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Disentangling Consummated Mergers – Experiences and Challenges – Note by Brazil

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This document reproduces a written contribution from Brazil submitted for Item 6 of the 138th OECD Competition Committee meeting on 22-24 June 2022.

More documents related to this discussion can be found at https://www.oecd.org/daf/competition/disentangling-consummated-mergers-experiences-and-challenges.htm

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Brazil[1]

1. The adoption of different configurations of economic groups in market economies is a natural process. Asset acquisition, diversification of areas of activity, portfolio updating, outsourcing and other phenomena are used to maximise the return in ever-changing economic contexts. Some of these changes are more lasting, such as the alteration of property rights of certain assets, or the modification of the corporate structure of businesses. As they have the potential to change incentives that improve market operations in a definitive manner, these more lasting changes are subject to merger control in Brazil.

2. Merger control in Brazil in past decades has seen two phases: one in which reviews were conducted after the facts (1994 to 2011), and another in which it is necessary to request an authorisation from the competition authority before completing the mergers (from 2012 onwards).

3. The system adopted from 1994 through 2011 imposed high costs for the competition authority to undo transactions but that is not necessarily a bad thing. Statistically, transactions are only blocked or conditionally cleared in a handful of cases submitted to merger control around the world. In most cases, they do not impact competition and represent an attempt to speed the pace of business development by entrepreneurs, besides presenting potential gains in synergy.

4. As the antitrust authority had not had much experience with the matter, the legislative choice seems to have been to avoid adopting an excessively interventionist approach. The problem with this choice was the seemingly practical difficulty to undo transactions or impose restrictions once they have been completed. The difficulty involved issues such as how to reorganise factories, brands and teams for everything to go back to its original form. It seemed necessary certain precautions prior to the completion of transactions.

5. The first move in this direction happened via preventive measures or an Agreement to Preserve the Conditions for Merger Reversal (APRO, in its acronym in Portuguese). At this point, these tools allowed for certain transactions to be forbidden, either by a unilateral decision of the Brazilian antitrust authority (using preventive measures) or as a result of a negotiation (APRO[2]). Nonetheless, this system was also flawed. Irreversible transactions were not covered and there was no clear limitation concerning actions taken prior to the reporting of the transaction. Few cases are as emblematic about these limits as the acquisition of Garoto (Chocolates Garoto) by Nestlé (Nestlé S.A.).

6. The transaction happened in February 2002 and was reported to the Administrative Council for Economic Defence (CADE), the Brazilian competition authority, the following

[1] This document has been written by Alden Caribé de Sousa, General-Coordinator for Antitrust Analysis. Arianne Mesquita and Ariel Menezes, Translators at CADE's International Unit, have translated it from Portuguese.

[2] Former Statutes of CADE. Consolidated on 2 August 2011. No longer in force.

'Article 99. Once one of the copies of the request filed by the applicants has been received from the Secretariat for Economic Law, the case is to be distributed in the following distribution session.

(1) Once a case is assigned, should the Rapporteur deem it necessary, they will summon the legal representatives of the applicants to discuss the signing of an APRO, or may impose a preventive measure.'

month. In 27 March 2022, the applicant and CADE signed an APRO to preserve the business distinction between Nestlé and Garoto, their operations and the separation of their workers, factories and brands. The idea was ensuring the useful outcome of the process in case of a decision that did not clear the transaction unconditionally. The acquisition affected three markets: sugar confectionery, chocolate coatings (mixes of cocoa, sugar and milk products, sometimes with additives, used for the production of bonbons or other chocolates), and chocolate confectionery (bars and bonbons industrially prepared and packaged for final consumption). There was no concern involving the sugar confectionery market.

7. When reviewing the transaction, the antitrust authority observed that, together, the applicants held more than 80% of the shares in the chocolate coating market. Garoto also had almost all of the market's idle capacity, which corresponded to three times the total volume sold in the entire market in the year prior to the review of the transaction. The authority concluded that an entry that could limit the market power of the applicants was unlikely in a two-year term, given the expected defensive strategy to be adopted by the firms after the transaction.

8. In the case of the chocolate confectionery market, the resulting concentration would be superior to 60% of the market shares. These high concentration levels would be reinforced by the difficulty of creating a competitive portfolio in this market, where incumbents and fringe producers found it extremely hard to develop new brands and recipes that appeal to consumers. In accordance with CADE's case law, artisanal chocolates were not included in the same relevant market.

9. Thus, in 2004, CADE's Tribunal blocked the transaction by the majority of votes because it resulted in high market concentration, causing adverse effects in the markets of chocolate coating and chocolate confectionery. The Tribunal also rejected conditional clearance and partial divestment as it observed such measures would threaten the existence of the acquired firm Garoto. A partial divestment would also make Garoto's manufacturing operations unfeasible in the medium and long terms, jeopardising market competition.

10. Nestlé challenged CADE's decision in court and the effects of the transaction's blockage were suspended. Hence, blockage was suspended, but the APRO remained in force.

11. In 2016, 12 years after CADE's decision, the antitrust authority and Nestlé reached a settlement with a new proposal for partial divestment aimed at deconcentrating the chocolate confectionery market. Concurrently, the authority launched a new investigation to understand the merger's effects on the market, which revealed many players entered the chocolate coating industry since then, reducing the concentration ratio. Conversely, there has been little change in the market of chocolate confectionery over the 14 years. The antitrust authority was favourable to the settlement proposal as, in its understanding, asset disposal would be beneficial at that time, potentially mitigating concerns in the market of chocolate confectionery. However, failing to be completed in time, the divestiture was unsuccessful.

12. The litigation has not ended to this day, and the challenge of undoing a deal that was consummated before the premerger notification regime remains a major challenge.

13. In 2012, the Brazilian parliament passed a new competition law, seeking a more efficient merger control by requiring premerger notification from parties with high sales

turnover by Brazilian standards.[3] The idea was to prevent cases such as the Garoto/Nestlé merger.

14. The rule applies to cases in which the merging parties exceed the sales turnover threshold. Businesses under development – with low or no sales turnover, such as start-ups – are not obliged to notify. Besides, premerger notification applies only to deals that lead to changes in corporate structure or in property rights over assets.

15. Post-merger control remains for cases in which one or both players do not reach the annual sales turnover established by law and for partnership agreements with a duration of less than two years or undetermined duration. In case of term extension, the parties must notify the authority about it before the agreement is in effect for two years.[4] Partnership agreements are those in which companies are not part of a same corporation but share the risks and results of the economic activity and compete in the relevant market described in the agreement.

[3] Equal or greater than BRL 750 million for one party and BRL 75 million for the other.

[4] CADE Resolution 17/2016: "Article 3. Parties are to notify CADE of agreements inferior to a two-year term or with an undetermined period if they reach or exceed two years as of their signature.

Paragraph 1. The parties must notify the agreements before their renewal; their continuity for a period equal or superior to 2 years is contingent on CADE's approval.