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2017 Highlights

Joint advocacy work by
the Secretariat of Fiscal Affairs, Energy and Lotteries
the Secretariat for Productivity and Competition Advocacy

Brasília
March - 2018

Seae Secretaria de Acompanhamento Econômico

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SEAE: its evolving role and structure

Brazil's 2011 (new) Competition Law has assigned the Ministry of Finance's Secretariat of Economic Affairs -- SEAE -- the role of national advocacy body *par excellence*. In February 2018, 15 years after its inception, SEAE was divided into two units: the Secretariat of Fiscal Affairs, Energy and Lotteries (SEFEL) and the Secretariat for Productivity and Competition Advocacy (SEPRAC). Competition advocacy initiatives in general, except for energy and lottery, have been allocated inside the latter, while advocacy in lottery and energy have been assigned to the former.

SEAE was created in 1995 to render opinions in investigations of anticompetitive practices and in merger reviews that would eventually be screened by Brazil´s Council for Economic Defense[1]. However, as early as 2004, SEAE was restructured and segmented into sectorial units: Each unit would carry expertise in one, or more regulated sectors of the economy, helping achieve better competition law enforcement. But beyond the Competition Law, the new structure was instrumental to let SEAE bring under its umbrella two new mandates: doing systematic competition advocacy in sectorial regulations and actively instigating sector regulators to do regulatory impact assessment.

Since 2006 has also been playing an important role in promoting further research and early involvement in competition law and economics by means of SEAE's Annual Essay Prize on Regulation and Competition. At the same time, SEAE has offered undergraduate and graduate students the chance to be part of a one-month internship in its units. The program has offered the chance to work with competition and complex regulatory issues in foreign trade and in sectors such as telecommunications, healthcare, financial services, energetic resources, transport and environment.

SEAE has been instrumental to the development of investments in infrastructure and an active member in regulatory fora dedicated to public policies in regulated sectors like telecommunications, energy, healthcare, financial services, transportation. SEAE is also the national lottery regulatory body.

Since 2011 – after the enactment of the new competition law – SEAE has been officially assigned a lead role in competition advocacy in Brazil, both in the public and in the private sectors, while increasing its role as an advocate for innovation and productivity alike. At the same time, SEAE lost its participation in the definition of merger reviews and law enforcement in anticompetitive behaviors. Even though SEAE was an active player in the formulation of the framework of the new competition system, the enactment of the new law created a vacuum of participation in the enforcement of the antitrust law that needed a period of accommodation.

At the very beginning SEAE persisted as an important advocate for competition inside the government, but still neglected the relevance of massive advocacy before market players, society, and in lawsuits. But since 2017 SEAE has embraced new roles like filing *amicus curiae* briefs before administrative and judicial courts, and has started elaborating (i) guidelines to help judges calculate cartel damages and (ii) rules of thumb to help consumers file lawsuits against cartel damages. SEAE has also learned to work in partnerships with private and public stakeholders to reach more efficient outcomes.

At the same, after understanding that advocacy before society needs a higher degree of transparency and accountability than other traditional roles historically performed by the Secretariat, SEAE has also started a *rapprochement* with national and international organizations and resumed its participation in international fora. As part of this effort, in 2017 Brazil's Secretariat of Economic Affairs (SEAE) for the first time submitted to the ICN-WBG Competition Advocacy Contest a number of cases that – as recognized by national stakeholders both in the public and in private sectors -- showed how relevant its competition advocacy activity has been all over the years.

On March 1st SEAE was notified that the story behind the privatization of the national lottery was selected as Winner under *Theme 2: Creating Markets for private sector development*. Moreover, the WBG

[1] Costa, Adriano and Ramos, Marcelo and Taufick, Roberto, A New Horizon for Competition Advocacy in Brazil (November 11, 2014). In: Denis Alves Guimaraes, Fabrizio Cugia di Sant'Orsola, Rehman Noormohamed. (Org.). Communications and Competition Law. Key Issues in the Telecoms, Media and Technology Sectors. 1ed.: Kluwer Law, 2014, v. 1, p. 357-372.

congratulated SEAE's increasingly proactive role reflected on the other stories submitted to the contest, from the advocacy to change administrative barriers at municipal level in Florianopólis to the promotion of competition in key sectors such as transport and natural gas.

What follows are summaries of the five cases that SEAE submitted to the ICN-WBG Competition Advocacy Contest that offer a small sample of the work that SEAE has done over the years, reaping fruits in 2017. For the full advocacy report in Portuguese, please visit:

http://seae.fazenda.gov.br/assuntos/advocacia-da-concorrencia/documentos/relatorio-promocao-da-concorrencia_ref2017.pdf

Theme 2: Creating markets for private sector development

STORY: OPENING BRAZIL'S LOTTERY MARKETS TO COMPETITION

Summary

Lottery services used to be statutory public monopolies in Brazil from 1962 to 2015. That year Congress enacted a new federal law that authorizes the privatization of 'instant games'.

Preliminary plans included a privatization process that would keep the relevant influence of CEF's sole shareholder, the federal government, over the new entrants and as such perpetuate a 'de facto' monopoly of the state-owned enterprise.

After the presidential impeachment in 2016 a new team started to rethink the privatization process. The Ministry of Finance, led by SEAE, coordinated the new privatization process, recommending the assignment of the service directly to a private firm.

SEAE has given special attention to creating a healthy and sustainable competitive environment. Even though only 'instant games' have been statutorily declared open to private competition, the degree of economic substitutability between lottery categories, or even inside a specific category, shows that by helping open the market for 'instant games' to private investors SEAE can eventually bring contestability to the entire lottery market. While Brazil is on the verge of auctioning LOTEX and open it to private investment, SEAE is also working to implement a modern and competitive regulatory framework, as the Brazilian lottery regulator.

STORY

Since 1941 Brazil's legal framework defines the exploitation of any kind of game involving a bet open to the public as "gambling". According to Article 50 of the Criminal Offenses Act (Decree Law 3,688 / 41), gambling is strictly prohibited throughout the national territory. The only exceptions allowed by Brazilian laws are lotteries controlled by the government.

According to the World Lottery Association, there are four categories of lottery in the world: 'draw-based games', 'sports games (pari-mutuel)', 'sports games (fixed odds)' and 'instant games'. The first two categories have been exploited in Brazil under a federal monopoly carried out by a state-owned enterprise. On the other hand, the last two categories are not available in Brazil now: While 'instant games' were suspended at the end of March 2015 under the former legal framework, 'sports games (fixed odds)' have never become operational.

Lottery has been exploited as a federal monopoly in Brazil for more than 55 years now. The federal monopoly is operated by *Caixa Econômica Federal (CEF)*, a bank 100% owned by Brazil's federal government that monopolizes the commercialization of 'draw-based games' and 'sports games (pari-mutuel)'. The CEF also used to monopolize the sales of 'instant tickets' until March 2015. The interruption of sales happened after an audit by the Office of the Comptroller General (*Ministério da Transparência e Controladoria-Geral da União - CGU*) in 2014 raised questions about the legality of the presidential decree that authorized their commercialization. According to the CGU, a law approved by Congress would be required instead.

In 2016 alone the federal lottery generated US$ 4.31 billion as gross revenue with US$ 2.05 billion applied in social duties (sports, education, culture, security, health and others)[2]. An overview of federal lottery´s sales is shown in the following chart (values in US$ million). As one can observe, the federal lottery used to generate a revenue between 0.21- 0.25% of the gross domestic product (GDP):

[2] All values are using Brazilian Central Bank average exchange rate in 2016 (US$ 1 = R$ 3,48).

Categories	2012	2013	2014	2015	2016	Share (2016)
Draw-based games (7 lottery products)	3,439	3,769	4,455	4,979	4,276	99.05%
Sports games - pari-mutuel (2 lottery products)	34	34	39	46	41	0.95%
Sports games – fixed odds	-	-	-	-	-	
Instant games (1 lottery product)	70	50	65	9	-	
Total	3,543	3,853	4,559	5,034	4,317	100%
% of GDP	0.21%	0.21%	0.24%	0.25%	0.21%	

Meanwhile, Congress enacted, on August 4, 2015, Law 13,155, addressing the concerns of the CGU and bringing back the possibility of the commercialization of 'instant lottery' in Brazil. The Law created the 'exclusive instant lottery' (*Loteria Instantânea Exclusiva* - LOTEX) with features aligned to the best global practices for 'instant lotteries' operations (specially the percentage of sales allocated for prizes – *known* as payout).

In the aftermath, preliminary plans conceived of a formal privatization using a subsidiary of CEF (CAIXA INSTANTANEA S.A.), which would operate new 'instant games' in Brazil. CAIXA INSTANTANEA S.A was created in January 2016 and the idea was to sell 51% of its equity to a private company with experience in 'instant lottery' operations. However, under this framework lottery would still be a 'de facto' monopoly due to the presence of CEF in LOTEX and the influence of the federal government over its strategic decisions.

However, after the impeachment of Brazil's former President in May 2016, a new team took office and designed a procompetitive regulatory framework with the help of the Secretariat of Economic Affairs (SEAE) of the Ministry of Finance. Besides its traditional competition advocacy role, SEAE has a unit dedicated to the regulation of lotteries in Brazil: SEAE is the federal public authority responsible for the authorization, supervision, enforcement and regulation of lottery activities in Brazil.

Having in mind the opening of Brazil's lottery markets, the new team, with SEAE's support, opened dialogue with the National Bank for Economic and Social Development (BNDES) in order to study the impact of a more competitive framework. The BNDES, which is the institution responsible for executing the privatization process of LOTEX, issued a study recommending that a public bid took place to assign the performance of the service to private firms on the grounds that LOTEX is not an essential public service.

In addition to a new legal framework paving the way to the assignment of LOTEX to the market as a concession – enacted by Congress as Law 13,155, -, the new team considered four elements in its decision:

(i) lottery should be provided at the risk and expense of the private concessionaire;

(ii) the absence of any subsidy from the federal government, either directly or through its state-owned companies;

(iii) the federal government would be the main beneficiary of the success of LOTEX and earn 16.7% of the instant lottery's revenue – earmarked for sports and social security spending items – and would collect taxes on the concessionaire's profits and income tax generated off LOTEX lottery winnings;

(iv) privatization of LOTEX should bring competition to lotteries as a whole

Special attention has been given by SEAE to item (iv). Because the statutory concentration of the lottery in the ultimate hands of the federal government has foreclosed the entry of competition and hampered

innovation for more than half-a-century, greater competition would certainly lead to the development and modernization of this sector in Brazil. Even though only 'instant games' had been statutorily declared open to private competition, the degree of economic substitutability[3] between lottery categories, or even inside a specific category, showed that, by opening the market for 'instant games' to private investors, Brazil would eventually bring contestability to the entire lottery markets.

In the second half of 2017, the Federal Council for the Program of Investment Partnerships (*Conselho do Programa de Parcerias de Investimento da Presidência da República* - CPPI) finally approved the concession of LOTEX. Under the new framework, concessions would last for fifteen years and, as defined by law, gross revenue from ticket sales would be split threefold: 65% for payout; 18.3% for the concessionaire; and 16.7% for the Federal Government – to apply in social duties.

The sale of LOTEX will take place by public auction. A public consultation was issued in September 2017, with the sale notice scheduled for April 2018. The auction is expected to be held in the first half of 2018, with the submission of sealed bids.

The winner of the auction will be determined by the highest bid, which must be paid in a single installment. The minimum bid for the right to operate LOTEX (for the next 15 years) will be approximately US$ 160 million.

The Finance Ministry expects the auction to attract major global instant lottery operators, which could result in a significant increase over the minimum bid in the auction and greater competition and innovation in the lottery markets.

FINAL WORDS

While LOTEX is on the verge of being auctioned and open to private investment, SEAE -- as Brazil's lottery regulator -- is working to implement a modern and competitive regulatory environment.

As an example of a procompetitive regulation, SEAE is working to align the bettor's payout of federal lotteries operated by CEF with the best global practices, in order to promote a healthy competition between the LOTEX concessionaire and CEF, increasing the entire market to a revenue around 1% of the GDP in the next ten years.

As outlined throughout this paper, the Brazilian Ministry of Finance, led by SEAE, has worked as the coordinator of the privatization process, which will allow private players to enter the 'instant lottery' market in the entire country, break 55 years of a lottery monopoly by the federal government and bring competition to the lottery markets as a whole.

[3] CLOTFELTER, Charles T.; COOK, Philip J..The demand for lottery products. In:_____ Selling hope: State lotteries in America. Massachusetts: Harvard University Press, 1989. cap. 6, p. 91-116.

Theme 2. Creating markets for private sector development

STORY: COMPETITIVE IMPACTS OF THE ENTRY OF E-HAILING IN THE RELEVANT MARKET OF TRANSPORTATION OF INDIVIDUAL PASSENGERS

Summary

For some years now, SEAE has assessed the competitive impacts of the introduction of e-hailing in the transportation of individual passengers. As a competition advocate, SEAE's opinion regarding a proposed regulation of e-hailing has been used by the Court of Appeals of Sao Paulo in a recent and important decision that declared unconstitutional a local law that restricted e-hailing services. It also has been submitted to Brazil's Supreme Court, where SEAE has joined as amicus curiae and where Justice Fux has admitted that SEAE can play its advocacy role as amicus curiae in court proceedings without the need to use public attorneys. SEAE has also played a decisive role as competition advocate in Congress in 2017, by suggesting amendments that the Senate has eventually incorporated in PLC 28/2017. SEAE has consistently advocated for the deregulation of e-hailing and for a legal framework that ensures competition in the transportation of individual passengers, allowing coexistence between traditional taxi services and the new individual private transport services provided by e-hailing services.

STORY

Since 2008, several studies have been carried out by SEAE to improve the regulatory environment of taxi services in some Brazilian municipalities. Such studies pointed out the need to improve the regulatory environment, since local legislations were outdated and generated user and taxi driver dissatisfaction. SEAE has updated the studies according to the evolution of both the Brazilian legislation and the economic background.

Since the very beginning of 2016, SEAE has actively supported the deregulation of taxi services. That year, in response to a request from the Office of the Federal Attorney General (Ministério Publico Federal), SEAE issued an opinion whereby it argued that taxi services were rapidly lagging behind e-hailing services, which could be explained in great part by a historical absence of competition between cab drivers. Lack of competition, SEAE claimed, was responsible (i) for high prices that circumscribed its use to corporations and wealthier individuals and (ii) for low quality that fostered the dissatisfaction of consumers with the service. The Office of the Federal Attorney General used the opinion as an input in a lawsuit filed by ABRACOMTAXI – a national association involving owners of taxi licenses – against Über.

In 2017 SEAE revisited its 2016 opinion in order to make it clearer that e-hailing services should not be regulated – both from the economic and legal perspectives. SEAE also played an important role advocating in favor of more competition inside the federal Executive Branch and, following the lead of an OECD working paper, joined forces with other units to advocate in Congress.

The following section brings general aspects of SEAE's studies and is followed by details of SEAE's 2017 advocacy work.

SEAE'S VIEW OF THE CATHEDRAL

A few years ago, two federal laws erected the legal framework that safeguards today's use of e-hailing services in Brazil. While in 2011 a federal Brazilian law (Law 12468) assigned to cab drivers the monopoly of the *public* transportation of individual passengers, since 2012 another federal law (Law 12587/2012) sets forth that individual passengers can also hail a *private* transportation that is not subject

to public service regulation.

The introduction of e-hailing services increased the pressure for the improvement of the traditional taxi service, as they enabled the drivers of the once called Private Hire Vehicle (*PHV*) service to expand their market by reaching a demand that was traditionally served by taxi drivers. E-hailing services have also addressed some of the problems of market failure that have led to regulations on taxi services, such as aspects related to user safety and the quality of the service provided. Besides the legal protection, e-hailing services now counted on economic theory to back the urge for the deregulation of the *transportation of individual passengers*.

But there is more: E-hailing has changed the offer and the demand for the transportation of individual passengers themselves. On the one hand, the use of mobile applications enabled any professional driver – not only former suppliers of *PHV* services – to join platforms that facilitated the access of drivers to users. The ability to enter the market and not have to prospect consumers – a job intermediated by the platform – helped increase the number of suppliers for the service and keep supply sufficiently high to lower the prices offered by cab drivers. On the other hand, the improvement of passenger experience, by combining the evolution of smartphones with the development of hi-speed Internet increased mobility to an unprecedented level, increased demand by making it possible to book trips and be collected by drivers in any environment, including on the streets. Hence, technological innovations provided greater development of e-hailing services, making it possible to enlarge the base of drivers and helping them meet a more significant portion of the demand.

From the regulatory point of view, these innovations have given birth to legitimate concerns of public interest, such as security and privacy issues, helping create a demand for a forward-looking regulation. In most cases, however, owners of cab licenses have lobbied to apply the existing and outdated regulation to new providers, claiming that regulatory asymmetry was unfair[4]. However, the application of traditional regulation to e-hailing services – including the need for authorization (quantitative barrier to entry), visual identification (sunk cost) and geographic allocation (lower contestability) -- would correspond, in practice, to the elimination of e-hailing as a maverick. As detrimental to consumer welfare as it might be, the strong lobby of license owners helped include in Congress bills of laws that would forestall competition from e-hailing platforms and help perpetuate the market power of rent seekers. PLC 28/2017, a bill that the House of Representatives approved and that the Senate scheduled to vote under fast track was the most significant example of the strength of the lobby. The following section explains in detail, among others, SEAE's advocacy role in this case.

SEAE, E-HAILING SERVICES: ADVOCACY TEXTBOOK PERFORMANCE IN THE PUBLIC SECTOR

Amicus curiae in ADPF 449

In 2017, based on general advocacy recommendation made by IBRAC[5], SEAE asked the Supreme Court to join a lawsuit (ADPF 449) as *amicus curiae*. In this lawsuit a political party claimed that a local law of the municipality of Fortaleza regulating the *public* transportation of individual passengers has been unconstitutionally applied to the private transportation of individual passengers. The Supreme Court's decision in this case will have *erga omnes* effect and bind every local law aiming at regulating the *private* transportation of individual passengers.

In November 2017 Justice Fux decided that SEAE had the required experience and jurisdiction over competition matters to join as amicus curiae. That was a historic decision, since it was the first time that SEAE has joined a lawsuit in this condition.

In a sum, SEAE's opinion claimed that:

[4] OECD. ***Disruptive innovation and their effect on competition***. June, 2015. Available on <http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2015)3&docLanguage=En>. Access in 12/11/2017.
[5] Available on http://www.ibrac.org.br/UPLOADS/Eventos.old/Eventos/IBRAC%20FGV/Advocacia_da_Concorr%C3%AAncia_%20vers%C3%A3o_02_09_2015.pdf. Access in 12/12/2017.

• that e-hailing services have altered the competition pattern by increasing the number of private drivers and by providing the rivalry that taxi services needed to evolve;

• because e-hailing platforms have helped address a great deal of market failures that demanded heavy regulation for taxi services – including asymmetry of information, reasonable pricing, adequate levels of supply, quality levels, safety concerns -, there is an urge for the deregulation of the transportation of individual passengers, including taxi services.

• at least while taxi services have public nature as defined by law, the regulation should contain strong incentives for fierce competition among taxi drivers. Said regulation would help turn competition into a driving force for improvements;

• governments should not adopt measures that prevent or hinder the operation of e-hailing. They must allow the consumer to reap the benefits of competition instead;

• besides the general increase in consumer welfare, e-hailing is also a competitive force putting pressure on the submarket for the *public* transportation of individual passengers;

• if Congress decides to regulate the *private* transportation of the individual passenger, a forward-looking law should be limited to establishing safety regulation, being unnecessary to regulate aspects related to the quality of services, the number of providers (drivers) and the rates charged.

By granting SEAE the status of *amicus curiae* in ADPF 449, Justice Fux helped make history again: The decision recognized that SEAE was entitled to go to court by itself, with no need to be represented by public attorneys. In SEAE's view, **this was a great win, because direct court performance gives SEAE more autonomy to deliver its opinions and more agility whenever a rapid answer is needed. It was also a great win insofar as reaching such a degree of autonomy inside a Ministry was a tough task**. SEAE believed, from the very beginning, that only a court decision from the Supreme Court would have a definitive impact in the definition of SEAE'S role as a competition advocate – as assigned by Law 12529/2011. SEAE believes that the decision of the Supreme Court makes it clear that its mission as competition advocate can only be fully fulfilled if its findings are not subject to the scrutiny of any other government unit.

Advocacy inside the government

SEAE has also played an important advocacy role out of court in a case that unfolded along all the year, culminating in the amendment of PLC 28/2017 in the Senate in terms that do not affect e-hailing services.

This story of competition advocacy in e-hailing services counted on a backstage performance. Counting on the relevant works of parliamentary advisors in the Ministry of Finance and legal and parliamentary advisors in the Presidency of the Republic, SEAE helped convince Congressmen in the Senate that PLC 28/2017, as approved in the House of Representatives, was detrimental to consumer welfare. Senators reversed the relevant restrictions raised by the bill of law, including the need for a license, geographic allocation and ownership of the vehicle. Because there were intense pro-taxi manifestations in the previous days inside Congress, the extent of the win was unexpected. The use of the influence of the Ministry of Finance and the Presidency of the Republic, which have shown to be indispensable to achieve said outcome, have also followed OECD's recommendation in the paper "Competition Advocacy: Challenges for Developing Countries"[6], where one can read:

> "There are two aspects to independence, structural and operational. An agency that is created as a separate entity, not part of a ministry and responsible directly to the parliament or legislature for its budget, is structurally independent. All else being equal, it will enjoy relative freedom in carrying out its enforcement and advocacy functions. *At the same time, however, structural independence can have ambiguous effects on competition advocacy. An agency that is entirely separate from other parts of government may lack good access to the decision makers in the executive and legislative branches. It*

[6] Available on http://www.oecd.org/daf/competition/prosecutionandlawenforcement/32033710.pdf. Access in 12/12/2015.

might not have the influence in government circles that it would have if it were part of a powerful ministry. It might even suffer from lack of information about activities in other parts of government that would benefit from its input."

The influence units in the Executive Branch, the access to real-time information regarding the preferences of the Senators and the access to decision makers in Congress has helped build a pro-competitive decision for all the Brazilians.

At the very beginning of November the Senate sent PLC 28/2017 back to the House of Representatives, where it will be voted one last time.

Amicus curiae in RE nº 1.054.110/SP

The Supreme is on the verge of delivering two key decisions, with *erga omnes* effect, in both the aforementioned ADPF 499 and in RE nº 1.054.110/SP. Knowledge of previous judicial decisions has made SEAE quite confident that even one step back by the House of Representatives (after the voting in the Senate) at this moment would not survive in the long run.

In RE nº 1.054.110/SP, the Supreme Court will hear an appeal against a decision issued by the Court of Appeals of the State of São Paulo earlier this year.

The Court of Appeals decided that local Law 16.279/2015 from the municipality of São Paulo, that forbids e-hailing services, is unconstitutional. The decision expressly quotes, among others, SEAE's and CADE's opinions. CADE, that joined the lawsuit in São Paulo as *amicus curiae*, has included a copy of SEAE's aforementioned 2016 opinion (as requested by the Office of the Federal Attorney General) in the lawsuit. Now SEAE has asked Justice Barroso to join this second lawsuit at the Supreme Court (RE nº 1.054.110/SP) as *amicus curiae* in order to deliver its 2017 opinion where its pro-deregulation position is even stronger.

CLOSING REMARKS

In 2017 SEAE has accepted suggestions from the private sector and joined forces with other units in the Executive branch in order to invigorate its advocacy role. SEAE has left its comfort zone to become an *amicus curiae* in a court proceeding for the first time in its history and has already asked to join a second one. Because SEAE has persistently applied OECD's toolkits and recommendations throughout the years, it has also played a decisive advocacy role in Congress, making use of the influence and the access to information that only a unit inside a prestigious ministry can show in order to promote competition.

Theme 1: Prompting structural reforms in key sectors

STORY: PROPOSAL OF A NEW LEGAL FRAMEWORK FOR THE NATURAL GAS INDUSTRY

Summary

Historically, the Brazilian natural gas industry has developed in a horizontally and vertically concentrated basis. Recently, in order to ensure that the oil and natural gas infrastructure is compatible with growth, the Brazilian government has reoriented energy policy towards implementing more competition and expanding private investment in all links of the supply chain. Petrobras has sold important holdings in different links of the supply chain and the government has developed several new initiatives since 2016, such as the "Gas to Grow" program. SEAE played a key advocacy role in the proposal of a new legal framework that incorporates (ii) ownership unbundling, (ii) universal access to essential facilities; (iii) the prohibition of interlocking directorates and mutual shareholding by vertically related companies; and (iv) the improvement of governance in transportation.

INTRODUCTION

Historically, the Brazilian natural gas industry developed in a horizontally and vertically concentrated basis. Since 2016, motivated by the need for growth, the Brazilian Government has oriented public policy towards the goal of attracting private investment and promoting competition. Entry barriers in all links of the supply chain need to be lowered in order to induce entry in the natural gas market.

OVERVIEW OF THE NATURAL GAS MARKET AND PETROBRAS'S ROLE

Exploration and Production (E&P). Petrobras controls almost all natural gas production and importation. Its market share is almost 93.8% (September of 2017) and, in terms of imports, its market share reaches 99.9%. This environment reflects few economic incentives for investments in E&P sector, mainly because of Petrobras's control of the midstream and downstream sectors.

Transmission. Petrobras holds almost all transportation infrastructure. Brazil has five companies operating a 9450 km gas pipeline system and Petrobras is a shareholder in four of them. Its' market power in the transmission sector, which has been characterized as a natural monopoly, is naturally amplified to other segments of industry. These segments are potentially competitive, like E&P and commercialization.

The outflow of natural gas offshore production. Petrobras controls almost all outflow infrastructure of offshore gas production and, in accordance with the legal framework, it has no obligation to offer access to third parties. Economies of scale create incentives to sell natural gas to the incumbent, since infrastructure construction imply high investments and a minimal amount of production. The lack of access to outflow gas pipelines for offshore production prevents competition, harming consumers.

Distribution. According to the federal Constitution, Brazilian states are responsible for gas distribution and they do it by means of state owned companies. Petrobras, through its subsidiary Gaspetro, is a shareholder in 19 out of the 27 distribution companies, which allows it to have significant influence on companies' market decisions, including control of the acquisition policy. This aspect, associated with the lack of access to the transmission infrastructure, increases entry barriers to natural gas.

In most Brazilian states, the distribution model prevents competition in the natural gas market. Brazilian legislation confers legal monopolies on state distribution companies, which are public franchises.

Therefore, even if access to transmission pipelines were allowed, the impact on local consumer markets may be limited, since there would be no competition in the distribution segment.

THE CURRENT LEGAL/REGULATORY FRAMEWORK

Over time, the legal and regulatory framework incorporated measures to mitigate the consequences of verticalization. Law 9478/1997 (the Oil Law) established free access to transmission pipelines while Law 11909/2009 (the Gas Law) compelled legal and accounting separation (ownership unbundling) between transmission and carrier activities for new gas pipelines. After that, Resolution 51/2013 issued by ANP, the regulatory authority, prevented carrier ownership of new gas transmission pipelines.

ANP acted to assure free access to transmission pipelines and to promote competition, as mandated by the Oil Law. For example, ANP implemented the "2003 Pipeline Project (Projeto Malhas 2003)" to force Petrobras to change its gas transmission model in order to ensure transparency in the management of the infrastructure, especially as concerns to free access rules.

Despite ANP's efforts, the number of competitors in the Brazilian natural gas market remained roughly the same. Nowadays, Petrobras still holds a dominant position in all links of the supply chain, and development of the sector depends on its investment capacity.

RECENT CHANGES

Recently, Petrobras announced a major divestment program in the following areas: oil E&P, oil supply, natural gas and energy. The company's strategy is associated with its new financial model, which has as goals: reduced leverage, cash preservation and focus on priority investments, mainly in oil and gas production.

In the transmission sector, Petrobras sold Brookfield 90% of its shares in Nova Transportadora do Sudeste. It an important step towards more competition in the Brazilian natural gas industry. However, Transpetro, Petrobras's subsidiary, will remain responsible for operation and maintenance for the next 10 years.

In the distribution sector, Petrobras sold to Mitsui 49% of its shareholding in Gaspetro. However, as Petrobras preserved control, the operation did not decrease its market power. According to the shareholder agreement, Petrobras still appoints commercial directors in all distribution companies where Gaspetro holds a minority position. By doing so, the company preserves influence on input acquisitions.

THE "GAS TO GROW" PROGRAM

At least since 2015, the Ministry of Finance (MF) – represented by the Secretariat of Economic Affairs, the Ministry of Mines and Energy (MME) and ANP have discussed changes in the legal framework of the natural gas sector. In 2016, the MME launched the "Gas to Grow" program, where public and private sectors have debated the main challenges for the Brazilian natural gas industry. As a stakeholder in the program, SEAE has actively contributed with proposals regarding the regulatory environment and the promotion of competition.

The focal point of the "Gas to Grow" program was to design a new and more competitive natural gas market. The program tackled eight themes. Work groups issued reports in each one of them, including legal and regulatory proposals.

The reports proposed a new legal framework with the goal of lowering barriers to entry . The framework contemplates important structural measures: (i) the institution of a new charging model, the entry-and-exit system; (ii) unrestricted access to essential facilities (iii) strengthening unbundling; and (iv)

the implementation of a gas release mechanism.

The new legal framework is now a bill of law that is currently under analysis in the Commission of Mines and Energy of the House of Representatives.

THE ROLE OF COMPETITION ADVOCACY IN THE PROPOSAL OF A NEW LEGAL FRAMEWORK

The proposed new legal framework contemplates the work of competition advocacy in six elements: (i) the gas release mechanism; (ii) access to essential facilities; (iii) capacity allocation; (iv) minority shareholding among rival firms in transportion segment; (v) Chinese Wall in transmission and distribution; and (vi) market manager.

These elements will allow ANP to implement its regulatory mandate to follow best practices for competition in the natural gas sector. The proposed new legal framework aggregates well defined rules to: increase the number of natural gas suppliers in the market allow competitors access to essential facilities, allow capacity allocation and block the transfer of sensitive information from transmission and distribution segments.

The great benefit of the proposed rules will come from their joint implementation. Increased supply to competitors will lead to a competitive environment only if it is accompanied by access to essential facilities and if transportation companies do not hold equity or influence in any company that deals with natural gas exploration, development, production, importation, carriage and commercialization.

The gas release mechanism may be used to compel companies that have high upstream market share to supply a fixed part of their output to the downstream market. This mechanism has the goal of offering natural gas at competitive prices in order to encourage entry in downstream markets.

Access to essential facilities by competitors represents the main obstacle to competition in the natural gas industry, since the downstream players need access to essential facilities in order to run their businesses.

The proposed new legal framework will provide rules for access to the transport gas pipeline on a nondiscriminatory basis. These rules are essential in order to develop competition in the natural gas industry, since transmission is a natural monopoly and downstream segments depend on access to natural gas.

Minority shareholdings among rival firms and its anticompetitive effects are on the agenda of antitrust authorities around the world. In general, shareholding among rival firms leads to the acquisition of highly sensitive information, especially if it involves the acquisition of voting rights in the board of directors.

Exchanges of information among rival firms usually undermine competition. Access to strategic information usually creates incentives to manipulate market conditions, such as through price increase, output restrictions and quality changes.

Minority shareholding among rival firms often takes the form of a shareholder taking part in the boards of different companies with horizontal and vertical relationships between them (interlocking directorates). In such cases, the shareholder can affect the commercial decisions of competitors and tilt the playing field.

The proposed new legal framework will not allow interlocking directorates nor vertically related companies holding equity in each other. In order to avoid this issue, the new legal framework prohibits representatives from other segments in the natural gas industry from being members of the board of directors of natural gas transporters and distributors. These measures reduce the incentives for anticompetitive conducts in the market.

Additionally, there is a transition rule for existing natural gas transporters. In this case, the transporter needs to have a “certification of independence” issued by ANP , which will be valid until the gas pipeline

authorization expires.

Finally, the proposed new legal framework will create a market manager to manage the natural gas transport segment. The main goal is to improve governance in transmission.

CONCLUSION

Brazil's infrastructure for natural gas outflow, transport and import is incompatible with future demand.

In order to develop, Brazil's natural gas market needs more competition in all links of the production chain. Petrobras's dominant position impedes needed investment.

Increasing competition in the natural gas market requires a compatible regulatory model. This was the main competition advocacy goal in the development of the new legal framework.

In conclusion, the competition advocacy function, as provided in article 19 of law nº 12.529/2011, allowed SEAE to participate in the development of rules compatible with competition in the natural gas market. The draft law mandates that (i) access to essential facilities will be universalized; (ii) the regulator will have the power to implement gas release program; (iii) minority shareholdings among rival firms will be prevented; (iv) the board of directors of transporters and distributors will not have representatives from other segments of the natural gas industry; and (v) there will be a market manager for the transmission segment.

Theme 4: Improving administrative procedures to remove obstacles to competition

STORY: PROMOTING BEVERAGE COMPETITION AT CARNIVAL ON THE BEACHES OF FLORIANÓPOLIS

Summary

In November 2016 the Council for Economic Defense (CADE) notified the Secretariat of Economic Affairs of the Ministry of Finance (SEAE) of a pending investigation involving the public administration of Florianópolis, capital of the state of Santa Catarina. According to the notification, the local government implemented a Carnival-oriented policy that included the registration of every salesperson allowed to sell food and beverages on the beaches of Florianópolis. The local government also restricted the number of brands of beers and soft drinks that each salesperson would be allowed to trade: only one besides the brand defined by a public bid. On top of that, the administration of Florianópolis created a true monopoly in the markets of energy drinks and water. In March 2017 SEAE joined as *amicus curiae* in a proceeding opened by the Court of Accounts of Santa Catarina in order to investigate the public policy. In June 2017 the Court of Accounts, using SEAE's opinion, recognized the existence of a monopoly in the sales of water and energy drinks and determined that the former major and former Secretaries should be heard.

STORY

In November 2016 Brazil's Council for Economic Defense (CADE) notified the Secretariat of Economic Affairs of the Ministry of Finance (SEAE) of a pending investigation involving the public administration of Florianópolis, capital of the state of Santa Catarina. According to CADE's notification asking for SEAE's advocacy, the local government of Florianópolis:

- implemented a Carnival-oriented policy that included the registration (and limitation) of salespeople allowed to sell food and beverages on the beaches of Florianópolis;
- limited the number of brands of beers and soft drinks that each salesperson was allowed to trade.

SEAE opened the investigation analyzing the documents sent by CADE – concerning the licenses for the 2017 Carnival and its registration process – and found out that:

- each salesperson should choose between one mobile license (as walking vendor) or one fixed license (as a point of sale vendor) to sell food and beverages;
- the licenses allowed the commercialization of food and beverages on one and no more than one beach of Florianopolis;
- the licenses lasted for the 2016/2017 summer (between December 15, 2016 and April 16, 2017);
- the presence of at least 1 but not more than 4 people in the point of sale was mandatory at any time during business hours;
- sublicensing was strictly forbidden.

Even though the rules showed clear concerns against the concentration of licenses in the hands of few, SEAE was concerned with:

- limitations in the number of salespeople;

• brand limitations in the sales of beers, soft drinks, energy drinks and water;

• geographic limitations in the sales of beers, soft drinks, energy drinks and water;

• the impact that a shortage in the beverages could have:

- on the price of the products;

- on the access by the people.

SEAE was convinced that:

• although limitations in the number of sellers could be justified as a means to limit harassment on bathers and to avoid an excessive number of people on the beaches during summer, numeric restrictions – especially in the high season for beach tourism -- are worrisome when combined with geographic allocations;

• it was not clear:

- how limited the space (inside the bag or in the point of sale) for the second brand would be;

- whether salespeople would be able to advertise the second brand they were free to choose, or if the second brand would only be subject to passive sales – where the seller cannot advertise, but can sell the product when approached by the customer.

A step further, SEAE prospected further rules regarding these public auctions and started to screen those that took place in the preceding years. SEAE identified that:

• the new set of arrangements started to be auctioned in 2015;

• even though they involved the registration of salespeople to sell different products on the beaches, only those contracts involving the commercialization of beverages involved brand restrictions because of the sponsorship that Kirin offered to the local Carnival;

• the contracts were initially executed for both the 2015/2016 and 2016/2017 summers, but have been extended to three further summers: 2017/2018; 2018/2019 e 2019/2020;

• the interested parties had just 16 working days to plea for a license;

• the interested parties had to show previous experience as salespeople.

Although SEAE respected the discretion of the local government to seek sponsors to the Carnival and avoid spending limited public resources therein, our team was not convinced that the restrictions on competition designed by the public authorities were strictly necessary to attain the level of investment required to promote Carnival. SEAE was particularly concerned with the fact that in Florianopolis bathers do not have direct access to local restaurants, limiting competitive pressure on beach commerce.

That concern was exponential when it came to energy drinks and water: In both markets Kirin was a monopoly and, unlike the market for beers and soft drinks – where Kirin offered a portfolio of beverages -, there was no intrabrand competition for Kirin's water and energy drink.

SEAE was also concerned that together the limitation in the number of licenses and the need of previous experience would foreclose the market to new entrants, with no clear benefit to consumers: SEAE did not identify externalities that justified the qualitative entry barriers, especially because the learning curve (in the market for selling beach food) was short. Luckily, the office of the Attorney General of Santa Catarina (Ministério Público de Santa Catarina) challenged said requirement *ex officio* and the Santa Catarina Judiciary suspended it.

On top of that, by extending the contracts from 2015 to 2020, SEAE believed the local government deprived the consumers:

• from *ex ante* competition from other brands that could compete for the sponsorship;

• from the chance of a new plan where brewers could bid for the most inclusive sponsorship – where, for instance, only one brand could advertise on banners and outdoors, but where salespeople would be free to sell as many brands as they liked.

ACTIVE SUPERVISION

SEAE learned from the local press that the government of Florianópolis offered only 24 agents to oversee all the beaches of Florianópolis. The absence of active supervision can lead to a scenario where no one respects brand limitations and competition thrives (which unfortunately proved not to be true, according to the press and local authorities) or to a costly supervision of the agreement by the winner who had already bid high for the competitive advantage. Either way, it shows that the local government was not convinced that, by not enforcing Kirin's semi exclusivity, it would lose Kirin's interest in Florianópolis' Carnival. If that is true, it may also show that said restrictions were not strictly necessary to attain the level of investment required to promote the local Carnival and that the local government could have bargained for a more competitive playing field. It also corroborates the idea that public managers in Brazil still undervalue competition and quite often use competition as a coin to attract (even poor) investment.

RECOMMENDATIONS

Based on the aforesaid, SEAE issued the following recommendations addressing the Major, the Secretary of Environment and Urban Development and the local legislators of Florianópolis:

• the interested parties should have at least two months to plea for a license;

• to eliminate previous experience as salesperson as a condition to compete;

• to reassess the limitation on the number of salespeople;

• to reassess the limitation on the number beers that compete against Kirin in the points of sale;

• to eliminate Kirin's monopoly in water and energy drinks;

• to clarify the rules concerning active sales and passive sales;

• to limit the licenses (in particular that one to sell beverages) to a maximum of two consecutive terms;

• to make all the contracts public and available for easy access on the Internet;

• to reassess the competitive impact of local Law 2496/1986, that allowed the limitation of salespeople on the beaches during high seasons.

SEAE sent copies of the opinion to the Court of Accounts, the Office of the Attorney General, the Judiciary and the Consumer Protection Agency – all of Santa Catarina. Following general advocacy recommendations made by IBRAC[7], SEAE also made itself available to act as *amicus curiae* in the Court of Accounts and in the Judiciary.

AMICUS CURIAE

In March 2017, the Court of Accounts of Santa Catarina accepted that SEAE joined as *amicus curiae* in an ongoing proceeding dedicated to investigating the public policy implemented by the administration of Florianópolis.

[7] Available on http://www.ibrac.org.br/UPLOADS/Eventos.old/Eventos/IBRAC%20FGV/Advocacia_da_Concorr%C3%AAncia_%20vers%C3%A3o_02_09_2015.pdf. Access in 12/12/2017.

The decision was a historic win for SEAE: For the first time in its history SEAE joined as *amicus curiae*. This investigation also prepared SEAE to join, a few months later, for the first time, as *amicus curiae* in a court proceeding[8].

In June 2017 the Court of Accounts, based on SEAE's findings, recognized the existence of a monopoly in the sales of water and energy drinks on the beaches of Florianópolis and determined that the former major and former Secretaries involved should be heard. The Court of Accounts decided, however, that it was beyond its jurisdiction to investigate other restrictions to competition that were not at the same time infringements to the federal Law of Public Bids and Contracts (Law 8666/1993).

CLOSING REMARKS

In 2017 SEAE has left its comfort zone and, after accepting suggestions from the private sector, has for the first time joined an investigation as *amicus curiae*. SEAE's performance before the Court of Accounts of Santa Catarina paved the way to joining lawsuits before the Supreme Court, a few months later, in this very condition.

SEAE has also proved that openness to dialogue with private think tanks, like IBRAC (a NGO at ICN), can be key to developing winner strategies in competition advocacy.

The case also corroborated SEAE's experience that public managers in Brazil still undervalue competition and quite often use competition as a coin to attract (even poor) investment.

[8] ADPF 449 before the Supreme Court, concerning e-hailing services.

Theme 1: Prompting structural reforms in key sectors

STORY: ANTICOMPETITIVE DEVELOPMENTS OF THE ANTENNA LAW

Summary

Since 2012 SEAE has advocated for pro-competitive changes in the proposed Antenna Law. SEAE warned that a symmetric obligation to offer access to idle capacity in the support infrastructure could lead to lower incentives to invest in the network. SEAE actually expressed the view that there was no need for new regulation concerning access to telecommunications support infrastructure, since ANATEL had already regulated access. SEAE also opposed the creation of a mechanism whereby market players would be required to invest in infrastructure whenever a certain level of congestion of their network was achieved. On April 20, 2015, the former President sanctioned the Antenna Law with several vetoes, including SEAE's opposition to the congestion trigger. In 2016 ANATEL held public consultations in order to adopt a new regulation adapting the existing one to the new terms of the Antenna Law. That year SEAE issued a new opinion suggesting that the regulation of the agency should try be as friendly as possible to competition, taking into consideration the spaces left by the law. In 2017 Anatel adopted a new regulation adapting the existing one to the new terms of the Antenna Law. The new regulation incorporated SEAE's advocacy work.

INTRODUCTION

Mobile communication services allow users to benefit from the service in any place, representing a communication alternative that is more in tune with current user preferences, such as data communication and Internet access. These are the main factors behind the extraordinary growth of the mobile telephony segment, which in September 2017 had already surpassed 241.06 million active lines (teledensity of 115.76 accesses per 100 inhabitants), which has resulted in a corresponding increase in demand for radiocommunication stations or Radio Base Stations (ERBs) – commonly called antennas – in Brazilian municipalities[9].

The deployment and the operation of the wireless telecommunications infrastructure involve detailed studies based on technological, legal, urban, environmental and public health aspects. High demand for antennas/towers require therefore a challenging commitment of institutional actors, such as the federal (through the National Telecommunications Agency - ANATEL), the state and the local regulators, as well as local, state and federal environmental agencies.

Having that in mind, several municipalities have approved laws and regulations for the deployment and the operation of mobile telephone networks. However, many of the regulations issued by the local governments have expressly or implicitly created zoning and licensing constraints that restrict the installation and expansion of support infrastructure for antennas, jeopardizing the deployment and the efficient operation of mobile telephone networks in urban areas. On top that, limitations to new infrastructure naturally give a head start to incumbents who have already deployed their equipment and foreclose the market to new entrants -- hence limiting market contestability.

By the end of 2012 the Secretariat of Economic Affairs – SEAE – issued a first opinion that analyzed Senate Bill - PLS 293/2012, known as the proposed Antenna Law.

THE ANTENNA LAW

SEAE's original opinion, issued in January 2015, agreed that the bill of law had the potential to

[9] Data available on http://www.teleco.com.br/ncel.asp.

lower barriers to entry in the mobile market by eliminating regulatory barriers to the implementation of telecommunications networks and to the licensing of infrastructure. As a matter of consequence, PLS 293/2012 could help create a level playing field for new entrants and eventually make an effective contribution to meeting the demand for antennas in Brazilian cities.

That notwithstanding, SEAE warned that a symmetric obligation to offer (either unrestricted or partial) access to idle capacity in the support infrastructure could lead to lower incentives to invest in the network. SEAE actually expressed the view that there is no need for new regulation concerning access to telecommunications support infrastructure, since ANATEL had already regulated access. In fact, ANATEL had issued clearer rules which left less room for conflicts of interpretation.

SEAE also opposed the creation of a mechanism whereby market players would be required to invest more in infrastructure whenever a certain level of congestion of their network was achieved. The identified problem was twofold:

• the trigger could lead to underinvestment, because the proposed law could be interpreted by mobile operators as a safe harbor against pressure from regulators until the legal threshold was met;

• by defining the means to meet quality goals, and not the goals alone, regulators fail to leave to market players the decision to find the most appropriate technology to reach the goal, thereby curbing technological innovation and competition alike.

Because SEAE' opinion was not contemplated by any amendment of the bill in Congress, SEAE issued a second opinion asking for presidential veto. On April 20, 2015, the former President sanctioned Law 13116/2015, known as the Antenna Law, with several vetoes, including one of SEAE's (the elimination of the trigger).

ANATEL: PUBLIC CONSULTATION AND SECTOR REGULATION

In October 2016 ANATEL held public consultations in order to adopt a new regulation that adapted the existing one to the new terms of the Antenna Law. In November that year SEAE issued a new opinion suggesting that the regulation of the agency should be as friendly as possible to competition, taking into consideration the spaces left by the law. SEAE was particularly concerned with free riding and lower incentives to invest – the very concerns that led SEAE to recommend a veto on mandatory access to infrastructure.

In 2017 ANATEL eventually adopted a new regulation adapting the existing one to the new terms of the Antenna Law. The new regulation incorporated SEAE's concern with compulsory access: Even though ANATEL, following the law, determined that access to support infrastructure be made under reasonable and non-discriminatory (RAND) terms, the decision of ANATEL's directors that approved the new regulation made it clear that ANATEL would not make *ex ante* cost-based price regulation of RAND access to infrastructure. Rather, in competitive markets ANATEL would only intervene *ex post* in order to settle price disputes.