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# Lessons from the First Year of Competition Law in Ecuador

Luis Marín-Tobar[1]

## I. INTRODUCTION

Ecuador's commercial and legal culture is undergoing a process of self-reflection, analysis, and evolution following the enactment of the Organic Law on Market Power Regulation and Control in October of 2011. The Law provides the first domestic framework on competition in Ecuador and was preceded by the application of Andean Community general norms on competition.[2] Pedro Paez's designation as first Superintendent for Market Power Control in September of 2012 signaled the beginning of the official practice. This paper seeks to provide an account of the exercise of powers granted to the Superintendency in the first year, as viewed from the standpoint of private legal practice, as well as to note some major areas of confusion that have been detected. The publication of this article comes shortly after the Authorities' first decision and completed investigation which resulted, on February 7, 2014, in a fine imposed on América Móvil's Ecuadorean subsidiary, telecoms operator Conecel/Claro, of $138M for abuse of dominance.

The author had the opportunity of participating in formulating observations regarding the Law and its regulations in sessions of the National Assembly—the Ecuadorian legislative branch—in panels and round table discussions organized by various business chambers and other public and private entities in Ecuador. A generalized concern was felt at that time with regard to certain recurrent issues, some of them modified in the final text approved by the Assembly, and others that remained after approval—although the fears have been unjustified in some cases.

By way of illustration, the Authority's explicit power to review personal agendas during inspections was deleted from the original text of the draft Law. The final text nevertheless allowed, with prior judicial order (to be dispatched within 24 hours), the power to review physical and virtual correspondence, including bank accounts and "other information of a confidential, privileged or secret character." This exception produced a debate regarding the Authority's power—with or without judicial authorization—to review these same types of personal agendas or documentation when prepared by the operators' internal or external lawyers, which might be subject to attorney-client privilege rules. Until resolved, this issue will give rise to discussions during inspections and, subsequently, further discussion about the evidentiary value

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[2] Decisions Nos. 608 and 616 of the Andean Community had been applied in Ecuador from 2009 to 2011 through the Office of the Under Secretary for Competition from the Ministry of Industry and Productivity.

of those documents—similar to those we have observed in European courts where the boundaries of such actions have been clarified and have evolved.[3]

To take a second example, Ecuadorian law implemented a number of prohibitions conditioned on a rule of reason analysis. In a culture where no competition regulation has previously existed, there is fear and confusion regarding the meaning and general applicability of these prohibitions, particularly those relating to vertical restraints such as exclusivity and non-compete provisions. In practice, applying a rule of reason has justified the implementation of vertical restraints in several cases, while restricting other practices. However, the private sector has sometimes generalized blanket approval from these conclusions, but then embraced certain restrictions as absolute prohibitions. This confusion has not been aided by analysis that has apparently justified the actions, but without a reasoned study of the merits.

In addition to these confusions, in the field of merger control there is an apparent discrepancy between the actual volume of transactions and stated statistics that may indicate a substantial number of cases might have not been notified to the Authority. This may be the result of (i) inadequate counseling, (ii) consent to a latent risk in favor of commercial expediency, or (iii) continued liberality from the time before concentration controls existed in Ecuador.

To take part in the beginning of a new era of law in Ecuador is a privilege and a responsibility. In the case of the public powers, this responsibility involves the Authority's fundamental task of educating business operators, general citizens, and other users regarding the new technical/economic complexities in order to enhance their own legal and commercial cultures compliance with the new regulations. From the private standpoint, the new law gives operators—large and small—the opportunity to improve their competitiveness by abiding by the rules; and gives practicing lawyers the responsibility of enhancing their knowledge to responsibly deliver their advice in such a sensitive area of law. All of the parties involved must recognize that all policies, decisions, and determinations issued by a country's competition authority can modify market structures—potentially generating greater efficiency or, if wrongly decided, distorting the market.

## II. GENERAL EVALUATION OF THE FIRST YEAR

It has been a busy year for Superintendent Pedro Paez, as he needed to both set his agenda and structure his agency. Having been designated eleven months after the Law was enacted, he began his operations (i) without a budget, (ii) with no infrastructure, (iii) with deadlines and terms expiring, (iii) in improvised premises, and (iv) with the immense task of implementing an Authority of the size and importance of the Superintendency of Market Power Control. This has been no easy task. Yet, one year later, we are looking at an Authority installed in premises more in keeping with its requirements. Plus there is in place an organic structure divided into four deputy superintendencies in the first level that cover the various competitions set forth in the law, a committee for resolutions in the first instance, a general deputy department, and four general coordination offices.

[3] Joint Cases T-125/03R and T-253/03R *Akzo Nobel Chemicals and Akcros Chemicals v Commission* [2010] Joint Cases T-289/11; T-521/11, *Deutsche Bank v Commission* [2013].

Mr. Paez and his agency employees have hosted more than twenty international seminars, built a webpage and a twitter account, and issued numerous technical rules and recommendations. Rules that regulate the labeling of transgenic food, promotional practices of the airlines, and invoicing specifications for mobile telephone services should be highlighted. The web portal has summaries of 77 cases and sectors investigated by the four deputy superintendencies, 51 of which are being processed and 26 which have been completed.

As noted above, the first decision to impose a fine just occurred. The Authority fined Conecel/Claro for abuse of market power relating to its exclusivity arrangements with landowners where telecoms masts are situated. The authority found that this agreement was an abuse of the company's market power and effectively excluded other operators from the market. The authority's fining guidelines allow it to fix fines based on total annual revenues from the year preceding the imposition of the fine, which in this case amounted to 10 percent of Conecel/Claro's total annual revenues. This is an exorbitant amount considering the reality of the local market, and will have to be paid in full even if the operator seeks administrative appeal. An appeal, according to Ecuadorean competition law, does not suspend the effects of the original decision, including payment of the fine.

In the merger control area, the website has published seven informative filings and two mandatory notices. Of particular note, in a "Concentrations Monitoring" section there is an illustrative exercise covering an analysis of a joint operation between Petroamazonas and Petroecuador, the Ecuadorean state oil companies.[4] Although not considered a concentration since there was no change of control but, rather, an intra-group restructuring, this market analysis could still be useful for people analyzing future hydrocarbon exploitation operations, particularly those deriving from changes of actual control over existing reservoirs.

Similarly, and of like importance, are the *Technical Guidelines for Analysis of Economic Concentration Operations* issued by the Deputy Superintendency of Merger control which presents important guidelines to be taken into account in concentrations control practice.

We are especially pleased to observe the joint cooperation between the Ecuadorian Intellectual Property Institute ("IEPI") and the Superintendency for Market Power Control in intellectual property and competition fora. Certainly, these are two areas with overlapping boundaries, especially regarding the development of new knowledge. Cooperation between both authorities will be particularly important during investigations involving unlawful competition and unfair practices—a power previously undertaken by IEPI, now entrusted to the Superintendency—where important intellectual property portfolios are involved.

It is also worth noting that we have observed the employment of new Superintendency employees during this time. It appears that the Authority has attracted skilled personnel with appealing remunerations, yet training and retaining those officers will be fundamental for the continuity, coherency, and congruency of ideas in the Authority's decisions.

[4] *Available at* http://www.scpm.gob.ec/wp-content/upload/2013/08/INFORME-FINAL-9-de-agosto-de-2013-PARA-WEB.pdf Access on line 16/10/2013. Emphasis added.

## III. MISTAKEN CONCEPTIONS: EXCLUSIVITY

To demonstrate the need for careful training and consistency, it may be worthwhile to look indepth at one example. Exclusivity is the example into which we will delve deeper due to its importance in the Ecuadorian market.

The European Commission's guidelines relating to vertical restrictions, and particularly the introductory section, state: "The Commission aims to help companies conduct their own assessment of vertical agreements under EU competition rules. However, the **standards set forth in these Guidelines cannot be applied mechanically**, but must be applied with **due consideration for the specific circumstances of each case**. Each case must be evaluated in the light of its own facts.[5]"

This statement provides a clear conclusion, essential for everyone involved in this practice—both in the public and the private sector—to understand: There is a limit regarding general guidelines that can apply to analysis, and it is essential for operators to assess each conduct separately in order to determine if it is compatible with the legislation.

Exclusivity, perhaps, may have been the most critical issue during the first year of the new law's implementation in Ecuador. In Ecuador, historically, exclusivities have been established as common practice for provision, supply, and distribution of commodities and services. Hence, in view of the new legislation, it has become necessary to evaluate their compatibility with the new law or their possible justification.

However, although we do not know of any current investigation based on claims involving contract clauses on exclusivity, we have seen that exclusivity has been demonized as a prohibited practice *per se,* and we have even observed criteria ranking exclusivity clauses into a rigid category with dangerous general conclusions. These conclusions make no analysis of the specifics of each case—including possible efficiencies as well as specific justifications with respect to different markets.

Understanding these exclusivity agreements requires a technical analysis to balance the contractual barriers to entry that exclusivity may create vis-à-vis the benefits and efficiencies that it could bring about. In more competitive and less concentrated markets—such as the European and North American markets—there are guidelines and policies providing clear rules and exceptions on prohibitions regarding vertical restrictions when the operator's market quotas do not exceed certain specific thresholds.

In the Law, the exclusivity prohibition is discussed in articles dealing with market power abuse (Article 9(11), (19)) as well as in an article describing prohibited agreements and practices (Article 11(19)). These articles state that dominant operators, as well as other operators, might be prohibited from applying exclusivity clauses or conditions. In both cases, however, it is provided that prohibition can be voiced if the practice is justified. This means that it is not possible to automatically conclude that an operator is banned from establishing exclusivity, for instance, on sales or distributions, but only if the applicable conditions do not justify that measure. Such

[5] Communication of the Commission regarding guidelines relating to vertical restrictions. European Commission (2010C 130/01),¶3 (2010).

justification does not depend upon a subjective assessment of the operator but, rather, it requires an objective, technical, and economic study to determine that implementing the exclusivity would result in market distortion or would restrict the access of other competitors into the market or, even if that were the case, the anticompetitive effect would not be reduced by pro-competitive effects and/or other efficiencies.

It is true that competition among several operators creates advantages for the market, resulting in better prices and added value for consumers. In some sectors and conditions, nonetheless, exclusivity may be more efficient or may not affect competition. We can highlight some of the benefits granted by exclusivity:

1. Although it reduces "intra-brand" competition (between identical goods), it may encourage greater "inter-brand" competition (between competitor goods), which in the long run is more advantageous for the final consumer;
2. It can prevent free rides for "intra-brand" competitors;
3. It can create an incentive to compete in added-value services such as post-sale services; and
4. It can allow the manufacturer to maintain quality uniformity, creating a more attractive product for the final consumer.

All of the foregoing elements may justify greater efficiency if their effects are examined. Hypothetical cases make this quite clear: For example, if exclusivity is not permitted the distributor could forfeit the incentive of investing in more attractive premises, hiring more skilled personnel, or granting post-sale services because the consumer might utilize those investments in order to subsequently purchase the same product from a competitor who did not incur such costs.

A recent European case, however, highlights how these benefits must be analyzed carefully to avoid damaging the market. This case concerned a manufacturer leasing or delivering facilities free of charge in order to display and sell its products. Specifically, the European Commission studied the case of vertical restraint imposed on supermarket owners in Ireland where a dominant operator provided refrigerators for ice cream marketing. This case is noteworthy in that the Commission's analysis and conclusions made it quite clear that several elements can lead them to consider exclusivity as an exclusionary practice.

The purpose or intention of the exclusion was studied at length. In this case, exclusivity began being implemented in contracts with the entry of a new competitor into ice cream market sales where the dominant operator held more than 70 percent of that market. A study was conducted which determined that it was not practical or realistic for the owners of the stores selling the ice cream to obtain additional refrigerators for the goods of other competitors that were unable to deliver refrigerators free of charge to those stores. This study led the EC to determine that the practical effect of the exclusivity measure was to restrict access into the market to the new competitor and other competitors. The Commission's decision in year 1998 was

confirmed by the General Court and the Court of Justice of the European Community in 2006.[6] This decision provides an example of the various elements that, altogether, can create a scenario of restrictions to competition due to the implementation of exclusivity.

The foregoing example is a valuable illustration given common marketing practices, in Ecuador, for consumer goods, medicines, accessories, among others. As already mentioned, exclusivity can be an extremely useful tool in commercial practices due to a number of factors that can enhance market efficiency. Further, certain beneficial effects might exceed the anticompetitive effects created by this conduct. However, operators must evaluate these effects carefully in order to prevent adversely affecting the market, and eventually being subject to *ex officio* investigation by the Authority or to an accusation from the competitors.

## IV. NON-COMPETE AGREEMENTS: A NECESSARY EVIL

Non-compete provisions are included in the same prohibition as exclusivity. It is restricted upon dominant operators and also depicted as a prohibited agreement and practice. There are, however, cases when these types of clauses are clearly justified. As with exclusivity, non-compete provisions have also been a source of debate and errors because non-compete provisions have been held as absolute prohibitions while, in some cases, they may be essential, and because certain transactions or relations beneficial for the market might provide economic justification.

As an example, in certain agency, distribution, and franchise agreements and transactions involving the transfer of knowledge or technology, non-compete agreements may be justified for a period during and even after the contract has terminated or the transaction has been performed. Without non-compete agreements, incentives to make acquisitions could disappear or be significantly deterred by the risk that, upon completion, the seller could immediately begin a competitive business, thereby reducing the value of the company sold to only its material assets.

### *A. Non-Compete Agreements Within the Context of Franchises and Distribution*

The extent of this paper does not allow delving deeply into the special features that justify non-compete clauses in franchises and distribution contracts, but it is important to consider that such justification depends on a reasonable balance between the assets protected by the restriction and the time provided for such protection.

In the case of franchises and distribution contracts, knowledge, know-how, and/or technologies are transferred during the contractual relationship. If these are not protected, it would dissuade operators from entering into such contracts fearing that, once the technique or the technology has been learned or the information has been acquired, the franchisees or distributors might commence a competitive business taking advantage of the know-how or technology developed by the grantor.

[6] Information about the First Decision: http://europa.eu/rapid/press-release_IP-98-242_en.htm. Ruling from the Court of Justice of the European Community: http://curia.europa.eu/juris/showPdf.jsf:sessionid=9ea7d0f130d582f434ed24e5aaf786b8ab67ff261.e34KaxiLe3eQ40LaxqMbN4Oahy/Te0?text=&docid=65800&pageIndex=0&doclang=ES&mode=lst&dir=&occ=first&part=1&cid=291255.

Terms regarding restrictions can vary substantially. To a great extent, the lawfulness of restrictions both during the contract term and after contract termination will depend on the type of franchise and of the goods or services involved. In Ecuador, these types of contracts are atypical or unnamed, and no specific regulation regarding them exists. Thus, it is common to find mere distributor relationships designated as franchises, in which case a justification of a non-compete type of restriction might be even more limited.

Legislation from other countries provides guidelines regarding the length of periods that may be considered justified when implementing non-competing clauses, depending on the value of the assets being transferred. Such rules should be implemented—without them, the impossibility of protecting the goodwill and the know-how transferred during this type of contractual relations discourages the use of those contracts.

### *B. Non-compete Within the Context of Concentrations*

Doctrine and international case law have developed clear guidelines in the area of non-compete clauses within concentrations. It is useful to refer to the communication issued by the European Commission in July of 2001[7] establishing restrictions directly relating to concentration operations that are deemed to be necessary. This document provides lessons from the experience acquired by the European Commission after several decades of analyzing hundreds of thousands of concentrations for which they found permissible restrictions and issued guidelines for operators to create further legal security regarding their operations.

In essence, the document seeks to protect the transferred value with reasonable measures that do not have less harmful or restrictive alternatives on competition. If such intangible elements cannot be protected, the value of the transaction would not exceed the value of the material assets. In other words: To be justified, restrictions ought to have direct, necessary, and objectives relative to the operation.

Further, when a transfer deriving from the transaction includes know-how or technologies that subsequently may be reproduced, a two-year restriction or even greater periods are justified depending on the type of know-how and/or the value of the commercial secrets transferred. Restrictions are allowed regarding the seller opening a competitor company and restrictions are even allowed on buying shares in competitor companies if such shares grant managerial functions or a material influence on the competitor company.

The technical guidelines issued by the Deputy Superintendency for Concentration Control from the Superintendency for Market Power Control make no reference to this issue, and the majority of authorized transactions have not resulted in developing guidelines. Therefore, regarding this issue, it will be necessary to follow up with new decisions, regulations, or directions to be issued by the Authority.

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[7] Communication from the Commission on directly related and necessary restrictions for concentration operations (2001/C188/03): *Available at* http://eur-lex .europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2001:188:0005:0011:EN:PDF.

## V. NOTIFIED CONCENTRATIONS VERSUS PERFORMED CONCENTRATIONS

As a curious piece of information, the first transitory provision of the Regulations to the Law ordered mandatory notice of all concentration operations carried out for the period from October 11, 2011 until the Superintendent took office on September 6, 2012, with no exception, including those that did not require notice on the basis of the thresholds of the Law. This provision sought to overcome the practical impossibility of filing transactions during that period, despite there being a legal obligation to do so. Aimed at covering all concentrations, the provision even included those that did not require notice because they did not surpass the thresholds established in the Law. In a strictly legal sense, in practice this would have led to the obligation of giving notice of all kinds of concentrations, including a purchase of a convenience store by a tiny operator, or the common administration of companies with no substantial turnover from the standpoint of the concentration thresholds.

However, we noticed that the volume of concentration notices published by the Authority in its web portal or in its report of first-year activities seemed not to be in keeping with the actual concentrations subject to mandatory notice that must have truly taken place since the Law came into effect, especially taking into consideration another transitory provision of the Law that obligated financial sector entities to alienate their non-financial assets by July 13, 2012 and the evident change of control that should have existed and made filing and approval mandatory.

## VI. CONCLUSIONS AND REFLECTIONS

Competition law is not an absolute science. Business practices deserve responsible and careful in-depth study by the operators from both a legal and economic standpoint to evaluate their legality. Serious economic liability may arise from the substantial fines imposed if a conduct is mistakenly considered to be permissible, or from opportunity costs that could result from a conduct mistakenly considered to be prohibited when it may have been justified by providing a competitive solution for the operator and that, if correctly evaluated, would have permitted the operator to compete with greater efficiency in the market.

Ecuador's first year of practice reflects precisely these issues, confusion and mistakes, and this reflective analysis determines the need to further promote and study the field in our culture.