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The Concept of Potential Competition – Note by Brazil

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This document reproduces a written contribution from Brazil submitted for Item 2 of the 135th OECD Competition Committee meeting on 9-11 June 2021.

More documents related to this discussion can be found at https://www.oecd.org/daf/competition/the-concept-of-potential-competition.htm

Please contact Mr Antonio Capobianco if you have questions about this document.
[Email: Antonio.CAPOBIANCO@oecd.org].

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Brazil[1]

1. Introduction

1. This contribution introduces CADE's approach to potential competition. The basic idea behind potential competition is that the possibility of a new player entering the market or of an existing player introducing a new product would be a constraint on pricing decisions of incumbent firms.

2. Posner[2], however, stated that there is no way to translate the theoretical insight of how the elimination of a potential competitor could affect the market into an objective standard of illegality, pleading, therefore, that the doctrine be abandoned.

3. Even so, throughout the past decade, CADE successfully made use of the potential competition doctrine when reviewing some of its most complex cases, a few of which called for remedies while others had to be blocked. Thus, the investigation of CADE's methods and understandings seems justified.

4. After this brief introduction, in Section 2 we will address the relevant legal framework in Brazil that relates to potential competition. In Section 3 we summarize some of the cases reviewed by CADE in past years that somehow involved potential competition. In Section 4 we highlight CADE's initiatives to promote competition between potential rivals and, in Section 5, we present some final considerations.

2. Legal framework

5. In Brazil, Law 12529/2011, the Brazilian Competition Law, regulates the review, by CADE, of antitrust violations, mergers and acquisitions. There is, however, no specific mention in it on how or when to address potential competition in each case.

6. In fact, until CADE published its Guide for Horizontal Merger Review in 2016, the potential competition doctrine did not seem to give the Brazilian competition authority much cause for concern, even though it was discussed in a few cases[3] prior to that.

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[1] This document was prepared by Marcus Vinicius Silveira de Sá, a civil servant of CADE, with comments from Patrícia Semensato Cabral, the Head of the Merger and Antitrust Unit 3, and Patrícia Alessandra Morita Sakowski, the Deputy Superintendent of CADE.

[2] POSNER, Richard A. Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions, 75 Columbia Law Review 282 (1975).

[3] As an example, we can refer to Merger Cases 08700.008687/2014-50, between GSK and Novartis, and 08700.003748/2014-92 between Bionovis and Merck, in addition to Administrative Proceeding 08012.008678/2007-98 related to the investigation into a possible antitrust violation committed by Construtora Norberto Odebrecht. In the merger cases, CADE discussed the potential competition between some medicines in development by the Parties that could compete in the future were the merges not to happen. In the administrative proceeding, in sum, the Brazilian competition authority assessed some exclusivity and non-compete clauses included by the investigated firm in its contracts with specialized equipment suppliers that resulted in market foreclosure and limited the potential competition in government procurements.

7. The Guide does not, however, exhaust the discussion, as it only briefly mentions the potential competition doctrine as an alternative/supplementary method of analysis, as it can be seen below:

> *4.3.2 Potential competition*
>
> *A merger between a firm that is already active and a potential competitor in the same relevant market may have similar anticompetitive effects to a merger or acquisition involving two active firms in the same relevant market.*
>
> *This is the case because a competitor may play a relevant role–whether in the present, by controlling prices, for instance, or in the future–even when it has already left or is yet to enter the market.*
>
> *We assess (i) whether a firm is on the brink of entering a market, and whether it has relevant assets, which may easily be used to return to the market without incurring significant sunk costs; (ii) whether it can bear the costs needed for entering the market in a relatively short term; (iii) amongst others.*
>
> *To assess potential competition, CADE may request, for instance, that firms provide their applications for registration, licenses, and/or authorizations filed with the government.*

8. Even though the document does not provide a full prescriptive methodological approach on how CADE should address potential competition, it is enough to bring the matter to its attention.

9. In addition, it is important to highlight that CADE's Guides are not legally binding documents. That means the aforementioned Guide for Horizontal Merger Review does not bind or limit CADE's actions in any actual case. It was written only to serve as a guide to the Brazilian competition community (e.g. lawyers, citizens, civil servants, firms, etc.), as it was pointed out in its very first pages.

> *[The Guide for Horizontal Merger Review] is aimed at:*
>
> *(i) providing greater transparency to CADE's reviews;*
>
> *(ii) guiding CADE's personnel to use best practices to review mergers that result in horizontal concentration; and*
>
> *(iii) assisting market players in understanding the steps, techniques and criterion adopted by CADE on its reviews.*
>
> *The methodology suggested is not binding nor a rule, and it is not aimed at exhausting all possible review methods. Furthermore, the analytical method adopted by CADE is to fit each specific case.*

10. That is why the most important source of information regarding potential competition in Brazil seems to be CADEs precedents. Taking that into consideration, we discuss some of them in the next section.

3. Case law

11. Amongst all mergers and antitrust violations that were investigated by the Brazilian competition authority as from the promulgation of Law 12529/2011, which involved

potential competition, it seems important to mention the merger cases (i) BM&F-Bovespa/Cetip[4]; (ii) Kroton/Estácio[5]; and (iii) Dow/DuPont[6].

12. Additionally, it would be useful to address some similar pharmaceutical joint ventures cases related to pipeline products.

13. Each case will be addressed individually below to facilitate the discussion.

3.1. BM&F-Bovespa/Cetip case

14. The BM&F-Bovespa/Cetip case consisted of a corporate restructuration that would result in the merging of the firms on the stock and over-the-counter stock markets in Brazil. It resulted in B3 ("*Brasil, Bolsa, Balcão*"), Brazil's official stock exchange. Since the horizontal overlap was irrelevant and most of the services provided by the parties were unrelated, CADE understood that the transaction was a conglomerate merger intended at expanding their portfolio of services/products.

15. In this case, CADE addressed the issue of potential competition by analyzing three distinct scenarios in which one of the parties could be perceived as a potential competitor to the other. This approach was chosen mostly because as the parties were monopolists in different segments of the stock market, the possibility of one of them entering the other's market seemed credible. Thus, it was necessary to test whether the firms could be considered potential entrants.

16. By assessing qualitative information–especially about how the parties perceived each other prior to the merger proposal–and evidence on whether Cetip actually intended to launch a service to enter and compete with BMF&Bovespa in any of those markets, CADE concluded that the possibility of Cetip entering the market was feasible in one of the analyzed scenarios. As a result, CADE concluded the merger would, amongst other things, result in the loss of the potential competition between the parties.

17. In the end, the matter of potential competition was considered together with other concerns and prompted the celebration of a Merger Control Agreement[7], to ensure third parties access to their infrastructure on fair, transparent and non-discriminatory terms. Thus, the transaction ended up being cleared subject to remedies.

[4] Merger Case nº 08700004860/2016-11. Parties: BM&FBOVESPA S.A. - Bolsa de Valores, Mercadorias e Futuros and CETIP S.A. - Mercados Organizados

[5] Merger Case nº 08700.006185/2016-56. Parties: Kroton Educacional S/A and Estácio Participações S/A.

[6] Merger Case nº 08700.005937/2016-61. Parties: The Dow Chemical Company and E.I Du Pont de Nemours and Company.

[7] Merger Control Agreements are used to deal with potential competitive issues associated to mergers and acquisitions submitted to CADE which would be otherwise blocked. According to article 125 of CADE's Statutes, Merger Control Agreements may be accepted from the date of submission of the application for merger review up to 30 days after the case has been assigned to a Rapporteur Commissioner. Merger Control Agreements negotiated with the Office of the Superintendent General must be submitted to the Tribunal for approval along with the decision of the Office of the Superintendent General to direct the case to the Tribunal.

3.2. Kroton/Estácio case

18. The Kroton/Estácio case involved the acquisition of Estácio by Kroton. Both parties are prominent players in the education sector in Brazil, which means the transaction would result in significant horizontal overlaps in different segments of the higher education market.

19. During the investigation, CADE found out that, at the time, no other firm could exert as much competitive pressure on the parties as they could do with each other. Both had similar market strategies, expansion plans and, in many ways, were becoming close rivals in many relevant markets.

20. Therefore, the Brazilian competition authority decided to investigate further and address any potential competition issues. In order to do so, CADE analyzed quantitative and qualitative evidence, especially the expansion plans provided by the parties and ongoing administrative proceedings with the Ministry of Education related to the mandatory accreditation of new educational institutions. These materials provided (i) some assurance about the parties intentions in entering markets and (ii) a means to make a reasonable prediction about when this entry could be expected to occur.

21. CADE concluded that not only the parties were rivals in a number of relevant markets, but they were also potential competitors in a number of others. As a result, the merger–already a matter of concern because of the significant horizontal overlaps–also involved the effects resulting from the loss of potential competition. In the end, after discussing possible remedies, CADE's Tribunal, in a majority opinion, decided in favor of blocking the merger.

3.3. Dow/DuPont case

22. The Dow/Dupont case involved the consolidation of the parties into one. Dow operates in the markets of performance plastics and performance materials and chemicals, agricultural sciences and products and services related to energy and hydrocarbons. DuPont operates in the markets of a variety of chemical products, polymers, agrochemicals products, seeds, food ingredients, amongst other materials. Because of that, the merger would result in horizontal overlap and vertical integration in a number of relevant markets related to (i) specialized products; (ii) materials science; (iii) pesticides; and (iv) seeds.

23. The issue of potential competition was briefly addressed in the case at the moment the effects on the relevant market of ionomers were considered (as part of the discussion on the effects on materials science related markets, which constitute the second biggest part of the transaction). More specifically, the Brazilian competition authority realized that the merger could result in a monopoly in the market of EAA (Ethylene Acrylic Acid) based ionomers and eliminate potential competition in the market of EMAA (Ethylene-Methacrylic Acid) based ionomers.

24. During its analysis, CADE pointed out the difference between perceived and actual potential competition, as follows:

> *Perceived Potential Competition: established firms may fear that high profits will attract new entrants, and this perception leads to cost and price reduction. A transaction that eliminates this perception would negatively affect the performance of the firm; and*
>
> *Actual Potential Competition: a new entry would increase competition in a said market, affecting a firm's behavior towards pricing, quantities and innovation. In*

> *fact, the market only benefits if the entry actually occurs, as it is the actual potential entrant that causes this future increase in competition.*
>
> *An assessment of perceived potential competition requires proof of the effects of the imminent entry on the behavior of incumbent firms. As for an assessment of actual potential competition, it is necessary some proof that the firm being acquired in the merger would be able to enter the market on its own.*[8]

25. With that in mind, CADE established that DuPont–the number one ionomer firm–could use the transaction as a means to eliminate a future potential aggressive competitor, which would be a matter of concern due to certain market characteristics, including a small number of established players and significant barriers to entry.

26. The Brazilian competition authority also asserted that only a few players in the world had a capacity for innovation equal to that of the parties, which can be understood as an issue for future competition, and pointed out that the analyses were focusing not only on static but also on possible dynamic effects of the transaction.

27. In the end, however, CADE decided not to address the matter in its totality in this case as the parties proposed worldwide divestment remedies that would, amongst other things, remove any horizontal overlap in that market. This led to a discussion regarding the effectiveness of such remedies and, ultimately, to the merger being cleared subject to remedies. More specifically, it resulted in a Merger Control Agreement sanctioned by CADE's Tribunal. Because it was a foreign transaction in its entirety, from a corporate point of view, the majority of the remedies were coordinated with other jurisdictions.

3.4. Pharmaceutical pipeline cases

28. The merger case involving GSK and Ares[9] was a summary case (i.e. its review was fast-tracked in comparison to a regular, longer review process) due to its lack of complexity from a competitive standpoint, as per CADE Resolution 16/2016. The transaction involved a Partnership Agreement between the parties for the development and commercialization of a pharmaceutical pipeline product.

29. The most important finding in this case is CADE's understanding that there is no competition (not even potential competition) between pipeline products in early stages of research[10]. That is, there is no competition prior to when a product obtains its Anatomical Therapeutic Chemical ("ATC") classification, especially when there is evidence pointing to differences between the drugs' Mechanisms of Action ("MOA"). Although brief, this case is invaluable as it has become a leading precedent for the absence of potential competition in these situations.

30. This understanding, however, only applies to specific cases like this one. That is, not all cases related to a pipeline product will necessarily involve an absence of competition

[8] Merger Case 08700.005937/2016-61, Opinion by the Office of the Superintendent General 2/2017/CGAA1/SGA1/SG, Annex II.

[9] Merger Case 08700.000831/2019-14. Parties: GlaxoSmithKline PLC. and Ares Trading S.A.

[10] Similar to the understanding of the European Commission in Case COMP/M.1846, CADE historically segments the pharmaceutical pipeline product process in three phases: Phase 1 being the beginning of clinical trials in humans, Phase 2 being the search for the correct dosage and the definition of the areas of application, and Phase 3 being an advanced stage involving large-scale human trial to assert the effectiveness of the drug.

or even potential competition, as noted in the merger cases involving Bristol-Myers/Celgene[11], AbbVie/Allergan[12] and Mylan/Upjohn[13] (all summary cases as well).

31. To sum it up, the common understanding in these cases is that (i) only pipeline products in phase 3 can exert some kind of competitive pressure on existing products (marketed-to-pipeline overlaps), and (ii) pipeline products in the same phase, with the same MOA and therapeutic indication can be expected to compete in the future (pipeline-to-pipeline overlaps).

32. Thus, CADE usually only applies the potential competition doctrine if the merger case at hand–which involve pipeline products–falls into one of the situations described in the previous paragraph.

4. CADE's initiatives

33. Nowadays, a large portion of the discussions about potential competition is related to competition in digital markets. Following this trend, in August 2020, CADE published the document *Competition in digital markets: a review of specialized reports* (Working Paper 5/2020), which has a whole section dedicated to potential competition.

34. More specifically, the aforementioned section reviews, amongst other things, the 2019 Final Report of the Stigler Committee on Digital Platforms, which addresses startup acquisitions by incumbent firms and advocates for a shifting of the burden of proof when a merger involves a dominant platform. Additionally, the document discusses the paper *Modernizing the Law on Abuse of Market Power* by Heike Schweitzer *et al.* and how it points out the importance of interventions based on potential effects due to the risk of long-term negative effects on the structure of markets.

35. The main purpose of CADE's publication was to summarize understandings on the matter, and to present to the Brazilian and international competition community how other jurisdictions perceive and address the challenges associated with competition in digital markets. As such, the views presented do not necessarily represent those of CADE.

36. To add to this theoretical discussion and gather factual information on the matter, in June 2020, CADE started proceedings[14] to monitor mergers and acquisitions completed by Big Tech in different digital market sectors throughout the past decade. The idea is to provide CADE with the necessary evidence and data to understand the evolution of digital markets in Brazil and the M&A behavior of leading firms, to inform its decision-making.

[11] Merger Case 08700.001892/2019-07. Parties: Bristol-Myers Squibb Company and Celgene Corporation.

[12] Merger Case 08700.004187/2019-53. Parties: Abbvie Inc. and Allergan Plc

[13] Merger Case 08700.004943/2019-44. Parties: Mylan N.V. and Upjohn Inc.

[14] Administrative Proceeding 08700.002785/2020-21.

37. As only mergers that meet the legal criteria for mandatory reporting[15] are usually[16] submitted to CADE, there may be a reasonable number of smaller acquisitions made by Big Tech that escaped the Brazilian competition authority but which could be a matter of concern to future competition. The elimination of possible maverick firms is one example, as it may reduce an industry's current or potential competition levels, reduce rivalry, and discourage innovation.

38. Thus, as there are many discussions involving potential competition, but there is usually not enough data to allow for proper investigation and assessment, CADE decided to carry out the aforementioned Market Study to collect the necessary information.

39. In order to do so, CADE reached out to about a couple dozen firms–amongst which were the likes of Facebook, Google, Twitter, Amazon, Booking, Microsoft, Uber and Tencent–which operate in different digital markets asking for information about past mergers, acquisitions, joint ventures, collaborations and partnership agreements, and any other transaction that results in concentration as per Article 90 of Law 12529/2011[17].

40. The proceeding has already resulted in the gathering of a considerable amount of data, which are currently being assessed by the Office of the Superintendent General and the Department of Economic Studies of CADE.

41. In order to reduce the number of mergers with potential negative effects on competition that escape the antitrust authority for not meeting the criteria for mandatory reporting, CADE once again turned its attention to other jurisdictions. To better understand how others are dealing with the matter, CADE, as one of the co-chairs of the ICN Merger Working Group, is coordinating a review of the ICN's Merger Notification and Procedures Template to ensure it reflects new developments in merger assessment, related to both digital and traditional markets.

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[15] According to Article 88 of Law 12529/2011 and Joint Ministerial Ordinance 994/2012, all mergers and acquisitions, related to all sectors of the economy, must be reported to CADE should they involve a firm that had an annual revenue equal to or greater than BRL 750 million in the year prior to the transaction, and another one whose annual revenue was equal to or greater than BRL 75 million.

[16] We say *usually* here as there are two situations in which transactions that do not meet the criteria are also reported: (i) the parties voluntarily choose to submit the transaction for CADE to review even though it does not meet the criteria for mandatory reporting; and (ii) after news of a transaction become public, upon request or on its own accord, CADE requests that the parties submit the transaction to be reviewed even if it does not meet the criteria for mandatory reporting. As examples of the former exceptional situation, we can mention Merger Cases 08700.000478/2016-20 and 08700.003903/2020-19. As for the latter, we have Administrative Procedures for Merger Review 08700.009828/2015-32, 08700.006355/2017-83, and 08700.005079/2019-06 (which originated Merger Cases 08700.005959/2016-21, 08700.005972/2018-42, and 08700.003244/2019-87 respectively).

[17] Art. 90. For the purposes of Article 88 of this Law, a transaction is considered a concentration if:

I - two or more independent firms merge;

II - one or more firms directly or indirectly acquire control over another, either by purchasing or exchanging stocks, shares, bonds or securities convertible into stocks, or by purchasing or exchanging assets, tangible or intangible, by means of a contract or by any other means or way;

III - one or more firms incorporate another; or

IV - two or more firms enter into a partnership agreement, consortium or joint venture.

42. Furthermore, as potential competition discussions are not limited to the digital economy, it seems worth mentioning that CADE published in 2016 a document entitled *Measures to stimulate competition in public procurements*, which was based on (i) the OCDE's general recommendations; (ii) international literature; (iii) international experiences and practices; and (iv) CADE's own case law.

43. The main purpose of the aforementioned paper was helping the Federal Government reconcile the adoption of the latest best practices in public procurement procedures – to promote competition and, at the same time, discourage concerted practices– with the necessary legal certainty, and respect for the economic environment–to stimulate private investments.

44. By ensuring an appropriate bid design, it is possible to maximize the potential participation of firms in government procurements, thus promoting effective competition. With that in mind, CADE recommends, amongst other things, that government authorities should (i) always evaluate the criteria for consortia to participate in the bid, as it can be used to lessen competition; and (ii) create incentives for new entrants to participate.

45. Moreover, CADE and the OCDE started a project in 2019 to analyze the legal framework related to government procurements in Brazil. The project is divided into different phases and involves a number of tasks, including, amongst others: (i) gathering information by means of questionnaires and interviews; (ii) organizing workshops to qualify civil servants to properly plan procurements processes and to detect frauds in government procurements; (iii) elaborating a guide to help qualify all persons involved in government procurements, using actual cases and exercises; and (iv) elaborating a report with suggestions and recommendations on how competition can be further increased and bid-rigging can be reduced.

5. Final considerations

46. CADE's Guide for Horizontal Merger Review provides some general guidelines about how and why to address the issue of potential competition. However, it does not exhaust the topic. Thus, to better understand CADE's approach to potential competition, it was necessary to analyze some of its previous cases.

47. The cases mentioned indicate that CADE's experience with potential competition points to an understanding that, in order to apply this doctrine, it is important to ensure that some conditions are simultaneously present: (i) the relevant market must have certain characteristics of an oligopoly, including a small number of potential entrants; (ii) a potential entry must have pro-competitive effects; and (iii) there must be clear evidence that a potential entrant could in fact enter the market. Without these conditions, any assessment involving potential competition would end up being mere speculation and would, therefore, be irrelevant to the analysis.

48. Furthermore, CADE has been proactively investigating possible antitrust violations and monitoring markets to identify and prevent attempts to lessen potential competition.

49. Finally, we listed some of CADE's publications and initiatives that deal with the potential competition doctrine and promote the discussion and adoption of best practices, while disseminating knowledge to the competition community.

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