

Administrative Council of Economic Defense

GUIDELINES

FOR THE ANALYSIS OF PREVIOUS CONSUMMATION OF MERGER TRANSACTIONS

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**GUIDELINES FOR THE ANALYSIS OF PREVIOUS CONSUMMATION
OF MERGER TRANSACTIONS**

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Introduction

The New Brazilian Competition Law No. 12.529/2011 established the pre-merger control in Brazil (Article 88, §2). Article 90 of the Law defines a merger as any operation in which: (i) two or more previously independent companies merge; (ii) one or more companies acquire, directly or indirectly, by purchase or exchange of stocks, shares, bonds or securities convertible into stocks or assets, whether tangible or intangible, by contract or by any other means or way, the control or parts of one or more companies; (iii) one or more companies incorporate one or more companies; or (iv) two or more companies enter into associative, consortium or joint venture agreements.

The consummation of mergers before the antitrust authority reaches a final decision (a practice known as gun jumping) is, however, forbidden by Article 88, §3 of the Brazilian Competition Law. This Article prohibits companies from closing a transaction before CADE concludes its analysis, under penalty of nullity and of a fine ranging from BRL 60,000.00 to BRL 60,000,000.00 – depending on the economic condition, intent and bad faith of the parties involved and the anti-competitive potential of the transaction, among others – without prejudice to the opening of an administrative proceeding against the involved parties. Thus, the competitive conditions among parties must remain preserved until a final decision is rendered (Article 88, §4).

These provisions under Article 88, caput and §3 of the Law No. 12.529/2011 have been regulated by CADE's Internal Statute (RiCADE). Article 108, §1 of the latter determines that mergers must be notified preferably after a formal binding instrument is signed by the parties and prior to the consummation of any act related to the transaction. Moreover, Article 108, §2, determines that the parties involved in a merger maintain their physical structures unchanged and remain competitors until the antitrust authority has a final assessment of the transaction. It bars, in particular, "any asset transfer and any type of influence of one party over another, and the exchange of competitively-sensitive information not strictly necessary for the signature of the formal instrument binding the parties".

This provision is intended to be broad due to the wide diversity of legal transactions considered as mergers for the purposes of the law. Thus, parties are initially responsible for clearly determining the limits to their relation, capable of preventing changes to physical structures and competitive conditions – which are intrinsic to a merger transaction.

Notwithstanding, aiming at better instructing the parties, promoting legal certainty, mitigating merger transaction costs and facilitating the lawful integration of the economic agents' activities, these Guidelines set some parameters in which merging parties may rely while designing their transactions. The instructions are based both on CADE's initial experience with

the enactment of Law No. 12.529/2011, as well as on other applicable sources of compared law that set precautions for joint activities and prior exchange of information among different companies.

It should also be emphasized that because of its very unique features, it is not possible to make abstract generalizations that could apply to all situations. Thus, any gun jumping must at all times be considered and verified in light of the particularities of each case. Nevertheless, the parameters below may be used as a reference by economic agents in their negotiations and merger assessments.

These Guidelines are divided in three sections. The first section addresses the definition of gun jumping and the activities that may lead to its configuration. The second section describes specific procedures economic actors may adopt to mitigate risks of gun jumping, such as the creation of clean teams and parlor rooms. The third section closes with a debate over penalties economic actors may face for failing to comply with the provisions of Article 88, caput and §3, of the Brazilian Competition Law.

The purpose of these Guidelines is to serve as a mechanism of administrative transparency and orientation with no binding effects.

Section I. Activities that might constitute previous consummation of a merger transaction (gun jumping)

This section aims at setting brief guidelines on the types of business activities related to merger transactions that may generate gun jumping concerns. Such activities can be divided into three major groups: (i) the exchange of information between economic agents involved in a merger; (ii) the definition of contractual clauses governing the relationship between economic agents; and (iii) the activities of the parties before and during the implementation of the merger.

As to (i) the exchange of information between economic agents involved in a merger, any unnecessary exchange of competitively-sensitive information between the parties should be avoided, as such exchange can harm competition between them if the merger is not yet consummated (either for the lack of CADE's approval or issues related to the negotiation itself). It is known that any merger implies the sharing of information between the parties to some extent, especially during the due diligence that generally precedes mergers and acquisitions. The extension of such information exchange may, however, vary, based on how integrated the parties will be after the merger and the complexity of the business under creation. Notwithstanding, CADE's case law and other authorities overseas tend to hold certain information particularly sensitive to the dynamics of competition, which is why the abuse on the information exchange may constitute gun jumping.

In general, competitively-sensitive information (therefore deserving of parties' special attention) is specific (e.g. non-aggregated) and directly related to the performance of the economic agents' core business. Such information may contain specific data about:

- a) costs of the companies involved;
- b) capacity level and plans for expansion;
- c) marketing strategies;
- d) product pricing (prices and deductions);
- e) main customers and deductions ensured;
- f) employees' wages;
- g) main suppliers and the terms of the contracts signed with them;
- h) non-public information on marks and patents and Research and Development (R&D);
- i) plans for future acquisitions;
- j) competition strategies, etc.

It is important to emphasize that concerns over the treatment of business-sensitive information can be reduced by the aggregation/anonymization of the data to be shared with counterparties, by presenting information after a certain time lapse and by creating clean teams and parlor rooms (specially for more complex operations demanding a higher exchange of information between the parties), as Section 2 of these Guidelines will highlight.

The (ii) definition of contractual clauses governing the relationship between economic agents, in its turn, focuses on the content of the rules governing the relationship between the economic agents before CADE finishes its assessment. As mentioned above, until the agency concludes its analysis, the concerns of the parties should always focus on maintaining the competitive environment which existed before the merger as intact as possible. Accordingly, such contractual clauses are intrinsically connected to the competitively sensitive activities described in more details below.

There is a myriad of possible contractual provisions to formalize a merger, thus listing every clause the antitrust authority could hold as unlawful is impossible. Despite the above, among those demanding greater attention there are the provisions that can result in a premature integration of the activities of the merging parties. Such contractual provisions comprise:

- a) no anteriority clause related to the term of effectiveness of the contract in relation to the date of its execution that brings any integration among parties;
- b) prior non-compete clause;
- c) clause for full or partial payment, non-reimbursable, in advance, in consideration for the target, except in case of (c.i.) typical down payment for business transactions, (c.ii.) deposit in escrow accounts, or (c.iii.) breakup fee clauses (payable if the transaction is not consummated);
- d) clauses allowing direct interference by any party in the other party's business strategies by submitting, for example, decisions over prices, customers, business/sales policy, planning, marketing strategies and other sensitive decisions (that do not constitute a mere protection against deviation from the normal course of business and, consequently, the protection of the value of the business being sold);
- e) in general terms, any clause providing for activities that cannot be reversed at a later time or which imply the expenditure of a significant amount of resources by the agents involved or the authority, etc.

Lastly, as to (iii) the activities of the parties before and during the implementation of a merger, these activities mainly concern the effective consummation of at least part of the transaction before it is duly approved by the antitrust authority. Some practices that can raise concerns to CADE are, among others:

- a) transfer and/or usufruct of assets in general (including voting securities);
- b) exercise of voting right or relevant influence on the counterparty's activities (such as decisions regarding prices, customers, business/sales policy, planning, marketing strategies, interruption of investments, discontinuing of products and others);
- c) receipt of profits or other payments connected to the performance of the counterparty;

- d) development of joint strategies for sales or marketing that set up an unified management;
- e) integration of the sales force among the parties;
- f) licensing the use of exclusive intellectual property to the counterparty;
- g) joint development of products;
- h) appointment of members to a decision-making body; and
- i) interruption of investments, etc.

It is important to reinforce that the list above presents only a few examples of the activities CADE may, after a case-by-case review of the particular features of the transaction, consider illicit for constituting previous consummation of a merger (gun jumping).

Section 2. Procedures to reduce the risk of gun jumping

Merging companies may follow some relationship patterns while the transaction is being negotiated or going through an antitrust assessment. This Section addresses possible ways of reducing gun jumping risks.

With the sole purpose of examining if the transaction is feasible, competitors may share business-sensitive information, both while negotiation is ongoing and while CADE is assessing the merger. To make sure the information will be shared pursuant to the Law No. 12.529/2011, companies should, among other measures, set specific procedures to be observed by independent committees that will handle such information ("Antitrust Protocol"). The aim underlying such measure is to prevent executives, employees or representatives of one company from having access to competitively sensitive information from the other party.

2.1 Antitrust protocol

Specific procedures to be followed by the parties, until a final decision is rendered by CADE, may be formalized as an "Antitrust Protocol", e.g. a document adopting procedures that are in line with what is suggested in these Guidelines.

2.2 Clean Team and Executive Committee

Independent committees can be composed of employees, independent consultants or both ("clean team"), or executives of each company ("executive committee").

The clean team is indicated for complex transactions where (i) there is significant concentration between the companies, (ii) it is necessary to exchange a vast amount of information or (iii) the transaction creates potential competitive risks.

The clean team is responsible for sending, receiving, gathering, analyzing and handling information related to the transaction. For this reason, clean team members are advised to sign a confidentiality agreement and to strictly observe the antitrust protocol previously agreed.

Clean team members may contact employees of the merging companies, but they may not disclose information of one company to another. If some clean team members are employees of the companies, they should request and receive information only from their own company. It is recommended that such employees work exclusively in the clean team or have it as a priority.

Any communication or request/sending of information should be made in writing and each clean team member should have a specific e-mail address for this purpose.

The clean team should classify the information received from the companies as: (i) public, (ii) confidential or (iii) competitively-sensitive. Any confidential and competitively-sensitive information has to be treated pursuant to the antitrust protocol.

Based on the information received from the companies' employees, the clean team may prepare a report on the transaction feasibility, which will be sent to the executive committee (formed by executives of the companies involved in the transaction).

The executive committee will then analyze the data the clean team sent and it might ask for details, within the limits set in the antitrust protocol.

The clean team must directly and exclusively report to the executive committee members, who must receive, at the same time, identical information for evaluation.

The clean team members cannot participate in the executive committee or vice versa. The information exchange process should be formally registered and the parties should expressly commit to preserve data confidentiality.

2.3 Access to information

The information must be exclusively exchanged by the clean team, which is the only contact point between the companies.

The data must be transmitted through different and independent communication channels. For example: (i) clean team – company A; (ii) clean team – company B; (iii) clean team - executive committee.

The information requested by the clean team to the companies' employees has to be restricted to what is strictly necessary for the operation. That means that the clean team or the executive committee must not analyze any data on other activities performed by the companies.

Any change in the composition of the clean team or executive committee must be informed to the other members in writing. The new member should sign a confidentiality agreement and comply with the antitrust protocol.

2.4 Confidentiality

All clean team and executive committee members must commit to preserve the merger data secrecy, especially of those information considered confidential or competitively-sensitive, even in view of the possibility of leaving the committee or the company. No data or information may be used, copied, transferred, published or mentioned without the companies' express consent.

Any information concerning the merger should be considered confidential, except for publically available information or otherwise considered as public by the company who owns it.

"Information" means any data belonging to the companies, whether original or copy, printed on paper or in electronic means, in text, spreadsheet, graphic or image format.

The access to the information is restricted to the clean team that must (i) carefully process the information by adopting protective measures to store the data in order to prevent non-authorized third parties from accessing it; (ii) keep register of any information received from the companies by identifying its nature, intend and storage.

2.5 Information treatment

The clean team may receive competitively-sensitive information from the companies. Upon receipt of this kind of information, the clean team must keep it in strict secrecy and must not disclose it to the executive committee or any third party.

If an assessment on the transaction feasibility is needed, the clean team should process the competitively-sensitive data by converting it into aggregated and/or historical information, within a recommended periodicity of at least three (3) months of its occurrence. Only after processed, the competitively-sensitive data can be shared with the executive committee.

It is recommended that the clean team meets and maintains all merger information in an exclusive room, ideally located outside the companies' facilities.

If the negotiation finishes without the consummation of the merger, the companies must demand that the clean team return or destroy integrally all the information sent and/or processed, so that no data is kept in files or is reused in the future.

If the negotiation finishes without the consummation of the merger, the companies may reassign the employees to their former activities, while the confidentiality obligation will remain, including in relation to the company itself.

2.6 Parlor Room

Executive committee members can meet to discuss the future integration between the merging companies, in specific meetings set for this purpose.

The parlor room meetings should be monitored in order to ensure that no competitively-sensitive information becomes the subject of discussions. Therefore, it is recommended that all parlor room activities are registered and supervised by an independent member.

The discussions in the parlor room cannot result in any kind of interference or partnership between the companies before CADE approves the merger. For example, no measure or procedure should be taken that may result in transferring or sharing of employees; restrictions to the other party's activities/enterprise in the market, with its customers or with suppliers; changes in the other party agreements or joint notifications to third parties on behalf of the integrated or organized company.

Section 3. Penalties possibly imposed in case of previous consummation of a merger transaction

Article 88, §3, of Law No. 12.529/2011, sets, while addressing gun jumping:

§ 3º The acts found under the provisions set forth in the caput of this article shall not be consummated before being reviewed, pursuant to this article and the procedure set forth in Chapter II of Title VI of this Law, under penalty of nullity and of a fine not inferior to sixty thousand reais (BRL 60,000.00) or higher than sixty million reais (BRL 60,000,000.00), to be imposed pursuant to the terms of the regulation, without prejudice to the opening of an administrative proceeding, under Article 69 of this Law.

The analysis of this provision leads to the conclusion that three (3) consequences result from CADE's decision confirming the occurrence of gun jumping, which are:

- a) the imposition of a pecuniary penalty ranging from BRL 60.000,00 (sixty thousand Brazilian reais) to BRL 60.000.000,00 (sixty million Brazilian reais);
- b) the opening of an administrative proceeding, pursuant to Article 69 of Law No. 12.529/2011;
- c) the nullity of the acts found under the provisions set forth in the caput of Article 88 of Law No. 12.529/2011, if consummated before CADE's assessment.

This Section 3 aims at discussing the application of each of these sanctions set by law, and to list, specifically concerning the imposition of the pecuniary penalty, some factors that may guide CADE while deciding on the fine calculation criteria.

3.1 Imposition of pecuniary penalty

The parameters for the fine calculation criteria must, in case of gun jumping, take into consideration the requirements of the general rule of Article 45 of Law No. 12.529/2011 on the imposition of sanctions. By considering the requirements mentioned in Article 45, it is assured that the rationale of the fine calculation in the event of gun jumping will be in pace with the Brazilian Competition Law.

Generally speaking, it is understood that, within the strict parameters of Article 45 of the Law No. 12.529/2011, the following factors, among others, are considered:

- a) as to the **status of the transaction**, whenever CADE suspects of gun jumping, it considers, for example, if (i) the transaction was not notified and was consummated

- without the notification; (ii) the transaction was notified to CADE only after consummation and after CADE opened an administrative proceeding to investigate the merger – APAC in its acronym in Portuguese; (iii) the transaction was notified to CADE only after consummation, but without CADE's awareness of its existence and (iv) the transaction was notified to CADE and consummated later, but before the decision was rendered;
- b) the nature of CADE's decision (block, conditional approval and unconditional approval), as well as the existence of horizontal overlap or vertical integration resulting from the transaction; and
 - c) the time and the economic size of the infringer.

In any of the cases, the penalty is never lower than BRL 60.000,00 (sixty thousand Brazilian reais) or higher than BRL 60.000.000,00 (sixty million Brazilian reais), considering that these are the minimum and maximum amounts set by the legislator for such cases.

3.2 Opening of an administrative proceeding

With respect to the opening of an administrative proceeding, it should be noted that possible infringements may arise from the integration of structures as a result of the merger. Here are some examples of practices that may lead to such situation: exchange of sensitive information, agreement between competitors on pricing, interference in the decisions of the target company, especially in cases of vertical integration or horizontal overlap.

The administrative proceeding is opened by CADE's General Superintendence, according to the procedure provided in Article 69 et al of the Law No. 12.529/2011.

3.3 Nullity of acts performed

Finally, with respect to the nullity of the acts performed, it is considered, among other issues, the timing of the conduct (the nullity is projected over the acts performed within the period between the transaction consummation and CADE's judgment); the proportionality of the measure and whether validating the business conducts performed is possible or not.