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Preparation material

For the Fifth APEC Training Course on Competition Policy

"Vertical Restraints and Interrelations between Competition Policy and Consumer Protection Policy"

I. Introductory remarks

The following document has been prepared as background material for the Chilean Economic National Prosecutor's Bureau (hereafter "FNE") presentation in the Fifth APEC Training Course on Competition Policy on the subject of vertical restraints. To be presented by Ms. Camila Ringeling.[1]

This document should be accompanied by a PowerPoint presentation. Both the presentation and background material will be sent on August 10, 2009 to the seminar's organizers. The presentation is to be no more than 15 minutes.

Disclaimer:

The views expressed in this document and accompanying presentation are purely those of the writer and may not in any circumstances be regarded as stating an official position of the of the National Economic Prosecutor´s Bureau.

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[1] The author is attorney at the Legal Division, of the National Economic Prosecutor's Bureau (FNE by its Spanish acronym). The author must acknowledge comments and guidance given by Mr. Ronaldo Bruna, Chief Economist at FNE, Mr. Cristían Reyes, Chief of Legal Division at FNE and Mrs. Carolina Bawlitza Senior Attorney of Legal Division at FNE. The usual disclaimer applies.

II. Introduction

As will be addressed during the seminar, there are different approaches towards vertical restraints: those who believe that they can only harm competition when the perpetrator has enough market power (e.g. that may allow him to raise prices and cut output without losing market to other producers.)[2]; others subscribe to a more strict view and claim that vertical restraints lead to a variety of anticompetitive effects and therefore must be prohibited.[3]

As a preliminary observation, it is important to note that the Chilean Antitrust Law[4] does not provide for any *perse* abuses. Thus, all vertical restrains will be analyzed on a case-by-case basis taking into account market power.[5]

III. Chilean Competition Law and Competition System

Legal Body: Decree Law N° 211/1973, as amended, by Law N° 19.911/12004[6]
Goal: to promote and defend the free competition in markets.
Defines the scope of the anti-competitive illicit: "…*any deed, act or contract that prevents, restricts or obstruct free competition, or that tends to produce these effects"*
Persons targeted by law: any private or public, without exemptions

- The Competition Agency: FNE, governmental agency that has investigative powers but no remedial ones.
- The Competition Court: (Court of Defense of Free Competition hereafter "TDLC"), replacing the old Antimonopoly Commissions. In operation from 2004 on, as part of the judiciary system. It assesses the claims and the

[2] See amongst others: BORK, *The antitrust Paradox: a Policy at War -With Itself,* New York 1978; *POSNER,* antitrust Law-an Economic Perspective, Chicago 1976.
[3] See amongst others: RAY *Resale Price Maintenance and Collusion*, Universite des Sciences Sociales, Toulouse, 9 May 2000, p 3.
[4] DL 211 of 1973 and its amendments EN version available at http://www.fne.cl/?content=marco_juridico
[5] CASTILLO, Maria Victoria PARDO, Marcia *Predatory Pricing in the Chilean Antitrust Framework* FNE December 2008.
[6] Recently amended by 20.361/2009.

non-contentious presentations and consultations from the competition agency or any private or public person. Has remedial powers in case of findings, being able to fine or to impose sanctions; to order to stop the offending conduct and propose the Government to modify laws and rules wherever the competition is affected.

- The Supreme Court

IV. Analysis of vertical restraints in Chilean competition law, regulation and policy

FNE will analyze vertical restraints in the following scenarios:

i) When analyzing the effects of a merger;

ii) as part of a concerted action (agreement between 2 or more competitors) [In which case a cartel investigation will be opened];

iii) as the result of an agreement (between non - competitors); and finally

iv) as unilateral conduct (by a dominant undertaking).

We will focus only on vertical restraints produced either by an agreement between non-competitors, or unilateral conducts by dominant undertakings.

When analyzing a case involving vertical restraints the FNE takes the following steps:

i) Defining and delimiting the relevant market: Product and geographical market(s) affected are defined. The test is done by analyzing both supply and demand substitution.[7] However, more emphasis is placed on demand substitution than on supply substitution.[8]

ii) Finding a dominant position (unilateral conduct): Participation of the undertaking in the relevant market is determined. The undertaking must be found to have a dominant position in the relevant market. Chile has no thresholds or safe harbors under certain market shares. However, it can be said that our analysis

[7] CASTILLO, Maria Victoria PARDO, Marcia *Predatory Pricing in the Chilean Antitrust Framework* FNE December 2008.
[8] Information provided by Chief Economist.

of dominance is in line with the one contained in the European court of Justice´s (hereafter " ECJ") *United Brands* case:

"A position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers. In general it derives from a combination of factors which taken separately are not determinative."[9]

[In the specific case of exclusive dealing, the cases investigated by the FNE have involved players with an extremely high market share (80 to 90 % in most cases) thus we have not had to deal with borderline cases where dominance might be more questionable.]

iii) Analyzing the agreement (between non -competitors): The agreement must be aimed at attaining, maintaining or increasing a dominant position in the market. It is important to mention that this test does not look at the *intent* of the parties to the agreement but at the *actual or potential effects* deriving from the agreement.

iv) Analyzing the effects: A case-by-case analysis is done to determine whether the conduct restricts or hinders free competition or tends to produce such effects in the relevant market. This will be a balancing test between different elements such as: efficiency-enhancing effects (e.g. reduction in the transaction and distribution costs of the parties or an optimization of their sales and investment levels) and on the other hand anti-competitive effects such as creating entry barriers (amongst others).

[In this specific point our balancing test is quite similar to the one contained in the new EU draft guidelines on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices:

"(7)The likelihood that such efficiency-enhancing effects will outweigh any anticompetitive effects due to restrictions contained in vertical agreements

[9] Case 27/76 United Brands v Commission [1978] ECR 207.

depends on the degree of market power of the parties to the agreement and, therefore, on the extent to which those undertakings face competition from other suppliers of goods or services regarded by their customers as interchangeable or substitutable for one another, by reason of the products' characteristics, their prices and their intended use."[10]*]*

Chilean evidential standard in competition leans on the rule of reason, that is, a factual evaluation of practices on a case-by-case basis. This is why a wide set of legal and economic information is needed to define an activity so that no alternative explanation for the observed facts is economically rational or plausible**.**[11]

The legal framework for vertical restraints is contained in Art 3 of DL 211 of 1973 and its amendments —The Chilean Antitrust Law—

Art 3 states: "*He who enters into or executes, whether individually or collectively, any deed, act or contract that prevents, restricts or hinders free competition or tends to produce such effects shall be liable to the measures prescribed by article 26 of this law, without prejudice to the corrective or restrictive measures that may be decreed in each case in respect of any such deed, act or contract.*

Amongst other, the following deeds, acts or contracts shall be regarded as preventing, restricting or hindering free competition:

(a) "Expressed or implied agreements between business agents or concerted practices between them having the intent of fixing sale or purchase prices, limiting production or assigning themselves market zones or quotas, abusing the power conferred upon them by such agreements or practices.

[10] DRAFT COMMISSION REGULATION (EC) No …/..of on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices para 7. available at http://ec.europa.eu/competition/consultations/2009_vertical_agreements/draft_regulation_en.pdf

[11] CASTILLO, Maria Victoria PARDO, Marcia *Predatory Pricing in the Chilean Antitrust Framework* FNE December 2008.

(b) The abusive exploitation by a corporation or corporations having a common holding company, of a dominant position in the market, fixing purchase or sale prices, imposing on a sale that of another product, allocating market zones or quotas or imposing like abuses on others.
(c) Predatory or unfair competition practices conducted in order to attain, keep or increase a dominant position".

Thus, vertical restraints involve but are not limited to the following conducts, which must be perpetrated with the aim of attaining, keeping or increasing a dominant position:

- Fixing purchase or sale prices
- Tying and bundling
- Allocating market zones or quotas
- Exclusive dealing

V. Case law study on Exclusive Dealing

We decided to narrow the subject of vertical restraints to exclusive dealing in our case law analysis for the following reasons: Firstly, because it is one of the conducts that fits best the questions planned for this seminar. [There has been an evolving discussion on whether this sort of provisions: a) should be prohibited: because they harm consumers and thwart competition by allowing a dominant firm to deter efficient entry[12] or because they may be a means for predatory exclusion of active rivals[13] ; b) should

[12] MOTTA, Massimo: Competition Policy, Theory and Practice. Cambridge U. Press, 7th printing, 2007. MOTTA, Massimo *Exclusive dealing and antitrust* European University Institute, Florence Erasmus Workshop on Law and Economics Universita di Bologna, 16 February 2007. Available at http://mle.economia.unibo.it/Papers%20MTM/Workshop%20in%20Law%20and%20Economics%20-%202007/Exclusive%20Dealing%20and%20Antitrust%20-%20Massimo%20Motta.pdf

[13] KLEIN, Joachim ZENGER, Hans *Discussion paper 2009-9 June 2009* Department of Economics University of Munich. "*Exclusive dealing is often defended as a means of raising static profits, but it may as well be an even easier way of predating in a dynamic context. Exclusivity provisions may not only allow excluding efficient competitors, but indeed are often a cheaper exclusionary tool than predatory pricing. This is the case if the prey's access to finance is not too limited. Furthermore, it is more likely that exclusive dealing is preferable compared to predatory pricing the more market power the predator has with respect to the prey. Most of the economic literature that supports the idea of exclusive dealing raising static profits is based on the theoretical scenario of an existing dominant firm preventing the entrance of a new market player, however many antitrust cases are actually concerned with predatory exclusion of active rivals"* available at http://lawprofessors.typepad.com/antitrustprof_blog/2009/07/predatory-exclusive-dealing.html

be allowed: and considered pro competitive in their ability to create efficiencies that will later be passed on to consumers (e.g. by stimulating specific investments)]; Secondly, because there has been a positive evolution in Chilean antitrust enforcement and advocacy in this area.

We will briefly present three recent cases that show the evolution of Chilean competition enforcement regarding exclusive dealing provisions. These are: a) *Philip Morris vs Chile Tabacos;* b) *FNE vs Cervecera CCU Chile Ltda.* [which was concluded by settlement with the FNE in the conciliation phase of the trial]; and, c) *FNE vs Compañia Chilena de Fósforos S.A* which is still pending at the TDLC.

Finally, we will mention a few investigations that are either ongoing or where closed without need of action in front of the TDLC because the parties decided to withdraw exclusive dealing provisions from their contracts.

A. Philip Morris VS Chiletabacos[14]

i) Facts

The case was initiated by *Philip Morris* (hereafter "FM") in the TDLC. MP claimed that *Chiletabacos* (hereafter "CT") had a dominant position in the cigarette market in Chile with a market share of 97,1% and had abused its dominant position by: a) refusing to deal, by conditioning the sales of its products to the compliance of exclusive dealing clauses; b) refusing credit, when products from other companies where offered at the same sales point; c) withdrawing products, promotional and advertising items of competing companies and replacing them by theirs; d) giving economic incentives to sales points conditioned to exclusive dealing; e) celebrating exclusive dealing contracts with mayor selling points.

In substance, PM claimed that the above-mentioned conducts had hindered its entrance and growth in the Chilean cigarette market.

In its defense CT presented, amongst others, the following arguments: a) PM had not been able to enter due to a bad marketing strategy b) there are important

[14] Ruling N° 26/2005 TDLC of August 5, 2005. *Chiletabacos* is the local unit of British American Tobacco.

structural entry barriers (i.e. tax costs) inherent to the tobacco industry that require huge investments in order to enter [which PM should have been able to make as it is controlled by one of the largest worldwide tobacco companies and owner of the most successful brand Marlboro]; c) CT distributes 63% of its products in Santiago through independent wholesale distributors which are free to distribute competitors products d) CT subscribes no contracts with exclusive dealing provisions, only *exclusive merchandising and publicity* clauses.

ii) The Ruling

The TDLC carried a separate analysis for each conduct and distribution channel in order to determine both the existence of such conducts and their effects on the relevant market.

And ruled on the following questions: a) existence of exclusive dealing contracts between tobacco companies and sales points; b) exclusionary acts by CT with regards to PM which resulted in barriers to entry; c) characteristics of CT's supply to independent wholesale distributors.

The TDLC ruled that CT was dominant in the Chilean cigarette market. When analyzing CT's dominance the TDLC took into account:

Entry barriers:

- Structural barriers mentioned by CT where found not relevant in this case (taxes) as both parties are subject to them in equal terms.

- Strategic barriers:

- Both PM and CT subscribe exclusive contracts for publicity and merchandising but in fact such contracts, specifically those subscribed between CT and the sales points, impede de sales of competing products and thus operate as exclusive dealing provisions.
- Economic incentives conditioned to exclusivity also constitute entry barriers.
- Independent wholesale distribution is not a viable alternative for CT's competitors due to the price difference produced by intermediation.

The TDLC ruled in favor of PM in all its claims, ordering CT to abstain from exclusionary conducts and to pay a fine.[15]

The ruling was later appealed to the Supreme Court (the Chilean Antitrust Law contemplates a specific antitrust recourse "*reclamación"*), which confirmed the ruling in all its points. The FNE was later requested by the TDLC to supervise the observance of the ruling.

iii) Civil law suit

PM filed the case in a Civil Court on 14 July 2008; the Civil Court must base its judgment on the Supreme Court´s ruling.

iv) Conclusions

Exclusive merchandising and advertising clauses are not considered anticompetitive at the outset. However, in this particular case preventing a competitor's product from being exhibited resulted in impeding the actual sales of the competing product. The clause operated as an exclusive dealing clause, and therefore was deemed anticompetitive.

B. FNE vs Cervecera CCU Chile Ltda [16]

i) Facts

The FNE filed a complaint *("requerimiento")* against *Cervecera CCU Chile Ltda* (hereafter "CCU") for the infringement of Art. 3 of DL 211 specifically on its letter (b)

> *"(b)The abusive exploitation by a corporation or corporations having a common holding company, of a dominant position in the market, fixing purchase or sale prices, imposing on a sale that of another product, allocating market zones or quotas or imposing like abuses on others."*

The FNE claimed that CCU had a dominant position [83%] in the relevant product and geographical markets of *Beers for immediate consumption in the national*

[15] US$560,000.
[16] C 153-08 TDLC, accusation by FNE of March 3 2008.

territory[17] ; and had abused its dominance by the following conducts amongst others: a) including exclusive dealing provisions in contracts celebrated with hotels, restaurants, bars and discotheques b) including exclusive advertising and merchandising provisions in contracts celebrated with hotels, restaurants, bars and discotheques.

In substance, the FNE claimed these acts where aimed at securing a dominant position in the beer market by creating entry barriers to potential competitors. The FNE asked the TDLC to rule in the following way: order CCU to terminate or modify all exclusive dealing provisions in contracts; prevent CCU from incurring in similar conducts in the future and to abstain from hindering the promotion and commercialization of competing products in its sales points; order CCU to pay the costs.

On the other hand, CCU replied asking the TDLC to reject the accusation in all its points as the objected provisions or business practices defined by them as *"Image clauses"* where in compliance with competition laws.

ii) The Settlement

On July 23 2008 the TDLC approved the agreement reached between FNE and CCU in the conciliation phase of the trial. It is important to note that the settlement does not entail an admission of guilt by CCU.

The parties agreed to the following: a) CCU will not establish either unilaterally or by agreement or by any other means expressed or tacit, with establishments (sales points) vertical exclusivity or exclusionary incentives; b) CCU will not subscribe exclusive publicity contracts with establishments with a duration over 3 years (exclusive publicity is conditioned to the compliance of certain requirements listed); c) CCU withdraws existing exclusivity contracts (the above mentioned "*Image contracts"*); d) CCU states that the agreement has been subscribed on good faith and thus will not incur in other conducts which entail similar effects.

[17] The FNE first defined the relevant product market as beers, however this market can be further subdivided by the specific distribution channel.

iii) Conclusions

Despite the fact that there was no formal pronunciation by the TLDC (the case was resolved by a settlement), a clear sign was sent to market players: *exclusive dealing clauses, subscribed by dominant undertakings that generate entry barriers will be deemed anticompetitive.*

C. *FNE vs Compañia Chilena de Fósforos S.A.* [18] *Pending case*

i) Facts

The case was initiated by a complaint filed by FNE *("requerimiento")* against *Compañia Chilena de Fósforos S.*A (hereafter "CCF") for the infringement of Art. 3 of DL 211 specifically on its letter (b)

> *"(b)The abusive exploitation by a corporation or corporations having a common holding company, of a dominant position in the market, fixing purchase or sale prices, imposing on a sale that of another product, allocating market zones or quotas or imposing like abuses on others."*

The FNE claimed that CCF had a dominant position [90%] in the relevant product and geographical markets of *commercialization of security matches on national territory*[19] ; and had abused its dominance by the following conducts amongst others: a) pressure and reiterated threats to a foreign providers to a Chilean competing undertaking; b) unlawful and abusive use of judicial and administrative recourses; c) rebates for exclusivity; d) exclusionary economic incentives.

In substance, the FNE claimed these acts where aimed at securing a dominant position in the beer market by creating entry barriers to potential competitors.

Comercial Canadá Chemicals S.A. also filed a complaint against CCF, which was accumulated to the same case. The company claimed that CCF had abused its dominant position by several exclusionary acts.

[18] C 165-08 TDLC, accusation by FNE June 20, 2008

[19] The relevant market can be further subdivided by distribution channels: commercialization through wholesalers and commercialization through supermarkets.

On the other hand CCF replied both the complaint by FNE and *Comercial Canada Chemicals S.A*. Regarding the reply to FNE: CCF argued that: a) the market definition should not be limited to security matches but should also involve other "lights" (such as cigarette lighters and others) and thus they should not be considered a dominant undertaking; b) inexistence of pressure or reiterated threats to a foreign provider; c) lawful exercise of judicial and administrative recourses; amongst others.

This case is now pending at the TDLC.

i) Conclusions

In the final ruling market definition will play a crucial role as CCF claims to have a very low participation in the market (contrasted with the 90% attributed by FNE). Also important will be proving the existence of a "boycott" to prevent the entry of Comercial Canada Chemicals S.A. into the Chilean market.

D. Other investigations ongoing or closed

The following investigations by FNE also relate exclusive dealing provisions. Some are still ongoing and the FNE is analyzing the effects of the provisions and advising parties to modify them to comply with competition law. Others have been closed without need of action before the TDLC because parties decided to withdraw exclusive dealing provisions from their contracts:

- Coca-Cola: parties voluntarily asked for revision of their contracts with distributors. No investigation opened

- Cervecería Chile: case closed parties withdrew the exclusionary causes from their contracts.

VI. Conclusions

In the analysis of vertical restraints, it is essential to determine dominance in the relevant market. Chile has no thresholds based on market shares or other indicators, dominance will be assessed by balancing a number of economic factors.

Market players investigated for vertical restraints have had a substantial market share; thus, we have not dealt yet with borderline cases where dominance may be more questionable.

There are *no perse* infringements in Chilean antitrust therefore all cases concerning vertical restraints will be analyzed on a case-by-case basis under the rule of reason.

In the specific case of exclusive dealing, the cases addressed by the FNE have resulted not only in good judicial outcomes, but also in an improvement in competition advocacy, as market players under investigation have decided to adapt their behavior and remove exclusive dealing provisions rather than risk an accusation by the FNE before the TDLC and potential sanctions.

Vertical restraints are far from being a resolved matter in Chilean antitrust, and there are still a number of questions to be answered; but we have taken strong steps forwards; two of them clearly being competition advocacy by sending strong messages to the public and offering settlement or conciliation solutions for market players.

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