



**MINISTRY OF FINANCE
MINISTRY OF JUSTICE**

HORIZONTAL MERGER GUIDELINES

PART I: INTRODUCTION

1. Brazilian Legislation establishes a system of merger control¹ by means of Law 8,884/94 (Competition Law). According to paragraph 4 of article 54 of that law, such transactions must be submitted for examination previously or, at the latest, fifteen working days after their fulfillment, following the forwarding of the pertinent documentation to the Secretaria de Direito Econômico of Ministério da Justiça (SDE) [Secretariat of Economic Law of the Ministry of Justice (SDE)]. According to paragraph 6 of that same article, it is the Secretaria de Acompanhamento Econômico do Ministério da Fazenda's (SEAE) [Secretariat for Economic Monitoring of the Ministry of Finance (SEAE)] duty to, initially, issue a non-binding technical opinion about mergers (Opinion), in up to thirty days.² Upon receiving of SEAE's Opinion, SDE must manifest itself in up to thirty days as well, thereafter forwarding the records with proper instructions to the Conselho Administrativo de Defesa Econômica (CADE) [Administrative Counsel for Economic Defense (CADE)], which will render a decision in up to sixty days.
2. Article one of Law 8,884/94 establishes the rule of reason as the fundamental principle in the control of mergers.
3. The goal of the present Horizontal Merger Guidelines (Guidelines) is to present the procedures and the principles that SEAE and SDE ought to adopt in the analysis of these transactions. These procedures and principles outline the main steps of the antitrust analysis and attempt to be, in practice, an instrument for the application of the rule of reason.
4. The Guidelines refer exclusively to horizontal mergers and does not apply to other transactions or contracts that may be included in the *caput* of article 54 of Law 8,884/94, such as:
 - Explicit or tacit agreements referring to prices, to production and distribution quotas, to geographic market division, or to the process of making competition conditions uniform amongst competitors;
 - Joint-ventures (that do not constitute a company under a common control);

¹ The present Guidelines deal only with mergers. However, article 54 of Law 8,884/94 also applies to the control of other transactions that may limit or otherwise harm free competition, or result in the domination of relevant goods and services markets, such as horizontal agreements among competitors.

²The deadline is suspended whenever additional documents or information related to the merger is requested from the firms.

- Exclusive distribution agreements or contracts; territorial restriction or the fixing of resale prices;
 - Other horizontal agreements or contract that do not qualify as mergers, according to the definition presented below in these Guidelines.
 - Corporate reorganization inside a same economic group, factually or by law, when no change in the control of stocks is verified; and
 - Situations in which the acquiring firm or its group did not participate, before the transaction, in the defined relevant market, in the markets below or above it in the production chain, or, in addition, of other markets in which the acquired firm or its group were active.
5. The procedures presented in this document have as their goal to serve as a mechanism for administrative transparency, constituting a mere description of the criteria and steps in the analyses made by SEAE and SDE in carrying out their respective attributions, which are derived from the Competition Law. Because it is merely an orientation for the analysis, the procedures presented here have no binding quality. Due to issues of processual enhancement, SEAE and SDE may not apply the Guidelines' instructions in the transactions that, following criteria established by them, do not bring about a real impact on competition, in which case a brief analysis procedure is applied.
6. The procedures presented in this document are applicable to the horizontal integration of firms, that is, transactions that involve goods or services providers that are competitors. Nevertheless, the logical principles collected in these Guidelines may also be used, with the proper adaptations, in merger cases that involve economic agents that consume the same good or service. In these cases, the four scenarios, once they are properly adapted, must still be used as a basic reference for the conclusions in the opinion.

PART II: PROCEDURE FOR THE ECONOMIC ANALYSIS OF HORIZONTAL MERGERS

7. In this second part, four basic scenarios, in terms of a merger's effect on economic welfare, are described. Three of them are scenarios in which the mergers do not reduce welfare and must, therefore, obtain a favorable opinion from SEAE and SDE. In the fourth scenario, the merger reduces economic welfare and must obtain from SEAE and SDE an opinion that is unfavorable to their approval or favorable, but with conditions.
8. To a certain extent, the opinions issued by SEAE and SDE will have to present a conclusion that corresponds to one of these four scenarios. Particularly, unfavorable opinions must indicate that the analyzed merger's effects over economic welfare do not correspond to any of the three other scenarios considered. When the conclusion presented does not correspond to any of the four scenarios, the opinion will state explicitly the reasons for such specificity.
9. The next section presents a general outlook over the analysis procedure for horizontal mergers. The five main steps are described: Step I – Definition of the Relevant Market; Step II - Determination of the Market Share; Step III – Examination of the Probabilities of the Exercise of Market Power; Step IV – Examination of the Economic Efficiencies Generated by the transaction; Step V – Evaluation of the Liquid Effects of the transaction.

General Outlook

10. Protection of competition is not an end in itself, but a means to create an efficient economy and to preserve the economic welfare of society. In an efficient economy, consumers enjoy the greatest variety of products for the lowest possible prices. In such a context individuals enjoy a maximized level of economic welfare.

11. Mergers between firms may produce positive and negative effects on economic welfare. Concentration may, by reducing the number of participants in the market, make the adoption of anticompetitive behaviors (price raises, quality reduction, diminished variety or reduced innovations) easier. However, mergers, as long as they provide competitive advantages for the participating firms (economies of scale, economies of scope, and reduction of transaction costs, among others), may also increase economic welfare.
12. In this context, it is not possible to define, in principle, if economic concentration affects economic welfare positively or negatively. To know what the effect of the concentration is, it is necessary to analyze each case specifically. The understanding that mergers involve potentially both negative and positive effects and that, therefore, they cannot be approved or rejected *per se*, is recognized in the Competition Law, which requires the consideration of each transaction's efficiencies *vis a vis* its negative effects, according to the terms set forth in §§1 and 2 of article 54.
13. General Criterion. If, on one hand, the exercise of market power reduces economic welfare, eventual productivity increments, improvements in quality, greater diversity of products, among other possible effects of concentration, represent an increase in economic welfare. SEAE and SDE will establish, as a basic criterion for the issuing of an opinion favorable to the operation, that the transactions have a non-negative liquid effect on economic welfare.
14. Non-Negative Liquid Effect. Mergers that do not reduce economic welfare, that is, that generate a non-negative liquid effect, are those that:
 - (a) do not generate control over a substantial market share; or
 - (b) generate control over a substantial share of the market in a market in which the exercise of market power is improbable; or
 - (c) generate control over a substantial share of the market in a market in which the exercise of market power is probable, but whose potential negative effects, derived from the possibility of exercising market power, are not higher than the potential increments to welfare generated by the concentration.
15. Exercise of Market Power. Exercise of market power consists in the transaction of a firm unilaterally, or of a group of firms coordinately, raising prices (or reducing quantities), reducing quality or the variety of goods and services, or still, reducing the speed of innovations relatively to the levels that would be in effect under conditions of unrestricted competition for a reasonable period of time, with the goal of raising profits.³
16. Substantial Share of the Market. Once the relevant market is defined, it is given that a firm controls a substantial share of that market when it is capable of, by restricting the quantities it supplies, causing variations in actual prices for a reasonable amount of time. In other words: these are firms that have market power.
17. Deciding to Exercise Market Power. Control of a substantial share of the market is a necessary, albeit not sufficient, condition for the newly formed firm to exercise the market power it enjoys. In addition, it is necessary to acknowledge that elements exist in the market that make restricting the quantities supplied profitable.⁴ If this condition is not verified, the

³ For simplicity's sake, from here on, only price increases, from among the possible forms of expressing market power, will be considered.

⁴ In other words, it is necessary that the residual demand curve be sufficiently inelastic: when the demand curve is sufficiently inelastic, the restriction of supply causes an increase in prices that is greater than the decrease in the quantity sold, making the exercise of market power a profitable strategy for the firm. The

adoption of such a conduct will not be economically attractive and the firm will choose not to follow it, even if it can divert its conduct from its competitive levels.

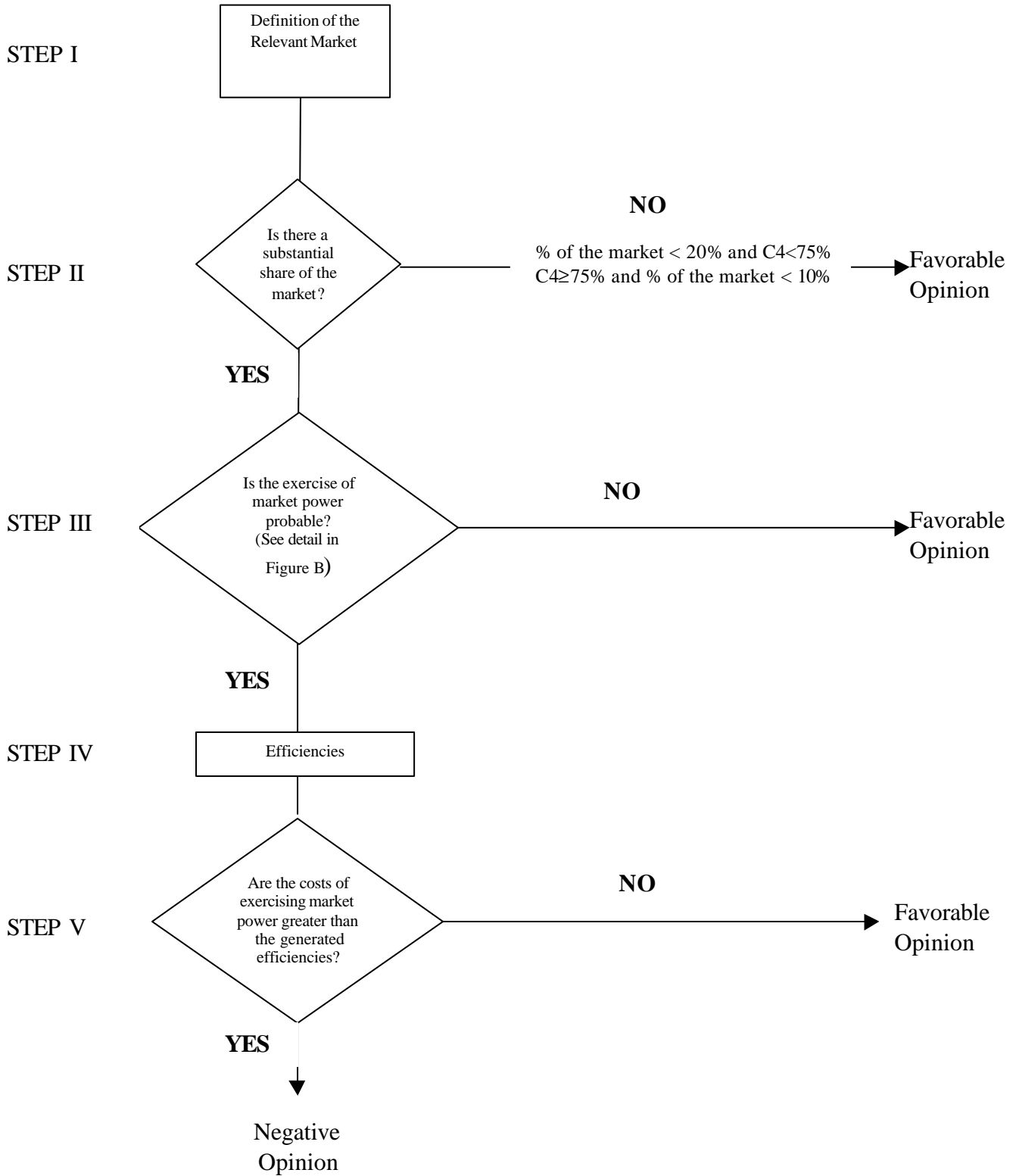
18. Variables that Affect the Probabilities of Exercising Market Power. In order to determine if there are sufficient conditions for market power to be exercised unilaterally by the firm, or coordinately by a group of firms, SEAE and SDE will proceed to the analysis of four main variables:
 - (a) Imports;
 - (b) Entry;
 - (c) Effectiveness of the rivalry; and
 - (d) Other factors that favor coordination of decision.
19. Negative Conditions. SEAE and SDE will deduce that the probability of the unilateral exercise of market power does not exist when at least one of the following conditions is present:
 - (a) imports are an effective remedy against the exercise of market power;
 - (b) entry is “probable, timely, and sufficient”; or
 - (c) rivalry between existing firms in the market is effective.
20. On the other hand, if there is a high market concentration, when none of these conditions is present the conclusion will be that the probability that market power be exercised unilaterally exists.⁵
21. Additional Negative Condition. In order for the coordinated exercise of market power to be possible, it is necessary that none of the conditions expressed in item 19 be fulfilled and that, in addition, “other factors that favor the coordination of decisions” exist in the market.
22. Chain of causation. SEAE and SDE will seek a “chain of causation” between the transaction and the control of a substantial share of the market or between the operation and the existence of conditions that favor the exercise of market power. Concentration can only imply a liquid negative effect for economic welfare in the cases in which the existence of that chain of causation is verified.
23. Effects on the economy as a whole. In order to evaluate the liquid effects of the concentration, SEAE and SDE may consider the effects upon other markets in the economy. It is possible, therefore, for SEAE and SDE to conclude that the liquid effects of a concentration are negative for the economy as a whole, while being null or positive in the realm of the market in which it effectively occurs.
24. Economic Efficiencies. Improvements in the production, distribution, and consumption of goods and services generated by the transaction, which cannot be obtained otherwise (“specific efficiencies” of the transaction) and that are persistent on the long run are economic efficiencies of the concentration.

notion of profitability refers to the concept of economic and not of accounting profits. Economic profits can be defined as the difference between revenue and costs, including the opportunity cost of invested capital in the definition of economic costs.

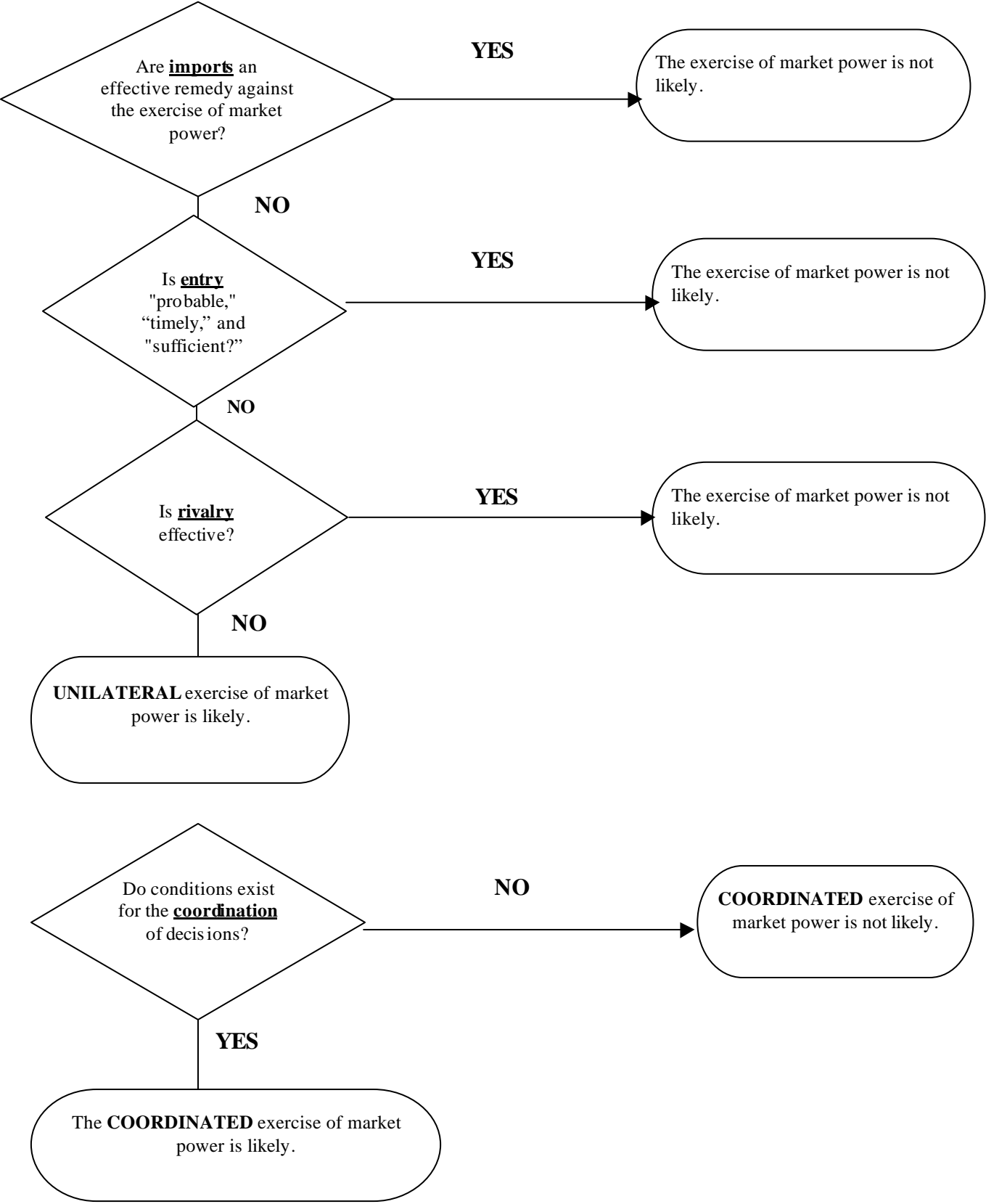
⁵ The absence of any of the conditions established in item 19 will not be a reason for SEAE and SDE to conclude that demand is not elastic and that the exercise of market power is likely. On the other hand, any of those conditions may be sufficient to consider that demand is elastic and, consequently, to consider that the probability that market power will be exercised does not exist.

25. The procedure adopted by SEAE and SDE for the analysis of mergers will consist of five main steps:
- Step I: Definition of the relevant market.
 - Step II: Determination of the market share that is under the control of the petitioning firms. The transactions that do not generate control of a sufficiently large share of the market will obtain a favorable opinion from SEAE and SDE, without further analysis. Other transactions will be subject to the subsequent steps.
 - Step III: Examination of the probability of the exercise of market power. When the exercise of market power is not probable, the concentration will receive a favorable opinion. When the exercise of market power is probable, the concentration will be subject to investigation in Step IV.
 - Step IV: Examination of the efficiencies generated by the transaction.
 - Step V: Evaluation of the relationship between costs and benefits arising from the merger and issuance of a final opinion. If efficiencies are equal or greater than costs (a non-negative liquid effect) SDE and SEAE will issue an opinion approving the merger. If efficiencies are inferior to costs, the merger will not be allowed or will have its approval conditioned to the adoption of measures that are considered necessary.
26. Figure A illustrates the complete procedure adopted by SEAE and SDE. Figure B illustrates Step III in greater detail.
27. The procedure used to outline the boundaries of the relevant market is explained in items 28 through 33. The criteria used to define if a merger generates a substantial market share are defined in item 36. The procedure used to determine the conditions for the exercise of market power is outlined in items 39 through 69. Finally, the procedure used to determine the economic efficiencies of a merger is defined in items 70 through 88.

**Figure A:
Steps in the Economic Analysis of Horizontal Mergers**



**Figure B:
Detail of Step III – Exercise of Market Power**



Step I: Definition of the Relevant Market

28. The definition of a relevant market is the process of identification of a set of economic agents, consumers and producers, which effectively limit decisions referring to prices and quantities for the firm that results from the operation. Inside a market's limits, the reaction of consumers and producers to changes in relative prices – the degree of substitution between products or the producers' sources – is greater than outside these limits. The "hypothetical monopolist" test, described below, is the analytic tool used to check the degree to which goods and services can be substituted and, as such, for the definition of the relevant market.⁶
29. Definition. The relevant market will be determined in terms of the products and/or services (hereinafter designated simply as "products") that compose it (product dimension) and of the geographic area for which the sale of these products is economically viable (geographic dimension). According to the "hypothetical monopolist" test, the relevant market is defined as the smallest group of products and the smallest geographic area needed for a supposed monopolist to be able to impose "a small but significant and non-transitory" increase in prices.
30. Procedure. The "hypothetical monopolist" test consists in considering, for a set of specific products and area, starting with goods produced and sold by the firms participating in the operation, and with the territorial extension in which these firms are active, what would be the final result of a "small but significant and non-transitory" increase in prices for a supposed monopolist in that area. If the result is such that the supposed monopolist does not consider the increase in prices profitable, then SEAE and SDE will add the product that is the closest substitute to that of the newly formed firm and the region from where the product that is the closest substitute to that of the firm in question comes from to the original definition of relevant market. This exercise must be repeated successively until a group of products and a set of localities for which it is economically interesting for a supposed monopolist to impose a "small but significant and non-transitory increase" in prices is identified. The first group of products and localities identified according to this procedure will be the smallest group of products and localities necessary for a supposed monopolist to have the conditions for imposing a "small but significant and non-transitory" increase in prices, this being the delimited relevant market.⁷ In other words, *"the relevant market is constituted of the smallest economic area in which it is feasible for a firm, acting by itself, or for a group of firms acting in coordination, to exercise market power."*
31. A supposed monopolist is able to impose a "small but significant and non-transitory" increase in prices when consumers cannot divert a significant share of demand to substitute goods or goods originated in another region. The sets of products and of geographic areas that a hypothetical monopolist must control in order to be able to impose a "small but significant and non-transitory increase" in prices determine,

⁶ It must be noted that this is not the only possible instrument that can be used in the delimitation of the relevant market. Other methods, such as crossed elasticity or the price correlation over time test may also be useful. However, regardless of the method used, the logic of the "hypothetical monopolist" test, that is, identifying the products and geographic regions that may limit the new created firm's capacity of deciding over prices and quantities, must always be present.

⁷ For the application of the previous procedure, SEAE and SDE will adopt as reference a "small but significant and non-transitory increase" in price of 5%, 10%, or 15%, depending on the case-by-case analysis, for a period under a year long.

respectively, the dimension of the product and the geographic dimension of the relevant market.⁸

32. The effect of a “small but significant and non-transitory increase” in prices for the hypothetical monopolist depends on the consumers’ reaction. This reaction, in turn, depends on the tendency with which the consumers are willing to divert their demand to a substitute product or to an identical product originating in another area, as a response to a “small but significant and non-transitory” increase in price. To examine the possibility of consumers diverting their demand to substitute products from a same region and to identical products originating from a distinct area, SEAE and SDE will consider the following factors:

- physical characteristics of the products;
- characteristics of the production processes;
- commercial characteristics of the products;
- evolution of relative prices and of quantities sold;⁹
- time and costs involved in the decision of consuming or producing substitute products;
- time and costs involved in the decision of consuming or producing identical products originating in other areas; and
- evidence that consumers will divert their demand or will take into account the possibility of diverting them should changes in relative prices or in other competition variables happen (consumers’ past behavior).

33. In specific cases, potential short run producers, that is, firms that are not currently producing, but who may take on production as a response to a “small but significant and non-transitory increase” in prices, in a period that is not greater than a year and without the necessity of significant spending to enter or to exit from the market, may be considered as participants in the market. Entry or exit costs that cannot be met in a period equal to or smaller than a year from the beginning of the product’s sale will be considered significant.

Step II: Determination of the Market Share

34. A necessary condition, though not a sufficient one, for an operation to have negative impacts on the consumers’ welfare and on the competition is the resulting firm’s control over a substantial share of the relevant market. In markets in which each firm’s supply, or the supply of a group of firms, is very small compared to the industry’s total supply, no firm or group of firms has the capacity, unilaterally or coordinately, to change its behavior (change prices, quantities, variety, or innovation), that is, exercise market power. This takes place because consumers will respond to such an initiative by diverting the totality of their purchases to rival firms.

⁸ The effects of the existence of potentially competitive producers (entry) on the decisions made by the firm that results from the operation will be investigated in Step III.

⁹ Besides consultations to the petitioning firms, their competitors, and consumers, another procedure that can be adopted, especially as a starting point for the definition of a relevant market, is the utilization of data about the evolution of relative prices and of quantities sold for statistic correlation tests. This tool, especially when applied exclusively to the price variable (which is usually the information that is available), is used very frequently. However, its results must be interpreted with reservations, since definitive conclusions would depend on the behavior of the quantity variable, information that is rarely available.

35. When a firm's supply, or the supply of a group of firms, is sufficiently large in comparison to the total supply of the relevant market, these firms will, unilaterally or coordinately, have the capacity to change their behaviors from those that would prevail under conditions of unrestricted competition, since rival firms will not be able to meet a substantial part of demand. In these cases, the firm or group will have a sufficiently large share of the market to exercise market power.
36. Criteria. The criteria used to identify if a merger generates control of a sufficiently large share of the market are the following:
- (a) SEAE and SDE will consider that a merger generates control over a sufficiently large share of the market to allow the unilateral exercise of market power whenever it results in a participation that is equal to or greater than 20% of the relevant market (article 20, §2, of Law 8,884/94);
 - (b) SEAE and SDE will consider that a merger generates control over a sufficiently large share of the market to allow coordinated exercise of market power whenever:
 - concentration makes the sum of the participation of the four largest firms (C_4) equal to or larger than 75% ; and
 - participation of the newly formed firm is equal to or larger than 10% of the relevant market.
37. Procedure. Participation in the market will be calculated based on all the firms that are part of the relevant market as defined in Step I. The firms that will be considered participants in the market are current producers, that is, firms that effectively produce or sell in the relevant market. The data can refer to productive capacity, to the volume of sales or to the value of sales, depending on what is more adequate in order to indicate conditions for competition in the relevant market.
38. In the cases involving homogeneous products, in which production capacity is the key competition variable, indicators based on production capacity will be used. Indicators based on the value of sales tend to be more adequate for markets involving differentiated products, since they are a better reflection of consumers' loyalty to a firm's brand and of the firm's access to the network of distributors, which are good indicators of competition in these markets.¹⁰

Step III: Examination of the Probabilities of the Exercise of Market Power

39. The fact that a merger involves a sufficiently large share of the market does not necessarily imply that the newly formed firm will exercise its market power unilaterally, or that firms will coordinate their decisions. In this section, the factors that determine if the exercise of market power is probable will be presented.
40. Imports. Imports and the possibility of importing are factors that inhibit the exercise of market power.¹¹ The larger the participation of imports and/or the possibility of

¹⁰ Homogeneous product markets are those in which the firms are distinguished mainly by their costs and/or production capacity and not by the particularities of their products. Differentiated product markets are those in which firms are mainly differentiated by their products (brands) and not by their production capacity or cost.

¹¹ Imports or the possibility of importing are factors that inhibit the exercise of market power, unilaterally or coordinately, both in markets for homogeneous products and in markets for differentiated

importing, the smaller the probability that market power will be exercised. Note that a reduced volume of imports is not enough to consider the exercise of market power probable. In addition, the possibility that imports may increase, in reasonable quantities and period of time, in response to a “small but significant and non-transitory” increase in prices must be considered.

41. Regarding this point, it is important to consider at which price the supply of imports becomes elastic. If this price is significantly greater than the current price in a competitive market, there will be room for the newly formed firm to raise its price to the level equivalent to the import price, which may, for example, incorporate the cost of transportation and import tariffs. In this case, even if the possibility of imports is substantial, there will be room for the firm resulting from the operation to exercise the market power acquired.
42. In order to verify the elasticity of imports, there will be a consideration of the barriers to entry in import activities, such as: distribution costs; the degree of dependency of imports in relation to local producers; the existence of exclusivity contracts between local importers and foreign firms; and the capacity of importers to accommodate increments in imports without the need to invest in new physical assets.
43. In principle, a period of one year and imports equivalent to at least 30% of the apparent consumption value¹² will be considered reasonable indications that the discipline imposed by imports is sufficient to avoid the exercise of substantial market power.
44. The possibility of imports can be inferred based on:
 - the information that imported products have exercised an effective discipline on domestic prices;
 - import tariffs;
 - costs of internalization of imported products (transportation, etc.);
 - the existence of non-tariff barriers;
 - consumer preferences;
 - international prices.
45. Entry. The possibility of entry of new competitors into the market is another factor that inhibits the exercise of market power. The exercise of market power will be considered improbable when entry is “probable,” “timely,” and “sufficient.” For the analysis of conditions of entry, SEAE and SDE will take into account the behavior that a hypothetical firm that wishes to enter into the market must adopt. In this step, it is not necessary to identify a firm with a real intention of entering the market. However, SEAE and SDE will not base themselves on a hypothetical firm that is not similar to potential entering firms. Examples of the new firms entering the market in the previous 5 years may be used as evidence for conditions of entry, as long as there are no

products. The discipline exercised in markets for differentiated products tends to be, naturally, inferior to that exercised in markets for homogeneous products. However, imports must be considered a relevant factor in both cases.

¹² Apparent consumption = total production + imports – exports. Imports and exports refer to the geographic dimension of the relevant market. They are, therefore, sales that are external to the geographic market (exports) or purchases originating outside of the geographic market (imports). The data only coincide with the aggregates of national accounts in cases in which the geographic dimension is equal to the national market.

indications that the example is no longer representative of the conditions of entry at the moment in which the analysis takes place.

46. Probable entry. SEAE and SDE will consider entry probable when it is economically profitable at pre-merger prices and when these prices can be assured by the potentially entering firm. Prices will not be able to be assured by the possible entering firm when the minimum increment of supply offered by the entering firm is sufficient to cause a reduction in market prices. In other words, entry is probable when the minimum viable scales are smaller than the sale opportunities in the market at pre-merger prices.
47. Timely entry. SEAE and SDE will, generally, consider a period of 2 (two) years as socially acceptable period for entry. All the necessary steps for entry into the market, such as planning, product design, market studies, obtaining licenses and permissions, constructions and operation of the plant, promotion and distribution of the products, are included in this period.
48. Sufficient entry. Entry will be considered sufficient when it allows all sale opportunities to be adequately exploited by potentially entering firms.
49. Sale opportunities. Sale opportunities are market shares that are potentially available to entering firms. The following must be included in the identification of sale opportunities:
 - restriction of production derived from the exercise of market power by established firms;
 - reduction of supply by established firms as reaction to entry;
 - the capacity of entering firms to appropriate part of the market of established firms; and
 - the capacity of the entering firm to capture a significant share of market growth.
50. EMV [MVS]. Minimum Viable Scales (MVS) are the smallest level of annual sales that the potentially entering firm must obtain for its capital to be adequately remunerated. The adequate remuneration of capital is equivalent to the profitability that the volume of resources applied in entering could obtain if used in a corresponding application in the financial market, adjusted to the risk of the sector in which the firm wishes to enter. The capital that is invested in the sector is equivalent to the totality of expenditures that a firm must incur in order to install itself in the market, to complete a production cycle and to obtain the conditions to sell its product.
51. Barriers to entry. The higher the barriers to entry, the larger the MVS necessary to make entry viable and the smaller the probability of new firms entering the defined relevant market.¹³
52. Definitions. Barriers to entry can be defined as any factor in a market that places a potential competitor in disadvantage toward the established economic agents. The following factors represent important barriers to entry:
 - (a) sunk costs;
 - (b) legal or regulatory barriers;
 - (c) resources belonging exclusively to established firms;
 - (d) economies of scale and/or of scope;
 - (e) the level of integration of the productive chain;
 - (f) the loyalty of consumers to established brands; and

¹³ Note that it is not necessary for the merger to increase barriers to entry but rather that a merger occurs in a market that is characterized by high barriers to entry.

(g) the threat of reaction by established competitors.

53. Sunk costs are costs that cannot be recovered when the firm decides to leave the market. The extension of sunk costs depends mainly:
- on the degree of specificity of the use of capital;
 - on the existence of a market for used machinery and equipment;
 - on the existence of a market for the rental of capital goods;
 - on the volume of investments needed to assure the distribution of the product (expenditures on promotion, publicity and on the formation of a network of distributors).
54. Legal and regulatory barriers are demands created by the government or by regulatory agencies for a firm's establishment and functioning, such as commercial licenses, permissions, authorizations, judicial warrants, among others. Legal barriers may represent, in practice, an increment to sunk costs, when their fulfillment implies higher costs or even the exclusion of the possibility of entry.
55. Property resources of the established firms may be production inputs, exclusivity in the use of the network of distributors or patents.
56. Economies of scale are physical economies of inputs derived from the increase in the volume of the final production. Economies of scope are economies derived from the joint production of two or more goods.¹⁴ The effects of economies of scale and of scope on entry conditions depend, among other factors, on:
- minimum efficient scales;
 - the increase of costs associated to sub-optimal scales; and
 - market growth.
57. The level of integration of the production chain may be a barrier to entry in that it may increase the sunk costs of potential entering firms or that it may require firms to enter two markets at the same time.
58. Consumer loyalty to established brands tends to be greater in markets in which product differentiation strategies are one of the main competition variables. In order to generate loyalty to its products, the entering firm must take on expenditures on publicity that become sunk costs in the investment.
59. The threat of reaction by established firms is a barrier to entry insofar as these firms are able to lower their prices, and to keep them low for at least a year, at levels that are inferior to those that existed before the concentration.
60. Effectiveness of the rivalry. Even if imports are not expressive and that entry is not probable, timely or sufficient, the effectiveness of the competition between the firm resulting from the operation and other established firms (its rivals) can make the exercise of the acquired market power improbable. This situation is probable in contexts in which established firms would tend to adopt aggressive behaviors in order to increase their participation in the market as a reaction to the exercise of market power by the firm that resulted from the operation. The following paragraphs identify three means by which a merger may reduce the effectiveness of rivalry between firms established in a market.
61. In markets for homogeneous goods the probability that market power will be exercised unilaterally increases as long as a significant share of its consumers cannot divert their

¹⁴ For a more extensive definition of economies of scale and of scope see, respectively, items 75 and 78.

purchases to competing providers. This will happen, for example, whenever remaining firms in the market cannot increase quantities supplied sufficiently in a reasonable amount of time. SEAE and SDE will consider that remaining firms will not be able to expand supply sufficiently, in a reasonable amount of time, when (a) they are operating at full capacity and it is not economically viable to expand production in a period of time that is smaller than two years or (b) when operating the existing idle capacity implies higher costs than the existing occupation level.

62. In markets for differentiated products, the probability that market power will be exercised unilaterally increases as long as a significant share of its consumers cannot divert their purchases to providers of substitute products. This will happen when an expressive share of consumers considers the products supplied by the concentrated firms as the first and second choices and when the subsequent choices are not close substitutes. The degree of substitution is smaller when the technical characteristics of the products are very rigid, when the product's brand is the consumer's main decision factor, or when information about the distinct combinations of price and quality available in the market are not easily understood.¹⁵
63. Other conditions for the coordinated exercise of market power. In addition to the aspects mentioned in items 45 through 62, there are factors that affect the probability of firms exercising market power in coordination. These factors improve the conditions for the coordination of behaviors and the supervision of rules, favoring the imposition of sanctions for those who stray from the agreements established between the firms.
64. The conditions for the coordination of decision between agents participating in the market are larger when:
 - (a) there are few firms in the market;
 - (b) the products and/or firms are homogeneous;
 - (c) relevant information about competitors is available;
 - (d) firms behave in manners that, although they are not necessarily illegal, restrict rivalry between firms.
65. Conditions for the explicit coordination of decisions are greater in cases in which firms have already involved themselves in this type of conduct or have already been subordinated to public policies that give incentives to this kind of behavior, such as, for example, price control, in the recent past.¹⁶ The acquisition by its rivals of a competitor that previously adopted aggressive competition conducts also makes the coordination of decisions easier.
66. The possibility of supervising behaviors agreed upon by a group of firms is larger when conditions for demand and production are stable, when information about commercial practices between competitors are available and when involved firms have little incentive to stray from the established agreement. The stability of supply and demand conditions make changes of conduct by members of the agreement more visible, while the availability of information makes secret transactions that stray from the agreement less viable. Firms have little incentive to stray from the established agreement when marginal costs are relatively inelastic, fix costs are relatively low and when the firm's most frequent transactions involve small quantities.

¹⁵ Note that when concentrated firms control the first and second substitutes (and the others are not close substitutes), an increase in the main product's prices, which would divert demand to product two, would not reduce the total income of the firm resulting from the operation, although it would very probably reduce the profits of the firm before the operation.

¹⁶ Price coordination does not need to be perfect (complete) in order to harm the consumer.

67. Vertical structures, specially when they involve the control of distribution channels and the simplification of sale price monitoring, may make the supervision of the fulfillment of the agreement by producing firms easier.
68. Sanctioning conditions for the participants that do not follow the agreement depend on the same variables expressed in item 64.
69. Societary grouping, insofar as it makes the exchange of information easier, increases the conditions for the supervision of collusion.

Step IV: Economic Efficiencies

70. The fact that the probability of exercising market power is not “practically null” does not imply that the concentration reduces the welfare of the Brazilian economy. In order to evaluate the liquid effect of a merger on the economy, it is necessary to compare economic costs with the possible economic efficiencies derived from the transaction. In this section the factors that can be considered economic efficiencies derived from the merger will be presented.
71. Economic efficiencies of the transaction. The increments in welfare generated by the transaction, and which cannot be generated otherwise (efficiencies specific to merger) will be considered economic efficiencies. Those that can be generated, in a period smaller than 2 (two) years, by feasible alternative means, and which involve fewer risks to competition, will not be considered efficiencies specific to concentration.
72. Verification. Increments to efficiency are difficult to verify and quantify, partly because the necessary information refers to future events. In particular, projected increments to efficiency, even with reasonable good faith, may not come about. Because of this, the efficiencies that will be considered specific to concentration are those whose magnitude and possibility of occurrence can be verified by reasonable means and for which the causes (how) and the moment in which they will be obtained (when) are reasonably specified. The alleged efficiencies will not be considered when they are established vaguely, when they are speculative, or when they cannot be verified by reasonable means.
73. Exclusion. Pecuniary gains that are the consequence of an increase in market share or of any transaction that represents solely a transfer of revenues between economic agents will not be considered efficiencies.
74. Efficiencies that are specific to horizontal mergers can happen as economies of scale, of scope, as the introduction of a more productive technology, of the appropriation of positive externalities or the elimination of negative externalities, and as the creation of a compensatory market power.
75. Economies of scale. Economies of scale are reductions in the average costs derived from the expansion of the quantity produced, given the price of the inputs. Average costs may decrease, among other reasons, when:
 - (a) fixed costs are a substantial share of total costs;
 - (b) productivity of labor increases;
 - (c) productivity of capital increases; and
 - (d) the physical properties of the equipment or of the productive processes can generate economies.

76. Fixed costs are costs that do not depend on the quantity produced, such as start up costs. When production increases, average fixed costs decrease, reducing average costs of production. When fixed costs are a significant part of average costs, concentration of production can allow important reductions in average fixed costs for the firm resulting from the operation.
77. Labor productivity is the relationship between the final quantity of the product that is generated and quantity of labor needed to generate it. Labor productivity can increase, for example, when the increase in a firm's production allows specialization of a production line or occurrence of learning economies.
78. Economies of scope. Economies of scope are reductions in average costs derived from the joint production of different goods, given the prices of the inputs. Average costs may decrease, among other reasons, because:
- (a) inputs common to the different goods are better taken advantage of by a single firm than by several;
 - (b) distribution and commercialization (sale and market) resources are better taken advantage of by a single firm than by several.
79. Introduction of a new technology. The introduction of a new technology can imply different forms of generating efficiencies. For example, to make the introduction of a new product (introduction of a new product technology) viable may be considered an efficiency increment specific to the transaction. Likewise, to make the introduction of production technologies with higher productivity levels, and which require higher minimum scales, viable, can be considered an efficiency increment specific to the transaction.
80. The acquisition of a firm that involves the substitution of a team of administrators that is capable of putting into action an increase in productivity in the firm for a team of ineffective administrators can also be considered a technological improvement that is specific to a merger.
81. Externalities. Externalities are effects over a third party, derived from an economic transaction, over which this third party has no control. Positive externalities increase this third party's welfare (for example, reducing production costs), while negative externalities reduce welfare (for example, increasing production costs). The generation of positive externalities, the elimination of negative externalities and the appropriation of externalities can be considered efficiencies specific to the transaction.
82. The appropriation of positive externalities increases the efficiency of markets. Examples of this kind of effect are:
- (a) the appropriation of technological spillovers;
 - (b) the rationalization of supply in sectors that are characterized by problems of excess installed capacity; and
 - (c) the availability of more and better information for consumers, in order to subsidize the decision making process.
83. Even if negative externalities are very frequent, it is important to consider that various public policy options are available to deal with the topic and that, therefore, the authorization of a merger is not necessarily the best way to eliminate them from the standpoint of economic welfare. Because of this, when considering the argument that the elimination of negative externalities is an efficiency increment that is specific to the merger, SEAE and SDE will be particularly attentive to the possibility of obtaining the same effect through other public policies. Only in the cases in which there are no

alternative public policy measures to deal with the topic will the elimination of negative externalities be considered an efficiency increment specific to the transaction.

84. Compensatory market power. If the increase in the merged firm's capacity to exercise market power contributes to the reduction of the capability of exercising market power in the market for inputs (shifting, for example, input prices, which may have been distorted before the merger, to their competitive levels), SEAE and SDE will consider this event an efficiency specific to the transaction.

Step V: Evaluation of the Mergers's Effect on Economic Efficiency

85. For a transaction to imply control of a substantial share of the market (Step II) in a market in which there are conditions for the exercise of market power (Step III) to be approved based on the efficiencies it generates (Step IV), it is necessary that the liquid effect of the operation on society's economic welfare be non-negative and that the limits that are strictly necessary to meet the intended goals be observed (art. 54, §1, IV).
86. SEAE and SDE will attempt to base their evaluation of the liquid effects of the concentration on quantitative estimates, when these are available or feasible, inside the limits of appropriate resources for their legal attributions. When quantitative estimates are not available or feasible, SEAE and SDE will present their conclusions based on a qualitative evaluation of these effects.
87. Competition law establishes as a formal requirement for the approval of mergers that the benefits be "distributed equally" among its participants, on one side, and its consumers or final users on the other (art. 54, §1, II). Even in the cases in which the competition policy organisms find the transaction "necessary for preponderant reasons pertaining to the national economy and to the common good," the legislator must forbid the approval of the transaction in case of the possibility of a consumer's or a final user's "loss." (art. 54, §2). Therefore, in these cases in particular, SEAE and SDE will try to evaluate if the effects of the transaction revert in the consumer's benefit in a reasonable amount of time.
88. Recommendations. Keeping in mind that the role of antitrust policy is not to control or to intercede arbitrarily in existing market structures, but to assure conditions for free functioning and for free initiative by economic agents and that the role of the merger control is to evaluate the economic effects of the transaction, interrupting the fulfillment of mergers that generate losses to economic efficiency and/or social welfare, SEAE and SDE may make three types of recommendations:
- a) approve a transaction, when it does not reduce the consumers welfare and economic efficiency;
 - b) approve a transaction with restrictions, preventing it from reducing the economic welfare or economic efficiency and
 - c) Disapproving of a transaction, when the previous alternative is not possible;
89. Structural measures. In the cases in which the approval of the transaction with restrictions (alternative "b") is suggested, SEAE's and SDE's recommendations will attempt "preferentially," creating conditions for the consolidation of a competitive atmosphere, to adopt structural measures in the involved markets.
90. Structural measures are those that attempt to reestablish the dynamics of competition in the defined relevant markets, eliminating the necessity for future control. Examples of this type of measure are the alienation of firms' assets, such as the sale of brands or of factories and breaking patents.

91. When the restrictions involve the alienation of firms' assets, SEAE's and SDE's recommendations must, in order to reach the desired goal, contain, among others, the following characteristics:

- a) involve the alienation of all the assets related to a specific business, in order to assure its economic viability;
- b) establish the smallest possible deadline for the petitioners to fulfill their alienation obligations; and
- c) avoid that the alienation be done by firms (or persons) that are not (or that do not have the conditions to become) effective competitors in the relevant markets where there has been a reduction in competition.

92. In the elaboration and application of non-structural recommendations, there must be an effort to make the proposed clauses generate efficiency gains that would not be obtained should these clauses not be stipulated. In addition, it is important to bring attention to a few fundamental precautions:

- a) antitrust analysis is based on the effective actual competition conditions and not on hypotheses about future competition patterns. In this sense, it is important to avoid the allusion to anticompetitive conducts, whose condemnation is already included in the legislation; and
- b) compromise clauses imply monitoring costs that must be considered. Therefore, they must be elaborated clearly and promptly, avoiding excessive costs for the authorities and unnecessary interferences in firm's strategies.

JOINT DIRECTIVE SEAE/SDE No. 50 OF AUGUST 1st, 2001

The **Secretariat for Economic Monitoring of the Ministry of Finance** and the **Secretariat of Economic Law of the Ministry of Justice**, in the use of their attributions, based, respectively, on articles 18 c. c. 39, “caput”, of the Addendum I of the Decree n. 3.698, of December 21, 2000, and of the articles 10, II, “a”, and 33, “caput”, of the Addendum I, of the Decree no. 3,782, of April 5, 2001, and considering that presented in §§ 4 and 6 of article 54 of Law no. 8,884, of June 11, 1994; and the necessity of establishing common principles for the systematization and the deepening of the economic analysis of horizontal mergers, so as to provide increased judicial security to private agents, as well as transparency and swiftness to the respective administrative processes,

RESOLVE TO:

- Art. 1 Issue the **HORIZONTAL MERGER GUIDELINES**, as attached to this directive.
- Art. 2 Directive SEAE n. 39, of June 29, 1999, is annulled.
- Art. 3 This directive becomes valid fifteen days after its official publication.

**CLAUDIO MONTEIRO
CONSIDERA**

**PAULO DE TARSO RAMOS
RIBEIRO**