COMMENTS

GOLD MINE OR MINEFIELD: UNDERSTANDING RUSSIAN LAW ON VERTICAL RESTRAINTS

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While the Russian Federation represents a significant opportunity for growth, that opportunity is coupled with serious risks. As it relates to managing product distribution, Russian vertical restraint law remains significantly more restrictive than that of the U.S. and, since unless a company is fully integrated, it must manage its distribution system by way of vertical agreements, presents a large problem for businesses seeking to conduct business in Russia. While Russia has made significant steps in the right direction, the lack of consistent application of economic analysis to evaluation of vertical restraints leaves companies exposed. Further, the sometimes inconsistent application of the laws also makes it hard to predict how any particular vertical agreement would be evaluated. Neither American nor Russian antitrust laws establish a list of possible vertical restraints. Thus, there is no exhaustive guidance regarding how these restraints should be treated. U.S. antitrust laws, however, generally place all vertical restraints into one of two categories, intrabrand restraints and interbrand restraints. Intrabrand restraints are those that restrain the downstream firm's freedom with regard to the resale of the product at issue (distribution restrictions). Interbrand restraints are those that restrict a downstream or upstream firm's freedom to deal with competitors of the firm imposing the restraint (interbrand restrictions). It should be noted that Russian law does not make this distinction.

This article compares and contrasts the U.S. and Russian treatment of select types of vertical restraints and identifies regulatory and enforcement pitfalls a company may encounter if the differences are ignored.

Keywords: antitrust law; vertical restraints; horizontal and vertical agreements; territorial restraint; intrabrand restraints; customer restraints; non-price vertical restraints; exclusive distributorship arrangement; exclusive dealing agreement; resale price maintenance; anticompetitive effects; rule of reason.

No international company can overlook the significance of the Russian market. When considering whether to enter Russia, however, a company must weigh the pros of lucrative revenues Russia promises against the costs and risks associated with navigating an imperfect, still-developing system. This is true with respect to both macro concerns, like the ever-changing Russian political climate and the country's attitudes towards foreign investment, and day-to-day operational concerns. One such operational concern is whether the company will have the freedom to establish and manage its product distribution system upon entering the market.

Unless the company is fully integrated, it must manage its distribution system by way of vertical agreements. A 'vertical agreement' is an agreement between firms at different levels in the chain of distribution.[1] For example, agreements between a manufacturer and wholesalers, between wholesalers and retailers, or between a manufacturer and retailers would all be considered vertical agreements.[2] Vertical agreements are a business necessity for any company that is not fully integrated.

This article compares and contrasts the U.S. and Russian treatment of select types of vertical restraints and identifies regulatory and enforcement pitfalls a company may encounter if the differences are ignored.

1. Russian Market and Regulatory Landscape

Why Russia? With a gross domestic product of approximately $2 trillion in 2012, the Russian Federation represents 3% of the world economy, making it a potential gold mine for firms looking to expand. However, investing in Russia requires a firm to wade through a confusing and inconsistently applied regulatory framework. For example, in 2012, according to the World Bank's Enterprise Surveys, Russian managers spent 14.7% of their time dealing with the requirements of government regulation, compared to only 9.5% in the rest of the world.[3] According to the World Economic

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1 *See* Mike Walker & Simon Bishop, The Economics of EC Competition Law: Concepts, Application and Measurement 187 (3rd ed., Sweet & Maxwell 2010).

2 Article 4 of the Competition Law defines the 'vertical agreement' as an agreement between economic entities, where one of them acquires and another one provides goods. *See* Федеральный закон от 26 июля 2006 г. № 135-ФЗ «О защите конкуренции» // Российская газета. 2006. 27 июля. № 162 [*Federal'nyi Zakon ot 26 iyulya 2006 g. 'O zashchite konkurentsii' // Rossiiskaya Gazeta. 2006. 27 iyulya. No. 162* [*Federal Law of 26 July 2006 No. 135-FZ on Protection of Competition*, 2006(162) Russian Gazette]], available at http://base.garant.ru/12148517.htm (accessed Aug. 5, 2014) [hereinafter Competition Law].

3 *Enterprise Surveys: Russian Federation (2012)*, Int'l Finance Corp., <http://www.enterprisesurveys.org/Data/ExploreEconomies/2012/russia#regulations-and-taxes> (accessed Aug. 5, 2014).

Forum 2011–12 rankings, 'Russia is in the bottom ten on the burden of government regulation, [and] its weak institutional framework [is usually] cited as a key obstacle to growth.'[4] Even when laws and regulations do not obstruct firms' entry and exit, the application and enforcement of rules are often inconsistent. To Russia's credit, it is not blind to the problem and has made major inroads to remove structural barriers to growth in order to create an economic environment that encourages long-term investment.[5] Yet, there is much left to be accomplished.[6]

As it relates specifically to market regulation, the Federal Antimonopoly Service [hereinafter FAS], Russia's competition enforcer, stated that its number-one priority is to promote healthy and competitive market conditions. While the FAS's goal is undoubtedly a laudable one, its approach in many instances can be undefined, inconsistent, or even contrary to the legislative guidance. FAS's treatment is usually ambiguous, does not include robust economic analysis, and too often results in finding a violation in situations where an anticompetitive restraint of trade could not be demonstrated had it been evaluated with any regard for economic theory. This surface-deep analysis is directly in opposition to the FAS's stated goal and should leave cautious any firm doing business in Russia.

2. Overview of the Russian Antitrust Laws

Before we discuss specific differences between the U.S. and Russian treatment of vertical restraints, it may be helpful to understand the Russian antitrust laws generally. Russia is a relative newcomer to antitrust enforcement.[7] In Russia, Competition Law is the major rule of law on antitrust, including the regulation of vertical restraints. In the last several years, this law has been substantially amended twice, first in 2009 (the Second Antimonopoly Package)[8] and again in January 2012

4 Doing Business in Russia 2012 1 (The World Bank 2012), available at <http://www.doingbusiness.org/~/media/FPDKM/Doing%20Business/Documents/Subnational-Reports/DB12-Sub-Russia.pdf> (accessed Aug. 5, 2014).

5 In 2011, the government committed to making Russia one of the most inviting places to do business, and a national initiative has been created to spearhead improvements in the investment climate for all businesses – domestic and foreign. *Id.*

6 Alberto Alesina et al., *Regulation and Investment*, 3(4) J. Eur. Econ. Ass'n 795 (2005), available at <http://scholar.harvard.edu/files/alesina/files/regulation_and_investment.pdf> (accessed Aug. 5, 2014).

7 Закон РСФСР от 22 марта 1991 г. № 948-I «О конкуренции и ограничении монополистической деятельности на товарных рынках» // Российская газета. 1991. № 89 [*Zakon RSFSR ot 22 marta No. 948-I 'O konkurentsii i ogranichenii monopolisticheskoi вeyatel'nosti na tovarnykh rynkakh' // Rossiiskaya gaseta. 1991. No. 89* [*Law of the Russian Soviet Federative Socialist Republic of 22 March 1991 No. 948-I on Competition and Limiting Monopoly Activity on Products Markets*, 1991(89) Russian Gazette]], available at <http://base.garant.ru/105108.htm> (accessed Aug. 5, 2014). This Law was the first Russian codified act regulating antitrust enforcement. One article of this act (describing affiliated persons) is still valid, but is applicable only in the field of corporate law.

8 Федеральный закон от 27 июля 2010 г. № 239-ФЗ «О внесении изменений в Кодекс Российской Федерации об административных правонарушениях» // Российская газета. 2010. 2 авг. № 169

(the Third Antimonopoly Package).[9] In addition to the codified law, Russian court precedents may guide businesses and practitioners looking to advise clients on their conduct in Russia.

3. Vertical Restraints

Both Russia and the United States generally recognize fundamental differences between vertical and horizontal agreements (namely cartels): the former are entered into by players selling complementary goods,[10] whereas the latter are entered into by competitors. Thus, it is not surprising that the approach for assessing horizontal and vertical agreements should be different. How different, however, is another story. Even though both countries generally agree on the fundamental differences between the two types of conduct, the legal implementations of those differences are not always consistent.

In the United States, there has been a long-standing trend toward more lenient treatment of all vertical restraints. For many decades, courts have recognized that horizontal and vertical restraints are inherently different,[11] so vertical restraints should be analyzed under the rule of reason.[12] By comparison, Russia has only recently

[*Federal'nyi zakon ot 27 iyulya 2010 g. No. 239-FZ 'O vnesenii izmenenii v Kodeks Rossiiskoi Federatsii ob administrativnykh pravonarusheniyakh' // Rossiiskaya gaseta. 2010. 2 avg. No. 169* [*Federal Law of 27 July 2010 No. 239-FZ on Amending the Code of Administrative Offences of the Russian Federation*, 2010(169) Russian Gazette]], available at <http://base.garant.ru/12177586> (accessed Aug. 5, 2014); Федеральный закон от 17 июля 2009 г. № 164-ФЗ «О внесении изменений в Федеральный закон «О защите конкуренции» и отдельные законодательные акты Российской Федерации» // Российская газета. 2009. 23 июля. № 134 [*Federal'nyi Zakon ot 17 iyulya 2009 g. No. 164-FZ 'O vnesenii izmenenii v Federal'nyi zakon "O zashchite konkurentsii" i otdel'nye zakonodatel'nye akty Rossiiskoi Federatsii' // Rossiiskaya gaseta. 2009. 23 iyulya. No. 134* [*Federal Law of the Russian Federation on Amending the Federal Law on Protection of Competition and Certain Legislative Acts of the Russian Federation*, 2009(134) Russian Gazette]] [hereinafter Federal Law No. 164-FZ].

9 *The 'Third Antimonopoly Package' Came into Force*, FAS (Jan. 10, 2012), <http://en.fas.gov.ru/news/news_31961.html> (accessed Aug. 5, 2014) ('On 6 and 7 January 2012 came into force the Federal Law "On Introducing Amendments to the Federal Law "On Protection of Competition" and Some Legislative Acts of the Russian Federation" and the Federal Law "On Introducing Amendments to the Code of the Russian Federation on Administrative Violations" that constitute the "third antimonopoly package"'). For additional coverage of the Third Antimonopoly Package, *see* Vassily Rudomino & Valentina Rucker, *Third Time's the Charm?: Russian Federal Antimonopoly Service Presents Its Third Antimonopoly Package*, 4 Int'l Antitrust Bull. 15 (2010), available at <http://www.wsgr.com/attorneys/BIOS/PDFs/rucker2010.pdf> (accessed Aug. 5, 2014).

10 Including products, works, and services.

11 *See Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007); *Continental T.V., Inc. v. GTE Sylvania Inc.,* 433 U.S. 36 (1977).

12 The only type of vertical restraint that is still characterized as per se unlawful in the United States is tying. Even in the case of tying, however, the *per se* rule does not apply in all circumstances, and its continued application remains subject to debate. *See* Christopher R. Leslie, *Patent Tying, Price Discrimination, and Innovation*, 77(3) Antitrust L.J. 811, 847 (2011) (noting that courts examine traditional tying

begun to recognize that vertical agreements may serve a procompetitive purpose and should not be treated similarly to cartels.

It was only in 2009 that Russia's Second Antimonopoly Package formally created a legal framework that distinguishes between vertical and horizontal agreements.[13] Since that time, the Russian Supreme Commercial Court has not provided extensive interpretations of vertical agreements. The lack of judicial guidance on vertical agreements is in stark contrast to the FAS's oversight of them. In fact, in 2012, the FAS considered 292 cases dealing with allegedly anticompetitive agreements, and about half dealt with vertical agreements.[14]

On May 23, 2012, the FAS issued a decision confirming that the legal rules governing horizontal agreements do not apply to vertical agreements.[15] In the most recent attempt to separate the two regimes, the Third Antimonopoly Package in 2013 specifically excluded maximum resale price maintenance from the *per se* treatment and eliminated criminal penalties for coordinated actions and vertical agreements. While these general directives are now on the books, the lack of judicial interpretations and inconsistencies in such interpretations, to be discussed below, make it almost impossible to predict how a particular restraint will be assessed, let alone predict an outcome of that analysis.

Neither American nor Russian antitrust laws establish a list of possible vertical restraints. Thus, there is no exhaustive guidance regarding how these restraints should be treated. U.S. antitrust laws, however, generally place all vertical restraints into one of two categories, intrabrand restraints and interbrand restraints. It should be noted that Russian law does not make this distinction.

Intrabrand restraints are those that restrain the downstream firm's freedom with regard to the resale of the product at issue (distribution restrictions).[16] Interbrand

arrangements under a 'nominal *per se* rule, which in practice operates as a truncated rule of reason'); Adam Weg, *Note: Per Se Treatment: An Unnecessary Relic of Antitrust Litigation*, 60 Hastings L.J. 1535, 1545 (2009) (noting courts' increased leniency toward tying agreements); Todd J. Anlauf, *Per Se Test for Antitrust Tying Liability: The Economic and Legal Rationale For a Rule of Reason*, 23 Hamline L. Rev. 476, 508 (2000) (noting that courts have deviated from a strict per se approach for tying claims).

13 Federal Law No. 164-FZ.

14 Доклад Федеральной антимонопольной службы о состоянии конкуренции в Российской Федерации [*Doklad Federal'noi antimonopol'noi sluzhby Rossiiskoi Federatsii o sostoyanii konkurentsii v Rossiiskoi Federatsii* [*Report of the Federal Antimonopoly Service on the State of Competition in the Russian Federation*]], FAS (July 29, 2013), <http://www.fas.gov.ru/about/list-of-reports/list-of-reports_30077.html> (accessed Aug. 5, 2014).

15 Decision of the Presidium of the FAS of 23 May 2012 No. 5-15/1-2.

16 Intrabrand restraints reflect a seller's preferences regarding how its own products are distributed and, for that reason, have been given relatively deferential treatment by U.S. antitrust law. Intrabrand restraints can be further subdivided into price and non-price distribution restraints. In 1977 the U.S. Supreme Court in *Continental T.V., Inc. v. GTE Sylvania Inc.*, *supra* n. 11, drew a fundamental distinction between (at the time) per se unlawful vertical price restraints and vertical nonprice restraints, which it held were subject to rule of reason analysis.

restraints are those that restrict a downstream or upstream firm's freedom to deal with competitors of the firm imposing the restraint (interbrand restrictions). In the United States, intrabrand restraints are considered to be less dangerous for competition than interbrand restraints. Intrabrand restraints are recognized as having the potential to actually stimulate interbrand competition.[17] Thus, if interbrand competition is strong, it is unlikely that restrictions with respect to the intrabrand competition would result in negative effects on competition. Regardless of the type, U.S. courts generally examine these under the rule of reason. Below we discuss the most common vertical restraints and compare and contrast Russian treatment *vis-à-vis* U.S. treatment of such restraints.

4. Territorial Restraints

Two of the most common forms of intrabrand restraints are territorial restraints and exclusive distribution arrangements. Like all intrabrand restraints, U.S. antitrust law treats these relatively leniently. Russia, on the other hand, applies stricter and less consistent standards that lead to confusing and inconsistent results. The central reason for this seems to be that U.S. antitrust law is centered on economic analysis and consumer welfare. The FAS, however, systematically fails to consider economic arguments and chooses to rely on arbitrary bright line legal rules instead. This approach instantaneously disadvantages any firm with a large market share.

In the United States, territorial – and in turn customer – restraints are treated relatively leniently. Territorial or customer restraints limit a distributor's freedom by prohibiting it from selling outside an assigned territory or to a particular category of customers.[18] These can be exclusive, where there is only one distributor per designated area, or include what is called an 'area of primary responsibility' clause.[19] Since *Continental T.V., Inc. v. GTE Sylvania Inc.*,[20] these types of restraints have been evaluated under the rule of reason in the U.S.

Similarly, application of the rule of reason to territorial and customer restraints on distributors is directly mandated by the Russian laws. Yet, there are instances in recent history where the FAS, despite a clear legislative and judicial directive to treat

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17 *Continental T.V., Inc. v. GTE Sylvania Inc.*, *supra* n. 11, at 51.

18 Territorial restraints are not to be confused with location clauses. Location clauses establish the physical place of business from which a distributor may sell the products of a particular manufacturer or where it may operate a business under the trade name, method, or format of its franchisor. In the United States, courts review these under the rule of reason and almost never find such clauses to be anticompetitive.

19 'Area of primary responsibility' typically requires a distributor to maintain effective distribution for a manufacturer's products in a defined geographic area. If a distributor fulfills its sales obligations in its primary area, the distributor may sell outside that area.

20 *Continental T.V., Inc. v. GTE Sylvania Inc.*, *supra* n. 11, at 49 (under the rule of reason 'the factfinder weighs all of the circumstances of a case').

such restraints under the rule of reason, evaluated these types of restraints under what appears to be a *per se* standard and found them to be anticompetitive without providing the extensive competitive analysis one would usually expect under the rule of reason.

Belarusian Automobile Plant. In May 2012, the FAS issued a decision against the Belarusian Automobile Plant [hereinafter *BelAZ*]. The FAS's approach in that case seems very reminiscent of the *per se* standard.[21] There, the FAS concluded that *BelAZ* (a foreign company) violated Russian antitrust law by restricting competition of dump trucks in Russia by limiting its dealers.[22] Specifically, *BelAZ* established a dealer network and assigned each dealer to a particular territory in Russia. Although there were no territorial provisions in *BelAZ*'s distribution contracts, BelAZ maintained information on its official website explaining that dealers could not send their products outside a defined territory. Additionally, in letters to direct customers, *BelAZ* indicated that customers should only buy products from authorized dealers in their respective territories. Otherwise, *BelAZ* claimed, it could not guarantee the delivery and maintenance of its products.

The FAS found that the following circumstances supported a finding that territorial restraints were anticompetitive:

- placing information on the official website about each dealer's activity area, including a prohibition on sending product supplies to a different area;
- informing consumers that they need to purchase products from dealers carrying out business activities in the nearest territory;
- distributing letters to consumer entities indicating the need to purchase products from particular dealers, including by providing written permits for supplies;
- written refusals of dealers to supply products to consumers beyond the area in which they were authorized to operate.

Notably absent from the list of factors are the actual or potential anticompetitive effects or any discussion of procompetitive justifications that one would expect to find in the rule of reason analysis. Instead, it appears that the FAS summarily concluded that *BelAZ* violated the Competition Law merely by coordinating the activity of its dealers.[23]

Power Devices – GAZ Group. While the *BelAZ* decision suggests that any dealer territory allocation will be prohibited, there may be some hope for businesses

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21 Decision and Determination of the FAS of 31 May 2012 No. 1 11/132-11 of the Case at the Request of JSC 'BELAZKOMPLEKT PLUS', available at <http://fas.gov.ru/solutions/solutions_34935.html> (accessed Aug. 5, 2014); *see also The Largest Manufacturer of Quarry Equipment Restricted Competition in Russia*, FAS (May 22, 2012), <http://en.fas.gov.ru/news/news_32214.html> (accessed Aug. 5, 2014).

22 *Russia Accuses BelAZ of Breaking Law on Competition*, Telegraf.by (May 22, 2012), <http://telegraf.by/en/2012/05/rossiya-obvinila-belaz-v-narushenii-zakona-o-konkurencii> (accessed Aug. 5, 2014).

23 *BelAZKomplekt Plus*, No. 1 11/132-11, *supra* n. 21.

looking to set up a dealer network in Russia. It appears that in at least one case, *Silovye Agregaty – Gruppa GAZ* (*Power Devices – GAZ Group*), the FAS undertook a full rule of reason analysis, in line with the Russian statutory law on vertical restraints. Unfortunately, the FAS's official version of the decision is not published. The FAS's findings and the ultimate resolution, however, are available in an article published by one of the lawyers involved in the case, which we summarize below.[24]

In January 2012, the FAS opened an investigation into *GAZ Group* distribution practices on a complaint from a former dealer, *Autodiesel Service*. *GAZ Group* distributed diesel engines and fuel injection equipment. In order to distribute its products, *GAZ Group* created a dealer network, with each dealer responsible for a particular territory. Allegedly, *Autodiesel Service* requested that *GAZ Group* remove the territorial restriction from its agreement; *GAZ Group*, however, not only refused to remove the territorial restriction, but also chose not to renew its agreement with *Autodiesel Service*.[25]

The FAS applied Art. 13 of the Competition Law, which, unlike in the *BelAZ* case, allowed the defendants to provide evidence of the procompetitive effects of their challenged vertical restraints. According to the lawyer involved in the case, Natalia Korosteleva, the FAS recognized the procompetitive aspects of territorial restraints as an admissible defense to a challenged agreement. Specifically, it found that the potential harm from the vertical restraints was offset by the manufacturer's or exclusive distributor's expansion of sales, optimized sales patterns, and production of a more competitive product.[26]

The FAS's treatment of arrangements instituted by *GAZ Group* demonstrates a shift in the FAS's methodology and opinion and may lay the foundation for the FAS to analyze territorial restraints more leniently going forward.[27] While the case is informative because it demonstrates the extent to which a company could implement a vertical territorial restraint without violating the Competition Law, one should still exercise caution when relying on the *GAZ Group* decision, since it was not published.

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24 *Коростелева Н.* Закон применяется неверно [Korosteleva N. *Zakon primenyaetsya neverno* [Natalia Korosteleva, *The Law Applied Wrongly*]], *Vedomosti* (Nov. 28, 2012), <http://www.vedomosti.ru/newspaper/article/352551/zakon_primenyaetsya_neverno> (accessed Aug. 5, 2014).

25 ФАС РФ возбудила дело в отношении предприятий «Группы ГАЗ» по признакам нарушения закона о защите конкуренции [*FAS RF vozbudila delo v otnoshenii predpriyatii 'Gruppy GAZ' po priznakam narusheniya zakona o zashchite konkurentsii* [*FAS Russia Initiated a Case Against Company 'GAZ Group' for Violating the Law on Protection of Competition*, *NTA Privolzh'e* (Jan 17, 2012), <http://www.nta-nn.ru/news/item/?ID=199509&mat=all> (accessed Aug. 5, 2014).

26 *Id*.

27 But *see* Korosteleva, *supra* n. 24.

5. Exclusive Distributorship Arrangements

An exclusive distributorship arrangement is another type of non-price vertical restraint that is frequently used by U.S. businesses in order to control their distribution channels. Even before *GTE Sylvania*, the U.S. Supreme Court treated simple exclusive distributorships with relative leniency, since they tend to align the incentives of manufacturers and distributors while eliminating the 'free rider' problem.[28] Under such an agreement, a distributor is incentivized to maximize sales of a manufacturer's product while maintaining the product's reputation and quality.[29] Additionally, these arrangements provide certainty that any dealer-specific investment from a manufacturer will not be used to benefit a competitor's product.[30]

In Russia, however, the treatment of exclusive distribution arrangements is entirely unclear. Both the FAS and courts[31] struggle with the proper framework for examining these arrangements. There is no holistic approach for evaluating exclusive distributorship arrangements; rather, these types of arrangements are viewed on a case-by-case basis and usually through a much narrower lens as compared to their U.S. counterparts. The cases below demonstrate that although vertical restraints should generally be examined under the rule of reason, in practice, the analysis is often conclusory and not supported by any economic evidence, which in effect makes these agreements a dangerous proposition at best and per se illegal at worst.

Angstrem. In November 2011, the FAS found that *Angstrem*, a producer of microcontrollers used in cash registers, entered into an anticompetitive exclusive distributorship agreement with *Smartronic Projects*.[32] *Angstrem*'s microcontrollers were the only ones approved by the Russian Federal Security Service for production in Russia. The FAS, in an unpublished opinion later adopted by the court, found *Angstrem* to have 100% of the market share for microcontrollers. Therefore, it summarily concluded that the exclusive agreement with *Smartronic Projects* to distribute those microcontrollers harmed the related market for cash registers. The Supreme Commercial Court agreed with the FAS and found that the agreement was aimed at restricting competition.

Dneprovagonmash and Eurasian Pipeline Consortium. More recently, in September 2012, the FAS found that an agreement between *Dneprovagonmash* (Ukraine)

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28 *See* Jonathan M. Jacobson, *Exclusive Dealing, 'Foreclosure,' and Consumer Harm*, 70 Antitrust L.J. 311, 357–58 (2002).

29 *Id.*

30 *Id.*

31 Russian courts usually uphold FAS decisions. Further, the Russian Supreme Commercial Court has only considered a few cases of vertical restraints that were not decided on procedural grounds.

32 Decision of the Presidium of the Supreme Commercial Court of 29 November 2011 No. 6577/11 (Re *Angstrem*).

and *Eurasian Pipeline Consortium* (Russian Federation) violated Art. 11(4) of the Competition Law.[33] The alleged violation was based on the 2010 contract between *Dneprovagonmash* and *Eurasian Pipeline Consortium*.[34] Along with the general conditions of the contract, *Dneprovagonmash* committed to manufacture and supply flatcars exclusively to *Eurasian Pipeline Consortium*. To the extent *Dneprovagonmash* wanted to make deliveries to other buyers, it had to receive written consent from *Eurasian Pipeline Consortium*.

The FAS found that such an exclusivity provision was an unlawful restriction of trade within the relevant market because it eliminated *Dneprovagonmash* as an independent competitor.[35] Additionally, it found the provisions were designed to prevent other potential competitors from purchasing directly from *Dneprovagonmash*.[36] While this explanation by the FAS is useful, it hardly constitutes the full rule of reason analysis usually undertaken in the case of exclusive distribution arrangements. Specifically, the FAS did not analyze the strength of interbrand competition, the duration of the agreement, or the geographic scope of the distributorship.[37] The FAS also alleged that the analyzed conduct could create unreasonable advantages for the supplement product market (railway transportation services), but similarly failed to provide economic market analysis in this respect.

Izhevskii Mehanicheskii Zavod and Izhevskii Arsenal. Further, a case involving *Izhevskii Mehanicheskii Zavod* [hereinafter *IMZ*] and *Izhevskii Arsenal* demonstrates how just the mere passage of time can turn nearly identical distributorship agreements from procompetitive to anticompetitive in the eyes of the FAS.

In 2009, the FAS considered for the first time an exclusive distribution arrangement between *IMZ* and *Izhevskii Arsenal*.[38] *IMZ* and *Izhevskii Arsenal* entered into an exclusive agreement to supply civil and nonlethal weapons. Prior to entering into this distributorship agreement, *IMZ* supplied its products to various distributors. However, at some point, *IMZ* decided to change its distributorship system and offered

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[33] ФАС уличила ПАО «Днепровагонмаш» и ООО «Евразийский Трубопроводный Консорциум» в реализации антиконкурентного соглашения [*FAS ulichila PAO 'Dneprovagonmash' i OOO 'Evraziiskii Truboprovodnyi Khonsortsium' v realizatsii antikonkurentnogo soglasheniya* [*FAS has Convicted PJSC 'Dneprovagonmash' and LLC 'Eurasian Pipeline Consortium' of the Implementation of Anti-Competitive Agreements*]], FAS (Nov. 1, 2012), <http://fas.gov.ru/fas-news/fas-news_33608.html> (accessed Aug. 5, 2014).

[34] Decision and Determination of the of the FAS of 26 September 2012 No. 1 11/227-11 of the Case PJSC 'Dneprovagonmash' and LLC 'Eurasian Pipeline Consortium,' available at <http://fas.gov.ru/solutions/solutions_35949.html> (accessed Aug. 5, 2014).

[35] *Id.*

[36] *Id.*

[37] Antitrust Law Developments 161–62 (7th ed., ABA 2012) (highlighting factors courts generally consider in exclusive distributorship arrangements).

[38] Decision of the FAS 24 February 2009 No. 1 11/43-08 against Federal State Unitary Enterprise 'IMZ,' available at <http://www.fas.gov.ru/solutions/solutions_23096.html> (accessed Aug. 5, 2014).

companies the opportunity to bid to be the sole distributor. *Izhevskii Arsenal* won the bid. *Cornett*, the competing distributor that lost the bid, complained to the FAS.

In March 2009, the FAS engaged in a rule of reason analysis, in line with the requirements of Art. 13 of the Competition Law, and found that the procompetitive benefits of the exclusive provisions outweighed any potential harm. The FAS found that the agreement: (1) increased sales; (2) increased warehousing efficiency; (3) increased quality; (4) increased research and development; (5) increased innovation in the weapon industry; (6) increased investment; and (7) attracted additional customers through the larger distribution network.

In 2010, during a period of increased consumer demand, *Cornett* again lodged a complaint with the FAS that *IMZ* refused to deal with it for the supply of gas cylinder pistols. *Cornett* claimed that *IMZ* refused because *Izhevskii Arsenal* had exclusive distributorship rights. In 2011, the FAS found *IMZ* in violation of the Competition Law even though its agreement contained nearly identical, previously approved language.[39] Despite its earlier decision that *IMZ*'s exclusive arrangement with *Izhevskii Arsenal* was procompetitive, this time the FAS found the provisions to be an unlawful restriction on competition that led to an unjustified refusal to deal.

This stark difference in outcome is very concerning. While it is plausible that market conditions changed in the span of two years to the point that a previously vetted arrangement became anticompetitive, any discussion of market change is absent from the FAS's analysis. This, unfortunately, leaves one to wonder whether there is any clear guidance or standard approach that the FAS utilizes in reviewing these arrangements. Courts are not much help – the FAS's decisions are usually summarily upheld.[40]

Svyaznoy and Apple. Finally, *Apple*'s largest Russian partner, *Svyaznoy*, is currently being investigated for violating Russian competition law in connection with its *Apple* distribution contracts. *Svyaznoy* became *Apple*'s largest distributor because Russia's top three network operators and largest distributors, *MegaFon*, *MTS*, and *Euronetwork*, refused to deal with *Apple* on its terms.

This unwillingness to distribute *Apple*'s iPhones in effect foreclosed *Apple* from the Russian mobile phone market. With around 8% market share,[41] the iPhone barely

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39 Decision and Determination of the FAS of 4 March 2011 No. 1 11/199-10 on the Complaint, LLC 'Cornet,' the Actions of the Federal State Unitary Enterprise 'IMZ' and LLC 'Izhevsk Arsenal,' available at <http://www.fas.gov.ru/solutions/solutions_32102.html> (accessed Aug. 5, 2014).

40 *See, e.g.,* Decision of the Federal Arbitration Court of Moscow District of 21 March 2012, case No. A40-58622/11-153-531.

41 Notably, the FAS analyzed the smartphone market one year ago and came to the conclusion that there is a separate market for premium smartphones. Although the case dealt with horizontal issues among *Apple* distributors, the FAS found that these distributors had combined market share of *more than 20%* and were therefore disallowed from applying for exemptions from certain vertical concerns. *See* Decision of the FAS of 12 March 2012 No. ATS/14567 on Violation of 'Mobile Telesystems' JSC, available at <http://fas.gov.ru/solutions/solutions_34642.html> (accessed Aug. 5, 2014).

scratches the surface of Russia's overall mobile phone market.[42] Since no other distributor wanted to work with *Apple*, *Svyaznoy* became *Apple*'s largest distributor by default. Just when *Apple* thought that it had found a way to break into the Russian mobile phone market with *Svyaznoy*, *Euronetwork* filed a complaint with the FAS.[43] Upon receiving *Euronetwork*'s complaint, the FAS opened an investigation into *Apple*'s distribution practices.[44] One outcome of such an investigation could be that *Svyaznoy*'s contracts are terminated, and *Apple* could be forced to deal with the three major network operators on their terms if it wants to sell in Russia at all.

Since territorial restraints and exclusive distributorship arrangements (particularly with foreign manufacturers) are widespread, it is critical to consider the antitrust authorities' ambiguous view of this type of arrangement before including it in a future contract. As the history of U.S. antitrust law has demonstrated, without robust economic analysis, enforcers too often mistake harm inflicted on a competitor as harm inflicted on competition. The FAS and Russian courts have failed to learn from these lessons and have traded complex economic analysis for arbitrary bright line legal rules that have little to do with a restraint's actual effect on consumers. In practice, any vertical restraint means to some extent a refusal to conduct independent activity, which alone should not be sufficient to demonstrate an anticompetitive restraint of trade. At times, the FAS merely points out a feature present in all exclusive dealing arrangements and considers it an adequate substitute for a comprehensive rule of reason analysis. This superficial analysis should make any firm cautious.

6. Resale Price Maintenance

Resale price maintenance is a vertical restraint and refers to agreements between participants at different levels of the distribution chain to establish the resale price of products or services. Resale price maintenance can take the form of setting a specific price or setting either a price ceiling (maximum resale price maintenance) or a price floor (minimum resale price maintenance).

Today, under U.S. antitrust law, resale price maintenance agreements are analyzed under the rule of reason. While U.S. courts historically have condemned

42 *IDC*: смартфоны в России достигли рекордной доли [*IDC: smartfony v Rossii dostigli rekordnoi doli* [*IDC: Smartphone in Russia Reached a Record Share*], C-News (Feb. 9, 2013), <http://www.cnews.ru/top/2013/09/02/idc_smartfony_v_rossii_dostigli_rekordnoy_doli_541216> (accessed Aug. 5, 2014) (Svyaznoy handled about 70% of Apple's iPhone distribution in Russia when the complaint was filed).

43 The market share of iOS devices is surprisingly small in Russia, according to an IDC report. With an 8.3% market share in the second quarter, iOS trails not only *Google*'s Android (73.3%), but also *Microsoft*'s Windows Phone (8.6%). *Id.*

44 Nick Shchetko, *Apple Inc. in Russia: iPhone Sales under Threat as Antitrust Case Hits Major Retailer*, Minyanville (Sep. 16, 2013), <http://www.minyanville.com/sectors/technology/articles/More-Trouble-for-Apple-Inc-in/9/16/2013/id/51773> (accessed Aug. 5, 2014).

both maximum and minimum vertical price restraints as *per se* illegal, two relatively recent cases changed this analysis to the rule of reason. In *State Oil Co. v. Khan*,[45] the U.S. Supreme Court held that vertical agreements to fix maximum resale prices were not per se unlawful. In *Leegin Creative Leather Products v. PSKS, Inc.*,[46] the U.S. Supreme Court overruled an almost hundred-year-old precedent set in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*,[47] and held that minimum resale price maintenance should be analyzed under the rule of reason.

Similarly, the most recent iteration of Russian competition law seems to suggest that resale price maintenance agreements would be examined under the rule of reason. However, since this rule was enacted as part of the Third Antimonopoly Package and is relatively new, its application in practice is still unclear.[48] In fact, the maximum resale price provision[49] was one of the more controversial antitrust elements of the Third Antimonopoly Package. The newly established framework differentiates between burdens of proof necessary for minimum versus maximum resale price. For minimum resale price, the Competition Law requires the defendant to show that its conduct is precompetitive. For maximum resale price, the plaintiff has to prove that the agreement has anticompetitive effects.

Despite this burden-shifting framework defined by the law, the FAS is generally skeptical of resale price maintenance agreements or their potential procompetitive aspects. Since the FAS is ultimately the agency enforcing the law (and the agency's decisions are usually summarily upheld by the courts), firms should hesitate to rely on the language of the statute instead of reviewing the FAS's commentary.

OJSC United Trading Company. The *OJSC United Trading Company* [hereinafter *OUTC*] case is also informative. Despite the fact that this case was decided before the Third Antimonopoly Package went into effect, the FAS's approach to the analysis is still used in current cases. In that case, the FAS found that *OUTC* had 90% market share in the sodium bicarbonate market and dictated resale prices to its dealers in various regions of the Russian Federation. When challenging the arrangement, the FAS concentrated on simply proving that the companies entered into an agreement rather than on the effects of any agreement on competition. This forced the companies to prove the agreement was not effective instead of demonstrating the procompetitive benefits of the agreement. The *OUTC* case is notable because it demonstrates a per se-like approach employed by the FAS when examining resale

45 522 U.S. 3 (1997).

46 551 U.S. 877 (2007).

47 220 U.S. 373 (1911).

48 *See Дианов В., Егорушкин А., Хохлов Е.* Комментарий к «третьему антимонопольному пакету» [Dianov V., Egorushkin A., Hohlov E. *Kommentarii k 'tret'emu antimonopol'nomu paketu'* [Alexander Egorushkin et al. Commentaries on the Third Antimonopoly Package]] 48–52 (Statut 2012).

49 Competition Law, *supra* n. 2, Art. 11(2)(1).

price maintenance.[50] Moreover, certain representatives of the FAS are in favor of the complete prohibition of the fixing of the minimum resale price (without taking into account the possibility of procompetitive effects).

The FAS's Recommendation to the Auto Industry. In 2012, after the Third Antimonopoly Package went into effect, the FAS specifically warned distributors and manufacturers of automobile parts within the Russian Federation (FAS Recommendation) not to carry out activities that result in minimum resale price maintenance, regardless of whether they had market power.[51] This Recommendation was made *even after* the FAS analyzed the automobile market and found that the market was characterized by significant and aggressive interbrand competition. The FAS Recommendation leaves much to be desired, especially because it does not address how intrabrand price restraints may lead to unlawful restraint of trade within an otherwise competitive market.

Despite being inconsistent with the Russian legislative directive, the FAS's reluctance to adopt economic theory in evaluating minimum resale price restriction is not surprising. Even in the United States, where the rule of reason is used nearly universally on the federal level, states have shown some resistance to abandoning per se treatment. Several states maintain that *Leegin* does not affect their existing laws,[52] which condemn resale price maintenance agreements as illegal *per se*, either by statute or by judicial interpretation of these state laws.[53] Also, states' attorneys general have gone after companies for resale price maintenance agreements under the old per se rule.

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50 Decision of the FAS of 27 December 2011 No. 1 11/139-11.

51 Рекомендации ФАС России дистрибьюторам и автопроизводителям автомобильной продукции в Российской Федерации [*Rekomendatsii FAS Rossii distrib'yutoram i avtoproizvoditelyam avtomobil'noi produktsii v Rossiiskoi Federatsii* [*The Recommendations of the FAS Russia to Vehicle Manufacturers and Distributors of Automotive Products in the Russian Federation*]], FAS (Sep. 7, 2012), <http://fas.gov.ru/clarifications/clarifications_30389.html> (accessed Aug. 5, 2014).

52 *See, e.g.*, *California v. ARC America Corp*., 490 U.S. 93 (1989) ('Congress intended the federal antitrust laws to supplement, not displace, state antitrust remedies . . . [and] the Court has recognized that the federal antitrust laws do not pre-empt state law'); *see also O'Brien v. Leegin Creative Leather Products, Inc.,* 277 P.3d 1062 (Kan. 2012) ('Although there are federal antitrust statutes, *e.g.*, the Sherman Act . . . and a large body of interpreting case law, antitrust law has traditionally been the province of the states . . . [F]ederal antitrust law is intended to supplement the remedies available under Kansas law, not to replace Kansas antitrust provisions').

53 States that have statutes specifically prohibiting RPM agreements include: California, Connecticut, Hawaii, Illinois, Indiana, Kansas, Maryland, Minnesota, Mississippi, Montana, Nevada, New Jersey, New York, Ohio, South Carolina, Tennessee, and West Virginia. For a summary of state antitrust laws, *see* Michael A. Lindsay, *An Update of State RPM Laws Since Leegin*, The Antitrust Source (Dec. 2010), <http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Dec10_Lindsay12_21f.authcheckdam.pdf> (accessed Aug. 5, 2014).

7. Exclusive Dealing Agreements

Up until this section we discussed intrabrand restraints, *i.e.* restraints on the downstream firm's freedom with regard to the resale of the product at issue. An exclusive dealing agreement, however, is an interbrand restraint. As opposed to intrabrand restraints, interbrand restraints, although entered into by parties at different levels in the chain of distribution, affect competitors. Exclusive dealing agreements generally obligate a buyer to purchase most or all products from the contracted manufacturer for a period of time. One result of such agreements could be potentially foreclosing competitors from access to either supplies (in the case of upstream restrictions) or outlets of distribution (in the case of downstream restrictions).[54]

In the United States, exclusive dealing agreements are reviewed under the rule of reason.[55] Courts have acknowledged that these contractual mechanisms can yield numerous procompetitive benefits and efficiencies,[56] and because of that, have shied away from bright line tests based on market share, instead asking whether the arrangement threatens to harm competition. Russia's competition laws, in contrast, apply a less flexible approach to exclusive dealing agreements. The Competition Law prohibits any obligation not to sell a product or service of a competing manufacturer, evaluating nearly all such agreements under a *per se* rule.[57]

There are two notable exceptions. The prohibition on exclusive dealing does not apply if contracting parties' relevant market shares do not exceed 20% or if the exclusive dealing provisions are used as a part of a franchising agreement. On the one hand, the establishment of a 20% safe harbor is a positive development. On the other hand, two problems emerge: (1) a market share above 20% does not necessarily demonstrate market power; and (2) it is unclear how markets will be defined and market shares calculated.

The first exception is imperfect. Specifically, while a safe harbor provision is useful for some, a market share higher than 20% does not necessarily translate into the ability to affect the market. Further, neither the FAS nor Russian courts have a good track record of implementing economics when undertaking market definition and market share calculations. At times, the FAS has summarily decided that a firm has

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54 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application, ¶ 1800a (4th ed., Aspen Publishers 2013).

55 *See Tampa Elec. Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961) (examining an exclusive dealing arrangement under a rule of reason standard).

56 *See Standard Oil Co. v. United States*, 337 U.S. 293, 306–07 (1949) (noting the potential benefits of exclusive dealing arrangements, including a buyer's assured supply, protection against price increases, and known costs for future planning, while a seller's benefits may include reduced costs with an assured buyer, protection against price fluctuations, and known capital expenditures).

57 Article 11(2)(2).

100% of the market for the sale of its own product, without employing even the most rudimentary substitution analysis. Thus, while the 20% safe harbor is a step in the right direction, it is not a cure-all for the lack of the real rule of reason.

The second exception is similarly flawed. As with the 20% safe harbor, the franchising exception does not require a market power or general market effects analysis. The exception can be abused by a firm with significant market power: an abuser could disguise its attempt to raise barriers to competitors as an agreement to sell under a trademark (as part of a franchise agreement). Again, this particular rule could also be improved by use of economic theory. There have been no significant cases evaluating exclusive dealing agreements since the Third Antimonopoly Package went into effect; therefore, the only insight one has into the FAS's thinking are the pre-Third Antimonopoly Package cases. We discuss a few notable decisions below.

Coca-Cola and Pepsi. The most famous exclusive dealing case in Russia is the FAS's proceeding against *Coca-Cola* and *Pepsi*.[58] Both companies executed contracts with firms selling soft drinks that restricted the firms from selling a competitor's products. In 2005, the FAS launched an investigation into both companies. During the proceedings, both *Coca-Cola* and *Pepsi* expressed their willingness to voluntarily correct violations and abandoned their usual contract provisions throughout Russia. The FAS dropped the case thereafter.

Zavolzhskii Motornyi Zavod. In 2007, *Zavolzhskii Motornyi Zavod* [hereinafter *ZMZ*] entered into agreements with its dealers, under which the dealers were not allowed to claim discounts if they bought, sold, or stored competing products.[59] The FAS concluded that the restrictions violated the Competition Law, as they prevented competing products from entering the market. The FAS ordered *ZMZ* to amend all its dealer agreements, indicating that dealers were free to purchase, sell, store, and advertise parts, components, and assemblies of *ZMZ*'s competitors. The company proposed amending its agreement allowing dealers to sell competing products, unless these dealers sold through specifically branded *ZMZ* stores. The FAS accepted such amendments.

Renault Trucks. The more recent case of *Renault Trucks* similarly demonstrates the FAS's aversion to exclusive dealing agreements. *Renault Trucks* entered into agreements with service stations based on which stations agreed not to service or

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[58] Красноярское управление ФАС России: дела в отношении Кока-Колы и Пепси идут параллельно [*Krasnoyarskoe upravlenie FAS Rossii: dela v otnoshenii Koka-Koly i Pepsi idut parallel'no*] [*Krasnoyarsk FAS Russia: The Case against Coca-Cola and Pepsi Are Handled in Parallel*]], FAS (Oct. 19, 2005), <http://fas.gov.ru/fas-news/fas-news_3120.html> (accessed Aug. 5, 2014).

[59] ФАС России изготовила решение и предписание по делу в отношении ОАО «Заволжский моторный завод» [*FAS Rossii izgotovilo reshenie i predpisanie po delu v otnoshenii OAO 'Zavolzhskii motornyi zavod'* [*FAS Russia Decides Zavolzhskii Motornyi Zavod (ZMZ) Case*]], FAS (Oct. 25, 2007), <http://fas.gov.ru/fas-news/fas-news_15819.html> (accessed Aug. 5, 2014).

repair competitors' trucks. The FAS found that the service stations, by refusing to service competing firms, were no longer independent market actors and therefore unreasonably restrained competition. Ultimately, *Renault Trucks* agreed to remove the exclusive dealing provisions from its contracts.[60]

In all these cases, the complete absence of any analysis from the FAS is especially notable. It is unclear whether the parties did not present procompetitive justifications or whether the FAS refused to entertain any such justifications and summarily found violations of the Competition Law. Without the FAS explicitly explaining its economic analysis, or lack thereof, it is extremely difficult to predict how it will respond to any particular exclusive dealing agreement.

8. Conclusion

While the Russian Federation represents a significant opportunity for growth, that opportunity is coupled with serious risks. Generally, expanding companies should take precautions when it comes to entering any new jurisdiction. Business practices and regulations vary across the global spectrum, and common practices in the United States may not always equate to international standards.

As it relates to antitrust laws and regulation, Russia has made significant steps in the right direction.[61] For example, Russian antitrust laws now differentiate between vertical and horizontal restraints. Acknowledging the potential procompetitive effects of vertical agreements, many vertical agreements are now to be treated under the rule of reason, at least according to the legislature. Still, Russian vertical restraint law remains significantly more restrictive than that of the United States. Further, the sometimes inconsistent application of the laws also makes it hard to predict how any particular vertical arrangement would be evaluated. Ultimately, however, if a company keeps in mind the differences in its ability to manage its distribution network in Russia as compared to the United States, it can minimize the risks and benefit from the plentiful Russian market.

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60 Decision and Determination of the FAS of 20 September 2012 No. 1 11/129-11 of the case 'Renault Trucks, SAS,' available at <http://fas.gov.ru/solutions/solutions_35948.html> (accessed Aug. 5, 2014).

61 On March 29, 2012, at the All-Russian scientific and practical conference at the Moscow State University, Head of FAS Russia Igor Artemiev announced that the FAS should improve the list of restrictions applied to vertical agreements. *See* Игорь Артемьев: «Построение конкурентной модели российской экономики у нас не только возможно, но и должно быть» [*Igor Artemiev: 'Postroenie konkurentnoi modeli rossiiskoi ekonomiki u nas ne tol'ko vozmozhno, no i dolzhno byt'"* [*Igor Artemyev: Competition Model of the Russian Economy, It Is Possible and Should Be Built*]], FAS (Apr. 3, 2012), <http://fas.gov.ru/fas-news/fas-news_32904.html> (accessed Aug. 5, 2014).

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