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To Issue Or Not To Issue Guidance: Comments On Geradin And Pereira Neto

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By Seth B. Sacher[1]

I. INTRODUCTION

In a recent working paper, Damien Geradin and Caio Marioda Silva Pereira Neto (hereafter GN) argue that the Brazilian competition system would greatly benefit from the adoption of guidelines like the *European Commission Guidance Paper*,[2] which offers a legal and economic methodology to implement an "effects-based approach" to vertical restraints adopted by a dominant firm.[3] This paper notes that while their proposed effects based analysis is far superior to *per se* treatment of vertical restraints, this framework can be further improved by careful attention to the challenges raised by the so-called "Chicago School" regarding the impact of vertical restraints. Further, whether it would be advisable for Brazil to write formal guidances regarding its policy toward vertical restraints should be evaluated in light of both the nature of Brazilian competition laws and the flexibility of the Brazilian economy.

WHETHER IT WOULD BE ADVISABLE FOR BRAZIL TO WRITE FORMAL GUIDANCES REGARDING ITS POLICY TOWARD VERTICAL RESTRAINTS SHOULD BE EVALUATED IN LIGHT OF BOTH THE NATURE OF BRAZILIAN COMPETITION LAWS AND THE FLEXIBILITY OF THE BRAZILIAN ECONOMY.

II. THE EVOLUTION OF ECONOMIC THINKING

GN begin with an excellent overview of the evolution of economic thinking regarding vertical restraints by a dominant firm. Thus, before the 1950s, vertical relationships between a dominant supplier and its customers that restricted the ability of those customers to deal with the dominant firm's rivals were viewed as unambiguously anticompetitive based on a rather underdeveloped concept of monopoly leveraging or foreclosure. These concepts do not appear to have been well thought out or modeled, but the idea is that the monopolist could somehow leverage its monopoly power in one market into another.

As GN note, a group of thinkers in the 1940s and 1950s criticized this monopoly leveraging theory. There is a tendency to refer to these thinkers as the "Chicago School," and indeed many of the thinkers associated with these critiques were faculty at the University of Chicago Law School or its Economics Department, although certainly not exclusively. For example, two Harvard Scholars - which some proffer as the antithesis of the Chicago School - Donald Turner and Philip Areeda, were responsible for much of the rethinking of enforcement and legal standards in the area of predatory pricing.[4]

These critiques raised two essential challenges for the view that harm would result from vertical restraints. The first is to establish that there is something the monopolist is able to accomplish by placing restraints on his customers' ability to deal with rivals he is not already accomplishing—i.e., the one monopoly profit theorem. The second is to explain why

customers would enter into a relationship that ultimately is supposed to make them worse off.

Further, given that these models led to the conclusion that there could not be customer harm from various vertical restraints, many Chicago School thinkers argued these restraints must be efficiency enhancing. Because of this conclusion, these scholars posited a number of ways in which such vertical restraints could be efficiency enhancing, and the paper provides an excellent taxonomy of these efficiencies.

As GN point out, the next phase in the economic modeling of vertical restraints has shown that the conclusion of the so-called Chicago School - that these vertical relations could never be anticompetitive - was rather strong. These models show that by breaking down some of the assumptions of the Chicago School, vertical restraints by a dominant firm can indeed produce anticompetitive results. Nevertheless, while these models showed that these vertical restraints *could* be anticompetitive, they do not imply that they *must* be anticompetitive.[5]

Many antitrust observers tend to group these models, with their more uncertain conclusions regarding the effects of vertical restraints, as the "Post-Chicago School." However, this may be a somewhat misleading description. The term Post-Chicago School may seem to imply that there has been some kind of radical break with the thinking of the so-called Chicago School. There might actually be more continuity between these models and the so-called Chicago School in that these models essentially use many of the propositions of the earlier scholars as a starting point and are merely breaking down some of the assumptions in those models. As will be expanded on further below, this may be a valuable way to think about vertical restraints as one attempts to apply economic models to actual enforcement or to provide guidance.

III. COMPETITIVELY AMBIGUOUS REASONS FOR VERTICAL RESTRAINTS

As noted above, the GN paper provides an excellent listing and description of the efficiency rationales for vertical restraints. However, the so-called Chicago School thinkers also put forward a number of other rationales for the existence of these restraints that are more competitively ambiguous. The paper might benefit from greater discussion of these rationales. One rationale to which greater attention should have been given is what economists and antitrust practitioners refer to as price discrimination—the charging of different prices to different customers for the same good or service. Thus, a number of models by prominent Chicago Scholars have shown that these vertical restraints can enhance a firm's ability to price discriminate.[6]

THUS, A NUMBER OF MODELS BY PROMINENT CHICAGO SCHOLARS HAVE SHOWN THAT THESE VERTICAL RESTRAINTS CAN ENHANCE A FIRM'S ABILITY TO PRICE DISCRIMINATE.

One of the classic examples of how vertical restraints can enhance price discrimination was the use of tying in the International Business Machines (IBM) tabulation card case.[7] As a condition of leasing its machines, IBM required its customers to purchase tabulating cards only from IBM. If customers were caught using non-IBM cards, the lease was canceled. The effect of this tie was essentially to charge those that used the system more intensively (i.e., those that used more tabulation cards) a higher price for the system. By charging for the entire system (i.e., machines and tabulation cards together) IBM could effectively charge these high intensity

users a higher price and lower intensity users a lower price.

While in the EU there may be some issues with price discrimination that get tied-up with issues of the common market, the actual welfare implications of price discrimination are highly ambiguous. Thus, while economic models tend to show that price discrimination enhances a firm's profits, it may be doing this by making the good available at a lower price, at least to some consumers, than would otherwise be the case. For example, in the IBM tabulation card case, IBM may have lowered the price of the leases for its machines in order to sell more tabulation cards, thereby increasing their availability to less intensive users.

In general, overall social welfare is higher under price discrimination, and at least some consumers benefit from the practice with the result that overall consumer welfare can be either higher or lower. Given its highly ambiguous welfare effects, price discrimination is generally not a good basis for an enforcement action, but it nevertheless may have a great deal of explanatory power with regard to many vertical restraints, particularly tying and conditional discounts.

For example, the paper describes the *Matec* case, where a supplier of large telephone switchboards was accused of refusing to supply spare parts to independent companies that were interested in providing maintenance services.[8] This case appears to bear many parallels with the US's *Kodak* case, which concerned a large manufacturer of photocopiers that similarly refused to supply spare parts to independent companies that were providing maintenance services.[9] Many would argue that what Kodak was trying to achieve was better price discrimination, although Kodak never raised this as a defense.[10]

Thinking about the possibility that many of these practices may reflect attempts by firms to better engage in price discrimination, and how to deal with it, might help Brazil continue to leapfrog many of the mistakes made by older antitrust regimes as one thinks about how to deal with vertical restraints, and whether - and how - to write guidances.

IV. LEGAL EVOLUTION

After discussing the evolution of economic thinking, GN give a brief overview of legal practice with respect to these restraints. GN note that the EU has moved away from *per se* treatment of such restraints and that countries like Brazil have been able to leapfrog over this *per se* period and straight to an "effects based" approach. The evolution of US law has been slightly different from that of the EU It is true that given the prominence of the monopoly leveraging theory, for a long time vertical restraints were treated very harshly in the US— essentially as being illegal *per se* as was the case in the EU Indeed, the US was probably harshly treating these relationships when very few countries, including those in the Treaty of Rome, even had competition laws of which to speak.

Over time, the conclusions of the Chicago School, with its more benign view of vertical restraints, started to influence legal outcomes as well. As GN note, US law follows a common law approach, so the impact of this thinking was not immediate but rather evolved over a number of years. Eventually, the courts began to take a highly skeptical view of plaintiffs' complaints in such matters (plaintiffs usually consist of the dominant firm's competitors, or spurned distributors or retailers). The antitrust agencies also cut back on their efforts in these areas.

Currently, it is still very difficult for plaintiffs to prevail in private cases in the US, which make up a substantial part of US antitrust enforcement. While the courts continue to take a skeptical view, the agencies recognize that vertical restraints can, in certain circumstances, harm competition. Indeed, with refinements to thinking on these issues, the agencies have challenged a number of instances of vertical restraints in recent years, exemplified by the *Microsoft*, *Dentsply* and *Intel* cases. Nevertheless, while both the US and the EU would appear to adhere to a rule of reason standard for evaluating vertical restraints, there is greater willingness in the EU and similar jurisdictions to condemn many of these behaviors than is the case in the United States.

NEVERTHELESS, WHILE BOTH THE US AND THE EU WOULD APPEAR TO ADHERE TO A RULE OF REASON STANDARD FOR EVALUATING VERTICAL RESTRAINTS, THERE IS GREATER WILLINGNESS IN THE EU AND SIMILAR JURISDICTIONS TO CONDEMN MANY OF THESE BEHAVIORS THAN IS THE CASE IN THE UNITED STATES.

This divergence at least partially results from a different emphasis on what GN referred to as *false positives* and *false negatives*.[11] Thus, the EU would appear more concerned with false negatives—incorrectly permitting anticompetitive practices—whereas US practitioners are more concerned with false positives—incorrectly condemning efficient practices.

There are several theories regarding the reasons behind this divergence. Many would argue these differences result primarily from the differing natures of the US and European economies, as well as their legal systems. Let's consider one argument for why competition authorities *should* be more concerned with false positives put forward by Frank Easterbrook, a prominent scholar strongly associated with the Chicago School.[12] He argues that a false negative (i.e., mistakenly permitting a monopolistic practice) is self-correcting because monopolistic behavior attracts entry. The entry may not occur as quickly as we would like, but he would argue it will nevertheless occur. On the other hand, so the argument goes, if an efficient practice is banned, then any other firm that uses the condemned practice faces sanctions in the name of *stare decisis,* or the legal principle of respecting precedents, no matter the benefits.

This argument probably carries more weight in the United States than other jurisdictions. The US economy has historically exhibited more flexibility for supporting new businesses than others. On the other hand, the US antitrust system may change more slowly than others. The European system, which, as GN note, is largely administrative in nature, can probably take a new direction more easily when new learnings take hold. In the United States, given its common law system, reversing previous precedents is a much slower process.[13]

This may be relevant as jurisdictions continue to develop their own competition laws and enforcement capabilities. The paper indicates that Brazilian law is more of an administrative system, so there may be more flexibility in terms of revising past practice as new learnings arise, suggesting false positives may not be of too great concern. On the one hand, whether one wants to be more aggressive or cautious in bringing enforcement actions against firms may also depend on how flexible one believes the Brazilian economy to be in terms of fostering new entrants. Brazil has certainly had enviable growth rates in a number of the past few years, which suggests it has a very dynamic economy; this may be a very relevant consideration as Brazil

attempts to balance the risks of false positives and negatives.

How dynamic an economy is would appear to be relevant to matters like the Iguatemi Shopping Mall cases.[14] These cases involved a luxury shopping mall that had signed exclusive contracts with a number of its tenants. The extent to which the Brazilian economy had the flexibility to support viable new entrants to compete with the established tenants might be a pivotal consideration in such a case.

V. TO ISSUE GUIDANCES OR NOT TO ISSUE GUIDANCES

Regarding policy prescriptions, there are two main issues to address: whether to issue a formal guidance regarding vertical restraints, and what to put in that guidance. Nevertheless, even if Brazil ultimately decides not to issue a new guidance paper, GN's recommendations for what to put in that guidance may be useful for guiding Brazilian vertical restraints policy.

On the issue of whether or not to issue a guidance at all, there is currently no such document issued by the antitrust agencies in the United States despite the existence of guidelines in the merger area for more than 40 years. There have been discussions of issuing such guidances, and one might consider the Section 2 report issued by the Department of Justice in 2008 as a US attempt in this direction.[15] However, the Federal Trade Commission never accepted the report and it was withdrawn less than a year after its issuance following a change in administration. This indicates the challenges in writing guidances in this area when there are divergent views as to when such conduct is unlawful. It is also noteworthy that recently the US Supreme Court had the opportunity to review a case involving conditional rebates,[16] but both of our federal antitrust agencies argued that the court should wait until the state of learning regarding such practices evolved before establishing a precedent,[17] an argument the Supreme Court accepted.

ON THE ONE HAND, GUIDANCES CAN PROVIDE MORE CERTAINTY FOR FIRMS REGARDING THE TYPES OF CONDUCT THAT ARE LAWFUL AND THOSE THAT MAY BE SUBJECT TO ANTITRUST SCRUTINY. ON THE OTHER, GUIDANCES CAN LEAD TO AN INFLEXIBLE LEGAL APPROACH THAT MAY BE INAPPROPRIATE, ESPECIALLY GIVEN THE STILL FLUID STATE OF LEARNING REGARDING VERTICAL RESTRAINTS.

There are clearly advantages and disadvantages to having guidelines and only a few of those issues are considered here. On the one hand, guidances can provide more certainty for firms regarding the types of conduct that are lawful and those that may be subject to antitrust scrutiny. On the other, guidances can lead to an inflexible legal approach that may be inappropriate, especially given the still fluid state of learning regarding vertical restraints. The absence of guidelines does not mean that one cannot provide *guidance* regarding the treatment of vertical restraints. Thus, a high degree of transparency on actual enforcement actions and investigations can still provide a great deal of information for stakeholders. In terms of being transparent on enforcement actions, this does not only mean being very public on cases where an action was taken. Being transparent in investigations that were ultimately closed can also be very important. Further, public conferences on the issues, inviting relevant stakeholders including academics and business people - something that the US FTC is quite active on - can also provide guidance.

As noted above, one reason to be reluctant to issue guidances is the unsettled nature of the theoretical economic literature regarding the impact of these vertical restraints. The actual empirical economic evidence on the effects of these practices is even more ambiguous, and is clearly an area where much more research would be beneficial. A group of FTC economists have summarized much of the existing empirical literature on vertical restraints.[18] This literature mostly looks at the impact of vertical restraints through: (1) evaluating the impact of various judicial antitrust decisions (usually evaluating impacts through stock market event studies); (2) evaluating the changes over time or differences cross-sectionally resulting from the enactment or removal of various laws regarding the extent of vertical integration allowed (frequently in the gasoline industry); and (3) cross-sectional surveys of the circumstances under which various vertical restraints are used. Most of the evaluations of judicial decisions have focused on resale price maintenance rather than practices such as exclusive dealing or conditional rebates. Overall, they found that the literature indicates that vertical restraints tend to reduce price and/or increase output (i.e., are procompetitive), also suggesting caution is warranted.

VI. GN'S POLICY PRESCRIPTIONS

Broadly speaking, the paper advocates a two-step process for evaluating vertical restraints. The first part is a foreclosure analysis in which the court or agency should first establish the presence of significant foreclosure, and then establish that the foreclosure will likely harm consumer welfare. They then recommend the analysis turn to whether there are efficiencies of such a nature that could offset any anticompetitive effects of the foreclosure.

There is reason to be skeptical of how often such a balancing is done in practice. For example, consider the area of exclusive dealing in the United States. Much of the case law in this area in the US has been made by our so-called Circuit Courts, which are the highest level of appeals courts before reaching the Supreme Court. Under this case law, for the most part, when a vertical arrangement passes antitrust muster, it generally does so on the basis that the foreclosure prong has not been met. There appears to be only one case where a court acknowledged the possibility of anticompetitive foreclosure, but held that the procompetitive efficiencies outweighed the effects of foreclosure. Thus, the Fourth Circuit (which has jurisdiction over a region consisting primarily of the Middle Atlantic States) considered an exclusive contract between a hospital and a radiology practice group to provide radiology services to inpatients at the hospital.[19] In holding that the exclusive contract was legal, the court found that even if the exclusive contract, which accounted for as much as 80 percent of the market for radiology services in the relevant geographic market, represented substantial foreclosure, the procompetitive benefits - including quality control, cost control, ensuring availability of services, and minimizing disruptions from utilizing a number of different providers[20] - justified the exclusive contract.Part of the reason the court held for the plaintiff on this basis, in this matter, is probably because it dealt with the healthcare field. In general, antitrust decision makers in the United States have shown more willingness to credit efficiency claims in the healthcare area than other areas given that most of the claims have to do with morbidity and mortality rather than monetary effects.

VII. ANSWERING THE CHICAGO SCHOOL CHALLENGES

While the proposed quantitative foreclosure analysis is a vast improvement over *per se* treat-

ment of these restraints, at times the various criteria for a finding of anticompetitive behavior may be met, but the analysis would still be incomplete. It may often be helpful to keep some of the Chicago School challenges in mind; doing so can help establish a more complete theory of competitive harm. Specifically, (1) what is it that the dominant firm is seeking to accomplish that it could not already accomplish without the restraint? And (2) why do customers agree to participate in a scheme that would have an adverse effect on them? There are numerous answers to these challenges, but it will often prove helpful to not lose sight of these challenges in an actual investigation. For example, Joe Farrell, certainly no friend of the Chicago School, still refers to these Chicago School challenges as "organizing principles."[21] This would appear to be evidence of the continuity between the so-called Chicago and Post-Chicago schools.

Consider the Windows Media Player (WMP) case in the EU described by the paper.[22] In this case, the Commission found that Microsoft infringed Article 102 by tying the WMP with its Windows PC operating system (Windows). This case would appear to pass the quantitative foreclosure test for tying laid out in the paper. Clearly, Windows had a dominant position in operating systems and the tie foreclosed a significant avenue of distribution. In the absence of significant and compelling efficiencies, the practice would appear to warrant condemnation under this so-called effects based analysis. However, it is not clear these steps alone demonstrate harm to competition as opposed to harm to competitors.

Let us consider the first Chicago School challenge—i.e., the one monopoly profit theorem. Given that Windows had a dominant position in operating systems, what did it hope to accomplish that it was not already able to accomplish through its virtual monopoly in operating systems? Because the WMP and the operating system appear to have been consumed in fixed proportions, it appears to be a classic case where its monopoly power could not be extended.

Now, clearly there are models that show that the one monopoly profit theorem need not hold, including that used by the US Department of Justice in its famous *Microsoft* browser case, with a more formal model of that theory having been developed by Carlton & Waldman[23] and others. Under this theory, the tied product might be a launching pad for entering the tying product market. This gives the monopolist a way in which it can increase (long run) profits through tying.

Alternatively, there is Whinston's theory where the tying product can be used to "organize" competition in the tied good market.[24] Consider a resort on an isolated island with a restaurant. The restaurant is open to other tourists in addition to guests at the resort. By requiring guests at the resort to use the restaurant, the resort monopolist can deny sufficient scale for other restaurants and thereby charge monopoly prices to tourists not staying at the resort.

Alternatively, one might argue that the WMP restraints resulted in a loss of variety and/or innovation and that, therefore, the consumer harm prong of the foreclosure test was met even if Microsoft would not raise prices because of the tie. Overall, it is not clear this argument answers the Chicago School challenge. As noted in the GN paper, the one monopoly profit theorem implies the monopolist should want a more competitive complementary market since this enables it to achieve greater profits on the monopoly good. A more competitive market would certainly include a market with more variety or innovation. Thus, it is not clear that positing a "but for" world that includes more variety and innovation solves the one monopoly

profit challenge and is therefore a complete theory of harm.

Moreover, caution is warranted if loss of variety is the sole or primary harm that can be identified. On the one hand, the importance of variety relies heavily on the welfare standard chosen. Under a consumer welfare standard, loss of variety would appear to be an unambiguous bad. On the other hand, it is not clear a competitive market produces the optimal amount of variety. Variety comes at a cost and it is not difficult to develop an economic model that shows the cost of increased variety may not be worth the benefit. Thus, new products that only capture sales from existing competitors are less likely to enhance overall social efficiency than are products that are expected to grow the market. Innovation can be a similarly uncertain standard since the relationship between market structure and innovation is undetermined. That is, it is unclear whether competitive or monopolistic market structures result in more innovation.

THE IMPORTANCE OF VARIETY RELIES HEAVILY ON THE WELFARE STANDARD CHOSEN. UNDER A CONSUMER WELFARE STANDARD, LOSS OF VARIETY WOULD APPEAR TO BE AN UNAMBIGUOUS BAD. ON THE OTHER HAND, IT IS NOT CLEAR A COMPETITIVE MARKET PRODUCES THE OPTIMAL AMOUNT OF VARIETY.

There is at least one exclusive dealing case in the US where the case appears to have been dismissed on the grounds of the one monopoly profit theorem: *E&L Consulting Ltd. v. Doman Industries* (2006). In this matter, the plaintiff was a distributor of the defendant's lumber products in several northeastern states. When another distributor, with which the defendant signed an exclusive dealing contract, replaced the plaintiff, the plaintiff sued. Here the Second Circuit upheld a lower court's dismissal of the case, holding that the plaintiff failed to demonstrate any harm to competition. The court noted that the defendant's 95 percent market share meant that any exclusive dealing arrangement "provides no monopolistic benefit to [the lumber manufacturer] that it does not already enjoy and would not continue to enjoy if the exclusive distributorship were enjoined."

A full consideration of the Chicago challenges could also be beneficial to the standards proposed for the other practices, such as conditional rebates (both single and multiproduct). Thus, conditional rebates involve giving customers lower prices, and clearly that is the essence of what the competition laws are meant to protect. Careful consideration of the Chicago School challenge that customers would not enter into relationships that make them worse off would appear to be warranted in such situations.

First consider the multi-product case. In the case of a multi-product rebate, the customer pays less than the monopoly price for the tying product in exchange for procuring another competitively-supplied good from the monopolist. Assuming the monopolist is not refusing to deal with customers that do not purchase the competitive good from it, the customer has the option of paying the monopoly price on the tying product and procuring the tied product from the competitor. Thus, on a simple level, the customer must be better off if he chooses to procure both goods from the monopolist. Similarly, single product conditional rebates operate in the same way—the customer chooses to obtain some portion of his contestable demand for the good from the dominant firm in order to obtain a discount on the non-contestable portion. Since he has the option of paying the monopoly price for the noncontestable portion and pro-

curing the contestable portion from the monopolist's rivals, he will only accept the dominant firm's conditional rebate if he is better off. Nevertheless, despite the fact that the customer is better off, clearly these situations can violate the "equally efficient competitor" test described by GN in the paper. (This test is also called the *Ortho* test among other names in the US after various Court decisions that have applied similar tests.[25])

There are a number of Post-Chicago models that have answered this Chicago School challenge and shown that customers can be made worse off by these conditional rebates. For example, Nalebuff, among others, has shown that the dominant firm can increase its profits from such an arrangement.[26] Nevertheless, in this model, consumers still benefit from the discount in the short-run; otherwise, they would not accept the deal.[27] The customer harm in this group of models comes in the long-run, when customers may be made worse off as the exit of competitors with difficult re-entry leads to monopolization of formerly competitive markets. The injury of competitors can also dampen incentives to innovate.

One might argue that this is clearly in line with the implications of the equally efficient competitor test. However, it differs in that there is a clear articulation of how consumers can be induced to participate in the scheme. It also clearly indicates that customers are better off in the short-run, which a simple application of the *Ortho* test does not necessarily make explicit. Indeed, under this class of models, conditional rebates are similar to a predatory story, where short-term pricing benefits must be weighed against longer-term harms (although, unlike a predatory story, the dominant firm can actually increase its profits in the short-run). It is noteworthy that GN advocate a predatory pricing type standard for such cases because that is exactly what these models suggest is going on, in a sense. However, there may be effects in terms of how much enforcement there would be in this area from treating such matters as predatory pricing matters. There are relatively few challenges by any global agency regarding predatory pricing matters,[28] so adopting such a standard may be a very stringent one from an enforcement perspective.

Similarly, there is another class of models, for example the one proposed by three economists that were, at the time, affiliated with the US Department of Justice that suggests there need not be such a short run trade-off and consumers *can* be made worse off in the short-run as well as the long-run.[29] Although the argument is complicated, in their model the customer is given a choice between paying a very high price for the monopoly good (e.g., a price even above the monopoly price or simply not being able to procure the good at all unless they purchase the bundle) and procuring both goods from the monopolist. The customer purchases the bundle because this is better choice of those offered to him, but he is worse off relative to a situation where bundling would not be permitted. This model is highly controversial, not least of which because the monopolist's offer may not be "credible."[30]

The point here is not to go through these various conditional rebate and bundling models. It is only to indicate that the *Ortho* test, in and of itself, even in the absence of procompetitive efficiencies, may not be sufficient to establish customer harm. Thus, something of a broader perspective may be needed to avoid false positives.

VIII. EFFECTS AND COUNTERFACTUALS

Certainly, a consideration of possible effects might be a useful part of any analysis. GN refer to a counterfactual analysis as a possible means for getting at the issue of effects; this could be a very useful tool in addition to answering the Chicago challenges for assuring that what is being done is protecting competition, not competitors. However, caution in applying the counterfactual to consumer or social welfare is advisable. On the one hand, there are issues of measurement. For example, ascertaining that prices would have been lower "but for" some vertical restraint cannot generally rely on simple evidence that prices went up after a dominant firm implemented some kind of practice. Such evidence typically requires that anticompetitive effects be isolated from other determinants of price. Thus, price may have gone up due to other supply or demand factors that also changed around the time of the practice's implementation, and these should be controlled for.

PRICE INCREASES IN AND OF THEMSELVES ARE NOT ALWAYS INDICATIVE OF CONSUMER HARM. RECALL THAT MANY OF THE AFOREMENTIONED EFFICIENCIES FROM VERTICAL RELATIONS RESULT IN EITHER GREATER DEALER OR MANUFACTURER EFFORT.

Further, price increases in and of themselves are not always indicative of consumer harm. Recall that many of the aforementioned efficiencies from vertical relations result in either greater dealer or manufacturer effort. In some cases, this will result in price increases that reflect a higher quality product (which may manifest itself in things such as a more pleasant shopping experience through greater dealer service). Similarly, both foreclosure and the possible efficiencies from vertical restraints can increase a firm's market share. Thus, increases in the market share of the dominant firm and a reduction in share for other firms are not necessarily indicative of foreclosure or harm.

Output effects might be the most unambiguous. If the practices are, on net, anticompetitive, output would go down and vice versa. However, measuring output is still subject to the same caveat that output may have changed for reasons unrelated to the practice, and these possible factors should be accounted for.

IX. ANSWERNG THE CHICAGO CHALLENGES DOES NOT NECESSARILY MAKE IT HARDER TO CHALLENGE ANTICOMPETITIVE VETICAL RESTRAINTS

It may seem that arguing for more attention to Chicago principles is equivalent to advocating for more obstacles to bringing cases against vertical restraints. This is not the goal. At times it may be easier to establish harm using such an approach. For example, as noted by GN, the foreclosure approach can be quite difficult to apply. Consider the conditional rebate test. A price-cost test applied to contestable sales involves estimating three magnitudes that can often only be estimated imprecisely: what does the dominant firm believe are the contestable sales; what is the dominant firm's incremental cost of supplying these sales; and what is the alleged dominant firm's revenue from supplying these sales? Estimating each of these magnitudes is likely to be very difficult. A supplier may not know exactly how much sales are at-risk. Incremental costs are sometimes difficult to estimate because it can be difficult to determine the time intervals and

volume levels at which some fixed costs become variable. Finally, the financial and non-financial considerations that a supplier offers on at-risk sales can be difficult to quantify.

A recent working paper by two FTC economists seeks to address the Chicago School challenge of why customers would accept an arrangement that appears to hurt them by applying a Post-Chicago model to the *Intel* case.[31] As part of this effort, they contrasted this approach with applying the *Ortho* test to the same case. The information requirements that might be needed to apply their approach to that case appeared considerably less burdensome to both the competition agency and the parties, and appear to have provided a more complete theoretical framework as well.

X. MONOPOLIZATION

FINALLY, ONE THING THE PAPER MIGHT CONSIDER MORE EXPLICITLY ADDRESSING IS THE POSSIBILITY OF MONOPOLY CREATION THROUGH VERTICAL RESTRAINTS AS OPPOSED TO MONOPOLY PRESERVATION.

Finally, one thing the paper might consider more explicitly addressing is the possibility of monopoly creation through vertical restraints as opposed to monopoly preservation. It is not clear where the paper is coming down on this right now, but it is something Brazil competition law stakeholders may want to consider.

This could be an area where US law and practice is actually more "interventionist" than the EU with respect to dominant firm restraints. In the US there is an incipiency standard regarding many vertical restraints. Article 102, which prohibits "abuse of dominance," may have much more difficulty trying to restrain non-dominant firms that are attempting to obtain a monopoly.

The legal standard in the US requires showing the existence of potentially problematic conduct, intent to monopolize, and a "dangerous probability of success." While the monopoly maintenance analysis focuses on evidence that shows the upstream firm's current or potential rivals cannot expand, proving monopolization requires evidence showing that rivals either will shrink, or have shrunk, because of the upstream firm's conduct.

Indeed, monopolization may involve competition for an exclusive - that is, situations in which companies compete to be the sole supplier for a particular distributor (for example, mobile phone manufacturers competing to be the sole or primary supply to a mobile network provider). This opens up an additional area of discussion, but suffice it to say, many economic models indicate competition among firms for an exclusive can be among the most intense forms of competition. Thus, this area might involve evaluating a trade-off between intense competition in the short run versus a less competitive long run.

XI. OTHER RECOMMENDATIONS

Currently there is very little empirical research on the actual effects of vertical restraints. One area Brazilian academics or its competition agency CADE may wish to foster is what are referred to in the United States as retrospectives and what other jurisdictions refer to as impact evaluations. The US FTC has a fairly extensive program looking at past merger actions, and many of the reports are available at the working paper website.[32] Most of these studies have

focused on mergers that were close calls but allowed to go through. Price has been the variable of interest in most of these studies. Nevertheless, other issues have been considered, including one study of possible quality effects from a hospital merger, and a study looking at changes over time in an industry where a merger was blocked.

Despite this active program in the merger area, not much has been done in the nonmerger area. Clearly such studies would be difficult and many of the caveats mentioned with respect to evaluating effects would apply here. But this appears to be something potentially quite rewarding and useful, and can make significant contributions to both competition enforcement and the economics literature.

XII. CONCLUSION

The GN paper is a very useful descriptive and prescriptive reference for Brazilian competition stakeholders. Whether its findings should be incorporated into formal guidances, or something less formal, should be decided on the basis of the nature of both Brazilian competition laws and the flexibility of the Brazilian economy. While the proposed effects based analysis are far superior to *per se* treatment of vertical restraints, the framework can be further improved by careful attention to the Chicago School challenges. ◀

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1. Economist, US Federal Trade Commission, Washington, DC 20580, ssacher@ftc.gov. The views expressed in this paper are solely those of the author and do not represent the views of the Federal Trade Commission or any individual Commissioner. This article is based on remarks delivered at the Centre for the Study of Development Strategies (CEDES), Conference on Vertical Restraints Adopted by Dominant Firms, in Brasilia, Brazil, December 6, 2012. Andrew Heimert provided helpful comments and suggestions. Remaining errors are my own.

2. 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.

3. See Damien Geradin, For a Rigorous 'Effects-Based' Analysis of Vertical Restraints Adopted by Dominant Firms: An Analysis of the EU and Brazilian Competition Law (June 2012).

4. E.g., see Bill Kovacic, The Antitrust Double Helix, 2007 Columbia Business Law Review 1.

5. Often the conclusions of these models are very sensitive to the assumptions behind them as well.

6. E.g., see George Stigler. *A Note on Block Booking,* in Stigler, the organization of industry (1968).

7. *International Business Machines v. United States* (1936).

8. Administrative Proceeding 08012.000172/1998-42, Claimant: Power-Tech Teleinformática Ltda, Defendant: MatelTecnologia de Informática S/A - MATEC, Reporting Commissioner: Celso Fernandes Campilongo, DOU: May, 13, 2003.

9. *Eastman Kodak Company v. Image Technical Services, Inc.,* 504 US 41 (1992).

10. E.g., see Benjamin Klein, Market Power in Antitrust: Economic Analysis After Kodak, 3 SUP. CT. ECON. REV. 43 (1993).

11. E.g., see Seth Sacher, The Past, Present and Future of Antitrust, 11 Georgetown journal of international affairs 115 (2010).

12. Frank Easterbrook, The Limits of Antitrust, 63 Texas Law Review 1 (1984).

13. Another reason the US may be more permissive toward dominant firm conduct has been put forward by Bill Kovacic (*supra* note 4). According to this argument, the US courts have raised liability standards to discour-

age the excess costs associated with private rights of action. Thus, private antitrust rights of action entail costs associated with mandatory treble damages, asymmetric shifting of costs, broad rights of discovery, class actions and jury trials. The mere threats of such costs could excessively deter legitimate conduct. The courts may have attempted to offset the possibility that the threat of these costs could be used to deter procompetitive conduct by raising liability standards.

14. Administrative Proceeding 08012.009991/1998-82, Claimant: Participações Morro Vermelho Ltda. Defendant: Condomínio Shopping Center Iguatemi and Shopping Centers Reunidos do Brasil Ltda, Reporting Commissioner:Roberto Pfeiffer, DOU: April, 14, 2004 and 113Administrative Proceeding 08012.006636/1997-43, Claimant: Associação dos Lojistas de Shopping do Estado de São Paulo and Procuradoria Geral do CADE, Defendant: Condomínio Shopping Center Iguatemi, Reporting Commissioner: Luís Fernando Rigato Vasconcellos, DOU: September, 19, 2007.

15. See US Department of Justice, *Competition and Monopoly: Single Firm Conduct Under Section 2 of the Sherman Act* (2008) *available at* www.usdoj.gov/atr/public/reports/236681.htm.

16. *LePage's Inc. v. 3M*, 324 F.3d 141 (3d Cir. 2003), *cert. denied*, 124 S. Ct. 2932 (2004).

17. Brief for the United States as Amicus Curiae, *3M v. Lepage's, Inc.*, 2004 WL 1205191 (May 28, 2004).

18. James, Cooper, Luke Froeb, Dan O'Brien and Michael Vita, *Vertical Antitrust Policy as a Problem of Inference*, International Journal of Industrial Organization, September 2005.

19. *The Imaging Center, Inc. v. Western Maryland Health Systems, Inc.*, 158 Fed.Appx. 413 (4th Cir. 2005).

20. *Id.* at 420.

21. Joseph Farrell, Deconstructing Chicago on Exclusive Dealing, 465 Antitrust Bulletin, 50 (2005).

22. Commission Decision, 24 March 2004, Case *COMP/C-3/37.792 Microsoft*.

23. Dennis W. Carlton and Michael Waldman, The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries, 33 rand journal of economics 194 (2002).

24. See, Michael Whinston, Tying, Foreclosure, and Exclusion. 837 American Economic Review 4 (1990).

25. E.g., s*ee Ortho Diagnostics Sys., Inc. v. Abbott Labs., Inc.*, 920 F. Supp. 455.

26. Barry Nalebuff, Bundling as an Entry Barrier, 119 Quarterly Journal of Economics 1 (2004).

27. Thus, a small reduction in price of monopolized good yields a small reduction in profits for the monopolist, but a much larger increase in consumer surplus. Conversely, a small increase in the price of the competitive good yields a large increase in profits for the monopolist, but only a small reduction in consumer surplus. Thus, the monopolist increases profit while consumer surplus increases as well. Essentially, this is a form of price discrimination where the bundle enables the monopolist to "carve out" consumer surplus on the monopolized good.

28. E.g., see *ICN Report on Predatory Pricing* (2008), p.3., "[d]uring the last ten years, responding agencies brought approximately twenty-four cases in which a predatory pricing violation was established and have initiated at least five times as many investigations in which predatory pricing was alleged, but no violation was found."

29. Patrick Greenlee, David Reitman, and David Sibley, *An Antitrust Analysis of Bundled Loyalty Discounts* (October 30, 2006). Economic Analysis Group Discussion Paper No. 04-13 (Revised). Available at SSRN: http://ssrn.com/abstract=600799 or http://dx.doi.org/10.2139/ssrn.600799

30. E.g., see Gregory K. Leonard, The Competitive Effects of Bundled Discounts in Wu, Economics of Antitrust: Complex Issues in a Dynamic Economy, (2007).

31. See Patrick DeGraba and John Simpson, *Theories of Harm in the Intel Case*. (unpublished mimeo), November 2010 available at http://ssrn.com/abstract=1705753. This paper was based entirely on publicly available information and was not meant to reflect how the FTC actually analyzed the case or would have litigated it.

32. http://www.ftc.gov/be/econwork.shtm