TAPR IQC Egypt

Technical Assistance to Support Economic Policy Reform

USAID Contract No. 263-Q-00-97-00104-00

Task Order 1: Delivery of TAPR Core Management Team

Potentially Anti-Competitive Behavior in the Wholesale-Retail Sector

Submitted to:

United States Agency for International Development / Cairo

Submitted by:

Chemonics International Inc.

2001

Potentially Anti-Competitive Behavior in the Wholesale-Retail Sector

Introduction

This report examines potentially anti-competitive behavior in the Egyptian wholesale-retail sector by examining the entry and exit of a food retailing chain in Cairo, a merger in the Egyptian beverage industry, and the phenomenon known as "burning the market". These events have occurred in the recent past. They have occasioned wide public comment and governmental interest in potential competition issues. There have been suggestions that if Egypt had had a competition law and a competition agency, the outcomes for these events might have been different. The concept of the report is to describe how a competition agency might approach the competition issues, and what the treatment might be under US competition law, EU competition law, and the competition law of some other countries.

A Note on Sources of Information. Most of the information in this report comes from interviews. Some comes from available documents and press reports. The time period for accumulating information was short. This limited process is in contrast to the resources usually available to a competition agency. In a qualifying merger the competition agency will have specified what information the merging parties would have to file initially with the agency. The agency can then request additional information from the parties and compel the production of documents and testimony from third parties having information relevant to the merger inquiry. The competition agency will also typically have access to any relevant information held by other government agencies. In a competition investigation, the agency can compel production of documents and testimony from the party under investigation, and from third parties possessing information relevant to the inquiry. It is for these reasons that all conclusions in this report should be treated as tentative and are dependent on the quality and completeness of the information accumulated.

The food retailing case will be examined first. The case raises interesting issues about marketing practices, vertical restraints and group boycotts. It will also illustrate how competition and regulatory regimes in other countries might differ in addressing these issues.

SAINSBURY'S

Sainsbury's is a large food retailing chain based in the United Kingdom. In April 1999 it proposed to enter the Egyptian food retailing market, and to do so first in Cairo. Its expressed intention was to revolutionize what it saw as an under-developed food retailing industry. Before entering food retailing in Egypt, Sainsbury's was a substantial importer of Egyptian foods for sale in the UK.

In 1999 Sainsbury's established Sainsbury's Egypt of which the parent company owned 80 percent and the Egyptian El Nasharty Group owned 20 percent. It began by acquiring first 25 percent and then 80 percent of the Cairo food retailer Edge. This acquisition gave Sainsbury's access to approximately 80 small stores, including approximately 50 government stores for which Edge held a management contract. In June 1999 it acquired the supermarket chain ABC Supermarket Expo, which had 5 stores serving high-end supermarket consumers but whose business strategy was to rent shelf space to those who wanted to sell products. By February 2000 Sainsbury's had 36 Edge outlets, 5 ABC outlets, a new retail store in Giza, a store in Shubra, and a "super gomla" (wholesale) store near the Autostrade. By the end of 2000 Sainsbury's was still opening stores, of which it now had over 100 with about 5,000 employees. More than 20 of these were stores that Sainsbury's opened after acquiring existing buildings and retrofitting them as food stores. However, by December 2000 plans were in the works for Sainsbury's to withdraw from Egypt. It did so in the Spring of 2001. Its 80 percent ownership in Sainsbury's Egypt was sold to the El Nasharty Group. The government stores were returned to the government. Other stores were closed. There are now 2 ABC stores that remain open.[1]

The first competition issue arose with respect to Sainsbury's marketing practices. As a new entrant, Sainsbury's adopted a "loss leader" marketing strategy. It is a well-established practice in food retailing, albeit a controversial one. What Sainsbury's did was every week to offer a few basic and popular items at prices that were alleged to be below the wholesale invoice cost to Sainsbury's. The exact items could change from week to week. A food retailer might adopt this marketing strategy rather than, for example, engaging in extensive advertising. In its overall business strategy, the cost savings from not spending on usual advertising go to fund losses on loss leaders.

Whatever was in the Sainsbury's business plan, the loss leader strategy worked all too well. Competitors were not happy. Here two sets of competitors will be discussed.

Small traders are small grocers who have one or two small stores. They cater to customers who cannot afford or cannot get to supermarkets. These small grocers are not equipped as are supermarkets – they do not carry fresh meat, for example. But before Sainsbury's came they had their own customers who were almost like family, and a quiet life. Since they were small grocers they served small areas, and there are many such small grocers. They do buy at wholesale branded products such as detergents or milk, and sell them in their stores. Their marketing strategy is to take the wholesale price, add a markup and sell the product.

Supermarket chains in general serve more affluent areas of Cairo. While they do not have the large numbers of stores often found in large cities, their stores are much larger and better equipped than are the stores of small grocers. For example, Metro Supermarkets has 18 stores, Alpha has 4 stores, and Shoprite has 3 stores.

---

[1] N. El-Sherif, "Learning To Love FDI", BUSINESS TODAY – EGYPT (April 2001) p. 24; "Sainsbury's pulls out of Egypt, while others plan to come in", COMMUNITY TIMES (May 2001) p.17; A. F. Hassan, "Counter Attack", BUSINESS EGYPT – TODAY (February 2000) p.17. *See also,* "Editor's Note". BUSINESS EGYPT – TODAY (January 2001 and June 2001).

An alternative description of food retailing competitors in Cairo, as a producer of detergents might see it, provides more detail:

UPPER TRADE --Supermarkets with greater than 1000 sq. meters
Discounter stores with 500 –750 sq. meters
Self Service stores with 500 – 1000 sq. meters

RETAIL TRADE -- “A” Grocers with at least 100 sq. meters
“B” Grocers with less than 100 sq. meters.
WHOLESALERS

PHARMACIES

Wholesalers sell direct from the producer to about 70% of the small grocers in Cairo. There are about 20 discounters in Cairo – these are stores who sell large quantities of products at very thin margins. It was discounters and wholesalers especially who were incensed by Sainsbury’s “loss leader” pricing.

Small grocers also immediately felt the effects of Sainsbury’s loss leader marketing strategy, since in contrast to other supermarket chains, Sainsbury’s had broad coverage through Edge. Larger supermarkets felt growing competitive effects as Sainsbury’s opened more and more stores. Attention of both sets of competitors focused on the loss leader strategy. Some supermarkets believed that Sainsbury’s was obtaining price discounts from suppliers that were not available to Sainsbury’s competitors. Some also believed that Sainsbury’s strategy was predatory, intended to drive all competitors from the market and then to recoup losses by charging high prices after competitors were eliminated. They also believed Sainsbury’s was making preemptive purchases of products at wholesale so as to deny the availability of these products to its competitors.

Consumers were apparently happy. The distinctive Sainsbury’s orange plastic bags could be found in many, many homes, including those who had usually shopped at small grocers.

To respond, an organization of food retailers called Misriyitna (Our Egypt) was formed. A number of small grocers belonged to this organization. So did discounters and wholesalers. Large supermarket chains deny they belonged. Perhaps it was not necessary.

Suppliers to Sainsbury’s and its competitors were approached by food retailers. They requested that suppliers agree to require that Sainsbury’s agree not to sell at prices below wholesale invoice price. A number of food retailers also agreed among themselves not to sell at below wholesale invoice price. In one instance the supplier of a particular commodity agreed with the food retailers, and required Sainsbury’s to agree not to sell at below wholesale invoice price as a condition of its continuing to sell to Sainsbury’s. This firm may have been a dominant firm in the product it supplied. In another instance a supplier of the same commodity, a multinational company that also may have been a dominant firm, refused the request of Sainsbury's competitors that it make a similar minimum price agreement with Sainsbury's. The small grocers then agreed to boycott this supplier and this boycott was joined by some supermarket chains. The first supplier benefited for a time from this boycott. Eventually several of the supermarket chains abandoned the boycott as unwise.

COMPETITIVE ISSUES IN THE SAINSBURY'S CASE

For purposes of this analysis, the product market will be defined as food retailing, and the geographic market is Greater Cairo.

"Loss Leader" Selling. Under US competition law no competition agency would take action against a firm engaging in a "loss leader" marketing strategy except in the most unusual circumstances. These circumstances would be a charge that the firm was engaging in predatory pricing as part of an attempt to monopolize. To satisfy this charge, a competition agency would have to show that the overall pricing was below average variable cost, that competitors were being driven from the market, and that the firm would be successful in recouping its losses once it had gained monopoly power. None of these conditions seems to be satisfied in the Sainsbury's case. No one had been driven out of business. Indeed one supermarket said it was "holding its own" against Sainsbury's and Sainsbury's could not be successful in any effort to monopolize. Supermarket competitors were continuing to expand and plans for new entry were occurring.

Under US law private parties have the right to bring their own lawsuits under federal competition laws even if the competition agencies decide not to sue, but the elements required to prove a violation of the law are the same as for competition agencies.

There is one exception under US law. Some states have adopted state "fair trade" laws which bar below cost selling except in certain circumstances. Federal competition agencies usually counsel against such laws. California has such a law but recently in California in a private lawsuit under California law the California Supreme Court made it more difficult for plaintiffs in such cases to prove their case.[2]

EU competition law bars below cost pricing when it is done by a dominant firm for predatory purposes.[3] In France it is a criminal offense to engage in "loss leader" selling.[4] In Germany the competition authorities recently required the Wal-Mart chain to raise some of its prices since German law bars "loss leader" selling where it harms small business. However, there is an exception in German competition law when "an undertaking enters a market for the first time in cases where its market share under the

[2] *Cal-tech Communications, Inc. v. Los Angeles Cellular Telephone Co,* 99 C.D.O.S. 2575 (April 8, 1999).

[3] Donncadh Woods, "An Outline of Community Competition Policy", (1996) *available at http://europa.eu.int/comm/competition/speeches/text/sp1996_008_en.html.*

[4] American Bar Association Section of Antitrust Law, II COMPETITION LAWS OUTSIDE THE UNITED STATES 6-1 at 35-36 (2001).

Bundeskartellamt's definition will be marginal anyway. That does not apply, however, when a firm changes hands or when a merger is involved."[5]

The Sainsbury's loss leader marketing strategy violated a sense of fairness felt by many Egyptians in the Sainsbury's competitors did not know how to fight back against selling below cost.

Discriminatory Pricing at Wholesale. So few facts are available on this issue that no conclusions can be drawn. Suppliers deny selling at different prices to similarly situated customers; competitors of Sainsbury's are sure it happened. If Sainsbury's did receive discounts, then there might be questions as to the extent that "loss leader" or below cost selling was occurring. In US competition law there is no objection to cost-justified quantity discounts at wholesale. There are also few facts as to preemptive purchasing at wholesale by Sainsbury's.

Vertical Restraints -- Resale Price Maintenance. Relationships between a supplier and a distributor are usually controlled by an agreement between them. In such an agreement the parties may agree to the imposition of conditions – termed "vertical restraints". At one time vertical restraints were roundly condemned. More recently it has been recognized that vertical restraints can be pro-competitive, depending on the circumstances for inter-brand competition and for intra-brand competition. Thus the legality of these restraints is generally assessed under a "rule of reason" analysis taking account of all the facts.[6]

One vertical restraint continues to be universally condemned, often on a *per se* basis. This is an agreement for minimum resale price maintenance. In such an agreement the supplier and the distributor agree that the distributor will not resell the supplier's products at a price below an agreed minimum.

Such agreements are condemned for two basic reasons. First, they interfere with the pricing mechanisms, which are at the heart of the competitive process. There are often less restrictive measures the parties can adopt to achieve legitimate objectives such as the prevention of free riding. These might include agreements as to exclusive territories or exclusive distributorships. Second, minimum resale price maintenance agreements may facilitate the formation of horizontal price cartels among competing distributors.

Minimum resale price maintenance agreements are unlawful per se in US competition law. However, if a supplier engages in unilateral conduct to prevent price discounting, there is no violation. Thus a supplier could announce that it will sell only to distributors

[5] "Announcement on sales below cost price (13.10.2000)", *available at* *http://www.bundeskartellamt.de/13_10_2000_englisch.html.*

[6] For a helpful review of EU law on vertical restraints and proposals to modify that law, *see* GREEN PAPER ON VERTICAL RESTRAINTS in EC COMPETITION POLICY (1997), *available at* *http://europa.eu.int/comm/competition/antitrust/96721en_en.pdf.*

who do not discount, and enforce that unilateral decision by cutting off any distributor it finds engaging in price discounting.

While there is not the same per se concept in EU competition law, the result with respect to minimum resale price maintenance is virtually the same in EU law as in US competition law. In the case of EU law, it should be remembered that the whole thrust of EU law, including its competition law, is to bring about the economic integration of member countries. Thus, EU competition authorities are vigilant against efforts by suppliers to bring about different sales prices in different countries for their products.[7]

The Sainsbury's case illustrates many of the features of minimum resale price maintenance. Distributors (food retailers) entered into a horizontal price-fixing agreement not to sell at below wholesale invoice price. Distributors and one supplier reached a minimum resale price maintenance agreement, and Sainsbury's agreed as well (or at least stopped discounting that supplier's products). Distributors attempted to reach such an agreement with another supplier and when that agreement was refused, established a horizontal group boycott to punish this supplier's refusal. In this latter case the supplier, a company operating worldwide, was said to have an agreement with Sainsbury's not to interfere with its pricing decisions. It is quite possible such an agreement would be intended to show compliance with the general condemnation by many competition authorities of minimum resale price maintenance agreements.

BURNING THE MARKET

The phenomenon of "burning the market" has been described in the following way. A putative businessperson obtains credit – either from a bank or from a supplier – and purchases products at wholesale for later resale. But this person then sells the products at prices below their wholesale in order to turn these products into cash. The person then defaults on the debt, and disappears or declares bankruptcy after the cash is hidden and there are no assets against which a creditor can recover. Alternatively, the businessperson might need cash to pay off a loan coming due, with the hope that somehow this businessperson could continue to get enough cash to stay ahead of his creditors. An example given was the purchase by such a businessperson of a certain amount of Coca-Cola at 39 L.E. per unit, which would be the usual wholesale price. The Coca-Cola would then be sold for cash at 32 L.E. per unit.

One could imagine that a competition agency could concern itself with alleged incidents of "burning the market", but it is unlikely to be an efficient use of its resources. "Burning the market" is really a problem associated with creditors' rights, credit arrangements, information collection and dissemination, determinations of credit worthiness, and criminal enforcement against fraudulent transactions.[8] Particular attention needs to be

[7] Minimum resale price maintenance agreements are on the "black list" of agreements the EU will not allow. *See* Commission Notice: Guidelines on Vertical Restraints (2000), *available at http://europa.eu.int/comm/competition/oj_extracts/2000_c_291_10_13_0001_0044_en.pdf.*
[8] Egypt apparently has serious problems with respect to defaulting on loans. "Hard Times Ahead", BUSINESS EGYPT – TODAY (March 2001) p.26 (…a result of repeated incidents of high-profile clients

given to the availability of a creditor to take a secured interest in the debtor's collateral, to track that interest and to enforce that interest. This is also a place where government can set a good example by making timely payment on its own obligations.

AL AHRAM BEVERAGES – EL GOUNA BEVERAGES MERGER

In February 2001 Al Ahram Beverages Company announced it had acquired its only domestic competitor El Gouna Beverages Group.[9] This gave Al Ahram a monopoly of all beer, wine and non-alcoholic beer produced in Egypt. The acquisition solidified Al Ahram's reputation for acquiring anyone in Egypt who produced alcoholic beverages.

Al Ahram began by purchasing the only Egyptian brewery from the government in a competitive tender process about four years ago. In 1998 it acquired from state ownership Gianaclis, then the only Egyptian winery. Soon Al Ahram bought the new Nile Brewery, before it had ever produced a can of beer. El Gouna Beverages was established in 1999 by some of those who had lost government tender offers to Al Ahram. It produced two brands of beer and the Obelisk line of wines.

It is unlikely that competition authorities in the US or the EU would have allowed this merger. Unless imported wine and beer are important competitors to Al Ahram (thus in effect expanding the geographic market definition beyond Egypt), a merger to monopoly or near-monopoly would not be approved. Competition authorities would have already known that the market structure before the merger was a duopoly, and that Al Ahram was a dominant firm.

Competition agencies would oppose the merger despite the fact that Al Ahram clearly has made major improvements to those entities it has acquired. An "efficiencies" defense would not prevail in a merger to monopoly. Al Ahram has also indicated it plans to expand internationally. Al Ahram might argue with the market position it has after merger, it should be viewed as a "national champion" for Egypt in international markets. However, most experts conclude that the best way for a country to compete internationally is to have strong competition in domestic markets. Facing the rigors of domestic competition prepares domestic companies for the rigors of international competition. Now Al Ahram will have no significant domestic competition.[10]

The circumstances of the merger also suggest other competition issues. In the process of acquiring the Nile Brewery, Al Ahram said it was sure Nile could only have succeeded by undercutting Al Ahram's prices. The acquisition was made to prevent this "market destabilization". Al Ahram let Nile Brewery spend the money to construct the brewery, and then bought Nile out at half the cost of the brewery. It also appears that Al Ahram

---

defaulting on their loans and fleeing the country. Several times, however, it was caused by the government failing to pay its debts to its suppliers.")

9 R. El-Bakry, "Revealing Egypt's 'Worst kept Secret", BUSINESS TODAY –EGYPT P.18 (June 2001).

10 Both Al Ahram and Gouna Beverages held alcoholic beverage licenses from the government. It would be interesting to know whether governmental approval was needed when the ownership of Gouna Beverages changed.

controlled the most suitable distribution outlets, which made any new entry very difficult. Al Ahram also states that it decided to "let El Gouna live", allowing El Gouna to sell at lower prices, with the plan to buy El Gouna when El Gouna became "too much of a threat."[11]

The issue is whether Al Ahram abused its dominant position in production and distribution (abuses either made or threatened) to force competitors out of the market or to force them to let Al Ahram acquire them. Competitors might give attention to the Al Ahram distribution system and whether it was in some sense an "essential facility" to effective entry. To the extent distributors were not owned by Al Ahram, there might be inquiry as to whether Al Ahram required such distributors to carry only Al Ahram products. For distributors owner by Al Ahram, consideration might be given to requiring them to handle products by competitors of Al Ahram, or to force divestiture of those distribution facilities owned by Al Ahram.

One might inquire why in a predominantly Muslim country competition authorities should give attention to an industry that produces products most of the population does not buy. This circumstance should not be controlling. For example, in the case of the hospital merger, the products are ones that most of the population would not use. Moreover, the beverage industry is certainly an important component of services offered to tourists. Egypt has every reason to be sure that no part of its tourism services is monopolized when Egypt must compete with the rest of the world for tourists.

[11] R. El-Bakry, "FACE OF BUSINESS *Ahmed Zayat",* BUSINESS TODAY – EGYPT, p. 38 (June 2001).

COMMENTS ON 2001 DRAFT LAW
ON ANTI-TRUST AND MONOPOLY ELIMINATION

This memorandum comments on the draft Egyptian Competition Law, which was translated into English on or about November 1, 2001. The law was drafted in the Ministry of Supply and Internal Trade under the direction of Professor Dr. Hassan Gemei of the Faculty of Law at Cairo University.

Overall Structure of the Law

There are four introductory articles and twenty-nine substantive articles to the law. Two matters in the introductory articles are of note. Article 2 says the President will issue a decree deciding which Minister will be responsible for the implementation of the law. This article suggests that the issue is still up in the air. Article 3 announces that the Prime Minister will issue the Executive Regulations implementing the law within three months of publication of the law. As will become clear below, an evaluation of this draft law cannot be made without studying the Executive Regulations, and it would be highly preferable to consider them together.

In the 29 articles of the draft law, Article 1 is hortatory; Article 2 has definitions; and Article 3 deals with extraterritoriality.

Article 4 is apparently intended to deal with horizontal agreements.

Articles 5 through 12 deal with abuse of dominant position, notification of possession of a market share greater than 30 percent, and merger notification. Provisions on the action to be taken by the competition agency with respect to these are combined within these articles.

Articles 13 through 29 describe the Anti-trust and Monopoly Elimination Bureau, its composition, organization and functions, its procedures and rights of appeal, and the penalties it can impose.

General Comments

It is always difficult to tell whether a perceived problem with a draft law translated into English derives from problems with the translation. However, the only way to approach comments is to assume that the translation is perfect.

In general the draft law is highly regulatory in its approach. It threatens criminal penalties and confiscation of goods for all violations of the law. All entities with a greater than 30 percent market share must submit a notification to the agency, with the contents of the notification to be specified in the Executive Regulations. At the same time, action against abuse of dominate position is limited to situations where the entity concerned has a greater than 30 percent market share. In addition, only those mergers which would achieve at least a greater than 30 percent market share are required to be notified for review -- there is no Egyptian pound value that triggers merger review. Enforcement of the law in many respects turns on the conclusion that a greater than 30 percent market share is held by an entity, but the apparent definition of a *market* in the draft law bears no relationship to agreed definitions of market commonly used in competition law and economics. The time for review of mergers will be inadequate for major mergers. There are substantial exceptions to the coverage of the law but their extent is unclear. It does not appear that the competition agency has the authority to compel testimony or the production of documents. This is a serious deficiency where the agency is dependent in the first instance on what interested parties tell it. For example, in the case of a merger another party might have announced an intention to enter the market. It would surely have done a market analysis. Compelled document production and testimony from that entity could provide highly useful information relevant to analysis of the proposed merger. It does not appear the agency has to explain its decisions and make those explanations public.

Specific Comments

I will comment only on those articles that present major issues.

Article (2) a). This part of the article defines *persons* and thus establishes the coverage of the law. The coverage of the law is expansive. It explicitly covers *unions*, suggesting that it also covers syndicates. It covers all *economic entities*, which suggests it covers state owned enterprises. I wonder if this expansive coverage is intended. Portions of Article 6 suggest it may not be.

Article (2) c). This part of the article defines what amounts to *dominant firm*, by defining the word *control* to mean a *person or group of persons* whose market share exceeds 30 percent. The definition seems to say that possession of a greater than 30 percent market share inexorably means the possessor is able *to control the product market.* There is also a puzzling addition to the 30 percent market share test: *this in addition to the market structure, that is to say, the position of this person vis-à-vis other competitors, this person's recent transactions and other auxiliary factors.* The meaning of this addition is unclear. It might be suggesting a rule of reason test for dominance but I doubt it. A concern is that it allows a determination of dominance for an entity possessing less than a 30 percent market share.

Article (2) d) provides: *Competitors: The persons producing, distributing, marketing, selling, purchasing, providing, updating, or developing similar or exchangeable products.* The problem here is construing the language. The idea of competitors has to be limited to those producing *or* distributing *or* marketing *or* selling, etc. That is, to say that competitors are all those who produce. A separate idea of competitors is all those who distribute. Otherwise, one gets the idea that if a company produces detergents and distributes detergents by selling to supermarkets, the producer and the supermarkets should be deemed competitors. This ignores the law and economics of vertical arrangements.

Article (2) g) is a critical definition:

The Market Concerned: The type of commercial activity involving restriction of free competition among products and within the territory, in which this activity is practiced, even if there are nearby areas giving this market access to products or substitutes thereto under reasonable conditions and reasonable costs, this in compliance with the Executive Regulations implementing the law.

I take this to be the definition of *market* in the law, although so far as I can tell, the phrase *The Market Concerned* nowhere appears in the law. It is not too much to say that market definition lies at the heart of competition law and enforcement. The legality of a merger often turns on market definition because once the market is defined, concentration ratios or HHI follow. So does the issue of monopolization or abuse of dominant position because it is market definition that determines monopoly or dominance. So it is critically important to get market definition right.

The main problem is that the definition appears to EXCLUDE from the definition of market *nearby areas giving this market access to products or substitutes thereto under reasonable conditions and reasonable costs, this in compliance with the Executive Regulations implementing the Law.*

I also rest my case that review of the Executive Regulations is critical to any evaluation of the draft law.

This market definition appears to reject the most basic ideas about market definition. It appears to exclude from the definition of a market, those products or substitutes that are reasonably available. Yet this is exactly how a market is defined in competition law and economics. I have wondered whether this is a misprint or a miss-translation. I here assume its statement is accurate. The consequences for regulation of dominant firms or for review of mergers are obvious. It also means that the law will have little relationship to promotion of competition, and is likely to punish success, innovation and any new entry that imperils existing competitors. In addition, no one will be able to tell ahead of time when they might run afoul of the law.

Article (4) reads*:*

Any agreement, conclusion of contracts, or practices of activities that may prejudice the rules of free competition shall be prohibited, with special emphasis on the following:

> *1) Manipulating the prices of products subject of transaction by increasing, reducing, or fixing thereof, or by any other means.*
>
> *2) Wholly or partially limiting the freedom of product flow to and from the markets by concealing, refraining from dealing therein, or unlawfully storing thereof by any other means.*

3) Fabricating a sudden abundance of products leading to the circulation thereof at unrealistic prices, thus negatively affecting the economic dealings of other competitors.

4) Preventing, obstructing any person from practicing commercial activity in the market, or seizing thereof.

5) Concealing, wholly or partially, the products available at the market from a certain person.

6) Dividing or allocating product markets, in accordance with any of the following criteria:

a. Territory
b. Distribution outlets
c. Type of customers
d. Seasons or periods

7) Influencing the normal flow of supply, provision, purchase or sale tenders of products whether in tenders, bids or supply proposals.

8) Fixating or cutting down industrialization, development, distribution, marketing or any other form of investment.

This article has a number of problems. It is not clear that it is in fact aimed at horizontal agreements among competitors. For example, in addition to contracts and agreements it also covers *practice of activities*, whatever this is. Moreover, subpart 6 of this article seems to refer, at least in part, to vertical restraints. If the article were clearly limited to horizontal agreements, its content would be less objectionable simply because competitors should not be agreeing to do many of the actions condemned in the article. But if it covers unilateral action as well, then a number of the provisions apply to unilateral conduct that is normal in a market economy, that should not be regulated, and then the article is likely to deter beneficial competitive activity.

The article appears to establish an incipiency test for illegality: actions that *may* prejudice the *rules of free competition*, and these rules are no where described. This test could greatly expand the scope of liability. On the other hand, if the article is aimed solely at horizontal agreements among competitors, then there is no *per se* illegality for price-fixing cartels.

Finally, the article states a general condemnation in its beginning and the subparts appear to be examples that do not limit the general condemnation. There are a number of other comments that could be made about language and desirability of various subparts, but these comments are the most important.

Article (5) deals with abuse of dominant position or *abusing their power.* The article contains the same broad coverage and incipiency test, with subparts stating only examples, as is found in Article 4. All *practices* engaged in by an entity with more than a 30 percent market share that *may distort competition* are condemned. Examples then include refusals to deal that lead to *unrealistic pricing,* which is not defined; and manipulating available quantities *leading to an unreal deficiency or surplus,* which is also not defined. All sales below cost are barred, there appears to be a bar against tying, and unjustifiable refusals to deal or to discriminate among competitors are also barred. I note that determinations of below cost pricing are notoriously complicated, even in so-called regulated industries, and often call for arbitrary allocation decisions as to fixed and variable, joint and common costs. The result is a statute with great potential for detailed regulation of competitors and mischief making by special interests.

Together Articles 4 and 5 condemn vertical arrangements such as exclusive territories or exclusive distributorships, which on many occasions have been shown to be pro-competitive and which are normally evaluated in a rule of reason analysis. The trend of competition law in the past few years has been to view vertical restraints more favorably, and a landmark of this trend was the issuance of the EU Green Paper on Vertical Restraints in 1996.

Article (6) has exclusions from coverage of the draft law. The first part of the article deals with Article (4), which is the putative article covering horizontal agreements among competitors. Article (4) is NOT to apply to *practices and agreements that restrict the freedom of competition* (note the reference to *practices* suggesting again that article (4) reaches unilateral conduct) that have the *purpose* of:

> *Reducing costs, improving production or distribution, or encouraging technological development*

provided that benefits to the consumer are greater than the impact of restricting freedom of competition.

The result of this part of Article (6) is to establish a sort of efficiencies defense for activities barred in Article (4). Without knowing what Article (4) covers, it is hard to assess the effect of the defense. Efficiency defenses are usually associated with merger analysis, or where potentially objectionable conduct is not condemned *per se* but is subject to a full economic analysis to weigh costs and benefits. Such defenses are almost never available in the instance, for example, of hard-core horizontal price-fixing agreements between competitors.

It is also a bit strange for the defenses to be available where the *purpose* of the conduct was to be beneficial, rather than where the conduct itself was actually beneficial. I also expect that large sophisticated business entities with highly capable talent will find it easy to take advantage of the defenses made available. The competition agency will find itself in proceedings where proof of costs and benefits to consumers is exceedingly difficult. Small entities will have a much harder time.

The second part of Article (6) excludes from the coverage of Articles (4) and (5) (which deal with agreements and abuse of dominant position):

agreements concluded by the government for the purpose of specifying set prices for strategic products determined by a decree issued by the Prime Minister.

and

products having a unique status impelled by the nature thereof within the provisions of the legislation regulating such products.

I cannot tell what these exclusions cover, but they look expansive and can be easily added to through a decree of the Prime Minister. I fear they cover products and services of great importance to consumers, where promotion of competition should be a high priority under this law.

Article (7) requires notification to the competition agency of mergers that result in a market share greater than 30 percent. It also requires notification from any entity that presently has a market share of more than 30 percent. However, Article (7) also contains the language stating that merger notifications are adjudicated by the competition agency. Basically the agency gets 30 days to look at the merger notification, and an additional 60 days for further examination if it so decides. Expiration of relevant periods denotes acceptance of the proposed transaction. The agency can also reject the merger by the end of the 30-day period. The time allowed will be insufficient to analyze mergers raising substantial issues.

The draft law leaves to the parties the decision whether a merger or a market position exceeds a 30 percent market share and notification is required, with little to guide parties on making that determination. Of course, once they file they have admitted to having a dominant position. It would also appear that if a party does not file and asserts that it does not possess the requisite market share, if the agency finds otherwise the party risks criminal prosecution. I do not know if there is room for a conditional notification, where the filing party denies having the requisite market share but files just in case. It would be highly preferable to have a merger filing trigger based on the value of the transaction. It would also be highly preferable to remove the "monopoly register" procedure, with the agency free to investigate, study, or initiate proceedings concerning abuse of a dominant position on a case-by-case basis.

Article (10) allows the merging parties to proceed with the merger even if the agency says it will take an additional 60 days for examination. The result will be that if after further examination the agency decides to reject the merger, it will have to unscramble the eggs.

Article (12) deals with the situation where management of competitive entities are combined. Here the agency gets 60 days to adjudicate, and it is not clear why the procedures in this instance should be different than those applicable to mergers.

Article (14) establishes a Board of Directors that takes actions for the agency. It has 13 members as I count them. This is a very large number of members for a controlling board of a competition agency. It takes 8 members to constitute a quorum, it appears that decisions must be approved by seven votes, but the Chair can only vote if there is a tie. The Board includes 3 members of the judiciary, including the Chair. I do not know enough about the role of the judiciary in Egypt but such membership seems unusual, given that appeal from agency action is to the Administrative Court. In addition it is the Chair of the Board who initiates criminal action, with consent of the Board (see Article 25). A civil action by the Board is without prejudice to initiation of criminal action (see Article 24). Article 23 provides that NGOs *concerned with protecting the consumer may file lawsuits* against the practices covered by Articles (4), (5) and (7) but the nature of those lawsuits and the nature of the remedies that can be sought is not described. The offender can be required to pay compensation of some amount, but there is nothing to indicate to whom the compensation is paid.

As described above, action by the agency can occur only if a relevant party has a greater than 30 percent market share. Under the draft law if the Anglo Egyptian hospital acquisition would not achieve a more than 30 percent market share, it would not be required to notify the competition agency even though the transaction was valued variously at L.E. 500 million or L. Sterling 34 million.

Under the draft law, if Sainsbury's did not have a greater than 30 percent market share, it would not have to file notification with the competition agency as a dominant firm and its use of "lost leader" pricing would not by covered by Article 5.

Egypt and the EU have recently entered into an Association Agreement. Articles 34, 35, 36, 48, 61 and 72 have some relationship to competition law. I focus on Article 34 which provides in part:

1. *The following are incompatible with the proper functioning of the Agreement, insofar as they may affect trade between the Community and Egypt:*

   (i) all agreements between undertakings, decisions by associations of undertakings and concerted practices between undertakings which have as their object or effect the prevention, restriction or distortion of competition;

   (ii) abuse by one or more undertakings of a dominant position in the territories of the Community or Egypt as a whole or in a substantial part thereof;

   (iii) any public aid which distorts, or threatens to distort, competition by favoring certain undertakings or the production of certain goods.

2. The Association Council shall, within five years of the entry into force of the Agreement, adopt by decision the necessary rules for the implementation of paragraph 1.

One might imagine that Article 4 of the draft law was meant to track section 1.(i) Article 36 of the Egypt-EU Agreement above, and Articles 5 – 12 of the draft law to deal with 1.(ii), above. The sections from the Association Agreement track Articles 81 and 82 of the EC Treaty. The Association Agreement has no merger provision. Section 2 of Article 36 also illustrates the EU approach – to define major aspects of implementation through issuance of subsequent regulations. The draft law seems to adopt a similar approach, which is another reason that examination of Executive Regulations is necessary to evaluate the draft law.

I conclude with a comment on the Terms of Disbursement language at page 25 of the Third Draft of the DSP II Monitoring Plan, dated October 16. As I told the Minister of Supply, the one area where there is virtually universal agreement is that hard core price-fixing cartels should be condemned in any competition law. The language often extends to agreements among horizontal competitors to fix prices, control output, share customers, or divide markets. EU competition law condemns *per se* such agreements, as does U.S. law. The terms of disbursement might require provision against such agreements.

It is not clear to me that the draft law includes "minimum exceptions," and whether it concentrates on anti-competitive behavior rather than market share.

DRAFT LANGUAGE TO ADJUST THE PROPOSED COMPETITION LAW TO MAKE IT COMPATIBLE WITH THE NEW EGYPT – EU ASSOCIATION AGREEMENT

The proposed Egyptian Competition Law -- the proposed LAW ON ANTI-TRUST AND MONOPOLY ELIMINATION – was drafted prior to the conclusion of the new Egypt-EU Association Agreement. That new Agreement contains provisions concerning competition law as it relates to Egypt-EU trade. These provisions follow EU competition law and Articles 81 and 82 of the EU Treaty, and are standard in EU Association Agreements. It is advisable that the proposed Egyptian Competition Law be compatible with EU competition law. With a few adjustments, the present proposed Egyptian Competition Law can be made compatible with EU competition law.

This memorandum begins by quoting relevant portions from the Egypt-EU Association Agreement in italics. The memorandum then suggests adjustments to the present proposed Egyptian Competition Law. Quotations from the present proposed Egyptian Competition Law are in italics; suggested adjustments are underlined.

Egypt-EU Agreement

Article 34 of the new Egypt-EU Association Agreement provides in part:

ARTICLE *34*

1. The following are incompatible with the proper functioning of the Agreement, insofar as they may affect trade between the Community and Egypt:

(i) all agreements between undertakings, decisions by associations of undertakings and concerted practices between undertakings which have as their object or effect the prevention, restriction or distortion of competition;

(ii) abuse by one or more undertakings of a dominant position in the territories of the Community or Egypt as a whole or in a substantial part thereof;

Suggested Adjustments

With some adjustments the proposed Egyptian Competition Law can be made compatible with the Association Agreement. These are:

I. Article 4 of the proposed Competition Law presently reads in part:

Any agreement, conclusion of contracts, or practices of activities that may prejudice the rules of free competition shall be prohibited, with special emphasis on the following:

Adjust this part of Article 4 to read:

All agreements between persons, decisions by associations of persons, and concerted practices between persons which have as their object or effect the prevention, restriction or distortion of competition shall be prohibited with special emphasis on the following:

Explanation of adjustment: This adjustment makes the relevant Article of the proposed Competition Law compatible with Article 34 of the Egypt-EU Association Agreement.

II. Article 5 of the proposed Competition Law presently reads in part:

Persons of control are prohibited from abusing their power in practices that may distort competition, especially in the following:

Adjust this part of Article 5 to read:

Abuse by one or more persons of a dominant position in a relevant market is prohibited, especially in the following:

Explanation of adjustment: This adjustment makes the relevant Article of the proposed Competition Law compatible with Article 34 of the Egypt-EU Association Agreement.

III. Article (7) of the proposed Competition Law presently reads as follows:

Persons of control must, within three months as of the effective date of this Law, notify the Bureau of such status.

Furthermore, persons who wish to own assets, proprietary or usufruct rights or shares, or to incorporate associations, amalgamations, or mergers leading to control must notify the Bureau accordingly.

Henceforth, the Bureau shall examine the notice stipulated hereunder in paragraph (2) and adjudicate in pursuance of the provisions stated in the following articles, against a fee of not more than ten thousand Egyptian pounds, as determined by the Executive Regulations implementing this Law.

Adjust Article (7) to read in its entirety:

Persons who wish to acquire assets, proprietary or usufruct rights, or shares, or to incorporate associations, amalgamations, or mergers, or to combine the management of more than one person, of a value in Egyptian pounds to be specified in Executive Regulations, must notify the Bureau accordingly.

Henceforth, the Bureau shall examine the notice stipulated hereunder in paragraph (2) and adjudicate in pursuance of the provisions stated in the following articles, against a fee of not more than ten thousand Egyptian pounds, as determined by the Executive Regulations implementing this Law.

Explanation of adjustment: The adjustment follows the EU competition law pattern of focussing on behavior of persons rather than on market structure. The adjustment removes the monopoly register by deleting the first paragraph of Article 7 of the proposed Law as inconsistent with EU competition practice. The adjustment also provides for the setting of an Egyptian pound value for a merger or acquisition or other transaction requiring notification to the Bureau, rather than a market share trigger to require notification, thus making this part of the Article compatible with EU competition law.

IV. Eliminate Article 12 and references to Article 12 in Articles 24 and 26.

Explanation of adjustment: This adjustment results from incorporating reference to the transaction contemplated in Article 12 into the adjusted Article 7, which deals with all forms of amalgamation.

V. Article 2 (g) of the proposed Competition Law presently reads:

The Market Concerned: The type of commercial activity involving restriction of free competition among products and within the territory, in which this activity is practiced, even if there are nearby areas giving this market access to products or substitutes thereto under reasonable conditions and reasonable costs, this in compliance with the Executive Regulations implementing the law.

Adjust Article 2 (g) to read in its entirety by substituting this language:

Market: Market is the relevant market. The definition of a relevant market has a product dimension and a geographical dimension. A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use. The relevant geographic market comprises the area in which the persons concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.

Explanation of adjustment: This adjustment sets the definition of the market concerned in the proposed Competition Law along the lines used by the EU in its competition law.

VI. Article 2 (c) of the proposed Competition Law presently reads as follows:

Control: The position through which a person or a group of persons, working jointly, are able to control the product market by possessing a share exceeding 30% thereof; this in addition to the market structure, that is to say, the position of this person vis-a-vis other competitors, this person's recent transactions and other auxiliary factors.

Adjust Article 2 (c) to read in its entirety by substituting this language:

Dominant: a dominant position is such that a person or a group of persons would be in a position to behave to an appreciable extent independently of its competitors, customers and ultimately its consumers. No person possessing less than a 30 percent market share in a market will be deemed to be dominant. The burden of proof as to market share is on the agency.

<u>Explanation of adjustment:</u> This adjustment changes the definition of market control so that it concentrates on market behavior rather than on market structure, which is in accord with EU practice.

VII. Articles 25, 26 27, 28 and 29 refer to criminal violations and the possibility of imprisonment. In addition, Article 28 provides for confiscation of goods. These provisions should be eliminated.

<u>Explanation of adjustment:</u> EU competition law provides only for monetary fines and not for imprisonment or for confiscation of goods.