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Does the Directive on Unfair Trading Practices Change Anything?

The Directive on unfair trading practices in business-to-business relationships in the agricultural and food supply chain has been adopted recently. For a long time, this sector has been on the radar of EU bodies, as sufficient reasons for the regulation and its methods have been sought. Meanwhile, many countries adopted their own national legislation – all of the countries of the Visegrad Group among them. The Czech legislation is considered one of the most stringent, and Czechia can even boast a very strict application practice by the supervisory authority. Thus, what does the directive bring about and what to expect from its implementation in the domestic environment? We would like to briefly address it in this release of Competition Focus.

History

The European Commission ("**Commission**") started to analyse the functioning of the food supply chain in late 2008 in response to price increases in agricultural production. One of the key elements found was the existence of asymmetry in bargaining power among undertakings at different levels of the chain. Although divergences in market power in business relationships are common, in the case of food supply, the imbalance is likely to result in unfair trading practices, the Commission says. Market players with more economic strength are simply more capable of enforcing arrangements to their benefit.

To remedy the situation, the Commission first opted for the recommendations. The Commission issued the Green Paper on unfair trading practices[1] and **requested the Member States to take appropriate measures to address the issue**. To date, only 8 Member States have not adopted any legislation. However, the fashioning of these measures highly varies among the Member States – most of them have chosen to regulate while others have opted for self-regulatory, voluntary initiatives among market participants.

Based on the request of the European Parliament[2] and the Commission's subsequent findings that the Member States had not complied with most of its recommendations,[3] the Commission presented a proposal for a directive in April 2018. On 17 April 2019, the proposal was adopted and then published under No. 2019/633 ("**Directive**").

The Directive has been chosen as an appropriate instrument to ensure the required minimum standard for elimination of manifestly unfair trading practices. At the same time, it enables the Member States to choose the method of integration of the respective rules into their national legal orders. The Member States are required to adopt appropriate transposing legislation by 1 May 2021. The legislation in question shall then come into effect no later than 1 November 2021.

For many of the Member States, there will be no major changes to existing legislation, which often goes beyond the requirements of the Directive. That is probably the Czech Republic's case as well, as the issue of prohibited contractual arrangements and unfair trading practices in the food supply chain is already covered by the Act on Significant Market Power[4] ("**SMPA**"), and the enforcement of such rules is entrusted to the Office for the Protection of Competition ("**Office**").

Let's do a brief comparison of both pieces of legislation.

Who is Protected and Against Whom?

Regarding the protection of a supplier, the Directive has opted for a so-called relative concept, according to which suppliers are protected only against buyers bigger than

[1] *Green Paper on Unfair Trading Practices in the Business-to-Business Food and Non-Food Supply Chain in Europe, COM/2013/037 final – 2012.*
[2] *European Parliament resolution of 7 June 2016 on unfair trading practices in the food supply chain, 2015/2065(INI).*
[3] *The Commission addressed the recommendations within the Report to the European Parliament and the Council on unfair business-to-business trading practices in the food supply chain of 29 January 2016, COM(2016) 32 final.*
[4] *Act No. 395/2009 Sb., on significant market power in the sale of agricultural and food products and abuse thereof, as amended.*

them. The turnover of both the supplier and the buyer is a basic criterion. The Directive introduces five turnover thresholds of the supplier, which equal turnover thresholds for a micro enterprise (not exceeding EUR 2 million), small (not exceeding EUR 10 million) and medium-sized enterprises (not exceeding EUR 50 million).[5] In addition, the Directive provides two more thresholds (not exceeding EUR 150 million and EUR 350 million). The Directive does not apply to relationships with suppliers whose turnover exceeds EUR 350 million. Moreover, the supplier is only protected if the buyer's turnover is higher than the maximum turnover in the category to which the relevant supplier belongs. For instance, a supplier with a turnover of EUR 23 million is protected by the Directive only against practices of buyers with a turnover exceeding EUR 50 million.

On the other hand, the prohibition of abuse of significant market power according to the SMPA applies to buyers – chain stores and their alliances with significant market power, under the presumption that buyers whose turnover exceeds CZK 5 billion (approx. EUR 200 million) have significant market power. The current wording of the act is in fact interpreted as an absolute concept by the Office – in practice, generally all suppliers are protected regardless of their market power or turnover. In comparison to the SMPA, the Directive applies to a wider group of buyers (the threshold could be far lower than CZK 5 billion), but at the same time only in relation to suppliers with a certain (lower) turnover in comparison to the buyer concerned. In addition, the Directive does not only cover practices of chain stores, but also of buyers at different levels of the distribution chain (processors and intermediaries).

What Behaviour is Unfair?

According to the Directive, unfair trading practices shall in general be "*practices that grossly deviate from good commercial conduct, that are contrary to good faith and fair dealing and that are unilaterally imposed by one trading partner to another.*" However, contrary to the SMPA, the Directive does not contain a general clause. It only provides a list of fifteen individual prohibited trading practices in relation to the sale of food products.

These practices are divided into two groups. The first concerns nine individual practices prohibited without further consideration. The latter concerns the remaining six individual practices prohibited only if they are not clearly and unambiguously agreed upon when a supply contract is concluded between the buyer and the supplier.

Always prohibited practices

As for several practices that the Directive considers a part of the first group, the SMPA already contains more stringent regulation. Firstly, it concerns the prohibition of payment periods exceeding 30 days for perishable food products, and 60 days for other food products. According to the SMPA, the payment period cannot exceed 30 days from the day of the delivery for all types of food products. Similarly, the Directive prohibits requiring payments from the supplier that are not related to the sale of food products. The more stringent regulation of the SMPA prohibits negotiating and requiring payments or other consideration for which a service or other consideration was not provided, but also which is inadequate or disproportionate to the value of the actually provided consideration. Further, while the Directive stipulates the obligation of the buyer to confirm in writing the terms of the supply upon the request of the supplier, the SMPA requires written form for any contracts between the buyer with significant market power and its suppliers. In addition, Section 3a of the SMPA regulates obligatory content requirements (e.g. a 3% cap for services provided by the buyer to the supplier).

Other practices covered by the Directive are not specifically addressed in the SMPA. They could be, however, considered a part of some of the broader practices of abuse of significant market power under Section 4(2) of the SMPA. These concern unilateral changes of contractual terms on frequency, timing or volume of the supplies, quality standards or price of food products, but also requiring compensation in cases where the damage was not caused by the fault of the supplier. Both of these practices could be qualified as applying contractual terms that create a substantial imbalance in the rights and obligations of the parties according to Section (4)(a) of the SMPA.

Some of the individual practices prohibited by the Directive could be qualified as abuses of significant market power in contrary to the general clause, or Section 4(2)(a) which covers the imbalance between the parties, or Section 4(2)(b) which covers requiring a payment without adequate performance. The Directive prohibits buyers from requiring compensation for the costs of dealing with customers' complaints relating to the sale of a supplier's products unless the reason for the complaints was caused by the supplier. A similar practice is covered by Section 4(2)(h) of the SMPA concerning sanctions imposed by an inspection authority. Therefore, the practice concerning the above-mentioned compensation is likely to be qualified as an abuse of significant market power under the current wording of the SMPA.

[5] *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361/EC.*

Another two of the prohibited practices are the unlawful acquiring and abusing of trade secrets and acts of commercial retaliation against a supplier if the supplier exercises its contractual or legal rights; the mere threat of retaliation is considered prohibited according to the Directive. Assumingly, the general clause in Section 4(1) of the SMPA could be applied to these three individual practices.

Finally, the group of practices always prohibited by the Directive concerns the prohibition of cancellations of orders of perishable products with such a short notice that the supplier is not objectively capable of finding an alternative for selling or otherwise processing the product. According to the Directive, the notice period cannot be shorter than 30 days. On the contrary, the SMPA does not explicitly regulate cancellation of orders – only arranging the right for the return of purchased food (with the exception of a gross breach of contract) is considered an abuse of significant market power. Therefore, the cancellation of orders could be qualified as an abuse of significant market power only on the basis of the general clause. Nevertheless, it is common in practice that buyers order perishable products less than 30 days before the delivery. According to the strict interpretation of the Directive buyers would be prevented from cancelling the order at all in such a case. Obviously, it is a sensitive issue, and for now it remains unclear how this provision will be applied in the context of the SMPA.

Practices permitted only when negotiated with a sufficient clarity

The second group of the practices prohibited by the Directive consists of six individual practices that are prohibited only if they are not agreed in clear and unanimous terms in the supply contract between the supplier and the buyer.

The first two practices concern returning of unsold food products to the supplier and charging payments for stocking, displaying or listing the food products. The SMPA is more stringent also in this case. While the Directive enables applying these practices in certain conditions mentioned above, the SMPA explicitly prohibits negotiating or applying the return of goods and listing payments as a special type of abuse of significant market power.

In addition, according to the Directive, contractual terms on costs of any discounts on food products that are sold as a part of a promotion organized by the buyer, must be clearly agreed as well. Similarly, it must be clear under which conditions the buyer requires the supplier to pay for the advertising, marketing and staff for fitting-out premises used for the sale of the supplier's products.

These requirements are not a novelty for the SMPA, since, as indicated above, the SMPA requires all contracts between the buyer and the supplier to be negotiated in writing. The written contract must contain the purchase price, the amount of the discounts (including promotional discounts) and the amount of all the supplier's payments. Simultaneously, the amount of payments (including marketing payments, according to the Office's current interpretation) is capped at 3% of the annual sales of the supplier with the buyer concerned (Section 3a(a) of the SMPA). Moreover, the marketing services provided by the buyer must be assessed in terms of their proportionality. The Office will assess whether the buyer provides the supplier with an adequate consideration for its payment (Section 4(2)(a) of the SMPA). Therefore, the SMPA seems to be more stringent to this extent as well since the Directive permits such arrangements as long as the terms are clear and unambiguous.

Requirements for the Enforcement Authority

The Directive also stipulates minimum requirements for the Member States for the sake of effective enforcement of its substantive rules. First, the Member States are required to designate an appropriate authority to enforce the prohibitions laid down in the Directive. In order to increase the efficiency, the Member States are also required to enable complaints to be submitted from both the suppliers and the producer organisations. In addition, the Member States must, on request, protect the anonymity of the complainant and also any other information the disclosure of which the complainant considers as harmful to its interests. The Czech legislation already fulfils such criteria, including the anonymity of the supplier, if requested and duly justified.

Further, the Directive lays down a minimum set of powers of the enforcement authority. In particular, the authority must have the power to conduct an investigation on its own initiative or on the basis of the complaint, to require the buyers and the suppliers to provide all necessary information, to carry out unannounced on-site inspections and to take decisions finding an infringement.

The SMPA fulfils all the aforementioned criteria as these powers are conferred on the Office.

Robert Neruda's Opinion

Although I have always been rather sceptical towards any regulation of supplier relationships in the food products sector, I welcome the adoption of the Directive. It shows that resolving such a complex issue is possible in a sensitive and targeted manner. I also consider such achievement a consequence of a prior open discussion with all of the relevant stakeholders as a part of it. I believe that the basic principles of the enacted regulation are easily comprehensible and therefore could be generally accepted, i.e. by both parties.

Unfortunately, the same does not apply to the current stringent and very vague wording of the SMPA. Its provisions are barely understood even by legal experts, and the robust contractual limitations neither conform to the buyers nor many suppliers.

Clearly, the current wording of the SMPA is more stringent, which is allowed by the Directive. I am concerned that this will be the principal argument of the proponents of the SMPA's current wording to maintain the *status quo*. Indeed, amendments to the SMPA brought about by the transposition of the Directive will be minimal (extending the scope of buyers concerned could be considered the most significant change). Representatives of the Ministry of Agriculture and the Parliament have already expressed their view that the regime of the abuse of significant market power will not be mitigated as a result of the Directive.

However, we would opt for the opposite, i.e. for the transposition of the Directive to be an opportunity for a rational review of the utility of certain concepts and prohibitions in the SMPA. Its application in practice has shown that some of the limitations simply do not make sense for anybody (rule of 3%). We should switch to the relative concept of significant market power also in the Czech Republic, since only this concept makes economic and common sense. If the Office's advocacy of the absolute concept was motivated by the simplicity of its applicability, the Directive clearly indicates that the relative concept could be applied by means of relatively straightforward rules of reciprocal turnover thresholds without the application of the relevant legislation becoming impossible or too complex.

I believe that revoking the general clause, reducing prohibited unfair practices only to those contained in the Directive and opting for the relative concept based on turnover proportions would encourage the spontaneous acceptance of the SMPA by its addressees as well as by experts. And all while not negatively affecting the consumers and the economy as a whole.

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