Organisation for Economic Co-operation and Development

DAF/COMP/LACF(2021)23

Unclassified

English - Or. English

10 September 2021

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session II: Efficiency Analysis in Vertical Restraints

-- Contribution from Brazil --

20-22 September 2021

The attached document from Brazil is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session II at its forthcoming meeting to be held on 20-22 September 2021 via a virtual Zoom meeting.

Ms. Lynn ROBERTSON, Competition Expert [Email: lynn.robertson@oecd.org].

JT03480708

Session II: Efficiency analysis in Vertical Restraints

Exclusivity clauses in CADE's case law

- Contribution from Brazil[1]*-*

1. The increasing relevance of digital platforms to the Brazilian economy brings about numerous challenges for competition analysis, especially involving abuse of dominance through vertical restraints, such as the adoption of exclusivity clauses by dominant firms.

2. Even though the list of antitrust violations provided in Article 36(3) of Law 12529/2011 (the Brazilian Competition Law) does not include exclusivity clauses, they are not allowed based on the effects they may produce, per the provisions of Article 36(3), Items 3 to 5.

3. Thus, despite the greater complexity of new business models used in digital platforms, the anticompetitive effects linked to exclusivity agreements were already widely discussed in CADE's former decision. Nonetheless, now the authority faces challenges concerning the need to standardize its decisions that involved these clauses and their possible anticompetitive effects in the market.

4. According to the *International Competition Network (ICN) Unilateral Conduct Workbook*[2], the analysis of exclusive dealings should consider the potential effects summarized in the following table:

Table 1. The effects of exclusive dealings

Negative effects	Positive effects
• Price increases caused by a diminished supply and the consequent decrease in production (deadweight loss); • An artificial increase in the market share of a dominant firm (unrelated to the quality or the natural supply-demand relationship); • Competitors could exit the market due to a discouragement caused by exclusivity clauses; • Potential competitors could be unable to enter the market.	• An encouragement for distributors to promote a manufacturer's products and for suppliers to assist distributors through information services; • The prevention of free-riding issues between suppliers; • The addressing of hold-up problems regarding specific consumer investments; • The quality control of the distribution carried out by suppliers is facilitated.

5. The report also demonstrates that there are different ways to create and enforce exclusivity obligations and that an exclusive-dealing arrangement may be *de jure* or *de facto*. In the case of contractual exclusivities (*de jure*), which are within the scope of this paper, there are variations as far as coverage, enforcement and duration of the agreement are concerned.

[1] Written by Ana Sofia Cardoso Monteiro, the Senior Advisor to the President of CADE.

[2] INTERNATIONAL COMPETITION NETWORK. **The ICN Unilateral Conduct Workbook.** Warsaw: ICN – International Competition Network. Available at <https://www.internationalcompetitionnetwork.org/wp-content/uploads/2018/07/UCWG_UCW_Ch5.pdf>. Accessed on 25 June 2021.

6. Exclusivity clauses can be partial or total, i.e., an arrangement may be seen as exclusive dealing even if it does not cover all of the purchases or sales of the business partner of a dominant firm. As the ICN report points out, partial exclusivity requirements may be enough to prevent competitors from reaching the necessary critical mass to compete with incumbents in that market.

7. Clauses that make provisions about the enforcement of exclusivity obligations may vary a lot. They may impose fines, suspend transfers, or even impose sanctions that would negatively impact the distributor's reputation as a means of retaliation.

8. Moreover, the duration of the exclusivity obligation is also a significant variable as short-term agreements are less likely to have market foreclosure effects since they allow other suppliers to present new proposals regularly[3]. On the other hand, long-term contracts can have more harmful effects, preventing regular disputes between competitors.

9. The format of exclusive dealings is essential to determine the degree of market foreclosure. Nonetheless, the market share size related to the obligation is much more relevant as an analysis criterion because it demonstrates what would be available for potential competitors to exploit. Therefore, the analysis must be carried out on a case-by-case basis to identify what a competitor would need in terms of critical mass to compete with the market's incumbents.

10. Then, after assessing the degree of market foreclosure, a second analysis begins, which seeks to ascertain the existence of potential compensatory efficiencies associated with the investigated practice. Thus, before denouncing or exonerating a particular practice, it is necessary to apply an effects-based approach and look into effective vertical restraints generated by an exclusivity clause. It involves using the rule of reason, which requires the authority to estimate the net effects from including these exclusivity clauses on the overall level of consumer welfare[4].

11. Regarding compensatory effects in cases involving abuse of dominance through vertical restraints caused by exclusive dealings, considering the 19 cases reviewed by CADE so far[5], the agency has identified several efficiencies.

12. Case reviews use the following criteria: (i) the degree of contractual exclusivity and the way it was adopted; (ii) the conclusion about whether the Respondent(s) has a dominant position in the market; (iii) considerations related to specific characteristics of the market that could influence the degree of foreclosure caused by the adoption of exclusivity clauses;

[3] GERADIN and PEREIRA NETO, 2013, p. 81.

[4] In this sense, per the provisions of Resolution 20/99, Annex 1, subitem B, "*(...) vertical practices usually indicate the existence of market power in the original relevant market, and it could reach a substantial part of the target market, imposing risks to competition. Though these restraints initially limit competition, they can also have benefits ("economic efficiencies"). These benefits must be weighed against the potential anticompetitive effects according to the reasonability rule*".

[5] To obtain a sample of cases in which CADE analyzed contractual exclusivity as an abuse of a dominant position because of the creation of barriers to entry, it adopted the following methodology: (i) first of all, using the keywords "exclusivity", "contractual exclusivity" and "closing market", CADE's precedent search tool presented data related to all of its former cases; (ii) then it excluded all cases related to structure control (involving mergers) from the results; (iii) then it excluded all cases that involved collusive practices, and only those related to vertical practices remained; (iv) afterwards, it also excluded all cases related to *de facto* exclusivity and to conditional discounts or any other non-contractual mechanism able to induce exclusivity; (v) finally, it excluded from the universe of related cases all cases with no final judgement were excluded–even those in which provisional remedies had been granted.

and (iv) the decision of the agency to dismiss the case, convict the parties or, when applicable, to enter into a Cease and Desist Agreement[6].

13. Out of the 19 studied cases, 47.36% were dismissed. In 31.57% of the cases, the authority found the defendants guilty, and 21.05% of the cases led to the signature of Cease and Desist Agreements.

14. In terms of the differences between these exclusivity clauses, it was identified a total of six patterns: (i) clauses establishing a minimum quota, which resulted in the interruption of the product supply as a penalty; (ii) radius clauses, that, if breached, would result in the automatic rescission of the contract; (iii) exclusivity contracts similar to adhesion contracts, including a clause allowing for contractual rescission in case of breaching; (iv) exclusivity clauses related to representation in bidding procedures; (v) exclusivity clauses adopted in response to regulatory determination; and (vi) exclusivity obligations related to final customers trade unions.

15. Regarding the analysis of potential market closing, the acceptable closing rate was only considered in 21.05% of the cases, indicating there are no fixed standards about the acceptable degree of foreclosure. On the other hand, discussions about potential efficiencies gained by adopting the exclusivity clauses took place in almost every case (84.2%). When these discussions did not happen, the authority decided to dismiss the case.

16. Of the efficiencies, the most common was the possibility of adopting a clause to stop the free-riders problem (an argument used in roughly 33.3% of the cases which regarded compensatory efficiencies). Other efficiencies mentioned included (i) economies of scale, (ii) the achievement of critical mass (described as the existence of a scalable minimum viable product), (iii) a tendency favourable to investments (meaning the adoption of exclusivity clauses would provide legal certainty to investors by assuring its counterparts), (iv) demand predictability, (v) more efficient rewarding to the agents involved in the supply chain and (vi) more security about the quality of products.

17. Thus, it is possible to reach a few conclusions regarding CADE's analysis standards concerning vertical practices of abuse of a dominant position involving the adoption of exclusivity clauses that may result in market foreclosure:

- Amidst the various structures of exclusivity clauses adopted (considering the degree, duration and enforcement of the provisions), the last one is the only one that has been effectively considered in CADE's analysis so far. The authority usually assesses the information obtained during the investigation to determine the type of contractual sanction established for breaching the exclusivity clause and whether the sanction was applied;
- The degree of market foreclosure was never a condition for a party to be found guilty or innocent. Besides, in the few cases that considered it, there was no clear decision pattern, since while there are cases in which the Tribunal rejected the argument that a degree of foreclosure below 20% would not be harmful to

[6] It is essential to point out that the criteria used relate to the literature review and the framework proposed by Judge Richard Posner in the Roland Machinery case (7th Circuit 1984). In that case, the judge identified the following as relevant variables in the evaluation of the liquid effects caused by the adoption of exclusivity clauses: (i) the adoption of the exclusivity clause must have the potential to exclude from the market at least one meaningful competing firm; (ii) the adoption of the exclusivity clause must have the potential to lead to a price increase, reducing the supply below the competitive level; and, finally (iii) the anticompetitive effects must be more significant than the expected benefits.

competition[7], in other cases, it concluded that estimates between 10.9% and 105% were harmless[8];

- When it comes to determining the net impact by analysing the potential efficiencies produced by those clauses, there is a somewhat clear standard of analysis. However, it has not necessarily preceded other analysis steps, such as the definition of market dominance and the scrutiny of the type of clauses adopted and the resulting degree of foreclosure.

1. Characteristics of digital platforms and their impact on the analysis of exclusivity clauses

18. In the case of digital platforms, the relationship among various groups and the platform create economic incentives different from what we usually observe in traditional markets. The interdependence of demand results in consumer's welfare depending on effects accumulating on its many sides, thus creating singularities regarding (i) the scope and scale of production, (ii) the achievement of critical mass and (iii) the creation of lock-in effects.

19. The economies of scale and scope–eased in the context of low marginal costs of digital markets–create a phenomenon of transition from competition in the market to competition for the market or the ecosystem[9]. In this situation, the incumbent may use exclusivity clauses to change the nature of competition, intending not to sell more units of products or services to consumers but to maintain an exclusive relationship with consumers, increasing costs for competitors. Thus, if market foreclosure prevents a significant number of competitors from maintaining or expanding their scale of operation[10], then there is an efficiency loss.

20. In the same way, the possibility of rivals achieving a critical mass is essential to business viability as the time it takes to get a return from investments in digital businesses is different from traditional business models. If the platform does not achieve the expected level of critical mass, it does not get any new users. Moreover, it faces the possibility of losing existing ones[11] due to the relevance of network effects in this business model.

21. Finally, the last relevant characteristic of digital platforms is the creation of lock-in effects. As platforms in markets with multi-homing tend to create entry barriers to have a lock-in effect in its users, exclusivity turns into one of the options to prevent migration when users access the platform (involving the use of data and the maximization of behavioural bias).

---

[7] ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE (CADE). **Administrative Proceeding 08012.007423/2006-27.** Petitioner: Della Vita Grande Rio Indústria e Comércio Ltda. Respondent: Nestlé Brasil Ltda. and Unilever Brasil Ltda.

[8] ADMINISTRATIVE COUNCIL FOR ECONOMIC DEFENSE (CADE). **Administrative Proceeding 08012.003303/1998-25.** Petitioner: Philip Morris Brasil S/A. Respondent: Souza Cruz S/A.

[9] MORTON, Fiona Scott et al. **Market Structure and Antitrust Subcommittee Report.** In STIGLER COMMITTEE ON DIGITAL PLATFORMS. Stigler Committee on Digital Platforms: Final Report. Available at <https://www.chicagobooth.edu/research/stigler/events/antitrust-competition-conference>. Accessed on 15 April 2021.

[10] GERADIN and PEREIRA NETO, Op. Cit. 2013, p. 33.

[11] EVANS, David S. **How Catalysts Ignite: The Economics of Platform-Based Start-Ups. In: Gawer, A. Platforms, Markets and Innovation**. US: Edward Elgar, 2010. Available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1279631>.

3. Final remarks

22. By revising CADE's precedents involving potential vertical restraints produced by exclusivity clauses, it is clear that the agency does not have consistent analysis standards. This is probably due to the small number of cases involving unilateral practices compared to the number of collusive practices that CADE has reviewed.

23. This has been changing in the past few years, however. With the growth of digital markets, CADE now faces the additional challenge of tailoring existing solutions to the difficulties imposed by the specificities of digital platforms (such as the scope and scale of production, the achievement of critical mass and the creation of lock-in effects).

24. In September 2020, CADE faced the challenge of dealing with Proceeding 08700.004588/2020-47, involving possible abuse of dominance in the food delivery sector, after Rappi Brasil filed a complaint against iFood. Even though the investigation is not over yet, CADE imposed a preventive measure requiring that iFood limits using exclusivity clauses with restaurants. In the decision, CADE pointed out some specificities of this market–such as the pioneer's advantage phenomenon, tipping effects, and network effects–and the delicate moment in which the food delivery sector is going through a much-needed expansion as a result of sanitary and social distancing measures.

25. Furthermore, the agency also considered the potential negative consequences of limiting multi-homing and the high costs for restaurants to switch platforms because of the duration of contracts and the imposition of termination fines–included in this text as enforcement of the exclusivity clauses.

26. Even though an isolated decision is not enough to determine that the agency is adopting a new standard of analysis, it does indicate it is going in a new direction, a much necessary move considering the current and future challenges to be faced.