights transferred by the seller to the purchaser;
- how long it will remain in force.

Distribution Contracts as an Instrument for Coordination

Article 11.5 of the Competition Law prohibits individuals, profit-making and non-profit organisations to coordinate economic activities of business entities if such coordination leads to any of the consequences of cartels and banned 'vertical' agreements that may not be allowed under Articles 12 and 13 of the Competition Law or that are not provided for by other federal laws.

According to the clarification issued by FAS Russia No. ИА/146 dated 12 January 2010 such illegal coordination is the coordination of actions of business entities by a third party that resulted in agreements between such business entities or concerted acts thereof which lead or may lead to the consequences specified in Article 11.1 of the Competition Law.

In practice, even if the distribution contract with an independent distributor does not violate

the Competition Law, in particular, where each distributor is assigned a certain territory and is banned to sell the goods outside such a territory, FAS of Russia may deem entering into several such contracts with different distributors as the coordination of activities of independent business entities which results or may result in the division of the commodity market by territory as well as by the composition of purchasers and sellers (in particular, Decision on the case No. 111/132-11, dated 31 May 2012, Belarus Automobile Plant OAO, BelAZ Trade House ZAO, BELAZKOMPLEKT PLUS COMPANY ZAO, BelAZ Trade House ZAO, BELAZKOMPLEKT PLUS COMPANY ZAO). In this case, both the supplier-coordinator and the distributors are held liable (in particular, Decision of FAS of Russia dated 3 February 2010 on the case No. 1 11/119-09).

Requirements and Restrictions in the Distribution Contracts Regarding Supply of Certain Types of Goods

The Federal Law No, 381-FZ dated 28 December 2009 'On Fundamentals of State Regulation of Trading Activities in the Russian Federation' ('Trading Activities Law'), Article 9, establishes a range of requirements and restrictions regarding terms and conditions of contracts for supply of food products which are applicable to a distribution contract entered into between the supplier of such products and business entity engaged in trading activities (distributor):

1. remuneration to the distributor for purchasing from the supplier a certain quantity of food products should be included in the contract price. The amount of such remuneration cannot exceed 10% of the price of the bought food products and such remuneration should not be factored in the price of food products;
2. the said remuneration cannot be paid when the distributor purchases certain types of socially important food products included in the List approved by the Government of the Russian Federation;
3. the contract price cannot include other types of remuneration for executing contract conditions by the distributor in and(or) changing contract terms and conditions;
4. when the contract contains the condition to pay for such goods within a given period after the goods were delivered to the distributor, such payment period is determined subject to the shelf-life of the goods;
5. the contract cannot prohibit assignment of a claim under the contract as well as liability of the contract parties for non-compliance with the prohibition;
6. the contract cannot include conditions that the distributor must render services for advertising the goods, marketing and similar services aimed at the goods promotion: to render such services the distributor should enter into separate service agreements.

Regarding the basis for calculation of the remuneration to the distributor FAS of Russia in its letter dated 5 September 2013 provided for the following ambiguous explanation: conditions of purchasing food products should be determined by the parties at their discretion subject to the provisions of the Civil Code and the amount of remuneration to the distributor may be based, inter alia, on the price of products purchased, price of the supply contract, amount of products purchased, but must not exceed 10% of the price of *purchased* products. (A conclusion may be drawn therefore that the amount of remuneration must be calculated upon delivery of the products confirmed by the consignment note.)

In practice, the territorial divisions of FAS of Russia, however, bring business entities to liability not for violation of the requirements referred to above but for violation of Article 13 of the Trading Activities Law which prohibits trade networks from establishing discriminatory conditions for their suppliers, in particular, to establish equal remuneration based on the price of goods supplied for different suppliers at different amounts of goods. The courts abrogate the relevant decisions if the proofs of discrimination are insufficient (Decisions of the West Siberian district FAC dated 25 April 2012 on the case No. A45-12199/201, dated 17 March 2014 on the case No. A45-13492/2013, and Decision of the Central district FAC dated 15 November 2012 on the case No. A08-1106/2012).

Despite the fact that the prohibitions and restrictions established by the Competition Law with respect to "vertical" agreements have been notably liberalised under the second and third 'antitrust packages' (amendments entered into force in 2010 and 2012), the parties to distribution contracts may assess the admissibility of restrictive conditions according to the following algorithm:

1. whether the parties belong to the same group of persons or one of them controls the other, or the parties are under common control by the same person according to Article 11.8 of the Competition Law - in this case, the contract will not be subject to the prohibitions set forth by this article; - if not, then
2. whether the parties compete at the same commodity market and, if so, whether the conditions refer to the ones per se prohibited pursuant to Article 11.1 of the Competition Law;
3. whether the contract is permissible under Article 12 of the Competition Law based on the shares of each of the parties at any market; - if not, then
4. whether the contract contains any conditions prohibited under Articles 11.2 and 11.4 of the Competition Law; - if yes, then
5. whether any evidence that such terms are allowed under Article 13.1 of the Competition Law be provided; if yes, then
6. whether the contract and its conditions comply with the General Exceptions for agreements between purchasers and sellers.

In case of any doubts as to whether certain terms of the contract are permissible either party may apply to FAS of Russia on the basis of Article 35 of the Competition Law for a preliminary evaluation of the compliance of the draft contract with the requirements of antitrust laws. The term for such review by FAS of Russia is 30 days from the date of receipt of all required documents and information and upon results of such a review FAS of Russia may decide that the draft contract does not comply with antitrust laws and to issue to the parties a prescription to amend the draft in order to ensure competition.

In addition, attention needs to be paid to the new amendments that the legislator intends to introduce to the Competition Law within the framework of the 'fourth antitrust package': the bill adopted in the first reading in October 2014 provides, inter alia, that the 'vertical' agreement will be considered valid if neither the seller nor the purchaser holds a share over 20 percent at the market of goods being the subject of the 'vertical' agreement, rather than any commodity market, as it is currently established.

Best Regards,

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