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For A Rigorous "Effects-Based" Analysis Of Vertical Restraints Adopted By Dominant Firms: A Comparison Of EU And Brazilian Competition Law

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By Damien Geradin & Caio Mario da Silva Pereira Neto[1]

I. INTRODUCTION

This short paper summarizes the main findings of a comprehensive study the authors conducted on the way “vertical restraints” adopted by dominant firms (with a focus on exclusive dealing, rebates and discounts and tying) have been treated by enforcement agencies and courts in the European Union (“EU”) and in Brazil.[2] A comparative analysis of the treatment of vertical restraints in these two jurisdictions is particularly interesting for the following reasons. First, the EU competition law system is mature, but the European Commission (the “Commission”)’s approach to vertical restraints has evolved in recent years notably through the Guidance Paper issued in 2008, promoting an effects-based approach to such restraints. The Brazilian competition law system is not as mature as the EU system, but Brazil has established itself as one of the key antitrust players among the fast-growing economies. Although less mature than its EU counterpart, Brazil has adopted an effects-based approach to vertical restraints for a long time, the problem being the inconsistencies that exist in the implementation of that approach. Second, the EU system and the Brazilian system rely on an administrative enforcement agency, and the Brazilian system has been influenced by the European model. The comparative approach is thus likely to be fruitful.

Among the main policy conclusions of our study is that competition authorities and courts should not apply *per se* illegality rules to vertical restraints adopted by dominant firms. Instead, they should adopt tests seeking to identify the pro- and anti-competitive effects of a given conduct and balance them. No vertical restraint should be banned without the demonstration that it affects competition and creates consumer harm. Such effects-based analysis must be developed according to a solid analytical framework in order to establish consistent standards of proof. Indeed, in the absence of such framework, even with an alleged effects-based approach, authorities may end up developing inconsistent standards of proof with decisions outcomes that may come close to a form-based analysis, as the Brazilian experience illustrates.

In this context, although the Guidance Paper adopted by the European Commission in December 2008 contains some shortcomings, it offers a useful conceptual framework for the analysis of vertical restraints adopted by dominant firms. This effects-based approach contained in the Guidance Paper, which relies on modern economic thinking, is largely followed by US agencies and courts, as well as by enforcement agencies and courts in many other nations. It is also supported by the vast majority of competition law and economics scholars around the world.

For rapidly developing jurisdictions like Brazil, which are attempting to leapfrog some of the earlier stages of more mature jurisdictions, the analytical framework proposed by the

Guidance Paper could serve as a starting point to provide a hard edge to an otherwise soft effects-based approach applied by the authorities so far. With some adaptations to the reality of these developing jurisdictions, new guidelines could be used to establish substantive standards to evaluate vertical restraints, leading to a healthy convergence of analytical approaches based on modern economic theory.

Our study also emphasizes the importance of the institutional environment to implement an effects-based analysis, as nicely drafted rules and principles are likely to remain dead letter unless the proper institutions are in place and the members of such institutions are given sufficient training in law and economics.

This short paper is structured as follows: Part II briefly addresses what we understand by vertical restraints. Part III discusses the evolution of the EU approach vis-à-vis vertical restraints, which culminated with the adoption of the *Commission Guidance Paper* in 2008. Part IV analyzes the Brazilian approach to the assessment of vertical restraints, as well as the inconsistencies in the implementation of that approach. Part V discusses the institutional background that must be in place for implementing a robust analytic framework to evaluate vertical restraints. Part VI briefly concludes.

II. VERTICAL RESTRAINTS: PRO-COMPETITIVE PRACTICES THAT MAY CREATE COMPETITION ISSUES

Vertical restraints include commercial strategies that are frequently used by dominant and non-dominant companies, such as:

- Exclusive dealing whereby the dominant firm sells a product on the condition that buyers not buy that same product from its rivals.
- Conditional rebates, whereby the dominant firm offers price incentives to customers buying all or a high percentage of their purchases from it. Rebates may be made over a single product (single-product rebate) or several products (bundled rebate).
- Tying and bundling, whereby the dominant firm agrees to sell one product only on the condition that the buyer also takes a second product from that firm (tying) or where the dominant firm will only sell two products as a package (pure bundling).

While in the vast majority of cases these agreements are pro-competitive in that they are a source of efficiencies, there may be circumstances where they foreclose rivals and create consumer harm. For several decades, vertical restraints have been a subject of debate among lawyers and economists and views as to how such restraints should be assessed have fluctuated. In recent years, however, a consensus has emerged that *per se* rules of illegality (or of legality) should not be applied to vertical restraints. Instead, such restraints should be assessed pursuant to an effects-based analysis balancing their pro- and anti-competitive effects. The difficulty, however, is to devise legal tests that allow this balancing to take place in a coherent and rigorous manner.

III. THE EVOLUTION OF THE EU APPROACH VIS-À-VIS VERTICAL RESTRAINTS

A. The formalistic approach of the Commission and the EU Courts

For the past several decades, a recurring criticism of the decisional practice of the Commission and the case law of the EU courts on exclusionary abuses (including anti-competitive vertical restraints) was that they were not in line with modern economic thinking. The reasons were that (i) cases were often decided on "formal" considerations, such as the nature of a given conduct, rather than its effects on competition and consumer welfare and (ii) that the efficiencies that could be generated by dominant firm conduct were not taken into consideration at all, or insufficiently so. That led to a case law that was highly unfavorable to dominant firms, which in some cases failed to engage in pro-competitive conduct by fear that such conduct may fall afoul of Article 102.

A related criticism was that the Commission and the EU Courts had failed to develop standards that would allow them to distinguish anticompetitive foreclosure from competition on the merits. For instance, Temple Lang and O'Donoghue stated in 2005 that "no currently-applied definition [of exclusionary abuse] has sufficient normative content to be applied ex ante as a normative rule by firms making pricing decisions or embarking on a given course of conduct."[3] As these authors suggest, the case law of the EU courts has been plagued by the application of standards based on vague concepts, such as that exclusionary abuses would amount to adopting "methods different from those which condition normal competition in products or services,"[4] behavior that is not "competition on the merits," or not in compliance with the "special responsibility" that dominant firms hold vis-à-vis their smaller rivals.[5] Reliance to such vague concepts was one of the reasons that led the Commission to adopt its Guidance Paper on Article 102, which, as will be seen below, contains a much more robust definition of exclusionary abuses.

B. The new effects-based approach promoted by the Guidance Paper

Roughly at the time Neelie Kroes became Competition Commissioner, it became clear that the Commission needed to move away from its form-based approach and embrace the effects-based approach it had already adopted with respect to the enforcement of Article 101. The first step in that direction came with the major policy speech given by Commissioner Kroes in September 2005 in which she declared that she was:

> "convinced that the exercise of market power must be assessed essentially on the basis of its effects in the market, although there are exceptions such as the per se illegality of horizontal price fixing. [...] Article [102] enforcement should focus on real competition problems: In other words, behavior that has actual or likely restrictive effects on the market, which harm consumers. [...] Low prices and rebates are, normally, to be welcomed as they are beneficial to consumers."[6]

Commissioner Kroes' speech was immediately followed by a Commission Discussion Paper on Article 82 EC (now 102 TFEU),[7] which promoted the very effects-based approach announced by the Commissioner. While the new economics-based principles guiding the ap-

proach proposed in the Discussion Paper were largely welcomed by commentators, the ways in which the Commission proposed to analyze certain categories of conduct were criticized as too reminiscent of the old formalistic approach. This being said, the Discussion Paper largely met its objective of stimulating debate as it was subject to abundant commentary, conferences, and events.

Almost three years later, the Commission published a Guidance Paper on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (hereafter, the "Guidance Paper").[8] This document is *sui generis* as it "sets out the enforcement priorities that will guide the Commission's action in applying Article [102] to exclusionary conduct by dominant undertakings."[9] The Commission does not therefore state or restate the way in which Article 102 should be interpreted, a task which falls within the exclusive remit of the ECJ, but explains the circumstances in which a given dominant firm's conduct is likely to be subject to enforcement action by the Commission.[10]

The Guidance Paper focuses only on exclusionary abuses leaving aside exploitative abuses and price discrimination. The Guidance Paper seeks to address the two criticisms referred to above. First, the Guidance Paper seeks to provide a definition of anticompetitive foreclosure (which is another formulation of the notion of exclusionary abuse) that carries more substance than the vague and largely unhelpful definitions referred to above. Second, the Guidance Paper signals that the Commission will pursue an effects-based approach in its enforcement of Article 102 TFEU.

The Guidance Paper defines the term "anticompetitive foreclosure" as:

> "a situation where effective access of actual or potential competitors to supplies or markets is hampered or eliminated as a result of the conduct of the dominant undertaking whereby the dominant undertaking is likely to be in a position to profitably increase prices to the detriment of consumers."[11]

This definition suggests that a two-stage test will be relied upon to assess whether a given conduct is anti-competitive. In accordance with such a test, the Commission should first establish the presence of foreclosure and then prove that such foreclosure will likely harm consumer welfare. The reference to consumer welfare is important as it suggests that a conduct that would merely affect the "structure of competition" by, for instance, eliminating less efficient competitors - but that would have no effect on prices, or on the quality of products or innovation, and thus would not harm consumers or lead to enforcement action by the Commission under Article 102. It is thus the presence of (likely) consumer harm that will trigger the intervention of the Commission.

The Guidance Paper then lists a number of factors that will generally be relevant to its assessment of foreclosure, including: the position of the dominant undertaking, the conditions on the relevant market, the position of the dominant undertaking's competitors, the position of the customers or input suppliers, the extent of the allegedly abusive conduct, possible evidence of actual foreclosure, and direct evidence of any exclusionary strategy.[12]

Finally, the Guidance Paper indicates that the Commission will normally intervene under Article 102 where there is "cogent and convincing evidence" that the allegedly abusive con-

duct "is likely to lead to anticompetitive foreclosure."[13] It also provides that the assessment of a given conduct will "be made by comparing the actual or likely future situation in the relevant market (with the dominant undertaking's conduct in place) with an appropriate counterfactual, such as the simple absence of the conduct in question or with another realistic alternative scenario, having regard to established business practices."[14]

The Guidance Paper also contains a section dealing with price-based exclusionary conduct. It states that to prevent anti-competitive foreclosure, the Commission "will normally only intervene where the conduct concerned has already been or is capable of hampering competition from competitors which are considered to be as efficient as the dominant undertaking."[15] As the objective of competition is not to protect (less efficient) competitors, the "as efficient test" is certainly conceptually correct, although its application may at times raise significant difficulties.

The Guidance Paper states that the cost benchmarks the Commission will normally use to perform the "as efficient competitor" test are the average avoidable cost (AAC) and long-run average incremental cost (LRAIC).[16] In practice, when the price of a product is not sufficient to cover the AAC of producing the good or service in question ($P_e < AAC$),[17] this means that the dominant firm sacrifices profits in the short term and that an "as efficient competitor" will not be able to serve the targeted customers without incurring a loss.[18] Failure to cover LRAIC ($P_e < LRAIC$) indicates that the dominant firm is not recovering all the fixed costs of producing the good or service in question and that an "as efficient competitor" could be foreclosed from the market.[19]

The Guidance Paper provides that if the data clearly suggest that an as efficient competitor can compete effectively with the dominant firm's price conduct, the Commission will "in principle" infer that this conduct is unlikely to adversely impact effective competition, and thus consumers, and will be therefore unlikely to intervene.[20] If, by contrast, the data suggest that the price charged by the dominant firm has the potential to foreclose as efficient competitors, the Commission will integrate this into the general assessment of anti-competitive foreclosure, taking into account other relevant quantitative and/or qualitative evidence (see the foreclosure analysis discussed above).[21] This language is important as it makes clear that, under the Guidance Paper, the performance of a price cost test is necessary, but not sufficient to determine the presence of foreclosure.

UNDER THE GUIDANCE PAPER, THE PERFORMANCE OF A PRICE COST TEST IS NECESSARY, BUT NOT SUFFICIENT TO DETERMINE THE PRESENCE OF FORECLOSURE.

The Guidance Paper indicates that the Commission intends to examine claims by a dominant firm that its conduct is objectively "justified" or that it generates "efficiencies" that are sufficient to guarantee that no net harm to consumers is likely to arise.[22] As far as efficiencies are concerned, the dominant firm that adopted the conduct leading to the foreclosure of competitors must "demonstrate, with a sufficient degree of probability, and on the basis of verifiable evidence" that the following cumulative conditions are met: (i) "the efficiencies have been, or are likely to be, realised as a result of the conduct"; (ii) "the conduct is indispensable to the realisation of these efficiencies"; (iii) "the likely efficiencies brought about by the conduct concerned outweigh any likely negative effects on competition and consumer welfare in the affected markets"; (iv) "the conduct does not eliminate effective competition, by removing all or most existing sources of actual or potential competition."[23] The Commission will thus accept efficiency

defenses provided that conditions comparable to those found in Article 101(3) TFEU are met.

IV. THE BRAZILIAN APPROACH TO VERTICAL RESTRAINTS

Although the first full-fledged Competition Act dates back to 1962,[24] a substantial evolution of Brazilian competition law occurred more recently, following the approval of the Competition Act 8.884/94 (BCA) and the implementation of market-oriented reforms during the 1990s. By that time, the modern economic theory on vertical restraints was already well established and there was a consensus that a form-based approach towards this type of conduct was not desirable.

The general framework for analyzing vertical restraints in Brazilian Competition Law was established in the annexes of CADE's Resolution 20, enacted in 1999.[25] Annex I of Resolution 20 establishes an effects-based approach towards vertical restraints, in line with the modern economic theory:

> "(…) in order to be capable of harming competition, vertical restraints usually require [the undertaking] to hold market power in the "original" market, [with the conduct] producing effects on a significant part of a "target" market. Although in theory such restraints might hinder competition [in a given market], they might also present offsetting economic efficiencies that must be balanced against potential anticompetitive effects, according to a rule of reason approach"[26]

The same approach remains in the new Brazilian Competition Act 12.529/11 (NBCA), in force since May 29, 2012. The NBCA implemented significant institutional changes. However, regarding the definition of anticompetitive conducts and the characterization of infringements, the NBCA keeps the system established by BCA basically intact.

THE BRAZILIAN EXPERIENCE HAS BEEN PRAISED FOR AVOIDING SOME OF THE PROBLEMS FACED BY THE RIGID FORM-BASED APPROACHES THAT PREVAILED FOR A LONG TIME IN MATURE JURISDICTIONS, INCLUDING THE EU AND THE US.

Thus, the Brazilian Competition Law System officially adopts an effects-based perspective towards vertical restraints. In this sense, the Brazilian experience has been praised for avoiding some of the problems faced by the rigid form-based approaches that prevailed for a long time in mature jurisdictions,[27] including the EU and the US. However, the casuistic approach adopted by the Brazilian Competition Law System, with an open-ended balance between negative effects and efficiency justifications, has also generated some inconsistencies.

A close look at the case law shows substantial variation in the qualitative analysis implemented by the Brazilian authorities. This variation generates inconsistency, especially when it comes to a definition of standards of proof in the context of the *rule of reason* analysis. Indeed, the relatively clear general framework for the effects-based analysis has not been capable of developing more detailed tests and standards to define when the net effects of a particular vertical restraint would be deemed negative to characterize conduct as illegal.

In particular, Brazilian Competition Law System's initial analysis of effects has been rel-

atively weak, as it has not focused on demonstrating actual foreclosure effects. Such demonstration requires a detailed, fact-based, analysis relying on objective economic criteria, such as, for instance, the "equally efficient" competitor test in the case of rebates. However, the approach used by Brazilian authorities has not gone that far, sometimes limiting itself to observing hypothetical foreclosure to declare certain conduct anticompetitive.

As for the balancing of the pro-competitive and anti-competitive effects, this step in the analysis should only take place once foreclosure effects have been thoroughly demonstrated. In the absence of clear foreclosure effects, there is no need to develop a balancing test. On the other hand, in cases where foreclosure effects are demonstrated, an objective balancing test should then be required. Brazilian Competition Law System has, however, applied a balancing analysis based almost exclusively on qualitative considerations, generating inconsistency of standards applied to different cases.

The original root of this problem can be found in the vague terms of the BCA itself, as Article 20 characterizes as illegal any conduct that may produce certain effects "*even if they are not achieved*" (*potential effects*) or any act "*with the scope*" to produce certain negative effects on competition (*scope of the act*). In practice, these vague terms result in some cases being dismissed with the application of strict standards of proof that require hard evidence of negative effects and other cases being condemned based on relatively relaxed standards of *potential effects* and *the scope of the act*.

For instance, in one precedent addressing exclusive dealing (*Itambé Case*),[28] CADE recognized that a case could not be dismissed based on the lack of evidence of actual effects on competition, stating that:

> "(...) the absence of factual evidence proving the occurrence of anticompetitive effects is insufficient for the dismissal of a case. (...) For any given conviction, initially it is necessary that the authority prove the existence of a given conduct. Afterwards, it must be assessed whether the conduct objectively aimed to produce or had a high probability of producing anticompetitive effects. As explicitly stated in the last part of article 20 [of the BCL], finding that the conduct actually yielded anticompetitive effects is irrelevant for Brazilian Law.
>
> Therefore, even though after 4 years [of the occurrence of the conduct] no damage to the market can be observed, it cannot be stated that the practice did not have the potential to produce such [anticompetitive] effects."[29]

SUCH A LOW STANDARD OF PROOF TO REFUSE THE DISMISSAL OF A CASE COMES VERY CLOSE TO A FORM-BASED ANALYSIS, WHERE A GIVEN COURSE OF CONDUCT IS PRESUMED TO HAVE A NEGATIVE EFFECT.

If the lack of effects after four years is not sufficient to dismiss a case, which might still be pursued on grounds of *potential effects* or the *scope of the act,* then the standard of proof to characterize an infringement is in fact extremely low. To characterize the conduct as infringement, it would be sufficient to show a purely theoretical harm to competition or a simple statement of the defendant showing an objective to dominate a market. Such a low standard of proof to refuse the dismissal of a case comes very close to a form-based analysis,

where a given course of conduct is presumed to have a negative effect. Even though this was not a final decision, which would have probably led to a more detailed analysis by CADE, the reporting commissioner was very clear in emphasizing that "potential effects" could be the sole ground for a conviction even in a context of no actual anticompetitive effects could be observed after four years.

A similar low standard of proof of actual negative effects seems to have been applied in the *Ambev Case,* where an allegedly low level of foreclosure (*i.e.* 10-12 percent of the points of sale served by Ambev) was insufficient to deem the conduct lawful and dismiss the case. Indeed, the perceived potential effects of the conduct in the context of Ambev holding a clear dominant position combined with evidence of an aggressive marking strategy was considered sufficient to declare the conduct anticompetitive. As for the balancing of the conduct's alleged anticompetitive effects with its potential efficiencies, this exercise was superficial and relied on qualitative elements.[30] Here again, CADE's analysis came close to a form-based analysis, as it did not require a clear demonstration of foreclosure nor any actual balancing of potential efficiencies.

However, this is not always the case. For instance, in the *CRT Case* referred to above, another precedent on exclusive dealing, the issue about the standard of proof was put very candidly and led to a split vote of CADE's Commissioners.

In this case, ANATEL, the regulatory agency in the telecommunications sector, had gathered evidence that exclusive agreements of the dominant telecommunications operator with retailers reached high levels of foreclosure (up to 90 percent in some municipalities). Nevertheless, the defendants alleged that, despite the vertical restraint in question, competition was healthy and new entrants gained substantial market share during the period of investigation. Invoking the wording of the BCA, and the available evidence, the Reporting Commissioner suggested the conviction of the defendant:

> "On the other hand, it is important to clarify that, according to the wording of article 20 of Law 8.884/94, a competition infringement may take place if [the conduct] has the scope to or may produce the effects mentioned in items I through IV of article 20, even if these effects are not achieved."
>
> Thus, whether the conduct actually produced [anticompetitive] effects is irrelevant for the characterization of an infringement, as the simple possibility that such effects might occur is considered to be sufficient [for a conviction]. (…) Following such an approach, the question being debated here is not whether the investigated conduct actually harmed competition, but rather if such conduct had a high probability of limiting competition or enabling the abuse of a dominant position (and if such risks were known by the economic agent).
>
> Due to the aforementioned reasons, I consider the defendant in breach of articles 21, V, VI and X c/c article 20, I, II and IV of Law 8.884/94"[31]

Taking an opposing view and applying a much stricter standard of proof, a Dissenting Commissioner argued for the dismissal of the case based on the lack of evidence, in the following terms:

> "The evidence contained in the records is not sufficient to indicate that the defendant has the possibility to (a) foreclose the market by requiring retailers loyalty (b) obtain monopoly profits with such strategy, preventing consumers from having access to competitors' products; (c) increase its rival's costs in a way that would be, even potentially, a strong restriction to its rivals' [performance] (...) Due to the aforementioned reasons, I vote for the dismissal of this complaint, as the evidence presented is insufficient to characterize a breach of Brazilian Antitrust Law."[32]

The final decision to dismiss the case because of the lack of evidence was taken in a split vote of three to three Commissioners, with the President untying the vote.

It is very difficult to reconcile the cases discussed above. Indeed, in the *Itambé* case, the unanimous decision was that the case should not be dismissed despite the lack of evidence of actual negative effects four years after a certain course of conduct was adopted. In the *Ambev* case, alleged low levels of foreclosure were also considered insufficient for dismissing the case. On the other hand, in the *CRT* case, despite apparent substantial evidence showing high levels of foreclosure in some municipalities, the majority vote required more evidence of actual negative effects to reach a conviction. Thus, while in the first two cases the standard of proof was set very low, focusing on the "*potential effects*" of the conduct, in the last case the standard was set quite high requiring substantial evidence of the presence of "*actual effects.*" These cases illustrate the inconsistencies generated by shifting standards of proof based on the vague terms of the BCA. Depending on the particular case, and whether CADE puts heavy weight on the language of "*potential effects*" and the "*scope of the act,*" the evidence (or the lack of evidence) considered sufficient to dismiss or convict a case may change dramatically. Some convictions based on lower standards of proof come close to a form-based approach, as they may simply ignore actual foreclosure effects and impose a fine based exclusively on the scope of the conduct or its potential effects.

EFFICIENT ENFORCEMENT CAN ONLY BE REACHED WHERE ADEQUATE SUBSTANTIVE STANDARDS ARE MATCHED BY THE RIGHT INSTITUTIONAL CAPABILITIES.

In conclusion, even though Brazilian Competition Law System's general approach towards vertical restraints seems in line with modern economic theory, it is necessary to develop clearer tests to evaluate actual effects and more consistent standards of proof. In this sense, for different reasons, both the EU and Brazil seem to have a similar challenge ahead: developing an analytical framework capable of translating the modern economic theory into a consistent approach towards concrete cases.

V. NECESSARY INSTITUTIONAL BACKGROUND FOR IMPLEMENTING A ROBUST ANALYTIC FRAMEWORK TO EVALUATE VERTICAL RESTRAINTS

Developing a robust analytical framework for evaluating competitive effects of vertical restraints is one step in the direction of a more efficient level of enforcement. However, the actual implementation of such a framework will generally depend on the institutional endowment of the relevant jurisdiction (competition authorities, courts, antitrust bar, etc.). In other words, efficient enforcement can only be reached where adequate substantive standards are matched by the right institutional capabilities. In particular, it is important to develop an institutional

system with rules, guidelines, robust analytic capabilities by the authorities, and well-prepared lawyers and economists on the ground.

A. The EU Institutional Background

As seen above, vertical restraints adopted by dominant firms are to be assessed under Article 102 TFEU, which, as it applies to vertical restraints, has been interpreted by the EU courts in a number of landmark judgments. In its 2008 Guidance Paper, the Commission has also expressed its priorities with respect to the enforcement of Article 102. There is therefore no need to introduce amendments to the TFEU or to adopt interpretative guidelines to allow an effects-based approach to the assessment of vertical restraints.

As far as the institutions in charge of enforcing EU competition rules are concerned, the EU system combines centralized and decentralized elements.[33] Cases presenting a so-called "Community interest" will be dealt with by the European Commission, whereas other cases will be handled by the national competition authorities ("NCAs").[34] Because Article 102 has so-called "direct effect,"[35] it can also be applied by national courts either on their own motion or when it is invoked by the parties. The General Court in Luxembourg hears appeals lodged against Commission decisions, and the European Court of Justice hears appeals lodged against General Court judgments or questions of legal interpretation raised by national courts.[36]

As far as the European level is concerned, DG Competition, the General Directorate in charge of enforcing EU competition rules, is a sophisticated institution. While the majority of Commission officials are lawyers, DG Competition comprises an important number of economists, as well as a Chief Economist that is supported by more than twenty PhD economists. There is therefore no doubt that DG Competition is able to apply the type of effects-based analysis it has itself recommended in its 2008 Guidance Paper.

A more nuanced view has to be taken with respect to the EU courts. The General Court and the European Court of Justice are largely composed of generalist judges who join the Court with little or no background in competition law. Nothing would, of course, prevent the EU Courts from retaining economic experts to help them assess economic arguments, but the EU courts only did this in a limited number of circumstances in the past.[37]

THE PROBLEM IS NOT ONE OF JUDICIAL DEFERENCE TO THE COMMISSION, BUT ONE OF DEFECTIVE DECISION-MAKING IN THAT THE LEGAL STANDARDS RELIED UPON BY THE COURT ARE OUT OF TOUCH WITH CONTEMPORARY ECONOMICS.

The problem in the field of vertical restraints is not so much that the EU courts are unable to grasp economic reasoning, but that they stick to their formalistic case law, which is no longer in line with economic reasoning. In fact, the legal tests developed by the Court of Justice in the field of abuse of dominance are sometimes so strict that they can almost accommodate any decision of the Commission. In other words, the problem is not one of judicial deference to the Commission, but one of defective decision-making in that the legal standards relied upon by the Court are out of touch with contemporary economics (and even in some cases with basic common sense).

The problem is, of course, that this case-law has in turn a negative impact on the decisional practice of the Commission as can be illustrated by the *Intel* decision.[38] While in that decision the Commission carried out an "as efficient competitor" analysis to demonstrate that Intel's rebates were exclusionary, it claimed that this analysis was "not indispensable for finding an infringement under Article 82 of the Treaty [now Article 102 TFEU] according to the case-law."[39] Referring to *British Airways* and *Michelin II*, the Commission indeed notes that "for the purposes of establishing an infringement of Article 82 EC [now Article 102 TFEU], it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned."[40] The Commission thus appears to be saying that no evidence of foreclosure is needed.

While this approach provides the Commission with the advantage that its decisions would become de facto "appeal proof,"[41] it is detrimental to the objectives of the 2008 Guidance Paper. The reason is that this approach hardly gives any incentives to the Commission to carry out a serious effects-based analysis as in any event the case can be won on the basis of the strict case-law of the European Court of Justice.

This does not mean, however, that the Guidance Paper is useless, since it continues to provide a roadmap of the way the Commission will pursue its enforcement of Article 102 TFEU. However, a great step forward in the field of vertical restraints would be for the EU courts to modify the legal standards they apply to this field so as to better accommodate economic reasoning.

B. The Brazilian Institutional Background

In Brazil, the effects-based analysis has been incorporated in the legal system at least since 1994. Both BCA[42] and NBCA[43] define antitrust violations based on actual or potential effects, or on the conduct's scope to generate those effects. Besides the wording of the law itself, there is a general consensus emerging both from the case-law and the Brazilian legal scholarship about the adequacy of the effects-based approach to identify vertical restraints that violate competition laws. Thus, at the statutory level, it is fair to say that Brazil is ready to implement an effects-based analytical framework.

However, the guidelines developed to evaluate anticompetitive conduct under BCA (i.e. CADE's Resolution 20)[44] are still insufficient to serve as the basis of a more detailed effects-based analysis. Indeed, the current guidelines merely suggest, at a very general level, that vertical restraints must be evaluated by balancing their potential negative effects with their possible efficiencies.[45]

In this context, new guidelines, incorporating the recent developments in economic and legal theory discussed in this paper, should be developed. The coming into force of NBCA is the right moment for developing such guidelines, as the authorities are already undergoing a complete overhaul of the regulations needed to implement the new law.

With the normative framework in place, attention must be shifted to the Brazilian Competition Law System's capacity to implement an analytical framework that heavily relies on economic reasoning. On this matter, the authorities composing the Brazilian Competition Law System have received international recognition.[46] Indeed, they have been able to handle an increasing number of cases in recent years with rising complexity, keeping a relatively constant

staff.[47] Yet, staff constraints will certainly be a challenge to implement a demanding analytical framework such as the one proposed in this paper.

Indeed, the last peer review published by OECD clearly stated that the total number of people working in Brazilian Competition Law System *"is small for a country of Brazil's size,"*[48] as summarized in the table on the next page.

Brazilian Competition Law System's Staff

	SDE/DPDE	SEAE	CADE	ProCade	MPF
Professionals	**32**	**78**	**49**	**8**	**2**
Support	**27**	**72**	**137**	-	-
Total	**59**	**150**	**186**	**20**	**2**

Source: OECD Peer Review (2010)

Also, the staff is largely composed of lawyers; hence the need to engage in deeper economic analysis would certainly require a more balanced staff, including a greater proportion of officials with background in economics.

The NBCA, which came into force in mid-2012, presents a good opportunity to boost the staff capacity of the New CADE. Indeed, the NBCA provides express congressional authorization for contracting 200 new permanent staff, especially selected for competition policy enforcement. This is a significant opportunity to select a balanced staff of lawyers and economists to bring Brazilian competition policy to the same level as mature jurisdictions worldwide. In addition, the new law creates an Economic Department within CADE, demonstrating a commitment to economic reasoning in competition policy enforcement.[49]

The staff expansion approved by the NBCA is probably the single most important institutional enhancement in Brazilian competition policy in the past 20 years and should be treated with great priority, as it will certainly give the New CADE the capacity to implement a more analytically complex framework of the type proposed in this paper.

BRAZILIAN COURTS ARE STILL VERY FORMALISTIC WITH JUDGES MASTERING PROCEDURAL RULES, BUT HAVING LITTLE SPECIFIC TRAINING IN COMPETITION LAW AND, USUALLY, NO BACKGROUND IN ECONOMICS.

Besides the authorities, Courts will always play an important role in complex cases as any large fine imposed on a dominant undertaking is likely to be reviewed by Brazilian Federal Courts since the defendant has the alternative to challenge CADE's final decision. The question is whether Courts are prepared to review decisions regarding vertical restraints. The answer to this question is far from clear. On the one hand, Brazilian courts are still very formalistic with judges mastering procedural rules, but having little specific training in competition law and, usually, no background in economics. This makes any review of a complex vertical restraint case a

significant challenge. On the other hand, judges may develop a standard of review based on a certain degree of deference to the economic analysis of the authorities, and focused more on procedural guarantees. Here, the challenge in Brazil seems similar to that in the EU, in finding a balance between some degree of deference and the court intervention to require a rigorous analysis from the administrative authorities.

Finally, in order to implement more detailed standards of analysis for vertical restraints, the antitrust community as a whole must be prepared to deal with this type of analysis. On this issue, it is fair to say that the Brazilian antitrust community is quite sophisticated and could certainly take up this challenge. In the past decade, attorneys and economists have been exposed to an increasingly complex array of arguments and economic tools.[50] Should the authorities adopt clear guidelines based on sound economic reasoning, the antitrust community as a whole would be prepared to apply them to concrete cases.

In this context, the Brazilian antitrust environment seems reasonably well prepared to implement a robust effects-based analytical framework, with, however, some important areas for improvement. These areas include: (i) developing more detailed regulations with guidelines to assess vertical restraints under the NBCA, (ii) using the opportunity opened by the NBCA for an expansion of staff that is balanced between lawyers and economists; and (iii) improving the ability of the courts to deal with economic arguments and/or developing standards of judicial review including some deference to the substantive economic analysis.

VI. CONCLUSIONS

Vertical restraints such as exclusive dealing, rebates and tying are common commercial practices adopted by both dominant and non-dominant firms. In the vast majority of instances, these practices are pro-competitive and a source of considerable efficiencies. There may be instances, however, where such practices may produce foreclosure effects. The task of competition authorities and courts in any jurisdiction is therefore to separate pro-competitive from anti-competitive restraints, and only prohibit the latter.

Because vertical restraints can be a source of efficiencies, *per se* rules of illegality should be avoided as they can lead to the over-enforcement of competition rules and thus prohibit some pro-competitive types of conduct. Rules that try to distinguish between pro- and anti-competitive conduct based on the form of such conduct should also be avoided as the form of a measure says little about its impact on competition. The application of form-based rules may therefore lead to significant errors of assessment and affect the credibility of the competition regimes in question, as some examples in mature jurisdictions as the EU and the US have illustrated.

Instead, competition authorities and courts should adopt tests seeking to identify the pro- and anti-competitive effects of a given conduct and to balance them. No vertical restraint should be banned without the demonstration that it affects competition and creates consumer harm. Such effects-based analysis must be developed according to a solid analytical framework in order to establish consistent standards of proof. Indeed, in the absence of such framework, even with an alleged effects-based approach, authorities may end up developing inconsistent standards of proof with decisions outcomes that may come close to a form-based analysis, as the Brazilian experience illustrates.

In this context, the Guidance Paper adopted by the Commission in December 2008 attempts to structure, in a fairly detailed manner, such an effects-based approach. Although the Guidance Paper contains some shortcomings, it offers a useful conceptual framework for the analysis of vertical restraints adopted by dominant firms. This effects-based approach contained in the Guidance Paper, which relies on modern economic thinking, is largely followed by US agencies and courts, as well as by enforcement agencies and courts in many other nations.[51] It is also supported by the vast majority of competition law and economics scholars around the world.

For rapid-developing jurisdictions like Brazil, which are attempting to leapfrog some of the earlier stages of more mature jurisdictions, the analytical framework proposed by the Guidance Paper could serve as a starting point to provide some hard edge to an otherwise soft effects-based approach applied by the authorities so far. With some adaptations to the reality of these developing jurisdictions, new guidelines could be used to establish substantive standards to evaluate vertical restraints, leading to a healthy convergence of analytical approaches based on modern economic theory.

Finally, this article also calls attention to the importance of the institutional environment to implement the proposed analytical framework. We discussed five different institutional elements: legislation, regulations with guidelines to implement the legislation, authorities' capability to develop sound economic analysis, courts' readiness to review this type of analysis and the antitrust community (i.e. in-house and outside counsel and economic consultants). The interplay among these elements is very important for the success of more robust analysis of vertical restraints. Although, both the EU and Brazil seem to be fairly prepared to implement the type of analysis proposed in this article, there is certainly room for improvement, especially in Brazil. ◀

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2. The full study can be found at able at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2173735

3. J. Temple Lang and R. O'Donoghue, "The Concept of Exclusionary Abuse under Article 82", *GCLC Research Papers on Article 82*, July 2005, mimeo.

4. Case 85/76 HoffmanLa Roche v Commission [1979] ECR 461, paragraph 91.

5. Case 322/81, *Michelin* v. Commission [*1983*] ECR *3461*, para. 57.

6. Neelie Kroes, "Preliminary Thoughts on Policy Review of Article 82", Speech at the Fordham Corporate Law Institute New York, 23 September 2005, available at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/537&format=HTML&aged=1&language=EN&guiLanguage=en.

7. DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, December 2005, available at http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf.

8. Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings issued in December 2008, [2009] OJ C45/7. Generally, on the Guidance Paper, See Damien Geradin, "Is the Guidance Paper on the Commission's Enforcement Priorities in Applying Article 102 TFEU to Abusive Exclusionary Conduct Useful?" in F. Etro and I. Kokkoris, Eds, *Challenges in the Enforcement of Article 102*, by Oxford University Press, 2010.

9. Id. at § 2.

10. See Commission Decision of 13 May 2009, COMP/37-990 Intel, available at http://ec.europa.eu/competition/sectors/ict/intel.html , at § 916: "The guidance paper is not intended to constitute a statement of the law and is without prejudice to the interpretation of Article [102] by the Court of Justice or the Court of First Instance. As a document intended to set priorities for the cases that the Commission will focus upon in the future, it does not apply to proceedings that had already been initiated before it was published, such as this case."

11. Guidance Paper, supra note 8, at § 19.

12. Id. at § 20.

13. Id. at § 20.

14. Id. at § 21.

15. Id. at § 23.

16. Id. at § 26.

17. P_e is the price effectively paid by the customer (for instance, the list price minus a rebate).

18. Guidance Paper, supra note 8, at § 26.

19. Id.

20. Id. at § 27.

21. Id.

22. Id. at §§ 27-30.

23. Id. at § 29.

24. The first competition act in Brazil was Law 4.137/62. However, the first rules specifically addressing competition issues were enacted even earlier, in the forties (Act 7.666/45).

25. Published in the Official Federal Gazette on June 28, 1999. Although part of Resolution 20 was revoked by CADE's internal rules of procedure, its annexes with the analytic framework for anticompetitive conduct remain in force since 1999, with no amendments.

26. Resolution 20/1999, *Annex* I, Item B.

27. *See* Paulo Furquim de Azevedo, "Restrições Verticais e Defesa da Concorrência: A Experiência Brasileira", (2010) Textos Para Discussão n. 264, FGV-EESP, at 11: "*As already mentioned, the decisions' basis show a surprising consistency in the procedures of analysis [of vertical restraints], especially if considered the significant controversy existent on the subject.*"

28. Administrative Proceeding n. 08012.009312/1998-39. Defendant: CCPR – Cooperativa Central dos Produtores Rurais de Minas Gerais Ltda. ("Itambé"), Reporting Commissioner Abraham Benzaquen Sicsú, DOU May 18, 2007 (the case addressed, among other issues, an exclusive agreement for the sale of a particular brand of milk, and it ended up being dismissed on procedural grounds, although SDE decided to open a new case to deal with the alleged infringements).

29. *Id.* at Reporting Commissioner vote, at page 4.

30. The analysis of efficiencies and the balancing test takes up only one page in the reporting commissioner's vote, concluding that the efficiencies are insufficient to justify the loyalty program. Administrative Proceeding 08012.003805/2004-10, Reporting Commissioner's vote, at 78-79.

31. Administrative Proceeding 53500.000502/2001, Claimant: Telet S.A.. Defendant: Celular CRT S.A., Reporting Commissioner Luís Fernando RigatoVasconcellos, DOU: June, 23, 2008, Reporting Comissioner vote at 25 – 26.

32. *Id.,* Dissenting Opinion of Commissioner Luis Carlos Delorme Prado, at 3.

33. See Damien Geradin, "Competition between Rules and Rules of Competition: A Legal and Economic

Analysis of the Proposed Modernization of the Enforcement of EC Competition Law", 9 (2002) *Columbia Journal of European Law,* 1

34. Commission Notice on cooperation within the Network of Competition Authorities, O.J. 2004, C 101/43, at §15.

35. Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, O.J. L 1/1, at §4.

36. Article 256 TFEU.

37. Experts were, for instance, used in the Wood Pulp case, Case C-129/85 Ahlström Osakeyhtiö and Others v. Commission, [1993] ECR I-1307.

38. In *Intel*, the Commission considered that the Guidance Paper did not apply on the ground that this document "was published only after Intel had been given the opportunity to make its views known on the 26 July 2007 SO, the 17 July 2008 SSO and the Commission's letter of 19 December 2008." Intel decision, supra note 10, at § 916. The Commission however specified in its decision that it was "in line with the orientations set out in the guidance paper." Id.

39. Id. at § 925.

40. Id. at § 922.

41. The General Court and the ECJ would be most likely to uphold this decision as in line with their case-law.

42. *See* BCA, articles 20 and 21.

43. *See* NBCA, article 36.

44. Resolution 20/1999

45. *See* Resolution 20/1999, *Annex* I, Item B: "(…) *in order to be capable of harming competition, vertical restraints usually require [the undertaking] to hold market power in the "original" market, [with the conduct] producing effects on a significant part of a "target" market. Although in theory such restraints might hinder competition [in a given market], they might also present offsetting economic efficiencies that must be balanced against potential anticompetitive effects, according to a rule of reason approach*".

46. For example, the Global Competition Review awarded CADE the prize of "Agency of the Year, Americas" in 2011.*See* http://www.globalcompetitionreview.com/news/article/29379/gcr-awards-2011-finalists/

47. The latest data released is from 2009 and 2010. CADE held 24 judgments sessions in 2010, judging 765 cases: (i) 660 mergers; (ii) 20 administrative proceedings; (iii) 57 preliminary investigations; (iv) 13 motions to clarify and; (v) 15 other proceedings. (CADE's Annual Report, 2010, p. 109). This represents more than 40% increase from 2009, when CADE held 22 judgments sessions, judging 538 cases: (i) 474 merges; (ii) 18 administrative proceedings; (iii) 40 preliminary investigations; and (iv) 6 consultations (CADE's Annual Report, 2009, p. 57)

48. *See* OCDE, Peer Review 2010, at 48.

49. NBCA, article 5, item III and article 121.

50. For an interesting overview of the cases with more complex economic analysis in Brazil see Cesar Mattos, A Revolução do Antitruste no Brasil: O Papel da Teoria Econômica Aplicada a Casos Concretos, São Paulo, Editora Singular, 2003.. The book (published in Portuguese) is clearly inspired by and adopts a similar format to the book Antitrust Revolution edited by John E. Kwoka Jr. and Lawrence White in the USA, presenting studies in cases where deep economic analysis was required. John E. Kwoka Jr. and Lawrence White, The Antitrust Revolution: Economics, Competition, and Policy, Oxford University Press, 2004.

51. See Einer Elhauge and Damien Geradin, Global Antitrust Law & Economics, 2nd Ed, Foundation Press, 2011, at Chapter III.