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Merger Control

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Colombia

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Overview of merger control activity during the last 12 months

Merger control activity increased in 2014 by 5% compared to 2013. The latter is in accord with the trends evidenced in the years following the issuance of Law 1340 of 2009, which significantly increased merger control activity in Colombia. The progression of Colombia merger review cases could be caused by three factors:

a) Law 1340, issued in 2009, obliges firms in all sectors of the economy to notify or inform all horizontal or vertical mergers that meet the economic thresholds defined by the SIC.
b) Foreign investment has been increasing steadily in the country in the past few years.
c) The SIC has improved the efficiency of the entity and is applying important fines in cases of *gun jumping.*

In total, last year 152 transactions were subjected to merger control before the SIC. Seven of these were conditioned or subjected to both behavioural and structural remedies. The conditioned transactions involved energy, telecommunications and agricultural markets, all deemed as strategic sectors for the Colombian economy.

Domestic transaction figures contrast with general M&A activity in Latin America, which definitely declined in 2014 compared to 2013. In 2014, foreign investment in Colombia increased by 10%, in contrast to the overall figures for Latin America, which showed a decline of more than 23% in transactions involving inbound investment.[1] This decline is basically attributable to a chilling of foreign investment towards oil & gas and mining projects due to a weakening demand for commodities by BRICs countries.

New developments in jurisdictional assessment or procedure

The most important recent milestone in merger review was the issuance of Law 1340 of 2009. This law created the "*National Competition Authority*" which was vested in the Superintendence of Industry and Commerce ("SIC").

As the National Competition Authority in Colombia, the SIC is also the main authority for merger control. Law 1340 grants the SIC the sole power to apply competition laws in all areas including specialised sectors such as Public Utilities, Banks and Insurance, Transportation and Ports, etc., with two exemptions – transactions involving exclusively financial entities and civil aeronautics deals.

As stated before, Law 1340 created higher penalties for *gun jumping*, with fines going up to US$ 30m, or 150% of the profits obtained from such behaviour, with the power to order the reversion of the transaction (legally and economically). The statute of limitations was increased from three to five years.

The law also modified the merger review procedure in order to give it more transparency and implemented a two-stage review that allows for fast-track authorisation (30 days) in less difficult cases, and a longer review period (three months in addition to the first stage) in more complex cases. If the SIC fails to decide within the review period, the merger is deemed automatically authorised (Administrative Positive Silence). The highlights of the merger review procedure are as follows:

- Article 4 of Law 155 of 1959 (amended by article 9 of Law 1340 of 2009) states that the companies that are engaged in the same economic activity or participate in the same value chain (vertically considered market), must inform the SIC on the operations which they propose to carry out for the purposes of merging, consolidating, acquiring control, or integrating – regardless of the legal form of the proposed transaction – provided they meet one of the following conditions: **(i)** that the companies, together or individually, had an operational turnover during the previous fiscal year to the proposed transaction, that exceeds the amount that has been established by the SIC;[2] or **(ii)** that the companies, together or individually, at the end of the fiscal year preceding the proposed transaction, had total assets in Colombia in excess of the amount established by the SIC.[3]
- In case any of the above conditions are met (hereinafter, economic thresholds), and provided that the 20% market participation threshold is also met, pursuant to article 10 of Law 1340 of 2009, the parties will have the obligation to file a Long Form Information (waiting period) and will have to obtain the previous authorisation from the SIC. For that purpose the interested companies must submit to the authority a pre-evaluation request of the proposed transaction. The application must be accompanied by a succinct report[4] expressing the intention of the companies interested in carrying out the planned transaction, and its basic conditions.
- After filing the request, the SIC will initiate an administrative process to determine if there was an obligation to inform the proposed transaction and, if it so considered, whether there are substantial risks for the competition and therefore more information must be requested in regard to the parties, the transaction and the relevant markets.
- In summary, the steps and time limits of the Long Form Information procedure are the following:
    - **First stage: (i)** Submit a "pre-evaluation request". **(ii)** Three (3) working days after the initial submission (pre-evaluation request), the authority will request the publication of an ad in a newspaper informing the public of the transaction. **(iii)** The authority will have thirty (30) working days after the initial submission to decide whether the procedure must continue to the second stage or whether it should authorise the procedure.
    - **Second stage: (i)** The authority will communicate that the procedure continues and will request more information. **(ii)** Once the parties have filed all the information, the authority will have three (3) months to decide whether to authorise or object to the transaction. **(iii)** In the second stage the parties discuss and negotiate the conditions or remedies to the transaction if they are necessary.
- If the economic threshold is met, but the market participation threshold is not met, then the parties will have the obligation to file a Short Form Notification (no waiting period). In effect, pursuant to article 4 of Law 155 of 1959, the transaction "is considered authorised" in the event the interested economic agents jointly have a share on the relevant market below 20%. In this case, article 9 of Law 1340 of 2009 provides that interested firms have a duty of notifying the SIC about the proposed operation, but

do not need to wait for its previous authorisation in order to carry out the transaction.

- In the case of international transactions, Colombia applies the effects theory, which means that SIC will review transactions entered into abroad when they produce an effect in the Colombian market(s). Foreign mergers are subject to the same legislation as local or domestic mergers. According to the SIC's doctrine, foreign mergers require clearance in Colombia when both parties to the merger sell their products in the Colombian territory, directly or through another company.

Currently there have been two major changes to merger control. First was the issuance of Resolution 10930 of 2015 and, on the other hand, the Government will soon present a bill to amend competition laws in Colombia before Congress.

Regarding the first set of changes, Resolution 10930 of 2015 first addresses the assets and income that should be considered to calculate the economic threshold defined in article 10 of Law 1340, 2009. Under prior regulations worldwide assets and income were taken into account to perform such calculation. The new Resolution introduced a territorial limitation to such calculation, limiting it to those located in Colombia. The second change introduced refers to information requested in phase I of the review. Prior regulations required that the parties disclose all the economic activities of all the entities in which they had a significant investment. The new regulations only require information to be provided on those who are competing in the same market or who belong to the same value chain.

The resolution provides clear guidelines for additional information requested and produced by the parties, and its impact on the time frame that the SIC has to decide the case. It also introduces some changes to the notification procedure previously described. If within the next ten (10) working days after the notification is filed before the SIC, the authority finds that the market share calculations are erroneous, it can order the parties to present the Long Form Information of the transaction with a waiting period, subject to the two phases above described. Lastly, the Resolution regulates the possibility that international mergers close abroad before the SIC has authorised the transaction, in which case the interested parties can enter into a "carve out" or hold-separate provision designed to put on hold the economic effects of the transaction in Colombia, while being able to close it abroad.

The prospective changes contained in the bill proposal are described in the final section of this document.

Key economic appraisal techniques applied e.g. as regards unilateral effects and co-ordinated effects, and the assessment of vertical and conglomerate mergers

Pursuant to article 11 of Law 1340, 2009, the SIC must prohibit or object to mergers that tend to produce an undue restriction to competition. Since every merger restricts competition in some way, the challenge is to find out which mergers will tend to produce an undue restriction to competition.

According to article 5 of Decree 1302, 1964, it is presumed that a merger will produce an undue restriction to competition in the following cases: **(i)** when the transaction is preceded by anticompetitive practices between the merging parties; and **(ii)** when the transaction will give the merged entity the power to impose "Unfair prices".

Apart from that, it should be considered that according to article 12 of Law 1340, 2009, the SIC can decide that it will not object or prohibit a transaction when the interested companies can demonstrate to the authority (based on economic studies) that the beneficial effects of the transaction for consumers exceed the possible negative impact on competition, and that such benefits cannot be achieved by other means. In this case the interested companies

must compromise to assign the beneficial effects produced by the transaction to consumers.

The SIC can also abstain from objecting or prohibiting a transaction when, independently of the market participation of the resulting company in Colombia, the conditions of the global market guarantee that there will be competition in the Colombian territory.

It is also important to mention that the SIC has accepted and applied, in at least two cases, the so-called "failing industry defence". In those cases SIC has authorised the mergers as a mechanism to save companies that were going bankrupt.

There is no explanation in the law of the reasoning or analysis that the SIC will use in merger cases, and the guidelines are somewhat vague to that effect. However, it is possible to identify some general points in the analysis:

- The SIC defines the general market based on the product market and the geographic market. The product market will be defined narrowly using the hypothetical monopolist test, in order to isolate the group of products (goods or services) that behave as perfect or imperfect substitutes of the product affected by the merger.
- The SIC will consider and evaluate the competitive pressure that arises from perfect and imperfect substitutes, as well as from potential competition coming from national or international players.
- The SIC will calculate the participation of the merging companies in the relevant market and apply concentration indexes like HHI and CR4 in order to evaluate the effect of the merger.
- The SIC will then evaluate the different kinds of barriers for entering the market including import tariffs and duties, transportation costs, excess capacity, cost of building a plant in the country, etc., in an effort to evaluate the contestability of the market or the likelihood of entry of new competitors.
- If the parties have proposed conditions to the transaction, the SIC will evaluate them and discuss them with the merging parties. In some cases SIC will modify substantially the conditions offered by the parties and in general, will prefer structural to behavioural remedies. Most likely, SIC will require prior divestment of part of the business.
- In summary it is not very clear what particular set of circumstances will trigger an objection or a conditioned approval; but most likely it will be a negative mixture of the above elements.
- This means that a merger that increases concentration in the relevant market to a high degree, with no perfect or even imperfect substitutes of the product, no potential competition in sight, high barriers to entry, scarce contestability and no possible structural remedies will probably be prohibited.
- Having said that, it is important to note that in its whole history, SIC has prohibited less than 1% of the informed mergers.
- As said before, for some years now SIC has been applying reasoning and analysis similar to those developed both in the European Union and the United States. There is much debate as to the use of economic tools, such as the concentration indexes, which were prepared for developed economies, without adjustment to the size and specific characteristics of the Colombian economy. It has to be considered that most markets in a developing economy are small and already concentrated, but that does not mean that there is no competition or that it will become impossible for new competitors to enter the market.
- The analysis towards unilateral effects was revisited by the SIC in relation to the aforementioned energy industry transactions. To properly assess the effects of them in

the marketplace (which is an open bidding market similar to a stock exchange), the SIC analysed the competitive effects of minority equity interest on O'Brien and Salop's paper (IHHM). The application of this formula led the SIC to propose as a remedy (not initially disclosed in the decision but later through public presentations) the divestment of EBB shareholding interest in some entities to avoid price manipulation via controlling both offer and demand sections of the market.

Key industry sectors reviewed and approach adopted to market definition, barriers to entry, nature of international competition, etc.

In 2014 the SIC focused on energy, telecommunications and the retail industry.

Three major transactions were filed in the energy industry, all related to the bid to acquire the shareholding interest of the Colombian Government in ISAGEN. ISAGEN basically participates in energy generation and commercialisation markets in Colombia.

The first one was Argos-ISAGEN. For both geographical and product market definition, the SIC primarily followed the definitions of the Energy Regulation Commission (CREG), which is the regulatory commission for such industry in Colombia. In this case, the SIC found both horizontal and vertical overlaps that posed a substantial lessening of the competition, and required remedies for its approval.

The SIC also included another value chain as part of the energy value chain: natural gas extraction. Given the fact that many power generation facilities can use thermal sources to produce energy, gas is a natural input for generating electricity. Therefore the economic analysis extended upstream to natural gas exploration, and downstream to energy retail markets.

The SIC found that if Argos acquired the shares of ISAGEN, it would surpass the market share limitation imposed by the CREG of 1,800 HHI points (the transaction led to a market power of 2,107 HHI points in the energy generation and commercialisation markets). Likewise, the transaction would violate the market share limits by output capacity (limit is 3,402 MW and the transaction would give the resulting entity an output capacity of 3,456 MW).

The remedies proposed by the SIC are confidential.

The second noteworthy transaction was between EEB and ISAGEN. In this opportunity the SIC found significant overlap in the energy generation and commercialisation markets. For this transaction market shares were lower and did not surpass the regulatory thresholds. On the vertical analysis of the transaction there were gas transportation concerns. The SIC once again stated that the energy value chain was intrinsically integrated with the gas value chain. Therefore the regulatory vertical prohibitions of gas regulations applied to all entities, even in the energy value chain. Accordingly, remedies were proposed in order to authorise the transaction, which were not disclosed to the public but probably involved divestitures in order to comply with vertical regulatory restrictions.

Finally, the third attempted transaction in energy markets was between EPM and ISAGEN. The merger review focused on energy markets and specifically on the energy generation market, in which EPM had a market share of aproximately 23% nationwide. The transaction led to a violation of the regulatory threseholds established by the CREG and resulted in a substantial lessening of competition. First, it would allow the resulting entity to determine higher prices in the energy market, and it would also have access to information that could lead to coordination of strategies with competitors. Therefore the SIC also subjected clearance to structural and behavioural remedies, which remain undisclosed.

In the telecommunications industry the SIC analysed the TIGO-UNE merger, which is the biggest M&A conducted in Colombian telecommunications history. TIGO is a mobile carrier with a market share of approximatly 12%, following Spanish-owned Telefonica and the Mexican America Movil Colombian Subsidiary. UNE, on the other hand, has a stronghold position in North Western Colombia (Antioquia) both in fixed lines and broadband internet access. UNE had revealed its intention to enter the mobile markets by participating in the Spectrum Bid conducted in 2012 by the Ministry of ICT. Back then, UNE was awarded 50MHz to develop its business, specifically targeting mobile data more than traditional voice services. The SIC concluded that horizontal and vertical overlaps represented important synergies to contest the market power of America Movil in Colombia and authorised the transaction, setting as a remedy to comply with Spectrum Thresholds (the resulting entity would have a licence to use 135MHz, and regulatory threshold sets the bar at 85MHz). The spectrum would have to be reverted to the Ministry of ICT within the next 28 months following the approval.

The other noteworthy transactions were the joint venture between Compañía de Cervecerías Unidas (CCU) and Postobon to build a new factory to compete with market leader SABMiller. Similarly, Grupo Nutresa acquired a shareholding interest in El Corral fast food chain. El Corral is a leading player in the fast food Colombian market, which recently began its international expansion.

It is important to note that PEPSICO filed for authorisation of its merger with Postobon, related to the production and distribution of Gatorade and Nestea. The Gatorade transaction had been previously blocked by the SIC in 2004 and the decision in this round is still pending.

Approach to remedies (i) to avoid second stage investigation and (ii) following second stage investigation

It is important for the merging companies to identify early in the review process if the transaction should be subject to conditions or remedies in order to offer them, at least in a general way, so that the authority is aware of the intention or willingness of the parties to discuss them. In those cases, when the SIC finds that the proposed transaction may pose undue restrictions to competition, but believes there are options to correct such distortion, it will authorise the merger provided certain conditions or remedies are undertaken.

Such conditions or remedies have ranged from elimination of exclusivity for distributors to the obligation of producing for a competitor at variable cost, allowing a competitor to use a percentage of installed capacity, and even the obligation to divest part of the business. The SIC has proved to prefer structural remedies, such as divestments, to conduct behavioural remedies.

The SIC customarily requires that the parties comply with structural remedies within a certain time limit (generally, less than one year). Compliance with behavioural remedies is also required for a limited period of time (generally, no more than three years). Pursuant to article 11 of law 1340, 2009, the SIC must review periodically if the parties have complied with the conditions and obligations imposed. Traditionally the SIC has required that an external auditor verifies full compliance with the remedies, and presents reports to the authority from time to time. Finally, the SIC requests that the merging parties put in place a bank or insurance bond to guarantee full compliance with the remedies.

The SIC has not made distinctions in regard to the imposition of remedies in foreign-to-foreign mergers. Even though SIC has not given its opinion on this particular matter, it

could be considered that the merger control authority may permit reasonable ancillary restrictions.

Key policy developments

Key policy developments include the recent issuance of Resolution 10930 of 2015 and the amendment to Competition Law. The first policy development intends to simplify the merger review procedure by reducing the amount of information requested to the entities participating in the transaction. Also, it includes new procedural regulations that create clear rules for information request and filing in regard with timeframes.

The second key policy development is the proposed amendment. The proposed reforms will consolidate the National Competition Authority and broaden the scope of merger review specifically to include conglomerate transactions. If this new regulation is enacted, it could easily flood the authority with merger review requests and slow down the pipeline of decisions. Yet this amendment would probably come into effect, at the earliest in 2016.

Reform proposals

The bill to amend Competition Law in Colombia plans to introduce the following changes: **(i)** it will give the National Competition Authority the power to review the mergers exempted from its scrutiny in Law 1340 (financial and civil aeronautics); **(ii)** the scope of merger review will widen, as the limitation stating that only companies in the same markets or value chain will be erased, thereby allowing for the study of conglomerate mergers; **(iii)** in the same direction of Resolution 10930 of 2015, the bill proposes that the assets and income for calculations of the economic threseholds should only take into account the true impact on domestic markets; and **(iv)** the SIC will charge a tariff for conducting the merger review. In the draft law project the fee has been set at 0.1% of the assets of the entities involved.

* * *

Endnotes

1. http://www.portafolio.co/internacional/inversion-extranjera-colombia-y-latina-2014.
2. Currently one hundred thousand (100,000) legal monthly minimum wages, pursuant to Resolution No. 75837 of 2011 of the SIC. Approximately US$ 27m.
3. Currently one hundred thousand (100,000) legal monthly minimum wages, pursuant to Resolution No.75837 of 2011 of the SIC. Approximately US$ 27m.
4. The authority has not issued new Merger Guidelines regarding the information that should be submitted in the “pre-evaluation request”. According to the new law, it should be a succinct information report over the transaction. However, the most recent application of the new law by the authority, specifically regarding the “pre-evaluation request”, shows that the authority is actually expecting a full submission according to the previous Merger Guidelines.

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