

Client Alert: The Future of Selective Distribution Systems in Egypt following the Egyptian Competition Authority's Apple Decision

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The recent decision by the Egyptian Competition Authority (ECA) concerning the permissibility of restrictive distribution contracts may have far-reaching consequences for the distribution of branded products in Egypt. At the same time, it testifies to the ECA's increasingly active role in addressing anti-competitive practices.

The Decree is the result of a two-year investigation into Apple's sale and supply practices. According to the ECA, Apple appointed its UAE-based Middle East regional distributor to supply Apple products to three Egyptian distributors, and obliged Apple retailers to source products from one of these local authorized distributors.

It was found that the prices of Apple products in the Egyptian market, including the iPhone, iWatch and MacBook, are in many cases up to 50 percent higher than the prices for the same products in other Middle East countries. The ECA confirmed that the prices of Apple products are "unjustifiably" higher in Egypt, even after accounting for the variable import restrictions and customs tariffs among other countries in the Middle East (including the United Arab Emirates, Kuwait and Saudi Arabia). Allegedly, this pricing disparity is the result of anti-competitive practices engaged in by Apple and its Middle East distributor.

The ECA's Decree No. 27/2018 ("**Decree**"), published on 9 December 2018, contains six Articles and effectively outlawed Apple's use of restrictive clauses to regulate its authorised distributors (Article 2). Furthermore, the ECA gave Apple 60 days to eliminate its supply chain agreements' vertical constraints, which restrict the passive sales of its products to authorized sellers, retailers, and end-customers in Egypt (Articles 3 and 4). The ECA also threatened criminal proceedings if Apple did not comply with the Decree (Article 6).

The ECA concluded that Apple's sourcing through a single distributor, to prevent parallel imports, isolated the Egyptian market geographically from intra-brand competition, and to ban any parallel imports to the Egyptian market. It also concluded that Apple's exclusive distribution agreements violate Article 7 of Law no. 3/2015 on Protecting Competition and Combating Monopolistic Practices ("**Competition Law**").

Restrictive Clauses under the Egyptian Competition Law (2005)

The Competition Law, and its Executive Regulations (Ministerial Decree no. 1316/2005), represent a developing discipline in Egypt that is intended to address anti-competitive practices. Over the last 13 years, the law has been amended three times, with the latest in 2014, and the Executive Regulations amended twice, with the latest changes in 2016.

The Competition Law includes restrictions applicable to market participants in general and stronger restrictions that are applicable to market participants who hold a dominant position. In recent years, the ECA has increasingly followed a sector-specific and determined enforcement policy; however, the focus remained on tackling anti-trust infringements (horizontal agreements) and the abuse of a dominant position in the market. The lawfulness of vertical constraints under the Competition Law was considered controversial as the matter has not been a subject of the ECA's decisions in the past.

Vertical Constraints in Distribution Agreements

Regarding vertical constraints, Article 7 of the Competition Law provides, in general terms: *“Any understanding or contract between a person and one of its suppliers or customers with the object to restrict competition is prohibited.”* Notwithstanding the broadly formulated prohibition, vertical constraints in distribution agreements are not *per se* prohibited. The ECA determines whether a vertical constraint that aims to restrict competition violates Article 7 of the Competition Law on a case-by-case basis.

Prior to the latest amendment of September 2016, Article 12 of the Executive Regulations stated that the ECA would consider the following factors when analysing vertical constraints:

- (1) The agreement's implication on the freedom to compete in a relevant market,
- (2) The agreement's benefits for the consumer,
- (3) Considerations regarding safeguarding the quality and reputation of products, as well as their safety, as long as these do not damage competition, and
- (4) How closely the agreement aligns with established commercial practices in a certain sector.

These factors have been understood as exceptions from the general prohibition on vertical constraints that may restrict competition.

Because the majority of brand product and automobile manufacturers use selective distribution systems, vertical constraints in distribution and franchise agreements had been legally justified as an established commercial practice in accordance with Article 12 (4) of the Executive Regulations. However, in the latest amendment of September 2016, Article 12 (4) of the Executive Regulations was eliminated. Vertical constraints in distribution and franchise agreements after September 2016 could only be justified by considerations regarding safeguarding the quality and reputation of products, as well as their safety, in accordance with Article 12 (3) of the Executive Regulations. Therefore, the Decree could arguably manifest a new twist in commercial practice regarding vertical constraints that prohibit members of a distribution network from passively selling products to retailers outside the geographic area of their sale activities.

Administrative and Criminal Sanctions

Violations of the Competition Law incur administrative and criminal sanctions. For violations of Articles 7, the ECA is empowered under Article 20 to order the vertical constraint be eliminated immediately or within a certain period of time. Failure to comply can render any agreement in breach of Article 7 as void. It was this procedure that the ECA followed when issuing the Decree.

The ECA's board of directors also have the option to vote in favour of referring Apple and its UAE-based distributor to the Prosecutor's Office for Financial and Administrative Affairs. The competent Economic Court could order Apple to pay a fine. Without prejudice to any more stringent penalty stipulated in any other law, the breach of the Competition Law's Article 7 incurs a fine of between one percent and ten percent of revenues for the time period in which the violation took place (Article 22[2] Competition Law).

Whether criminal proceedings will be initiated in this case is at the discretion of the ECA. In any case, the Competition Law grants the ECA authority to settle the dispute extra-judicially at any stage of the proceedings (Article 22[b] Competition Law).

Implication for Distribution Systems in Egypt

The ECA's findings regarding Apple's distribution agreement network is restricted to the investigated practices. The decision of whether a vertical constraint violates the Competition Law is still determined on a case-by-case basis. However, this decision could establish a precedent regarding the ECA's position on vertical constraints in distribution and franchise agreements. In its press announcement dated 9th December 2018, the ECA stated that businesses that do not hold a dominant position are entitled to determine a geographic scope for their distributor's sale activities. Furthermore, such businesses can restrict their distributors from actively selling outside the said geographic scope. Nevertheless, preventing passive sales and parallel imports, such as by restricting distributors along the supply chain from passively selling products to buyers outside their sales activity area is prohibited.

This position could lead to the voidability of any vertical constraints in distribution agreements that restrict distributors based in Egypt and distributors based outside Egypt from passively selling products into the Egyptian market. It is still debateable whether the ECA will follow this position in general, regardless of the particulars of each distribution network or of each commercial sector, and to what extent a vertical constraint that aims to restrict passive sales and parallel imports can still be justified on the grounds of safeguarding the quality and reputation of products.

In any case, companies selling into Egypt through exclusive distribution channels should review their distribution agreements for potential infringements of the Competition Law.

If you would like more information about this topic, please contact us.

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