

CARROT OR STICK – ENFORCING FAIR TRADING IN POLAND’S FOOD SUPPLY MARKETS



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I. INTRODUCTION

Interestingly, the first nation mentioned in Adam Smith’s “Inquiry into the Nature and Causes of the Wealth of Nations” is not Scotland, but Poland. He characterized its 18th century economy with these words:

The corn of the rich country, therefore, will not always, in the same degree of goodness, come cheaper to market than that of the poor. The corn of Poland, in the same degree of goodness, is as cheap as that of France, notwithstanding the superior opulence and improvement of the latter country. [...] the corn-lands of France are said to be much better cultivated than those of Poland. [...] In Poland there are said to be scarce any manufactures of any kind, a few of those coarser household manufactures excepted, without which no country can well subsist.²

Today’s Poland can no longer be taken as an example of a poor agrarian society. However, its agriculture still remains an important part of the economy, and the sector’s problems stem to a large extent from a strange amalgam of feudal and communist legacy.

With the adoption of the EU’s Unfair Trading Practices Directive (“UTP Directive”),³ vertical relations in the agricultural and food supply markets will come into focus in EU countries. While most EU jurisdictions have already adopted some laws that protect the interests of suppliers of food products, other countries will continue to face the challenge of retrofitting the new regulation into the existing competition protection framework. We attempt to shed some light on problems and dilemmas that these and other jurisdictions may face when going through the same exercise. The paper begins with a description of Poland’s agricultural and food supply sectors. We recall the origins of the EU and the Polish UTP regulation. In this article, the history of unfair trading practices (“UTP”) enforcement is presented in the context of its interplay with the existing antitrust regime.

² A. Smith, “Inquiry into the Nature and Causes of the Wealth of Nations,” 1776, Volume I, Book I, Chapter 1, Paragraph 4.

³ The UTP Directive is: Directive (EU) 2019/633 of the European Parliament and of the Council of April 17, 2019 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain (Official Journal of the EU L 111/59 - https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.111.01.0059.01.ENG).

II. POLAND'S FOOD SECTOR

The food sector is one of the most important and fastest growing branches of the Polish economy.⁴ The total value of production of food processing sector in Poland accounted for 16 percent of manufacturing in 2018. As much as 41 percent of production from the Polish food sector is exported. The EU's internal market, with over 500 million consumers, became one of the main driving forces for the sector after Poland's accession to the EU. Poland is a leading EU producer of fruits (apples, raspberries, blackcurrants, blueberries), meat (poultry, pork), dairy products, and mushrooms. Despite this export success and strong domestic consumption, the profitability of Polish agricultural production is deteriorating. This stems from structural challenges: atomization of farms (of 1.4 million farmers, 1 million i.e. 76 percent own less than 10 hectares or 25 acres),⁵ inadequate consolidation of the means of production and sluggish emergence of producer groups and organizations. The latter factor is one of the major tools of the EU policy to overcome bargaining power distortions in the food supply chain.⁶ Despite this, no more than 20 percent of Polish farmers are involved in some form of cooperation, such as producer groups.⁷ The exception is dairy – 70 percent of Polish milk supply is processed by cooperatives. A likely culprit is the fact that, in Poland, “Agricultural Production Cooperatives” are associated with the forced collectivization of farms during the communist era.

The Polish market is also characterized by a relatively low concentration of both food processing and retail trade. The food processing sector is represented by 1,385 large and medium-sized companies,⁸ not counting small or micro firms. The largest domestic retail chain has a share of at most 20 percent, the four largest retail chains have a combined share of at most 33 percent, the eight largest 46 percent and the twelve largest 52 percent.⁹ Polish consumers seem to prefer small-format stores. The two leading retail chains are “soft discount stores,” usually with a sales area that meets the definition of a supermarket. The largest store formats, i.e. hypermarkets, have been losing market share in recent years. In the meantime, the small-format segment is growing due to the development of franchise chains.¹⁰

Disparities in bargaining power at various levels of the food chain resulting in UTP remains a common problem. In the case of agricultural products, moreover, the sector is forced to deal with a heightened level of information asymmetry related to the underdeveloped commodity exchange market. For example, Poland is one of the world's largest producers of apples and concentrated apple juice (and the largest in Europe). At the same time, there are no commodity exchanges that could provide farmers with reliable information on prices and trends.

4 Polish Investment and Trade Agency, “Food processing,” available at https://www.paih.gov.pl/sectors/food_processing#.

5 Statistics Poland, “Land use and sown area in 2018,” March 29, 2019, available at <https://stat.gov.pl/en/topics/agriculture-forestry/agriculture/land-use-and-sown-area-in-2018,7,14.html>.

6 Taking into account the disparity in bargaining power economic theory suggests that any form of farmers' cooperation, such as cooperatives, may be potentially welfare-improving— by reducing transaction costs (institutional economics) or setting competitive yardstick (neoclassical approach) – see L.F. Schrader, “Economic Justification,” [in:] D. Cobia (ed.), “Cooperatives in Agriculture,” Prentice Hall, Englewood Cliffs New Jersey 1989, p. 132.).

7 This share is reaching 60-100 percent in some EU-15 countries, which in some cases raises concerns regarding compliance with competition law, see European Commission, “The application of the Union competition rules to the agricultural sector,” Report from the Commission to the European Parliament and the Council, October 26, 2018; available at <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:52018DC0706>.

8 Data for the year 2018, companies with over 49 employees, see: Polish Investment and Trade Agency, op. cit.

9 Estimates based on the value of turnover from the 2017 financial statements.

10 Statistics Poland, “Internal market in 2017”, November 29, 2018, available at <https://stat.gov.pl/en/topics/prices-trade/trade/internal-market-in-2017,7,16.html>.

III. ORIGINS OF UTP REGULATIONS IN THE EU

The discussion on UTPs in the EU can be traced back to the year 2007 when the food price index calculated by the Food and Agriculture Organization of the United Nations (“FAO”) rose by nearly 40 percent, compared with 9 percent the year before. Nearly every agricultural commodity was part of this rising price trend.¹¹ In response, the European Commission (“EC”) issued a communication aiming to create “[a] better functioning food supply chain in Europe.”¹² The EC paid particular attention to the fact that the prices of many commodities have come down to levels comparable to, or lower than, those from before the start of the price surge. However, consumer food prices continued to increase and only started declining in May 2009, prompting concerns about the functioning of the food supply chain. These changes have caused considerable hardship for agricultural producers and implied that consumers are not getting a fair deal.

In the following years, the Commission continued to carry out in-depth research into the problem of unfair supply chain practices. The result was a “Green paper on unfair trading practices in the business-to-business food and non-food supply chain in Europe.”¹³ At this point, the need for UTP regulations seemed non-controversial. However, there were at least a few unresolved issues on the table. Is self-regulation sufficient or is hard law needed? Should regulations apply only to food or also to other products? Should the entire chain be regulated, or supplier-retail relations only? During lengthy discussions at the EU level, 20 out of 28 Member States decided to introduce various types of regulations against UTPs to their jurisdiction and started to enforce it *ex officio*.¹⁴ The Czech Republic and Germany belong to the countries with the longest experience with this type of regulation. In both cases, the national competition authorities (which had received additional competence in the field of UTPs), after issuing the first decision against the big retail chain, were faced with protracted appeals procedures. Surprisingly, the main grounds for legal challenge in both countries were not supposedly dishonest business practices, but economic evidence of a bargaining power disparity.

IV. EMERGENCE OF UTP REGULATION IN POLAND

Given the importance of the agricultural and food processing sector, the fact that Poland had not adopted its first UTP law until 2017 is somewhat surprising. Even though the Unfair Competition Act had been in place since 1926,¹⁵ it did not seem to provide an adequate legal framework to deal with the problems stemming from the existing contractual imbalance in the food supply sector. Its largest drawback was its civil law nature – it provides a basis for private damages lawsuits but there is no public agency responsible for enforcing it. Plaintiffs cannot claim damages beyond direct financial damage suffered, so there is little deterrent effect from such lawsuits. Also, due to the very nature of the contractual imbalances at issue, those who might be interested in filing lawsuits are not launching such actions because of their economic dependence on adverse parties. As a result, only a handful of lawsuits had been filed, all of which were “divorce cases,” filed after an existing contractual relationship fell apart.

The sector’s problems could not be addressed effectively under competition protection regulations either. The Office of Competition and Consumer Protection (“OCCP”) – Poland’s Competition Authority – was unable to intervene, as the parties with contractual advantages typically do not hold a “dominant position” as defined in Polish and EU competition rules.¹⁶ While it was relatively easy to show that the undertakings that used UTPs can act “to a significant degree independently of [their] contracting parties,” it was often impossible to prove that they enjoy a similar degree of market power *vis-à-vis* consumers and competitors. In addition, those who came forward with testimony of unfair business practices made it clear that they were doing so on the condition of anonymity and were reluctant to provide much detail, in fear of retaliation.

11 J. von Braun, “Rising Food Prices: What Should Be Done?,” International Food Policy Research Institute IFPRI Policy Brief, April 6, 2008, available at <http://www.ifpri.org/blog/rising-food-prices-what-should-be-done>.

12 European Commission, “A better functioning food supply chain in Europe,” Communication, October 28, 2009, available at https://ec.europa.eu/economy_finance/publications/pages/publication16061_en.pdf.

13 European Commission, “Green paper on unfair trading practices in the business-to-business food and non-food supply chain in Europe,” January 31, 2013, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52013DC0037>.

14 European Commission, “Report from the Commission to the European Parliament and the Council on unfair business-to-business trading practices in the food supply chain,” January 29, 2016, https://ec.europa.eu/growth/content/commission-publishes-report-unfair-trading-practices-food-supply-chain-0_en.

15 The Unfair Competition Act of 1926 r. was never formally repealed, but practically unenforceable during the communist times. The new Act was adopted in 1993.

16 According to the legal definition contained in the Polish Act of 16 February 2007 “On competition and consumer protection,” a dominant undertaking must be “capable to prevent effective competition in a relevant market by enabling it to act to a significant degree independently of its competitors, contracting parties and consumers.”

The shortcomings of the national legal framework became the topic of heated public debate in 2015. The pressure for regulation started mounting, perhaps fueled by the growing strength of supermarket chains positioned in the “discount” segment. Initially, the solution preferred by the President of the OCCP and the food retail industry was self-regulation in the form of an industry code of conduct. However, attempts to draft a compromise text failed and the Parliament put a legislative proposal in motion. The Parliamentary project was soon abandoned and a more comprehensive piece of legislation was proposed by the Ministry of Agriculture in June 2016.¹⁷ The official motives for the regulation focused on the apparent widespread unfair practices of the retail chains towards their suppliers. However, the proposal did incorporate one of the main claims of the retail industry: that due to high concentration levels (and high level of market power) on the side of the food processing industry, the retailers, including the strongest supermarket chains, often fall victim to unfair practices of the suppliers. The proposal therefore allowed for public intervention at all stages of the food supply chain, against the buyers and the suppliers of agricultural and food products alike. Despite this concession to the retail industry, the proposal was criticized and opposed by this group of stakeholders.

The President of the OCCP was involved in multilateral talks on the subject, participated in drafting of the proposal, and was eventually entrusted with the role of the main enforcer of the new UTP rules. The decision to add UTP enforcement to the OCCP’s portfolio of powers was based on several factors. First, the Office had experience with enforcing “competition related rules.” Second, it had procedures and trained staff already in place, which would allow it to “hit the ground running” with the new regulations. Third, due to the complicated subject matter of UTP infringements, it seemed natural that the judicial review of administrative decisions should be placed with civil courts, as was the case with the existing privately enforced unfair competition law. The Court for Competition and Consumer Protection – a civil court specialized in reviewing OCCP’s administrative decisions – was a natural candidate for this task. OCCP’s lack of detailed expertise in agricultural markets was not viewed as a major obstacle, since the interventions were expected to affect mostly the food retail sector – which the OCCP was more or less familiar with, thanks to its merger control activities.

V. CONTENTS OF THE FIRST UTP ACT

The Act “On counteracting the unfair use of contractual advantage in the trade in agricultural and food products” – a new law concerning UTP – came into effect on July 12, 2017. Unfair use of contractual advantage was outlawed under article 6 and defined in article 7 of the Act. According to the original wording of the latter, a “contractual advantage” was a position of a purchaser *vis-à-vis* the supplier, where the supplier did not have sufficient and opportunities to sell agricultural or food products to other purchasers and where there was a significant disparity in economic potential between the two entities, which put the purchaser at an advantage (or *vice versa*).

Holding a contractual advantage is not in itself an infringement under the Polish UTP regulations. Only an abuse of such an advantage, i.e. behavior that is contrary to good practices and infringes upon vital interests of the other party, is considered unfair and unlawful.

The Act contains an illustrative list of unfair trading practices:

- unreasonable termination or threatening with such termination;
- conferring only upon one party the right to terminate or withdraw from contract or to rescind it;
- making the conclusion of a contract contingent upon considerations having neither substantive nor customary relation with the subject of such contract (tie-in sales or purchases);
- unreasonable extension of payment periods for the agricultural or food products supplied.

Apart from the practices listed in the Act, the general prohibition clause of article 6 enables the President of the OCCP to contest practices that are not specifically named in the Act and this clause has already been applied several times.

According to the Act, the President of the OCCP is competent to investigate cases of alleged practices involving the unfair use of contractual advantage and issue administrative infringement decisions. The OCCP has powers to request information, conduct unannounced on-site inspections and impose financial penalties (up to 3 percent of an annual turnover).

¹⁷ More information on the origins of the new law can be found in: M. Błachucki & S. Józwiak-Górny, “New act on contractual advantage in the trade in agricultural and food products in Poland,” *European Competition Law Review*, (2018) 39, Issue 4.

VI. THE EARLY UTP CASE LAW

In March 2018, the Office closed its first ever UTP proceedings, which focused on extended payment periods for carrot supplies. In the final decision, the investigated food processor committed to making payments no later than in 45 days for weekly deliveries (instead of the previous 60 days counted from the end of all deliveries of a supplier) and also to establishing a non-discriminatory time schedule of supplies. Under previous arrangements, a carrot producer had to maintain readiness for an order any time between August 15 and March 30. This was unfavorable for those supplying only in the later months. Those farmers who had to wait till the end of the winter risked that their product would be deemed non-compliant with quality standards (e.g. frozen or withered) and rejected.

Somewhat unexpectedly, the complaints filed with the Office in 2017 and 2018 concerned mainly the relations between farmers and processors, rather than the practices of food retailers. Following new market signals, five more proceedings were launched, four of which concerned industrial apple supplies and one regarded the conduct of a major sugar producer towards its suppliers of sugar beets.

In the infancy of the regulation, the Office led advocacy and educational activities following a lenient policy and allowing time for the food producers and traders to align to the new legal provisions.¹⁸ In this spirit, three decisions concerning apple processors were issued.

In the *Dohler* case, an apple concentrate producer committed to shortening payment periods (30 day for flat-rate farmers and 60 for VAT payers, instead of a previous uniform 90 days) and refraining from payment delays. Vague price clauses were also modified. The fruit processor committed to informing its contractors in advance about minimum prices in the season and to ensuring each supplier's right to withdraw from a contract. Furthermore, to make money available to contractors sooner, Dohler committed to promoting factoring among fruit producers, organizing educational meetings and to sharing the bank fees. The last element of the processor's commitment was to order an independent audit of its transactions with fruit suppliers from past 2 years. In case of late payment, Dohler was to pay statutory interest.¹⁹ In the OCCP's assessment, these remedies were sufficiently transparent to ensure fairness in fruit supply contracts, while not interfering directly in the final sale price, and redress any harmed contractors. No fine was imposed on the food processor.

Two parallel cases of fruit concentrate producers were concluded with similar commitment decisions (*Real* and *Rauch*) whereas the *T.B. Fruit* case proved to be the first one where a monetary fine was imposed for unfair use of contractual advantage.²⁰ The OCCP's "carrot" strategy, applied in the first five cases and accompanied by soft but increasing pressure on other companies, is slowly being replaced with a "stick" or – at least – a mixed approach.

To sum up, in the first six administrative decisions, but also in its reports and the so-called "soft calls,"²¹ the OCCP challenged mostly late payments, extended payment periods, vague provisions on price determination (or lack thereof), non-transparent and discriminatory supply schemes, extended contract termination periods (e.g. 9, 12, or 15 months) combined with price reductions during a termination notice period, as well as the lack of an appeals procedure in case a certain product is rejected or its price reduced by the buyer due to inadequate quality.

¹⁸ See: OCCP's reports on the dairy sector, available at https://www.uokik.gov.pl/aktualnosci.php?news_id=14287&print=1 and the fruit market, available at https://www.uokik.gov.pl/aktualnosci.php?news_id=15031.

¹⁹ The interest was to be calculated following rules provided for in the Polish Act "On payment dates in commercial transactions" implementing Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions.

²⁰ For more information see the official OCCP's press release: https://www.uokik.gov.pl/aktualnosci.php?news_id=15826.

²¹ Letters addressed to businesses in which OCCP presents its objections and requests for explanation or discontinuation of allegedly unfair practices.

VII. LESSONS LEARNED – THE NEW UTP ACT

When drafting the Act, it was necessary to take into account the large number of entities operating on the food market in Poland and a still greater number of annual transactions between them. In addition, according to market signals, the biggest problem was UTPs in transactions between retail chains and their suppliers. There was a great concern and uncertainty about the initial number of notifications and the risk that the OCCP would be swarmed with minor complaints. Therefore, the initial version of the Act contained certain thresholds. It applied only to contracts where: (1) the aggregate value of turnover between parties, exceeded PLN 50,000 (roughly EUR 12,000), and (2) during the year preceding the year of commencement of the proceedings, the turnover of the infringer exceeded PLN 100,000,000 (roughly EUR 24,000,000).

Moreover, the original definition of ‘contractual advantage’ contained the following provisions: “where the supplier does not have sufficient and actual opportunities to sell agricultural or food products to other purchasers” and “where there is a significant disparity in economic potential between the two entities which puts the purchaser at an advantage” (or *vice versa*). Such a complex definition of contractual advantage could make these cases difficult to deal with. Prior to the amendment it was hardly possible to prove that the supplied goods could not have been sold to another buyer (especially retail chain, given that the Polish hypermarket, supermarket and discount store (“HSD”) market is perceived to be highly competitive). In some instances, this was more cumbersome and time-consuming than defining a relevant antitrust market and proving the existence of a dominant position under competition law rules, as no guidance on markets were available. It also turned out that there were not as many notifications (complaints) as expected.

A new wave of discussions on the effectiveness of the Act prompted the Ministry of Agriculture to initiate legislative proceedings. On October 4, 2018 an amendment was enacted by the Parliament and came into force on December 12 that year. The thresholds were abandoned, as was the first part of the contractual advantage definition (i.e. the “lack of alternative buyer/supplier” condition). Some additional minor modifications were made, such as enhanced protection of complainant anonymity during the investigation, which was aimed at alleviating the problem of intimidation and retaliation.

It is worth mentioning that further modifications, related to the implementation of the UTP Directive²² are currently being drafted.

These changes made it easier to handle cases of producer-to-retailer relations and lead to the first investigation into the activities of a retail chain. This on-going investigation, launched in September 2019, concerns the practices of Biedronka, the largest retailer in Poland, which allegedly forced food producers to grant additional discretionary retroactive rebates. It was preceded by an unexpected inspection at the premises of the chain’s owners, Jeronimo Martins Polska. The OCCP is now facing a challenge concerning its assessment as to whether the practice of imposing unilaterally determined *ex post* rebates deviates from good commercial conduct.

VIII. CONCLUSIONS

Incorporating new UTP powers into an existing competition enforcement portfolio is not an easy task. There were fears that the OCCP’s competition enforcement “DNA” may be negatively affected, as the goals pursued by the two strains of law are not entirely compatible: competition law focusing on maximizing consumer welfare, while UTP law aims to get a “fair deal” for all market participants. We now know that these fears were exaggerated. Competition law strives to achieve its main goal by protecting and promoting competition on the merits, as consumers are able to reap the full benefits of the market system only if that system rewards those who can win in a fair battle and not those who rely on “dirty tricks.” If the markets themselves are not capable of punishing unfair players, a public referee must sometimes step in. This is equally true with regard to unfair behavior enabled by monopoly power, a conspiracy, or some other form of market advantage. An antitrust mindset – fixing market mechanisms across a full spectrum of markets, instead of directly protecting a narrow group of market participants – was helpful in putting the sectoral regulation on the right track.

We believe that the facts and observations provided above can be particularly useful to policymakers and enforcers in countries where sector-specific UTP rules are not yet present and in those where an adjustment of the legal framework is contemplated. Still, many important questions remain to be answered. What are the long-term effects of UTP regulations? Who are the biggest beneficiaries of improved competition culture? Will additional restrictions on vertical relations push the sector towards vertical integration? The implementation of UTP regulations is a natural experiment, which provides an opportunity for researches to identify its true effects. We hope the results of such research will soon become available and will assist in working out recommendations for future policy adjustments.

²² Directive (EU) 2019/633, *supra* note 3.

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