Brazilian Competition Law and M&A: Key Elements to Bear in the Current Context of the Global Economy

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The level of antitrust scrutiny of M&A transactions in Brazil has significantly increased over the past few years, with several transactions being subject to in-depth review, remedies, or even rejected by the Administrative Council for Economic Defense ("CADE"). This has made antitrust a key aspect in the negotiation of many M&A transactions. One must evaluate in advance the likelihood of a given transaction being unconditionally cleared by CADE, and what types of remedies might be imposed if there is a concrete probability of conditional clearance. This all of course also impacts the expected timeline of CADE's merger review, and affects the substance of negotiations between parties, such as issues regarding price, investment exit strategies, as well as issues regarding the allocation of antitrust risk, bringing about discussions on break-up fees, hell-or-high water clauses, among other related contractual mechanisms. This discussion becomes even more relevant in times of crisis, when timing, flexibility and creativity to find reasonable solutions become critical for practitioners and enforcers alike. However soon the end of the current health crisis will come, its negative effects on the Brazilian economy are visible and will likely worsen. Against this background, we cover in this article a few key elements in Brazilian competition law and practice that may be of particular relevance during these times of economic crisis.

I. Dealing with the Timing Issues: Possibilities Available to Companies

It is possible that the timetable for the antitrust review of transactions will be impacted in some way in light of the current restrictions imposed on society. CADE, in an exemplary manner, has been adopting measures to keep its activities running in normal course. In fact, CADE's balance for the first half of the year shows that the productivity of the antitrust authority was not affected by the pandemic: while in the first half of 2019 CADE issued 206 decisions on merger cases and the average review period was 30.7 days, in the same period in 2020 the number of merger case decisions issued was 203, with an average review period of 28.8 days. Notwithstanding, especially in the context of highly complex transactions submitted to CADE under the long-track proceeding, the authority must often resort to competitors, customers and suppliers to obtain the necessary information to complete its assessment. In these cases, CADE's timetable may be adversely impacted by external factors.

In order to mitigate the risk of delays, companies may explore mechanisms available under Brazilian competition law, such as a what is known as a "precarious authorization," which allows transactions to be carried out before the merit analysis is completed by CADE, or the use of debt securities convertible into shares, which enables the capitalization of a company in difficulty without the need for a clearance from CADE until the debt security is effectively converted into shares.

The rules for the subscription of convertible securities without prior approval from CADE are simple, straightforward, and have already been used several times in past transactions reviewed by CADE, even in the absence of situations of financial distress. In such cases, only the effective conversion of the debt into shares may be subject to prior approval by CADE, unless the security itself already grants the acquirer the right to appoint members of the company's management or supervisory bodies or voting rights or veto on competing sensitive issues of the company.

On the other hand, even though they are in practice less relied upon by parties as they are restricted to situations of serious financial distress, requests for precarious authorization

can gain relevance in an environment of economic retraction such as the one we are currently experiencing. Under applicable rules, there are three cumulative requirements for precarious authorizations: (a) there must be no risk of irreparable harm to competition; (b) the transaction must be reversible in the event of a negative final decision by CADE; and (c) there must be an imminent risk of substantial and irreversible financial losses for the target company if the precarious authorization is not granted.

In addition to the challenge of demonstrating that all three criteria are met in a specific case, companies must keep in mind the total period of 60 days that CADE has to decide on precarious authorization requests. Depending on the characteristics of the transaction, it may make more sense to present the case under the fast-track proceeding and adopt a transparent and cooperative stance with CADE, reinforcing the urgency faced by the parties. The *OpenGate Capital Group/Zodiac* case is a good example of this. At that time, the parties withdrew the precarious authorization request originally formulated, since it would no longer make sense because the transaction was eligible for fast-track review. In fact, the decision of the General Superintendence was issued in just 17 days, that is, CADE's final approval was obtained in practically half the time stipulated for the assessment of a precarious authorization request.

This does not mean, however, that requests for precarious authorizations should be outright discarded as viable options in concrete cases. For example, the mechanism was used successfully to expedite closing of the sale to Excelente B.V. of 60 percent of the shares of Rio de Janeiro Aeroportos, the parent company of the Antônio Carlos Jobim International Airport concessionaire, previously controlled by the Odebrecht Group. CADE granted the precarious authorization in less than 10 days, making it possible for the concessionaire to continue operating.

II. The Failing Firm Defense

In addition to the question of urgency regarding CADE's review period, one can reasonably expect that discussions based on the theory of failing firm will gain prominence in several cases that will be assessed by CADE in this context of crisis.

This theory is widely known in the antitrust field, and is even mentioned in CADE's Guide to the Analysis of Horizontal Mergers. Traditionally, its application is restricted to cases in which the parties cumulatively prove that, in the absence of the transaction, (i) the company would exit the market or could not fulfill its financial obligations; (ii) its assets would not remain in the market, which could lead to a reduction of supply and higher levels of market concentration; and (iii) there would be no alternative resulting in less harm to competition, and that there is no other solution for maintaining the target's activities other than the approval of the transaction.

Although the full application of this theory has been ruled out in most of CADE's precedents where the discussion has arisen, there are cases in which CADE took into account for its approval elements that derive from this theory, such as, for example, the *Petromex/Petrobras* transaction, which was approved, among other reasons, for being the least harmful option to the market to avoid the exit of relevant assets, even if considering that the transaction could result in a monopoly. At that time, the crisis faced by Petrobras and the evidence that there was no other player interested in the assets were weighed, leading CADE to approve the transaction conditioned to behavioral remedies.

In the face of a structural crisis like the one we are experiencing today, it is important for CADE to be attentive and open to this type of approach. Although proving that the criteria of the failing firm defense are met in a concrete case is a difficult task, we believe that it would be important for CADE to at least rely on the basic concept of the theory when making a dynamic analysis of the specific situation of each transaction, particularly in the context of recent and unparalleled developments that have been transforming the economic reality of companies very quickly.

This approach was seen, for example, in a recent decision of the British competition authority (Competition and Markets Authority "CMA"), which, in April 2020 (arguably a peak of the pandemic worldwide), provisionally authorized Amazon's minority investment in Deliveroo, one of the main food delivery companies in the United Kingdom. Although that transaction was announced prior to Covid-19, the pandemic completely changed the financial reality of Deliveroo. The CMA acknowledged that, as a company still in a development/growth phase, Deliveroo depended heavily on continuous investments to maintain its financial sustainability. Based on the evidence presented by Deliveroo, the CMA concluded that the matter was, in fact, urgent, and that the company's exit from the market would be inevitable if the company did not have access to significant investments – which only Amazon would be willing to make, given the scarcity of financial resources available to developing businesses like Deliveroo. The most interesting part of the case is that, in June of this year (therefore, two months after the decision that provisionally approved the transaction), the CMA reversed its position and re-reviewed the case. The CMA argued that the effects of the pandemic were not as severe as it thought they would be and that, for this reason, the case would no longer fit all the criteria necessary for the approval under the terms of the failing firm defense.

CADE's substantive analysis in mergers involving companies undergoing judicial reorganization is not, in principle, different from the analysis that is made in transactions involving companies that are not in financial trouble. In the recent past, CADE has assessed many merger cases involving companies undergoing judicial reorganization: there is no sign, in any of them, that CADE adopted a more lenient stance due to the financial situation of one of the parties involved in the transaction. The competition assessment conducted can be different only in cases where a failing firm argument is also presented - and accepted by CADE.

However, experience shows that CADE is open to more quickly analyzing mergers involving companies under judicial reorganization, particularly when the parties present solid justifications for the authority to do so.

III. The Declining Markets Theory

The theory of declining markets was originally addressed in a seminal paper by Malcom Coate & Andrew Kleit, who argued that a merger in a market that was demonstrably experiencing a structural crisis was unlikely to produce anticompetitive effects (see Coate, M.; Kleit, Antitrust Policy for Declining Industries, Journal of Institutional and Theoretical Economics, vol. 147, No. 3, 1991). They argued that this was because, if a market was experiencing a sustained fall in demand and there was a very low probability of new players entering – which would be due, for example, to a change in consumer habits, or to a technological innovation that made a market obsolete – it is unlikely that the players would be able to arbitrarily increase prices, or engage in other anticompetitive strategies: this

would only accelerate the process of falling demand already being experienced by the sector. Therefore, mergers in declining markets would not, at first, be of concern.

The pandemic is expected to increase the pace of digitalization of the economy, as companies are expecting deep changes in the way consumers purchase products and services. In this context, it is possible that many markets will start to become obsolete, arguably fitting in the concept of declining market. CADE has already used the theory of declining markets in its precedents, and its analysis generally focuses on the following threshold questions: (i) does the case indeed involve a declining market (i.e. is there really evidence of a structural change in demand patterns)?; (ii) even if the case indeed does involve a declining market, is it in fact unlikely that the transaction in question would create conditions for price increases?; and (iii) are the net effects of the transaction (i.e. the result of an assessment of both pro- and anticompetitive effects) indeed positive?

In at least five cases assessed in the past (the last one in 2016), CADE concluded that the markets under analysis were in decline and that an increase – even a significant one – in concentration in those markets would be more beneficial than the disappearance of the market. To date, no merger submitted to CADE in the context of the pandemic has raised – at least in an evident way – the theory of declining markets as a reason for approving the transaction. Although CADE seems more open to this theory than to the failing firm defense, the fact is that companies interested in taking the argument forward need to be prepared to provide CADE very robust data to support their claim that the transaction does indeed involve a declining market, and that clearing that transaction will, in the aggregate, be better for consumers than the disappearance of the market as a whole.

IV. Conclusion

A dynamic approach to the current economic scenario should be adopted by CADE – much like the approach taken (at least initially) by the CMA in the *Amazon/Deliveroo* case. In many cases, the main purpose of the transaction will be to address a financial problem for the acquirer, not the acquired company. In other situations, such as in vertical transactions, the aim will be to ensure competitive and service to consumers conditions in a related market, which depends on the full functioning of both the acquirer and the acquired company. There will also be others in which the crisis will have the effect of limiting the growth and expansion of smaller innovative companies, which could have their products and services boosted and reach the market in full if they had the financial investment and know-how of more established players. Finally, there will be cases in which the pandemic will have produced an irreversible drop in demand – which, in the medium term, will lead to the disappearance of the market as a whole, although this market still has value for a relevant number of consumers today.

In all these cases, it is important to set aside any prejudice in relation to the full application of the failing firm theory, as well as the theory of declining markets, and bring their elements to the debate and evaluation of the net effects of each transaction, both for the companies involved and for the market more broadly.

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