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CHAPTER 4

Brazil's Antitrust and Regulatory Reviews of TIM/Telefónica: Lessons Learned

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The well-known 2007 transaction involving the indirect acquisition of a minority stake in Telecom Italia/TIM Brasil by the Spanish Group Telefonica raised a number of regulatory and antitrust concerns in Brazil, with landmark decisions being issued by the Brazilian telecommunications regulator, *Agência Nacional de Telecomunicações* ("*ANATEL*"), and the country's competition agency, *Conselho Administrativo de Defesa Econômica* ("*CADE*"). More recently, in September 2013, Telefonica announced an increase in its shareholding of Telco, the holding company through which it holds stakes in Telecom Italia. The new proposed transaction reignited the discussions on desirable concentration levels of the Brazilian telecommunications industry, with CADE quickly issuing a decision against further concentration and highly-ranked public officials stating that the Brazilian government would not allow such a transaction to go forward.

This article aims to discuss what lessons were learned from such a high profile case, from a Brazilian law and practice perspective. Section 1 of this article briefly describes the Telefonica/Telco deal. Section 2 describes the regulatory framework in Brazil and the issues raised by the transaction. Section 3 briefly describes Brazil's merger review system and CADE's relevant decisions. Section 4 discusses lessons learned, namely that: (i) behavioral remedies are resource-intensive and will likely be viewed with skepticism as a remedy under Brazil's new pre-merger review system; (ii) the Brazilian regulatory and antitrust agencies are expected to conduct independent reviews; (iii) minority shareholdings raise substantial antitrust concerns; and (iv) there is an enhanced skepticism towards the role of economics in minority shareholdings cases.

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1. BRIEF DESCRIPTION OF THE TELEFÓNICA/TELCO TRANSACTION

In October 2007, Telefónica S.A. ("*Telefónica*") and certain financial institutions (Intesa San Paolo S.p.A., Mediobanca S.p.A., and Assicurazioni Generali S.p.A.) announced the acquisition of Olimpia S.p.A., through Telco S.p.A ("*Telco*"), which held approximately 23.6% of the voting capital of Telecom Italia S.p.A. ("*Telecom Italia*").

Until September 2013, Telefonica owned 46.18% of Telco voting rights. On September 24, 2013 Telefónica announced an increase in its shareholding in Telco to 66% through the acquisition of newly issued non-voting shares,[1] executed on the date of the agreement. The transaction contemplated three additional steps. As of January 2014, Telefónica would convert its non-voting shares of Telco into voting shares up to a limit of 64.9% of the voting capital. Subsequently, Telefónica would further increase its shareholding up to 70% of the total capital through the acquisition of additional shares to be issued by Telco. Finally, Telefonica would have an option to acquire the shares of the other shareholders and become the owner of 100% of Telco.

Telecom Italia indirectly controls the Brazilian telecommunications operator TIM Participações S.A. ("*TIM Brasil*"), which offers mobile, fixed line local and long distance telephone and data services. Telefónica is also active in the Brazilian telecommunications market – offering mobile, fixed line local and long distance telephone, data and paid television services – through Telefônica Brasil S.A. ("*Telefônica Brasil*").[2] In July 2013 Telefonica finalized an extensive corporate reorganization, consolidating in Telefônica Brasil all its telecommunications services, including mobile services previously offered through Vivo.[3]

2. REGULATORY ASPECTS

This section discusses: (i) the regulatory framework for reviewing transactions in the telecommunications sector in Brazil; (ii) why Telefónica's indirect equity interest in TIM Brasil may be viewed as problematic from a regulatory perspective; and (iii) ANATEL's review of the Telefónica/Telco transaction.

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1. Press release available at http://www.sec.gov/Archives/edgar/data/948642/000094787113000686/ss189848_ex9938.htm.
2. Both TIM Brasil and Telefônica Brasil are publicly traded companies listed on the Bovespa stock exchange.
3. Telefónica entered the Brazilian market in 1998, when the restructuring and privatization of Telebrás was taking place. Later, in 2002, Telefónica and Portugal Telecom created a joint venture to operate in the Brazilian mobile market and they began their commercial operations under the name Vivo in April 2003. In 2010, Telefónica increased its stake in Vivo, transaction which was subject to both ANATEL's and CADE's review. The contract included a clause which provided that Telefónica and Portugal Telecom would not compete with each other in Spain and Portugal as from the end of September 2010. In January 2013, the European Commission imposed fines of EUR 66,894,000 on Telefónica and of EUR 12,290,000 on Portugal Telecom as such clause was considered to be in breach of Art. 101 of the Treaty on the Functioning of the European Union (TFEU).

2.1. Regulatory Framework for Reviewing Transactions in the Telecommunications Sector in Brazil

The Brazilian Constitution assigns telecommunications activities to the federal government (Article 21, XI). In practice, this means that telecommunications services, namely fixed, mobile, wireless and satellite services, may only be provided by private parties that obtain authorization or delegation to operate from the federal telecommunications regulator and not from state or local governments.

Beginning in 1995, the Brazilian government undertook a comprehensive reform of Brazil's telecommunications regulations. In July 1997, Brazil's Congress adopted the Brazilian General Telecommunications Law (Federal Law 9,472/1997 – "*LGT*"), which together with the regulations, decrees, orders and plans on telecommunications issued by Brazil's executive branch, creates a comprehensive regulatory framework introducing competition into the Brazilian telecommunications sector and promoting the privatization of Telebrás and its subsidiaries. Under Articles 6 and 18 of LGT, competition and universalization are key principles for the provision of telecommunications services in Brazil.

In addition to defining legal regimes for the provision of services, the LGT created the National Telecommunications Agency – ANATEL, an independent agency to which it gave broad powers to regulate the sector.[4] ANATEL's independence in relation to the government is guaranteed by a provision in the LGT which states that it shall operate without hierarchical subordination to the Executive Power. ANATEL's tribunal is composed by five commissioners, appointed by the President and confirmed by the Senate, for a single five-year term;[5] this reduces the ability of political pressure influencing their decisions. ANATEL acts both on a case-by-case basis and also through the issuance of the so-called "Resoluções" (resolutions), which regulate the telecommunications sector.[6]

ANATEL has the power to grant licenses to private companies offer services and to oversee the provision of such services, including rates and quality of services. The use of spectrum also requires a specific license from ANATEL – distinct from the license to offer services – which may be subject to a bidding process.

As a rule, licenses may only be transferred with prior approval of ANATEL. The same requirement applies to the transfer of the direct or indirect control of a company that holds a license.[7] For mobile services, this condition is included in all licenses and is also provided for in Article 9 of ANATEL's Resolution No. 321/2002.

4. Brazil regulates television and radio broadcasting separately from telecommunications services. Broadcasting companies are regulated by the Ministry of Communications, under Law 4117 of Aug. 27, 1962, and Art. 21 of the Federal Constitution.
5. A list of current ANATEL's Commissioners is available at http://www.anatel.gov.br/Portal/exibirPortalNivelDois.do?codItemCanal=804&nomeVisao=Conhe%C3%A7a%20a%20Anatel&nomeCanal=Sobre%20a%20Anatel&nomeItemCanal=Quem%20%C3%A9%20Quem.
6. In 2008, through ANATEL's Resolution 516, ANATEL approved the *General Plan for Updating Telecommunications Regulations* in Brazil (PGR), which sets forth a timeframe for the review of the regulatory framework, dividing the actions into short-, medium- and long-term.
7. There are a few exceptions to this rule, which are not relevant for the purposes of this article.

ANATEL assesses transfer of control based on a concept of control that is distinct and broader than the one found in corporate law (Article 116 of Law No. 6,404/76). The latter considers the controlling shareholder to be the individual, group or legal entity that has the majority vote in decisions of the general meeting, that has the power to elect the majority of the company's officers, and that effectively uses its power to manage the company's corporate business and influence the operation of the company's bodies.

ANATEL's Resolution No. 101/1999 defines the controlling shareholder as the individual, group or legal entity that individually or jointly holds the power to manage the business in a direct or indirect, internal or external manner. The resolution further broadens the concept of *controlling shareholder* to include any shareholder that, in a direct or indirect manner:

(i) has the power to elect or remove members of the Board of Directors and/or officers of the company;
(ii) has veto rights provided either by the company's bylaws or by a shareholders' agreement; or
(iii) is able to obstruct, by any means, the verification of a qualified quorum for the installation of a shareholders' meeting.

ANATEL may only grant its approval to a transfer of control if the economic, technical and legal conditions for a company to hold a license are preserved. In other words, the agency verifies whether or not the change of control affects any of the regulatory requirements applicable to the license holder.

Until the enactment of the new Brazilian antitrust law (Law No. 12,529/11, which entered into force in May 2013), ANATEL would also issue a non-binding opinion directed to the antitrust agency (CADE) on antitrust aspects in connection with the transaction's merger review. Although such an opinion is no longer required under the new law, in its regulatory review ANATEL has repeatedly addressed competition issues of a given transaction, given that competition is one of the core values for the provision of telecommunications services under Brazil's LGT.

Finally, there are no restrictions on indirect foreign ownership applicable to the telecommunications sector. Decree No. 2,617 of May 6, 1998 simply provides that companies that hold licenses for the provision of telecoms services shall be organized under Brazilian law and have their principal place of business in Brazil.

2.2. Why Telefónica's Indirect Equity Interest in TIM Brasil May Be Viewed as Problematic from a Regulatory Perspective

Article 8 of ANATEL's Resolution No. 321/2002 forbids two companies belonging to the same economic group to hold licenses to render *mobile services* in the same area.[8]

8. Article 8. Its forbidden for a company, its controlling entity, a company that it controls or an affiliated company, to offer SMP, SMC [mobile services] or both through more than one license or concession, in the same geographic area.

This restriction was created to foster competition in mobile services and it prevents Telefónica from controlling both TIM Brasil and Telefônica Brasil.

Therefore, from a regulatory perspective, Telefónica could only acquire the control of TIM Brasil, as broadly defined by ANATEL, if mobile licenses of either TIM Brasil or Telefônica Brasil are cancelled to avoid an overlap of licenses within the same economic group. Licenses for mobile services are granted on a regional basis in Brazil and both TIM Brasil and Telefônica Brasil hold licenses for all the three regions in which the country is divided for regulatory purposes.

Table 4.1

Region	*Geographic Scope*	*Primary Mobile Licensees*
I	States of Rio de Janeiro, Minas Gerais, Espírito Santo, Bahia, Sergipe, Alagoas, Pernambuco, Paraíba, Rio Grande do Norte, Ceará, Piauí, Maranhão, Pará, Amapá, Amazonas and Roraima	Vivo, TIM, Claro, Oi, CTBC, and Nextel
II	Distrito Federal and States of Rio Grande do Sul, Santa Catarina, Paraná, Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre	Vivo, TIM, Claro, Oi, CTBC, Nextel, and Sercomtel
III	State of São Paulo	Vivo, TIM, Claro, Oi, CTBC, and Nextel

Source: Anatel, January 2014.

Cancelling licenses regarding mobile services also results in the cancellation of the corresponding licenses to use the spectrum, as established by Article 169 of the LGT. Under Article 168 of the LGT, spectrum licenses are always connected to service licenses and may not be held or transferred independently of them.

Some have argued that Articles 169 and 168 of LGT would not prevent the consolidation of the licenses of Telefônica Brasil and TIM Brasil in a single entity. This would be so because, even if part of the services licenses are cancelled after this consolidation, the spectrum licenses would not be affected as the resulting entity would continue to hold a valid service license.

However, ANATEL has recently refused this interpretation while reviewing the proposed merger of Unicel into Nextel – the transaction was blocked because the two companies hold mobile services and spectrum licenses in the same regions, which would violate the provisions of the LGT.[9] Furthermore, consolidating the spectrum licenses of Telefônica Brasil and TIM Brasil in certain regions would go beyond the limits imposed by the rules under which these licenses were auctioned.

9. *See* Analysis 621/2012-GCRZ; Procedure 53500.023842/2012.

In exceptional circumstances, ANATEL accepted that it may consider changes to regulatory restrictions to grant regulatory approval to a transaction. For example, in 2008 ANATEL suggested that the Executive Branch approve a rule change (*Plano Geral de Outorgas*) allowing fixed-line telecoms to operate in more than one region of Brazil – this allowed the consolidation between two major telecommunications groups in Brazil, Telemar Norte Leste S.A. ("*Telemar*") and Brasil Telecom S.A. ("*BrT*"), to form Oi S.A. ("*Oi*").[10] An important aspect of the justification for the change was that the transaction did not raise any antitrust concerns as the two entities primarily offered their services in different regions. ANATEL cleared the transaction subject to a number of ancillary conditions.

2.3 ANATEL's Review of Telefónica/Telco Transaction

From October 2007 to July 2009, ANATEL reviewed the transaction through which Telco – and indirectly Telefónica – became a shareholder of Telecom Italia in 2007. ANATEL took the view that Telefónica was acquiring indirect control of TIM Brasil as defined by ANATEL's Resolution No. 101/1999,[11] which would violate the above-mentioned Article 8 of ANATEL's Resolution No. 321/2002.

To clear the transaction, ANATEL imposed significant restrictions to the share-holder rights of Telefónica. The restrictions were envisioned to block any interference of Telefónica in matters related to TIM Brasil, a direct competitor of Vivo in Brazil, a company jointly-controlled by Telefónica and Portugal Telecom.[12] The restrictions:

(i) prohibit Telefónica from exercising control – as defined in ANATEL's Resolution No. 101/1999 – over any company of Telecom Italia with activities in Brazil;
(ii) prohibit Telefónica and executives appointed by Telefonica from voting, vetoing or participating in any board meeting or general assembly that discusses matters regarding the Brazilian telecommunications market;
(iii) prohibit interlocking directorates between Telefónica and Telecom Italia in Brazil;
(iv) limit the commercial relationship between companies of the Telefónica and the Telecom Italia groups in Brazil; and
(v) impose ancillary obligations to allow the agency and third-parties to monitor the fulfillment of these restrictions.

ANATEL took the view that these restrictions would be sufficient to prevent Telefónica from exercising any *control* on companies of Telecom Italia in Brazil and would make the transaction compatible with regulatory restrictions.

Furthermore, ANATEL asserted that the restrictions were sufficient to neutralize any competition concern that the transaction could raise. Based on this assessment,

10. ANATEL's decision available at http://www.teleco.com.br/pdf/ato_7828.pdf.
11. *See* Act 68276/2007 of ANATEL.
12. *See* Act 68276/2007 and Act 3804/2009 of ANATEL.

ANATEL also issued an opinion recommending that CADE approve the transaction subject to the above-mentioned remedies.[13]

As for the 2013 transaction, it was envisioned that there would be an increase in the shareholding of Telefonica in Telco and indirectly in Telecom Italia and TIM Brasil. If all steps are implemented, Telefonica would become the sole shareholder of Telco. From a strictly regulatory perspective, this does not represent a major change when compared to the 2007 transaction. Based on its past decisions,[14] ANATEL could accept behavioral restrictions as sufficient to prevent Telefónica from exercising any influence on TIM Brasil. However, as Telefónica may eventually substantially increase its economic interest in TIM Brasil, ANATEL could take the view that it is no longer possible to transform Telefónica's stake in TIM Brasil into a passive financial interest, in which case structural remedies would be required.

3. ANTITRUST REVIEW

This section provides an overview of the merger review framework in Brazil and then discusses: CADE's review of the 2007 Telefónica/Telco transaction; and CADE's more recent review of the 2010 Teléfonica/Portugal Telecom transaction and its impact on the 2013 Telefónica/Telco transaction.

3.1. Merger Review Framework in Brazil

Competition law and practice in Brazil is primarily governed by Law No. 12,529/11, which entered into force on May 29, 2012 and replaced Law 8,884/94. The new competition law has consolidated the investigative, prosecutorial and adjudicative competition functions into one independent agency, CADE.

CADE's new structure includes: (i) a Tribunal composed of six Commissioners and a President; (ii) a Directorate-General for Competition ("*DG*"); and (iii) an Economics Department. The new DG is the chief investigative body in matters related to anticompetitive practices and is responsible for clearing simple transactions and challenging complex cases before the Tribunal. CADE's Tribunal is responsible for adjudicating the cases investigated by the DG, including both mergers and alleged antitrust violations. All the Tribunal's decisions are subject to judicial review.

13. *See* Procedure 53500.013482/2007.
14. ANATEL reviewed the 2007 transaction under the strict terms of ANATEL's Resolution No. 101/1999 and concluded that Telefónica was acquiring *control* over TIM, which would violate Art. 8 of ANATEL's Resolution No. 321/2002. However, ANATEL found that the behavioral restrictions described in the preceding section were sufficient to prevent Telefónica from exercising any influence over TIM. Behavioral restrictions were also adopted to clear other transactions in which similar regulatory restrictions would prevent a party from acquiring shares in a company holding licenses to offer telecommunications services in the same area. *See,* for example, the recent decision in Procedure 53500.000466/2013.

Apart from the new institutional framework, the 2011 Law has introduced a mandatory pre-merger notification system, i.e., transactions that meet the Brazilian merger filing thresholds may not be closed before obtaining CADE's clearance.[15]

As for the types of transaction subject to merger review, whereas the new provisions specifically refer to "concentration acts," although these are defined very broadly as: (i) two or more companies merging; (ii) one company directly or indirectly (through any type of securities, including convertible loans) acquiring sole or joint control of the stock or assets of another, or even a minority shareholding; (iii) an absorption of other companies takes place; or (iv) a joint venture, an association or a consortium is formed.

CADE's Resolution No. 2/2012 defined clear criteria to determine when an acquisition that does not involve change in control is subject to mandatory filing. That would be the case: (i) if, as a result of the transaction, the acquirer becomes the largest individual shareholder of the target company; (ii) in cases that do not involve companies that are horizontal or vertically related, if a party acquires at least 20% of the voting or total capital stock of the target company, or in cases where the party already holds 20% of the voting or total capital stock of the target company, if the party acquires at least 20% of the voting or total capital stock from the same seller; or (iii) in cases involving horizontally or vertically related parties, acquisition results in the buyer having at least 5% of the voting or total capital stock of the target company, or in cases where the party already holds at least 5% of the voting or total capital stock of the target company, every time the shareholder acquires an additional stake of at least 5%. If the acquirer is already the controlling entity, a filing would only be mandatory in cases where it acquires at least 20% of the voting or total capital stock of the target company from the same seller.

As for the filing thresholds, the competition law provides for minimum size thresholds, expressed in total revenues derived in Brazil in the last fiscal year by each of at least two parties to the transaction. Ministries of Finance and Justice Joint Resolution No. 994/2012 established that one party must have Brazilian revenues in the last fiscal year of at least BRL 750 million[16] and the other BRL 75 million[17] – both acquirer and seller, including the whole economic group,[18] should be taken into account.

15. Parties are not allowed to close the transaction while a CADE's decision is pending. Fines for gun-jumping range from BRL 60,000 to BRL 60 million, regardless of whether clearance is granted or not and CADE may seek to unwind a transaction that has been consummated in violation of the law. In exceptional circumstances, the Reporting-Commissioner may authorize the parties to close a transaction before receiving CADE's clearance, subject to conditions such as limitations on the freedom of the acquirer to integrate activities, dismiss workers, close stores or plants, and terminate brands or product lines.
16. Roughly USD 370 million.
17. Roughly USD 37 million.
18. Pursuant to CADE's Resolution No. 2/2012, the following entities shall be considered as part of the same "economic group" for the purposes of calculating the group's revenues: (i) entities subject to common control; (ii) all the companies in which any of the entities subject to common control holds, directly or indirectly, at least 20% of the voting or total capital stock. In transactions involving private equity funds, the turnover of the following entities shall be taken into account for the purposes of determining whether a filing is mandatory: (i) management

The law also provides for a clawback provision that allows CADE to review transactions that fall outside the merger thresholds within one year of its closing. Consumer associations, clients, suppliers and competitors may file complaints against a transaction before the agency, prompting CADE to act.

Brazil's antitrust law does not contain language specifically setting forth the substantive standard to be employed in reviewing mergers, but CADE's interpretation of the law allows us to conclude that the standard applied in Brazil considers both a dominant position and a lessening or restriction of competition tests. No Merger Guidelines have been issued by CADE to date, but it is expected that CADE will take into account the case law and regulations under the previous law, including SDE's and SEAE's Horizontal Merger Guidelines.[19] Such guidelines employ traditional merger analysis and describe five steps in the review process:

(a) *Step 1: Defining the relevant product and geographic markets*. The methodology used for defining the relevant product and geographic markets is mostly based on substitution by consumers in response to hypothetical changes in price. The guidelines incorporate the "SSNIP test", aiming to identify the smallest market within which a hypothetical monopolist could impose a small and significant non-transitory increase in price (usually taken as a price increase of 5%-10% for at least twelve months). Supply side substitutability is also sometimes considered at this stage.

(b) *Step 2: Determining whether the market share of the merged entity is sufficiently large to permit the exercise of market power*. The law presumes a market power to exist if the parties jointly hold a share of at least 20% of the market. The guidelines describe threshold levels of market concentration that raise concerns about the possible exercise of market power in either of two ways: (i) by a single firm unilaterally, when that firm has a market share of at least 20%; or (ii) through coordination of firms in a market in which the four-firm concentration ratio is at least 75% and the resulting firm has a market share of at least 10%. If the market concentration exceeds either of those levels, CADE proceeds to step three. The guidelines do not explicitly adopt the Herfindahl-Hirschman Index (HHI) as a measure of concentration, but CADE usually uses it, following the U.S. or even the E.C. standards.

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company; (ii) funds under the same management company; (iii) limited partners that hold at least 20% of at least one of the funds mentioned in item (ii); and (iv) the portfolio companies in which one of the funds mentioned in item (ii) holds at least 20% of their voting or total capital stock.

19. Prior to Law No. 12,529/11, there were three competition agencies in Brazil: the Secretariat of Economic Monitoring of the Ministry of Finance ("*SEAE*"), the Secretariat of Economic Law of the Ministry of Justice ("*SDE*"), and the Administrative Council for Economic Defense ("*CADE*"). The SDE was the chief investigative body in matters related to anticompetitive practices and issued non-binding opinions in connection with merger cases. The SEAE also issued non-binding opinions relating to merger cases and issued opinions in connection with anticompetitive investigations. CADE was structured solely as a administrative tribunal, composed of six Commissioners and a President, which made final rulings in connection with both merger reviews and anticompetitive practices.

(c) *Step 3: Assessing the probability that market power will be exercised post-merger.* CADE will consider market conditions relating to the likely exercise of market power, taking into account both unilateral and coordinated effects. These conditions include the opportunity for increased imports, conditions of entry, and other factors that may affect rivalry, e.g., scope of competition between the merging parties and customer switching patterns, as well as previous similar mergers and countervailing market power of buyers[20] or suppliers. Vertical issues are increasingly being raised during the review. If CADE concludes there is a likelihood of market power exercise following the completion of the transaction, CADE proceeds to Step 4.

(d) *Step 4: Examining the efficiencies generated by the transaction*. The authorities will consider whether cognizable efficiencies resulting from the merger are likely to reduce or reverse adverse effects. It is incumbent upon the merging firms to substantiate efficiency claims so that CADE can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved, how each would enhance the merged firm's ability and incentive to compete and why each would be merger-specific.

(e) *Step 5: Evaluating the net effect of the transaction on economic welfare.* Historically, everytime CADE reached Step 5, the transaction was either blocked or subject to substantial remedies.

The law allows CADE to take whatever measures deemed necessary to ensure the merger will not impact competition and there is a preference for adopting structural rather than behavioral remedies. If CADE finds a transaction to be harmful to competition, it may block it or accept remedies, particularly divestitures of production facilities, stores, distribution networks or brands. Under the new law, parties can negotiate undertakings with CADE to remedy perceived competition issues. Parties can offer undertakings from the day of filing up to thirty days following the challenge of the transaction before the Tribunal by the DG.

3.2. CADE's Review of the 2007 Telefónica/Telco Transaction

In its review of the 2007 Telefónica/Telco transaction, CADE concluded that the transaction raised concerns particularly in the mobile services markets in Brazil. CADE also noticed that there were overlaps in fixed line local and long distance telephone services and in data services, but such overlaps were not as relevant as the expected concentration in the mobile markets.

In local telephony and data services, TIM Brasil's market shares were insignificant. In long distance services, the national combined shares of the parties in 2009 were 26.64% for international calls and 29.26% for national calls – based on minutes

20. Countervailing buyer power is generally defined by CADE as the bargaining strength that the buyer has vis-à-vis the seller in commercial negotiations due to its size, its commercial significance to the seller and its ability to switch to alternative suppliers.

charged by the operators. Nonetheless, CADE noticed that TIM Brasil was a minor player in these markets and that there were other players – Embratel and Oi – with greater shares. This led CADE to conclude that the transaction would not have a relevant impact on competition in relation to such markets.

With respect to mobile services, CADE undertook a detailed analysis of the market structure. Unlike ANATEL that measured concentration based on three regional markets corresponding to the geographic areas of each license, CADE defined separate geographic markets for mobile services for each local area code. Although the market shares of the parties varied according to each local area code, CADE noted that, in general, the combined share of Telefônica Brasil and TIM Brasil was above 50%.

CADE pointed out that mobile services markets were already concentrated prior to the transaction and also identified market conditions that made the exercise of market power likely, such as the existence of high entry barriers. Remedies were, therefore, deemed necessary to clear the transaction. CADE concluded that the restrictions imposed by ANATEL combined with a few further restrictions[21] would be sufficient to prevent Telefónica from exercising any meaningful influence over TIM Brasil. The restrictions imposed by Brazil's antitrust agency are detailed in an agreement executed between CADE and the parties (*Termo de Compromisso de Desempenho – TCD*).

CADE took the view that, with the adoption of a number of behavioral remedies, the transaction was not expected to negatively impact competition due to the following:

(i) the indirect shareholding of Telefonica in TIM would be small and, at the same time Telefónica owned a large equity in Vivo – at that time, 50% of its controlling entity Brasilcel N.V. ("*Brasilcel*"). This would limit the gains of Telefónica in a strategy not to compete with TIM;
(ii) Telefónica did not solely control Vivo, since 50% of its controlling entity Brasilcel was owned by Portugal Telecom SGPS S.A. ("*Portugal Telecom*"); and
(iii) there were two other competitors of equivalent size – Oi and Claro – that could disrupt any strategy of TIM and Telefónica to reduce competition between them.

CADE also highlighted that the change in any of these circumstances would increase the risks of negative impacts on competition, which would demand a new review by CADE.

On December 4, 2013, CADE's Tribunal, following an opinion issued by CADE's Legal Services ("*ProCADE*"), ruled that the parties violated the TCD commitments referred above because of: (i) the sharing of sensitive information between Telefónica and TIM Brasil; and (ii) the implementation of the 2013 transaction without prior notice

21. CADE added to the restrictions imposed by ANATEL (i) confidentiality commitments from the companies and individuals involved, (ii) the obligation to present annual reports and market data to CADE, and (iii) penalties for violation of the restrictions.

to CADE, as TCD's very first clause provided for commitments from the parties to maintain the two economic groups separately.[22]

CADE fined Telefonica BRL 15 million (approximately USD 6.3 million), under the terms of the TCD (the maximum fine provided for in the TCD is BRL 20 million), and ordered it to undo the first step of the 2013 transaction – i.e., the increase of its stake in Telco to 66% – and not to increase its stake in Telecom Italia through any other means (the deadline to fulfill this obligation was kept confidential). It also fined TIM BRL 1 million (approximately USD 420,000) due to the illegal sharing of information associated with the execution of an agreement with a company which was part of the Telefónica group. According to CADE's President, Vinicius Carvalho, who reported the case, "*Any changes in Telefonica's stake in Telecom Italia could compromise the competitive landscape of the market*".

3.3. CADE's Review of the 2010 Telefónica/Portugal Telecom Transaction and Its Impact on the 2013 Telefónica/Telco Transaction

Following the 2007 Telefónica/Telco transaction, Telefónica acquired in 2010 the other 50% stake in Brasilcel, Vivo's controlling entity, from Portugal Telecom – and Vivo was later merged into Telefônica Brasil, as mentioned in section 1 above. ANATEL approved the transaction in December 2012, stating that it would not change the current market structure as Telefónica already controlled Brasilcel and no changes to the restrictions imposed to the previous Telefónica/Telco deal were necessary.

CADE adjudicated the case on December 4, 2013, during the same session where it concluded that there was a breach of the TCD, and took the 2013 Telefónica/Telco transaction into account in its analysis. In August 2013, CADE asked Telefónica to explain the possible change in the minority stake Telefónica holds in Telecom Italia and, more recently in October 2013, it required details on all the corporate transactions involving the two companies.

In its vote, the Reporting-Commissioner Eduardo Pontual Ribeiro[23] presented 2013 data of the affected markets, primarily mobile services. He noted that the structure of the market for mobile services had not substantially changed since CADE analyzed it in 2010 in the context of the 2007 Telefónica/Telco review. Although there were variations in the shares held by the companies, the structure remained substantially the same, with four major operators of equivalent size.

The Reporting-Commissioner also presented concentration levels taking into account local area codes, following the market definition adopted by CADE while reviewing previous cases. Taking into account local area codes, Vivo and TIM Brasil would have a joint share of over 50% in forty-five out of sixty-seven markets. Also, according to the Reporting-Commissioner, from 2011 to date, prices for mobile services in Brazil have raised by 14%, while from 2006 to 2010 the increase was around 6%.

22. Full decision is available at http://www.cade.gov.br/temp/D_D000000764071270.pdf.
23. Full decision available at http://www.cade.gov.br/temp/D_D000000765321537.pdf.

Furthermore, in 2010 TIM Brasil acquired Intelig, a long distance operator and has significantly increased its share in this market since then. In fixed national long distance services, TIM is currently the biggest player. Nonetheless, competitive concerns are not as high as in the mobile markets, which is the reason why CADE did not make any meaningful considerations while reviewing the Telefónica/Portugal Telecom transaction.[24]

In his decision, the Reporting-Commissioner acknowledged that the higher the shareholding of Telefónica in Vivo, the lower its economic incentive to unilaterally reduce competition with TIM Brasil. At the same time, the fact that Portugal Telecom owned 50% of Brasilcel and that Telefónica did not solely control the company reduced its ability to engage in anticompetitive strategies. According to the public version of the decision:

> "the consolidation of control of Vivo by Telefônica, in a scenario where Telefónica holds a stake in TIM, clearly results in a tacit decrease of competition between the two providers of mobile services, reducing the launch of new products and services, quality and increasing prices". (…) "It is necessary to adopt remedies, as the presence of Telefónica in Telecom Italia, without the existence of an independent co-controlling entity in Vivo, increases the incentives for coordination among competitors, among other antitrust concerns in the market for mobile services, which is the main telecommunications market in Brazil. Therefore, I believe it is necessary to either divest the direct and indirect final interest that Telefónica now has in TIM Brasil or for Telefónica to seek an experienced sector partner[25] that will share control of Vivo with Telefónica, in conditions equivalent to the ones of Portugal Telecom. The deadline to comply with this decision is [Confidential]."

To sum up, CADE gave Telefónica three options: (i) sell down to 50% of Vivo, selling its stake to an experienced partner with no activities in the Brazilian market for mobile services and reduce its interest in Telco to the original level; (ii) exit Telco completely; or (iii) direct Telecom Italia to sell TIM Brasil. On December 13, 2013, Telefónica issued a statement saying that it considered that the remedies imposed by CADE were unreasonable and that it was analyzing the possibility of initiating appropriate legal actions.

4. LESSONS LEARNED

The following lessons can be taken from the Brazilian review of the Telefónica/Telco transaction.

24. Barriers to entry are lower in long distance services and the other companies that lost share have consolidated networks with available capacity. Please note that the rapidly increase of TIM's market share from 5.92% (2007) to 50.08% (2012) was possibly based on a business strategy difficult to be sustained in the mid/long-term. According to ANATEL, in 2011 the share of TIM based on turnover and not minutes was only 18.20%.
25. In the final disposition of his vote, the Reporting-Commissioner also stated that the new partner needs to have experience in the telecommunications sector, without, on the other hand, "*having participation in other company providing mobile services in Brazil*".

4.1. Lesson 1: Behavioral Remedies Are Resource-Intensive and Will Likely Be Viewed with Skepticism as a Remedy under Brazil's New Pre-merger Review System

Starting from 2012, Brazil shifted from a post-merger review system to a pre-merger one, i.e., transactions that meet the Brazilian merger filing thresholds cannot be consummated before CADE's clearance and the scrambled-eggs dilemma is no longer a concern for the agency.[26]

Under the old law, approximately ten transactions out of over 8,000 were fully blocked and many others were cleared mainly subject to behavioral remedies. Following the entering into force of the pre-merger review system, CADE has been adopting a much stricter approach and the number of transactions blocked or subject to substantial structural remedies (as opposed to behavioral remedies) has substantially increased. The experience in monitoring compliance of the commitments agreed for the 2007 Telefónica/Telco transaction seems to have played an important role in this new approach taken by the agency – CADE realized that it is highly-resource intensive to ensure compliance, which seems to be behind the rationale for the much more aggressive 2013 decision.

4.2. Lesson 2: The Regulatory and Antitrust Agencies Are Expected to Conduct Independent Reviews

While there are appropriate cooperation frameworks for ANATEL and CADE to exchange views and information in the context of a merger review in the telecommunications sector, CADE is expected to conduct an independent review and not necessarily adopt the approach suggested by the regulatory agency. This seems to point to a more mature stage in the interaction between such Brazilian agencies.

4.3. Lesson 3: Minority Shareholdings Raise Substantial Antitrust Concerns

Since 2010, following the review of the 2007 Telefônica/Telco case, CADE has been taking issue with the acquisition of minority shareholdings by competitors and interlocking directorates. Telefónica/Telco became a landmark case in Brazil, when CADE took a strict approach regarding minority shareholdings, deemed capable of reducing competition, either through incentives for collusion (explicit or tacit), or through unilateral effects resulting from passive minority equity interests or from access to commercially sensitive information.

Following that case, in August 2012 CADE blocked two transactions involving the acquisition of hospitals based on minority shareholding issues. In another important case involving minority shareholding, CADE adopted an unprecedented decision and issued an order prohibiting Brazilian steel maker CSN from continuing to acquire an

26. Penalties for "gun jumping" include fines ranging from BRL 60,000 to BRL 60,000,000 and the transaction may be also declared null and void by the authority.

equity stake in its major competitor Usiminas while the authority conducted a detailed assessment of the competition environment.[27] CADE's interim measure suspended all shareholder rights of CSN other than essentially its right to profit from dividends paid by Usiminas. In April 2014, CADE confirmed its decision, with CSN committing to reduce its stake in its competitor. In many other cases, CADE has imposed several restrictions for clearing the transaction, preventing the buyer from appointing members to the Board and prohibiting interlocking directorates.

4.4. Lesson 4: Enhanced Skepticism towards the Role of Economics in Minority Shareholdings Cases

There are two major – and conflicting – trends that currently contribute to defining CADE's stance in minority shareholdings cases. The first is the increasing availability of an apparatus that enables the competition authority to employ economic analysis and evidence. The use of economics in Brazil has grown in competition matters dramatically over the recent years and is expected to play a major part in every important merger case. The creation of an Economics Department within CADE by the new law is certainly a watershed event in that respect.

Nonetheless, recent decisions, such as the Telefónica/Portugal Telecom case discussed above, seem to point out a second trend that is at odds, apparently, with the ever-growing sophistication of competition analysis. That trend could be defined as an enhanced skepticism towards the role of economics in minority shareholding cases (e.g., CADE's 2013 decision did not adopt any economic test to determine what would be the maximum passive financial interest Telefónica could have in TIM, through Telecom Italia). The reason the latter trend is counter-intuitive in light of the larger role currently played by economics in antitrust analysis is obvious – standard economic analysis would recommend caution against 'over-enforcement'. Still, it seems that CADE has not been and will continue not to be shy about intervening.

It will be very interesting to follow future developments and see the interplay of these two undercurrents: it can be hoped that in the end they will balance out and we will have a CADE that is more proactive, but still selective in its interventions.

27. Merger Case No. 08012009198/2011-21, CSN/Usiminas, adjudication date (interim measure): Apr. 11, 2012. Adjudication date of the final decision: Apr. 9, 2014.