

**Notice pursuant to Article 19(3) of Council Regulation No 17 ⁽¹⁾ concerning Case
COMP/E-3/38.139 — DTC ‘Supplier of choice’**

(2002/C 273/02)

(Text with EEA relevance)

1. INTRODUCTION

1. On 3 May 2001, the European Commission received from the Diamond Trading Company (hereafter DTC) an application for negative clearance or, alternatively, for exemption under Article 81(3) of EC Treaty in respect of a set of standard agreements between DTC and its customers, the ‘sightholders’. This notification relates to the ‘supplier of choice’ initiative for the supply of rough diamonds by the DTC to its customers.
2. On 25 July 2001, the European Commission opened proceedings against the DTC and issued a statement of objections to this company as regards the supplier of choice arrangements.
3. On 8 October 2001, the DTC replied to the Commission’s objections and started exploring remedies to these objections with a view to reaching a settlement.

2. THE PARTIES

4. The DTC — formerly known as the Central Selling Organisation (CSO) — is the marketing arm of De Beers Group of companies (De Beers). De Beers has extensive interests in operations throughout the world, principally in relation to diamond exploration, mining, recovery, valuation and marketing.
5. DTC’s customers are diamond merchants known as ‘sightholders’, a term derived from the fact that DTC sells its rough diamonds at periodic sales events known as ‘sights’ ⁽²⁾. There are currently approximately 120 sightholders worldwide with businesses in the principal diamond cutting centres. Sightholders are generally traders or manufacturers (or both). Traders buy a range of rough diamond and sell them on to their customers. Manufacturers cut and polish rough diamonds either at their own factories or by subcontracting the work.

3. THE DIAMOND MARKET

6. Diamond is the hardest substance occurring in natural form. It is mined from the ground, from the seabed or from alluvial deposits and is distributed in its rough state by rough diamond producers. A clear distinction is made between ‘industrial’ diamonds of a poorer quality which are used in manufacturing processes (such as drilling equipment) and ‘gem’ diamonds which are used in jewellery. The present case only concerns gem diamonds.

Rough diamond producers, which extract rough diamonds from the ground, such as De Beers, are usually large industrial groups often also involved in the mining of other mineral resources.

7. Rough diamonds are sorted according to their weight (calculated in carats), their colour, their clarity and their potential polished cut in order to be sold. They are sold either to traders or to manufacturers. All steps in the manufacturing process (cutting, cleaving, polishing) can be done by different or the same economic operator. Once the diamonds are polished they may again pass through the hands of traders who thereafter supply wholesalers or retailers who then manufacture the jewellery. The DTC only sells rough diamonds and the notified agreements only concern rough diamonds sold by the DTC.
8. Rough diamond manufacturing and trading is concentrated into five main diamond centres: New York, Antwerp, Johannesburg, Tel Aviv and Mumbai. The importance of these centres in manufacturing is inversely proportionate to the respective prevailing cost of labour. Over 90 % of rough diamonds are manufactured in India and only very few top quality ones in New York. China has started manufacturing diamonds on a large scale recently. Antwerp has become particularly important as trading centre in the last years and less so as manufacturing centre. In terms of diamond jewellery sales, the United States represents about 50 % of the world market, in value.

4. THE POSITION OF DE BEERS IN THE DIAMOND MARKET

9. For much of the 20th century De Beers has controlled over 80 % of the supply of rough diamonds worldwide. In addition to its own mines in South Africa, De Beers also controls large diamond resources in Botswana, Namibia and Tanzania where it has entered into joint venture agreements with the local governments. Furthermore, over the years De Beers has entered into sales agreements with its main competitors in order to secure the distribution of their production, in whole or in part, on the world market through its own sales and marketing division the CSO, now renamed the DTC.
10. At present, De Beers controls around 60 % of worldwide rough diamond supplies, the rest being very fragmented. The rough diamonds sold by the DTC still originate from De Beers’ own mines, from its joint venture mines and from its purchases from third party competitors.
11. DTC allocates its rough diamonds supplies to a selected number of sightholders. Sightholders are entitled to make applications, through their brokers, to purchase rough diamonds at the 10 annual ‘sights’ organised by the DTC.

⁽¹⁾ OJ L3, 21.2.1962, p. 204/62.

⁽²⁾ When sightholders go to De Beers’ London offices where parcels of diamonds can physically be ‘seen’ and inspected.

12. After diamonds have been sorted into many different categories ⁽³⁾, they are blended into an 'assortment' and divided into specific ranges of goods, which are known as 'boxes'. De Beers maps out the sightholders' yearly allocation of boxes and allocates boxes to sightholders at every sight in response to the applications it has received. Sightholders apply for boxes specifying the value they require by category and are informed shortly before each sight how much De Beers intends to allocate them so they can make financial arrangements to that effect. Cash payments are made to De Beers before the goods are sent out.
13. De Beers is also active downstream from rough diamond distribution through its subsidiaries, the Diamdels and the Polished Division. The Diamdels are located in most diamond centres ⁽⁴⁾ and focus on sales to the secondary market (one level down from the sightholders). Their other main function is to provide market feedback to De Beers on new assortments and on how DTC boxes 'perform' in the market. The Polished Division ⁽⁵⁾ is a series of De Beers subsidiaries, which are involved in polishing diamonds. De Beers' Polished Division also buys rough diamonds from the DTC and sells polished diamonds to wholesalers and jewellery manufacturers.
14. In addition to the detailed information it collects through its sightholders and their brokers, De Beers thus also receives feedback from its subsidiaries all over the world on both the rough and polished markets. De Beers also undertakes regular surveys of consumer taste and demand on the market for diamond jewellery, which complete the web of information sources available to this company.

5. THE NOTIFIED AGREEMENTS

5.1. The aims and structure of the notified agreements

15. De Beers announced its supplier of choice initiative in July 2000 to all its existing sightholders in view of implementation by July 2001. By the end of 2000, existing and applicant sightholders had already been sent the documentation on the basis of which supplier of choice would be implemented. Its implementation was suspended pending the investigation of the European Commission.
16. The objective of the notified agreements is to drive growth in consumer demand for diamond jewellery. According to De Beers, one of the aims of supplier of choice therefore, should be to develop DTC's business relationships with sightholders in a manner, which will encourage long-term growth at the retail level by the creation of a multi-brand environment and shorter distribution channels. In order to do this, the DTC through the notified agreements intends to limit the number of

selected sightholders, encourage them to work with downstream partners in order to improve the efficiency of diamond distribution and invest in retail branding.

17. The contractual framework set out by De Beers and which constitute the notified agreements is a complex set of documentation, which will serve to select diamond merchants who are most suited to the supplier of choice strategy and to formalise De Beers' sales policy towards them. These documents set forth the basic conditions under which DTC will select sightholders and supply diamonds to them.
18. The notified agreements are set out as follows: the 'sightholder profile' is a questionnaire sent to existing De Beers sightholders and applicants alike with questions on aspects of their business in order to take part in the selection process. The 'sightholder criteria and other considerations' set pre-defined criteria in order to carry out the selection process. The data collected from the applicant sightholders is subsequently evaluated by a computer model, the 'evaluation and allocation model', on the basis of the sightholder criteria. Once the most suited candidates are chosen to become sightholders of De Beers, they are allocated diamonds on the basis of the results of the 'evaluation and allocation model' and on their actual requirements of rough diamonds at any sight. The conditions underpinning the commercial relationship between De Beers and its selected sightholders are set forth in the 'policy statement'. In addition there are 'conditions of sale' which are incorporated into every contract and selected sightholders also have to adhere at all times to a code of good conduct set forth in the 'Best Practice Principles'.

Details of this documentation are set out below.

5.2. Sightholder profile

19. This document is a questionnaire, which is sent to applicants to solicit information to fill in the 'evaluation and allocation model' on the basis of which applicants will be selected and evaluated. The requested information is designed to assess all applicants (including in relation to each other) against the pre-established 'sightholder criteria and other considerations' and therefore pertains to detailed aspects of their business.
20. Questions originally featured in the 'sightholder profile' included by way of non-exhaustive examples: purchases of rough and polished diamonds in carats and value, sales of rough, polished and diamond jewellery in carats and value, capital expenditure, assets and investments, details on stocks per category of goods, debts, credit facilities, details on payables and receivables per type of product, cash flow, detailed market position in relation to particular products, geographic breakdown of sales, details of sales plans, distribution patterns, types of customers, sales frequency for particular products, marketing spend, details on nature and amount of advertising initiatives and details on own factories or subcontractors and on related technical ability.

⁽³⁾ De Beers uses 16 000, each corresponding to a price point.

⁽⁴⁾ They are based in Antwerp, Israel, India, Hong Kong and South Africa.

⁽⁵⁾ The Polished Division has sales offices in London, Antwerp, Israel, Hong Kong and Russia.

5.3. Sightholder criteria and other considerations

21. There are eight criteria, which are to be applied by the DTC in its determination whether the applicants are eligible to apply for boxes of diamonds. Each of them accounts for a percentage of the overall score obtained by each applicant. These criteria are 'financial standing and reliability', 'strong market position in relation to particular diamonds', 'distribution ability', 'marketing ability', 'technical and manufacturing ability', 'general business reputation', 'compliance with the best practice principles' (see point 5.5 below), 'no dealing in non-natural diamonds/full disclosure of treatments'. The last 3 criteria are assessed on a pass/fail basis. The other criteria are further divided. Applicants are assessed against these and a general evaluation is then compiled on the basis of the individual assessments.
22. An evaluation will therefore be obtained by sightholders on the basis of their performance against one another under the criteria. As well as being used for the overall selection of sightholders, the results of the evaluation process will also be used for the allocation of rough diamonds at the sights where the best sightholders are given priority for highly demanded goods for example.
23. De Beers has also defined considerations to take into account when determining eligibility of sightholders and the allocation of stones to them. These considerations are as follows:
 - (a) the availability of supplies, particularly of the kind(s) sought by the applicant;
 - (b) the efficient administration of the system for the distribution of rough diamonds including the operation of the sight system and all supporting or related activities;
 - (c) the political, legal and economic requirements of certain diamond producing countries; and
 - (d) the need to spread DTC's commercial risk between cutting centres.

5.4. The policy statement

24. This document sets forth the general principles of the new arrangements and constitutes the contractual terms that will apply between the DTC and the sightholders since appointment as a sightholder will not, of itself, oblige DTC to offer boxes to sightholders. The policy statement provides that subject to current market conditions, DTC will use reasonable endeavours to meet applications for boxes, taking into account the following: (a) the requirements of other sightholders; (b) the level of satisfaction of the sightholder criteria as that compared with those achieved by other sightholders; (c) the sightholder considerations; and (d) the relative importance of the different geographical and product sectors and the sightholders' position in these sectors. DTC may refuse to sell boxes if the sightholder is not complying with the policy

statement or the other documents which constitute the supplier of choice arrangements.

25. The policy statement also includes further details related to eligibility of sightholders, allocation of boxes, prices, provision of information, marketing and further support and training for sightholders.
26. In particular, the policy statement sets how De Beers is entitled to vary the description of boxes or to review their prices. Sightholders' obligations relate to information reporting on compliance of the criteria, marketing activities, access to premises granted to De Beers to make verifications, respect of strict intellectual property obligations in relation to De Beers and the DTC.
27. Any dispute arising out of the arrangements set out under the policy statement can be referred to senior representatives of the DTC and the sightholder concerned for resolution in accordance with such procedures as the senior representatives may agree. If no resolution is reached within 25 days, the dispute will be determined by arbitration in London, pursuant to the rules of the London Court of International Arbitration ('LCIA').

5.5. 'DTC diamond best practice principles'

28. The DTC diamond best practice principles is a code of conduct which is intended to ensure that consumers buying diamond jewellery are able to rely on the professional and ethical standards and the technical skills of the gem diamond industry. These principles identify unacceptable practices such as buying or trading diamonds from areas where this would encourage or support conflict and human suffering; using child labour; using practices, which intentionally or recklessly endanger or harm the health or welfare of individuals; or artificially treating diamonds. Sightholders have to adhere to these principles at all times in order to be eligible under supplier of choice.

6. THE STATEMENT OF OBJECTIONS

29. On 25 July 2001, the Commission adopted a statement of objections addressed to the DTC, on the supplier of choice agreements as notified. The objections of the Commission set out in that document relate to both Article 81 and Article 82 of the Treaty.
30. In summary, the main objections raised by the Commission were that the implementation of supplier of choice would give De Beers the possibility to restrict the commercial behaviour of its clients/distributors. These restrictions would result from the way the selection criteria are applied, the amount of detailed confidential information requested from applicant sightholders and the contractual commitments required from them, once they are selected. Furthermore since these restrictions would be imposed by a dominant company, the implementation of the supplier of choice would also constitute an abuse of dominant position.

31. De Beers replied to the statement of objections on 8 October 2001. It argued that the supplier of choice agreements should fall into a normal economic and regulatory analysis of vertical restraints, which are generally considered as benign and rarely challenged under competition law — even where the supplier has market power. In that context, De Beers submitted that the supplier of choice arrangements were compatible with Community law. At the same time De Beers stated that it was willing to explore any modifications to the supplier of choice that might address the Commission's concerns whilst preserving the general features of the arrangements.
32. De Beers made several proposals to amend the notification and the supplier of choice documentation. The details of the final proposals are explained below.

7. THE NOTIFIED AGREEMENT AS AMENDED

7.1. Ombudsman and dispute resolution procedures

33. The introduction of a third party, an Ombudsman, was considered the best way to introduce a check into the system of selection of sightholders and allocation of diamonds to them. The terms of reference of the Ombudsman are quite detailed, providing for a comprehensive system of dispute resolution. The scope of authority of the Ombudsman will comprise the ability to determine whether improper procedures have been followed by the DTC under the supplier of choice documentation (by ignoring relevant matters or taking irrelevant matters into account or applying provisions incorrectly): (1) in making selection or de-selection decisions; (2) in relation to DTC's supply decisions that it proposes to make to sightholders over a six month period. In both cases, if the DTC has not followed proper procedures, the Ombudsman will recommend that the DTC reconsider the relevant decision.
34. The appointment of the Ombudsman will be subject to the approval of the Commission. It is foreseen to appoint a senior figure (for instance a retired judge or a former partner of a law firm) to this function, who will be backed up by the administrative support of an accountancy firm. De Beers will put at the disposal of the Ombudsman all internal documents and information used in the evaluation and allocation model to assist the Ombudsman in his tasks.
35. Complaints as to the selection or evaluation of sightholders can be addressed to the Ombudsman. The latter will issue recommendations, which are final⁽⁶⁾ and binding on the parties when it is established that improper procedures have been followed. Exact terms of reference and procedural steps for the Ombudsman's tasks have been foreseen. De Beers will pay a retainer fee for the hiring and initial training of the Ombudsman. As for dispute/complaints, direct costs of the prevailing party as

well as incremental costs of the Ombudsman will be imposed on the unsuccessful party.

36. Several guarantees are built into the system in order to ensure that the Ombudsman recommendations are made in a timely manner and such as not to disadvantage sightholders who feel they have been unjustly treated.
37. The DTC and the applicant will have a right to refer the matters in dispute to the London Court of International Arbitration or to litigate in the courts, should they be unhappy with the Ombudsman's determination⁽⁷⁾. Having recourse to the Ombudsman in order to settle disputes is therefore a means of dispute resolution in addition to the arbitration foreseen in the policy statement and in the conditions of sale (see points 7.4 and 7.5 below).

7.2. Revised sightholder profile

38. The initial sightholder profile was substantially reduced from 60 questions to 21. Some of the remaining questions have been reformulated so as to be less intrusive. Special confidentiality notices have been inserted so that the sightholders filling in the questionnaire are aware that business secrets will be treated as such and that no more details than necessary are required.
39. The replies to the sightholder profile will still provide information to De Beers in order to run the evaluation and allocation model as initially foreseen in order to select sightholders. This model also had to be modified in substance to adapt to the reduced amount of information available for each applicant sightholder.

7.3. Revised sightholder criteria and other considerations

40. The criteria have been modified somewhat in accordance with the reduction in the number of questions in the sightholder profile. As regards the criteria on the compliance with 'Best Practice Principles' and the non-natural/artificially treated diamonds, sightholders will now be able to buy or sell artificially treated/synthetic diamonds as long as they disclose it.
41. As regards the sightholder considerations, De Beers has improved the clarity as to the application of the sightholder considerations, which cannot therefore be applied with a broad discretion. In particular the consideration 'efficient administration of the system' has been amended and further explained with regard to the minimum value of rough diamonds that each box must contain to guarantee a consistent assortment from sight to sight. In addition, the Ombudsman will have the ability to determine whether the DTC has properly applied the sightholder considerations.

⁽⁶⁾ Except if the matter is referred to arbitration or to litigation.

⁽⁷⁾ Litigation is foreseen only on the condition that the parties apply to the court for an order that no business secrets be referred to in open court or in any resulting judgment or order.

7.4. Revised policy statement

42. Sightholders will be appointed for a period of 24 calendar months, with a six-month termination notice, instead of the three months' notice initially foreseen.
43. As regards the supply conditions, sightholders will indicate their purchasing requirements every six months and De Beers will subsequently announce its intention to offer for those same six months. This reduces the insecurity of sightholders as to the supply intended for them, which was previously known on a sight basis. Additional flexibility is also provided for in the new version of the document in terms of the kind of goods sightholders may request. A mechanism has been put in place to clarify that sightholders may now apply for boxes they have not been allocated in the past. And on request DTC will, if possible, propose non-standard boxes for sale to the sightholders asking for it.
44. As regards access to premises, whereas before sightholders were required to grant access to premises to De Beers to verify compliance with the policy statement, such access to premises and verification will now be undertaken by an independent third party on behalf of De Beers.
45. As regards 'marketing', sightholders are no longer obliged to keep DTC informed of their specific marketing or promotional initiatives but should only do so when they request marketing support from the DTC.
46. De Beers agreed to remove a clause regarding any sightholder having to renounce any claims against De Beers relating to the period before signing the new supplier of choice arrangements.
47. In addition to arbitration, litigation in the courts is made possible as additional dispute resolution mechanism ⁽⁸⁾.

7.5. Revised conditions of sale

48. Conditions of sale now specify that only boxes applied for will be offered to purchase to sightholders, leaving them the opportunity to purchase all boxes, only a few or none at all. Furthermore, a certain percentage of the boxes offered can be rejected by the sightholders after inspection of the goods.

49. In addition to arbitration, litigation in the courts is made possible as additional dispute resolution mechanism ⁽⁸⁾.

7.6. Other undertakings

50. De Beers proposed a set of transitional periods for transfer of sales and marketing people as well as firewalls as regards exchanges of sensitive customer information between its subsidiaries (Diamdels and Polished Division) and the DTC and between the subsidiaries themselves. These transitional periods and confidentiality arrangements would be put in place in order to reduce the risk that this information, particularly at the level of the DTC, would be shared between these companies.
51. De Beers will ensure that appropriate terms and conditions of employment are put in place as regards its staff to safeguard the confidentiality of any information which relates to sightholders (and potential sightholders) and their customers.

8. THE COMMISSION'S INTENTION

52. On the basis of the above, the European Commission intends to adopt a favourable position with regard to the notified agreements as amended. Before doing so, however, it invites all interested parties to submit any observations they might have within one month of the publication of this notice.
53. In doing so, all interested parties are also requested to provide the European Commission with a non-confidential version of their submission, in which business secrets and confidential passages are deleted and replaced by a non-confidential summary, where possible, or an indication 'business secrets' or 'confidential' as the case may be.
54. Interested parties should send their observations quoting the reference COMP/E-3/38.139 — DTC 'Supplier of choice' to:

European Commission
Directorate-General for Competition
Unit E-3
B-1049 Brussels
Fax (32-2) 295 01 28.

⁽⁸⁾ On the same condition as explained in footnote 7 above.