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Out-of-Market Efficiencies in Competition Enforcement – Note by Argentina

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More documents related to this discussion can be found at https://www.oecd.org/daf/competition/out-of-market-efficiencies-in-competition-enforcement.htm.

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1. In Argentina, debating the existence and entity of potential out-of- market (OOM) efficiencies necessarily implies thinking on the concept of General Economic Interest (GEI) – the interest protected by Act 27.442 on the Defence of Competition (LDC, for its acronym in Spanish) - and on the objectives of competition policy. Last June, the National Commission for the Defence of Competition (CNDC, for its acronym in Spanish) participated in a roundtable of the Competition Committee which discussed the advantages and disadvantages of different welfare standards which are closely linked to both GEI and OOM efficiencies.

2. The task of the CNDC – as the enforcement authority of the LDC in Argentina – is to protect and promote competition under the premise that a higher economic welfare can be achieved through more and better competition in the markets. Safeguarding the GEI is the main goal of competition policy, and it is also the welfare standard that guides the LDC. It is the underlying principle that allows to determine if a particular result satisfies or not, complies or fails to comply with the law's objectives so as to therefore assess the outcome of competition policy.

3. In this sense, and in light of the debate on OOM efficiencies, the question to be posed is whether it is the mere restriction of competition that makes a practice anti-competitive, or whether it is the damage to the GEI that a practice, agreement or merger produces −through the restriction of competition− that determines it as such.

4. OOM efficiencies comprise those benefits that may derive from an anti-competitive conduct, or from a merger capable of hindering competition in a market. These benefits are not captured in a more "traditional" impact assessment of an act with anti-competitive effects, but could, in theory, offset such effects in the affected market, or benefit a market other than the one in which the harm occurs. Here the delineation of the GEI plays a preponderant role as it allows, firstly, to establish whether OOM efficiencies occur and, secondly, to assess whether they succeed in neutralising or counteracting a hypothetical harm to the competitive environment.

5. In order to analyse to what extent the assessment of OOM efficiencies is admissible within the Argentine regulatory framework, and the recent precedents of conduct and mergers analysis that incorporated their evaluation, this note is structured as follows. The first part analyses certain provisions of the LDC, particularly the sections referring to agreements among competitors and their effects on competition, and the exemptions that could be issued by the competition authority, even in the face of evidence of anticompetitive effects. The second part examines the new "*Regulation for Mergers Notification*", issued in 2023, and the reinterpretation of the old section on "efficiency gains" in transactions with potential anti-competitive effects. That section is now called "Benefits of the transaction on the general economic interest" and it incorporates the analysis of certain OOM efficiencies. The third section describes the "Avon/Natura" merger, objected by the authority in 2022, in the context of whose analysis the companies raised the existence of efficiency gains and benefits to the GEI that would mitigate the potential adverse effects of the transaction. As a conclusion, the fourth section reflects on the rapprochement between competition policy and the rest of the regulatory body that makes up the economic policies of a jurisdiction, which is implicit in the OOM efficiencies' assessment within the antitrust analysis.

1. Regulatory Framework: Horizontal Agreements and Special Permits

6. Section 1 of the LDC provides that agreements among competitors are prohibited if they "have as their object or effect to limit, restrict, or distort competition or access to the market" and if, at the same time, they may result in "harm to the general economic interest".

7. Section 2 of the LCD lists four types of agreements among competitors which are "presumed to be detrimental to the general economic interest". These cases are considered as "practices which are absolutely restrictive of competition" and are qualified as agreements which are null and void and, therefore, have no legal effect whatsoever.

8. The four cases listed in Section 2 of the LCD are what the specialised literature classifies as hard-core cartels, i.e., those horizontal agreements that involve: (a) fixing prices; (b) restricting output; (c) dividing or sharing markets; and (d) submitting collusive tenders.

9. These conducts may be the object of the agreement in question, or they may arise as an effect of that agreement. This distinction between object and effect makes it possible to distinguish among different types of cases that may fall within the scope of Section 2 of the LDC. It follows from the text of the regulation itself that, if the object of a horizontal agreement is to agree on prices, quantities or bids in tenders, or auctions, or to share or divide markets, customers or sources of supply, then it will automatically be considered as an agreement which is absolutely restrictive of competition and which causes harm to the GEI. A horizontal agreement whose object is lawful, which includes any clause or restriction or whose application generates as an effect any of the hypotheses of section 2 of the LDC, could also be considered as a case in which the GEI is being affected.

10. Section 29 of the LDC establishes that the enforcement authority is empowered to issue permits for agreements among competitors that contemplate the commission of any of the anti-competitive practices included in Section 2 of the regulation, provided that the authority finds that such agreement does not imply a detriment to the GEI.

11. Following the distinction between object and effect of a horizontal agreement and the provisions of Section 29 of the LDC, there could be agreements among competitors in which, even though their purpose is not to restrict competition, the application of any of their clauses or restrictions might lead to the execution of an anti-competitive conduct that verifies any of the hypotheses of Section 2 of the Act.

12. In this regard, it is worth considering the regulation of section 29, carried out through Decree 480/2018, which establishes the prerequisites that agreements among competitors must meet in order not to generate a detriment to the GEI, which can only be satisfied if the agreement in question has a purpose that is not anti-competitive. According to the decree, the agreement to be subject to the special exemption must meet the following cumulative objective conditions:

- Contributing to improving the production or distribution of goods and/or services;
- Promoting technical or economic progress;
- Generating concrete benefits for consumers;
- Not imposing restrictions on the undertakings concerned which are not indispensable to the attainment of the objectives set out in subparagraphs (a), (b) and (c); and
- Not giving such undertakings the possibility of eliminating competition in respect of a substantial part of the market likely to be affected.

13. It is up to the undertakings that take part of such hypothetical agreement to prove that it meets the conditions listed above. The mentioned provisions are interpreted restrictively, since, in order to obtain such a permit, it must be proven that the agreement in question meets all the stipulated requirements.

14. At the same time, the text of the regulation allows for the consideration of economic effects, which do not necessarily have to be limited the competition conditions in the market in which the agreement takes place and can therefore be considered as OOM efficiencies. For example, and in line with the urgency of putting the sustainability dimension of the production and commercialisation of goods and services on the agenda of state bodies, it could be considered that the production, distribution and sale of more sustainable products regulated through an agreement among competitors could be a factor that offsets the potential anti-competitive effects of such an agreement. However, there has not yet been any precedent of such alleged OOM efficiencies in Argentina.

15. The CNDC is working on guidelines for the analysis of agreements among competitors in order to clarify and provide predictability on the interpretation of the two sections of the LDC mentioned above - specifically, the interplay between Sections 2 and 29 – in order to contribute to a better understanding of how OOM efficiencies could be considered in the framework of an antitrust approach to horizontal agreements.

2. The New Regulation for Mergers Notification and the Benefits to the GEI

16. On 6th July 2023, Resolution 905 of the Secretariat of Commerce of the Ministry of Economy came into force, and it approved the new "*Regulation for Mergers Notification* ", repealing Resolution 40 of 2001 of the former Secretariat for the Defence of Competition and Consumer Affairs, which had established the "*Guidelines for Mergers Notification* " and two standard forms for the notification of operations, called form F1 and form F2.

17. In line with the LDC, which was last updated in 2018, the new regulation establishes that the analysis of an economic concentration can be carried out exclusively through two types of procedures: the Summary Procedure (PROSUM) and the Ordinary Procedure.

18. In a merger analysed under PROSUM, notifying undertakings are required to provide only the information and documentation required by Form F0. Given that the forms operate cumulatively, when dealing under the Ordinary Procedure, undertakings are required to submit the information required in both F0 and F1. Eventually, the analysis of the transaction under the Ordinary Procedure may require the submission of form F2.

19. The F2, in this sense, is an exceptional form, which is requested when the CNDC considers that the merger is highly likely to lead to the acquisition or strengthening of market power of the merging firms. The information requirements here focus on confirming that hypothesis, as well as probing any circumstances that may mitigate the preliminary conclusion on competition risks (e.g., the existence of benefits to the GEI).

20. The F2 provided for by the previous regulation −in force between 2001 and 2023− had a section dedicated to efficiency gains. In that regard, companies that had notified a merger which was considered by the CNDC as potentially problematic could report those gains that arose as a result of the transaction and were capable of being passed on to consumers in Argentina. In this sense, efficiency gains could have a positive or neutral impact on the authority's assessment of the transaction. The CNDC had to assess the extent to which these gains could mitigate the negative effect of the transaction on competition and the harm to the GEI.

21. Only those gains that arose directly from the merger and could not be achieved without it would be considered as efficiency gains. However, those cost reductions that did not represent real savings of resources and, instead, derived from the increased bargaining power of the merged firm as a consequence of the transaction, could not be invoked as efficiency gains derived from the merger.

22. The efficiency gains to be considered were those arising from merger transactions which made it possible to maintain the quantity, quality and variety of the products offered by using fewer resources, or to increase the quantity, quality or variety of the products offered by using the same resources, or to reduce financial costs and/or increase the possibilities of access to the capital market. In addition to proving the existence of these efficiency gains, the parties involved in the transaction also had to account for how the savings resulting from the efficiencies achieved through the merger in terms of price, quality and quantity would be passed on to consumers in Argentina.

23. The F2 proposed by the new regulation incorporates a reinterpretation of the old efficiency gains section, now called "*Benefits of the operation on the general economic interest*". The new section requires notifying companies to indicate the efficiency gains arising from the merger and how they will be passed on to consumers, in the same terms established in the F2 approved in the old regulation. However, this new regulation adds the possibility of identifying the benefits that the transaction could have on aggregate variables such as employment generation, income, import substitution, level of investment, environmental care and gender policies, among others. It also requires the identification of parameters, measurements and/or ratios that make it possible to determine the fulfilment of such benefits and their sustainability over time.

24. In this regard, the new regulation provides, in the case of mergers that could raise competition concerns and could therefore be objected to by the CNDC, a formal instance in which the parties involved in the transaction can inform the authority of certain economic benefits resulting from the transaction that constitute OOM efficiencies, since these are not positive effects directly linked to competition, nor exclusively related to the market affected by the transaction.

3. The Natura/Avon Merger Transaction

25. While the new " *Regulation for Mergers Notification* " came into force in July 2023, in the Avon/Natura merger −objected by the CNDC in August 2022− the parties raised the existence of OOM efficiencies arising from the transaction.

26. In the Objection Report[1] issued by the CNDC, the acquisition of the US cosmetics company Avon by the Brazilian firm Natura −dedicated to the commercialisation of beauty and personal care products− was analysed. Both companies channel most of their marketing by direct sales or catalogue sales through resellers.

27. Based on the analysis carried out by the authority, it was concluded that the transaction gave rise to horizontal effects in several segments of the beauty and personal care products market. Particularly, it generated competitive risks in the colour cosmetics

[1] Objection Reports were introduced by the LDC enacted in 2018. It is an instrument inspired by the "Statement of Objections" of the European Community competition law. It is a document in which the Argentine competition authority carries out a preliminary assessment of the impact of a merger, and in which it sets out the specific concerns that could arise from such a transaction in terms of its effects on the structure of a given market.

market, where the companies would then have a share of 40%, and the mass fragrances market, where the combined share would amount to 53.7%.

28. Although concentration levels were found to be high in these specific segments within both companies' product portfolios, Natura and Avon argued to the CNDC that there were certain efficiency gains and other benefits to the GEI that the transaction would generate, which could mitigate the potential adverse effects of the transaction.

29. Indeed, the companies involved informed the CNDC that, as a result of the operation, the production of certain sections −previously imported or manufactured in local third parties− would be internalised in Avon's local plant, in the province of Buenos Aires. This would imply investments in Argentina to increase the local production which would reduce imports, the demand for foreign currency, and transport costs, and would generate direct and indirect employment in the country. In addition, the notifying parties said they were planning investments in raw material developments, which would also contribute to reducing imports and generating benefits for local employment.

30. Specifically, Natura has indicated that the relocation of the companies' fragrance production to a local plant would imply an increase of 24,4% in the plant's production capacity. This additional capacity would be used to replace imports from other countries by 14% and to internalise the production of local tollers by 86%.

31. Regarding employment, with the expansion of capacity, companies reported having hired 74 people on a permanent basis and 150 people on average on a casual basis, with plans to further expand hiring in Argentina.

32. In summary, the companies indicated that the operation would generate certain OOM efficiencies, which include employment generation, increased revenues, import substitution and increased level of investment.

33. However, at the time of the issuance of the Objection Report, the CNDC did not have data that would allow it to measure new jobs in relation to previously hired staff. When asked about the investment found and its relation to previous plans, the notifying parties stated that 40,4% of the total projected investment had been made by August 2021 and, with regard to import substitution and foreign exchange savings, they indicated that 14% of the expanded capacity intended to substitute imports had not yet generated such savings, as they were at the stage of testing and pilot batches for the approval of the manufactures at the Buenos Aires plant.

34. In this sense, in the context in which the Objection Report was issued, the impact of the operation on all these variables −local investment, increase in installed capacity, import substitution, development of local suppliers, foreign currency savings and increase in employment− remained as potential and/or in evaluation status for most part of the projections. The uncertainty regarding the plans presented did not allow the CNDC to affirm that the merger would involve an effective benefit for the GEI in the terms set out in the new merger notification regulations. In this instance, the CNDC called on the companies to attest the such effects and those to be verified in the proposed variables, to identify how they actually affect the GEI and to prove their current and/or future compliance so that these effects could be considered by this authority.

35. At present, the CNDC is still evaluating whether these efficiency gains and benefits on the GEI outweigh the potential anti-competitive effects of the Natura/Avon merger.

4. Final Remarks

36. The assessment of OOM efficiencies as part of the analysis of the economic effects of a suspected anti-competitive conduct or a merger with an anti-competitive impact on certain markets implies a closer interrelation of competition policy with the body of economic policies that a jurisdiction may pursue to improve general social welfare.

37. Competition law and its enforcement cannot be carried out in isolation. It is desirable for it to be in harmony with other legal regulations in force in a given jurisdiction, so as to maintain coherence with the economic goals set forth by these regulations and the public authorities in charge of their enforcement.

38. The variables that make up social welfare may mutate over time, and if welfare is the objective of competition policy, it must be receptive to these modifications. A clear example of this is the importance that the dimension of sustainability has acquired in any law aiming at regulating production and marketing of goods and services, a phenomenon from which competition policy is not exempt. In this sense, the Argentine regulatory framework and jurisprudence have been updated in recent years to provide a broader approach to the effects of those acts that harm competition, incorporating OOM efficiencies into the assessment matrix, with the ultimate goal of preserving the GEI.