

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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Non-price Effects of Mergers - Note by Brazil

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More documents related to this discussion can be found at www.oecd.org/daf/competition/non-price-effects-of-mergers.htm.

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Brazil

1. Non-price effects of mergers in the Brazilian competition law and practice

1. According to Law n. 12.529/2011, article 88, §5º, the mergers that result in the elimination of competition in a substantial part of a given relevant market; the ones that might create or reinforce dominant position; or the ones that might result in the dominance of a relevant market shall be prohibited. However, §6º of the same article establishes that even those mergers could be authorized provided that they enhance productivity or competitiveness, result in higher quality goods and services or encourage efficiencies or technological and economic development. All of these subject to the condition that those benefits are substantially shared with consumers.

2. The Brazilian horizontal merger guidelines¹, more specifically when referring to coordinated effects, also mentions that CADE shall evaluate if a merger changes other relevant competition elements besides prices, such as innovation and quality. The guidelines also mentions that a merger involving a maverick could undermine competition and discourage innovation, resulting in loss of economic welfare.

3. In this sense, non-price effects such as impacts on quality, innovation, and technological or economic development are relevant elements to be considered in the merger reviewing process in Brazil.

4. CADE has never rejected or required remedies in a merger based exclusively in non-price effects. In recent merger cases, however, the Brazilian competition authority has been increasingly considering those effects. Variables such as quality and innovation have been important dimensions of remedies recently adopted.

2. Dow/DuPont

5. In the Dow/DuPont case², a merger of equals between The Dow Chemical Company and DuPont de Nemours & Company, CADE considered the possibility of negative effects on innovation, especially in the crop protection and corn seeds markets.

6. In the crop protection segment, CADE identified two categories of companies in the industry: innovators, which are companies with strong capabilities on the development of new active ingredients, new formulations, usually protected by patents; and “generics” manufacturers, focused on products based on known, off patent, active ingredients. At that point, the innovative segment was highly concentrated in five big

¹ Guidelines on Horizontal Mergers. Available at http://www.cade.gov.br/aceso-a-informacao/publicacoes-institucionais/guias_do_Cade/guia-para-analise-de-atos-de-concentracao-horizontal.pdf.

² Merger case n. 08700. 005937/2016-61, approved by Cade subject to remedies on May 17th, 2017. For more detailed information see CADE's press release: <http://en.cade.gov.br/press-releases/merger-between-dow-and-dupont-is-approved-with-restrictions>.

players: Bayer, Syngenta, BASF, Dow and DuPont. Together, those companies respond for about 40% of the R&D expenditures in crop protection worldwide.

7. Both Dow and DuPont were innovators and invested largely in R&D of new molecules. By combining two of the five companies with strong capabilities in innovation in the world, it would be possible to argue that the merger could reduce incentives to innovate in the market, due to the possible accommodation of the few big players after the merger. This discussion, however, was not further investigated, since the Parties had offered global remedies which included substantial assets that would allow the reestablishment of the pre-merger competition level. It is important to observe that the debate around impacts on innovation, or the innovation capabilities of rivals, were key background factors, although CADE had not developed a theory of harm based primarily on innovation effects.

8. In the corn seeds market, CADE has adopted a similar approach: incumbent's innovation capabilities were key to the analysis, although adverse impacts on innovation was not a theory of harm itself. The transaction would lead to substantial market concentration: considering the corn seeds market broadly defined, without further segmentation, both Dow and DuPont had 20%-30% each of the market in the year previous to the merger, resulting in a combined market share of 40-50%. Besides Dow and DuPont, the corn seeds market in Brazil had only two more competitors with significant market shares: Monsanto (40-50%) and Syngenta (10-20%).

9. In addition to concentration levels, another factor was essential to CADE's assessment: Dow and DuPont strong positioning in corn seed breeding activities. Although there were relevant difficulties in establishing objective criteria that allowed comparisons between the Parties' germplasm banks and breeding programs, CADE considered there were enough elements to conclude that Dow and DuPont had a privileged position in both areas. Not all competitors, especially those without significant market shares, own such high quality germplasm banks, in terms of size, variety and range. This context reinforces the conclusion that the parties, especially after the merger, would hold considerable market power.

10. In order to address concerns in the corn seeds markets in Brazil, the Parties proposed to divest part of Dow's assets. It is interesting to observe that concerns with innovation capabilities of the buyer are present in the design of the remedy for the Brazilian corn seeds market. In this sense, the package to be divested included a set of assets considered by CADE as being sufficient to "allow the new competitor to be a relevant competition force in the medium and long term". Those assets necessary to sustain the new competitor's position in the market consist in essential in assets to build R&D capacity, such as good quality germplasm bank, research centers and personnel.

3. Bayer/Monsanto

11. In the case of the global acquisition of Monsanto by Bayer (Bayer/Monsanto case³), possible impacts on innovation were also considered an important background. In Brazil, the merger affected especially the cotton and soybean seeds markets, including biotechnology markets.

12. CADE considered that the merger would reduce competition in already concentrated markets, with few competitors, which might have resulted in impacts on innovation competition, especially in biotechnology markets. According to the General-Superintendence's opinion on the case,

“452. It is clear that, in the case of prospective analysis, it is not possible to state categorically what the net effect of the merger will be on incentives to innovate. However, it is clear that the concern about the reduction of rivalry in research and development of transgenic events was manifested strongly by several competitors. It should also be noted, as analyzed above, that it cannot be concluded that the remaining competitors on the market, namely Dow/DuPont and Syngenta, could maintain a level of market rivalry sufficient to minimize the risks of reducing incentives to innovate, either for the Parties or for the market. Therefore, even if one cannot predict the likelihood of adverse competitive effects on innovation, this hypothesis cannot be ruled out. Thus, in spite of the fact that there may be synergies between the research and development efforts of the Applicants' transgenic soybean events, which will be discussed later, it is considered that the reduction in innovation rivalry can generate four main effects, which summarize the concerns raised during the investigation phase.”

13. The four possible effects would be: (i) reduction of Parties' incentives to continue existing innovation efforts (either by discontinuing, redirecting, or postponing some research projects) in the case of overlap between them in existing research pipelines and products in early pipeline stages; (ii) in the long term, fewer incentives for Parties to develop the same number of new products that they could have developed if acting separately, considering that Bayer and Monsanto would no longer be under competitive pressure from each other; (iii) reduction of incentives of the other players to innovate in research and development of transgenic events; and (iv) concentration of research and development of GMO events in the world among the Parties, as well as their performance in breeding activities, could increase barriers to the entry of new innovators in the market, as well as to the introduction of new products in the market, so that potential entrants can see their incentives to innovate reduced.

14. It is possible to observe that although CADE had not developed a consistent methodology to quantify such effects, the possible effects on innovation, besides the traditional price effects analysis, was considered. The Parties offered remedies that were considered sufficient to remove competitive concerns, including the ones concerning non-price effects, since the proposed divestment included relevant R&D capabilities.

³ Merger case n. 08700.001097/2017-49, approved by Cade subject to remedies on February 15th, 2018.

4. Kroton/Estácio

15. In 2017 Cade rejected the acquisition of Estácio by Kroton⁴, which would potentially create the largest education company in Brazil and one of the largest in the world. Both companies work mainly in the segment of higher education, both on-site and distance-learning education, in the offer of undergraduate and postgraduate courses.

16. Kroton, which in 2013 had merged with its main competitor, Anhanguera Educacional, was already the market leader in 2016, when it announced the purchase of Estácio, the second largest company in Brazil. With the possible merger, the resulting company would be larger than the other seven largest higher education institutions in Brazil together. In several relevant markets - analyzed in Brazil by course and by municipality in on-site graduation courses and by course and at a national level in the distance-learning system - concentrations were higher than 50% (for distance-learning graduation courses, in 90% of the markets the concentration exceeded 50 %).

17. There were several competitive concerns arising from the transaction, including the risk of exercising market power in cities where both operated and also the risk of eliminating a potential competitor. Both companies had very similar performance strategies: aggressive growth through acquisitions of smaller institutions and also via organic growth.

18. According to data assembled by the Department of Economic Studies of Cade, between 2001 and 2015, 62 transactions were submitted for Cade's analysis, of which 39 (63%) involved either Kroton or Estácio. In addition, both had very similar organic growth plans. Since the higher education market is regulated in Brazil, organic expansion, whether for the construction of new campuses or for the creation of new poles to support distance-learning education, depends on authorization from the Ministry of Education.

19. In this way, Cade asked the Ministry of Education for information on requests already made by companies to open new campuses and poles. Approximately 339 requests to open new poles were reported for Kroton and 91 for Estácio. Regarding the on-site education modality, 28 new campuses were opened for Kroton and 12 for Estácio, with at least two cities coinciding with the opening of campuses for both companies. Such information confirmed the potential competition theory between the two.

20. In addition to potential competition, another relevant point concerning aspects of non-price competition was the quality analysis of the offered education. As stated, the higher education market in Brazil is regulated and perhaps the main focus of regulation is the quality of education. The Ministry of Education adopts a system of periodic evaluation of all Higher Education Institutions in Brazil, with several quality indicators that comprise, at the end, the IGC - general index of courses.

21. In general terms, the Ministry of Education classifies universities with grades 1 to 5, where levels equal to or higher than 3 indicate satisfactory quality, while institutions classified as IGC 1 or 2 are qualified as poor quality institutions. In addition to signaling to society about the quality of each institution, the IGC is used for possible interventions by the regulatory body: institutions that present a recurring unsatisfactory level may be prohibited from offering new vacancies.

⁴ Merger case n. 08700.006185/2016-56, rejected by Cade on July 11th, 2017.

22. In this sense, Cade verified that, both Kroton and Estácio typically offer courses with grades that meet the minimum required by the regulator, but without incentives to seek excellence in teaching. Both institutions are classified as "mass institutions", whose main characteristics are the low price offered and a very large number of students. By competing for prices, such institutions do not have as their main focus the formation of the country's intellectual elite, but only a medium-level and affordable education. The merger would make it even less likely that the resulting company would invest in higher quality of education. Moreover, third parties stated that the merger could make the higher education in Brazil more homogeneous, with a large group controlling non-price variables such as course programs and teaching methodologies.

23. Therefore, Cade's concern, besides price, was based on the creation of an economic group with great market power and no incentives to offer a teaching of excellence. As pointed out in the General-Superintendence's opinion, when it comes to the higher education market, the homogenization of education's quality at medium levels with low pedagogical proposals' differentiation could be an effect perhaps even more disturbing than the price increase in itself. Reducing competition for differentiation between players with so much market penetration could reduce incentives for innovation and quality improvement.

24. The General Superintendence challenged the transaction to Cade's administrative Court, which rejected the transaction, since it considered that the non-price impacts were of fundamental importance, according to the excerpt from the vote of Commissioner Paulo Burnier:

I would like to highlight an additional element, which seems to me of particular importance in this specific case: the educational sector. It is a key sector of the economy - and for the country as a whole, for its catalytic role in education for a large part of the Brazilian population.

In this context, the merger must be analyzed under special perspective of its non-related effects to "price". This issue was recently highlighted in the International Competition Network (ICN), under the heading "non-price effects", which emphasized the importance of taking into consideration, especially in key sectors such as the education sector, aspects related to quality of services, the variety of supply and the potential for innovation.

It should be noted that these factors have been increasingly valued by the antitrust authorities in the framework of merger review.

In Brazil, the need to analyze the anti-competitive repercussions beyond the "price" dimension leads us to a broader doctrinal debate about the purposes that CADE should pursue in its institutional mission.

In the present case, it is clear that the merger raises important concerns about its meta-economic repercussions. Considering the high market share of the parties, if closed, the merger would have great potential for the homogenization of higher education in the country, significantly compromising the variety of supply. In addition, from a dynamic perspective one could consider possible negative impacts on the development of new technologies, which would represent setbacks mainly in a sector so central to the economy and to development.

5. Itaú/XP

25. The purchase of a stake in broker XP investimentos by Itaú Unibanco ⁵ was notified in 2017 and approved at the beginning of 2018 with restrictions by Cade.

26. Itaú is the largest private Brazilian bank with a market share in terms of assets close to 20%. XP, in turn, is a company that operates in the market, still in development, of marketplaces of financial products, offering investments in investment funds, private pension plans, debentures, among other investment products through a digital and innovative platform.

27. The Brazilian banking market is relatively concentrated, with approximately 90% of the market, total assets under the control of the country's five main financial institutions. Traditionally, the offer of investment products in this market is done by these institutions, in a vertical way: each bank offers the products developed internally by its own departments or companies of the conglomerate (asset management).

28. However, in the last five years, and more intensively, in the last two years, the supply of investment products has grown through financial marketplaces and open digital platforms. This allowed consumers access to various types of investment products developed and offered by various agents, such as other small and medium sized banks, asset management companies, insurance companies, among others. It is an innovative, non-verticalized business model, in which the platform allows competition between several suppliers of similar products within the platform itself.

29. This business model was leveraged in Brazil by XP, a pioneer in the market which currently holds approximately 50% of assets under management on open platforms. The rest of the market divided among several other companies do not reach 10% each individually.

30. The evidence gathered by Cade throughout the investigation demonstrated that this business model has provided consumer many benefits, challenging the market power of the traditional banking system, making affordable, high-quality investment products available to a growing number of people, with greater returns than average and with administration fees and other costs significantly lower than banking products.

31. Thus, in addition to the price variable, Cade greatly emphasized the quality of the products that have been offered by the marketplaces, a quality that is expressed in economic terms, in the form of greater profitability for consumers, but also products with better relation of risk and return and, above all, greater diversity. As pointed out in the investigation, XP offers an amount of higher fixed income funds (185%) to the sum of the amount of funds offered by the four largest banks in the country. In relation to hedge funds, XP offers twice the amount of funds offered by the country's largest private bank, Itaú, acquirer in the transaction, with average administrative fees 60% lower and yields at least 10% higher.

32. Faced with these facts, Cade considered XP a maverick, since its performance has been able to challenge the dominant position of the banks, causing a disruptive effect very favorable to consumers. Consideration of the qualitative effects of the transaction were

⁵ Merger case n. 08700.004431/2017-16, approved by Cade subject to remedies on March 14th, 2018.

relevant both in the definition of the relevant market and in the examination of the competitive effects of the transaction.

33. Therefore, although the transaction was related to a minority stake acquisition of XP's voting shares by Itaú (49.9%), the General-Superintendence expressed great concern about the possible effects on XP and on the market as a result of this acquisition, considering the powers that Itaú would have after the transaction. The main concerns were: (i) weakening of the competition exercised by XP over the other banks, based on the influence of Itaú on its management; and (ii) increased barriers to entry into the financial market segment, due to the increase in market power of XP with its association with Itaú.

34. Although these concerns are not limited to the price variable, the competitive analysis focused primarily - possibly with greater relevance - on the qualitative variables that could be impacted by the operation, although some of these variables, such as profitability, are also monetary, but not necessarily price.

35. On the other hand, considering the transaction to be a minority interest acquisition - not a control one - and several cautions in terms of corporate governance adopted by the parties, the General-Superintendence concluded that, under certain conditions, there was room to recommend the clear of the merger. . Therefore, the General-Superintendence negotiated an agreement with the parties to adopt behavioral remedies that could eliminate the risks to competition.

36. Essentially, the negotiated obligations aimed at: (i) minimize Itaú's influence on the strategic decisions of XP, vetoing the participation of board members appointed by Itaú in commercial matters; (ii) prevent XP to adopt exclusivity or any type of condition that has exclusivity effects in the relationship with investment products' suppliers or with investment agents; (iii) impose practices that facilitate the portability of products between competing platforms and the dissemination of such procedures to consumers; and (iv) impose non-discrimination treatment between bidders and (v) maintenance of the open platform, with the prohibition of any preference or privilege for Itaú products.

37. Through the negotiated obligations, Cade understands that it will be possible to mitigate the risk of Itaú's influence over XP, keeping its management independent and in its disruptive trajectory, as well as eliminating or preventing the entry barriers that may hinder the growth of platforms.

6. AT&T/Time Warner

38. The proposed merger between AT&T and Time Warner⁶ was submitted to CADE in March of 2017. It was cleared by CADE subject to behavioral remedies submitted by the Parties, since de merger raised foreclosure and coordination concerns. Some of the aspects that concerned CADE were non price effects that could be generated by the merger, such as a decrease in diversity and plurality of pay TV content.

⁶ Merger case n. 08700.001390/2017-14, approved by Cade subject to remedies on October 18th, 2017.

39. AT&T is a large American telecommunication company that owns Sky, a pay TV operator that offers TV content through satellite dishes, in Brazil. Time Warner is also an American company operating mainly in the media sector through content production and programming. In Brazil, Time Warner offers a variety of channels for pay TV operators. The merger would therefore result in a vertical integration, since Sky uses the channels offered by Time Warner as inputs.

40. The pay TV market in Brazil is fairly concentrated, with Net (owned by the Claro Group) with approximately 50% of market share and Sky with almost 30%. Two other operators have each between 5 and 10% and the rest of the market is composed by very small local operators that do not have more than 1% of market share.

41. For the programming market, CADE considered two scenarios. In the first one all the channels compete for audience and, therefore, are on the same relevant market. Depending on the data used, Time Warner has between 20 and 30% of market share and is the second largest programmer in Brazil. The first group is Globo, a Brazilian company, with a market share of 30 to 40%. The second scenario divided the market into different types of channels, such as sports, news, children's and movies. Time Warner has important channels in most of the relevant markets and its market shares varied from less than 10% in the varieties genre to more than 50% in the international news genre.

42. After the investigation, CADE concluded that the resulting company would have both the capacity and the incentive to foreclose the upstream and the downstream markets. The authority found that Time Warner's channels were essential for the operators. Time Warner offers important channels, with great audience, such as TNT, CNN, HBO, Cartoon Network and Esporte Interativo (a Brazilian sports channel). All operators in Brazil distribute Time Warner's channels and all of them stated that the channels were crucial to maintain the pay TV operation. Likewise, all programmers consulted confirmed that being distributed by Sky was very important to maintain a channel in Brazil. The General Superintendence concluded that the merged company could adopt a series of conducts that could weaken competition in both markets and even completely foreclose the pay TV market for small and new programmers. This would not only affect prices but would also diminish the diversity, plurality and possibly the quality of the content watched by consumers.

43. CADE was also concerned with coordinated effects of the merger. Globo – the largest programming company in Brazil – has minority interest shares in both Net – the largest pay TV operator – and in Sky, which is owned by AT&T. Although Globo was not allowed to decide in matters of content in Sky, it had the right to veto content acquisition in Net, which allowed the companies to operate in a vertical integrated way. Thus, CADE concluded that the vertical integration could increase the probability of collusion, since it would allow the flow of information among the largest groups in both markets and increase the symmetry of the two largest groups in the industry.

44. Therefore, the merger was cleared subject to behavioral remedies that were proposed by the parties. The remedies included mechanisms to avoid any kind of discrimination by the parties, arbitration and the imposition of a Chinese Wall between the companies to avoid the sharing of sensitive information.

7. Regulated Markets - Gontijo/São Geraldo

45. CADE has also reviewed mergers in markets in which the prices are regulated, but the companies can compete through other variables, such as quality. For example, the market for interstate passenger bus travel has its prices regulated by the National Agency for Land Transportation (ANTT). Even so, CADE has reviewed a few cases in this market.

46. In 2006, CADE reviewed a merger between two interstate bus companies – Gontijo e São Geraldo – that caused overlaps in a number of routes. CADE analyzed the merger considering the effect that it could have on the quality of services. The merger was eventually cleared considering that the Parties had enough competitors to sustain the competition in the market.