

## RESALE PRICE MAINTENANCE AND THE BRAZILIAN ANTITRUST LAW

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### ABSTRACT

The resale price maintenance is a vertical restriction<sup>1</sup> through which the producers fix a price to be adopted by the retailers, in order to avoid competition between their products in the downstream market.

In the past, the practice was considered anticompetitive per se by the American Courts, since it has the potential effect of restraining competition between products of the same brand

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1 Vertical restrictions are established in the contracts between companies in different stages of the production chain.

and could facilitate cartel formation, working as a mechanism to monitor prices. However, methods of rigorous economic analysis introduced by the Chicago School demonstrated that this practice could generate efficiencies previously not identified by the Courts, which would justify a case-by-case analysis in order to assess the effects on competition (through the rule of reason). According to the new theories, the resale price maintenance could increase sales effort of the retailers and avoid the problem of the free riding.

In Brazil, the practice is described by the article 21, item XI, of the Law no. 8,884/1994 (“Antitrust Law”) and can be punished if it produces some of the effects set forth by article 20. The Administrative Council for Economic Defense (“CADE”) addressed the resale maintenance price a few times recently, but there is not a solid case law on the subject yet. However, two cases currently under analysis of the agency may demonstrate what will be CADE’s interpretation over the effects of this practice on competition<sup>2</sup>.

There are many questions regarding the acceptability of the practice under the Antitrust Law. Besides the effects commonly associated to the resale price maintenance – mentioned above– it is important to question if the existence of market power is necessary in order to consider the practice unlawful. Another question is related to the limits between the resale price suggestion and the resale price maintenance. CADE’s case law indicates that the suggestion can not negatively affect the market<sup>3</sup>. However, it is important to establish criteria to differentiate the suggestion from the maintenance of resale price, for example: to determine if the existence of internal mechanism of penalty for the case

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2 Administrative proceeding no. 08012.001271/2001-44 and preliminary inquiry no. 08012.009674/2008-16.

3 Consultation no. 020/1997.

of noncompliance by the retailer with the producer's rules is necessary to imply in the wrongfulness of the practice and what kind of penalty should it be.

To answer these questions, the methodology used will be the analysis of the economic effects of the resale price maintenance and study of the interpretation given by foreign jurisdictions. In this context, the development of the American case law and theory—as well as the opposition between the per se conception and the new ideas introduced by the Chicago School related to the rigorous economic analysis of vertical restrictions—are specially relevant.

Therefore, this paper aims to assess how the resale price maintenance should be examined based on the Antitrust Law provisions, considering the experience of the foreign law, the study of the cases currently under analysis of the Brazilian antitrust authorities and CADE's case law on the subject.

**Key words:** resale price maintenance, competition, Brazilian Antitrust Law, law and economics.

## ***EL DERECHO DE LA COMPETENCIA EN BRASIL Y LOS PRECIOS DE REVENTA***

### *RESUMEN*

*El mantenimiento del precio de reventa es una restricción vertical a través de la cual el precio de producción de una solución a ser adoptada por los minoristas, en el comando para evitar la competencia entre sus productos en el mercado downstream.*

*En el pasado, la práctica fue considerada anticompetitivas per se la competencia por los tribunales estadounidenses, ya*

*que tiene el efecto potencial de limitar la competencia entre los productos de la misma marca e facilitar la formación de cárteles, trabajando como asesor de los precios del mecanismo. Sin embargo, el método introducido por la Escuela de Chicago de un riguroso análisis económico demuestra que esta práctica que antes no se podía identificar eficiencias generadas por los tribunales, lo que justificaría un análisis caso por caso para evaluar el efecto sobre la competencia en la orden (a través de la regla de la razón). De acuerdo con las nuevas teorías, el mantenimiento del precio de reventa podría aumentar el esfuerzo de los minoristas y evitar los problemas de free riding.*

*En Brasil, la práctica es descrita por el artículo 21, inciso XI, de la Ley no. 8884/1994 ("Ley de Defensa de la Competencia") y puede ser castigado si se produce alguno de los efectos establecidos en el artículo 20. El Consejo Administrativo de Defensa Económica ("CADE") se dirigió a los precios de reventa un par de veces recientemente, pero no hay una jurisprudencia sólida sobre el tema todavía. Sin embargo, dos casos actualmente bajo análisis de la agencia puede demostrar lo que será la interpretación del CADE acerca de los efectos de esta práctica sobre la competencia.*

*Hay muchas preguntas acerca de la aceptabilidad de la práctica bajo la Ley de Defensa de la Competencia. Además de los efectos comúnmente asociados con el mantenimiento del precio de reventa - mencionado anteriormente - es importante a la pregunta de si la existencia de poder de mercado es necesario a fin de considerar la práctica ilegal. Otra pregunta se refiere a los límites entre la sugerencia de precio de reventa y el precio de reventa. La ley del CADE caso indica que la propuesta no puede afectar negativamente el mercado. Sin embargo, es importante establecer criterios para diferenciar la idea del mantenimiento del precio de reventa, por ejemplo: para determinar si la existencia de mecanismos internos de sanción*

*para el caso de incumplimiento por parte del vendedor con las reglas de los productores es necesario implicar en la la ilicitud de la práctica y qué tipo de sanción debe ser.*

*Para responder a estas preguntas, la metodología utilizada será el análisis de los efectos económicos de los precios de reventa y el estudio de la interpretación dada por jurisdicciones extranjeras. En este contexto, el desarrollo de la jurisprudencia estadounidense y de la teoría -, así como la oposición entre el concepto per se y las nuevas ideas introducidas por la Escuela de Chicago relacionados con el riguroso análisis económico de las restricciones verticales - son especialmente relevantes.*

*Por lo tanto, este trabajo tiene como objetivo evaluar cómo los precios de reventa debe ser examinado sobre la base de las disposiciones de Derecho de la Competencia, teniendo en cuenta la experiencia de la ley extranjera, el estudio de los casos actualmente bajo análisis de las autoridades brasileñas antimonopolio y la ley del CADE caso sobre el tema .*

***Palabras clave:*** Competencia económica, agente económico, eficiencia, empresa, economía

## 1. INTRODUCTION

The classical economic doctrine identifies two types of relation between companies: (i) horizontal, between competitors; and (ii) vertical, between companies with activities in different stages of the production chain. In the context of the antitrust law, horizontal and vertical agreements are scrutinized when the net effects are harmful to consumer welfare, i.e., when the pro-competitive effects do not compensate the injuries generated from the practice. Therefore, the practices that aim only to restrict output (naked restraints) are treated as anticompetitive *per se* –for instance, collusion to fix prices– while practices that limit competition in order to generate efficiencies (ancillary restraints) –v.g., market division to improve

the distribution of a product—are analyzed under the rule of reason. The resale price maintenance is the practice through which the producer determines the resale price—maximum, minimum or fixed—of its product to the dealer. Thus, the practice is considered a vertical restriction, since it is imposed by a company of the upstream market to the other in the downstream market. In the past, this practice was considered anticompetitive *per se* by the US Supreme Court, since it could eliminate intrabrand competition and work as a mechanism to facilitate cartel formation. However, more rigorous methods of economic analysis introduced by the Chicago School demonstrated that this practice could generate efficiencies previously non-identified by the Courts, which justified the analysis case-by-case in order to verify the net effects on competition. According to these new theories, the resale price maintenance could improve the sales effort of the retailers and avoid the free rider problem—i.e., a competitor that “takes a ride” in its rival’s investment.

In Brazil, the practice is described by the article 21, item XI, of the Law no. 8,884/1994 (“Antitrust Law”) and can be punished if it produces some of the effects set forth by the article 20 of the same Statute. Therefore, the practice is analyzed through the rule of reason, in order to access its net effects and objective.

Considering the new theories regarding the effects generated by the resale price maintenance, it is necessary to analyze these new approaches, in order to determine how this practice should be treated by the Antitrust Law in Brazil.

In order to access these questions, it is necessary to analyze the American literature and case law, which addressed the effects of the resale price maintenance deeply. In addition, it is also important to analyze the Administrative Council for Economic Defense (“CADE”)’s case law, in order to determine the current understanding of the agency on this matter. Finally, this paper will evaluate the effects of the resale price maintenance, using the concepts and knowledge developed by the American and Brazilian experience, in order to determine what should be the treatment given to this practice by the antitrust authorities.

## 2. RESALE PRICE MAINTENANCE: THE AMERICAN EXPERIENCE

The effects of the resale price maintenance on competition and its lawfulness were highly discussed by the U.S. Supreme Court and American literature. Therefore, the study of the American antitrust case law and recent changes in the understanding regarding the resale price maintenance is necessary, in order to better address the Brazilian case.

### 2.1 U.S. SUPREME COURT CASE LAW

The resale price maintenance was subject to the U.S. Supreme Court scrutiny in several cases. The first notorious case was *Dr. Miles Medical Co. v. John D. Park & Sons Co*<sup>4</sup> (“Dr. Miles case”), judged in 1911. In this leading case, a medicine producer, *Dr. Miles Medical Company* (“Dr. Miles”), accused the company *John D. Park & Sons Company*, dedicated to the wholesale of medicines, of entering into combination and conspiracy with other retailers and wholesalers, with the purpose to breach the agreement that set forth minimum resale prices. Notwithstanding the provisions in connection with the resale prices, the agreement also established a pecuniary fine in case of non-compliance with its provisions –i.e., prices fixed below the minimum value determined.

Dr. Miles defended the lawfulness of this agreement under the allegation that some department stores were setting the prices of its products too low, which was reducing the margin of the other retailers, especially drug stores, and causing loss of reputation within the public, due to the successive cuts in prices. Since the drug stores were the main distribution channel of the medicines, Dr. Miles affirmed that the reduced margin and the loss of reputation were negatively affecting the sales of the products.

The U.S. Supreme Court, however, considered that Dr. Miles sole purpose in entering into agreement with dealers was to injure

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4 220 U.S. 373 (1911).

competition by controlling the trade of medicines and decided that the resale price maintenance was unlawful. According to the decision, restraints of trade could only be acceptable if it benefit the parties involved and the public, which could not suffer any injury<sup>5</sup>. Since the system implemented by Dr. Miles prevented its products to be sold below the determined price, the U.S. Supreme Court concluded that the only effect of the agreement was to avoid competition among retailers. Therefore, the resale price maintenance would be comparable to a cartel:

[T]he complainant [Dr. Miles] can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and thus to achieve the same result, by agreement with each other. If the immediate advantage they would thus obtain would not be sufficient to sustain such a direct agreement, the asserted ulterior benefit to the complainant cannot be regarded as sufficient to support its system.

Therefore, if dealers could not justify a cartel formation based in the advantages they would obtain, the producer would not be able to determine the same price alleging the same reason. Thus, the precedent established the understanding that the resale price maintenance was unlawful *per se*, once its effects were comparable to a cartel and could not generate any benefit to the public.

Later, in 1919, the U.S. Supreme Court analyzed another important case in connection with resale price maintenance: *United States v. Colgate & Co.* (“Colgate case”)<sup>6</sup>. In this case, it was stated that, although the vertical price fixing was unlawful, the producer could deny to enter into contract with a dealer that did not agree

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5 In this context, the decision cited the precedent *Nordenfelt v. Maxim Nordenfelt Guns & Ammunition Co.*, 220 U.S. 373 (1984): “restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is sufficient justification, and indeed it is the only justification, if the restriction is reasonable, - reasonable, that is, in reference to the interests of the parties concerned, and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favor it is imposed, while at the same time it is in no way injurious to the public”.

6 250 U.S. 300 (1919).

with its price policy. Thus, it was decided that the Sherman Act did not forbid any company to take business decisions that it thought inconvenient and, therefore, the producer had the right to declare the conditions of resale before entering into contract with the dealer<sup>7</sup>.

The U.S. Supreme Court understanding developed in the Colgate case was complemented in the case *Monsanto Co. v. Spray-Rite SVC. Corp.* (“Monsanto case”)<sup>8</sup>, which defined that the producer has the possibility to establish contractual restrictions or refuse to contract only if it does that independently, without any combination or conspiracy with other companies. Furthermore, in Monsanto case the U.S. Supreme Court affirmed that the producer concern with the resale prices and, consequently, the constant contact with the dealer to exchange information regarding the prices charged do not mean that the Colgate case precedent can not be applied. Therefore, this type of communication between the companies could not be used as material evidence to characterize the unlawfulness of the practice.

The Dr. Miles case was used to justify the condemnation *per se* of the resale price maintenance until 2007, when the precedent was overruled by *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*<sup>9</sup> (“Leegin case”), which determined the analysis by rule of reason. The circumstances of the case were very similar to those of Dr. Miles and involved a producer of leather accessories, *Leegin Creative Leather Products, Inc.* (“Leegin”) and its retailer. As in Dr. Miles, aggressive retailers were affecting the sales of the product, reducing its competitors margins and injuring the reputation of the product. In a effort to keep the product attractive to the distribution channels, Leegin determined minimum prices to grant a reasonable margin to its dealers.

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7 Thus, the U.S. Supreme Court stated that “the [Sherman] act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business freely to exercise his own independent discretion as to parties with whom he will deal, and, of course, he may announce in advance the circumstances under which he will refuse to sell”.

8 465 U.S. 752 (1984).

9 551 U.S. 877 (2007).

In spite of the decision rendered in the *Dr. Miles* case, in *Leegin* case the U.S. Supreme Court decided that the resale price maintenance could generate efficiency and pro-competitive effects and, therefore, should be analyzed under the rule of reason. According to this decision, even if the resale price maintenance eliminated intrabrand competition (i.e., competition among products of the same brand), the purpose of the Sherman Act was to protect interbrand competition or, in other words, products of different brands. Thus, the practice could generate benefits, such as: (i) increase dealers' sales effort; (ii) reduce incentive to free riding; and (iii) create incentives to the entry of new producers and dealers in the market, attracted by margins and profits granted by the resale price maintenance.

The increased sales effort would be generated by the greater margin created by the resale price maintenance: while the dealers would have more resources to invest, they would also have more incentives to differentiate from its competitors, due to the equivalent price of the product offered. Additionally, the equivalent price would avoid the free riding problem. The U.S. Supreme Court mentioned, for instance, the hypothesis of a consumer that gets information about a product with a dealer that offers costumed services –and, for that reason, has greater costs and prices– and actually buys the product from other dealer, which does not offer this type of special service and, therefore, has lower prices. Finally, the profit granted by the resale price maintenance, as well as its pro-competitive effects, could attract dealers and producers to the market, creating an incentive to entrance of new competitors in the market. Besides the aforementioned effects, the establishment of minimum prices, as the U.S. Supreme Court recognized, could also avoid the lost of reputation suffered by the successive cuts on prices applied by the aggressive dealers.

On the other hand, the U.S. Supreme Court's decision also highlighted that the resale price maintenance can generate anticompetitive effects, such as: (i) to serve as a mechanism for the producers to monitor a cartel; (ii) to organize a cartel among

dealers; and (iii) to be used as an instrument by the producer or dealer to abuse its market power.

In this manner, the resale price maintenance could be used as a mechanism to monitor the compliance of members of a cartel among producers. The members of the cartel that decided to set prices below of those established by the agreement among competitors –and take advantage of the increased demand for its products– could be more easily detected in case of resale price maintenance. Accordingly, dealers could fix their prices by agreement and require the producers to establish it vertically<sup>10</sup>. The U.S. Supreme Court’s decision also mentions some situations that would imply in abuse caused by the use of resale price maintenance: a dealer could, for instance, avoid development and innovation in the distribution system that would reduce costs and increase efficiency or the producer could offer greater profits to dealers that compromise not to sell products of other brands.

## 2.2 THE CHICAGO SCHOOL

In the 1980 decade, the theories of the Chicago School, defended specially by Robert Bork and Richard Posner, had great influence over the antitrust doctrine<sup>11</sup>. The new ideas introduced by these scholars were related to the necessity of more rigorous analysis in antitrust cases and the adoption of economic rational to evaluate the effects of certain business practices. Moreover, it was affirmed that every type of vertical restriction benefits consumers and should be considered lawful<sup>12</sup>.

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10 According to Herbert Hovenkamp (Federal antitrust policy, 471, West Publishing Co., 2005), the resale price maintenance in Dr. Miles case was imposed by the dealers: “[o]ne year earlier the Dr. Miles signed a consent decree agreeing not to participate with drug retailers in the horizontal price fixing of drugs. Park was an “aggressive cutter” – a pharmacy that did not participate in the cartel, but instead cut prices. RPM was clearly being used to facilitate horizontal collusion”.

11 FORGIONI, PAULA, *Fundamentos do Antitruste*, 163 (Editora RT, 2010).

12 BORK, ROBERT, *The Antitrust Paradox*, 297 (The Chicago Press, 1993).

The theory that every vertical restrictions should be considered lawful was based on the idea that, by establishing them, the producer did not intend to restrict output and, therefore, the practice could not affect consumer welfare. In this sense, it was affirmed that such restrictions could generate efficiencies. The argument was defended by Robert Bork<sup>13</sup>:

When a manufacturer wishes to impose resale price maintenance or vertical division of reseller markets, or any other restraint upon the rivalry of resellers, his motive cannot be the restriction of output and, therefore, can only be the creation of distributive efficiency.

Thus, according to the Chicago School doctrine, there is no economic rationality in the U.S. Supreme Court decisions in the cases involving resale price maintenance. If a producer wishes to abuse of its economic power to raise prices and harm consumers, it would do it directly and not through its dealers.

According to the Chicago School, the main efficiencies created by the resale price maintenance by the producers are the incentive for dealers' sales effort and avoid free riding. These theories were applied by the U.S. Supreme Court in *Leegin* case.

### 3. CADE'S CASE LAW REGARDING RESALE PRICE MAINTENANCE

The resale price maintenance is most commonly addressed by CADE in cases related to price suggestion spreadsheets published by professional associations<sup>14</sup>. The administrative proceeding no. 148/1994, related to a price suggestion complaint made by the São Paulo's Bakery and Confectionery Industries Labor Union (*Sindicato das Indústrias de Panificação e Confeitaria de São Paulo*) and the São Paulo's Bakery and Confectionery Industries Association (*Associação das Indústrias de Panificação e Confeitaria*

13 BORK, ROBERT, *The Antitrust Paradox*, 289 (The Chicago Press, 1993).

14 The former Commissioner João Bosco Leopoldino da Fonseca cited 10 cases judged by CADE related to "price parallelism caused by price suggestion spreadsheets or other communication and information instruments" in his vote in the judgment of the administrative proceeding no. 08000.012252/1994-38.

*de São Paulo*) against Indústria Alimentícias Gerais S.A. (“IAG”) –owner of the ice cream brand Kibon–, is considered as the first and leading case regarding vertical price fixing<sup>15</sup>. In its decision, CADE differentiated the resale price imposition<sup>16</sup> from the mere suggestion, concluding that the IAG practice was not related to the former, but to the latter<sup>17</sup>. The decision was based in the following facts: (i) lack of structural conditions able to compel the dealers to adopt IAG’s price policy, i.e., lack of market power; (ii) absence of contractual provisions or agreements with the purpose of forcing the dealers to exhibit the suggested prices, or, in other words, lack of sanction for non-compliance; and (iii) lack of uniform behavior, reflected by the different prices charged by the competitors.

The first issue raised by CADE is almost intuitive: the resale price suggestion –or imposition– can only harm consumer welfare if the producer has market power. In the absence of market power, there would still be substitute products available for the dealers and consumers, since there would be interbrand competition. Therefore, there would not be violation to the article 20 of the Antitrust Law. As for the second issue, the existence of penalty for the dealer that does not comply with the prices determined by the producer is essential to bind the parties of the agreement and is inherent to the resale price imposition effectiveness. Finally, the third aspect is related to the effects of the resale price imposition: if it does not result in limitation of the competition or harm to consumer welfare, there is no unlawful conduct, according to the Antitrust Law.

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15 The bases and fundamentals of this case were later used in CADE’s decision in the consultation no. 20/1997, filed by Ferrero do Brasil Ind. Doceria e Alimentar Ltda., related to price suggestion.

16 The expressions resale price imposition and resale price maintenance will be used in the same sense, since both reflect the same idea of prices determined by the producer for the products sold by the dealers.

17 Accordingly, the former Commissioner Leônidas Rangel Xausa stated in his vote in the judgment of the case: “the practice refers to *suggested retail price*, commonly used in stable economies, which allows the maintenance of the prices through long periods. Therefore, its is important to repeat, the practice does not bind the retailer, since there is no obligation to adopt the suggestion, in opposition to the resale price maintenance.”

CADE has developed, through its case law, these three aspects mentioned above. Therefore, they must be analyzed in more detail.

### 3.1 STRUCTURAL CONDITIONS AND MARKET POWER

The existence of market power, as declared by CADE in several occasions<sup>18</sup>, is an essential condition to the resale price imposition effectiveness. Additionally, other aspects that facilitate the abuse of market power, as the existence of barriers to entry, are also necessary<sup>19</sup>.

#### 3.1.1 Existence of market power

As for the existence of market power in the relation between producers and dealers, there are three possibilities: (i) both parties, producer and dealers, have market power; (ii) only the producer has market power; and (iii) only the dealers have market power (i.e., buying power).

In the first hypothesis, in which both producer and dealers have market power, Daniel Goldberg<sup>20</sup> demonstrated, using the negotiations between supermarkets and hypermarkets and producers of the food industry as model, that they will seek to maximize their profits jointly through efficient agreements, bargaining each one's part of the sales' result<sup>21</sup>. In this sense, it can be affirmed that

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18 For instance, preliminary investigation no. 08012.008443/2007-04 and preliminary investigation 08012.005994/2004-65, among others.

19 In this sense, the former Commissioner Leônidas Rangel Xausa stated in his vote in the judgment of the administrative proceeding no. 148/1994 that “the high interbrand competition, in addition to the low barriers to entry, atomization of the market, as well as the fact that it is not an essential product, make any attempt of price imposition in order to obtain extraordinary profits or attain market domination, virtually impossible.”

20 GOLDBERG, DANIEL K., *Poder de compra e política antitruste*, 221 (Editora Singular, 2006).

21 Therefore, the author declares that “when the contracts are not linear [and, thus, are efficient], the parties are bargaining only the division of profits that were jointly maximized by them, since both recognize their mutual interdependency.”

the possibility of restriction of output and, consequently, injury to consumer welfare in case of resale price maintenance will be unlikely –which does not eliminate, however, the possibility of negative effects from this practice<sup>22</sup>. Notwithstanding, if the resale price maintenance does not imply in measures to prevent the entry of competitors in the market or restriction of output to consumers, there is no violation to article 20 of the Antitrust Law.

As for the second case, i.e., producer with substantial market power, the economic consequences of the resale price maintenance are well known by the competition law: there will be low intrabrand competition, due to the standardized prices, and there will also be low interbrand competition, due to the lack of rivalry in the market. Additionally, there is the possibility of abuse of market power by the producer, as demonstrated by the U.S. Supreme Court in *Leegin* case.

In the third hypothesis, the market power is exercised by the demand, i.e., by dealers. It is more probable that the resale price maintenance be imposed by dealers, in order to maximize their profits. Therefore, the dealer will try to reduce the price paid for the product as possible and, depending on the level of competition in the market, the decrease in producer's profit may affect output<sup>23</sup>. If the dealer also have market power besides the buying power –i.e., if it has market power in the downstream market as well as in the upstream –the negative effects in consumer welfare may be even greater. The increase in prices caused by the exercise of market

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22 It would be the case, for instance, of market power increase by any the parties. As asserted by Daniel Goldberg (*op. cit.*, p. 223), “if dealers already have bargain power, an increase in concentration will enhance its market power with no benefit to the society or consumers.” Therefore, the increase in market power in case of efficient contractual relations between interdependent parties can give cause to abuse or opportunistic behavior by the strongest party, without any benefit to consumer welfare.

23 It would not be the case, for instance, if the upstream market, i.e., where the producer competes, has characteristics of perfect competition. In this case, the output will be that in which producers' marginal cost equals price. Therefore, the output will not suffer restriction if the revenue is enough to remunerate producer's average total costs.

power may reduce the demand for the product, directly affecting producer's revenue. While the dealer will be able to maximize its profits because of the high prices it charges, the producer will continue to receive a reduced payment as a result of the exercise of buying power by the dealer. Therefore, the resale price maintenance in case of dealers with buying power may cause restriction of output and inflict injuries to consumer welfare.

### *3.1.2 Structural conditions that facilitate the abuse of market power*

The unilateral exercise of market power—including situations related to resale price maintenance—can be mitigated by other structural characteristics of the market. According to the SEAE/SDE Joint Ordinance no. 50/2001 (“Joint Ordinance”), there is basically two aspects that must be considered: (i) existence of barriers to entry; and (ii) effectiveness of rivalry between the competitors in the market. In order to verify the existence of barriers to entry, there are three aspects that shall be analyzed: if the entry of a new competitor in the market would be (a) probable, (b) timely and (c) sufficient. According to the Joint Ordinance, the entry will be probable when the minimum viable scale are smaller than sales opportunities in the market. Therefore, it is necessary that the entrant is capable to justify the investment to enter the market, which implies in the existence of a residual demand to be explored<sup>24</sup>. The entry will be timely when the entrant is able to offer its products within two years. Finally, the entry will be sufficient when the entrant can explore the sales opportunity<sup>25</sup>.

24 According to the Joint Ordinance, “[p]rices will not be able to be assured by the possible entering firm when the minimum increment of supply offered by the entering firm is sufficient to cause a reduction in market prices.” Thus, the entry will not be probable if the whole demand—considering the viable price to remunerate the invested capital—is already supplied by the competitors of the market.

25 Although the Joint Ordinance mentions “all the sales opportunity”, it is reasonable to affirm that the entry will be sufficient if the entrant is capable to explore part of the residual demand that is necessary to remunerate the invested capital.

Notwithstanding, even if there is barriers to entry, the possibility of unilateral exercise of market power can be mitigated by the effectiveness of rivalry of the competitors that are already in the market. Therefore, the Joint Ordinance identifies two situations in which the unilateral exercise of market power can be challenged. In case of markets with homogeneous products, the unilateral exercise of market power will not be possible if other competitors are capable of supplying the part of the demand diverted by the abusive conduct. This will happen if the other competitors are able to increase production to absorb this part of the demand, i.e., if there is idle capacity<sup>26</sup>. In case of differentiated products, on the other hand, the unilateral exercise of market power will be unlikely if the demand elasticity is high enough to enable other competitors that offer similar products to supply the part of the demand diverted by the abusive conduct. The demand elasticity will be more rigid in presence of consumer's loyalty to certain brands, if the features of the product prevent its substitution by another one or if there is information asymmetry that make it difficult to the consumer to correctly evaluate and compare prices and substitutability by other products available in the market.

### 3.2 SANCTION FOR NON-COMPLIANCE WITH THE IMPOSITION OF RESALE PRICE BY THE PRODUCER

The existence of sanction for the case of non-compliance with the conditions set forth by the producer is essential to configure the resale price imposition. The issue was subject to discussion in several cases analyzed by CADE related to price suggestion spreadsheets published by professional associations, trade unions and other kinds of representative associations. Although these cases

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26 Thus, the Joint Ordinance determines that the rivalry between competitors will not be effective if “(a) they are operating at full capacity and it is not economically viable to expand production in a period of time that is smaller than two years or (b) when operating the existing idle capacity implies higher costs than the existing occupation level.”

do not imply in vertical restrictions, but in entities influencing in prices horizontally, the same premises can be applied in both situations. As declared by former Commissioner César Mattos in the vote of the administrative proceeding no. 08012.009922/2006-59, “the theory of suggested prices can be applied to both vertical and horizontal relations.”

As for the nature of the sanction, according to the concurrent vote of the former CADE’s Chairman Elizabeth Farina in the administrative proceeding no. 08000.020294/1996-03, the existence of a formal mechanism of penalty is not necessary if there are other sufficiently credible mechanisms to force the competitors to follow the imposed price. Therefore, the simple threat of retaliation –v.g., the exclusion of the competitor from the association– or the existence of high costs related to the non-compliance of the determination can be enough in order to achieve the effects aimed by the imposition. Accordingly, in the preliminary investigation no. 08012.005994/2004-65, CADE concluded that the determination of price through a price suggestion spreadsheet could not generate anticompetitive effects due to the lack of market power and mechanism of penalty for those that did not comply with the values set forth. Notwithstanding the fact that these cases were related to spreadsheets published by associations or trade unions, the same premises were used as fundamentals to a decision in a recent case related to allegations of resale price maintenance between producers and dealers<sup>27</sup>, which demonstrate that both cases can be treated similarly.

### 3.3 EFFECTS OF THE RESALE PRICE IMPOSITION

Any practice will be considered unlawful under the Brazilian antitrust law if it generates the effects listed in the article 20<sup>28</sup> of

27 Preliminary investigation no. 08012.008443/2007-04.

28 “Article 20. Notwithstanding malicious intent, any act in any way intended or otherwise able to produce the effects listed below, even if any such effects are not achieved, shall be deemed a violation of the economic order: I - to limit, restrain

the Antitrust Law. Additionally, even if certain practice generate negative effects on competition, it can be considered lawful if its liquid effects are positive<sup>29–30</sup> (e.g., creation of efficiencies that overcome the restrictions of competition). Therefore, the resale price maintenance will be unlawful if its negative effects overcome the benefits.

Based on the viewpoint that the analysis of the effects of certain practice is more important than the existence of formal elements to configure the unlawfulness of the price suggestion spreadsheets, the theory of the focal point was created. In the concurrent vote in the preliminary investigation no. 08012.005994/2004-65, the former Commissioner César Mattos considered that even the resale price suggestion, without a formal mechanism of coercion<sup>31</sup>, may be

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or in any way injure open competition or free enterprise; II - to control a relevant market of a certain product or service; III - to arbitrarily increase profits; and IV - to abuse of dominant position.”

- 29 The first paragraph of the article 54 of the Antitrust Law lists the pro-competitive effects that may be considered: “Paragraph 1. CADE may authorize any acts referred to in the main section of this article, provided that they meet the following requirements: I - they shall be cumulatively or alternatively intended to: (a) increase productivity; (b) improve the quality of a product or service; or (c) cause an increased efficiency, as well as foster the technological or economic development; II - the resulting benefits shall be ratably allocated among their participants, on the one part, and consumers or end-users, on the other; III - they shall not drive competition out of a substantial portion of the relevant market for a product or service; and IV - only the acts strictly required to attain an envisaged objective shall be performed for that purpose.”
- 30 In this sense, in accordance with the Annex II of CADE’s Resolution no. 20/1999, “the analysis of the specific practice, based on the rule of reason, is concluded with the evaluation of the anticompetitive effects and the possible benefits or efficiencies identified and scrutinized in the previous steps, with the aim of identifying if the latter are sufficient to compensate the formers, determining the lawfulness of the practice.”
- 31 However, the former Commissioner used an informal mechanism of coercion as an example for his thesis (which would be equivalent to the “sufficiently credible ways to obligate the competitors to follow the imposed price” mentioned by former CADE’s Chairman Elizabeth Farina in the administrative proceeding no. 08000.020294/1996-03): “[i]n some cases, it is possible that, even lacking explicit mechanism of coercion by the association, the **market structure** can influence the behavior of the competitors, **in order to escape, for instance, from a price war**. The threat of a price war is the main fundament for the economic models related

considered unlawful if dealers actually followed the determination and set the same prices. In this sense, the former Commissioner declared:

[N]ot only the price imposed with coercion is punished (“to obtain”), but also the suggestion adopted by competitors with some market power (“to influence”).

[...]

If everyone believes that the equilibrium appointed by the spreadsheet is in accordance with the expectation of the other competitors, the result becomes closer to the result of a collusion, with injuries to the society welfare.

Therefore, the analysis of the effects produced by the resale price maintenance is the main criteria in order to define if the practice is anticompetitive or not. If the practice does not generate anticompetitive effects, or if these effects overcome its benefits, it can be considered pro-competitive.

#### 4. CASES CURRENTLY UNDER ANALYSIS BY CADE

Two cases currently under analysis by CADE may solidify the understanding of the agency related to the resale price maintenance: the preliminary investigation no. 08012.009674/2008-16 (“PI no. 08012.009674/2008-16”) and the administrative proceeding no. 08012.001271/2001-44 (“AP no. 08012.001271/2001-44”).

The PI no. 08012.009674/2008-16 refers to a claim related to minimum resale price maintenance by a company of the water filter and drinking fountain market. In the investigation of the case, the Secretariat of Economic Law (“SDE”) focused in the structure of the downstream market. Notwithstanding the fact that

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to cartel viability in the theoretical context of games infinitely repeated. This price war corresponds to a penalty for the non-compliance with the cartel” (emphasis added).

SDE concluded in its technical opinion<sup>32</sup> that the company has substantial market share in some sectors and, therefore, “could abuse its economic power”, SDE considered that the practice could not generate anticompetitive effects due to the demand elasticity. Thus, “in order to a company be able to impose prices to dealers, its products must be essential to consumer and not be subject to comparisons, substitutions or innovations that differentiate the product.” Therefore, SDE decided to dismiss PI no. 08012.009674/2008-16, and the conclusions were agreed by CADE’s Attorney Office (“ProCADE”) <sup>33</sup> and by the Federal Public Prosecutor Office<sup>34</sup>. The case is now under CADE analysis, which will either agree with SDE’s opinion or request further investigation.

The AP no. 08012.001271/2001-44 refers to the allegations of resale price imposition by a company of the rolling bearings, retainers, grease and lubricants, maintenance equipment and monitoring equipment markets. The claim was filed because of a document entitled “Preliminary Remedies”, in which the producer established prices to be followed by dealers, besides “monitoring activities” and “penalties”. SDE, ProCADE and the Federal Public Prosecutor Office recommended the dismissal of the case due to the producer’s lack of market power and structural conditions of the market, which was considered competitive. The Reporting Commissioner of the case, César Mattos, followed the recommendations and voted for the dismissal<sup>35</sup>. However, in the occasion, the former Commissioner Vinícius Marques de Carvalho requested to analyze the case in order to render a concurrent vote.

In his dissent<sup>36</sup>, the former Commissioner considered the practice unlawful, based on the market structure, and voted for the condemnation. Thus, he affirmed that some types of rolling

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32 Technical opinion of the Department of Economic Protection and Defense (“DPDE”), of December 3, 2009.

33 ProCADE Opinion no. 50/2010.

34 Federal Public Prosecutor Office Opinion no. 311/2010/AARAS/CADE.

35 Vote rendered in the CADE’s 455th Ordinary Judgment Session.

36 Vote rendered in the CADE’s 483rd Ordinary Judgment Session.

bearings have some level of differentiation –since there was substantial variation in the price– and, on the demand side, there was evidence that the definition of relevant market was very strict. Additionally, he also affirmed that there was no evidence that interbrand competition could *per se* avoid anticompetitive effects in the market. Finally, Commissioner Carvalho mentioned previous cases in which the importance of the market share was mitigated by other factors, since, in some markets, small competitors have greater influence in competition. Then, Commissioner Ricardo Ruiz followed the same rationale and also voted for the condemnation<sup>37</sup>. The case is currently under analysis of Commissioner Olavo Chinaglia, who also requested to make an analysis. Therefore, the final decision in the AP no. 08012.001271/2001-44 will be an important reference in CADE’s case law related to resale price maintenance.

## 5. CONCLUSION

Although the impact of vertical restrictions over competition is an often discussed subject, it is still hard to assess it. Nonetheless, it is commonly accepted that the practice generates both benefits and injuries to competition<sup>38</sup>. In this sense, the resale price maintenance shall be analyzed in a case-by-case basis, in order to access its net effects.

The American experience, through the U.S. Supreme Court case law and literature, has identified some of the effects resultant of the vertical price fixing by the producer. Among the positive effects, firstly indicated by the Chicago School and adopted by the U.S. Supreme Court in the *Leegin* case, it can be listed:

- a) to improve dealers’ sales effort;
- b) to reduce the incentive to free riding;
- c) to enhance interbrand competition; and

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37 Vote rendered in the CADE’s 485th Ordinary Judgment Session.

38 Paula Forgioni, *Fundamentos do Antitruste*, 376 (Editora RT, 2010).

- d) to increase the incentives for the entrance of new producers and dealers in the market.

However, the theory defended by Robert Bork that the resale price maintenance should be considered *per se* pro-competitive is not widely accepted, due to the harm caused by the practice. The anticompetitive effects identified, specially by the U.S. Supreme Court case law, are:

- a) to facilitate cartels between producers and dealers;
- b) to reduce intrabrand competition; and
- c) to create artificial barriers to entry.

CADE has built a solid case law related to price suggestion spreadsheets published by professional associations, trade unions and other types of representative associations. In these cases, it was decided that three cumulative conditions are needed to determine the practice: (i) favorable structural conditions, i.e., existence of market power and probability of abuse; (ii) existence of a mechanism capable of compelling the dealer to comply with the imposed price policy; and (iii) harm to competition, i.e., standardized behavior by dealers. The cases currently under CADE analysis may solidify the agency case law in connection with resale price maintenance.

The Brazilian antitrust authorities shall analyze the cases of resale price maintenance through the rule of reason, as currently occurs in the American antitrust law. To adopt a *per se* prohibition, as determined by Dr. Miles case, or a *per se* allowance, in accordance with the theories by the Chicago School, do not seem to be the best approach. Vertical restrictions, notwithstanding the injuries they can inflict on competition, can generate benefits and efficiencies, enhancing consumer welfare. Therefore, an analysis that evaluates the negative and positive effects is the most recommended for an adequate antitrust policy in Brazil.

