CPI Columns
Latin America

March 2021

Merger Control in Peru: The Political Economy and Economics of a New Regulation

By Javier Coronado | Garrigues

Edited By María Fernanda Viecens & Esteban Manuel Greco

Merger Control in Peru: The Political Economy and Economics of a New Regulation

By Javier Coronado[1]

After years of exhausting, yet interesting, debates, in the following weeks a general and compulsory pre-merger control regime will come into force in Peru that will be implemented by INDECOPI, the national competition agency. In this article, I address some key aspects of the political economy related to the process for adopting such a competition policy instrument, as well as some economic aspects of the regime that are of a paramount significance.

The process seemingly finished in November 2019 with the approval of a merger control regime by means of an Executive Urgency Decree (DU 013-2019, the "DU") that was set to come into force on March 1, 2021. The DU considered very standard parameters, such as objective thresholds for notification based on sales, gun-jumping provisions, a two-phase administrative procedure, the search for mergers that may cause significant restrictions to competition, efficiency claims, and the possibility of conditional approval upon the implementation of remedies.

When everything seemed to be set for a smooth take off, the Peruvian Congress revealed a final and interesting chapter for this novel. Indeed, Congress resurrected the debate again in the second half of 2020 with the aim of transforming the DU into a Law.

Finally, Congress replaced the DU with a Law that was published on January 7, 2021 (Law 31112). The Law kept all the substantial provisions of the DU but added some important novelties. The most relevant are: the introduction of assets as an alternative variable for calculating notifications thresholds, the mandate to initiate *ex-officio* investigations over mergers that may not meet the thresholds, and a voluntary procedure of notification

The Law will come into force conditional on the issuance of specific regulations in the following weeks, meaning that it has not fixed a specific date.

Possibly the Longest Public Policy Debate Ever

In 2017, the Peruvian congress opened a public debate to design and propose a general merger control regime under the responsibility of INDECOPI, the national antitrust agency. So far, INDECOPI could only review mergers in the electricity sector.

Way back, before 2017, and for a long time, conservative parties as well as the Ministry of Economics blocked congressional representatives' initiatives in parliament for a general merger control review.

At least two arguments were used systematically against that competition policy instrument. First, stakeholders against the regulation argued that there was no need for an *ex ante* structural control in the market, because in their view *ex post* conduct controls were

[1] Director at Garrigues and professor of economics at UDEP and PUCP. Disclaimer: The opinions and reflections are of the author's individual responsibility. The author was Chief Economist at INDECOPI from august 2013 to April 2015 and from January to October 2017. Later on, he was appointed CEO of the authority from October 2017 to August 2020. All the information and opinions are taken from public sources.

enough to address competition issues. Said argument takes structural and conduct regulations as close substitutes. Second, old ideas of promoting Peruvian national champions and private investment were also used as arguments that outweighed the objectives of preserving competition in the market.

For a trained antitrust practitioner, the first argument would sound flawed, as *ex ante* structural controls may prevent the reduction of competition that may follow the creation or strengthening of a dominant position. In most jurisdictions, as in Peru, *ex post* conduct regulations usually deal with the abuse of a dominant position rather than the pure exercise of market power. In other words, *ex post* conduct regulation, in most instances, may address the exercise of market power but only in relation to a previous abuse of a dominant position, usually related to an exclusionary practice. On the other hand, merger controls can prevent the pure exercise of market power, dealing with future price increases, supply cuts, choice reduction and the slowdown of innovation that are not attached to an exclusionary strategy. Therefore, at least from an economic standing, *ex ante* structural control happens to be complementary to *ex post* conduct regulations in the competition policy arena.

The second argument deserves some discussion of its policy and political rationale. The Ministry of Economics could have been concerned with the overall slowdown in economic growth that followed the international sub-prime crisis in 2008 and the falling trend of international metal prices on which the Peruvian economy depends. In any case, this policy view was consistent with most stakeholders' positions, holding some influence in the conservative parties that had, in turn, some control over parliament between 2006 and 2016. Proposals of a merger control regime were dismissed because of its eventual effects over investment decisions.

As a complementary argument, some stakeholders raised worries that the uncertainty a merger control regime would have brought over investors' decisions was even higher due to lack of trust in the competition authority. This lack of trust, they said, was mainly related to a sense of technical fragility and lack of independence in the competition authority and that, although it had not created actual negative impacts in the market so far, it may not resist future political pressures.

Curiously, INDECOPI stands as one of the most prestigious public institutions precisely because of the technicality of its decisions and its internal organization that secures the independence of the decision-making processes. Indeed, decisions on cases are taken by independent bodies that are not attached to the administration, or even to the members of the board of directors.[2] Any attempt by the administrative branch to influence INDECOPI over the rulemaking of the independent bodies would be illegal and has never happened so far.

What changed, then, in 2017? It is difficult to say, however one hypothesis could be that

[2] INDECOPI's organization Law separates the institution into two branches, an administrative branch and a decision-making branch. The administrative branch manages the resources, provides services to the decision-making branch, and promotes general policy making. The Board of Directors, whose president represents INDECOPI, leads the administrative branch. The decision-making branch is composed of independent specialized commissions with specific mandates. For example, the Commission for the Defense of Free Competition deals with antitrust and merger cases. Each commission has four independent members that are not in INDECOPI's payroll and are appointed by the Board of Directors after an evaluation by an independent Advisory Group. Commissioners are appointed for a 5-year period. The commissioners can only be removed on the basis of a very serious administrative offence.

around that year the market witnessed a number of mergers regarding some products sensitive to public opinion. This may have triggered a new wave of discussions and the consensus among most stakeholders, including the Executive, in favor of a merger control regime. Also, in 2018, the OECD and the IADB performed a peer-review of Peru's competition policy and alerted policymakers of the importance of providing the authority with a merger control instrument as a necessary step to deepen competition dynamics within the markets.

The parliament, still with some doubts, approved in July 2019 a merger control law much in line with international standards, but with a five year-period of validity after which a new debate should be started to decide whether to withdraw the law or make it permanent. However, a last-minute change in the final text approved by congress, related to the application of a general procedural deadline for merger revisions that clashed with the special two-phase procedure devised in the law, required a new revision. The new text did not see the light, because the President constitutionally dissolved parliament in October 2019.

The Executive, however, took over the responsibility to approve the text of the merger control law as an Urgency Decree in November 2019 (DU 013-2019) introducing in Peru, for the first time in its history, a merger control regime. The Executive also gave INDECOPI financial resources for the implementation of the new mandate, as well as flexibility for managing its budget.

Economic Design and Policy Objectives of the Regime and Some Newcomer Additions

The DU 013-2019 introduced a compulsory pre-merger control regime. Mergers and acquisitions that change the control of one or more firms with a geographical nexus in Peru are required to file an authorization request before INDECOPI whenever two objective thresholds are simultaneously met:

- The joint sales of all merging parties are greater than US$ 144 million approximately,
- The individual sales of at least two merging parties are greater than US$ 22 million approximately.

These figures come from the average of a sample of thresholds observed in merger regulations for a number of OECD countries. They seemed reasonable as a starting point to focus INDECOPI's efforts on high profile operations with likely significant competition effects. However, the decree allowed for periodical revisions of such thresholds for policy adjustments, much in line with ICN recommendations.

The aim of the review is to identify those mergers that significantly restrict competition in the market, by way of a standard economic analysis including pro-competitive efficiencies claimed by the parties. On a more general policy perspective, the objective of the regime is to protect market efficiency in favor of final consumers. As such, it seems clear that allocative efficiency is at the core of merger analysis.

The DU introduced a two-phase procedure, as in most OECD merger control regimes. Phase 1 gives a 30-day period of analysis in which INDECOPI may decide to grant approval or to

bring the operation to a more exhaustive analysis. Phase 2 extends the procedure to 90 days more, for a deeper analysis and final decision.

The Technical Secretariat of the Competition Commission at INDECOPI will conduct the investigation. The Technical Secretariat's 20 years of experience in merger analysis in the electricity sector would be of great relevance for the enforcement of the new merger control regime. The Competition Commission, a decision-making body of four independent commissioners, will take the final decisions that could grant approval for the operation, approve upon the implementation of conditions, or block the operation.

The parties can offer, at any point of the procedure, structural or behavioral remedies. Remedies and conditions also have a specific procedure for *ex post* revision on demand or as part of a sunset review.

In any case, the parties can challenge the Commission's decision before the administrative Court of Appeals specialized in competition matters at INDECOPI's Tribunal for the Defense of Competition. The Court of Appeals has 90 business days to take a decision. These second instance administrative decisions can be taken to the judiciary.

Other important features of the regime are some gun-jumping provisions, as well as confidentiality procedures and limits to the role of third parties with legitimate interests in the operations. The regime includes a sanctioning regime with fines that may go up to an upper limit equivalent to 12 percent of the offender's annual sales.

The DU provided a *vacatio legis* of 9 months, so that the Executive could issue specific regulations (e.g. details on the calculations for thresholds) and INDECOPI could execute the budget allocated for its strengthening. The *vacatio legis* was extended to March 1, 2021, as a consequence of the financial distress that came with the COVID-19 pandemic that left INDECOPI with very limited resources to allocate to current operational activities.

The equation of the merger regime up to mid-2020 implied a delicate balance of variables such as technical design, budget, policy objectives, and specific timing. That equation was changed by a new congress Law (Law 31112) that respected all substantial issues raised by the DU, but introduced three main novelties that may have some significant impacts:

- Assets were included as an alternative variable for the calculation of thresholds, keeping the monetary level. This addition aims at including mergers that, because of a bad year, may include parties with short-run reductions in sales that would not meet the sales thresholds. Congress and its advisors took this proposal from the experiences of Ecuador and Bolivia.
- INDECOPI was granted *ex-officio* powers to investigate mergers that do not pass the thresholds but may create a dominant position or affect competition in the relevant markets. This last addition is aimed at considering the so-called "killer acquisitions." This design was apparently taken from the Chilean experience.
- Mergers that do not meet the corresponding thresholds can voluntarily file a notification. This feature was also

taken from the Chilean experience and, combined with the point above, may provide incentives for merging parties to notify operations that are not necessarily relevant to the original objectives of the regime, as a precautionary measure to avoid an *ex-officio* investigation.

The new Law was issued on January 7, 2021 and will come into force once the specific regulations are approved by the Executive, something that has not happened yet.

By and large, the most striking feature of the new Law is the possibility of *ex-officio* investigations of mergers that do not meet the notification thresholds. This novelty has brought about a wave of uncertainty that the authority now has to deal with. The question is whether there are actions or messages that can bring balance to the merger regime upon the introduction of the *ex-officio* investigative powers.

In our view, there are at least four concrete rules that could be implemented and may, at least, bring clarity on how the *ex-officio* policy will unfold. First, the specific regulations should establish a limited period within which the authority can launch an *ex-officio* investigation over mergers that were already closed by the merging parties. This could be of six to twelve months for example. Second, specific regulations should clearly define what a killer acquisition is, which, as far as we understand, involves highly innovative small firms. This would bring clarity to the limits of *ex-officio* investigations over mergers that *could affect competition in the relevant market*. Third, specific regulations – or future guidelines – should also define some quantitative threshold over which the authority may launch an *ex-officio* investigation based on the creation of a dominant position. For example, a market share threshold of some percentage over the relevant market may help the authority to only keep an eye on operations that are economically meaningful. Fourth, policy makers should push for an initiative to give constitutional autonomy and independence to INDECOPI, much in the way some jurisdictions have done in recent years (e.g. COFECE in Mexico). This should help secure a future technical usage of the *ex-officio* investigative powers in merger cases, and also help the authority to better manage its resources.

Not addressing these key points may put the authority at risk of falling short of resources, distracting itself with non-relevant mergers and, even worse, bringing back those old concerns about being at the center of political pressures that may also be an additional issue to manage on top of the technicalities of sound merger control rulemaking.

Congress however, eliminated one key element of uncertainty from the DU. The Law 31112 made the merger control regime permanent, that is, it eliminated the five-year period of validity. Therefore, firms already know that merger notification is part of their checklist in the long run, and the authority knows that no one can ask for those financial resources allocated by the Executive back.