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## Merger Control Reform in Brazil

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## I. INTRODUCTION

The main purpose of merger control is to secure the competitive structure of markets by identifying, *ex ante*, concentrations that may significantly impede the process of competition. Merger control is a key component of any competition regime and its efficient operation remains critical for the construction of a solid pro-competitive environment.

On October 5, 2011, the Brazilian Congress approved a new competition law that introduced a number of changes to its antitrust legislation in order to increase its transparency and the efficiency of its competition regime. The bill was signed into law by the President on November 30. In the particular area of merger control, the Brazilian reform envisaged three central changes, namely: the introduction of a pre-merger review system, the implementation of new notification thresholds, and the concentration of merger review responsibilities into a single authority.

The Brazilian reform in merger control certainly enhances the competitive assessment of mergers and acquisitions in the largest Latin American economy and the expected benefits of this reform are large. In the context of the recent Brazilian reform, this note provides some reflections on the challenges created by the implementation of an efficient merger control system in two specific areas: pre-merger review and notification thresholds. Notwithstanding that the following thoughts are discussed in the framework of the current Brazilian reform, the economic and policy implications of these reflections are not necessarily exclusive to that economy.

## II. PRE-MERGER REVIEW SYSTEM

One of the main features that characterized the pre-reform merger control system in Brazil was that merging parties were not precluded from materializing their transaction before the final approval of the competition authority.<sup>3</sup> A merger review system of this type may have some advantages with respect to alternative systems of merger assessment, but it also has an important drawback: There may be instances in which the competition authority may consider it necessary to reverse an already-implemented transaction, which can impose non-negligible economic costs on the parties that merge.

The potential risk of having to force the reversal of an already-implemented transaction in Brazil was historically minimized by the implementation of the so-called *Acordo de Preservação de*

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<sup>3</sup> However, Brazilian competition law establishes the obligation of firms to notify a merger, at the latest, 15 days after the deal is closed—provided the transaction meets certain threshold notification requirements.

*Reversibilidade da Operação* (“APRO”)—an agreement between the merging parties and the competition authority that imposed some restrictions on the type of actions that the parties were allowed to implement before the authority’s final decision was reached. The clauses contained in an APRO were particularly diverse and somehow merger-specific, but common clauses were associated with specific prohibitions to implement:

1. Changes in the legal structure of the companies;
2. Changes in the location of facilities;
3. Changes in rights and obligations related to assets, brands, patents, and roll of customers and suppliers;
4. Changes in logistics, distribution systems, and sales;
5. Changes that affected the number of jobs or labor’s transfers among facilities, distribution networks, stores, and research and strategic staff;
6. The interruption of investment projects associated with the purchased company or the interruption of sale plans that had already been approved; and
7. The discarding of brands and products.

The possibility of implementing an APRO in the pre-reform merger review system in Brazil clearly minimized the potential economic costs that would have been imposed on the merging parties from a mandatory reversal of the transaction. From this perspective, an APRO was a policy instrument that allowed the “replication” of a pre-merger review system in Brazil since transactions subject to this type of agreement were not allowed to materialize—at least in central aspects of the merger—until the competition authority released its final opinion. It can be argued, however, that this regime replication was imperfect since CADE’s (*Conselho Administrativo de Defesa Econômica*) ability for monitoring APROs was historically weak.<sup>4</sup>

The new merger control system in Brazil is going to be based on a formal pre-merger review scheme, in which mergers and acquisitions cannot be implemented before the competition authority makes its competitive analysis and reaches a final decision. In the new merger control system, closing a deal without the authority’s approval will be sanctioned with fines ranging from US\$32,000 to US\$32 million.

The implementation of a pre-merger review system in Brazil has its own merits, but it also raises some potential risks. One risk derives from that fact that, in a pre-merger review system, the merging parties are obliged to wait until the competition authority releases its final approval, which may lead to significant delays in the authorization of mergers and acquisitions.

Delaying decisions on anticompetitive transactions is not socially costly, but delaying decisions on pro-competitive transactions may impose non-negligible social costs. For example, consider the review of a merger in a stressed financial sector. The prompt approval of the acquisition of a failing bank is critical for controlling financial contagion effects that may affect the rest of the banking system and for avoiding a succession of increasingly damaging financial

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<sup>4</sup> The monitoring of restrictions and remedies imposed by competition authorities has always been a complex task. In recent days, the Mexican Competition Commission has been criticized by its inability to monitor the proper implementation of the remedies imposed in a deal that involved the acquisition of cable assets by a major broadcaster.

shocks on the economy.<sup>5</sup> The 2008 acquisition of *Halifax Bank of Scotland* by *Lloyds TSB Group* in the United Kingdom illustrates the importance of quickly clearing mergers under specific circumstances—and even in cases where anticompetitive effects may be generated as a result of the merger’s approval.<sup>6</sup> Since time is of the essence in mergers under particular circumstances—as in the case of recession-driven failing firms—a pre-merger review system may lead to involuntary review delays which, in turn, may be the source of important economic risks in some industries.<sup>7</sup>

A second risk derived from the implementation of a pre-merger review system is the possibility that the competition authority may lose a useful instrument for the extraction of “private information” about the anticompetitive effects associated with a particular transaction. The reason is simple. Consider a system where merging parties are allowed to close transactions before approval. Merging parties that propose an intrinsically anticompetitive transaction hardly are willing to take the risk of closing the merger before the approval of the competition authority, since the likelihood that the transaction will be reversed is high—closing the transaction before the authority’s approval thus imposes a very high (expected) cost. Therefore, a clearly anticompetitive transaction is not expected to close before the authority’s approval.

In contrast, parties involved in an intrinsically pro-competitive transaction are willing to take the risk of closing before such approval since the risk of reversal is low. Hence, this asymmetry in the incentives for closing the merger before approval provides key “private information” to the competition authorities about the magnitude of expected anticompetitive effects. In this last scenario, for example, the competition authority may pay more attention to a merger that deliberately decides not to close before approval since it may signal that more significant anticompetitive effects are present.

Naturally, this “self-selection mechanism” assumes that merging parties are perfectly aware of the competitive effects of their own transactions and that competition authorities are always able to detect, and successfully block, anticompetitive mergers. Thus, under the assumption that merging parties have more and better information about the anticompetitive effects of their own transactions, the implementation of a pre-merger review system may deprive competition authorities of having access to information that can be valuable during the process of merger assessment.

### III. NOTIFICATIONS THRESHOLDS

A second major change in the new merger control system in Brazil relates to notification requirements. In general, the determination of notification thresholds for merger control is not an easy task. Consider, for example, the determination of the “right” threshold value for reporting transactions to the competition authority. A first complication arises from the fact that

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<sup>5</sup> Bearing this in mind, the Brazilian Congress has been discussing, for some years by now, a bill that proposes that the Central Bank should be the competent authority to clear a financial merger in cases where systematic risks for the banking sector are present.

<sup>6</sup> A. Stephan, *Did Lloyds/HBOS Mark the Failure of an Enduring Economics-Based System of Merger Regulation?* NORTHERN IRELAND L.Q. (forthcoming, 2011).

<sup>7</sup> It is worth mentioning that the new merger control system in Brazil provides an implementation “transition period.” During the first year of the enforcement of the act, merging parties are able to request authorization to close transactions before a final decision is made.

notification thresholds are not typically industry-specific, so there can be instances in which the general threshold may be too high to capture an entire industry or market.

The Swedish Competition Authority, for example, pointed out some years ago that its combined-turnover threshold was too high with respect to the economic value of certain industries in Sweden. This implied that there were Swedish industries in which merger notifications never occurred since the economic value of *any* transaction in those industries lay below the determined threshold.<sup>8</sup> Hence, the determination of too high thresholds with respect to the average economic value of industries in a particular economy may be the source of competition concerns since too many anticompetitive transactions may be “bypassing” merger control legislation.

The new merger control regulation in Brazil establishes compulsory notification of transactions provided one of the merging parties reports revenues in Brazil of, at least, R\$400 million—approximately USD \$210.5 millions—while the other party reports revenues of, at least, R\$30 million—approximately USD \$12.5 millions. The principal change in the area of merger notification relates to the elimination of the “20 percent market share” test, by which a transaction was obliged to be reported whenever the market share resulting from the merger represented, at least, 20 percent of the relevant market.

In principle, a market share test may seem to be a superior economic indicator for the impact of a concentration on competition in a given market. However, the main shortcoming of such a test is that it requires the upfront determination of relevant product and geographical markets. Given the natural complexity associated with the determination of antitrust markets, the use of market shares as a screening device in merger control creates unnecessary difficulties in the process of notifying mergers and also leads to a high level of uncertainty as to whether a specific transaction has to be notified.

Notification thresholds based on turnover figures are widespread around the world, but they are by no means the only ones. Thresholds may also be expressed, for example, in terms of the economic value of the assets transferred. However, the main drawback of using asset-based thresholds is that, when a firm operates simultaneously in different countries, it can be difficult to allocate the economic value of assets to each of the relevant jurisdictions. This, in turn, may increase unnecessarily the review costs of the competition authority.

In contrast, the use of turnover figures for the determination of merger thresholds has the advantage that these figures are not particularly difficult to collect. Admittedly, turnover figures are imperfect “proxies” of the creation of market power, as they fail to consider other factors, such as price elasticity and the relative size of the firm, that are crucial in the ability of the merged firm to increase prices. However, the fact that turnover thresholds do not require complex assessments for the purposes of deciding whether or not a concentration should be notified, explains their widespread use—and most jurisdictions employ them in one form or another. Hence, the elimination of the market share test for merger control in Brazil represents an important improvement in its merger control regime since it makes the entire process of reporting more transparent and efficient.

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<sup>8</sup> Swedish Competition Authority, *Troskelvarlden för Koncentrationsprovningar*, KONKURRENSVERKETS RAPPORTSERIE 26:3. Stockholm (2006).

Finally, it is worth mentioning that the new merger control regulation in Brazil contains a “minor” amendment with interesting policy implications. Paragraph 7 of article 88 of the approved bill gives CADE the power to request the notification of any transaction that does not fall within the filing thresholds of the new regulation up to one year after the implementation of the deal. This amendment is particularly interesting since it seems to represent a policy answer to the risk that some mergers may “go through” without competition review as a result of having a too high notification threshold. This issue has been clearly characterized by the OECD:

[F]irst, it is obvious that in the right circumstances small mergers can be anticompetitive, and the competition agency should not be powerless to remedy them; and second, the lack of such powers would tend to cause the agency to define the class of notifiable mergers too broadly, in order to catch all possible harmful mergers. This would have negative effects in efficiency.<sup>9</sup>

The main problem with such a flexible merger control approach is that some degree of legal certainty is lost since competition authorities retain a significant amount of discretion as to whether or not to investigate transactions that lie below the threshold. However, the flexibility to require below-threshold mergers for review may also represent a valuable instrument for merger control in cases where there exists the presumption that too many mergers are bypassing merger review due to the prevalence of too high notification thresholds.

The discussion of whether competition authorities should retain some level of discretion to review below-threshold mergers is beyond the scope of this note but it certainly represents an interesting area of debate for merger control policies in general and particularly in Brazil.

#### IV. FINAL REMARKS

The recent merger control reform in Brazil—a part of a more comprehensive package of changes to the Brazilian competition law—represents an important movement of its competition policy regime towards best international practices. By providing some reflections about the policy challenges posed by the recent reform in merger control in Brazil, this note hopes to enrich the discussion about the efficiency of merger policies in Latin America and beyond.

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<sup>9</sup> Organization for Economic Cooperation and Development & Inter-American Development Bank, *Merger Control Laws and Procedures in Latin America and the Caribbean* (2005).