

Kluwer Competition Law Blog

Ukraine's 10 Year Antitrust Tobacco Saga Is Coming To An End

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In October 2019, Ukrainian news feeds ‘exploded’ as the Antimonopoly Committee of Ukraine (‘**AMC**’, ‘**Committee**’) imposed a record-breaking fine of a total of about €240 million for a long-lasting cigarette cartel (‘**AMC Decision**’) (‘**Tobacco Case**’). The respondents in the Tobacco Case are four large cigarette manufacturers – British American Tobacco, Philip Morris, Japan Tobacco, Imperial Tobacco (‘**Manufacturers**’) – on one side, and the biggest wholesale cigarette distributor in the country – Tedis Ukraine (‘**Tedis**’) – on the other side (‘**Respondents**’).

It is worth mentioning that this high-profile case evoked an unprecedented political reaction and has even been brought to an international arena: one of the Respondents – Philip Morris – in connection with the AMC Decision lodged a claim against the Government of Ukraine to the International Center for Settlement of Investment Disputes (ICSID).

Below follows a brief chronology of the key facts pertaining to the Tobacco Saga development.

Episode 1: Let's go back 10 years ago – how it all started

The following events led Tedis to become a monopolist on the market

The beginning of the Tobacco Case dates back to 2010 when Tedis entered the primary cigarette sales market (‘**Market**’) on which 56 wholesale cigarette distributors had already been operating. Between 2010 and 2011, the AMC issued approvals to Tedis for the acquisition of at least 19 wholesale cigarette distributors – a third of those that were operating on the market at that time. Interestingly, the first cigarette distributor acquired by Tedis in 2010 was the leading one on the market.

During the same period, all the Manufacturers received numerous letters from the remaining wholesale cigarette distributors informing them post-factum of their decision to early leave the Market and thus terminate the distribution agreements.

Unsurprisingly, following the acquisitions and exit from the Market of the remaining distributors, the market share of Tedis grew exponentially. Already in 2011, its share in the Manufacturers’ sales was about 50% and, in 2012, it almost doubled reaching around 95%. By 2013, Tedis had become a monopolist on the Market with an approximately 99% share. It is noteworthy that later

the AMC will accuse the Manufacturers of not reacting to Tedis's acquisitions and further changes in the market structure.

The above-described chain of events left the Manufacturers with no choice but to intelligently adapt to the situation which had arisen on the Market and to continue working with Tedis.

Episode 2: (Unsuccessful) attempts of the AMC to tackle the self-created monopoly

Step 1: The Committee starts by issuing recommendations to the Manufacturers and Tedis -

In 2014, the AMC opened the investigation against the Manufacturers and Tedis into the alleged anticompetitive concerted practices. The signs of competition law violation were found in the following.

First, the Committee stated that the economic analysis it had conducted demonstrated the signs of the market allocation among the Manufacturers. More specifically, the analysis showed that cigarette retail prices set by the Manufacturers in 2012–2014 had increased synchronously among them, based on which the Committee concluded that active competition between the Manufacturers had not taken place.

The Committee also examined the agreements between the Manufacturers and Tedis and stated that the provisions the agreements contained could have facilitated the exchange of sensitive information between the parties thereby leading to the establishment of control over the market, as well as the elimination or restriction of the competition.

The investigation ended with the AMC issuing recommendations to the Manufacturers and Tedis (**'Recommendations-1'**), requiring the recipients to take measures and ensure full compliance of their relations with the competition legislation. These recommendations were fulfilled and this resulted in the proceeding being closed by the Committee. Even though no violations were found and the case was closed, the AMC will later use the above-mentioned economic data in the AMC Decision for the purpose of demonstrating the alleged anti-competitive effect the Manufacturers' actions had on the Market.

Soon in 2015, the Committee issued another set of recommendations directed solely at the Manufacturers, which required publishing the criteria for potential wholesale cigarette distributors (**'Criteria'**) on their websites (**'Recommendations-2'**). The recommendations were timely implemented and all the Manufacturers subsequently applied to the Committee for feedback on whether the Criteria published satisfied its demand. The feedback, however, was never provided. Despite this, the Committee will later (in the AMC Decision) assess the Criteria as an 'artificial barrier' to entering the market for newcomers.

Step 2: The Committee starts investigation into Tedis's abuse of dominance

After the change of political power in Ukraine, the AMC started an investigation into Tedis's abuse of dominance on a nationwide cigarette distribution market in the years 2013-2015. The AMC found that Tedis, being during this period the sole wholesale cigarette distributor in Ukraine, inter alia, set the same wholesale prices for both wholesale and retail cigarette distributors, as well as retail cigarette distributors and its own retail chain (**'Tedis Case'**). The fine of approximately €16

million was imposed on the distributor and was subsequently attempted to be challenged by Tedis before the Ukrainian courts. However, after a two-year judicial struggle, in 2018, the case was ultimately lost by Tedis in the Ukrainian Supreme Court.

Step 3: The Committee finishes by imposing fines on the Manufacturers and Tedis

In 2017, the AMC started an investigation against the Manufacturers and Tedis into the alleged anticompetitive concerted practices that resulted in the Respondents being fined in October 2019. The Committee justified imposing these fines with the following two main arguments presented in the AMC Decision. First, that the Manufacturers were working with Tedis as the sole wholesale cigarette distributor and thus created and helped to maintain its dominant position on the market. Second, that by developing the ‘excessive’ Criteria for potential wholesale cigarette distributors, the Manufacturers created an ‘artificial barrier’ to entering the Market.

Episode 3: Inconsistent theory of harm

The theory of harm presented in the AMC Decision is of an unprecedented nature in the Ukrainian antitrust enforcement practice due to the following facts.

Firstly, the AMC accused the Manufacturers of creating and maintaining Tedis’s dominance while itself in 2010–2011 granted approvals to Tedis for the acquisition of at least 19 wholesale cigarette distributors. The Committee also accused the Manufacturers of not reacting to these acquisitions and further changes in the Market structure, without, however, specifying how exactly the Manufacturers had to respond.

Secondly, the AMC concluded that the Criteria the Manufacturers had developed in response to the Recommendations–2 were excessive and thus, created an artificial entry barrier for the wholesale cigarette distributors wishing to enter the market. It was, however, the Committee itself, who, in 2015, required setting the respective Criteria, and who did not provide the feedback on them.

Finally, the Committee’s accusations presented in the AMC Decision rely heavily on the evidence collected within the other antitrust proceedings, such as Recommendations–1 and Tedis Case. However, the AMC overlooked the facts that *(i)* the Recommendations–1 were duly fulfilled by the Manufacturers and Tedis, and thus the respective proceeding was closed, and *(ii)* the Manufacturers were not the parties in Tedis Case and thus could not provide the objections or evidence within the respective investigation.

The ‘single economic entity’ doctrine presented by the AMC

The manner in which the Manufacturers were fined is worthy of attention too. In Ukraine, each Manufacturer is represented by **(1)** a manufacturing enterprise, the activity of which is producing cigarettes and further selling them solely to its own sales house; and **(2)** a sales house, which distributes the cigarettes to the wholesale distributors. This means that the entity which directly cooperates with the wholesale distributors, including Tedis, is the sales house, not the manufacturing enterprise.

Nevertheless, the AMC fined both manufacturing enterprise and sales house of each Manufacturer separately, based on the concept of a single economic entity. The Committee explained this by the

fact that both manufacturing enterprise and sales house had allegedly received benefits (i.e., profit) as a single economic entity as a result of selling cigarettes to Tedis.

Episode 4: (Unsuccessful) litigation attempts by the Respondents

AMC's errors outlined by the Respondents

In order to annul the AMC decision, the Respondents lodged claims to the first instance court providing strong arguments, to name a few: *(i)* that the monopolization of the Market happened as a result of the numerous acquisition approvals issued to Tedis in 2010-2011 by the AMC itself, *(ii)* that the Committee unlawfully used the evidence collected within the antitrust proceedings in Tedis Case as well as Recommendations–1, *(iii)* that the AMC itself closed the antitrust proceeding after the Respondents fulfilled the Recommendations–1, and *(iv)* that the Manufacturers were not the respondents within the antitrust proceeding in Tedis Case.

Spin-on pressure

It is worth noting that during the proceedings in the first instance court, significant parallel pressure from the Committee was observed. Right after the Respondents submitted the claims to the first instance, the AMC lodged a separate claim asking the court to collect fines from all the Respondents and issue interim injunction to freeze funds on their bank accounts, which could potentially have led to the stoppage of manufacturing. Having faced such unprecedented pressure, some of the Respondents were forced to pay these fines to mitigate further financial exposure.

First and appeal instances

It is interesting that both Manufacturers and Tedis lost their cases in the first instance court. The appeal court also followed the position of the first instance (so half of the Respondents' appeals, including the appeal of Tedis, were dismissed) right up to the moment when the Supreme Court, in February 2021, ruled in favour of Tedis, thereby dramatically changing the course of the Manufacturers' judicial struggles.

Episode 5: The Supreme Court 'dots the i's and crosses the t's'

Tedis wins before the Supreme Court

By the judgment dated 2 February 2021, the Supreme Court satisfied Tedis's cassation appeal. Overturning the decisions of two lower instances, the Court found that the following procedural and substantive law infringements had occurred during the antitrust investigation in the Tobacco Case and court proceeding.

The first and the most important one is in that the Committee mainly based its accusations in the AMC Decision on the findings from the other antitrust proceedings (i.e., Recommendations–1 and Tedis Case) and thus did not collect the primary evidence by itself (which would have proved the violation). In this regard, the Supreme Court provided detailed clarifications saying that:

- Ukrainian legislation sets forth no prejudicial nature of the AMC's previous decisions and recommendations from the other antitrust proceedings;
- the legislation does not exempt the Committee from the obligation to prove the violation and its findings in each particular antitrust case;
- the AMC was not entitled to use the findings from the other antitrust proceedings, that is, the Recommendations–1 and Tedis Case. The Court also noted *(i)* that the Recommendations–1 were fulfilled and the proceeding was closed, and *(ii)* that the Manufacturers were not the parties in Tedis Case.

The Supreme Court also stated that the Committee and the lower courts had failed to examine the reasons for cigarette distributors' exit from the Market in 2010–2011 highlighting that the AMC itself issued the acquisition approvals to Tedis between 2010–2011.

Last but not least, the Supreme Court confirmed that neither the Committee nor lower court instances had found which exact barriers were created by the Respondents, preventing the potential distributors from entering the Market.

Manufacturers are winning their cases

Right after the victory of Tedis, on 15 April 2021, British American Tobacco ('**B.A.T.**') won its case before the Supreme Court, and on 1 June 2021, Imperial Tobacco's cassation appeal was satisfied by the Court. In its judgments, the Supreme Court reiterated its position from the court case of Tedis, and provided the same arguments as specified above.

Currently, the cases of the two other Manufacturers – Philip Morris and Japan Tobacco – are pending before the Supreme Court. It is highly possible that they are also about to win since they asked the courts to annul the AMC Decision on grounds similar to those in Tedis, B.A.T., and Imperial Tobacco court cases.

Epilogue: key takeaways

What is left behind the camera

Although the Supreme Court 'dotted the i's and crossed the t's' and stated its position concerning most arguments provided in the statements of claim by Tedis, B.A.T. and Imperial Tobacco, some of them remain unaddressed.

In particular, the Supreme Court did not provide feedback on whether the Manufacturers had to react to Tedis's acquisitions in 2010–2011 and further Market structure changes, and if yes, in what way. Secondly, the Court did not assess whether the Criteria of the Manufacturers were indeed excessive, as the AMC alleged.

Finally, the Supreme Court did not clarify whether the Committee had grounds for imposing fines on both manufacturing enterprise and sales house of each Manufacturer based on the concept of a single economic entity. The Court did not comment on the arguments presented in the claims of the Manufacturers that no benefits were received by the manufacturing enterprise as a result of cooperating with Tedis.

The position of the Supreme Court is of paramount importance

Despite the fact that the Supreme Court remained silent on some of these arguments raised by the Manufactures, overall, with its findings in Tedis, B.A.T., and Imperial Tobacco court cases, it raised a bar and took a very significant step towards increasing the standard proof required in antitrust proceedings.

Considering numerous procedural and substantive law infringements which occurred during the investigation in the Tobacco Case, and which were also noted by the Supreme Court, it is also expected that further investigations of the Committee will be performed on a higher level. In particular, it is expected that the position of the Supreme Court will have a direct influence on the obligation of the AMC to provide the evidence of a violation and prepare a strong case within the scope of each particular antitrust investigation.

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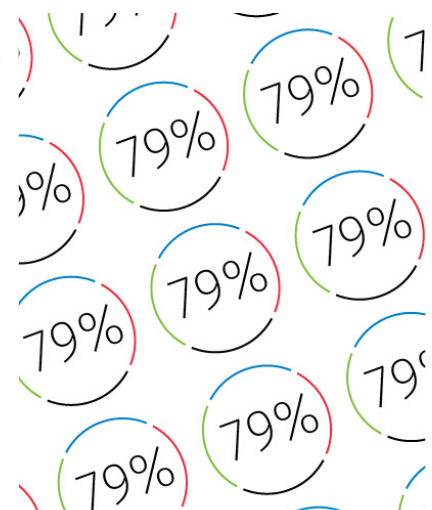
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