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Commission clears De Beers' Supplier of Choice system, but objects to agreement with Alrosa

Following an in-depth investigation, the European Commission has cleared the De Beers's Supplier of Choice system for the sale of rough diamonds, but it will remain watchful of its actual implementation to ensure that the market remains competitive. Separately, the Commission has sent a statement of objections to De Beers and Russian diamond producer Alrosa warning about its preliminary view that the agreement under which the latter commits itself to selling half of its production through De Beers is in breach of European Union competition rules.

De Beers/Alrosa trade agreement

Alrosa Company Limited, a state-owned company which is the exclusive producer of rough diamonds in Russia, is the second largest producer of rough diamonds in the world and, therefore, a potential competitor to De Beers.

De Beers has a dominant position in the world's supply of rough diamonds as it controls 60-65% of supply. It has headquarters in both South Africa and Britain.

By virtue of a trade agreement notified to the Commission in March 2002, Alrosa agrees to sell to De Beers rough diamonds worth around €800 million a year for a period of five years which De Beers will, subsequently, release on the market. Alrosa's contractual sales to De Beers amount to about half the annual production of the Russian company.

The Commission takes the view that the notified agreement restricts, to an appreciable extent, competition on the rough diamonds market by eliminating competition from Alrosa. The Commission also takes the view that by entering into the agreement, De Beers has abused its dominant position in the rough diamonds market.

De Beers's control over the production of rough diamonds together with the strategic use of its stocks enables it to determine the quantity, the quality and, to a large extent, the price of the diamonds that it releases onto the market every year. The remainder of the market, consisting of players in Angola, Australia and Canada, is very fragmented.

The sending of a Statement of Objections is a step in antitrust investigations which does not prejudge the final outcome. De Beers and Alrosa have two months to reply to the Commission's objections and they can also request an oral hearing.

Supplier of Choice

Separately, the Commission has decided to close proceedings with regard to De Beers Supplier of Choice (SoC) distribution system.

The SoC system is intended to replace De Beers's traditional monopolistic approach based on the control of supply with a strategy focussed more on adding value to the diamonds already under its dominion, through marketing and branding initiatives.

The system to a large extent formalises what has so far been an informal commercial relationship between De Beers and its customers, known as the Sightholders, for the purchase and sale of rough diamonds. There are currently approximately 120 sightholders, which buy rough diamonds at periodic sales from De Beers at events known as "sights". The sightholders can be manufacturers that cut and polish the diamonds or traders. The SoC agreements between De Beers and the Sightholders were notified to the Commission in May 2001 for clearance under Article 81.

In July 2001, the Commission warned De Beers in a statement of objections that the agreements could not be approved in their original form as the criteria for selecting the sightholders as welll as the amount of detailed confidential information and contractual commitments required from them could restrict their commercial behaviour.

The introduction of an Ombudsman, whose name will have to be approved by the Commission, was considered the best way to introduce a check into the system as far as the selection of sightholders and the allocation of stones to them was concerned.. This does not preclude litigation in courts. De Beers also streamlined the selection process and agreed to give longer notice to terminate contract. Furthermore, the sightholders will be able to buy only the boxes that they have applied for and after inspecting the stones.

A summary of the notification and of the modifications was published in the EU's Official Journal C273, of 9 November 2002 inviting third parties to comment.

The Commission has now decided not to oppose the SoC system. But given remaining concerns that the SoC system could be used to artificially reduce supply, namely of high quality diamonds, and considering that the implementation of Supplier of Choice has not yet taken place, the Commission will keep a close watch on the market. The Commission will also particularly want to ensure that the system does not lead to a restriction in the supply of adequate quantities of rough diamonds to traders in order to ensure enough liquidity in the market.

The Commission, therefore, reserves the right to reopen the case should changes in the factual or legal situation as regards any essential aspect of the agreements modify its present view.