

ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE

RESOLUTION No. 20, OF JUNE 9, 1999

(Published in the Official Gazette of the Federal Executive, Section I, on June 30, 1999)

Provides, on a supplementary basis, for administrative proceedings pursuant to Article 51 of Law 8884/94.

THE BOARD OF THE ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE - CADE, in the use of the powers bestowed thereon by law, and in view of the provisions of Articles 7, XIX and 51 of Law 8884/94 and Article 26, III of the Internal Regulations, approved by CADE Resolution No. 12 of March 31, 1998,

R E S O L V E S:

Article 1. - The Reporting Commissioner must verify whether the proceeding was duly supported with the elements necessary to form his opinion in view of Attachments I and II to this Resolution, which are mere guidelines.

Article 2. - Within sixty (60) days from the distribution date, the Reporting Commissioner, by means of an order, shall inform the Board whether supplementary supporting documents are required.

Sole Paragraph - Request for additional information shall be made by registered mail, return receipt requested, facsimile or electronic mail, the two latter subject to confirmation.

Article 3. - After the evidentiary phase of the proceeding is completed, the Reporting Commissioner shall include it in the trial docket to be judged as soon as possible.

Paragraph 1. - After the judgment phase is initiated, requests for supplementary procedures by the Board shall imply withdrawal of the proceeding from the trial docket by the Reporting Commissioner.

Paragraph 2. - After the supplementary procedure is carried out, the proceeding shall be included again in the trial docket by the Reporting Commissioner, and a new judgment will be initiated.

Article 4. - This resolution shall take effect on the date of its publication in the Official Gazette of the Federal Executive.

GESNER OLIVEIRA
CADE President

ATTACHMENTS

Examination of anticompetitive practices requires a careful scrutiny of the effects of the different practices on the markets in light of Articles 20 and 21 of Law 8884/94. Domestic and international experience has shown that it is necessary to take into consideration the specific context in which each practice occurs and its economic reasonableness. Therefore, not only the costs resulting from the impact of such procedure should be considered, but also the set of possible benefits resulting from such impact in order to verify its net effects on the market and on consumers.

The definitions and classification included in Attachment I do not cover entirely the universe of practices that under certain circumstances may be considered anticompetitive. Likewise, the basic steps to examine the restrictive trade practices listed in Attachment II merely provide the guidelines for routine examination by the authorities, ensuring transparency of the procedures and criteria adopted by CADE.

Therefore, both Attachments contribute to inform the public as to anticompetitive practices pursuant to Article 7, XVIII of Law 8884/94.

ATTACHMENT I

RESTRICTIVE TRADE PRACTICES: DEFINITIONS AND CLASSIFICATION

A. - HORIZONTAL RESTRICTIVE TRADE PRACTICES

Horizontal restrictive trade practices are defined as an attempt to reduce or eliminate market competition, whether by establishing agreements between competitors in the same relevant market with regard to prices or other conditions or by adopting predatory pricing. In both cases these practices seek, immediately or in the future, jointly or separately, to increase the company's market power or create the conditions required to more easily exercise such power.

In general, these practices presume the existence of or the search for market power in the relevant market. In different levels, some of these practices may also generate benefits in terms of market welfare (economic efficiencies); in this case, application of the rule of reason is recommended. It is therefore necessary to consider these effects in light of the practice's potential antitrust impacts. A restrictive practice will only generate net efficiencies if the economic efficiencies resulting from it outweigh its anticompetitive effects.

Although other situations are possible, the most common situations are:

1. - Cartels: express or implied agreements between competitors in the same market, involving a substantial part of the relevant market, regarding prices, production and distribution quotas and territorial division, in an attempt to increase prices and profits jointly to levels that are closer to monopolistic levels.

Some structural factors may favor cartelization: high level of market concentration, existence of barriers to the entry of new competitors, homogeneous products and costs, and stable cost and demand conditions.

2. - Other agreements between companies: horizontal restrictions involving only part of the relevant market and/or temporary joint efforts aimed at achieving a higher level of efficiency, especially productive and technological efficiencies.

These agreements need a thorough scrutiny, not only because their anticompetitive effects are possibly lower than those of the cartels, but also because any possible economic efficiencies must be evaluated, which demands a more judicious application of the rule of reason.

3. - Illicit practice of professional associations: any practice that unreasonably limits competition between professionals, mainly price-fixing practices.

4. - Predatory pricing: deliberate practice of prices below the average variable cost, seeking to eliminate competitors and then charge prices and yield profits that are closer to monopolistic levels.

When scrutinizing this practice, the actual cost and price oscillation conditions throughout a period of time must be thoroughly examined, to exclude normal seasonal practices or other marketing policies of the company. The strategic behavior must also be examined to assess the objective conditions of subsequent potentially extraordinary gains that are sufficiently high and capable of offsetting the losses resulting from selling below cost.

B. - VERTICAL RESTRICTIVE TRADE PRACTICES

Vertical restrictive trade practices are restrictions imposed by manufacturers/providers of products and services in a certain market (“market of origin”) on vertically related markets, downstream or upstream along the production chain (the “target market”).

Vertical restrictions raise antitrust issues when they imply the creation of mechanisms that exclude rivals, whether by increasing the barriers to the entry of potential competitors or by increasing the costs for actual competitors, or furthermore when they increase the probability of concerted exercise of market power by manufacturers/providers, suppliers or distributors, through mechanisms that enable them to overcome obstacles to the coordination that would otherwise exist.

Therefore, in the case of vertical restrictions, examination of the interaction between different relevant markets becomes particularly important. This is so because the major effect on competition of a certain practice in the target market may be not only its impact on the target market in point, but on the market of origin, where the dominant position may have become stronger as a result of such vertical practice. Resale price maintenance, which is discussed below, may for example increase the probability of success of a cartel because of the reduction in the cost of monitoring the participating companies with a view to avoiding noncompliance with the illicit agreement.

As in the case of horizontal restrictions, vertical restrictive practices presume, in general, the existence of market power in the relevant market of origin, as well as an effect on a substantial share of the market that is the target of such practices, typifying a risk of harming the competition.

Although these restrictions are, in principle, limitations to free competition, they may also bring benefits (“economic efficiencies”), which must be weighed against the potential anticompetitive consequences, in accordance with the rule of reason. These benefits are frequently related to transactional cost savings for manufacturers/providers, either by avoiding that an increase in intrabrand competition lead to proliferation of opportunistic practices by dealers, suppliers and/or competitors to the detriment of service quality and its reputation, or by ensuring the dealer/supplier an appropriate compensation, which will motivate it to allocate funds for the supply of products and services.

Although other practices are possible, the most common practices are the following:

1. - Resale price maintenance (RPM): the manufacturer establishes in an agreement the price (minimum, maximum or fixed) to be adopted by distributors/dealers.

This practice gives rise to sanctions for failure to comply with price regulation. In most cases, it is the fixing of minimum prices (or fixed prices adopted as minimum prices) that presents actual anticompetitive effects, usually related to:

- (i) easier coordination of actions that seek to form cartels or other collusive price practices between manufacturers (the market of origin), when it makes it easier to police consumer sales prices or protects tacit agreements between manufacturers by blocking the entry of new distributors that are more innovative and/or aggressive, hindering the development of new and more effective distribution systems; and
- (ii) unilateral increase in the manufacturer’s market power, insofar as it permits the same effect described above of deterring the entry of new and more competitive distributors. In the specific case of after-sales services, this type of restriction also permits, in principle, monopolistic exploitation of users after purchase of the products when the alternatives offered them are drastically reduced.

As in other vertical restrictions, the possibility of benefits resulting from transactional cost savings must be considered and taken into account when assessing the net effects on the market. Fixing of maximum resale prices may pose anticompetitive risks in conditions in which distributors/dealers of the “target” market have market power and aggregate substantial value to the product/service, and in conditions in which there is an intent and the possibility of the manufacturer eliminating them from the market.

2. - Restrictions on territory and customer base: the manufacturer establishes limits as to the area of operation of the distributors/dealers, restricting competition and the entry in several regions.

This practice facilitates: (i) collusive practices that lead to cartelization by manufacturers/distributors to the extent that they are used as an instrument for monopolization of local markets by distributors or increase costs of rivals, stimulating them to reduce quantities and increase prices, and therefore, to participate in the collusion; and (ii) unilateral increase in market power of a manufacturer.

These restrictions raise the costs of entry into geographical markets limited by agreements insofar as the extension of the market not covered by the agreement is not economically attractive to new distributors/dealers; or furthermore, restrict the access of actual competitors to prospective consumers, insofar as they create obstacles to the sale by competing distributors or dealers to consumers located within the exclusivity area. Monopolistic exploitation of the users of after-sales services may also occur if such services involve high costs relating to changes and lock-in situations, in which consumers have no feasible alternatives for consumption of these services. Similarly, possible benefits in terms of transactional cost savings should be taken into consideration when reviewing these cases.

3. - Exclusive dealing arrangements: customers who buy a certain product or service undertake to buy it exclusively from a certain seller (or vice versa), and are consequently prohibited from marketing products of rivals.

The potential anticompetitive effects are related to: (i) the implementation of collusive practices, which usually tend to cartelization, in the market of origin, when used as an instrument for market division among substitute products; or (ii) the unilateral increase of market power of the company imposing the exclusivity by blocking and/or increasing barriers to the entry into the distribution segment (or input supply), which may result directly from contractual clauses or indirectly by raising rivals' costs.

Possible benefits of this practice involve again transactional cost savings by curbing opportunistic practices to protect unrecoverable investments, as in trademarks and technology, and to protect specific assets. These benefits must be carefully considered, as always, when conducting a final review.

4. - Refusal to deal: the supplier or purchaser, or a group of suppliers or purchasers, of a certain product or service, unilaterally establishes the conditions in which it is willing to market such product or service, usually to a distributor/dealer or supplier, possibly forming its own network for distribution/resale or supply.

The potential anticompetitive effects are mainly related to blockage to and/or increase in barriers to entry into the distribution or supply channels, as in the preceding item, (including possible cost increase for rivals), as well as to the after-sales services indicated in item 2 above. The possible economic efficiencies are essentially the same as those mentioned in the preceding item. This practice is generally used together with other anticompetitive vertical practices such as exclusive dealing arrangements or resale price maintenance as a form of retaliation against distributors/suppliers which are reluctant to adhere to the anticompetitive practice.

When the anticompetitive practice is carried out by a party that controls essential infrastructure, a more specific analysis of its effects on competition will be required.

5. - Tie-in sales: the party supplying a given product or service imposes a condition for its sale that the buyer also acquire another product or service.

The main anticompetitive effects refer to the leverage of market power involving different products, abusively increasing profits to the detriment of buyers, and at the last instance, of the consumers, while “blocking” the downstream segment (generally, of distribution) for actual and potential competitors (increase in barriers to entry).

Tying arrangements may also be used to circumvent the return rate and price limits in regulated industries to the extent that the company is able to increase the total price by forcing a tied product or service into the package. Anticompetitive effects on after-sales services may also occur. Possible economic efficiencies similar to those verified in the preceding cases should be evaluated, placing emphasis on the possibility of the products in question being complementary products of the system type and/or presenting economies of scope (note 1).

6. - Price discrimination: the manufacturer uses its market power to establish different prices for the same product/service, discriminating between buyers, whether individually or in groups, so as to appropriate the excess portion from the buyer and thus earn higher profits.

This practice, which is widespread in modern economies, is not anticompetitive *per se* because although it increases the manufacturer’s profits it may not affect consumers’ welfare, since it may not restrict, or may even increase, the volume of market transactions. Specific analysis becomes particularly important in this case, especially because of the variety of manners in which price discrimination may occur.

In public utility services, price discrimination frequently reflects the presence of consumer categories with very different consumption levels; because of high economy of scale, it is usually efficient to charge less from large-volume buyers. In the same sense, when the marginal supply cost of a service substantially increases during certain periods of time—normally designated “peak periods” - the fixing of differentiated prices consists of an efficient procedure.

When a company discriminates between two or more consumer groups with different elasticity demand curves, a careful analysis must be carried out because the impact of such practice on the consumer welfare depends on several factors regarding which the authorities not always have sound information.

In certain cases, the price discrimination may be indicating a variant of refusal of sales or tie-in sales; this practice is relatively frequent, under such indirect manners, in regulated sectors open to competition.

When a company has partial or total control over an essential network or infrastructure, the price discrimination can be used to raise rivals’ cost, and consequently harm free competition.

ATTACHMENT II

BASIC CRITERIA FOR THE ANALYSIS OF RESTRICTIVE TRADE PRACTICES

A. - SUBMISSION

The main assumption-which is to be investigated first when examining a restrictive practice--is that practices that injure competition and not only competitor(s) usually require prior existence, the use of leverage in one market to attempt to gain market share in another or the search for a dominant position in the relevant market by the party adopting such practice.

Under the rule of reason, these requirements are conditions that are necessary but not sufficient to typify a practice that injures competition. To this effect, it is necessary to assess its anticompetitive effects and weigh them against its possible compensatory benefits (efficiencies).

The basic steps of this analysis are:

1. - Characterization of the practice.

- 1.1. - Identification of the nature of the practice and definition of its legal classification.
- 1.2. - Verification of whether there is sufficient evidence of the practice in the case records.

2. - Analysis of the Dominant Position.

- 2.1. - Definition of the relevant market(s).
- 2.2. - Estimate of the total market share of the companies in the relevant market(s).
- 2.3. - Analysis of the actual and potential competitive conditions (barriers to entry) on the relevant market(s) (including institutional conditions).

3. - Analysis of the specific practice.

- 3.1. - Assessment of the anticompetitive damage caused by the practice on this (these) (or other) market(s).
- 3.2. - Examination of possible economic efficiency gains and other benefits generated by the practice.
- 3.3. - Final assessment (balance) of the anticompetitive effects and the economic efficiencies of the practice.

According to the rule of reason, practices whose anticompetitive effects cannot be sufficiently offset by possible compensatory benefits/efficiencies should be condemned.

B. - DETAILED DESCRIPTION

1. - Characterization of the practice.

- 1.1. - Identification of the nature of the practice and definition of its legal classification.

The first step in the analysis of a market practice is the characterization of its anticompetitive nature, clearly identifying the author of the practice, the products and markets involved (for example, whether horizontal or vertical, and type), its rationale from the viewpoint of the party

adopting such practice, and a preliminary analysis of its probable effects on the market(s), followed by a first proposal of legal classification.

1.2. - Verification of whether there is sufficient evidence of the practice in the case records.

The proceedings are properly documented, when the case records contain sufficient evidence of the practice in question, which need not be restricted to documentary evidence, but may include circumstantial evidence such as the absence of economic rationale for adoption of a practice that is not necessarily illegal.

2. - Analysis of the structural and/or institutional conditions.

2.1. - Definition of the relevant market(s).

The relevant market is the space--in terms of product or geographic area--in which it is reasonable to think of the possibility of abuse of dominant position.

By adopting the hypothetical monopolist test, the relevant market is defined as the smallest group of products (or the smallest geographic area) in which a supposed monopolist can maintain its price above competition levels for a significant period of time.

The possibility of substitution is the key variable in identifying the relevant market, since free competition depends on the possibility of the exercise of choice by buyers. Therefore, a relevant product market includes all products or services considered interchangeable by buyers because of their characteristics, prices and use.

On the other hand, a relevant geographic market includes the area in which companies supply and demand products/services on sufficiently homogeneous competitive conditions in terms of prices, consumer preferences and characteristics of products and services.

In the event of abuse of dominant position, the definition of relevant market demands additional care. In fact, since this is a situation in which the investigated agent has already possibly raised its price above competition levels, the methodology implicit in the hypothetical monopolist test mentioned above will give rise to distortions.

Actually, since the starting point of the exercise represents a minimum monopoly price level, the supposed final price increase could lead to an overestimate of the possibilities of substitution. This would make the relevant market artificially broad, underestimating the share of the investigated company. The source of this distortion would therefore lie in the acceptance of the initial price basis as a competitive price reference, in contradiction with the very nature of the subject matter under investigation, which involves the unit that holds a dominant position (note 2).

2.1.1. - Determination of sufficiently good substitute products from a demand viewpoint to make up the relevant product market(s).

2.1.2. - Determination of the relevant geographic market(s) already defined in terms of products.

To define each of the relevant product market and relevant geographic market, the following information must be taken into consideration:

- the relative efficiency, quality and convenience of the substitute products;
- the evolution of relative prices and quantities sold;
- the costs of consuming substitute products from the same or other areas;
- the time required to carry out any substitution; and

- evidence that consumers would change their demand trends or take into consideration the possibility of changing such trends as a result of changes in relative prices or in other competitive variables.

2.2. - Estimate of relevant market(s) shares.

2.2.1. - Determination of the companies that hold relevant market(s) shares, including uncommitted entrants (i.e., those that do not have significant entry and exit costs), taking into consideration the elasticity of supply.

2.2.2. - Calculation of the market shares of the relevant market(s) participants, particularly the companies accused of restrictive practice.

The market share of each agent will be defined based on the relevant market as described in 2.1, and will serve as a useful indicator for a preliminary assessment of potential abuse of dominant position. Any market share calculated outside a relevant market is of no interest at all from the point of view of competition protection. For example, market shares in the buccal hygiene segment, which comprises toothpaste, toothbrush, dental floss and mouthwash are irrelevant from a competition protection standpoint because these products are not substitutes from a supply or demand point of view. Therefore, they form four different relevant markets. As a result, the market share variable is only important from CADE's standpoint for each of these specific products separately.

There are several forms of measuring the share held by each agent in the relevant market:

- sales of each agent in relation to the total sales of the relevant market;
- total quantity sold by each agent in relation to the total quantity sold in the relevant market;
- production capacity of each agent of the relevant product in relation to the total existing production capacity of the relevant market.

Sales variable is frequently used, although the level of adequacy of the variable chosen depends on different factors such as information availability, the role of the production capacity as a factor that defines market power, the price differentiation between products of the same relevant product market (which renders measurement by sales more conditioned to price than to quantity), among others.

For example, in the case of drugs, production capacity may be an irrelevant restriction if compared to trademarks and patents. On the other hand, the use of total quantity share in physical terms depends on the degree of homogeneity of the product. Likewise, other variables may be considered for certain sectors, such as the total deposit share in the bank system, when the practice verified falls under the bank segment, or total exports, when production is exclusively targeted at the foreign market and access to the infrastructure for outflow of production to the rest of the world is a decisive factor in competition relations.

2.3. - Analysis of effective or potential competitive conditions (barriers to entry) in the relevant market(s) (including institutional conditions).

2.3.1. - Measurement of the level of concentration of relevant market(s) according to the HHI (Herfindahl Hirschman Index) or similar method.

The concentration indexes adopted may also vary, especially in light of the availability of data in each specific case. There are no better or worse indexes for one or another country. As with all statistic tools, the authority must use it carefully, seeking to understand its technical meaning and its inevitable limitations.

The two more commonly used indexes are the CRX and the Herfindahl Hirschman indexes, which are discussed below.

“THE CRX INDEXES”

The CRX indexes measure the percentage share of the “X” largest firms in the relevant market. Thus, one may use the CR2 index, which is the percentage market share of the two largest companies in the market, the CR3, which includes the three largest companies, and so on.

Chart 1 shows hypothetical data on the market shares of the companies that hold shares in both markets, A and B.

Chart 1

Market share of companies in relevant markets A and B

(in sales percentage)

Companies	Market A	Market B
Company 1	50%	20%
Company 2	15%	20%
Company 3	10%	20%
Company 4	5%	20%
Company 5	5%	20%
Company 6	5%	-
Company 7	5%	-
Company 8	5%	-

The CR2 for Market A is 65% (50% share of Company 1 plus the 15% share of Company 2), the CR3 is 75% and the CR4, 80%. Naturally, CR8 is 100% because it covers all Market A, in which eight companies participate.

Note that CR2 for Market A (65%) is greater than CR2 for Market B, which is 40% (the sum of the 20% shares of companies 1 and 2). However, the CR4 for Market A is 80% (50 + 15 + 10 + 5), which is equal to the CR4 for Market B (20 + 20 + 20 + 20), although it would be reasonable to presume a more dominant position of Company 1 in Market A, since it controls half the market. It is clear that in certain cases this index does not provide sufficient information. The HHI, which is described below, is useful to overcome this obstacle.

The Herfindahl Hirschman Index (HHI)

The Herfindahl Hirschman Index (HHI) is the sum of the squares of each firm in the relevant market. In the example shown in the above chart, the HHI is calculated for Markets A and B as follows:

$$\begin{aligned} \text{HHI for Market A} &= 50^2 + 15^2 + 10^2 + 5^2 + 5^2 \\ &+ 5^2 + 5^2 + 5^2 = 2500 + 225 + 100 + 25 + 25 + 25 + 25 + 25 = \\ &2950 \end{aligned}$$

$$\text{HHI for Market B} = 20^2 + 20^2 + 20^2 + 20^2 + 20^2 = 2000$$

In this case, differently from the CR4, the HHI shows a greater concentration in Market A in relation to Market B (2950 against 2000).

HHI varies from 0 to 10000. In a market similar to a perfect competition model, with a very large number of units, the importance of individual market shares is insignificant and the HHI tends to zero. In the opposite direction, in a monopoly, in which there is only one firm, its share is 100% and the corresponding HHI is 10000 (100).

Chart 2 compares briefly these two types of indexes:

Chart 2
Brief Comparison between the CRX and HHI

Features/Indexes	CRX	HHI
Level of information provided by the index	Low. In the example shown in Chart 1 the CR4 for Markets A and B is the same, despite a clearly sharper concentration curve in Market A.	High. The HHI provides a greater volume of information on concentration.
Volume of information required to calculate the index	Small. Sales data of leading firms are usually available.	High. In markets with a significant fringe of small firms, the volume of information required may render calculation prohibitive. The larger the share of this fringe in the total relevant market, the greater the possibility of committing an error when estimating the shares in such fringe.
Relation with the market power index of a firm, such as the Lerner index = $L = P-MC/P$.	In a simple Cournot model of oligopoly (note 3) the CR1 is directly related to the Lerner index, i.e., to a market power measurement.	In a simple Cournot model of oligopoly (note 4) the HHI is directly related to the weighted average of the market power indexes of the oligopolistic firms, and the weighting factor is the market share of each unit.

2.3.2. - Analysis of the competition standards on the relevant market(s), to verify whether the practice being condemned is common to all its participants, and for which reason.

2.3.3. - Determination of the level of rivalry (competitive, strategic and technological) among the participants in the relevant market (s).

2.3.4. - Assessment of barriers to entry

According to Bain's historical definition, entry barriers deal with those conditions which would permit that firms established in a certain relevant market make extraordinary profits without

inducing potential entrants to enter the industry.

Some of the most common examples of barriers to entry are listed below:

- Economies of scale;
- Economies of scope;
- High minimum capital requirements for entry, both for production and distribution;
- Institutional factors, such as tariffs, quotas and sanitary regulations;
- Difficult access to technology, requiring patents;
- Apprenticeship cost;
- Difficult access to raw materials;
- Customer brand loyalty;
- High irreversible costs (“sunk costs”).

In view of the existing entry restrictions, an antitrust analyst must evaluate the probability of firms outside the relevant market entering such market quickly enough and with an output rate sufficiently high to compete with established firms.

Sometimes Stigler’s approach is useful, according to which barriers to entry would lie in asymmetries between established firms and potential entrants.

The entry barrier would be the costs which must be borne by the entrant, but not by the established firm, justifying, for example, the emphasis on the portion of sunk costs of entry into a certain relevant market.

Evaluation of the Barriers to Entry and Profitability Expectations in the Relevant Market in point

The size of the barriers to entry is related to the profitability expectations in a certain sector. Accordingly, if the profitability expectations in a certain segment is negligible, then small or even insignificant barriers in other segments may represent a deterrent to entry of competitors.

This type of analysis makes possible measurement of entry barriers. A project for entry into a certain market has a probability of success as well as a probability of failure. Thus, it is possible to estimate the probability of success related to an expected zero profit. If there is a relatively high probability of success, the barrier to entry must be deemed high.

2.3.5. - Examination of the level of exposure of relevant market(s) to competition by imports.

3. - Analysis of the specific practice.

3.1. - Evaluation of the anticompetitive injuries to such or other market(s) ensuing from the practice.

Injuries to competition resulting from restrictive practices, as mentioned in Attachment I, vary mainly in view of the fact that the practices in question are characterized as horizontal or vertical.

3.1.1. - The main anticompetitive effect of horizontal practices is lessening or elimination of competition in the relevant market either within a short term (cartels and other agreements between companies, price fixing by professional associations) or within medium or long terms (predatory pricing).

3.1.2. - The main anticompetitive consequences of vertical practices are: facilitation of concerted practices (formation of cartels, and so forth), or unilateral increase of market power of a dominant company in the relevant market “of origin” (common to all practices), blockade to entry into the target relevant market involved in the practice for actual or potential competitors (increase of barriers to entry), including by way of raising rivals’ costs; monopolistic exploitation of the users of after-sales services; and lessening of intrabrand or interbrand competition.

In investigating possible anticompetitive effects of vertical practices, the following basic information should be taken into consideration:

- the proportion of the target relevant market(s) affected by the vertical practices under examination;
- the duration of restrictive practices;
- the scope of the barriers to entry into the market(s) involved in the restrictive practice;
- the level of interbrand competition;
- the substitutability level of competing brands;
- price differentiation of equivalent products of different brands;
- prior practices of companies operating in the relevant market(s) in terms of coordinated behaviors; and
- consumption levels in effect prior to and after the vertical practice.

3.2. - Analysis of any economic efficiencies generated by the practice.

As indicated in **Attachment I**, application of the “rule of reason” to all anticompetitive practices requires the identification and evaluation of possible benefits or efficiency gains related to any such practice.

3.2.1. - In the case of horizontal practices, any benefits may be related only to the making of investments that achieve - or to the interaction of already existing complementary assets that provide – higher levels of productive or technological efficiency in certain agreements between companies; or enhancement of the quality of the services provided, in certain cases of prices fixed by professional associations.

3.2.2. - In the case of vertical practices, the main possible benefits/efficiencies consist of reduction in transaction costs, translated in the adoption of free rider behavior, so as to preserve/increase quality of services in the “target” markets (distribution, after-sales, and so forth) and protect the reputation and investments in specific assets of companies in the market of “origin”. In certain cases, such practices may also stimulate economies of scale and scope in the "target" market, or protect technological development in the market of “origin”. In the specific case of fixing of maximum resale prices, the possibility of elimination of market power exercised by distributors must be considered.

In evaluating possible economic benefits (efficiencies) arising from vertical restrictive practices, it is necessary to investigate whether the contractual relationship among the companies involved--if the practice being scrutinized had not been adopted--would be vulnerable to opportunistic acts of any of them, for which purpose the following basic information is required:

- characteristics of the product or service that is the subject matter of the transaction, in order to estimate the costs each party to a hypothetical and simple purchase and sale agreement would incur in monitoring compliance with the terms of the agreement by the other party;
- the costs involved in pursuing alternatives to purchase or sell the same product or service, in the event such hypothetical and simple purchase and sale agreement is terminated. Such costs depend on investments to be made in specific assets by one of the parties or by both parties, i.e. specialized assets which are depreciated when used in transaction with other agents. The asset specificity may result from: (i) geographic location; (ii) equipment physical characteristics; (iii) specialized technological expertise; (iv) production capacity to meet the demand of a large customer.

Where such practices involve relations between manufacturers and distributors/providers of after-sales services (maintenance, etc), possible efficiencies must be investigated on the basis of specific information, which includes:

- physical characteristics of the products traded, especially those characteristics that lead consumers to depend on a supplementary offer of services, whether for choice of the product or for correct use and/or maintenance thereof;
- characteristics of the consumers which cause them to depend on third parties in connection with the abovementioned services;
- characteristics of the channels of distribution for the products, identifying agents with effective powers to influence consumers on their decisions;
- identification and evaluation of the investments made by manufacturers in fixed assets used by the distributors/providers of after-sales services, considering the possibility of such distributors/providers using such assets to boost sales of products of competing manufacturers;
- identification and evaluation of the investments made by the manufacturers in the training of distributors/providers of after-sales services, estimating the complexity of the capacities involved and considering the possibility of such distributors/providers using any expertise obtained to boost sales of products of competing manufacturers;
- identification and evaluation of the investments made by the manufacturers in advertising and marketing, which lead consumers to choose the distributors of such manufacturers, but which also allow the distributors to lead consumers to acquire products from competing manufacturers, which offer a greater profit margin when sold;
- estimate of variables that may affect the costs incurred by the manufacturer in monitoring performance of distributors and providers of after-sales services, such as the number and geographic distribution of distributors, service providers and customers;
- verification and evaluation, if possible, of the possibility of the manufacturer rewarding each distributor for its sales effort.

3.3. - Final evaluation (balancing) of the anticompetitive effects and economic efficiencies ensuing from the practice.

As already mentioned, the last step of the analysis of the specific practice based on the rule of reason principle is concluded upon weighing the anticompetitive effects and possible benefits or efficiencies identified and evaluated above, in order to verify whether such benefits or efficiencies will suffice to outweigh the anticompetitive effects and, therefore, consider the practice in question licit. In view of the difficulty in quantifying such effects, whether because many of them are only potential or due to the intrinsic problems involving calculation of the transaction costs (present in the potential benefits ensuing from almost all vertical practices), inevitably such analysis will be mostly qualitative, but must be carried out accurately and carefully.

Note 1: Economies of scope occur when the joint production cost of more than one asset or service is cheaper than the production cost of each of them separately. An economy of scope indicator “Es” may be calculated as follows: $Es = (C(a) + C(b) - C(a,b))/C(a,b)$, where $C(a)$ and $C(b)$ represent the separate production cost of assets a and b, respectively, and $C(a,b)$ represents the production cost together of such assets.

Note 2: Although the problem is more evident in the cases of abuse of dominant position, the same care must be taken in reviewing concentration acts, especially in Brazilian jurisdictions, because Brazilian laws allow notices to be served at a later date, thus permitting that anticompetitive arrangements occur before the antitrust authority has issued its decision.

Note 3: See Tirole (1988, p. 218-219)

Note 4: See Viscusi et al. (1995, p. 150-151) and Tirole (1995, p. 222)

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