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The economic approach in Polish courts: permitted agency agreements or prohibited price fixing? Case comment to the judgment of the Appeal Court in Warsaw of 13 February 2007 – *Roche and Hand-Prod* (Ref. No. VI AcA 819/06)

Facts

By the decision of 29 June 2004 (no. RWA-18/2004), the President of the Polish Office for Competition and Consumer Protection (hereafter, UOKiK) found that the agreement between Roche Polska Sp. z o.o. (hereafter, Roche) and Hand-Prod Sp. z o.o. (hereafter, Hand-Prod) fitted the definition of a competition restricting practice. The President of UOKiK stated that the agreement restricted Hand-Prod's right to freely decide the selling price of two of Roche's medicinal products containing Erythropoietin: Recormon and NeoRecormon (hereafter, the Products). As a consequence, these products would be offered for sale, by way of centrally organised tender proceedings, at fixed prices agreed upon by the two parties. The President of UOKiK ordered the companies to cease the practice and imposed on them the following fines: Roche – PLN 235,850 (EUR 50,000) and Hand-Prod – PLN 70,755 (EUR 15,000).

Both companies appealed the contested decision. Hand-Prod asked for the proceedings to be dismissed claiming that they were groundless; the company, alternatively, requested that the fines be lowered. Roche asked for the decision to be changed in full and stated that the alleged anticompetitive practice did not exist; it further requested that the fines be cancelled or, alternatively, that the President of UOKiK declared that the prohibited practice had existed but had not been employed since 15 March 2003.

The Competition and Consumer Protection Court in Warsaw (hereafter, SOKiK) issued on 29 March 2006 a judgment changing the appealed decision. SOKiK ruled that Roche and Hand-Prod had not engaged in an anticompetitive practice of entering into a prohibited vertical agreement restricting Hand-Prod's right to set the selling prices of the two aforementioned products and offering them, by way of centrally organised tender proceedings, at prices fixed by the two companies. SOKiK stated that the agreement between Roche and Hand-Prod was in fact an agency agreement the provisions of which were not subject to assessment under antitrust law.

SOKiK's judgment was appealed by the President of UOKiK. The appeal was based mostly on the claim that SOKiK wrongly interpreted the agreement between Roche and Hand-Prod as an agency agreement and that, by doing so, it groundlessly applied in this context the European Commission's Notice – Guidelines on Vertical Restraints (hereafter, the Notice).

By the judgment of 13 February 2007, the Court of Appeal in Warsaw dismissed the appeal lodged by the President of UOKiK. The Court of Appeal accepted the judgment of SOKiK presenting additionally its own analysis of some of the aspects of the case. Below is the outline of that assessment.

Key legal problems of the case

The core problem in this case was the correct classification of the relationship between Roche and Hand-Prod as well as the question: which antitrust rules should be applied in the assessment of this relationship.

The accused companies were not unanimous in their interpretation of the problematic price-fixing clause (hereafter, the Arrangement) nor, more broadly, in their interpretation of the nature of the whole of their agreement (hereafter, the Storage Agreement). Although both parties raised many sound procedural and substantive arguments, they were weakened by the fact that they were not consistent.

Roche claimed that the Arrangement was in fact an agreement on setting maximum, rather than fixed, prices. It also stated that the Arrangement did not have any negative effects on the relevant market since it was never implemented. In fact, due to the changes in the system of public tenders applicable to the pharmaceutical sector, during the time the Arrangement was in force, no centrally organised tenders were actually held.

Hand-Prod also claimed that the Arrangement only set maximum prices. It also argued that the Arrangement should be considered in conjunction with other provisions of the Storage Agreement, seeing as this would show that the clear economic aim of the Arrangement was to enter into an agency and logistic services agreement, rather than a typical distribution agreement. In the context of the tenders, Hand-Prod was meant to act therefore only an agent of Roche, a fact that precluded the application of the price fixing prohibition. Hand-Prod agreed with Roche that the practice had no negative effects on the relevant market.

The President of UOKiK did not agree with the line of argumentation presented by the parties. The authority interpreted the Arrangement as a prohibited agreement between independent undertakings which had the effect of restricting competition. The President of UOKiK did not agree that the Arrangement was in fact an agency and logistic services agreement, seeing as it contained all the typical elements of a distribution agreement that gave Hand-Prod the role of a distributor in its relationships with Roche. Therefore, the relationship between the two companies had to be treated as a vertical agreement subject to an antitrust analysis. The President concluded also that the Arrangement represented a form of cooperation between the companies that set fixed, rather than maximum, prices. In response to the argument that the

Arrangement did not cause any harm (considering that no tenders were actually organised) the authority pointed out that even potential restrictions of competition should be penalised.

Key findings of the Courts

SOKIK and the Court of Appeal commented in detail on all of these arguments, providing the Polish doctrine with a valuable body of jurisprudence in this context. However, while worthy of approval is the overall assessment of the courts stating that an anticompetitive practice did not occur in this case, some parts of the justification of the judgments call for the following comments.

Difference between maximum and fixed prices

The distribution of the Products by Hand-Prod was organised on the basis of the Storage Agreement that stated that Hand-Prod undertook to sell the Products for the same price at which they were purchased from Roche, without any mark-up, provided it was not agreed in writing with Roche. Hand-Prod undertook to provide Roche, on a monthly basis, with its price list. The contract stated that Hand-Prod had the right to grant rebates to its clients on the condition that Roche agreed to them and that the rebates would be granted according to the conditions set out by Roche. Rebates given by Hand-Prod to its clients were to be reimbursed in full by Roche.

Taking the above into account, the opinion of the President of UOKiK seems to be justified finding that a system of fixed prices was agreed upon by Roche and Hand-Prod. Thus, the view taken by SOKiK and the Court of Appeal that the companies merely agreed on setting maximum prices should be considered to be incorrect. The courts based their opinion on the mere fact that the Storage Agreement allowed Hand-Prod to sell the Products below the fixed price suggesting that it was a maximum, rather than a fixed, price. Such reasoning could be accepted in a situation where a distributor had to respect only the maximum level of prices, agreed upon with the supplier, but retained full discretion concerning the sell below that level. However, in this case, giving rebates was dependent on Roche's consent. Therefore, Hand-Prod was bound both by the fixed price and by the level of rebates approved by Roche. Clearly, if Roche did not agree to a rebate, Hand-Prod would have to apply the fixed price.

Both courts concluded that the Arrangement between the companies was in the public interest since it reduced the prices of the Products. This view was based on the assumption that the described situation, where the fixed price may be lowered by the rebates granted by Hand-Prod upon prior approval by Roche, is equivalent to creating a maximum price system. This line of thought gives rise to justified reservations however seeing as it distorts the proper understanding of the concept of prohibited price fixing. If the approach of the courts was indeed correct, the prohibition of price fixing could be easily circumvented by supplementing all price fixing contracts with a clause allowing the use of rebates upon agreement of the supplier. Such clause would

give an alibi to prohibited price fixing contracts making it possible to claim that they merely constituted permitted maximum price setting agreements.

Thus, the interpretation given by the courts concerning the qualification of the Arrangement as a maximum price fixing clause remains controversial.

Possibility of relying on soft European Union law in national proceedings

SOKiK was of the opinion that the Storage Agreement should be analysed in the light of the European Commission's Notice on vertical restraints. The Notice concerns agreements which are excluded from assessment under Article 81(1) EC. SOKiK pointed out that the provisions of Article 81(1) EC have their equivalent in Polish antitrust law; agency agreements are however not covered by Polish block exemptions from the prohibition of competition restraining agreements, while they are dealt with by the EC Notice. Thus the analysis whether or not the arrangement between Roche and Hand-Prod was excluded from the domestic provisions prohibiting uncompetitive agreements should be performed on the basis of the conditions specified in the Notice. SOKiK stated also that national antitrust law should not be considered to be more restrictive in this field than EC law, if the Polish legislator had not enacted domestic regulations regarding the exclusion of agency agreements from the prohibition of competition restricting agreements.

In the appeal against the judgment of SOKiK, the President of UOKiK tried to challenge the above reasoning by pointing out that it was not possible to assess the Storage Agreement between Roche and Hand-Prod in the light of EC law, especially the Notice, as the contract was concluded before Poland's accession to the European Union.

The Court of Appeal did not accept this argument and referred to the European Agreement of 16 December 1991 Establishing an Association between the European Communities and Their Member States, of the One Part, and the Republic of Poland, of the Other Part. Although the Association Agreement did not serve as a basis for direct applicability of EC law in Poland, it was nevertheless a source of obligations to adjust the Polish legal system with that of the Community. Therefore, even though prior to Poland's accession the national legislator had not regulated the problem of the exclusion of agency agreements from the prohibition of competition restricting agreements, EC law cannot be excluded in the assessment of agency agreements. The Court of Appeal stressed that the interpretations given by Polish courts should be in line with the spirit of EC law and EC jurisprudence.

The reasoning presented by SOKiK and the Court of Appeal carries great significance for the assessment of the behaviour of businesses in the context of antitrust law. The President of UOKiK has not yet issued any formal guidelines or notices on the proper application of Polish antitrust law. This situation causes many problems for practitioners seeing as many of its rules are so general that it is difficult to apply them without further instructions from the President of UOKiK regarding their rationale and their interpretation. Thus the judgments given in this case clearly show that it is justified to rely on EC law in the absence of domestic legislation.

The important consequence of these judgments is that the courts imposed on the President of UOKiK the obligation to abide by the provisions of the Notice even though it constitutes an act of Community soft-law only and thus, it is not actually legally biding.

Proper identification of an agency agreement

Taking into account the conditions specified in the Notice, both SOKiK and the Court of Appeal were in agreement that the Storage Agreement had the features of an agency agreement. The risks associated with the activities of Hand-Prod such as storage financing, financing the investments needed for the activities conducted by Hand-Prod and risks resulting from selling the Products, were to be exclusively associated with Roche. Roche was the owner of the Products until they were sold to clients. Hand-Prod did not bear the costs of supplies to the warehouse, marketing and advertisement costs or costs of post-sale service.

SOKiK considered the relationship between Roche and Hand-Prod to be clear. Roche remained the only company controlling the prices of the Products but, at the same time, commissioned all the activities relating to the storage and sale of the Products to Hand-Prod, which specialised in such activities. Hand-Prod was paid for its services only in the form of a 21.7% commission on the Products sold. Hand-Prod's economic interest was not in any way connected with sales profits of the Products, which were associated in full with Roche.

The courts were right to conclude that Roche and Hand-Prod should have been treated by the President of UOKiK as one economic body. Considering that the prohibition of pricing agreements applies only to agreements between economically independent businesses, the Arrangement between Roche and Hand-Prod should not be deemed to be prohibited.

A more economic approach to the analysis of alleged breaches of competition law

The Court of Appeal stressed that the assessment whether or not a given agreement was anticompetitive could not be done solely by referring to the literal wording of the contract but also consider its economic context and the analysis of the relevant market. The Court of Appeal emphasised that the Arrangement between Roche and Hand-Prod was not implemented since the government resigned from organising central tenders for the Products in question. The President of UOKiK could therefore only attempt to prove that the aim of the Arrangement was in breach of antitrust rules. According to the Court however, it is not certain that the contract had such aim. The authority did not prove its accusations limiting its analysis to the statement that the mere wording of the Storage Agreement in the context of price fixing unquestionably proved the existence of a competition restricting arrangement.

In the opinion of the Court of Appeal, the position taken by the President of UOKiK was not justifiable. It is not permissible to interpret antitrust rules on the assumption that any potential threat to competition resulting from an agreement

constitutes a breach of law regardless of whether such threat has any chance of materialising. The Court of Appeal referred to the jurisprudence of the Supreme Court which stated that any threat to free competition must be real in order to be interpreted as a breach of competition law.

The position presented by the Court of Appeal is in line with the need, currently discussed by the European Commission and national competition authorities, to take a more economic approach to antitrust law. Antitrust law is a special kind of law that is in fact a mixture of legal rules and economic theories. Seeing it as a form of an administrative intervention into the free market, its scope must be interpreted in a narrow way and applied only in justified circumstances. If other clauses of the agreement suggest the opposite, antitrust authorities may not pick out only those contractual provisions that seem to prove the theory of the existence of an anticompetitive practice. Most importantly, antitrust authorities cannot base their decisions purely on the assumption of a contract's anticompetitive effect without checking whether its effects, or its aim, would be in fact detrimental to the market.

It can only be hoped that future antitrust enforcement proceedings will follow the line of argumentation presented in this case by the Court of Appeal.

Final remarks

The relationships between market players in the pharmaceutical sector are quite complex. In most branches of the economy, the role of a producer or importer of goods usually ends with their sale to wholesalers or other distributors. The latter companies resell the goods that are, at that time, already their property, to final customers and independently develop marketing strategies and advertising campaigns, rebate systems and other sales enhancing initiatives.

The role the suppliers of medicinal products play in the pharmaceutical sector is very different. Although they also use intermediaries, they continue to pursue their own market strategies regarding their products. They use their own sales representatives to promote products already sold to wholesalers, pharmacies and hospitals (the main purchasers of medicinal products).

In Poland, the system of reimbursement from public funds for medicinal products as well as the distribution margins system between the various participants of the pharmaceutical distribution chain is quite complex. In this unclear legal environment, suppliers of medicinal products try to cooperate with other market participants in a way that would guarantee the lowest possible final prices for their products ensuring in turn their competitiveness vis-a-vis substitute products.

Properly adjusting these trading strategies to antitrust law is problematic. A couple of years ago, relevant antitrust rules were not yet well known to the participants of the pharmaceutical markets; the case under consideration here is an excellent example of that fact. Both Roche and Hand-Prod had no clear position regarding the assessment of their contract. During the proceedings, they tried to raise many arguments in their defence putting ultimately far too little emphasis on the one argument most important in this respect, that is, the identification of their contract as an agency agreement.

Luckily, SOKiK and the Court of Appeal assessed their contract properly developing this argument in full.

Undertakings conducting business activities in Poland right now, including pharmaceutical companies, are far more aware of the fact that their vertical agreements are subject to antitrust scrutiny. They identify from the outset what effects they wish their contract to achieve, drafting its provisions so as to prepare either a distribution or an agency agreement. Unfortunately, the Polish legislator has still not issued its own guidelines on the relationship between antitrust law and agency agreements. However, in line with the views of the Polish courts, as expressed in this case, reviewing domestic contracts in the light of the EC Notice on vertical restraints has become common practice in Poland.

The Polish pharmaceutical market has recently undergone significant changes, the distribution of medicinal products in particular. More companies think about introducing direct sales systems in their relationships with pharmacies and hospitals, using their former distributors as agents only. It is likely therefore that the interpretation given by SOKiK and the Court of Appeal in the case against Roche and Hand-Prod will progressively gain in importance.

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