The New Rules of the Brazilian Antitrust Authority on Associative Agreements

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The Administrative Council for Economic Defense (CADE) has recently issued new rules on the so-called "associative agreements", with CADE's Resolution No. 17/2016 coming into effect on November 25, 2016. These new rules modify the legal threshold for mandatory notification of this type of agreement, bringing more clarity on the matter and legal certainty to the market.

Quick Background

Generally speaking, the revoked Associative Agreements Resolution (Resolution No. 10/2014) had been a controversial issue from the outset (it entered into force in early 2015), notably due to its allegedly vague terminology and tricky thresholds. For instance, depending on the interpretation given to Resolution No. 10/2014, it was relatively common to see simple and routine supply and distribution agreements falling within the compulsory thresholds for notification, even when these were in no way jeopardizing the antitrust landscape. In that vein, one could notice a certain flurry in over the business community in view of what they understood as unnecessarily high (and not negligible) transaction costs arising from the need of mandatory notification, in particular those related to the timing of pre-merger obligations.

In that line, it was relatively commonplace that the need to file common day-to-day associative agreements with CADE would cause certain harm to economic agents, such as delays or, to a certain extent, restraining such an economic agent from performing its ordinary activities in due time for the profitability of the business, once pending approval is granted. In addition to that, the practitioners had seen the revoked rules as being prone to deviate the focus of the antitrust authority from other relevant matters in the pipeline. As a consequence CADE, practitioners, economic agents, academics and civil society groups started discussions geared towards revising and refining the terms of the revoked resolution, turning it into a more workable and adherent to the legal framework.

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In this workflow, it is worth highlighting CADE's transparency in its interactions and dialogue with civil society, aiming at establishing rules that could best capture the nuances of the business environment, while being consistent with the local mindset.

The New Rules in a Nutshell

As per CADE's Resolution No. 17/2016, alongside with the revenue criteria set out in the Brazilian Antitrust Law, "associative agreements" are defined as those lasting for two or more years, which set up a joint enterprise (*empreendimento comum*) to explore business activity. To this end, **it is essential that two conditions are cumulatively fulfilled: (i) the agreement must establish the sharing of risks and results of the economic activity which constitutes its object; and (ii) the contracting parties shall be competitors in the relevant market subject to the agreement**[2].

For the purposes of the new rules, economic activity has to do with the notion of acquisition or supply of goods and services on the marketplace. This applies even when said economic activity has no lucrative purpose, but as long as the activity can be performed by a private company with the (theoretical) purpose of earning profit, the notion of economic activity could be fulfilled from the reading of the Resolution No. 17/2016.

As one of the core changes brought by the new rules, CADE has chosen to focus its analysis and resources in transactions involving competitors in the relevant market subject to the agreement (i.e., horizontal overlap). As a result, a number of plain supply and distribution agreements previously criticized for being encompassed by the former rule will no longer – strictly speaking – require prior approval from the authority if horizontal overlap is not envisioned.

One additional remark to stay under the companies' limelight under the new rules is related to a temporal subject: agreements that fall within the nature of an associative agreement but for a term inferior to two years or for an indefinite period shall be notified to CADE whenever the period of two years counting from the date of its execution is reached or exceeded[3]. In these cases, the agreements should be filed prior to renewal, and the continuity of its duration will depend on CADE's approval.

In light of the foregoing, one might argue about the effectiveness/feasibility of this specific rule that determines the suspension of an agreement already underway while waiting for CADE's approval. In practical terms and to bear in mind: what should be done with the production plant? And what about the underlying costs? Also, how should the parties address issues derived from preexisting customer demand and employees? It seems to us that apart from other points, these questions indicate some of the next challenges that might be faced daily, requiring an attentive view from economic agents.

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[2] Article 2 of the Resolution No. 17/2016 establishes the following:

"It is considered as being associative any type of agreement with duration equal to or greater than two years which sets up a joint enterprise (*empreendimento comum*) for economic activity exploration, since, cumulatively:

(I) the agreement establishes the sharing of risks and results of economic activity which constitutes its object; and

(II) the contracting parties are competitors in the relevant market subject to the agreement".

[3] In addition, as regards the temporal aspect, the Resolution No. 17/2016 sets forth the following in its article 5º: "The agreements executed before the entry into force of this Resolution, and which term reaches or exceeds 2 (two) years, under paragraph 3 of Article 2 of Resolution No. 10, of October 29, 2014, must be submitted to Cade's review if they are considered associative agreements under the terms of this Resolution".

Still, by way of case law precedents, one should mention a formal Consultation that was recently ruled by CADE[4] in which, among other aspects, the notion of joint enterprise for exploration of business activity being a central and inherit element when assessing associative agreements has been pointed out for the purposes of Resolution No. 17/2016. The Reporting-Commissioner also highlighted that the requirement of joint enterprise has brought associate agreements closer to joint venture contracts for the purposes of mandatory notification and pre-merger control by the Antitrust Law.

PERCEPTIONS AND INITIAL CONCLUSIONS

At this seminal stage, we envision a public choice behind the sense of the new rules established by CADE in such a way that the authority shall prioritize the antitrust analysis for transactions that pose some risks to the market – hence, in theory, a myriad of trivial and day-to-day agreements would be exempted from antitrust scrutiny as regards merger review control, despite not being exempted from investigation should any sort of abuse be verified (i.e., anticompetitive conduct control).

In sum, although it is possible to improve certain aspects of the new rules, we see the outcome of CADE's initiative in revisiting the matter as sensible and positive, since it provides more clarity to the matter and it has showed that CADE is closely listening to the market's demands. For us, the changes at hand also send a clear-cutting message in the sense that the discrepancy between theory and practice must be a matter subject of questioning, taking into account a transparent debate that considers the viewpoints of economic agents, academia, civil society and the local context, with the ultimate goal of bringing legislation closer to the reality of facts in a coherent and consistent pace.

As always, in a scenario shortly following a legal shift, it will be important to follow-up on how these new rules will be digested by the market and how the economic agents will react to them, in a way that one can infer the practical effectiveness of these new rules in a holistic perspective.

[4] Consultation No. 08700.000843/2016-04. Consultant Party: Hamburg Südamerik.anische Dampfschifffahrts-Gesellschaft KG. Ruled by CADE on hearing session held on November 23, 2016 (the Consultation was partially acknowledged – absence of requirements for mandatory notification).