

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON COMPETITION ISSUES IN FOOD CHAIN INDUSTRY

-- Note by Lithuania --

This note is submitted by Lithuania to the Competition Committee FOR DISCUSSION under Item XII at its forthcoming meeting to be held on 30-31 October 2013.

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1. Background

1.1 *What have been the main characteristics of retail food trends in recent years and what factors have given rise to these trends?*

1. In Lithuania four major retail chains operate in the food retail sector. Market shares of these retailers have been gradually increasing during recent years and currently cover about 75 percent of the market. This market structure and participants (four major retail chains) of the food retail sector has not changed for the last fifteen years (1997-2013). Even though there was no significant new entrant to the food retail sector during the last fifteen years, in 2009 largest Finnish retail company *Suomen Osuuskauppojen Keskuskunta (SOK)* opened its first *Prisma* hypermarket for daily consumer goods in Vilnius. Currently *SOK* manages three hypermarkets (two in Kaunas, one in Vilnius) and is considering expanding its hypermarket chain. In 2013 Germanys *Schwarz Gruppe* managing one of the biggest discount supermarket chains has started construction of the first *Lidl* supermarket in Vilnius. The food retail market attracted interest from foreign companies, which launched their business in Lithuania (see question 2.2 for a more detailed description). As to the other participants in the food retail sector it is noticeable that cooperation process between small retail shops in order to negotiate more favourable conditions of sale and purchase with food product manufacturers increased.

2. Although consumers remain very price sensitive, there is increasing demand for high quality food products. This is also reflected in the product assortment of the major retail chains, which are not only expanding supply of low price private label products, but also offering organic, gourmet food products branded with private label. Recent trends show that both specialized shops of organic, gourmet products and cash and carry, discount type shops are expanding their activities; however they still are of low prevalence in Lithuania.

3. One more growing trend, which may not be directly related to the food retailing, but is significant for food price transparency and thus price setting in general is an increasing popularity and number of price comparison sites in Lithuania (see question 1.5 for more detailed description).

4. Since in recent years large retail chains are gaining more market power and a number of certain business risks are shifted onto their suppliers, these problems were addressed in 2009 by the Parliament of the Republic of Lithuania law passing the Law on the Prohibition of Unfair Practices of Retailers of the Republic of Lithuania. This law imposes certain restrictions and requirements on retailers having significant market power when dealing with their suppliers which might have impact on the competition conditions in the retail market (see question 3.3 for a more detailed description).

1.2 *Have there been increased concerns about the functioning of the food supply chain following the world commodity price spikes in 2007-2008 and 2011?*

5. The Competition Council of the Republic of Lithuania (the “CC” or the “Competition Council”) often receives requests to address changes in the food prices and provide assessment on the functioning of the food supply chain both from the governmental institutions and public. Especially the retail level raises major public concerns. For example in the year 2007 the CC conducted two market studies: first, pursuing the mandate of the Government of the Republic of Lithuania the CC analyzed causes for the price volatility across wide range of food products (see question 3.1 for a more detailed description); second, the CC *ex officio* conducted a market study regarding changes in the food retail sector and standing of four major retail chains in Lithuania (see question 2.1 for a more detailed description).

6. As already mentioned, concerns about the functioning of the food supply also prompted the Parliament of the Republic of Lithuania to enact the Law on the Prohibition of Unfair Practices of Retailers of the Republic of Lithuania in order to prohibit retailers from performing actions contradictory to the fair business practice (see question 3.3 for a more detailed description).

1.3 *What factors may result in retail prices not fully reflecting changes in world commodity markets? What factors may cause these potential differences in the patterns of price adjustment between the raw commodity and retail price levels?*

7. Results of the market studies regarding price volatility of food products (see question 3.1 for a more detailed description) suggest that retail prices are affected not only by the changes in world commodity markets, but also by increases in production costs, changes in value added tax and other factors.

8. The Competition Council has also identified that one of the reasons why retail prices does not fully reflect changes in the commodity markets or increases in production costs in the food supply chain might be the different capacity of food supply chain participants to influence and apply pressure over the remaining chain members, e.g. retail sale channels and processing of primary food products are mainly controlled by large undertakings, though productions of primary agricultural commodities like milk, grain and vegetables are often produced by small farms and individual farmers. Therefore lack of bargaining power by certain participants in the supply chain adds to the concern about the present situation in food markets and retail prices not fully adjusting to changes in agricultural commodity markets.

1.4 *Has the functioning of the food chain featured in the concerns about national food security and, if so, how?*

9. N/A

1.5 *Are food prices monitored in your jurisdiction? If so, by whom and to what purpose?*

1.5.1 *Food prices monitoring activities*

10. In October 2010 the Competition Council launched a market study on retail prices of food products. Purpose of this study was to continually gather and analyze information regarding food prices in order to provide consumers with possibility to compare prices of different food products and also enable the CC promptly respond to the changes in food prices and provide preliminary conclusions on reasons for price spikes. For the collection, management and publication of relevant information the CC entered into a cooperation agreement with the SE Agricultural Information and Rural Business Centre and the Lithuanian Institute of Agrarian Economics. Results were placed on the website www.produktukainos.lt and

included weekly data on the lowest, highest and average prices of most important food products (total 45 articles), also aggregated data on the margins charged by the retail chains in respect of 10 most common food products and average price comparisons among Lithuania and the EU member states. In July 2013 the Competition Council cancelled this market study after consideration that measures by the CC are not the only source of information on food prices and both Statistics of Lithuania and increasing number of private initiatives (price comparison websites) are providing information on food prices for consumers.

2. Recent Developments in the Food Chain

2.1 *What have been the primary changes in the food chain over the past decade or so? Has concentration increased? Have these changes been more notable at the retail or manufacturing levels? What has driven these changes?*

11. For the last decade no significant structural changes has occurred in the food retailing sector and market shares of four major retail chains were gradually increasing. No legal requirements for the establishment of retail centers provided the possibility for the retail chains to expand successfully and allowed them to locate their stores not at the outskirts but in the center and residential areas of the cities. Locally some changes in the retail market are caused by the emerging specialty food stores and other new initiatives such as Farmers' Markets, which provide fresh products straight from the manufacturers to consumers; however their market shares are very small.

12. In 2007¹ the CC analysed the changes in the food retail sector and gathered information on the standing of the large retail chains. The CC established that in the period 2004-2007 the market share of the four major retail chains increased by about 10 percent. The operating strategy of the retail chains was mainly targeted expansion in regional centres and major settlements. The CC concluded that due to their extensive capacities major retail chains acquire a significant advantage in respect of the smaller undertakings both in terms of consumers and in their negotiations with the suppliers concerning product prices, discounts and other supply terms. The more favourable terms in supply agreements enable major retailers to ensure higher profit margins or fix lower sale prices which eventually grant them significant competitive advantage in respect of smaller retailers. On the other hand, the capacities operated and facilities offered by retail chains are beneficial to consumers who can purchase all their necessities in a single place, are offered a wider assortment of merchandise.

2.2 *To what extent have the changes in the food supply sector been associated with increased presence of foreign firms?*

2.2.1 *Foreign firms in Lithuanian food retail*

13. In 2002 low-price retail chain *Lidl* decided to expand its activities in the Baltic countries. Lithuanian *UAB Lidl* was founded in 2002 and in 2004 *Lidl* purchased land and buildings suitable for developing its shops. However, in 2007 *Lidl* announced that due to adverse market conditions it decided to postpone development plans in the Baltic countries. Since 2011 the company returned to active development in Lithuania and the first *Lidl* store is expected to open in 2014 in Vilnius.

14. In September 2009 Finland's largest retail company *Suomen Osuuskauppojen Keskuskunta (SOK)* already operating in five European countries opened its first hypermarket *Prisma* in Vilnius. SOK was planning to open 6-7 *Prisma* stores. However the original plans to expand in Lithuania was affected by the market situation and investors plans, therefore currently (2013) *SOK* owns three *Prisma* hypermarkets, two in Kaunas and one in Vilnius. *Prisma* offers not only food products, but clothing and household, leisure

¹ More information in Annual Report of 2008, p. 14-15. http://www.kt.gov.lt/en/annual/2008_eng.pdf

products. In addition to products already known in Lithuania *Prisma* introduced new brands; among which the chain's own brands for food, hygiene, household and home textiles.

2.3 *Have there been any notable changes in the retail sector following recent experience in food price inflation and the economic downturn? For example, through the increased presence of discount outlets? Have there been changes in policies directed at the retail food sector? What have been the main factors driving these policies where applicable?*

15. N/A

3. Competition in the Food Chain

3.1 *Have there been sector reviews of the food chain in recent years? If so, what has been the primary motivation for these reviews? What has been the principal focus: vertical, horizontal or both? What were the conclusions?*

3.1.1 *Study on price volatility across wide range of food products²*

16. In August 2007 following the price spikes in world markets and pursuing the mandate of the Government of the Republic of Lithuania, the Competition Council conducted analysis addressing price increases of food products. The CC concluded that price increase for grain was caused by a nearly double jump of grain prices in global markets as a result of poor grain harvest. Due to the spike in grain purchase prices, flour sale prices, as a result bread and bakery product prices increased. The increase in meat product prices was mainly caused by higher labour costs and increase in prices of raw materials used in the production. The analysis into the dairy production showed that to quite a tangible extent the price spike was caused by the increase in raw materials purchase prices and labour costs. The analysis of the data on the changes in retail prices of food products showed a rather diversified pattern in the manner of changing prices. In most cases the retail chains increased prices following the increase by the producers, but on individual occasions the retailers would increase the prices to a higher rate than the producers, and vice versa.

3.1.2 *Study on milk and retail sectors³*

17. In 2009 the Competition Council conducted study regarding milk and retail sectors. Analysis covered structural developments and activities in milk sector and food retailing analysis focused on development of four major Lithuanian retail chains and evaluation of supply contracts. Analysis showed that in the period 2004-2008 the number of retail food stores, sales area and the share of the retail food sector held by the major retail chains were continuously increasing and the number of sales outlets operated by independent or incorporated small retailers decreased. Accordingly the share of the four major retailers in the retail food product market in 2004–2008 increased by 11 percent – from 61.9 to 72.3 percent, while the share of the independent or incorporated smaller retailers decreased from 38.1 to 27.7 percent. Information collected did not support the conclusion that major retail chains would unlawfully use their market power. However, the CC found that certain practices, e.g. fines for the failure to supply products or fulfil other obligations, marketing fees for trading in trade centres, discounts, etc, could be considered excessive since during 2008 major retail chains collected about 244 million LTL from their suppliers in the form of different charges and fees (discounts, advertising, promotion, marketing), also during the same period claimed about LTL 5 million in fines.

² More information in Annual Report of 2007, p. 17. http://www.kt.gov.lt/en/annual/2007_eng.pdf

³ More information in Annual Report of 2009, p. 18. http://www.kt.gov.lt/en/annual/2009_eng.pdf

3.1.3 Study on price volatility across wide range of food products⁴

18. In autumn 2010 the Competition Council has completed a study concerning price volatility across a wide range of food product prices. This market analysis was prompted by price increases for certain food products. The purpose of the investigation was to identify the factors and reasons that have caused changes in food product prices. The information collected in the course of the investigation led to a conclusion that the price increase trend had been observed both in Lithuania and in other neighbouring markets and the causes for price volatility had not been limited to the national territory. The investigation has also revealed that the price fluctuations are also dependent on the number of intermediaries operating in the food supply chain, the competitive structure of the elements of the chain and the differences in the bargaining power of the parties.

3.2 Has there been an increase in competition authority enforcement in the food sector in recent years? Please supply details.

3.2.1 Anti-competitive agreements

19. The Competition Council conducted several investigations of possible anti-competitive agreements in the food sector.

3.2.2 Exchange of commercially sensitive information in dairies sector⁵

20. In September 2007 the Competition Council ex officio initiated investigation into activities of undertakings purchasing and processing milk, and the association joining such companies. The investigation has been prompted by the increase in prices of food products in the middle of the year and the interim findings of the analysis of the price increase conducted by the experts of the CC. This investigation involved analysis of the different levels of dairy products supply chain – purchasing of raw milk and marketing of various dairy products. As a result of the investigation, the CC concluded that for the period from 2000 to 2007 the undertakings active in the milk and dairy processing market on regular monthly basis exchanged sensitive information which provided them with data on prices of the procurement of raw milk, as well as quantity data. Undertakings concerned were able to precisely monitor the activities and strategic decisions of their competitors, to align their behaviour accordingly and maintain stable market shares. The CC imposed fines total 647 590.44 EUR. However several undertaking appealed the decision of the CC and the Supreme Administrative Court of the Republic of Lithuania annulled findings of the CC on the grounds of the expiration of prescription regarding the undertakings which filed the appeals.

3.2.3 Investigation into the meat processing market⁶

21. In 2007 the Competition Council closed an investigation into possible anticompetitive agreements between meat producers and their association. The trend of price increases in year 2006-2007 on the market for processed meat products and a preliminary market analysis suggested that undertakings engaged in the meat processing activities as well as their association could have coordinated their actions related to setting the price and also could have exchanged confidential information. However, the Competition Council did not gather substantial evidence that would have allowed it to conclude that a price-fixing agreement has been concluded between the undertakings active in the meat processing market.

⁴ More information in Annual Report of 2010, p. 32. http://www.kt.gov.lt/en/annual/2010_eng.pdf

⁵ More information in Annual Report of 2007, p. 8. http://www.kt.gov.lt/en/annual/2007_eng.pdf

⁶ More information in Annual Report of 2007, p. 9. http://www.kt.gov.lt/en/annual/2007_eng.pdf

3.2.4 *Investigation into the pricing practices in the flour and bakery products, milk and milk products markets*

22. After having observed substantive price increases in August – September 2010 in the food retail sector and having received additional information from the Ministry of Agriculture, the Competition Council has conducted an assessment of the change in the key input prices as well as the wholesale and retail prices for dairy and grain products. The study showed that recent increase in the input prices alone did not fully account for the extent of the increase in the retail prices for dairy and grain products in the country. The analysis of the CC revealed that the prices for food products had not increased exclusively for objective economic reasons and that the fluctuations could have emerged due to a weakening of competition. Based on these findings, the CC initiated investigation aimed at assessing whether a number of undertakings engaged in the production and/or marketing of food products (milk and milk products, flour, bakery goods) have participated in anti-competitive agreements or concerted practices that could have possibly led to the increase in retail prices of mentioned products. The investigation is still ongoing.

3.3. ***How have competition investigations addressed buyer power? What (if any) provisions exist for addressing buyer-supplier relations in the food chain? How are these relations regulated (for example, through guidelines, soft law provisions, codes of conduct)? Are there plans for tighter regulations in the future?***

3.3.1 *The Law on the Prohibition of Unfair Practices of Retailers of the Republic of Lithuania*⁷

23. In 2009 by the Parliament of the Republic of Lithuania passed the Law on the Prohibition of Unfair Practices of Retailers of the Republic of Lithuania (the „Law on Unfair Practices“). The purpose of the Law on Unfair Practices is to ensure the balance between the interests of the suppliers and large retailers and to limit the use of market power by large retail undertakings enjoying a significant market power. The Law on Unfair Practices prohibits retailers having significant market power to perform any actions contradictory to the fair business practice that result in the transfer the operating risk from retailers upon their suppliers, or additional supplementary obligations which limit the possibilities of the suppliers to freely operate in the market and which are expressed as requirements for the supplier. For example black list of practices which are deemed to be in conflict with the requirements of this law include “entry” fees, compensation for the lost or smaller-than-expected income of the retailer from the sale of goods received from the supplier, acquiring goods, services or property from third parties specified by the retailer, etc. The Competition Council is the authority responsible for the enforcement of the Law on Unfair Practices and according to this Law is obliged to draw up and submit the Statement on the Monitoring of this Law specifying the progress in attaining the objectives pursued by this Law, any negative outcomes, as well as any proposals concerning improvement of the Law on Unfair Practices. The CC has conducted couple of investigation regarding infringements of the requirements of the Law on Unfair Practices.

24. In 2012 the CC acknowledged that *PALINK*⁸, managing the stores belonging to the retail chain *IKI*, had infringed the Law on Unfair Practices as it unreasonably restricted possibilities of suppliers to freely operate in the market. *PALINK* as a retailer having significant market power conducted prohibited actions while concluding contracts with food and beverages suppliers regarding the provisions of advertising services. These contracts included a provision whereby analogous goods will not be supplied to the undertakings engaged in the retail trade for the same or lower price during the whole period of the promotional campaign in *IKI*. In the resolution, the CC noted that *PALINK* by the means of prohibited actions not only limited the freedom of suppliers, but also due to such limitation the consumers could have

⁷ Law of the on the Prohibition of Unfair Practices of Retailers, 22 December 2009 – No XI-626 http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=406491

⁸ More information in Annual Report of 2012, p. 19-20. http://www.kt.gov.lt/en/annual/2012_eng.pdf

been harmed, since other shopping centres had less opportunities to offer the same goods for a lower price. For the established infringement the company was fined of 104 250 EUR.

3.4 What exemptions (if any) are applied by the competition authority relating to competitive practices at any stage of the food supply sector?

25. No national legislation provides exemptions for anti-competitive practices in the food supply sector. In 2001 the Competition Council has adopted a decision providing general exemption for certain agreements between the agricultural land users. Mentioned decision was abolished in the autumn of 2004. Since May 1st of 2004 when the Republic of Lithuania became a member of the European Union, the CC is subject to European Union legislation. For example Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) provide certain exemptions from competition law to agricultural commodities is directly applicable. Naturally, The Law on Competition as also TFEU provides possibility to argue individual exemption to certain anticompetitive practices.

4. Other Factors Determining the Functioning of the Food Chain

4.1 What other policies affect the functioning of the food supply chain including the extent and intensity of competition? For example, restrictions on retail practices (planning, price controls, restrictions on the services sector)?

4.1.1 Merger assessment

26. The Competition Council has been assessing a number of notified mergers in the food supply chain. The market assessed included manufacturing and wholesale of food products and also retail of food products. The Competition Council has issued a merger prohibition decision in food retail sector.

27. In *Maxima (2008)*⁹ merger case the CC passed a decision ordering *Maxima* – one of the biggest retail chains in Lithuania, to remove the outcomes of concentration, i.e. extinguish lease contracts for the commercial premises in which *Maxima* has been conducting its retail trade activities of food products and household products, or to transfer the ownership rights in respect of such premises. The CC concluded that in the geographic markets examined (certain municipalities) *Maxima* had a sufficiently large market share and with an increase in the market share (up to 5 percent) as a result of concentration a dominant position could have been created in these markets or competition in the retail markets for retail of food products could have been significantly weakened. During this concentration the Competition Council also established that although the possibilities of any new market participant to enter the retail food product market is neither directly nor indirectly restricted by any statutory requirements, the entry is impeded by the administrative restrictions in respect of the construction of new trade centres, significantly increased prices for the lease of trading space, etc. Remedies imposed by the CC were considered sufficient for the purpose of responding to competition problems in the relevant markets as they facilitated the reduction in the level of concentration down to the previous level in these local markets.

4.2 What aspects of state enterprise involvement in the supply chain or marketing boards may (or have) affect(ed) the food chain?

28. N/A

⁹ More information in Annual Report of 2008, p. 12. http://www.kt.gov.lt/en/annual/2008_eng.pdf

5. Advocacy

5.1 *Has there been an increased advocacy role for the competition authorities in recent years with regard to the functioning of the food chain (for example, with respect to barriers to entry, promoting regulation/de-regulation, trade and agricultural policies)?*

29. N/A