Minimum Resale Price Maintenance and Fuel Cartel in CADE: Back to the World *Per Se*

César Mattos

I) Introduction

In 2013, the Brazilian antitrust authority, the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica – CADE), handed down a judgment against minimum resale price maintenance (RPMm) implemented by SKF do Brasil on bearings, retainers, grease, lubricants, tools in general, monitoring equipment, and others. The deciding opinion in the case was handed down by councilor Vinicius Carvalho following review of case rapporteur César Mattos’ not-guilty vote. A penalty of 1% of the company’s annual revenue was set, the minimum legally mandated sanction for a conviction based on the prior statute, Law No. 8,884/94.

The interest in RPMm conduct in a collection of essay intended to examine cartels is clear: the key anticompetitive problem with RPMm is the potential of facilitating cartels in the upstream or downstream segment alike, including for brand resales. RPMm, in this light, could serve as an instrumental tool for cartels, as we will see in greater detail in section II.

While not constituting an unlawful act of RPMm *stricto sensu per se*, the SKF case in Brazil signals a shift toward a significantly more rigorous stance in toward this type of conduct, including in relation to other vertical restrictions.

On the one hand, councilor Vinicius Marques’ opinion sought to demonstrate that SKF exercised coordinated power and, perhaps, unilateral power, thus meeting the requisite standard for a finding of anticompetitive conduct. By contrast, the opinion of councilor Marcos Veríssimo indicated that demonstrating market power, whether unilateral or coordinated, is not necessary. The harm caused by RPMm is assumed. As such, and the corresponding efficiencies would have to be greater than the harm deriving from the conduct, a burden that would fall to the company, not CADE, indicating full transfer of the burden of proof to the Defendant. Given the usual difficulties involved in demonstrating the existence and scope of efficiencies, this standard of review would, in practice, come close to a *per se* illegality standard.

The approach adopted reflected a change in CADE’s jurisprudence. Previously, the rule of reason had been applied to RPMm, as occurred, for example, shortly prior to the matter in question in the Everest case, also examined in these pages. Nonetheless, in a more recent case the fuel

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1 Ph.D. in Economic, former council member of the Brazilian competition authority, CADE, permanent staff member of the Brazilian Chamber of Deputies, and coordinator of the MBA program in Regulation of the Getúlio Vargas Foundation.

2 08012.001271/2001-44. All of the opinions cited in these pages are available at [http://www.cade.gov.br/Default.aspx?aid=28896ca6a6d0b241d34d0b696fc](http://www.cade.gov.br/Default.aspx?aid=28896ca6a6d0b241d34d0b696fc)

3 The lone council member voting with the rapporteur was Olavo Chinaglia. Voting with council member Vinicius Carvalho were council members Fernando Furlan, Marcos Veríssimo, Eduardo Pontual, and Ricardo Ruiz, all of whom submitted separate opinions.
distributor Shell was convicted for an alleged act of RPMm. In the latter case, the company argued that it had merely provided a “suggested resale price” and had not engaged in RPMm, a reasonable position as will be seen below.

RPMm represents a paradoxical conduct, the direct product of the age-old problem of “double marginalization,” as described by the Organization for Economic Co-operation and Development – OECD (2008):4

“How might RPM be anticompetitive? Two possible explanations hinge on RPM’s being a cover or facilitating device for horizontal price-fixing or a horizontal cartel. One possibility is a cartel among manufacturers that cannot observe each others’ wholesale prices but that can observe retail prices. They may collectively fear that ‘price wars’ among their retailers may tempt individual manufacturers among them to cut wholesale prices surreptitiously, thereby undermining the cartel. Resale price maintenance would prevent these price wars.

Alternatively, RPM might be motivated by a dealer cartel (among a group of dealers that collectively have market power, if they could succeed in colluding) that find they cannot collude without external help.”

The two important cases decided under CADE’s new jurisprudence, SKF and Shell, involved an alleged reseller cartel. In this light, the analysis will focus on downstream resale, not upstream resale.

The first question when analyzing RPMm that results in a reseller cartel is what is the seller’s rationale in the upstream market for engaging in such

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conduct? Suppose a monopolist in the upstream market with various resellers (or input customers in the downstream market). What would the monopolist’s possible anti-competitive interest be in forcing its resellers to sell a given product at the minimum price?

In many cases, the answer is no interest. That is because the seller in the upstream market has market power in relation to its resellers and in general will prefer to exercise its own monopoly price. To this end, there is no need for RPMm. In truth, imposition of RPMm will cause the seller’s profits to fall and that of its resellers to increase. Imposing RPMm corresponds to the upstream seller conferring artificial market power on the set of resellers. At a higher resale price, provided the upstream seller maintains its price constant, the quantity sold to the end consumer will be less, generating lower revenues and profits to the upstream seller. By fixing a monopoly price for resellers, the supplier does everything it needs to obtain maximum profit, which, by extension, is the monopoly profit. RPMm can only reduce the supplier’s profit. Thus, the supplier has no natural interest in playing the role of organizer of a reseller cartel. Blair and Kaserman (2009) highlight the conflict of interest between the supplier and its resellers:

“Why would the manufacturer agree to participate? A dealer cartel that increases the price and decreases the sales of the manufacturer’s product will increase the distributor’s joint profits while decreasing the manufacturer’s profit. This is true whether the manufacturer faces some competition or is a pure monopolist. In general, the manufacturer’s profit is maximized when its dealers charge competitive prices, which is precisely the opposite of what colluding dealers want to achieve.”

Resellers consider the upstream seller’s price a cost and add a margin (in addition to the margin set by the upstream seller) to the price of the product sold to the end consumer. In economics, this situation is called “double marginalization.”

If the existence of market power by the downstream resellers is disadvantageous for the upstream seller, why would the voluntary offer of an equivalent artificial market power through RPMm, mimicking the market power of the reseller, be positive? The supplier would be creating a “double marginalization” problem, generating a negative effect on its own profit.

The argument that RPMm can lead to a reseller cartel is based on the pressure the reseller in the downstream market can exert on the seller in the upstream market to serve as cartel “conductor.” This requires presuming that the set of dealers exercises reasonable bargaining power over the seller. But if the resellers do not exercise reasonable bargaining power in relation to the supplier, the former will have no way of obligating the latter to do something it does not wish to do – apply RPMm.

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5 A fundamental hypothesis is that the restriction is not redundant. That is, the minimum RPM is greater than the market price without the conduct.
Note that the only justification for resellers to force sellers to impose an RPMm for purposes of forming a cartel would occur when resellers are unable to coordinate among themselves. However, dealers unable to coordinate sufficiently among themselves would have minimal combined bargaining power. On the other hand, if dealers are able to coordinate to pressure the monopolist or the cartel in the upstream market, why would they not organize a reseller cartel directly, instead of resorting to RPMm?

Moreover, a reseller cartel is only feasible if inter-brand competition is limited, i.e., when the brand possesses reasonable market power. If the supplier does not exercise unilateral market power, the resellers will certainly not exercise this power either and, in fact, will require the support of the supplier, which, for its part, will have no incentive to provide that support.

Cases like these in which minimum RPM facilitates the cartel in resale markets are rare. Even in the case of the upstream market, it is worth assessing if more direct and rapid strategies than RPMm are available to achieve the intended objective. Blair and Kaserman (2009), for their part, point to evidence that would seem to contradict the allegation of a high incidence of cartels made possible by RPMm:

“there is scant evidence that either a manufacturer or a dealer cartel is, in fact, a primary motivation for implementing Retail Price Maintenance (RPM). In practice, it does not appear that RPM is primarily, or even frequently, employed to facilitate collusive arrangements. For example, many of the cases involving vertical price restraints have involved manufacturers with relatively small market shares.....In an exhaustive analysis of cases involving vertical price restraints, Ippolito found that only about 10 percent of private enforcement cases and about 13 percent of all cases (private and public) involved allegations of horizontal collusion”.

The upstream seller may also seek to increase competition between dealers through RPMm by means other than price. If the seller believes the consumer will attach relatively higher value to service quality than to prices, it may be efficient to stimulate more inter-brand competition among resellers through a higher level of service quality than through lower prices. Gellhorn and Kovacic (1994) summarize the three key pro-competition justifications for RPMm reflected in the antitrust literature:

“1) It may be to a manufacturer’s advantage that the retailers provide effective service to their costumers......... or that the product be better promoted throughout a sales area in order to attract buyers (e.g., cosmetics and other drug store items). Creating an effective minimum retail price induces dealers to compete more aggressively on non-price criteria such as service (repairs, returns, credit) and promotion (advertising)”.

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2) The second beneficial purpose of RPM is to protect the signal of high quality created by a retailer’s approach to doing business.

3) A third procompetitive goal of RPM is to facilitate entry by new firms and the introduction of new products. New, unknown firms may face difficulty in persuading store owners to allocate scarce shelf space and inventory capacity to stock their goods. New or existing companies seeking to introduce new products may believe that detailed explanations and demonstrations at the point of sale will be essential to attract customers. Ensuring generous resale margins with RPM can induce retailers to carry a new entrant’s goods or to stock a product early in its life cycle.

Let us consider how the basic theory applies to RPMm in the alleged reseller cartel cases brought before CADE.

III) SKF Case

As noted in the introduction, in 2013 CADE reversed its previous position that RPMm should be addressed by the rule of reason. Councilor Marcos Veríssimo, who voted to convict SKF, advocated for a more stringent analysis of RPMm, which did not reach the level of a *per se* rule, but involved the presumption that the conduct causes harm in almost all cases, in a manner similar to cartels, which could in some cases, however, be offset by efficiencies.

However, the councilor did not clarify why the costs of the analysis of net effects would be especially high in RPMm conduct. For example, the practices of exclusivity and tie-in sales directly affect inter-brand competition, generating at least as much potential harm as the damage to competition caused by conduct with a more direct effect on inter-brand competition, while involving, *ceteris paribus*, the same degree of complexity for purposes of analysis. There is no reason to approximate the analysis of RPMm more to cartel conduct under the *per se* rule standard than any of the other practices examined under the rule of reason standard. This point is underscored by Motta (2005):

“there is no economic justification for a policy that treats restraints in a different way, say using a *per se* rule of prohibition against retail price maintenance while allowing all other restraints”

The author suggests that an exemption be granted, from an operational standpoint, for all vertical restraints in companies with a market share below the 20%-30% level, as in the SKF case.

An additional aspect of councilor Marcos Veríssimo’s assumption against RPMm is that the authority would not be required to demonstrate the harm or, for the matter, the existence of market power. Instead, the burden of proof for demonstrating sufficiently significant efficiencies from RPMm conduct, where these are not obtainable by other means, to offset the resulting harm – deemed certain and unquestionable – would fall to the company.
Councilor Olavo Chinaglia, who voted to acquit SKF, underscores the deficiency of transferring the burden of proof for efficiencies to the company: “in the case under consideration it is precisely the inability of the practice under investigation to affect normal functioning of the market and, consequently, generate any notable effect from an antitrust standpoint. Conditioning dismissal of the case to a showing of economic efficiencies by the Defendant creates a scenario similar to that referred to in procedural theory as devil’s proof.” As such, according to councilor the case in question involved an “indiscriminate resort to presumptions as to both the existence of market power and the potential harm of the conduct.”

Councilor Ricardo Ruiz also highlighted the company’s obligation to demonstrate that RPMm generated efficiencies, however without tying this requirement to a previous finding as to the anticompetitive effects of the conduct.

Yet, in any competition review the need to evaluate efficiencies assumes that damages were generated by the conduct, an assumption which was far from demonstrated in this case. An anticompetitive problem cannot be condemned due to the absence of offset efficiencies if the potential effects have not been shown. Simply put, offsets cannot be required when there is nothing to offset.

The problems of measuring offset efficiencies, in addition to the traditional bias of antitrust authorities commonly against these, are well known. In particular, the “service quality” variable, presents a series of dimensions that are difficult to observe and verify.

In addition, councilor Ruiz’s vote upon further review demanded the “realization of efficiencies” in place of a reasonable expectation that the efficiencies would occur. It is our view, however, that effective realization of efficiencies should not be necessary for these to be considered, as no business action can be guaranteed ex-ante.

Finally, SKF was required to demonstrate improvements in the quality of services that were not actually provided by the company, but rather by the reseller, which were not parties to the case.

We believe the analysis should have centered on the extent to which there was a reasonable expectation of efficiency from the conduct in the context of the sector and the companies involved.

This expectation should be deemed plausible to the extent service quality is considered relevant to the brand’s support and/or growth. Indeed, this hypothesis cannot be disregarded in the SKF case, as the opinion of councilor Marcos Verissimo indicated the need to give resellers in the bearings for

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8 Observable means when a company is capable of identifying improvements in quality. Verifiable means when a company is able not only to observe but to demonstrate the improvements to a third party, specifically the antitrust authority or a judge, for example.
industrial application segment special treatment at the time of purchase. As stated by the councilor:

“A subsequent study of SKF distributors by the SDE [Secretariat of Economic Defense] confirmed that in the industrial sector assistance, where necessary, is encapsulated in the first sale, but, without prejudice to this, that there are also pre- and post-sale services in this sector and the automotive bearings resale sector as well.”

Another indicator that service quality at the time of resale was important to SKF lies in a statement submitted by the company, as transcribed in councilor Furlan’s opinion:

“SKF also invested in technical certification programs for its industrial distributors and development partnership models with entities interested in receiving differentiated assistance in their post-sale services. This was accomplished through the ‘Authorized Distributor,’ ‘Value Partner,’ and ‘Joint Action’ programs (...). In addition, SKF established a distributor development department for the exclusive purpose of developing a distribution channel based on processes and best practices of services to the market, organizing, for this purpose, a number of workshops and training programs.”

However, in the opinion of councilor Furlan, the resale service quality enhancement actions undertaken by SKF produced a negative effect for the defendant argument. Rather than viewing these as an indicator of the importance of service quality which could be achieved by various additional means the councilor noted that “as the quality of distributor services was supposedly ensured through the actions of the distributors themselves, separately from the conduct under investigation,” RPMm was not necessary.

In other words, the councilor’s working theory was that the actions of a company for a given end (improved resale service quality) are always substitutes. The possibility that a given action may not exhaust the full potential for gains in service quality was not considered. The fact that actions may be complementary and not substitutive was disregarded. To be sure, quality service “training” should be more effective where the reseller can derive higher profits from this “input.” At the same time, the possibility of higher profits from resale could come to naught without the appropriate training.

It is extremely risky for the authority to arbitrate the best way for a company to address specific problems in connection with protection of its brand (or any other problem relating to management of the business). The authority may determine that a specific method entails less potential harm to competition than another, an assessment that surely falls within its scope, but not whether a particular method is better than another, from a private enterprise standpoint, or, by extension, that adoption of the allegedly “worse” option constitutes evidence of a competition problem. It is highly unlikely the authority could ever be in a better position than the company itself, which lives the day-to-day realities of its business activities, to make this judgment.
However, councilor Furlan took the opposite view, stating that “for purposes of protecting brand reputation, for example, establishment of an exclusive or selective distribution system that ensures the product was only sold by resellers with solid reputations and standing would be far more effective for combating the free-rider effect through quality certification” than RPMm.

A significant aspect of councilor Ruiz’s vote involved the duration of the conduct. In general, potentially anticompetitive conduct is deemed more serious the longer it persists. To be sure, if SKF’s RPMm had continued, say, five years, CADE’s analysis would have centered on how the conduct produced negative effects on society, providing an added motive for conviction. However, SKF’s conduct extended only a few months, a fact that should have been deemed a mitigating circumstance. Councilor Olavo Chinaglia interpreted the short duration from this more prevalent perspective – as evidence against conviction – thus reinforcing “the position that the conduct could not have influenced the behavior of the reseller for which it was intended.”

But this was not the interpretation that prevailed in the Council. In the SKF case, the opposite interpretation was given for the short timeframe: if the conduct had actually been efficient, it would have continued. As councilor Ruiz argued:

“If efficiencies had existed, there would have been no reason for the RPM practice to be discontinued after such a short time, as reported by SKF. Yet, the pre-sale assistance service was suddenly no longer essential after only seven months of the conduct? The Defendant argues that the practice was too costly to monitor. In fact, this only serves to demonstrate that RPM was not ‘essential,’ the only means for ensuring differentiated resale assistance.”

As such, the signal sent to the market was that duration of any allegedly anticompetitive conduct, whether long or short, would always be used against companies.

Ultimately, the Courts reversed CADE’s decision in the SKF case based on the authority’s own decision to reverse its position on the issue without providing any prior notice to the market.

IV) Everest Case – Acquittal of RPMm by CADE

In a peculiar twist, in October 2011 CADE rendered a not guilty verdict in an RPMm case reported out by councilor Elvino Mendonça. Bearing significant similarities to the SKF case, a more flexible application of the rule of reason was employed. In the Everest case, the Council examined RPMm in the water treatment equipment market. Despite the company’s allegation that it had a market share of slightly less than 5%, SEAE [Secretariat of Economic Development] 08012.009674/2008-16. The article by Coelho and Silva (2013 - NEW DEVELOPMENTS ON THE ANALYSIS OF RESALE PRICE MAINTENANCE IN BRAZIL defended at the ALACE Meeting, Rio de Janeiro de 2013) with an excellent review of the RPM jurisprudence in Brazil and a description of the course reversal adopted in the SKF case, which drew wide attention to the Everest case. See case at [http://www.cade.gov.br/Default.aspx?aid889b6ca60b241d345d069fc]
Oversight] identified specific types of equipment for which the company held a market share above 20%. In addition, no significant entry barriers were verified. The rapporteur’s ruling found an “absence of structural conditions” capable of harming competition.

As in the SKF case, services in connection with equipment installation and maintenance played a significant role. Just as in the SKF case, the problem involved the reputed quality of those services.

Another important facet of the Everest case was that despite reporting on the company’s alleged efficiencies, the rapporteur’s decision did not include a requirement to “realize efficiencies” as occurred in the SKF case. Rather, the rapporteur referred to these as “likely efficiencies generated,” a conclusion more in line with our view of the appropriate interpretation, rather than “efficiencies realized,” a showing for which is an “almost impossible mission” in most cases.

In sum, the absence of evidence of market power and the simple expectation of efficiencies in the Everest case were sufficient to preclude conviction. In accordance with the analysis put forth, the rapporteur ordered that the preliminary inquiry be set aside, as per the unanimous decision of basically the same Council membership, suggesting that Everest had enjoyed better luck than SKF and Shell.

V) Shell Case

The Shell case basically reinforced the precedent set in the SKF Case. The case involved the allegation of RPMm conduct imposed by Shell on affiliated Shell gas stations in the municipality of São Carlos.

The rapporteur, councilor Alessandro Octaviani followed the same line of reasoning he had adopted in the SKF case, arguing that there was a “presumption of illegality” and that the Defendant bore the responsibility for demonstrating that the matter entailed “accessory, necessary, proportional and essential conduct to ensure accomplishment of the principal legal object and for purposes of steering the proceeding toward an analysis of the corresponding effects, not the object.” In sum, for the conduct to be deemed legal it had to be shown to have generated efficiencies.

A specific aspect of the case does approximate RPMm conduct, namely the recorded telephone conversations between representatives of Shell and gas station owner. By extension, clause eight of the franchise agreement reported by councilor Márcio de Oliveira provides that Shell will suggest the maximum (not the minimum) price as a condition for receipt by the franchise of an amount above the minimum established operating revenue. This peculiarity in the franchise agreement made mention only of maximum resale prices, not minimum resale prices, a fact wholly neglected in the votes of CADE’s council members.

The clearest indication that the case was virtually per se lies in the evaluation of market share. The Brazilian competition statute, Law No.
12,529/11, includes a specific provision that a dominant position is assumed at a share above 20% (article 36, § 2).

The 20% parameter for unilateral market power is recognized to be a low criterion for presumption of market power. As stated above, Motta (2005) argued that conduct involving companies with percentages below 20%-30% market share should simply be disregarded for purposes of antitrust reviews. As the author illustrates, the UK’s Office of Fair Trading (OFT) operates on the premise that at a market share below 40% a company is unlikely to hold a dominant position. Article 15 of the European Community’s Merger Regulation approaches the stringent criterion applied in Brazil a bit more, providing that a market share below 25% would result in the assumption that the merger in question had not generated a dominant position.

That said, the twenty percent (20%) level is deemed, in general, a “de minimus” rule under Brazilian Law, similar to the position spelled out by Motta (2005).

While the rapporteur simply disregarded the issue of market share, councilor Márcio de Oliveira did consider the question.

The market share of Shell fuel distribution based on capacity sold in São Carlos at the time of the conduct in 2002 was 13.34%, thereby below the limit referenced above.

In fact, Shell was not even the market leader. That position was held by Petrobrás, with a 16.95% share, leaving Shell in second, closely followed by Esso at 12.58%, Agip at 12.02% and Chevron at 9.16%. In other words, none of the distributors, including the leader, held a 20% market share or higher in São Carlos. The table presented by the councilor with data compiled by ANP [Brazilian Petroleum Agency] indicates a dispersed market consisting of 34 distributors.

However, councilor Márcio Oliveira questioned the data, claiming these failed to differentiate between the various “destinations of the fuel; there is no way to know if the capacity refers exclusively to fuel sales at resale stations or for other commercial activities.” As such, he argued that Shell’s 13.34% share was underestimated.

Based on this reasoning, the councilor opted to calculate market share, not by volume sold, but by the number of stations operated by each distributor. There were a total of 29 gas stations in São Carlos at the time, of which 6 were operated by Shell and 7 by Petrobrás (note that under this criterion Shell remained in second place) and a total of 12 independently. Using this measure, Shell’s market share rose to 20.69%. The councilor deployed the new figure, which was a mere 0.69 percentage points above the minimum presumption of dominant position, to conclude that Petrobrás and Shell exercised market power in the fuel distribution segment in São Carlos.

Yet, it was subsequently shown that councilor Márcio de Oliveira had
added the number of Shell and Esso stations together, when, in fact, at the time the two brands had not yet merged. As such, even if computed on the basis of total gas stations Shell’s effective market share was below 20%.

Even after taking the new information into account, councilor Ana Frasão denied that the 20% share constituted a “de minimus” rule. As such, even actors with market shares below the threshold could be presumed to exercise a dominant position.

Given that Shell’s market share as considered by CADE was low and that the company competed with the leading distributor, Petrobrás, which, moreover, held a virtual monopoly on the upstream distribution market, Shell’s capacity to exercise unilateral market share was significantly constrained. What sense would there be for Shell to create a reseller cartel without the participation of Petrobrás resale chain? The cartel would be doomed to failure.

The only alternative in this case would be for Shell to coordinate with the other distributors, most notably Petrobrás, at the same time it sponsored the reseller cartel. However, there is no evidence of such coordination in the case file. Other distributors did not apply RPMm capable of contributing to coordination.

Officially, Shell’s resale prices were suggested by the distributor, not imposed. As per the consensus evaluation of CADE, the difference between suggested and fixed resale prices, in practice, involves the existence of credible enforcement mechanisms by the distributor over gas stations. This was a critical point raised by the rapporteur, Alessandro Octaviani, who argued that enforcement does not need to be explicitly specified in contract, requiring only that it have a compulsory character supported by sanctions for nonperformance by the dealer of the RPM. In fact, the rapporteur went further, indicating that a suggested price does not apply when there is a “sense of obligation” tied to a price recommendation, which would encompass a form of “tacit coercion.”

The principal evidence in the proceeding on the existence of non-contractual coercive mechanisms in connection with resale prices were the recorded telephone conversations. Interestingly, in a pure RPMm conduct case the very same evidence would have indicated that the distributor had not in fact set a fixed price, to the extent the Shell representative indicated that the station owner should follow the price in effect in São Carlos, irrespective of the prevailing price. To be sure, at no time in the conversation did the parties mention Shell’s suggested prices.

Understanding the role of the Shell suggested prices requires an evaluation of the intelligence work performed by the company on behalf of its resellers, and which would redound, invariably, to the benefit of the entire chain. CADE’s assumption that the exchange of information between the distributor and its dealers was harmful to competition is difficult to understand. This error is revealed in the following statement by councilor Márcio de Oliveira:
“Shell’s commercial representative reported to the franchisee the prices charged by other resellers. As such, Mr. Odon engaged in the exchange of sensitive information between supposed competitors.”

The councilor ascribes a negative interpretation to the Shell representative’s statement that “the suggested price policy was based on an analysis of the station’s area of influence, considering that the potential sales volume the station could achieve with a price, which, according to Shell, was the ideal price for reaching that volume. The respective price also took into account the prices charged by competing stations in the area of influence.”

Now, all pricing is based on information. The distribution business is critically dependent on the performance of resellers. It is essential that they be fully informed of the competitive conditions in their area. There is clear complementarity between the intelligence service provided by the distributor based on the competitive dynamics of gas stations throughout the country and the local information held by stations. In addition, Shell employs information available to all gas stations to develop its suggested price. Ultimately, the theory of prices, in the context of either significant or negligible competition, is based on the idea that each agent observes the prices of other agents before adjusting its price. This is an intrinsic component of the market mechanism CADE is charged with defending. If the prices of competitors are not taken into account, the adjustments stemming from the competitive dynamic will occur at a far slower rate. Each player only adjusts its price when it has fully observed a variation in its demand over time, which otherwise might be mistaken for cyclical reductions unrelated to its competitors. With the support of the distributor’s intelligence service, price adjustments can be implemented far more quickly, benefiting each link in the supply chain. Competition requires continuously evaluating competitor prices, and the “help from above” within the supply chain can make a significant difference for the entire chain. This is inter-brand competition at work.

If a distributor in the segment is able to provide better information than each individual resale station is capable of extracting from its own market, the effect will be to help “grease” the gears of information and ensure the market operates more effectively. To contend, as the councilor does, that “knowing competitor prices” is a bad thing, in conjunction with his criticism of the influence of distributor implemented accounting systems on the network, on the argument that this results in reseller cartels, seems to us a fundamental misunderstanding of the role information plays in the operation of basic market mechanisms. In sum, according to the council the competition process should not be based on information!!

The distributor has an interest in stimulating gas stations operating under its brand name to provide quality services. Yet, stations do not always possess adequate incentives to ensure delivery of the service standard demanded by the brand. Furthermore, the problems in connection with fuel quality and reliability in Brazil are well known, namely product tampering with the objective of increasing the profit margins of gas stations. In this light, each distributor has a natural concern with ensuring that affiliated stations do not tamper with their
fuel, under penalty of jeopardizing the distributor’s reputation and, by extension, the brand’s value.

Note that each gas station is indeed interested in providing quality service, insofar as a portion of the reputational gains is appropriated by the station. Customers will return multiple times not just because they recognize the chain’s quality standards, but because of the service provided by the gas station itself. What the gas station does not appropriate and, therefore, does not internalize are the externalities that benefit the entire chain. The cost required to improve service quality is largely incurred by the gas station. This difference, reflected precisely by the chain’s volume of externalities, means the ideal service quality for the station is lower than the ideal service quality for the chain. Therefore, it makes sense for the distributor to put forward mechanisms to control and induce higher service quality.

However, the distributor faces a moral hazard problem in relation to its resellers. Consequently, the distributor is not able to fully implement the ideal service quality from the chain’s perspective. This is due to the fact that it cannot perfectly monitor all of the gas stations to which it sells fuel.

In this light, if Shell had in fact engaged in RPMm conduct, the possibility that the conduct was associated to a strategy to induce improved service quality from gas stations, and, in particular, to prevent product tampering, should not have been discarded.

However, the rapporteur challenged the idea of support to quality, stating that “no concern with service quality or guidance from the distributor’s brand was identified, only the express intention to ‘follow market prices’ preventing any reduction in the respective [price] level.”

Yet, an agreement was signed containing various clauses and actions aimed at enhancing resale quality. Application of RPMm to support an increase in quality does not need to be expressly prescribed by contract or verbally.

Defining the contractual obligations of gas stations in relation to quality investments, including combating product tampering, is a mechanism employed to mitigate the free-rider problem of each station vis-à-vis the chain. In these cases, the distributor acts as a “regulator” for the chain, applying typical “command and control” regulation to its affiliated resellers.

However, as with regulation, “command and control” mechanisms are generally not sufficient, including as a result of the distributor’s moral hazard problem vis-à-vis the gas stations. In this light, RPMm would be a natural candidate to correct the incentive structure of the resale station so as to align more closely with the objectives of the distributor and its chain.

The issue raised by the rapporteur is that “resale price fixing would not be capable of eliminating the incentives to engage in product tampering, but...at most... would only reduce these....indicating a disconnection between means and ends, given the existence of more effective approaches with, more
importantly, a less harmful impact on competition.” In other words, the rapporteur acknowledged that the conduct may reduce – signaling a major step forward – but not eliminate the incentives to product tampering.

As in the SKF case, an evaluation was conducted as to whether RPMm is a proportional measure or not, in the light of the existence of other quality control actions. As the rapporteur noted:

“price fixing would not survive a needs test – i.e. less harmful means could be identified to achieve the same end. To be sure, a number of other quality control mechanisms, less harmful to competition, capable of ensuring fuel quality are available to distributors, including mechanisms implemented by the Defendant Shell, pursuant to the company’s own submission: ‘Shell DNA system’ (p.19), ‘electronic locks,’ and ‘mobile laboratories’ (p.20)...”

CADE insists these product tampering control mechanisms can be substitutive, but never complementary, a clearly mistaken position. RPMm corresponds to an incentive regulation and may be necessary to complement (not substitute) “command and control” mechanisms, which are also important in the effort to control product tampering.

The franchise agreement demonstrates Shell’s concern with inducing efficiency in its resale operation. As recognized in his opinion, councilor Márcio de Oliveira notes that in the case at hand “the franchise system encompasses the know-how and techniques for resale operations. Specified in so-called Operating Manuals,” that “address the techniques and methods, designs or instructions, as well as all of the information and data relative to installation, operation and maintenance of Shell gas stations.” Clause twelve prescribes a number of service quality requirements for resale operations, including initial training and re-training, in addition to visits by Shell supervisors.

In particular, clause 12.1, line “m,” of the agreement provides that franchisees may not “sell products or services not previously authorized by the FRANCHISER, products and services which are not in adequate condition for purposes of supply to the end consumer or products of doubtful origin or quality, which in any way cause harm to the copyrights and intellectual property rights of third parties and/or the FRANCHISER,” a provision which more directly addresses the risk of tampering.

In addition, Shell applied management software as well as a unified accounting system to enable support to the activities of resellers and provide an idea of the distributor’s investment in quality resale operations.

This is one of the typical risks that emerge when the bureaucracy takes it upon itself to evaluate which specific method is “least harmful to competition,” without having a deeper understanding of how each method works in practice and the product tampering indicators they reach. It is very unlikely that those not engaged in the day-to-day operation of the business will be in a position to make this judgment. Analysis of the existing incentives of agents is possibly the
The connection between RPMm and quality in the case of gas stations in general is associated to the “quality certification” argument. In the Brazilian case, it can serve as a substitute to full vertical integration of the distributor and its gas station resale chain, a practice prohibited by ANP Resolution No. 41, dated 11/05/2013.10

The point is that the verticalization mechanisms developed for distributor-gas station arrangements in Brazil are imperfect substitutes to full verticalization. In other words, RPMm conduct may be a response, albeit an imperfect one, to a regulatory restriction. ANP’s own concerns regarding the appropriateness of verticalization restrictions were manifested by CADE itself in a 2010 opinion by councilor Carlos Ragazzo de 2010:11

“In assuming that some degree of verticalization is desirable, certain jurisdictions, in contrast to Brazil, set limits on the percentage number of gas stations that a distributor can own and operate, or own and outsource. And why is this degree of verticalization desirable? The answer to that question resides in the transaction cost savings of the partnership model (to which we could also add the elimination of double mark-ups and the consequent increase in product demand). In these cases, wherein verticalization is subject to a legally mandated limit, the risk of anticompetitive conduct would be controlled, at least a priori, generating incentives to competition by requiring verticalized companies to compete with “pure” resale groups, potentially sufficient in number to disincentivize coordination in the resale and distribution sectors. (...) evaluation is required to determine whether the prohibition of verticalization, as set forth in ANP Directive No. 116, should be revised, given the potential efficiency gains arising from corporate-operational verticalization, provided, as applied in the pertinent international models, limits are imposed on this form of operation by ensuring a significant number of free dealers are maintained.”43 (underline added)

In other words, CADE itself has already acknowledged that it is not at all clear if the restriction on full verticalization is beneficial to competition, recognizing that the related efficiency gains warrant consideration, with a view to possibly revising the current regulatory framework. Given the antitrust authority’s signal on this matter, the question then is why weaker vertical arrangements, including RPMm or suggested resale prices, were found to be violations a posteriori.

The mechanism used by Shell involved a suggested resale price, not RPMm, whether in theory or in practice. Let us consider the reasons for this.

The rapporteur’s arguments were strongly grounded in the information transmitted between the distributor and the gas stations. The restriction on this

information flow by CADE seriously compromises the business models of franchise-based chains.

The rapporteur drew a distinction between RPMm practiced by upstream companies on its resale operations and inducement to concerted action provided under the antitrust law, a strategy typically employed by unions and professional associations. This distinction was based on the fact that the first practice requires a standard of proof that includes enforcement mechanisms, whereas the second does not. The rapporteur concluded that the telephone conversation revealed coercive conduct.

For her part, councilor Ana Frasão adhered to councilor Márcio Ribeiro’s position that the case did not involve coercion and, by extension, RPM, while arguing, however, that “the mere suggestion of prices to dealers may represent influence to adopt uniform conduct, thereby constituting, as per article 20 of Law No. 8,884/94, an antitrust violation.”

However, again, the objective functions of the upstream distributor through RPMm or of a union or professional association by means inducement to concerted action are wholly distinct cases. The interest of the upstream distributor, all things being equal, is to reduce prices, thereby containing double marginalization, or to induce an increase in resale service quality. It is no coincidence that the suggested prices consisted of maximum prices, not minimum prices. The councilor applied, for purposes of this case, the standard of proof of unions and professional associations with the same objective function as that of their associates, a rule not applicable, however, to upstream distributors. Therefore, the councilor discarded RPMm, but ruled that the suggested resale price had influenced parallel conduct.

Be that as it may, condemning suggested prices runs directly counter to CADE’s jurisprudence, as described above, and the international legal scholarship. US and European authorities do not extend the standard as far.

Moreover, this constitutes one of the distinctions between the SKF case and the Shell case. While in the former, SKF acknowledged imposing commercial restrictions to resellers that failed to adhere to the indicated mark-ups, in the Shell case no restriction of any type was imposed on resellers who failed to adhere to the suggested price. In fact, the telephone conversation corroborates the position that no reference was made to mandatory prices.

Yet, the disparities between the two cases are even more pronounced, given the sharp differences between the incentive structures. The objective function of unions and professional associations that are normally charged with inducing concerted action is the same as that of their associates. These entities simply seek to solve the problem of natural collective action faced by their associates. Yet, the objective function of the inducing agent and the induced agent is the same.

However, the objective function of the distributor, responsible for implementing RPMm or a suggested resale price, centers, naturally, on its own
profits, and may, in fact, conflict to some degree with the objective function of resellers, especially with respect to the price levels applied by both players, as reflected in the potential double marginalization problem where both players hold at least some market power.

The reseller also seeks to maximize its own objective function, i.e. its profit. To this end, if by chance it exercises some market power (e.g., a gas station located at a greater distance from others) it will also want to charge a higher price, adding a second margin to the price (the first margin is the distributor’s), leading to a reduction in the amount sold by the distributor and, hence, in its profit. Again, the question of double marginalization is essential for understanding the inconsistencies in CADE’s new standard of proof for RPMm.

The difference in objective functions is significant, such that there is no basis for characterizing RPMm, as councilor Márcio de Oliveira did, “as a specialized form of the influence of parallel conduct.” Additionally, it is unreasonable to simply switch from RPMm to influence of parallel conduct as councilor Ana Frasão did, given here understanding that coercion did not occur. In truth, the councilor inverted the causality: given the absence of coercion, there was no RPM and, therefore, there must have been conduct aimed at influencing parallel conduct, irrespective of the player involved.

The definition of suggested upstream distributor prices is “suggested resale price,” not “influence of parallel conduct.” If the upstream distributor suggests a price, naturally it wants to exercise influence, but that does not justify classifying the conduct as influencing parallel conduct. Otherwise, the metric for coercion by which RPMm is distinguished from suggested resale price would not be employed. The difference between RPMm conduct and influence of parallel conduct pertains, therefore, to the agent that engages in the conduct. Cases involving the same agent are defined in the legal scholarship as suggested resale price. These cases do not raise antitrust concerns.

Nonetheless, while adopting differing positions regarding characterization of the conduct, all of the councilors assessed the same penalty amount on Shell (R$ 31,706,254.52) and Mr. Odon (R$ 31,923.00).

In both the Shell and SKF cases, CADE ruled that the conduct facilitated a reseller cartel, but not a vendor cartel. In each case, the supplier’s market power to allegedly ensure the success of the reseller cartel for anticompetitive ends is highly debatable. The existence in the Shell case, in particular, of another supplier, BR, which held a larger market share and was vertically integrated backwards, supplying fuel to itself as well as other distributors, significantly undermines the claim of the upstream agent’s market power.

Another fundamental difference with the SKF case pertains to who requested the price fixing rule or suggested resale price. In the SKF case, the resellers themselves requested fixing of the resale price. In the Shell case, in turn, the resellers did not demand price fixing, rendering even more unsustainable the theory of a reseller cartel.
To the contrary, resellers were engaged in offering discounts to increase sales. In fact, the rapporteur characterized the owner of the gas station that made the recordings as "a victim of the difficulties arising" from the price reduction. In other words, the position of the rapporteur was that the resellers faced disadvantages, while advantages accrued to the distributor from the conduct.

The problem with this formulation takes us back to a basic aspect of RPMm. What does the distributor have to gain in attempting to induce an increase, instead of a reduction, in the reseller’s price? The rapporteur’s position to extract a minimum of economic logic from the anticompetitive RPMm (and not pro-efficiency) conduct is revealed in the passage below:

“The economic rationality of Shell’s alignment in the downstream market is explained by the fact that the ‘price war’ (competition) between resellers generated pressure on distributors to lower fuel prices with a view to charging more competitive practices in the market, which can certainly be the objective of a market organized under competitive conditions...... Therefore, ensuring that the reseller maintains the sales volume at higher prices enables the distributor to increase its own margins.”

Based on this theory, the distributor assumes the role of conductor, coordinating the resellers toward a higher resale price, something that would not occur if stations acted independently, insofar as the distributor’s ex-ante price will depend on the ex-post price charged to drivers by the resellers. In other words, the input price is defined by the final product price, not the other way around.

Therefore, the distributor’s incentive to exercise all of its bargaining power to force ex-post resellers to charge higher resale price lies in the fact that it is not capable of using all of its ex-ante bargaining power to charge those same resellers higher distribution prices!!! In the end, does the distributor exercise bargaining power over the resale or not??

The question is: would it not be easier for the distributor to set its own higher ex-ante input price, inducing in this way all resellers, in coordinated fashion, to raise the price charged to end consumers, instead of fixing the resale prices (rather than its own prices) of its resellers? Ultimately, by raising the cost of the principal input on resellers, the distributor would automatically induce all of them at the same time to charge resale prices that were both higher and consistent with the increased distribution price. As we assume that resellers are in competition, it would be natural for them to set their prices at cost, which would itself now be higher. There would be no incentive for them to offer discounts at below cost prices. In this way, the distributor could increase its margins without the need to provide its resellers with any margin, thereby avoiding the double marginalization problem.

Again, the distributor has no interest in increasing the reseller’s margin, unless it is seeking to incentivize higher quality service, which, in the case in question, refers principally to the quality of services offered at franchise gas
stations. In these cases, increasing the reseller’s margins could lead to an increase in the distributor’s margins simply because consumers would be more willing to pay a higher price on the understanding that they would receive a better service in exchange, including a more reliable product. That is, the higher the confidence that the services provided to drivers will be increased the higher the corresponding well-being, resulting, therefore, in a greater willingness to pay a higher price.

Under this scenario, the rapporteur’s position could be correct. To increase its margin, the supplier applies RPMm that raises the reseller’s margin, with a view to inducing higher service quality. The higher service quality displaces the demand curve, providing the distributor with the opportunity to increase its own margin as well. Coordination of the resellers by the distributor in this case would only be advantageous to the distributor if higher service quality were induced.

Other than this, the claim of a resellers’ cartel is generally deemed an eccentricity, as we have seen. On the one hand, the resellers exercise so much bargaining power that they coerce the distributor into doing something it does not want to do. On the other hand, this greater joint bargaining power does not redound into a greater ability to coordinate the resellers into a cartel, in which case they could dispense with the distributor. Further, it is not enough for the distributor to merely suggest resale prices. The distributor is also forced to coerce the resellers into adhering to the resale price through application of available enforcement means. In other words, the resellers coerce the distributor into exercising coercion over the resellers themselves!!!!!!

VI – Conclusion

The decisions in the SKF and Shell cases did not result in a per se rule regarding RPMm in Brazil. However, given the difficulty of demonstrating offset efficiencies, they do constitute a virtually per se rule of reason in which the evaluation of market power is a secondary component and the potential or effective harm is assumed.

The initial intuition sustaining that RPMm is almost always anticompetitive was, in fact, quite strong: the upstream agent forces downstream agents to not compete via prices. The precarious economic analyses of antitrust in the early 20th century led to the establishment of a per se rule by Dr. Miles that contaminated not only all of American jurisprudence, but, subsequently, European jurisprudence as well12.

Antitrust requires analysis founded on rigorous economic logic, which helps explain why the bias against RPMm has slowly waned. The 2007 Leegin case brought before the American Supreme Court, by which the per se rule was abandoned in favor of the rule of reason, represents a critical inflection point in this process. The European approach continues to be significantly more restrictive and was widely referenced in the votes upon further review. However,

12 The opinions of councilors Vinicius Carvalho and Marcos Verissimo offer very interesting summaries of European jurisprudence and practice.
the European position expressed in the OECD roundtable discussions (2008) reveal an inclination toward greater flexibility. The SKF and Shell cases are the equivalent of our “anti-Leegin” precedents, running in direct opposition to the trend toward more substantive economic content in RPMm analyses.

In the end, how should we address RPMm? Motta (2005)\textsuperscript{13} suggests an antitrust exemption for all vertical restrictions involving companies with a market share of 20%-30%, which would correspond precisely to the SKF and Shell cases.\textsuperscript{14} Following definition of a safe harbor for market share, the anticompetitive RPMm hypothesis could be tested: i) facilitates a supplier or reseller cartel; ii) creates barriers to entry; iii) restores upstream market power. Upon confirmation of an effective or potential harm, an evaluation of offset efficiencies could be conducted, in particular those relative to increased service quality. The recent OECD (2013) discussions on the issue, referenced above, could offer a starting point for incorporating efficiencies in the respective analyses.

Finally, the examination of RPMm should not deviate from the approach adopted for other vertical restrictions, so as to ensure greater consistency in Brazilian antitrust policy and avoid the type I error of ruling against conduct that may in fact generate significant efficiencies. In this light, an urgent review of the signal sent by the Brazilian antitrust authority in the SKF and Shell cases is imperative.

\textsuperscript{13} Chief economist of the European Competition Commission.
\textsuperscript{14} Comanor and Scherer, cited by the OECD (2008), establish a parameter of 50% or an HHI above 1800.