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Our File No. 69459
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VIA EMAIL to consultapublica012019@cade.gov.br and alexandre.barreto@cade.gov.br

Conselho Administrativo de Defesa Econômica
Setor de Edifícios de Utilidade Pública Norte
SEPN Entrequadra 515, Conjunto D, Lote 4, Edifício Carlos Taurisano
Cep: 70770-504
Brasil
Attention: Alexandre Barreto de Souza, President

Dear President de Souza:

Re: Consulta Pública nº 01/2019

We write on behalf of the Merger Streamlining Group ("MSG" or the "Group"), whose membership consists of multinational firms with a common interest in promoting the efficient and effective review of international merger transactions.[1] The Group works with competition agencies and governments to help implement international best practices in merger control, with particular focus on the *Recommended Practices for Merger Notification Procedures* (the "*Recommended Practices*") of the International Competition Network ("ICN"),[2] of which the Conselho Administrativo de Defesa Econômica ("CADE") is a longstanding and active member.

The Group commends CADE for its efforts to increase transparency regarding the enforcement of the provisions in Law 12,529 of 2011 (the "Brazilian Competition Law") related to merger filings and for seeking public input on the proposed approach set out in the draft resolution that governs the administrative procedure for determining concentrations (the "Draft Resolution").

The Group recognizes that the Draft Resolution is designed to implement the provisions in the Brazilian Competition Law related to merger filing requirements, including penalties for non-compliance, and that such filing obligations constitute an important component

[1] The current members of the MSG include Accenture, BHP, Bosch, Chevron, Cisco Systems, Danaher, GE, Novartis, Oracle, Procter & Gamble, Siemens, and United Technologies.

[2] International Competition Network, *Recommended Practices for Merger Notification Procedures*, available online at <https://www.internationalcompetitionnetwork.org/wp-content/uploads/2018/09/MWG_NPRecPractices2018.pdf >.

of Brazil's merger control framework. This submission focuses on the manner in which penalties will be set within the very broad range authorized by the statute.

I. Penalties

The Brazilian Competition Law prescribes a minimum penalty of R$60,000 and a maximum penalty of R$60 million (approximately US$15,400 to US$15.4 million) when parties fail to submit a filing in respect of a notifiable transaction or consummate a notified transaction prior to the completion of CADE's assessment. The Draft Resolution will provide important guidance regarding the determination of penalties within this range, which the existing Resolution 13 lacks. However, the Group has concerns regarding the design of the upward adjustments that will be added to the R$60,000 basic penalty related to days of delay (*i.e.*, duration of non-compliance), gravity and intentionality.

(a) *Duration of Non-Compliance*

Article 21, item II.a of the Draft Resolution indicates that the penalty amount will be increased by 0.01% of the transaction value for each day after a transaction is consummated either without a filing or before CADE's assessment is completed. This formula may result in significant cumulative penalties (*e.g.*, 1.5% of the transaction value for a 150-day breach of the notification or no-close requirements).

The Group has three concerns regarding this provision: (i) lack of connection to the affected market(s) in Brazil; (ii) uncertainties regarding the measurement of transaction value; and (iii) potential delays in CADE's acceptance of filings as complete.

(i) Lack of Connection to Brazil

Based on the translation available to the Group, it appears that this provision is not limited to transactions occurring wholly within Brazil, and that the transaction value will be based on the entirety of the transaction rather than any attempt to identify an amount that would reflect the proportional significance of Brazil relative to other countries in which the merging parties are active.

For global transactions, it can generally be expected that the Brazil-related sales of the merging parties might be roughly proportional to Brazil's share of global GDP (*i.e.*, about 2.8%).[3] There may be global transactions in which the Brazilian share is somewhat higher or lower, but in any case the use of a global transaction value would substantially overstate the significance of the failure to file or the premature closing in Brazil. It would also result in penalties that are disproportionate and punitive for international transactions relative to domestic transactions in which the merging parties have a comparable level of Brazil-related activities.

[3] World Bank Open Data.

By way of hypothetical example, under the Draft Resolution, a US$1 billion merger involving two global companies (a transaction value of US$1 billion being very modest size for a global merger) would trigger an upward penalty adjustment of US$15 million (R$58.3 million) for a 150-day breach of the Brazilian Competition Law (before adjusting for any reductions due to the time of notification provided under Article 21, item III of the Draft Resolution), even if only 2.8% of the merging parties' business activity was in Brazil. In contrast, a 150-day delay for a domestic merger with a R$108.9 million (US$28 million) transaction value (*i.e.*, comparable scale within Brazil) would only receive an upward penalty adjustment of R$1.6 million (US$420,000).

The Group respectfully submits that this approach would not treat international mergers on a fair and proportionate basis. One option for addressing this discrimination would be to switch the formula for the delay factor in the Draft Resolution to focus directly on Brazil-related revenues, which would be a more relevant proxy for the possible impact of a failure to file or premature closing on competition in Brazil. An alternative would be to calculate the penalty adjustment based on an estimate of the portion of the value of an international transaction that would be attributable to the merging parties' activities in Brazil, as measured by sales or assets in Brazil relative to their total sales or assets.

(ii) Uncertainty

The Group's second concern with the proposed design of item II.a is the complexity and uncertainty associated with the use of transaction value (for both domestic and international transactions). While there are some straightforward purchase transactions where a cash price for assets or shares is readily and objectively identifiable, in many other cases the measurement of transaction value may be uncertain and difficult to ascertain.

For example, it may be difficult to determine the value of certain non-cash considerations, such as debt with variable repayment terms, "earn-out" mechanisms based on future performance of the acquired business, or an exchange for the acquirer's shares. Part of the consideration may be subject to certain conditions being met or determined in the future, such as certain post-closing adjustments. Consideration may be paid in different currencies, whose relative value may fluctuate and the appropriate time at which value should be measured may be unclear.

In more complex transaction structures such as mergers or combinations, it can be even more difficult to determine what constitutes the value of the transaction.

As discussed above, these issues could be addressed by revising the formula for the delay factor to focus on a simpler measure such as revenues generated in Brazil. Domestic revenues would also be a more appropriate measure of potential impacts of a breach on markets in Brazil.

(iii) Delays due to CADE

The Group is also concerned that the merging parties may not have full control

over the duration of non-compliance. In particular, for example, where parties failed to submit a filing in respect of a notifiable transaction attempts to rectify the non-compliance by making a filing, there may be delays in CADE verifying and accepting the filing as complete. There may be further delays if CADE determines the filing to be incomplete and requires the filing be amended.

Under the proposed design of item II.a, it appears that the entire period between date on which the parties' making a filing to rectify the non-compliance and date on which CADE eventually accepts the filing to be complete would be counted towards the duration of non-compliance. In such situations, the parties have no control over the duration of non-compliance, notwithstanding that they have made a attempt at rectifying the non-compliance. Moreover, the Group is concerned about the potential financial incentive on the part of CADE to delay the verification of a filing or to demand amendments to the filing in order to lengthen the duration of non-compliance and therefore increase the available fines.

The Group respectfully suggests that item II.a should clarify that the period of non-period ceases when the parties submits a filing to rectify the non-compliance rather than when CADE accepts such filing as complete.

(b) ***Gravity***

Article 21, item II.b of the Draft Resolution states that the penalty amount will be increased by 2%-4% of the value of the transaction if the merger is approved with restrictions or is blocked by CADE.

The Group has three concerns regarding this provision: (i) the potential impact of such a financial incentive on CADE's substantive merger decisions; (ii) the use of transaction value as a relevant measure; and (iii) the uncertainty associated with the broad penalty range.

(i) Agency Financial Incentives

The concern related to financial incentives is that any decision to impose a restriction (large or small), or decision to block a merger that was not notified or that closed prematurely may generate a substantial financial payment to CADE. In the case of the hypothetical US$1 billion global merger discussed above, even a narrow restriction imposed by CADE in respect of a single product market in Brazil would trigger an incremental penalty payment of at least US$20 million and up to US$40 million (before adjusting for the reductions due to the time of notification provided under Article 21, item III of the Draft Resolution), immediately exceeding the R$ 60 million (approximately US$15.4 million) penalty cap.

The Group respectfully suggests that the gravity factor should be removed from the Draft Resolution. Whether or not a merger is anti-competitive is a decision that should be made on a normal substantive basis and be subject to normal remedies under the Brazilian Competition Law. Failures to file or premature closings are problematic conduct regardless of whether a transaction has anti-competitive effects and should be penalized independently of the gravity or lack of gravity of the transaction's competitive effects.

Even if CADE were to self-impose processes to attempt to maintain the independence of substantive decisions from penalties for filing non-compliance, we doubt that private parties would be confident that substantive enforcement decisions have been made without any direct or indirect influence of their potential effects on penalties. This may lead to appeals of CADE's substantive and/or penalty decisions in particular cases. More generally, it may affect domestic and international perceptions and public confidence regarding the manner in which CADE administers Brazil's merger control regime.

(ii) Use of Transaction Value

If CADE elects to retain the gravity factor, notwithstanding the above-noted problematic effect that it may have on the perceived legitimacy of the agency's enforcement decisions, the Group has the same concerns about the use of transaction value as have been discussed above. Switching to a measure based on the merging parties' revenues in Brazil, would be fairer and more relevant or a mechanism for identifying a proportionate Brazil allocation of the value of an international transaction.

(iii) Breadth of Discretion

If the gravity factor is retained by CADE, the Group is also concerned about the lack of predictability and risk of inconsistency inherent in the 2%-4% penalty range. The Group considers that the application of a fixed percentage to a measure that reflects the merging parties' revenues in the market(s) in which the merging parties have horizontal overlaps[4] would provide greater certainty (for private parties and CADE) and would reduce the risk of arbitrary or inconsistent penalties being impossible.

(c) *Intentionality*

Article 21, item II.c of the Draft Resolution focuses on the intentionality of the conduct of the parties that failed to notify a transaction or that completed a transaction prematurely. For this factor, CADE may impose an additional penalty amount of 0.1%-0.4% prior year sales if the parties did not act in good faith.

The Group agrees that merging parties that have acted in good faith but nevertheless failed to notify a transaction or consummated a transaction prematurely should be penalized less harshly than parties that committed such breaches of the Brazilian Competition Law deliberately. However, the Group is concerned about the lack of connection of this penalty factor to relevant commerce of the merging parties, the uncertainty associated with the broad penalty range, and the possibility that merging parties may effectively be required to prove that they acted in good faith.

[4] A measure limited to the merging parties' revenues in the market(s) in which CADE imposed restrictions or blocked the transaction would be even more targeted, but would be subject to the same agency incentive concerns identified above.

(i) Lack of Connection to Relevant Commerce

Based on the translation available to the Group, it appears that the revenues to be considered when applying this factor may include all the domestic and international revenues of the merging parties as well as the affiliates in their economic groups, including vendors of assets or shares who will not be competing in the relevant market(s) post-merger.

Similarly, the Group recommends that the revenues to be considered should be limited to only the revenues generated in Brazil by the target. In this regard, the international revenues of merging parties are entirely irrelevant to the issue of intentionality of a breach of Brazil's filing or no-close requirements and bear no relation to the revenue thresholds that form the basis of the filing obligation in art. 88 of the Brazilian Competition Law. In addition, the vendor and any other affiliates that are not part of the merger transaction are entirely irrelevant to the issue of intentionality of a breach of Brazil's filing or no-close requirements. The acquirer's revenues in the relevant market(s) in which it competes with the target might also be considered to be relevant to an assessment of the intentionality factor[5], but other unrelated revenues of its other affiliates would not appear to be relevant.

By way of hypothetical example, in an transaction where a global company with US$10 billion global annual revenue (2.8% of which being from Brazil) acquires a business with annual global revenue of US$1 billion (also 2.8% of which being from Brazil) from another global company whose remaining business generates US$9 billion revenue annually, under the Draft Resolution, the parties' failure to prove good faith would trigger an incremental penalty of $20 million to 80 million (before adjusting for any reductions due to the time of notification provided under Article 21, item III of the Draft Resolution), immediately exceeding the R$60 million (approximately US$15.4 million) penalty cap. However, the vendor's US$9 billion of remaining global revenue and the 97.2% of the acquirer's and target's revenues which are outside of Brazil have no bearing on the impact of a failure to file or premature closing on competition in Brazil. The Group recommends that the relevant commerce should be limited to approximately US$308 million (i.e., the revenue of the acquirer and target generated in Brazil, approximately 2.8% of the US$11 billion global revenue). That approach would generate an incremental penalty amount of approximately US$308,000 to US$1.23 million.

(ii) Breadth of Discretion

The Group is concerned about the very wide discretion contained in a 0.1% - 0.4% penalty range for the same reasons related to predictability and risk of arbitrariness / inconsistency as discussed with respect to the gravity factor above. The use of a revenue measure (which should be refined to focus on relevant revenues, as discussed above), can provide a basis for the magnitude of an intentionality adjustment to vary according to the transaction in question, while applying a fixed multiplier (*e.g.*, 0.2%). Alternatively, intentionality could be structured as an aggravating factor that is applied to the basic penalty plus

[5] As noted above, further limiting the relevant revenues to the markets in which CADE imposed restrictions or blocked the transaction might appear to be even more relevant, but would create problematic agency incentives.

the duration adjustment (e.g. increasing the penalty by a further fixed percentage, such as 10% or 20%).

(iii) Good Faith

It appears from the translation available to the Group that the Draft Resolution will require the merging parties to establish that they acted in good faith in order to avoid an upward adjustment for intentionality. The Group considers that this "reverse onus" is inappropriate where significant penalties are proposed to be imposed on the basis that breaches were intentional. The Group respectfully submits that CADE should only be imposing upward adjustments on the basis of intentionality when it has affirmative evidence that the failure to file or premature closing was deliberate.

II. Concluding Observations

The Group commends CADE for addressing these important issues transparently and hopes that these comments will assist CADE in finalizing the Draft Resolutions. We would be please to respond to any questions or discuss these issues further with CADE personnel.

Yours very truly,

Casey W. Halladay

Copy to: Members of the Merger Streamlining Group
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