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I. INTRODUCTION

So common and yet so controversial. Vertical restraints are among the contractual forms that Ronald Coase ironically called 'strange forms'; strange, not because they are unusual, but for the lack of a consensual understanding among economists and competition authorities about how to assess their effects on competition and welfare (Menard, 2004).

It was not always like that. During the 1950s, at the Warren Era, economists had a reasonable common understanding, shared with the competition authorities, that vertical restraints were presumably harmful to competition and to consumer welfare (Hovenkamp, 2005). Since then, economics has advanced significantly, first with the Chicago Critique and subsequently with the Post Chicago School. Our understanding about vertical restraints is certainly more comprehensive and rigorous, and while this makes the job of competition authorities more accurate, it does not make it easier. In particular, the theoretical models, even those largely accepted, do not provide a clear guidance for policy implementation, such as determining the degree of foreclosure that is sufficient to harm competition, or evaluating how to quantify efficiency gains from vertical restraints.

Without a common knowledge as to how to translate the theoretical models into practical rules, it is difficult to discriminate lawful and unlawful vertical restraints. Therefore, the rulings of competition authorities may be inconsistent and, hence, unpredictable. As firms are unable to anticipate competition authorities' decisions, antitrust institutions fail to deliver their primary role: to induce behaviors and to deter anticompetitive strategies.

This is one of the conclusions of Geradin and Pereira Neto's article on vertical restraints.[2] Although competition policy is sometimes consistent on the general principles that orient the analysis of vertical restraints – as observed, for instance, in the Brazilian case – the application to concrete cases is mostly inconsistent. Their suggestion is to anchor the antitrust scrutiny in what they call a "rigorous effects-based analysis," grounded mainly in quantitative evidence and economic theory. These short comments aim to discuss this proposition in further detail, and to argue that some presumptions are still necessary in the investigation of vertical restraints. Moreover, the problem of inconsistency – rightly pointed out by the authors – is more appropriately addressed by means of explicit presumptions in the form of safe harbors.

The remainder of these comments is divided into four sections. The next section presents the main features and results from Geradin and Pereira Neto's article. The following section critically discusses the proposition that the enforcement of competition policy towards vertical restraints should abandon presumptions based on qualitative evidence and focus only in the quantitative assessment of the anticompetitive effects of those conducts. An illustrative case (the Madeira River exclusive dealing case) is then presented to exemplify the importance of qualitative evidence and presumptions in the scrutiny of vertical restraints. The last section concludes.

II. GERADIN AND PEREIRA NETO: FOR A RIGOROUS "EFFECTS-BASED" ANALYSIS OF VERTICAL RESTRAINTS

This is a long-awaited article. There are plenty of competent surveys on the economic theory empirical literature of vertical restraints, and about the jurisprudence in several jurisdictions.[3] What was missing was a study on the antitrust praxis that was applicable for both developed and emerging jurisdictions, such as both the EU and Brazil, and, at the same time, combined the positive and normative dimensions of competition policy. With the support of the Center for Studies in Social and Economic Law (CEDES), a Brazilian think tank, Geradin and Pereira Neto fully meet the readers' expectations in an excellent study on the subject. The paper is not restricted to the economic or legal debate, but is oriented to transform and improve public policy.

In a clear and comprehensive analysis, the article identifies the principles that drive the applications of antitrust norms towards vertical restraints by means of a comparative analysis of the antitrust praxis in the EU and Brazil. This was a wise choice since both jurisdictions are similar in their administrative enforcement systems, and in their legal origins, inasmuch continental European law largely influenced the Brazilian judicial system. Their main difference is the stage of economic development, which allows for an interesting discussion about the design of competition policy in developed and emerging economies. Moreover EU and Brazil have become important benchmarks in antitrust enforcement since the mid-1990s; the EU as the most influential jurisdiction, for its implementation within 27 countries and institutional ties with its former colonies; and Brazil as a benchmark for developing countries, whose competition policy systems are still incipient and face various constraints to their development.

The study is also careful to identify the institutional differences between the two jurisdictions that impose non-negligible restraints on the emulation of the European experience as a parameter for the application of antitrust in Brazil. Policy suggestions to the Brazilian jurisdiction take into account not only, as expected, the legal framework for competition policy, but also the resource constraints that the competition authority faces in developing countries like Brazil. The study acknowledges that CADE, the Brazilian authority, consistently observed certain principles of analysis, such as dominant position, market foreclosure and compensatory efficiencies. Nevertheless, the application to concrete cases tends to rely on qualitative evidence, rather than the quantitative assessment of anticompetitive effects, which creates leeway for inconsistencies. In their words:

> "A close look at the case law shows substantial variance 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."

The European experience illustrates how the scrutiny of vertical restraints grew in accuracy and predictability. The 'rigorous effects-based' analysis, deeply grounded on economic theory and quantitative evidence, is the basis of the evolution of the EU antitrust enforcement on exclusive dealing, bundling, and rebates. This is one of the main suggestions from the authors to competition authorities in general, and to CADE in particular, given that they identify in the Brazilian authority a higher inconsistency in terms of standard of proof.

To reduce the punishment of procompetitive business practices (i.e., type 2 errors or 'false positives'), the authors propose that the antitrust authorities, similar to what occurs in the European Union, use the criterion of 'equally efficient competitor.' In other words, a vertical restraint should be unlawful only if it excludes competitors that are as or more efficient than the company under investigation. Underlying this proposition is the notion that antitrust is not intended to preserve competitors – efficient or not – but to sustain competition, so as to ensure the selection of practices, technologies, and organizational forms that are more efficient.

The authors also argue that the competition authority should rely on quantitative analysis, grounded in economic theory, and avoid qualitative assessments, which, according to the authors, would be more vulnerable to discretionary interpretation of antitrust authorities. By requiring a standard of proof less subject to variations in interpretation, the decision of the antitrust authority would be more predictable and thus could fulfill its role of orienting strategies and deterring anticompetitive conducts.

III. A CRITICAL ASSESSMENT

These proposals are a valuable input for discussion on the design of competition policy. The study not only inspires new thinking about antitrust practice, but also opens up the debate to criticism and counterarguments. In these comments, I highlight two aspects for a more detailed discussion: the unavoidable trade-off between deeper analysis and costs of investigation, and the myth of precision of quantitative models.

IN THESE COMMENTS, I HIGHLIGHT TWO ASPECTS FOR A MORE DETAILED DISCUSSION: THE UNAVOIDABLE TRADE-OFF BETWEEN DEEPER ANALYSIS AND COSTS OF INVESTIGATION, AND THE MYTH OF PRECISION OF QUANTITATIVE MODELS.

Throughout the paper, there is an implicit assumption that a deeper (more rigorous) analysis is always better, irrespectively of resources constraints. This idea is clear in the following excerpt:

> "Modern economic thinking teaches that competition authorities and courts should focus on the effects of vertical restraints on competition in the market. As will be seen below, whether vertical restraints create foreclosure effects may require complex analysis. Yet, failure to engage in such analysis will lead to so-called Type 1 or Type 2 errors. […] There is debate in the literature as to whether Type 1 errors are more frequent, than Type 2 errors, and vice-versa. As both forms of errors are damaging, it is important for competition authorities and courts to minimize them through proper analysis."

It is undisputable that a predictable and more consistent analysis is preferable, *ceteris paribus* the costs of investigation. The crucial question is defining the standard of proof given an efficient investigation; *i.e.* that provides the most comprehensive set of answers for a given set of investigation resources. In this setting, there is always a trade-off between the costs of investigation and the level of type I and II errors; otherwise, the preferable standard of investigation would always be the full rule of reason, with no presumptions. What the authors call a “proper analysis” that minimizes decision errors may be too costly or even unattainable. That is the reason why authorities establish decision rules and presumptions, so as to save investigative resources. In particular, in the case of emerging economies, where the antitrust agency normally has fewer available resources and expertise, requiring more sophisticated analysis would probably imply higher false negatives.

In particular, in the case of vertical restraints, requiring the proof of actual effects, as suggested in several passages of Garadin and Pereira Neto’s article, will probably lead to a decrease in false positives (the benefit of a higher standard of proof), but also, on the other hand, to a sharp increase in false negatives. This is not necessarily a better policy, as the Madeira River case, presented at the end of these comments, illustrates.

IN PARTICULAR, IN THE CASE OF EMERGING ECONOMIES, WHERE THE ANTITRUST AGENCY NORMALLY HAS FEWER AVAILABLE RESOURCES AND EXPERTISE, REQUIRING MORE SOPHISTICATED ANALYSIS WOULD PROBABLY IMPLY HIGHER FALSE NEGATIVES.

Moreover, empirically establishing causality between a strategy and its anticompetitive effects is quite difficult and rare (Angrist and Pischke, 2008). In the vast majority of vertical restraint cases there is not enough information to statistically prove causality of a foreclosure effect, which implies that requiring that standard of proof would ultimately imply ‘underpunishment’ of unlawful conducts.

The second aspect to highlight is the implicit belief that economic models provide definite and undisputable results or, alternatively, that it is preferable not to rely on qualitative evaluation, but only or mainly on quantitative evidence. This view is clear in the following excerpt.

> “For rapid developing jurisdictions like Brazil, which are attempting to leapfrog 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. Indeed, in Brazil, the problem is not so much that there is a lack of consensus over an effects-based approach, but the fact that this approach is carried out through balancing tests relying on qualitative, rather than quantitative, criteria. This leads to considerable inconsistency and uncertainty. 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.”

There is no doubt that rigorous economic thinking is necessary for an appropriate scrutiny of vertical restraints. Less trivial, though, is to conclude that the economic thinking should count on quantitative evidence alone. The reasons for keeping qualitative evidence at the core of the antitrust analysis are twofold. First, there is no *a priori* justification to discard information, be it qualitative or quantitative. These two sets of information are usually distinct, and, therefore, relying only on the quantitative set implies less information. In short, there are good reasons not to dismiss qualitative information on the analysis of vertical restraints. Second, the adoption of rigorous (formal and quantitative) economic models does not necessarily translate into lower discretion of the judge or greater predictability of their decisions. Available economic models are often sensitive to arbitrary choices (auxiliary hypothesis) and economic theory does not always provide a definitive answer to eliminate or mitigate the discretion of the modeler. Behind the apparent accuracy of the figures, there is great variation in their reliability and robustness.

For all this reasoning, the definition of safe harbors may be a more efficient alternative than an in-depth, effects-based analysis. The authors acknowledge the convenience of this approach in several passages of their article. It is also arguable that there is some benefit from the presumptions of anticompetitive effects in some extreme cases that could dispense with the actual observation of effects. In the next section, the Madeira River case illustrates how useful it is to rely on presumptions of potential foreclosure, rather than the observation of actual effects.

IV. THE MADEIRA RIVER CASE

The 2007 Madeira River case[4] is arguably the most effective in Brazilian competition policy, at least if one takes into account its immediate effect on Brazilian economy. The case ended with a settlement (*Termo de Cessação de Conduta*) signed between CADE – the Brazilian competition authority – and Construtora Norberto Odebrecht S.A., which was being prosecuted for exclusionary conducts by means of exclusive dealings contracts. Odebrecht is a diversified company, but excels mainly in building large infrastructure projects, such as highways, bridges and hydropower plants. The administrative proceeding investigated illicit, exclusive-dealing contracts with a likely effect of market foreclosure in the public competitive bids for the concession of the hydroelectric power plants of Santo Antônio and Jirau, located at Rio Madeira.

The case required urgent measures, given the proximity of the competitive bid of those plants, which was, according to the evidence available, limited to one sole participant: Odebrecht. The company held the rights of exclusive-dealing contracts with three of the only four companies in the world that were able to provide the turbines necessary for the construction of the plants: Alstom, VA Tech and Voith Siemens. Furthermore, the fourth company, General Electric Company (GE), was contractually precluded from participating in the public bids, unless it did so through a consortium with Odebrecht, even though it could freely supply turbines to the winner consortium.

These specifications made the case especially subject to the anticompetitive use of exclusive dealing. Environmental concerns barred the hydroelectric plants of Santo Antonio and Jirau from using conventional turbines, and required surface turbines that allow the transit of fish and reduce environmental damage. Nevertheless, only the four companies mentioned above had the expertise and operational conditions to supply this type of equipment. Aggravating the situation, at least two suppliers, if not three, were necessary to make the required investment viable.

Therefore, there was strong evidence to presume market foreclosure, although it was not possible to quantify this effect or even to observe it concretely before the bids took place. Considering the urgency of the case, as the first public bid was expected to occur within the next three months, on September 14, 2007, the investigatory body of the Brazilian competition policy system[5] initiated an administrative procedure and, through a preliminary injunction, extinguished the exclusivity effects of the contracts signed between Odebrecht and the four suppliers of surface turbine. That injunction was then contested in court by Odebrecht, but the company and the antitrust authorities ended up signing a settlement on October 29, 2007, where Odebrecht renounced to all its exclusivity rights before the four suppliers. GE was immediately released from its obligation, including being part of a rival consortium, while the other three companies became free to supply equipment to any rival consortium that eventually won the public bids.

Given the technical complexity, the drafting of that agreement involved several State bodies that formed a task force to handle the case with the required urgency. This was a very rare case whose results could be immediately assessed. The bid was the price to be charged to final consumers, with a maximum price of R$122/MWh, for 30 years of concession. Without competition, Odebrecht would rationally choose the maximum price as its bidding strategy, and there was clear (qualitative) evidence that it was the sole expected bidder. The settlement allowed for the participation of at least two competitors, that formally manifested their interest during the proceedings. At the public bid's auction, the winning bid, from Odebrecht itself, was of R$78,87/MWh, 35.4 percent lower than the maximum price. The present value of those savings amounted to R$16,4 billion, more than two thousand times greater than CADE's annual budget at that time, which was about R$8 million.

THE MADEIRA RIVER CASE WOULD BE PROBABLY DISMISSED IF THE STANDARD OF PROOF WOULD REQUIRE THE OBSERVATION OF ACTUAL EFFECTS (THAT WOULD ONLY OCCUR AFTER THE PUBLIC AUCTION) AND AN IN-DEPTH QUANTITATIVE ANALYSIS.

A rival consortium won the following public auction, which at first seemed very unlikely under the previous contractual conditions. This case illustrates, as few others do, the extent of damages that can result from unilateral conducts based on vertical restraints. Moreover, the Madeira River case would be probably dismissed if the standard of proof would require the observation of actual effects (that would only occur after the public auction) and an in-depth quantitative analysis. At the end of the day, the case illustrates how important it is to rely on presumed effects, making the intervention possible and timely.

V. CONCLUSIONS

Competition authorities and practitioners will probably have Geradin and Pereira Neto's article as a key reference for the analysis of vertical restraints. The study fills the gap between the academic surveys on the law and economics of vertical restraints, and the actual decision on the level of competition authorities, with a competent and comprehensive comparative analysis of the EU and the Brazilian jurisdictions.

For being a controversial issue, it is not expected that the publication of this study will end all disputes on the assessment of vertical restraints. Its role is primarily to foster the debate and to instigate the reform of the antitrust praxis towards a more predictable and effective intervention. And this is an aim that Geradin and Pereira Neto achieve with excellence.

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2. Geradin, D. and Pereira Neto, C.M. *For a rigorous "effects-based" analysis of vertical restraints adopted by dominant firms: an analysis of the EU and Brazilian competition law*. Working Paper presented at the CEDES Seminar on Competion Law, Brasilia, Dec 6th 2012 and reproduced in this issue of *CPI Journal*.

3. To name but a few, see Dobson and Waterson (1996), Posner (2005), Ray and Tirole (2007), and Lafontaine and Slade (2008).

4. Administrative proceeding # 08012.008678/2007-98, reported by Commissioner Luís Fernando Schuartz.

5. At that time, the Secretary of Economic Law, at the Ministry of Justice, played this role.