**Competition Law and Litigation**

*Ricardo Casanova Motta* | *Catarina Lobo Cordão*

# Cade's Resolution 24/2019: a new parameter for gun jumping' fines?

On October 14, 2019, the General Superintendence of the Administrative Council for Economic Defense (GS/Cade) recommended the condemnation of the companies IBM and Red Hat for the practice of gun jumping,[1] with the suggestion of applying a historical fine.[2] The GS/Cade's recommendation was confirmed by the Administrative Tribunal during the 151st Ordinary Judgement Session held on December 11, 2019. The Concentration Act[3] was approved without restrictions on November 13, 2019.

What makes the analysis of this case become even more interesting is the fact that this was the first gun jumping investigation after the publication of the Resolution that regulated the Administrative Procedure for the Analysis of Mergers (APAC),[4] which was amended mainly to suppress the need of clearer parameters for the calculation of fines in gun jumping[5] cases. From the material point of view of the analysis, this new precedent does not seem to have been innovative enough to alter Cade's previous understandings. However, the fine of BRL 57 million

[1] The practice of previous consummation of merger transactions, also known as gun jumping, is prohibited by art. 88, §3 of Law 12.529/2011 and may result in nullity of the operation, a pecuniary fine, and the opening of an administrative proceeding to investigate possible exchanges of information with anti-competitive effects. According to art. 106, §2 of the Internal Regulation of the Cade (RiCade), "*The parties shall maintain unchanged physical structures and unaltered competitive conditions (...),it being forbidden to transfer assets or any kind of influence from one party to another, as well as exchanging competitively sensitive information, except when strictly necessary for the execution of the formal instrument binding the parties.*", until the final approval of the transaction by Cade.

[2] The GS/Cade had recommended a fine of R$ 60 million. This amount was confirmed by the Administrative Tribunal, which, nevertheless, granted a 5% discount on the amount, totaling R$ 57 million.

[3] Concentration Act No. 08700.001908/2019-73.

[4] Resolution No. 24, of July 8, 2019, available at: https://sei.cade.gov.br/sei/modulos/pesquisa/md_pesq_documento_consulta_externa.php?DZ2uWeaYicbuRZEFhBt-n3BfPLlu9u7akQAh8mpB9yO5RrijG9RkET6zcTOuRswuqKMVhLlJQGfBcrJ8Z9UIiW2b8UgA_ZdZL9vA4W3TPQmbWnRELU7feqYjaB3zGS4L [Access on 11.05.2019].

[5] In several situations, members of Cade's Tribunal have stated the need to produce a resolution with parameters for the calculation of fines in gun jumping cases. Refer to: Administrative Proceeding to Investigate a Merger No. 08700.010071/2015-20, 08700.010394/2015-13, 08700.000631/2017-08, and 08700.003319/2018-49.

imposed on the petitioners seems to have inaugurated a new level of sanction for this type of infraction. In this brief article, we intend to analyze the main points of the decision and compare the fine applied to IBM/RedHat, based on previous precedents, in order to understand the factors that may point to a new level of fines for gun jumping.

- **ANALYSIS OF CADE'S DECISION**

The transaction was approved without restrictions by the GS/Cade on June 24, 2019, yet Cade's Tribunal decided on the avocation of the Merger on July 2, 2019. On July 17, 2019, Cade ordered the opening, *ex officio*, of an APAC[6] against the petitioners, after becoming aware of the global closing of the transaction that transferred the corporate control of Red Hat, Inc. ("Red Hat") to IBM Corporation ("IBM"), while still pending the approval of Cade's Tribunal.

Based on the public documents analysed, the parties justified the need of the global closing of the deal, due to the uncertainty of the re-establishment of the procedural deadlines of Cade,[7] that were suspended by the absence of the Tribunal's quorum. According to IBM/RedHat, the delay for Cade's analysis and final approval would be implicating considerable losses for the petitioners and the other parties interested in the transaction, such as shareholders, employees, and customers. Therefore, the petitioners decided to create a hold separate structure (hold separate) for Brazil, who was the only country where the antitrust authority's authorization was still pending. This was done in order to ensure that the companies continued acting independently and so that no effects would be produced in the Brazilian market, as a result of the global closing of the transaction.

This separate structure (hold separate), intended to last until the final approval from Cade, would be adopted, based on the Disney/Fox and Pfizer/GSK precedents, in which the Tribunal, in terms of the Settlement on Merger Control ("ACC", in its Portuguese acronym), authorized the consummation of the transaction, even before the divestiture of the business required by the structural remedies negotiated with the parties.

First of all, the question of consummation due to uncertainty as to the re-establishment of procedural deadlines is quite unique in this particular case, given the particular and exceptional circumstances of the absence of a quorum of the Tribunal and the external dependence on new nominations by the President of the Republic and then the approval by the Federal Senate. When analyzing the issue, Cade understood the argument as unfounded, pointing out that, despite the overall situation, the parties had decided to close the transaction 75 days after the analysis period had begun, while the maximum period for the analysis would have been up to 330 days, considering its complexity. Cade's conclusion in this respect is that the parties deliberately did not comply with the legal deadline for assessment. Even though it recognized that mergers involving several jurisdictions face timing challenges, the Tribunal considered that this could not be a reason for the parties to ignore the deadlines set forth for consummation of a transaction.

[6] Administrative Proceeding to Investigate a Merger No. 08700.003660/2019-85.

[7] According to the Order issued on July 17, the suspension of the proceedings before Cade's Tribunal was decided, as well as the deadlines set forth in Law No. 12,529/2011, due to the absence of a quorum because of the end of the mandate of 4 of the 7 Commissioners.

In addition, the GS/Cade also understood that if the costs of awaiting the antitrust agency's decision had been decisive for the applicants, this could have been analyzed in a precarious application for authorization, whose procedure is foreseen and regulated, which at no time was requested by the parties.

The possibility of a precarious authorization is provided for in Article 114 of RiCade and may be granted as long as (i) there is no danger of irreparable damages of the competition conditions in the market, (ii) the measures, whose authorization is requested are fully reversible, and (iii) the petitioner is able to demonstrate the imminent occurrence of substantial and irreversible financial damages of the purchased company, if the precarious authorization for consummation of the merger is not granted. The only case in which it was granted was in Merger 08700.007756/2017-51, involving Excelence B. V. and the Rio de Janeiro Airports.

In regards to the way the petitioners avoid the characterization of gun jumping, Cade considered that the hold separate business would have natural effects, being similar to a carve out agreement, in which both parties are unable to demonstrate the absence of consumptive effects on the market. Both instruments are contractual solutions that establish principles for maintaining separate business structures with independent administrations, ensuring that there is no exchange of information between companies.[8]

According to the GS/Cade, *"There is a consensus that this is a difficult tool for competition authorities to monitor, with its highly questionable effectiveness in terms of preventing the exchange of sensitive information between competitors.[9]"* Therefore, the GS/Cade pointed to the Technicolor/Cisco[10] precedent for not allowing these instruments, as well as the lack of acceptance of these instruments (carve out and hold separate) by other antitrust authorities around the world. In relation to the precedents mentioned by the petitioners, the GS/Cade pointed out that this separation is commonly discussed when the antitrust authority negotiates a structural remedy under the ACC or when the authority unilaterally imposes it, as a condition for approval of a merger, which are situations very different from the IBM/Red Hat case, in which there was no final negotiation or decision allowing the use of the instrument.

Furthermore, the GS/Cade concluded that *"The parties have practiced gun jumping, in order to carry out the transaction as soon as possible and that the justifications provided by the parties' representatives are not enough to disregard the infringement."*[11] Thus, applying Resolution No. 24/2019, in which the GS/Cade recommended the imposition of a BRL 60 million fine for a gun jumping violation resulting from the prior acquisition of RedHat.

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[8] Carve-out agreement consists in the separation of companies at the organizational, financial, legal, and technical levels of an organization, which then becomes two independent entities. The hold separate business is an institution that establishes the creation of a separate structure that will ensure measures of preservation and separation of the companies' businesses. The hold separate manager has the function of managing the business during the transition period.

[9] Technical Note No. 36/2019/CGAA4/SGA1/GS/CADE.

[10] Administrative Proceeding to Investigate a Merger No. 08700.011836/2015-49.

[11] Technical Note No. 36/2019/CGAA4/SGA1/GS/CADE.

After the files were forwarded to the Tribunal on November 22, 2019, the companies began negotiating an agreement with the objective of closing the open APAC. In summary, the represented companies compromised to collect a pecuniary contribution of BRL 57 million.

- **ANALYSIS OF THE FINE IMPOSED**

One of the biggest criticisms of Resolution No. 13/2015, prior normative framework for Proceeding to Investigate a Merger, was the absence of methodology to calculate the pecuniary fine. In fact, the articles that deal with pecuniary fines (art. 7, II and art. 10, II, "a") simply establish that the fine should be set at an amount between BRL 60.000,00 and BRL 60.000.000,00, thus stating what the law reads, but without clear parameters of dosimetry.

The new resolution about APACs came to fill this gap. Under the terms of the Rapporteur Commissioner of APAC, Paula Azevedo's vote, "Such devices left the judge with less discretionary power, since the application of an upper bound and mitigating circumstances are contingent, the amounts or ranges of amounts are pre-established, making the calculation methodology clearer and more objective." In regards to Resolution No. 24/2019, the factors considered for calculating the fine are: (i) reoccurrence, which doubles the basic penalty, (ii) course of time, which may increase the fine by 0.01% of the transaction amount per day of delay, (iii) gravity of the conduct, which may increase the fine by up to 4% of the amount of the transaction, (iv) intentionality, which may increase the fine by 0.4% of the average revenue in the year prior to consummation, and (v) the moment of notification, which may reduce the fine by 50%, 30%, or 20% (art. 21).

According to the decision, the following factors were used as base plate magnifiers: (i) 1% of the amount of the transaction, due to the gravity of the conduct; and (ii) 0.4% of the average revenues of the economic groups of the Represented in 2018, due to the intentionality of the agents. Factors such as (i) reoccurrence, (ii) course of time, and (v) moment of notification were not applied to this case. The mitigating factors, which refer to the moment of notification of the transaction, were not applied.

According to the Rapporteur Counselor's constant voting data of applying the methodology of Resolution No. 24/2019, the amount informed, regarding the expected fine would be over one billion reals (BRL 1,332,517,782.67). Nevertheless, the Represented submitted an APAC proposal agreement, in terms deemed convenient and timely by Cade, thereby granting them a discount of 5% of the amount of the expected fine, resulting in a total of BRL 57,000,000.00, the highest penalty ever imposed for the practice of gun jumping in the history of the Council.

Up till present day, there have been a total of 26 APACs opened by Cade seeking to investigate the existence of gun jumping. Of these, 12 led to a final conviction. The biggest fine payed for the infringement was of BRL 30 million, in the Technicolor/Cisco case. In this case, the companies also claimed that they had celebrated a carve-out agreement to exclude Brazil from the effects of the transaction abroad, and CADE stated that the agreement demonstrated the dishonesty of the petitioners, who sought a contractual means to carry out the transaction before the Brazilian antitrust authority had made its final decision.

Therefore, the fine imposed on IBM/RedHat practically doubled the amount of the highest fine imposed so far, which was in the Technicolor/Cisco case, considered a fairly similar scenario of consummation and intentionality.[12] Once again, emphasizing that in accordance with the Rapporteur Counselor's vote, the amount of the fine was expected to be over one billion reals. As can be seen from the summary table presented in her vote, the amount of 1 billion reals was achieved by the simple application of the criterion of intentionality, set at 1% (that can reach up to 4%).

The IBM/RedHat case then becomes the case in which the Council applied the highest fine for a gun jumping infringement, coming very close to the legal maximum amount, which only did not occur by virtue of an agreement with the authority. In this respect, there are already notes in the Rapporteur Counselor's decision pointing out that the legal limit of 60 million would no longer be appropriate for the reality of the case, given that its amount would be monetarily outdated, and therefore, it would not adequately punish large transactions.[13]

As this is the first case decided based on Resolution No. 24/2019, it is still hasty to foresee the effects of the new Resolution for the calculation of fines in APAC, since the fines use the amount of the transaction and billing of the parties as its basis. The suggestion of a fine at the maximum legal level, which had never happened until this case, may indicate that the new Resolution is hardening the pattern historically applied by Cade. It is necessary to wait for the next cases to understand if there is a new jurisprudence parameter of fines for this type of infraction. However, one thing is for sure: the new conditions brought about by Resolution No. 24/2019 removed the part of the discretion of the judge in applying the fine.

From the material point of view of the analysis, this new precedent does not seem to have innovated to such an extent as to alter previous understandings of Cade. However, the fine on the petitioners, amounting to BRL 57million, may be inaugurating a new level. Only time can indicate more precisely the legal direction.

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[12] "*Malice is characterized by intention; that is, the volitional desire for a certain action. Well, in this case, it is clear that* ***the previous consummation of the merger was part of a rational choice, within a deliberated strategy of the parties to close the deal before Cade's approval***. *Both the news on Technicolor's website and the carve-out agreement presented by the Represented companies confirm this intentional character of closing the deal before Cade's green light was given.*" (§79 of Rapporteur Paulo Burnier's vote)

[13] This statement was made by Commissioner Paula Azevedo during the trial of the case, at the 151st Judgement Session. The audio of the session can be accessed at: http://www.cade.gov.br/assuntos/sessoes/sessoes-pasta-geral/prospectos-audio-soj/2019/151a-soj.pdf.