

<b>Case number:</b>	<b>Vj-94/2005</b>
<b>Short title:</b>	<b>BAT and its exclusive distributors</b>
<b>Type of case:</b>	<b>Restrictive agreements</b>
<b>Description:</b>	Though BAT's market share on the Hungarian market of tobacco products is 40-50 % and it concluded contracts with its 23 distributors for an indefinite duration in the period between 2001 to 2006, the differences between those agreements and their "counterparts" covered by Regulation (EC) No 2790/1999 have no adverse effects on the agreements' in question meeting the conditions established by Article 81(3) EC.
<b>Decision:</b>	There are no grounds for further action of the GVH, the proceeding was terminated.
<b>Date:</b>	<b>Budapest, 20 May 2006</b>

### **Commencement of the proceeding, legal rules applied**

The GVH examined in its proceeding started in June 2005, whether the contracts concluded between the British American Tobacco group (BAT) and its 23 distributors about the distribution of tobacco products in the territory of Hungary infringed/infringe, in the period between September 2001 to May 2006, the provisions prohibiting restrictive agreements of the competition law.

In different parts of the period mentioned above, provisions actually in force of the Hungarian Competition Act and Act X of 2002, Article 81 EC, furthermore, the relevant block exemption regulations of the Hungarian Government and Commission Regulation (EC) No 2790/1999 might have been applied. The Competition Council of the GVH held, however, that for the case it would find the contracts in question not to be unlawful under the provisions currently in force, it would be unjustified to establish an infringement even if those contracts infringed, in any former part of the period, the provisions in force that time. On the other side, in cases where national competition authorities apply both national competition law and Article 81 EC to restrictive agreements, the application of national competition law may not lead to the prohibition of agreements which are not prohibited under Article 81 EC, as Article 3 of Council Regulation (EC) No 1/2003 provides for. Therefore, the Competition Council examined the facts of the case first under Article 81EC.

### **The contracts**

BAT, the Hungarian subsidiary of a multinational tobacco-company, distributes the tobacco products it produces or imports, in the same way as do other tobacco products manufacturers, in the whole territory of Hungary. Within this activity,

- it sells the major part of the products directly to retailers/retail chains (with these sales amounting to 94 % of the total turnover),
- while the remaining 6 % is forwarded by its distributors to the retail trade, to places, where direct distribution would not be economically viable for BAT.

In the contracts between BAT and its exclusive distributors (wholesalers)

- BAT obliged itself not to appoint other distributors in the territory allocated to its distributor;
- the distributors obliged themselves
  - § not to supply retail shops the direct supply to which BAT reserved for itself;

- § to sell exclusively tobacco products produced or imported by BAT;
- § furthermore, not to perform active sales outside their respective territories.

The contracts were concluded for an indefinite duration with the possibility for any of the parties to terminate in writing their respective contracts with a 60-day notice period.

The exclusive distributors get the products at the list prices of the supplier. Their ability to determine their sales prices is in no way restricted by their contracts with the supplier. But in Hungary Act CIII of 1997 on Excise Duties allows manufacturers and importers to fix the retail prices of tobacco products. With the retailers' sales prices being fixed, there is no wide scope of action for the exclusive distributors when they bargain about prices with the retailers. Under certain conditions, their contracts with the supplier provide monthly bonuses to the exclusive distributors.

### **The Hungarian tobacco products market**

BAT's share on the Hungarian tobacco products market (as the relevant market) is between 40 and 50 % (with its annual turnover being much higher than EUR 40 million); the remaining three tobacco products manufacturers in Hungary have 30-40 %, 10-15 % and 5-10 % respectively. Apart from these four undertakings, some foreign manufacturers (Altadis, Gallahar, Scandinavian Tobacco) are also present with their products on the Hungarian market, their share from the total turnover in Hungary is, however, insignificant (i.e. below 1 %).

Tobacco products distributors are required to have an excise licence. More than 200 undertakings are licensed distributors. Of them, in addition to the 23 distributors of BAT, further seven undertakings are bound by an exclusive agreement to one or another of the tobacco products manufacturers. The distributors activity also covers, besides the distribution of tobacco products, the wholesale marketing of other (typically drink and food) products.

### **Legal assessment**

It is beyond doubt that the provisions of the contracts restrict the sales activities of both BAT and its distributors, furthermore, they restrict the purchasing activities of the latter, infringing in this way the provision laid down in point (b) of Article 81(1) EC.

The contracts qualify as vertical agreements within the meaning of Commission Regulation (EC) No 2790/1999 (hereinafter: the Regulation); however, the exemption provided for by the Regulation does not apply to them as

- the market share held by BAT exceeds 30 % of the relevant market (Article 3(1) of the Regulation); and
- they have been concluded for an indefinite duration (point (a) of Article 5 of the Regulation).

The provisions of Article 81(1) EC are, however, inapplicable to agreements caught by Article 81(1) which satisfy the conditions of Article 81(3). Pursuant to recital (5) of the Regulation, the benefit of the block exemption is limited to vertical agreements for which it can be assumed with sufficient certainty that they satisfy the conditions of Article 81(3). Consequently, it may normally be sufficient to examine the possible adverse effects the differences between an agreement not covered and the agreements covered by a block exemption could have on the agreement's in question meeting the conditions established by Article 81(3) EC. In the absence of such adverse effects, Article 81(3) EC applies to the agreement.

Objective of the limitation of the duration of (the non-compete obligations contained in) vertical agreements is to prevent the supplier (in this case: BAT) from binding to itself customers (in this case: the distributors of BAT) for an excessively long period of time, even if they are no more interested in the sustainment of their contracts with the supplier, the termination of which could therefore promote the expansion of (new) competitors of the supplier; from another aspect, a further existence of the contract could even result in market foreclosure. The contract may be unilaterally terminated with a 60-day notice period, without any reasoning, by any of the parties. Hence, distributors do not run the risk they would not be able to exit their respective contracts should they be no more interested in the continuation of their business relations with BAT. The possibility of termination with a short notice period and without any reasoning to be given granted by the contract is, from the point of view of competition law, a much favourable option in comparison to, say, an agreement concluded for a definite duration which is longer than 60 days but shorter than five years, though this latter agreement would enjoy, supposed the other conditions are met, the benefit of the block exemption under the Regulation.

Starting point for the Competition Council was the presumption underlined in recital (12) of the Regulation that, under the conditions established by the Regulation, market shares of the participating undertakings not exceeding 30 % of the relevant market normally ensure that the agreements do not enable those undertakings to eliminate competition. The market share of BAT is higher than this threshold. Nevertheless it cannot, for the following reasons, enable BAT to eliminate competition.

- a) The manufacturers of tobacco products are in an intense competition with each other, the maintenance of which is guaranteed by the facts that, in addition to BAT, another manufacturer with a similar market share and two further manufacturers the market shares of which are not negligible either are active on this market; furthermore, the number of foreign tobacco products manufacturers entering the Hungarian market has been growing recently.
- b) Apart from the distributors of BAT, a great number of market players deal with the wholesale trade of tobacco products. Currently, many of the other undertakings which have already received the (excise) licence required for the distribution of tobacco products distribute other products (mainly drinks and foods). This enables them to enter, without any further investment, the wholesale market of tobacco products, promoting in this way the market entry of foreign and possible new domestic manufacturers.
- c) Though the market share of BAT to be considered for the purposes of the Regulation is as high as 40 to 50 %, nevertheless, the turnover covered by the agreement accounts for only (6 % x 40-50 % =) 2 to 3 % of the whole turnover on the tobacco products market in Hungary.

## **The decision**

The Competition Council has found that there are, within the meaning of Article 5 of Council Regulation (EC) No 1/2003, no grounds for further action on its part as concerns Article 81 EC. With regard to what has been mentioned above, it found needless to also examine the facts of the case under any other legal norm.

Budapest, 20 May 2006