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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session II: Efficiency
Analysis in Vertical Restraints**

-- Contribution from Honduras --

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

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Session II: Efficiency analysis in Vertical Restraints

- Contribution from Honduras -

1. The relevance of vertical restraints

1. The term “vertical restraints” refers to an element of competition policy: the restrictions contained in agreements between suppliers and distributors relating to the resale of products and services.
2. Distribution in online marketplaces has raised some issues in relation to the value chain, including the development of new distribution models and the emergence of intermediary agents (digital platforms), as well as the emergence of vertical restraints in online distribution, which competition agencies and academia are beginning to study.
3. The detection of this type of restraint suggests that these vertical restraints that exist in more traditional marketplaces have begun to penetrate marketplaces involving digital platforms and online points of sale. In Honduras, since 2020 the gap between the expansion and use of digital platforms and the number of online marketplaces has narrowed significantly, which has attracted the attention of the Commission due to possible distortions and vertical restraints that may appear.
4. However, broadly speaking, in recent years no complaints have been received or sufficient evidence found in Honduras to bring cases related to vertical restraints. It is clear that fewer reviews of this type of case does not necessarily mean that these practices and behaviours are disappearing. Instead, it may reflect a transitional stage, affecting many different markets in which these practices and behaviours are not yet noticeable.
5. It is worth mentioning that one of the last cases investigated by the Commission relating to vertical restraints analysed an exclusive distribution case in the beer market on the island of Roatán, part of the insular region of Honduras.

2. Evaluation of vertical restraints under the Law for the Defence and Promotion of Competition in Honduras

6. One of the most important and relevant elements of the Law is the incorporation of the concept of economic efficiency and consumer welfare, as contained in Article 9. The article provides that: *"Those contracts, agreements, combinations, arrangements or behaviours that generate increases in economic efficiency and consumer welfare and compensate the possible negative effect on the process of free competition do not unduly restrict, diminish, damage, impede or violate free competition."*
7. Improvements in the conditions of production, distribution, supply, marketing or consumption of goods or services are considered to increase economic efficiency and consumer welfare.
8. An economic agent that invokes increases in economic efficiency and consumer welfare to justify its acts or behaviours, when these are prohibited, must provide proof of these benefits.

9. The procedure for sanctioning prohibited practices, acts or behaviours is initiated by a motion or at the request of a party. It is established by procedure and general rule that the burden of proof when evaluating this type of restriction falls on the alleged offender and, where appropriate, the complainant. Both parties may produce all legally established evidence. To facilitate this process, the Commission determines, among other things, the manner in which evidence must be presented and evaluated. It may reject evidence that is not given in accordance with the law, is not related to the merits of the case, or is irrelevant or unnecessary.

10. The evidence is evaluated in accordance with the principle of reasoned judgement, and analysis gives precedence to the material reality reflected by the evidence, regardless of the legal forms adopted by the economic agents.

11. In this regard and in accordance with Article 9 of the Law, the Commission's Regulations establish that, when evaluating the behaviours referred to in Article 7 of the Law, the Commission shall take into account the existence of economic efficiency gains, derived from the practice being analysed, that favourably affect the competition process by allowing its participants to integrate their productive capacities, make their economic activity more efficient, promote innovation or encourage productive investment, and that translate into benefits for consumers in the respective activity.

12. The regulation defines efficiency gains as, though not limited to: a) making savings in resources that allow the economic agent, on a permanent basis, to produce the same quantity of the good at a lower cost or a greater quantity of the good at the same cost; b) reducing costs when two or more goods or services are produced jointly rather than separately; c) a significant decrease in administrative expenses; d) innovation and transfer of technology and of commercial information; e) a decrease in production or marketing costs as a result of expanding an infrastructure or distribution network.

13. To analyse cases involving vertical restraints, the Commission takes a multidimensional approach that is based primarily on the provisions contained in the Law, but that is supported by the formal guidelines of counterpart agencies, international doctrine and other existing texts on the subject.

14. The national legal system establishes the principle that an agent may take unilateral action in the market, independently of the actions of customers or competitors. This means that the contracts, agreements, combinations, arrangements or behaviours that could be considered restrictive practices to be prohibited according to their effects (vertical restraints) may only be declared prohibited if it is proven that the economic agents involved, or just one of them, hold a share of the affected market that exceeds a given limit. This limit is established by the Commission for the purposes of determining whether the behaviour of economic agents is prohibitive. The Commission is therefore empowered, taking into account the market conditions and the behaviour of those involved in it, to establish higher or lower shares in the relevant market.

15. This makes it extremely important to rigorously apply criteria, on a case-by-case basis, to determine significant market share, since analysis under the "rule of reason" will proceed as long as a specific level of market distortion can be demonstrated. The Commission shall assess the charges as a whole, taking into consideration their seriousness and the concordance and convergence between them, and in relation to other evidence in the file. Even if a reported fact can be proven, it will only be considered valid if the charges brought can be shown to be a consequence of the offending party's intention to restrict competition. Various assessment criteria are used to make this judgement, which may vary by case but will share some fundamental general principles, relating to, for example, the

indispensable nature of the restrictions and the requirement for the transfer of efficiencies to the consumer and the market to be measurable.

16. It should be noted that, when analysing vertical restraints, the inclusion of exclusivity clauses has been studied in specific conditions liable to cause harm. In general terms, the main aim of this type of clause is to prohibit the use or marketing of goods or services provided by competitors of the economic agent imposing the clause. However, an exclusivity clause is harmful if it restricts competition, i.e. if this type of practice is intended to cause harm to the process of free competition and, ultimately, to consumers. In particular, it is harmful when such action involves limitations on access to distribution channels in a general sense, and when these channels are – or become – essential factors for maintaining an effective competitive situation.

17. Moreover, it can be argued that a transaction subject to the condition of not using, acquiring, selling or providing goods or services produced, distributed or marketed by a third party restricts free competition, especially when it affects other competitors' freedom to participate in the market. The effects observed as a result of this type of restrictive practice include current competitors being displaced (exclusionary effect) or inhibited from gaining access (entry barriers).

3. Analysis of efficiency in vertical restraints

18. The following case, which came before the Commission, provides an example. It involves the imposition of certain exclusivity conditions by the dominant firm in the beer market through the on-trade distribution channel (bars and restaurants) to prevent other competitors from entering that market. The case was initiated by a complaint filed with the Commission by Bay Island Brewery Company S. A. against Cervecería Hondureña S. A. for violation of the provisions of paragraphs 5 (exclusive distribution) and 9 (relating to any other restrictive agreement or action) of Article 7 of the Law.

19. In its analysis, the Commission considered it unnecessary to segment the market according to the different types of beers, but it did separate the “off-trade” distribution channels (supermarkets and grocery stores) from the on-trade distribution channels (hotels and entertainment), restricting the relevant product market to on-trade distribution channels and the geographic scope to the island of Roatán.

20. With respect to market power, the Commission considered that the mere fact that the defendant firm had a nearly 95% share of the market, thus defined, enabled it to raise artificial barriers to entry.

21. With regard to the alleged conduct, the Commission found that the exclusivity conditions or clauses that the defendant company had imposed on its distributors on the island of Roatán constituted artificial barriers to market entry and had the effect of either excluding competitors from the market or preventing the entry of potential competitors. Nonetheless, it ruled that the exclusion of the complainant from the affected market was not due to these practices, but to consumer choice.

22. The analysis carried out by the Commission established the following facts:

- The purpose of claiming to generate increases in economic efficiency or consumer welfare through a practice that is deemed restrictive by law is to establish whether those increases compensate for the negative effects on free competition. In other words, to make this claim, it is necessary to find valid arguments that clearly demonstrate that the negative effects produced in the market by the exercise of an anticompetitive practice have been compensated. Regarding the economic

efficiency alleged by the petitioner (granting of cooling equipment to the businesses and other benefits such as credits, discounts, promotions and advertising for Cervecería Hondureña's customers), both in the final report hearing and in the appeal, the following conclusion was reached:

- It had to be demonstrated that the efficiencies were a direct result of the sanctioned behaviours, to show that they compensated for the negative effects on free competition produced by the restrictive practices. In other words, in order to accept the hypothesis that the practices analysed do not restrict, diminish or violate free competition, these practices must generate increases in economic efficiency, which translates into improved consumer welfare, but without eliminating competitive dynamics in the relevant defined market.
- The "all-inclusive" service offered by some hotels is different from the product being investigated in the relevant defined market. Although, as part of this all-inclusive service, some alcoholic beverages (not only beer) are offered on an unlimited basis, consumers do not necessarily use this service to consume the product in question in the relevant market.
- The need to enter into an exclusivity agreement to ensure and guarantee the supply of a certain good to a certain economic agent can be substituted for a supply contract, which would guarantee the use of a certain supplier for a specific period while allowing the buyer (the entity being supplied) the freedom to sign other supply contracts with other suppliers.
- The offending economic agent, when alleging increase or gain of economic efficiencies, had to ensure that its claim was admissible under the provisions of Article 6 of the regulation of the Law.
- With respect to the alleged benefits, two aspects were specified and a number of points were established.
 - **Regarding the cooling equipment**, the following conclusions were reached:
 - a) The investigation determined that 61% of the establishments visited use Cervecería Hondureña's equipment to cool the product and, according to those interviewed, the loan of equipment is dependent on its being used exclusively to cool products distributed by Cervecería Hondureña;
 - b) Consumer preferences, especially on the island of Roatán, are linked to the warm climate, in which beer is consumed to satisfy thirst, i.e. as a refreshing beverage. It is therefore important that the product should be cold when purchased. As a result, it is essential that establishments that sell beer, especially those where the sale is for immediate consumption (bars, restaurants, hotels, etc.) have cooling equipment to meet the needs of their consumers;
 - c) The above considerations imply that it is logical or reasonable to assume that companies whose goal is to increase their sales will have to offer their products at cold temperatures. The aim is to attract as many customers as possible. However, the conditions under which a company provides its product at cold temperatures and the implications of its commercial policies should not harm the process of free competition;
 - d) It was considered, on the basis of the analysis of the information gathered, that in establishments where there is no space or where the energy cost of maintaining another cold room outweighs the benefits for the said establishments of maintaining a varied product offering, the agreements concerning the loan of equipment restrict companies to marketing only Cervecería Hondureña's brands, and prohibit the introduction of competitors' products, thus becoming a barrier to entry for new competitors, with the

consequent adverse effects on the process of free competition; e) The condition of exclusivity in relation to the cooling equipment is reasonable and legally possible only when there is space to install other cooling equipment for competing products and the energy cost of maintaining other equipment is less than the benefits derived from offering a wider range of products. In circumstances where the space available does not allow for other cooling equipment, such conduct prevents inter-brand competition, thus diminishing the exercise of free competition, and;

- **Regarding other benefits**, it was established that: a) Cervecería Hondureña grants its customers a number of benefits for buying its products, including credit to purchase the product, product giveaways, discounts, “happy hour” offers, beer bucket promotions, advertising for the business, tables, chairs and giant screens; b) the benefits described above are reasonable and legally possible to the extent that they do not depend on exclusive purchasing of the product; and, c) the benefits related to products giveaways, discounts, happy hour and beer buckets promotions could however disrupt competition in a concentrated market with only one dominant player if such benefits are not the result of efficiencies obtained in Cervecería Hondureña’s production and/or commercialisation process and Cervecería wants to pass them on in some way to the final consumer.
- There is a lack of relevant economic justifications showing that the inclusion of the exclusivity clauses is intended to produce efficiencies in economic relations and thereby generate clearly perceptible benefits for consumers in terms of quality and/or prices.

23. Given these conclusions, the Commission determined that there were sufficient elements to justify the complaint against Cervecería Hondureña. Consequently, it imposed a sanction of L 9 645 416 (approximately USD 507 653) on the company, equivalent to 10% of its gross profits on sales in the previous fiscal year. It should be noted that this ruling is currently being reviewed in court.