An economic evaluation of the Ideal/Nutrabien merger proposal

Expert Report

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1. Assignment and summary of my views

1.1 Assignment

I have been requested by the Fiscalía Nacional Económica (FNE) to prepare an economic report in the matter of the merger proposal between Ideal and Nutrabien. More specifically, the report should assess the economic arguments used by the FNE in its *Informe de Prohibición*, dated 9 May (henceforth, "Informe de Prohibición") and in its prohibition decision, and their being consistent or not with economic theory, with the facts and data available, and with standard competition practice in the main antitrust jurisdictions worldwide.

To write this report I have been using data and information contained in the FNE's record during the investigation of the matter; documents and reports submitted by the merging parties; relevant economic literature; decisions and case-law from other jurisdictions.

I will limit myself to discuss the economic aspects – on which I am more competent – relying on the information provided by the FNE and submitted by the parties. Therefore, I am acting as an expert economic witness and not as a witness of fact. Furthermore, this report must not be read as expressing opinions on matters of Chilean law, which lie outside my expertise.

I understand this is standard practice for economists offering expert opinions on economic issues in competition law cases.

Although I have been commissioned this report by the FNE, I understand that my primary duty is to the *Tribunal de Defensa de la Libre Competencia* and as such I will be truthful, honest and complete in matters of economics or economic evidence which fall within my expertise. This duty overrides any other obligation, and the opinions expressed in this report represent my true and complete professional opinion.

1.2 On the author, and his collaboration with the FNE

I am a Research Professor at ICREA-Universitat Pompeu Fabra, and the Barcelona Graduate School of Economics. I served as Chief Economist at the European Commission's Directorate General for Competition from September 2013 to August 2016. I have been working on competition policy issues as a researcher for some twenty-five years. My research has been published in top international economic journals. My book titled *Competition Policy: Theory and Practice* (Cambridge University Press, 2004) is considered the standard international reference on the economics of antitrust. I have recently published a new book on *Exclusionary Practices* (with Chiara Fumagalli and Claudio Calcagno, Cambridge University Press, 2018), on abuse of dominant position.

I have extensive experience in advising competition agencies, on cases and policy. In particular I have had a long collaboration with the Competition Commission of South Africa, and more recently (after my mandate at the European Commission) I have been advising Portugal's Autoridade da Concorrência, as well as the FNE.

My collaboration with the FNE started in 2017, and within this framework I have been advising it on several (around fifteen so far) cases regarding mergers, abusive practices and agreements, at different stages of the investigations, as well as on broader competition policy issues. My tasks involve helping the FNE frame the investigation in its early stages; advising them on how to structure the economic analysis and which data or information may be helpful to better understand the case; giving feedback on documents drafted by the case teams, thus acting as a "peer reviewer"; and generally trying to improve their economic analysis. Obviously, it is our mutual understanding that my opinions are not binding to the FNE.

It is within this framework that I had been asked to offer my advice on the Ideal/Nutrabien merger proposal. I had first become acquainted with the merger in the second half of November 2017. I discussed this case (as well as other cases) during my visit to the FNE (28 November to 1 December 2017), and then we corresponded about it in several other occasions until the prohibition decision. It should therefore be clear to the Tribunal that I have been familiar with the case well before my recent assignment to write this report. In particular, I had suggested to the FNE – given the lack of data - to commission a survey questionnaire to be able to estimate diversion ratios; advised them to contact the Competition and Markets Authority of the UK in order to draw on their considerable experience on surveys; given advice on how to conduct UPP-based analysis with multi-product firms; commented on drafts of the *Informe de Riesgos* and the *Informe de Prohibición*, and the economic reports submitted by the economic consultants of the parties.

Finally, I have written this report in English because I can render my opinion in a more precise way in this language than in Spanish. However, I believe that my command of Spanish is more than sufficient to fully understand all the documents related to this case. All my oral and written interactions with the FNE have always been in Spanish, and I have been speaking, reading and lecturing in Spanish for more than twenty-five years.

1.3 Summary of my views

This is a merger between two firms, Ideal and Nutrabien, which produce and sell bakery products. This is a highly differentiated market where each firm sells differentiated products, often making use of several brands. In such cases, it may not be straightforward to define the relevant markets, because the decision to include or not a product in the relevant market is a binary decision ("in" or "out") that may not fully reflect that the degree of substitution between products is imperfect.

Traditional antitrust analysis proceeds by first defining relevant product markets and analysing the importance of the merging parties in these markets, to infer possible anti-competitive effects from the merger. By following this approach, and relying on the available information, one relevant market would be identified as "bizcochos individuales (including "bizcochos rellenos", "brownies", "queques individuales") and alfajores sold in the *supermarket channel"*. In such a market, the combined shares of the merging parties is above 50%, which would raise competition concerns in any jurisdiction. In Europe, this may also give rise to *prima facie* evidence of the creation or strengthening of a dominant position. If further analysis (such as lack of countervailing buyer power and absence of likely, timely, sufficient entry) confirmed the finding of dominance, then antitrust authorities would typically not need to investigate the impact of the merger on prices (or other relevant variables, such as quality, variety and so on).

Another possible relevant market could be "bizcochos individuales and alfajores (possibly including also "galletas mini" and "galletones") sold in *smaller shops"*. On such a market, the parties would have a similar (if "galletas mini" and "galletones" were included in the market) or substantially higher (if they were not) combined share as in the previous one, and the same considerations as for the supermarket channel would apply. However, the survey evidence supporting such a market definition is more ambiguous, and one cannot exclude that the relevant market may also include "galletas dulces". On this more broadly defined market, the parties (which have almost insignificant sales of "galletas dulces") would have a much lower market share, and it would be unlikely that an antitrust authority supporting this definition of the market would challenge the merger.

To go beyond the crudeness of an approach which obliges to draw demarcation lines as if differentiated products had either zero or perfect substitutability -- when in truth some degree of imperfect substitutability exists -- antitrust authorities nowadays go beyond the traditional approach and (by either complementing it or bypassing it altogether) focus on how close to each other the merging parties' products are. This reflects economic theory, which emphasises that the incentives to raise prices after the merger increase with the closeness of competition between the merging parties. Indeed, the incentive to raise the price of a product of one party will be the higher the closer the substitutability with the other party's products (because most sales lost due to the price rise will be "redirected" towards another product now sold by the newly merged entity),[1] and the larger the profit margin these products will command (the "recaptured" sales will be more profitable).

Such a closeness of competition analysis can be done in qualitative and quantitative terms. From the qualitative point of view, the evidence gathered by the FNE points to Ideal and Nutrabien being close competitors (with asymmetries: Ideal's products appears to constrain Nutrabien's more than

[1] A measure of product substitutability is the *diversion ratio*. See below.

Nutrabien's products appear to constrain Ideal's), thereby suggesting that there will indeed be an incentive to raise prices post-merger.

Both the FNE and the economic experts of the parties (henceforth, "BC") have carried out a detailed quantitative assessment of the effects of the merger. They have both gathered consumer survey questionnaires to estimate the *diversion ratios* (that is, the extent to which sales lost by a product when its price increases are captured by another product) between products of the parties, and used profit *margins* to perform the quantitative analysis which makes use of different Pricing Pressure Indices (PPIs).

The FNE and BC have focused on GUPPI calculations, and used a slightly different approach to implement them. The FNE has estimated diversion ratios and calculated the GUPPIs at the level of each product. This is in my view the most correct approach although it underestimates the incentives to raise prices (because the incentive to raise the price of a product implies the latter's margin will be higher and this in turn should feed back into the estimation of the other merging parties' GUPPIs, but this feedback is ignored).

BC instead estimate diversion ratios and calculate GUPPI at the firm's level, which implicitly assumes that each product of a firm have exactly the same price elasticities and substitutability relationship with all other products. Although this is a strong assumption (and it is not the approach I would choose for an estimation of UPP for multiproduct firms), this does not imply that their exercise is worthless.

Reassuringly from this point of view, when the FNE estimates GUPPIs based on the same margins, it obtains quite similar results whether using the diversion ratios at the firm level or at the product level. Hence, a discussion on which estimates of diversion ratios are best may be of theoretical interest but is largely immaterial for the case at hand.

Margins are the other important ingredient for the calculation of the GUPPIs. Among the different measures of margins, the obvious candidate for the sake of estimating PPIs is the *contribution margin*, because it includes only the variable costs faced by a firm, which are those that drive its price decisions. The FNE uses a conservative approach and also includes *short-run* incremental costs in its margin calculation (that is, it also includes fixed costs which may be incurred when making a discrete change in production, or over a short time horizon). The parties' economists, BC, also include some long-run incremental costs in their margin calculations. This is not supported by theory and does not conform with standard practice by international authorities. Once said so, it turns out that the margins calculated by the FNE and BC differ only marginally. Therefore, like for the different methods to compute the diversion ratios, the differences in the way margins are computed are only a minimal source of difference in the quantitative assessment of the merger.

The GUPPIs estimated by the FNE suggest that post-merger there would be a strong incentive to increase prices of Nutrabien's products, both in the

supermarket and in the traditional channel; and a more moderate incentive to increase prices of Ideal's products (in line with the qualitative assessment, pointing to Ideal's products exercising a stronger competitive constraint on Nutrabien's brownies than vice versa).

By using the firm-level estimation of the diversion ratios based on the Cadem survey conducted by the parties' consultants, the estimated GUPPIs show a similar picture as the ones calculated by the FNE. Additionally, since the data gathered by the Cadem survey also allow to compute the GUPPIs for alfajores of both companies, the results from the Cadem survey also show a significant incentive to raise prices for both Nutrabien's and Ideal's alfajores, independently of the distribution channel.

Despite small differences, therefore, it seems to me that the quantitative assessment made by the FNE and the parties broadly share the same methodology and obtain similar results.

While useful because they need very little information, GUPPIs are a very crude measure of the incentive to raise prices post-merger. In particular, they tend to underestimate the pricing pressure, for different reasons, the main ones being that they neither account for the feedback effects that the price rise of a product will exercise on the other parties' product(s), nor will they account for the rivals' reactions, all these effects giving further incentives to raise prices.

Because of these shortcomings, economists have developed other PPIs that are often used by antitrust authorities. Compensating Marginal Cost Reductions (CMCRs) is probably the best among them. This index consists of finding the parties' cost savings that would lead to the same equilibrium price of the insiders as before the merger. This calculation makes use of the same information used to calculate GUPPIs (and it is only marginally more complex than the calculation of GUPPIs), does not need data on outsiders, nor does it require making assumptions on demand functions, but it does allow to take into account all equilibrium reactions of competitors as well (simply because the merger does not change reaction functions of outsiders, and hence if insiders do not modify their price, nor will outsiders).

I compute the CMCRs for the parties' products, both using Activa Research and Cadem data, and find the efficiency gains that the parties would need in order to neutralise or outweigh the incentives to raise prices post-merger. By using Activa Research data, this analysis reveals that – for the merger not to lead to a price increase in the supermarket channel – it should entail cost savings for Nutrabien's brownies which are above 15%, and cost savings for Ideal's products above 5%. For the traditional channel, cost savings should be much higher (above 12% also for Ideal's products). By using Cadem data, which also allow to compute the effects on alfajores, the required cost savings for the supermarket channel (and respectively for the smaller shops) would be: for Ideal bizcochos ███ (respectively ███ for Ideal alfajores ███ (resp. ███ for Nutrabien bizcochos ███ (resp. ███ and for Nutrabien alfajores ███ (resp. ███

Whether using GUPPIs or CMCRs, or any other PPI, it becomes then fundamental to estimate the likely efficiency gains from the merger, to see whether they could offset or outweigh the incentives to raise prices.

The FNE carefully assesses the efficiency claims made by the parties, in the light of the principles of verifiability, merger-specificity and likely benefit to consumers (that is, whether the cost savings are expected to be passed-on to consumers in the form of lower prices). These principles inform the practice of antitrust authorities around the world, and in my view the FNE applies them correctly (and conservatively) in its analysis of the parties' efficiency claims.

As a result of its assessment, the FNE recognises efficiency gains for *Nutrabien*'s "bizcochos individuales" of the order of 4.4% at most (this figure should be intended as the upper bound of acceptable efficiency gains) in the supermarket channel, and of 1.8% in the smaller stores channel. Hence, such efficiencies fall well below the GUPPIs and the CMCRs estimated above. Furthermore, it is important to stress that the parties claim cost savings only and exclusively for Nutrabien's products. Therefore, the incentives to raise prices of Ideal's products are not reduced to any extent by efficiency gains in such products.

Because of the static nature of the qualitative and quantitative assessment of the competitive risks of the merger, it is important to also consider how the merger might affect strategic variables such as product offerings and entry. Such dynamic effects are complex to predict (also because they entail the interaction among competing firms), but in my view the following points can be made.

In terms of product offerings, documentary evidence from the parties indicates that they intend to suppress one product (which would further increase the competitive risks of the merger) and reposition others (with effects which are more ambiguous, but possibly more benign).

As for current rivals, the only firm with expansion plans appears to be Carozzi, which has been considering for some time the launch of two new products, but has not made firm commitment to it yet. Even if it did take place, though, it is unlikely that these product introductions may offset any pressure to raise prices: first, there is no guarantee that such new products will be successful; second, due to Carozzi's market position, it is unlikely that it will price such products aggressively, because of the risk of cannibalising sales of some of its other products.

There appears to be no indication of likely, timely, sufficient entry either. Recent entrants, in particular, have been confined to some niche products, and there is no evidence of bigger players having intention to enter. This should not be surprising, given also the importance of brand recognition, which calls for large investments to successfully introduce new brands. Likewise, it appears that entering the market at hand might also involve significant investments in new product lines.

In summary, the competitive assessment indicates that the merger would likely increase prices, and that neither efficiency considerations nor entry would offset these anticompetitive effects.

In such cases, a merger could still be approved should the merging parties submit comprehensive and effective remedies which eliminate competition concerns entirely.

Ideal's proposed remedies, though, do not address the relevant competition concerns raised by the FNE. They are purely behavioural and as such they are not suitable for horizontal mergers. Among other drawbacks, they are limited in time and – unlike structural remedies - do not solve a competition concern once and for all; they require constant monitoring, which would effectively oblige the antitrust authority to invest resources to monitor compliance and effectiveness; and they interfere with the regular market functioning, and thus create possible market distortions.

In particular, all these drawbacks apply for the price freeze (likely the main component of the remedy package) proposed by the merging parties. Additionally, this measure would also suffer from other drawbacks, including the fact that it would not help in the case of a counterfactual in which prices for the products at issue would fall; that the existence of a maximum prices may represent a focal point and hence facilitate a collusive outcome; and that a price cap may be circumvented by restricting supply of products whose sales price is lower than average.

For all these reasons, antitrust authorities do not rely on behavioural remedies in general, and on price measures in particular, when dealing with horizontal mergers. The FNE is therefore right, in my view, in rejecting this remedy and prohibiting the transaction.

2. Preliminaries: The merger, and products at issue

2.1 The merger

This case concerns the proposed acquisition by Ideal (a *Grupo Bimbo*'s affiliate) of Nutrabien, both companies being active in the industrial production and distribution of bakery products.

The proposed merger would lead to overlaps in several products, which could in general be defined as bakery products. In particular, the arising overlaps concern product categories such as "bizcochos individuales" and "alfajores". While these products basically account for [redacted] of [redacted] turnover, they represent about [redacted] of [redacted] turnover.

I understand from the submissions of the parties that the current owner of Nutrabien – two companies belonging to the Grupo CCU, mainly active in alcoholic and non-alcoholic beverages – intends to sell Nutrabien because it did not manage to attain the synergies it had originally expected from combining its existing operations with food-related activities.

As for Ideal, the stated rationale of the merger is that it would allow it to expand in the sales of products associated with a more "healthy and natural" image. I also understand that Ideal would expect the merger to give rise to several advantages, such as: (i) using its logistic network so as to allow for higher market penetration of Nutrabien's products (these efficiency claims making the object of a detailed discussion in both the FNE and the parties' evaluations – see below); (ii) using Grupo Bimbo's multinational presence to market Nutrabien brands abroad; (iii) allowing it to quickly expand its production capacity in Chile; (iv) making use of the Nutrabien brand to develop new products.

2.2 The products at issue

One can identify several product categories within the general term of "bakery products". Of particular interest in this case is the category that I would loosely define as "biscuits", and which include among the others "bizcochos individuales" – that is, biscuits such as "brownies", "bizcochos rellenos", and "queques individuales" which are marketed in separate individual portions –, as well as "alfajores", and "galletas dulces", among others.

It is disputed between the FNE and the parties what are the degrees of substitution between these products, notably between "bizcochos" and "galletas dulces". (I will return below on the issue of market definition, as well as on the UPP methodology, which allows to bypass it.) I understand that it is industry practice to treat separately these two categories, but that sometimes in presentations and internal documents firms may look at a broader "sweet snacks" scenario.

The main overlap between the merging parties occur in the category of "bizcochos individuales", where Ideal is the leading company (with slightly over of overall sales) and sells through several brands, the main ones being (in descending order of sales) Mankeke, Pingüino, Rayita and Gansito. Ideal also sells two types of brownies under the Fuchs brand. As will be further discussed below, these products – which were first marketed in the first half of 2017 – appear to be very similar to Nutrabien's brownies and apparently aimed at the same segment of demand.

Nutrabien's brownies (branded "Brownie" and "Braunichoc") account for more than of the company's sales of the category "bizcochos individuales", and place Nutrabien as the third company by sales (about overall) in this category.

The second seller is Carozzi, with about of overall sales, present with the products such as Chocman, Tuareg Cake and Frac Cake. Other companies selling in the same category are Buenas Migas, which accounts for about of sales (but whose main product is "magdalenas", included in the "bizcocho individual" category, but appearing a much weaker substitute to the other types of biscuits belonging to this category) and Fruna, with about (but it appears to be active only in the traditional sector).

The other significant overlap occurs in the category "alfajores", where Ideal is present with several brands and accounts for some of overall sales, whereas Nutrabien is present with one type and accounts for some of sales. Carozzi (Fruna (and Arcor (are the other main sellers in this segment.

In both categories "bizcochos individuales" and "alfajores" Nutrabien appears to command a higher price than Ideal (see Figures 10 and 12 of BC's Informe "Analisis de Riesgo"), possibly signalling that they are perceived as being of higher quality.

The other relevant category for the case consists of "galletas dulces", that – according to the parties' Recurso especial de revision (henceforth "Recurso") – should be considered as belonging to the same relevant market as "individually sold biscuits" and "alfajores".[2] In this category the leading company is Nestlé (of overall sales) followed by Carozzi (and private labels (with both Ideal and Nutrabien accounting for less than of overall sales.

[2] While the FNE's Informe de Prohibición also discusses the category "bizcochos familiares" there is little point in discussing it here since it is immaterial for the case.

2.3 Distribution channels

Bakery products are sold in different types of outlets, such as supermarkets, convenience stores, and in smaller shops.[3] The type of outlet has a bearing through the degree of substitution for consumers. For instance, it is well known that consumers would typically go to supermarkets for planned purchases (e.g., the weekly shopping), but do not for "impulse purchases". Accordingly, one would expect biscuits that are bought for immediate consumption to be bought more often in smaller shops than in supermarkets; on the other hand, one would expect family packages to be bought more often in supermarkets.

The Activa Research survey indeed shows differences in the pattern of purchases across distribution channels: it does confirm that immediate purchases take place mostly in smaller shops, and additionally reveals that when individual biscuits are bought for children's snacks (presumably in a planned way and not daily) this is mostly done in supermarkets.[4]

Furthermore, in such cases it is very unlikely that supermarkets may represent a competitive constraint on impulse purchases, and that smaller shops may represent a competitive constraint on planned purchases. As a consequence, it is appropriate for the FNE and the parties to have conducted questionnaires separately for different distribution channels. Furthermore, this should result in defining relevant product markets according to the distribution channel. I shall come back to this point in Section 3.1.1 below.

3. Competitive assessment: introduction

Let me now turn to the analysis of the possible anticompetitive effects of the merger. Traditional antitrust analysis proceeds by first defining relevant product markets and then analysing the importance of the merging parties in these markets, to infer possible anti-competitive effects from the merger.

However, this approach is problematic when assessing a merger in differentiated products industries, because it obliges to draw neat demarcation lines between such products, and assign them to the same market or to a different market (as if they were almost perfect substitutes or, respectively, no substitutes at all) when in truth there exists imperfect substitutability between them.

Accordingly, antitrust authorities nowadays go beyond the traditional approach and (by either complementing it or bypassing it altogether) they devote a lot of

[3] While convenience stores share some features with supermarkets, for the purpose of this case both the FNE and BC have included them within the category "smaller shops", or "traditional channel", as BC call it. (I understand that the difference is of terminology and not of substance.)
[4] See Table 6, Informe de Prohibición.

attention to the *closeness of competition* among merging parties' products.[5] This fully reflects economic theory, which emphasises that the incentives to raise prices after a merger will increase with the closeness of competition between the merging parties. Indeed, the incentive to raise the price of a product of one party will be the higher the closer the substitutability with the other party's products (because most sales lost due to the price rise will be "redirected" towards another product now sold by the newly merged entity), and the larger the profit margin these products will command (the "recaptured" sales will be more profitable).

Such a closeness of competition analysis can be carried out both in *qualitative* and *quantitative* terms. The qualitative analysis is typically based on internal documents, market research or other considerations that may allow understanding the degree to which merging parties are close competitors.

The quantitative approach aims at identifying the incentives to raise prices through a so-called "Upward Pricing Pressure" (UPP) methodology, which has the advantage of being of relatively simple implementation because it is based on very low informational requirements (in its simplest versions, just diversion ratios and margins of the merging parties). Furthermore, it allows to completely bypass the different stages considered in the traditional approach, and in particular does not require defining relevant markets.

Both qualitative and quantitative analyses matter and complement each other. Accordingly, I will first deal with the more traditional approach and discuss relevant product market definition and market shares. I will then briefly discuss the qualitative evidence available on closeness of competition. Finally, I will analyse and discuss the UPP approach followed by the FNE and the parties' economists (BC).

3.1 The traditional approach

3.1.1 Relevant product market

In order to define relevant product markets, one has to find the set of products which – because of substitutability on the demand or the supply side – exercise enough of a competitive constraint onto each other. Conceptually, it is well accepted that the framework of analysis consists of the so-called SSNIP test: would a hypothetical monopolist selling all products in product category A find it profitable to raise prices in a small but significant (say, by 5-10%) and non-transitory manner? If so, then the relevant market will be defined as the A product category. If not, one should expand the potential relevant market and

[5] The closeness of competition can be assessed qualitatively or inform the quantitative analysis captured by "Pricing Pressure Indices" discussed below. Such quantitative analysis has been pioneered by the US antitrust agencies and has been used systematically by the UK agencies for a number of years, and more recently by the European Commission, which also engages in a qualitative assessment of the closeness of competition (see for instance the mobile merger cases cited *infra*).

carry out the same SSNIP test on, for instance, the set of A and B products jointly; and so on, until a profitable increase is found.

The SSNIP test is an abstract one, and helps frame the issue. But to make it operational, one needs data that can inform the SSNIP question. One can resort to estimates of elasticities based on historical consumption data, look at price correlations, try to identify how the market reacted to particular events such as unexpected withdrawal of some products, unexpected shortages, capacity outages, or sudden rise of imports, and so on. In the case at hand, it appears that such data were not available. However, the surveys commissioned by the FNE and the parties' economists do offer important inputs towards the understanding of how to define the relevant product markets in this case.

Before commenting on the survey results, though, it is worth noting that the appropriate relevant market should be delineated across distribution channels.[6]

Distribution channel

First of all, I understand that there is no disagreement between the parties and the FNE that the relevant product markets should be differentiated at the level of the distribution channel. This appears to be the right approach, in the light not only of the different demand patterns across outlets (see Section 2.3 above), but also that there appears to be [redacted] across distribution channels, and that some firms operate in one channel but not in the other (for instance, Buenas Migas operates only in the supermarket channel, Fruna only sells to smaller stores). All this seems to strongly suggest that if a hypothetical monopolist raised all prices of a given category of products sold in one channel by 5-10%, this would likely be profitable. Accordingly, it is appropriate to define markets at the level of distribution channel.

Product market: supermarket channel

The survey commissioned by the FNE to Activa Research contains some questions which not only allow to estimate diversion ratios but also help understanding how to define markets. In particular, Table 8 of the Informe de Prohibición asks consumers what they would buy – if at all – should their favourite product category not be available.

Note that the exact SSNIP question would be of the type: "what would you buy, if at all, if the prices of all (say, brownies) were 5-10% higher?" Instead, the question of Table 8 asks "what would you buy, if at all, if all (say, brownies) were not available for purchase in the market?" Although this question may at first sight appear not the right one, there are several reasons why best practice in conducting this type of surveys recommends asking this "unavailability" (of "forced diversion") question rather than the "marginal increase" (or "price

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[6] Both the FNE and the parties accept that the relevant geographic market is Chile. This seems to be justified in the light of different national demand preferences, promotional campaigns, and distribution networks, as well as the insignificant role of imports. They also agree that in order to understand the pattern of substitutability the survey should be directed to final consumers. This makes sense, since to a large extent the demand of supermarkets and smaller shops will be driven by final consumers' decisions.

diversion") question.[7] Among other reasons, consumers often have very imprecise recollection of the price they have paid (even if the purchase happened few minutes prior to being asked), tend to have imprecise ideas about the rise in absolute terms implied by a 5-10% increase, and asking the "marginal increase" question may not give sufficient answers. Furthermore, asking the "unavailability" question is in this context quite conservative: if consumers are not ready to substitute from, say, brownies to, say, "galletas dulces" when brownies are permanently not available, then a fortiori they will not switch to "galletas dulces" when brownies' prices just increase by 5-10%.

Coming back to Table 8, its results show: (i) that consumers of "bizcochos rellenos" may replace them with brownies (15.9%), alfajores (14.4%) or queques individuales (13.1%) but very unlikely with other types of biscuits (2% or below); and (ii) that consumers of "brownies" may replace them with "bizcochos rellenos" (41.3%), alfajores (6.3%), or "queques individuales" (7.6%), but again very unlikely with other products.[8]

Table 7 summarises the answers given by consumers to the question "what would you buy – if at all -- should your favourite brand not be available?" As such, this question is less directly related to the SSNIP question, but still indicative of what products consumers perceive as substitutes. The results show a similar picture as those in Table 8.

On the basis of these results, it is quite reasonable in my opinion to delineate a first relevant product market as one composed of individual biscuits (brownies, "bizcochos rellenos", and "queques individuales") possibly extended to also include "alfajores", sold in the supermarket channel.

Product market: smaller shops

Table 10 of the Informe de Prohibición reports the results to the same question as Table 8, but for consumers of smaller shops. The emerging picture of the pattern of product substitutability is less clear-cut than in the supermarket channel. Indeed, if – as suggested in the parties' Recurso – one thought of "galletas dulces" as including various types of biscuits ("galletones", "galletas en formato mini", "galletas en formato clásico") then around 20% of both "bizcochos rellenos" and "brownies" consumers would switch to "galletas dulces" if their *favourite product category* was not available.

Table 9 is the equivalent for smaller shops of the question asked in Table 7 for supermarkets, and asks consumers "what would you buy – if at all – should your *favourite brand* not be available?" As argued above, this question – while less directly related to the SSNIP question – is still indicative of what products

[7] See Competition and Markets Authority, "Good practice in the design and presentation of customer survey evidence in merger cases. Revised", 2018, especially at 3.41 and ff.

[8] There are asymmetries in the pattern of substitutability among products, "bizcochos rellenos" appearing to constrain "brownies" more than vice versa (perhaps due to the fact that Nutrabien's brownies are sold at a slightly higher price range, whereas "bizcochos rellenos" may face competition from brownies but also from less expensive types of individual biscuits).

consumers perceive as substitutes. But this time its results are not in line with those in Table 10. For instance, if a “bizcocho relleno Ideal” were not available, only 2.6% of consumers would switch to “galletas dulces”; and if a “Nutrabien brownie” was not available, only 3% of consumers would switch to “galletas dulces”.

Another important consideration when discussing the inclusion or not of “galletas dulces” in the same relevant market as “bizcochos individuales” and “alfajores”, comes from the *supply side*. The fact that the parties, which together account for about two-thirds of sales in “bizcochos individuales” and more than of sales in “alfajores” have an irrelevant share of the market in “galletas dulces”, and that the leader in the latter market, Nestlé is absent from the “bizcochos individuales” and “alfajores” market (and similarly for private brands and other firms) points to the existence of some very distinct features of these product categories.

Also, in the light also of the discussion of entry barriers (see also below), it is unlikely that a SSNIP in “bizcochos individuales” and “alfajores” may be rendered unprofitable by a switch of production from market participants in “galletas dulces” over a short-run horizon.[9]

Accordingly, given the above considerations on both demand substitutability as emerging from survey questionnaires,[10] and of the supply differences, it would be difficult to reach a firm conclusion on the relevant product market in the smaller shops channel, either way. There are arguments suggesting a broader market may be appropriate, and others suggesting that “galletas dulces” may not belong to the same market as “bizcochos individuales” and “alfajores”.

In some circumstances, although it is clear that each national market may typically have different features both at the level of consumer preferences and at the level of production, marketing and distribution, it is helpful to look at the experience of other antitrust authorities and courts, in order to obtain some hints about possible market definitions.

However, this is often more useful at the initial stages of an investigation, so as to formulate some working assumptions that one can them confirm or discard with data or other relevant information on the actual case at hand.

Moreover, in previous merger cases on markets that are more or less related to the industry at hand (those regarding biscuits and chocolate confectionery), I have not seen any clear-cut pattern of market definition. For instance, in most of

[9] See also paragraph 73 of the Informe de Prohibición, which reports a statement by Nestlé, the leader in the “galletas dulces” according to which starting production of “bizcochos individuales” would entail investments in specialised machines and labor.

[10] Recall also the “unavailability” question tends to be conservative: it may well be that consumers would switch from, say, “bizcochos individuales” to “galletas dulces” if the former category was completely unavailable, whereas they would not switch if that product category prices increased only by 5-10%.

its cases,[11] the European Commission has decided to leave the market definition open because however broad the market the merger would not have created competition concerns. In others, market definitions sharply differed according to the national market considered.[12]

Only a very selective reading may therefore find support for one market definition or the other in merger investigations conducted in other jurisdictions, at least in the case at issue here.

Note that since the FNE has decided to focus on the quantitative analysis and bypass the stages of the traditional analysis, it did not need to reach a conclusion on the market definition. The same approach has been followed by the parties' economists, BC.

Finally, I understand that the parties proposed a much broader market definition consisting of all "sweet snacks", including not only all different categories of biscuits but also a number of other products ranging from yogurt to fresh and dried fruits, to chocolate and cereal bars. Since there is limited support (and only for the smaller shops channel) even for the inclusion in the product market of categories of biscuits other than "bizcochos individuales" and "alfajores" (notably, "galletas dulces"), it would a fortiori be very difficult to imagine that products of such a very different nature as yogurt, fruits, cereal bars and so on may provide a competitive constraint to individually sold biscuits and alfajores. I hence see no support whatsoever for such a broad market definition.

3.1.2 Market position of the merging parties and rivals

The following step in a traditional analysis of the competitive assessment of a merger consists of looking at the market position of the merging parties and their rivals. One may here assess different elements, including market shares, production capacity, financial resources, distribution and marketing assets and so on.

Since neither the FNE nor the parties make a detailed assessment of relative market positions, I will also limit myself to discussing market shares, which would be the first and most important step in this part.[13]

Table 11 of the FNE's Informe de Prohibición reports market shares for what appears as a likely product market candidate, that is, "bizcochos individuales and alfajores sold in supermarkets". It shows that Ideal accounts for [redacted] and

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[11] *Mars/Wrigley*, COMP/M.5188; *Nabisco/United Biscuits*, COMP/M.1920;*Kraft/Danone Biscuits*, COMP/M.4824; *Kraft Foods/Cadbury*, COMP/M.5644; *Philip Morris/Nabisco*, COMP/M.2072.

[12] For instance, in *Kraft/Danone Biscuits*, Case COMP/M.4824, The European Commission Decision says (at para. 19): "The market investigation indicated that the strong differences in national consumption habits, as also outlined below, should lead the Commission to define product markets with regard to each country."

[13] Beyond market shares, I note that some supermarket chains consider Ideal and Nutrabien as "must-have" brands (that is, they have products they feel obliged to stock because of consumers' preferences). See paragraph 246 of the Informe de Prohibición.

Nutrabien for [redacted] of sales, Carozzi being the second player with [redacted] and Buenas Migas the third one with [redacted] (although it sells mostly "magdalenas" which appear to have little substitutability with the biscuits sold by the parties).

Therefore, if one defined the market as "bizcochos individuales and alfajores sold in supermarkets", the inevitable conclusion would be that the merger would raise competitive concerns in all main antitrust jurisdictions. In Europe, notably, the combined share of the parties would be sufficiently high for the European Commission to establish a presumption that the merger would create or strengthen a dominant position, and therefore be anti-competitive.

Similar conclusions would be reached if one looked at smaller shops and defined the relevant market narrowly – that is, including only "bizcochos individuales and alfajores" (the combined market share would be about [redacted] or extending it also "galletas mini and galletones" (combined market share of about [redacted] but without considering all of the "galletas dulces" category.[14]

If instead the relevant market for smaller shops was defined so as to include the whole of "galletas dulces", then the merging parties would have a combined market share of about [redacted] and it would be much less likely for an antitrust agency to find anti-competitive effects of the merger in such a market.

3.2 Closeness of competition: qualitative elements

One of the problems with a purely traditional approach, based first on the definition of relevant market, and then on the assessment of firms' market positions in such a market, is that the competitive assessment of a merger may end up being univocally determined by the decision on how to define markets, which would lead to sharper differences than in reality. Indeed, in differentiated goods industries, two products will typically have some degree of substitution, but an approach giving centrality to market definition does not admit nuances: either the two products are considered to be in the same relevant market, and then market shares will not be weighted by taking into account the degree of substitution; or they will not be considered part of the same relevant market, thereby excluding completely the consideration of a product, despite the fact that some substitutability exists.[15]

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[14] See Table 12, Informe de Prohibición.

[15] "One source of difficulty, and of tension between law and economics, with the conventional market-share based approach to the assessment of market power is that products are treated as either "in" or "out" of the relevant market. The danger with this the "zero one" fallacy, so to say is that products deemed "out" of the market may be effectively treated as of little or no competitive significance, while products that are "in" the market are implicitly regarded as close to perfectly substitutable with those at the centre of concern.[...] In fact, the substitutability between one product and another or between one geographic location and another is a matter of degree, and it is artificial to force categorisation. See John Vickers, Market Power in Competition Cases, 2, *European Competition Journal*, 3 (2006), page 8.

To go beyond the crudeness of an approach which obliges to draw neat demarcation lines and declare products either "in" or "out" of the relevant market, antitrust authorities nowadays go beyond the traditional approach (by either complementing it or bypassing it altogether) and they devote quite a lot of attention to how close to each other the merging parties' products are. This is fully in line with economic theory, which emphasises that the incentives to raise prices after the merger would increase with the closeness of competition between the merging parties. Indeed, the incentive to raise the price of a product of one party will increase with the substitutability with the other party's products (because most sales lost due to the price rise will be "redirected" towards another product now sold by the newly merged entity – something which is captured by the so-called *diversion ratios*), and with the *profit margin* these products will command (because the "recaptured" sales will be more profitable).

Such a closeness of competition analysis can be done in qualitative and quantitative terms. In this Section, we deal with the former; in the following one, with the latter.

Closeness of competition: survey results

To start with, it appears from the Activa Research survey that Ideal and Nutrabien's customers share a very similar profile, in terms of gender, socio-economic situation, age, and reasons behind the purchase.[16]

One of the main objectives of this survey was to estimate diversion ratios, instrumental for the calculation of the Pricing Pressure Indices (see below). But since the diversion ratios are a measure of the closeness of substitution between products, they shed light on the question at hand in this Section.

Tables 9 to 14 of Annex 1 of the Informe de Prohibición report the diversion ratios from each of the main products of the parties (Brownie and Braunichoc for Nutrabien, Gansito, Rayita, Pingüino and Mankeke for Ideal) to a number of products – both by the parties and other competitors, for the supermarket channel. Tables 23 to 28 report the same ratios, but for the smaller shops.

Overall the Activa Research results demonstrate that Ideal is the closest competitor for Nutrabien's products (the highest diversion ratios are towards Ideal's products) whereas Carozzi is the closest competitor for Ideal's "bizcochos individuales" products.

The Cadem survey confirms this picture but it also reports diversion patterns for alfajores (not analysed by the Activa Research survey), and reveals that for Ideal's alfajores, Nutrabien is the closest competitor.[17]

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[16] See Table 8, Annex 1, Informe de Prohibición.

[17] See Table 14, Informe de Prohibición, which calculates the proportion of the diversion ratios to the parties over the total sales diverted to competitors. Effectively, this is an index of closeness of competition.

Closeness of competition: the launch of Fuchs

One other element that may suggest closeness of competition is when a company systematically monitors a rival, or when it takes it into account in its strategic decisions. In this respect, it is worth noting that in March 2017 Ideal launched a new product line (under the Fuchs brand) which not only enters the segments where Nutrabien is most successful, but it also appears from internal documents [redacted] Obviously, the launch of the Fuchs product line increases the closeness of competition between the merging parties.

Closeness of competition: product repositioning post-merger

Finally, another indicator of the closeness of competition between the merging parties is that there exist internal documents showing plans for [redacted] [18] This indicates that the parties' product lines overlap and are close enough to make a product readjustment necessary should the transaction take place. Indeed, the comparison of the two panels in Figure 1 (pages 42-43of the Informe de Prohibición) show the possible [redacted]; the [redacted] of the Fuchs and Ideal brands [redacted]

3.3 Interim conclusions of the qualitative assessment

The qualitative analysis of the closeness of competition between the merging parties reinforces in my view the conclusion coming from the traditional analysis that the merger would raise significant competitive concerns. In particular, the fact that Ideal appears to exercise a strong competitive concern to Nutrabien's products appears to be independent on the distribution channel. In either case, Ideal is the closest competitor to Nutrabien, and this would translate in a tendency to raise prices after the merger.

3.4 Competitive assessment: quantitative analysis

As discussed above, antitrust authorities have in the last two decades or so moved beyond the traditional approach, and by relying on economic theory they have developed quantitative methods that aim at identifying the likely price effects of a merger. Some methods simulate the effects of a merger by using rich datasets and relatively sophisticated econometrics to first estimate demand parameters of interest and then infer the effects of a merger. Other methods, more relevant for the case at hand, need little information and are of simpler implementation. I refer here to the so-called Upward Pricing Pressure (UPP) approach and the related Pricing Pressure Indices (PPIs) that some competition agencies – and notably the UK agencies – have been routinely using for a number of years.

[18] Paragraphs 135 to 142, Informe de Prohibición.

3.4.1 The UPP approach

A number of scholarly articles have contributed to this approach,[19] which is built on a simple and well-established principle. Relative to a situation where all competitors are independent, merging with a competitor will give a firm an incentive to charge a higher price:

> "This is because some of the customers it would lose when it increases price are diverted to its merger partner. Thus, a merger allows the acquiring firm to recapture some of the profits that would be lost from the price increase absent the merger. Once it takes this customer recapture into account, it would perceive a greater gain from a price increase."[20]

Clearly, this incentive to raise prices will increase with (a) the proportion of the customers lost that are recaptured by the merger partner's product(s), and (b) with the profit margin that the partner makes on these recaptured customers; indeed, the simplest PPIs only need data on (a) the *diversion ratios* between the parties' products, and (b) the parties' *margins*.

Importantly, Farrell and Shapiro (2010)'s original proposal was to use a very simple PPI purely as a screening device to be used in the initial investigation of a merger, with the idea of undertaking a more sophisticated analysis later (perhaps including demand estimation-based simulation, data permitting), should the screening exercise reveal a more thorough analysis be needed.

However, because of lack of data, human capital, or time (and one needs a lot of all these in order to undertake more sophisticated analyses such as demand-estimation based simulations), several competition agencies have (understandably) increasingly used this simple approach not only as a screening device, but also as the main tool in the competitive assessment of mergers.[21] For this reason, it is important to appreciate the limitation of this approach, and in particular the biases that some of these PPIs may be associated with.

In our case, the FNE and the economic experts of the parties, BC, have devoted most of their reports to the estimation of the so-called Gross Upward Pricing

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19 The earlier papers in this literature are: Carl Shapiro (1996), "Mergers with Differentiated Products", *Antitrust*, Spring Issue; Gregory J. Werden (1996) , A Robust Test for Consumer Welfare Enhancing Mergers Among Sellers of DifferentiatedProducts, *The Journal of Industrial Economics*, 44, 4, pp. 409-413; Jonathan B. Baker (1997), "Product Differentiation Through Space and Time: Some Antitrust Policy Issues", *Antitrust Bulletin*, 4, 177-96; Gregory J. Werden (1998), "Demand Elasticities in Antitrust Analysis", *Antitrust Law Journal*, 66, 363; Daniel O'Brien and Steven Salop (2000), "Competitive Effects of Partial Ownership: Financial Interest and Corporate Control", *Antitrust Law Journal*, 67, 559-614. The most often cited article is: Joseph Farrell and Carl Shapiro (2010), "Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition", *The B.E. Journal of Theoretical Economics Policies and Perspectives*, 10, 1.

20 O'Brien and Salop (2000), page 573.

21 The main example is probably given by the UK Competition and Markets Authority. The European Commission has also used them more recently to assess a series of mobile mergers (see *infra*).

Pressure Indices (GUPPIs) to identify the parties' incentive to raise prices.[22] Note that GUPPIs are "gross" indices, in the sense that they do not take into account possible efficiencies, which are considered at a later stage. In this respect, therefore, there is no conceptual disagreement between the FNE and the parties about which quantitative tool to use.

They have both gathered consumer survey questionnaires to estimate the *diversion ratios* (to repeat, the extent to which sales lost by a product when its price increases are captured by another product) between products of the parties, and used profit *margins* to perform the quantitative analysis sketched above.

3.4.2 Diversion ratios

The FNE and BC have used a different approach to compute the GUPPIs. The FNE has estimated diversion ratios and calculated the GUPPIs at the level of *each product*, whereas BC instead estimate diversion ratios and calculate GUPPI at the level of *each firm*. In other words, while the FNE (using the Activa Research survey it has commissioned) estimated the GUPPIs for each of Ideal and Nutrabien's products, BC (using the Cadem survey the parties have commissioned) estimated two GUPPIs, one for Nutrabien and the other for Ideal.

In my view, the first approach is the correct one, because it allows to account for asymmetric patterns of substitutability.[23] However, it does *under-estimate* the merging parties' incentives to raise prices. This is because the incentive to raise the price of a product implies the latter's margin will be higher, and this in turn should feed back into the estimation of the other merging parties' GUPPIs, but this feedback is instead ignored.[24]

As mentioned above, BC instead estimate diversion ratios and calculate GUPPI at the firm's level, which implicitly assumes that each product of a firm have exactly the same price elasticities and substitutability relationships with all other products, and vice versa. Although this is a strong assumption, and it is not the approach I would favour for an estimation of UPP for multiproduct firms, in my view this does not imply that their exercise is worthless. (Nor is it clear to me that this approach would lead to systematic biases in one direction or the other, in this case.) Furthermore, there may be cases where firms' product lines are very fragmented, so that conducting surveys at the level of products may be cumbersome (and create small sample size problems, see also below), or cases where diversion ratios may be readily available but aggregated at the level of

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[22] The FNE has also estimated the Illustrative Price Rise (IPR) for each product. This has the advantage to take into account the feedback effect between the parties' products, otherwise absent from the GUPPI and a source of under-estimation of price effects, but the disadvantage that requires making assumptions on particular functional forms of demand.

[23] See also the arguments made by the FNE in paragraphs 105-114 of the Informe de Prohibición.

[24] In other words, the GUPPI looks at each product in isolation. But if the price of, say, products A and B increase, then one should take into account that the margin of B is higher, and since the margin of B enters the GUPPI of A, this should feed back into the GUPPI of A, by making the Price pressure index higher. This feedback is instead ignored.

firm.[25] In such circumstances, it would be preferable to conduct the analysis at the firm level.

Reassuringly, it appears that when the FNE uses the same margin estimation, it obtains very similar GUPPIs with diversion ratios at the firm level and at the product level. It seems to me, therefore, that – at least in this particular case -- a discussion about whether it is better to calculate GUPPIs for multi-product firms at the product or at the firm level is largely immaterial.

As for the diversion ratios resulting from the Activa Research survey, I will limit myself to note that the survey has been conducted following the Guidelines issued by the UK Competition and Market Authority, which is the most experienced antitrust authority in the world with respect to using customer surveys in competition cases.[26]

The parties have criticised the FNE estimation of the GUPPIs in the smaller shops channel because of the small number of observations in the Activa Research survey.[27] In the surveys it commissions, the CMA aims (as a general rule) to achieve a minimum of 100 completed interviews with any pre-defined group of interest. However, the target of 100 replies is not always met. When this occurs, results are not necessarily fully invalidated, but certainly they should be reported with more caution, because results are less precise. In the case of Nutrabien's products for the small channel, the Activa Research survey is below 100 replies. However, this is reflected in the wider confidence intervals that the FNE reports on its GUPPI tables.

Furthermore, by using the firm-level estimation of the diversion ratios based on the Cadem survey conducted by the parties (where there is not a small sample size problem), the estimated GUPPIs give a very similar picture as the ones obtained based on the Activa Research customer survey.

3.4.3. Margins

Profit margins are the other important ingredient for the calculation of the GUPPIs. It is then important to discuss the criteria that should be taken into account when measuring margins.

First of all, price decisions are driven by variable costs (not fixed costs), and indeed the margins that appear in the various formulas of PPIs consist of the difference between price and marginal cost. As a consequence, it makes sense to use a measure of margin that includes the closest possible proxy to marginal

[25] For instance, telecom regulators may have Mobile Number Portability data showing switching of users from firm A to firm B, but there may be no information about which particular tariff plan the customer had in A or will have in B.

[26] CMA (2018), "Good practice in the design and presentation of customer survey evidence in merger cases", May.

[27] While the most correct approach, the decision of conducting the survey at the level of single products implies the risk that sub-samples may become fragmented and that for each product one may end up with a small simple size.

costs. This is the approach followed by the European Commission in a series of mobile mergers[28] where it calculated various PPIs (as well as merger calibrations and estimated demand-based merger simulations):

"(97) For the purposes of the merger simulation analysis, the Commission is primarily interested in the margin measure that best reflects marginal costs, that is, those costs that are usually taken into account by firms when setting prices. The most intuitive starting point is therefore the contribution margins.
(98) The contribution margins are based on the direct variable costs only, that is, those costs that naturally vary in direct proportion to each customer acquired or lost. To the contrary, incremental margins include a proportion of indirect costs and the extent to which these costs vary with subscriber numbers is prima facie less intuitive."[29]

Once said so, what is a variable cost and what is not also depends on the time horizon considered, and a discrete change in sales may also entail some additional costs, which would not be incurred when selling one additional unit of the product. Therefore, it may make sense in some cases to consider some incremental costs. Indeed, the European Commission has often used incremental margins as *sensitivity scenarios*,[30] where incremental margins are calculated by deducting some incremental costs from contribution margins. More specifically, it has included in this measure the incremental costs generated by a 10 percent variation in sales.[31]

Similarly, one may want to include incremental costs incurred over a short-run horizon. The UK's OFT has used short-run variable profit margins in some merger investigations, e.g., in the ASDA/Netto case:

"A.14 The parties' approach in calculating the relevant profit margin was to calculate the short run variable profit.[Footnote omitted] This offered a pragmatic proxy to using marginal costs in the calculation which are substantially more difficult to measure. The OFT used one month as a reasonable definition of short run.[Footnote omitted] Over the course of a month a supermarket can change its staffing levels (for particular shifts), stocking and pricing decisions.
A.15 The parties' variable cost calculation comprised cost of goods, staff costs other than managerial and supervisory staff (these costs were considered to be fixed) and the proportion of distribution costs which Asda considers to be variable for its own weekly management reporting purposes [ ]."[32]

By using short-run incremental margins for its GUPPI calculations, the FNE's approach is therefore in line with the practice of other jurisdictions,[33] and

[28] See e.g., Telefónica Deutschland/E-Plus, M.7018; HUTCHISON 3G UK / TELEFONICA IRELAND, COMP/M.6992; HUTCHISON 3G UK / TELEFONICA UK, CASE M.7612; HUTCHISON 3G ITALY / WIND / JV, CASE M.7758. I am not aware of any other industry where the EC has used UPP-like indices in its merger investigations.
[29] HUTCHISON 3G UK / TELEFONICA UK, CASE M.7612, Annex 1.
[30] In the case of the UK merger, after the Parties' reply to the Statement of Objections showing that these affected their Price decisions, the EC used short-run incremental network costs in the calculation of the mobile operators' margins.
[31] More precisely, in the mobile merger cases, a 10 percent variation in the number of users.
[32] Anticipated acquisition by Asda Stores Limited of Netto Foodstores Limited, case ME/4551/10, Office of Fair Trading.
[33] I am not aware of any antitrust authority having used long-run incremental costs for the purpose of calculating margins and estimating GUPPIs.

certainly more conservative than the EC, which typically uses contribution margins as its baseline estimate.

In any event, despite the claims made by the parties in their Recurso, the FNE has accepted most of the cost items used by the parties for the sake of calculating margins, and has left out only some fixed costs of production and personnel which are very unlikely to vary even under significant changes in the scale of production. Tables 3 and 4 of Annex III(II) of the Informe de Prohibición compare all the cost items considered by BC and the FNE for the purpose of computing margins, and reveal that differences are minimal. Table 2 of Annex III(II) reports the margins computed by BC and the FNE[34] and shows that differences between them are minimal.

3.4.4. Quantitative assessments: GUPPIs

As mentioned above, both the FNE and the parties' economists share the same basic methodology and compute GUPPIs (the former at the product level, the latter at the firm level) to identify incentives to raise prices post-merger. GUPPIs are a very simple pricing pressure index, and roughly indicate the pressure to raise price that would be induced by a higher marginal cost incurred by the parties. Or equivalently, they indicate what marginal cost reduction of a product, say, A, would be needed (as a percentage of the price of A) to have no price increase after the merger, *ignoring any feedback effect*. (We shall discuss below an alternative index, the so-called Compensating Marginal Cost Reductions, CMCR, which instead is consistent with equilibrium analysis, and therefore superior to the GUPPI, because it does consider feedback effects.)

The following Table 1 reproduces the GUPPIs calculated by the FNE:[35]

Table 1 - GUPPI computed by the FNE (from Activa Research diversion ratios)

Products	Supermarkets			Smaller shops		
	GUPPI (mean)	Confidence interval 95%		GUPPI (mean)	Confidence interval 95%	
Brownie Nutrabien	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Braunichoc Nutrabien	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Gansito	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Rayita	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Pingüinos	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Mankeke	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

[34] The latter are the results of aggregating the product margins used by the FNE. Recall that the FNE computes the GUPPIs at the level of products and hence needed disaggregated margins.
[35] Annex 1 of the Informe de Prohibición discusses weight-adjusted v. non-weight-adjusted GUPPI, but the differences are marginal anyhow. I understand that Table 17 of the Informe de Prohibición was supposed to give the results without weight-adjustment (but instead reported weighted-adjusted results), and accordingly I reproduce those results here.

The GUPPIs estimated by the FNE suggest that post-merger there would be a strong incentive to increase prices of Nutrabien's products, both in the supermarket and in the traditional channel; and a more moderate incentive to increase prices of Ideal's products. This is roughly in line with the qualitative discussion made above: Ideal's products appeared to exercise a stronger competitive constraint on Nutrabien's brownies than vice versa. Accordingly, the GUPPIs show a bigger incentive for Nutrabien's products to increase prices than for Ideal's products.

By using the firm-level estimation of the diversion ratios based on the CADEM survey conducted by the parties, the estimated GUPPIs give a similar picture as the ones above, as showed by the following Table.

Table 2 - GUPPI computed by the FNE (from Cadem diversion ratios, but FNE's estimates of margins)

Products	Supermarkets			Smaller shops		
	GUPPI (mean)	Confidence Interval 95%		GUPPI (mean)	Confidence Interval 95%	
Bizcochos Nutrabien						
Alfajores Nutrabien						
Bizcochos Ideal						
Alfajores Ideal						

It is worth noting that the data gathered by the Cadem survey also allow computing the GUPPIs for alfajores of both companies, while the Activa Research survey did not allow it. The results demonstrate that there would be a significant incentive to raise prices for both Nutrabien's and Ideal's alfajores, independently of the distribution channel.

3.4.5 Possible shortcomings of GUPPIs

While very useful because they need very little information and are extremely simple to compute (one does not even need a calculator), GUPPIs are a very crude measure of the incentive to raise prices post-merger. In particular, they tend to <u>under-estimate</u> the pricing pressure, for different reasons.[36]

Firstly, they do not take into account the feedback effects of pricing pressures between merging parties. Suppose for the time being that the merging parties are single-product firms, say firms 1 and 2. Firm 1's GUPPI is computed in isolation and by taking as given the price and margin of firm 2, and vice versa. But if firm 2's price is higher, then its margin will also be higher, which will feed

[36] The under-estimation bias of pricing pressure indices such as the GUPPI is well-known. Farrell and Shapiro (2010, p. 23), for instance, state: "All of these tests, like those based on UPP_1 in the previous section, can generate false negative results because they do not fully account for the feedback effects between the two products."

back into firm 1's price decision, creating an additional pricing pressure. And vice versa for firm 2.

Secondly, this underestimation is compounded when firms are multi-product and the GUPPI analysis is done at the level of products, as is the case for the FNE's computation. In this case, the price and margin of each product of the merging firm is taken as given when computing the GUPPI, which further exacerbates the underestimation.

Thirdly, the GUPPI also ignores the feedback effect coming from outsiders to the merger. When the merger insiders raise their price, the outsiders will have higher residual demand and they will increase their prices as well (although to a minor extent), in turn determining a further incentive to raise prices by the insiders. At the equilibrium, therefore, the consideration of the whole system would give rise to higher price pressure than predicted by the GUPPI.

Finally, an additional source of underestimation comes from the fact that whenever there are some cost savings they will increase margins, and this will raise the incentive to increase price.[37]

Because of these shortcomings, economists have developed other indices that are often used by antitrust authorities. The Illustrative Price Rise (IPR) – as the name suggests – has the advantage of providing an indicative estimate of the expected price effect of the merger; however, it still does not take into account rival firms' (i.e., outsiders) reactions (and therefore under-estimates the final price rise), and requires making assumptions on demand functions.

The FNE estimates IPRs assuming linear demands. For the more conservative case of the Cadem diversion ratios, it finds that in the supermarket channel (respectively, smaller shops) price increases would be: bizcochos Nutrabien (resp. alfajores Nutrabien (resp. bizcochos Ideal (resp. alfajores Ideal (resp. See paragraph 129 of the Informe de Prohibición. Note also that IPRs are typically lower than GUPPIs, because the price effects depend on the pass-through rates.[38]

Calibrated merger simulations allow taking into account outsiders' reactions and therefore to compare the post-merger equilibrium price with the pre-merger equilibrium price. However, apart from requiring assumptions on demand functions, this index also requires data on outsiders, not available in this case.[39]

Perhaps the best index, because of its low informational requirements and because it is fully consistent with equilibrium analysis, is the so-called

[37] Of course, if there are cost savings these will also be taken into account when comparing GUPPIs with likely efficiency gains. Both the FNE and BC duly consider them, but the point I am making here is that efficiency gains also affect margins, and this effect is not considered in either of the two reports.
[38] See Farrell and Shapiro (2010, p. 19 ff.).
[39] In its mobile merger investigations, the EC gave centrality to calibrated merger simulations, but it was able to obtain data from the other main market participants.

Compensating Marginal Cost Reduction (CMCR). It was first proposed by Werden (1996), and it consists of finding the parties' cost savings that would lead to the same equilibrium prices for insiders (and, as a consequence, for outsiders too) as absent the merger. This index does not need data on outsiders, nor does it require making assumptions on demand functions, but it does allow taking into account all equilibrium reactions of competitors as well (simply because the merger itself does not change reaction functions of outsiders, and hence if insiders do not modify their price, nor will outsiders).[40]

The European Commission has been computing CMCRs in its quantitative assessment of the recent mobile mergers, and argues that:

> "(26) As with the computation of the GUPPI, the CMCR only requires information for the merged entity's products at the pre-merger price and diversion ratios between the merging parties' products. This is because at pre-merger prices the post-merger first order conditions for non-merging firms equate to zero. CMCR also requires no specific assumption on the shape of the demand function as prices change.
>
> (27) Although GUPPIs are sometimes used to approximate required marginal cost efficiencies, CMCRs provide a better indication for the required marginal cost reductions, because they take account of the fact that a marginal cost reduction of product j will, via an increase in the margin of product j, also have a feedback effect on the first order conditions for other products. This effect is ignored in approximations based on GUPPI. As the informational requirements for both approaches are the same, CMCRs are to be preferred as a benchmark for required marginal cost efficiencies."41

In some cases, especially when the parties do not make efficiency claims, or when there are strong reasons to believe that such claims are unfounded, it may be desirable to carry out calibrated simulations (or IPRs if data on outsiders are not available), so as to have a better feeling for the likely magnitude of the price increases. In our case, though, given that the case may ultimately evolve around whether or not efficiency gains are sufficient to offset the incentive to raise prices, it may be useful to compute CMCR. This is what I am doing in the following Section.

3.4.6 Compensating Marginal Cost Reductions: results

As mentioned above, to compute CMCR one needs exactly the same data used for the GUPPI, and just has to carry out a slightly more complex calculation (see Annex for a formal description of the CMCR methodology and how to calculate CMCRs),[42] that is, solving a system of *n* linear equation in *n* unknowns, where each unknown is the difference between a product's pre-merger and post-

[40] Farrell and Shapiro (2010, p.12 and ff.) describe it under the heading of "a more accurate – but more complex – test". They seem to prefer their UPP test because of its simplicity (recall that they proposed PPIs for the purpose of making an initial screening of mergers), but recognise that it may lead to underestimating the pricing pressure.

[41] Hutchison 3G UK/Telefonica UK Decision M.7612, Annex 1; page 580 of the Decision.

[42] Note that whenever diversion ratios were not available (this was the case for the diversion ratios from "other Ideal products" and "other Nutrabien products" towards the main products for the Activa Research survey data, and from "Galletas Ideal" to the other categories for the Cadem survey), I have assumed that they are equal to 0. This is a conservative assumption and hence the results reported below are under-estimating the "true" CMCR values.

merger cost, and the objective is to find the vector of these cost differences which would lead the insiders to charge exactly the same prices after the merger as absent the merger.

Table 3 - CMCRs (from Activa Research diversion ratios, and FNE's estimates of margins)

	Supermarkets		Traditional channel	
	CMCR ($/K)	**CMCR (% price)**	**CMCR ($/K)**	**CMCR (% price)**
Brownie	[redacted]	[redacted]	[redacted]	[redacted]
Braunichoc	[redacted]	[redacted]	[redacted]	[redacted]
Gansito	[redacted]	[redacted]	[redacted]	[redacted]
Rayita	[redacted]	[redacted]	[redacted]	[redacted]
Pingüino	[redacted]	[redacted]	[redacted]	[redacted]
Mankeke	[redacted]	[redacted]	[redacted]	[redacted]
Otros Ideal	[redacted]	[redacted]	[redacted]	[redacted]
Otros NB	[redacted]	[redacted]	[redacted]	[redacted]

Table 4 - CMCRs (from Cadem diversion ratios and FNE's estimates of margins)[43]

	Supermarkets		Traditional chanel	
	CMCR ($/K)	**CMCR (% price)**	**CMCR ($/K)**	**CMCR (% price)**
Bizcochos Nutrabien	[redacted]	[redacted]	[redacted]	[redacted]
Alfajores Nutrabien	[redacted]	[redacted]	[redacted]	[redacted]
Galletas Nutrabien	[redacted]	[redacted]	[redacted]	[redacted]
Bizcochos Ideal	[redacted]	[redacted]	[redacted]	[redacted]
Alfajores Ideal	[redacted]	[redacted]	[redacted]	[redacted]
Galletas Ideal	[redacted]	[redacted]	[redacted]	[redacted]

These estimates provide us with the benchmark levels against which efficiency claims must be compared. Only if the accepted efficiency levels match or outweigh the CMCRs, will the merger be competitive-neutral.

[43] As explained in the previous footnote, diversion ratios from "Galletas Ideal" to any other category were not available, and I then conservatively assumed them to be equal to zero. It is immediate to check that this implies that to keep the price of "Galletas Ideal" at the same level as absent the merger, no efficiency gain is necessary. Hence the values "0" in the respective row of the Table. Since no competition concerns relative to the "galletas" products have been raised, calculating the CMCR for "galletas" is immaterial anyhow.

3.4.7 Summary

Both the qualitative and the quantitative assessment of the competitive effects of the merger reveals that the transaction is likely to give the merging parties the incentive to raise prices. In particular, prices which are likely to be more significantly affected are those of Nutrabien's brownies, followed by alfajores of both parties and – to a more moderate extent – by Ideal's biscuits.

However, it is worth reminding at this point that these anti-competitive effects may not necessarily materialise if the merger gave rise to offsetting efficiency gains (so far not considered), or if it was expected that the reaction of competitors (whether current rivals or not) or other dynamic considerations may neutralise such incentive to raise prices. It is to these issues that I turn next.

4. Efficiency considerations

4.1 General principles

The incentive to raise prices post-merger identified by the qualitative and quantitative assessments might in principle be offset or even outweighed if the merger entailed sufficiently large (variable) cost savings.

As is well known, certain criteria (that the FNE shares) need to be satisfied for the efficiency gains claimed by the parties to be accepted by antitrust authorities. The US Horizontal Merger Guidelines (2010), for instance, state:[44]

> "The Agencies credit only those efficiencies likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having comparable anticompetitive effects. These are termed merger-specific efficiencies.[...]
>
> Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific.
>
> Efficiency claims will not be considered if they are vague, speculative, or otherwise cannot be verified by reasonable means. Projections of efficiencies may be viewed with skepticism, particularly when generated outside of the usual business planning process. By contrast, efficiency claims substantiated by analogous past experience are those most likely to be credited.
>
> Cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.
>
> The Agencies will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant

[44] Pages 29-30, footnotes omitted.

> market.[...] To make the requisite determination, the Agencies consider whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm customers in the relevant market, e.g., by preventing price increases in that market."

Similar ideas are expressed in merger guidelines and decisions of antitrust authorities worldwide.[45] Such criteria are that the efficiencies must be *merger-specific* (they cannot be obtained without the merger), *verifiable* (the burden of proof falls upon the merging parties, which must support their claims with unambiguous evidence[46]), timely, and beneficial to consumers (that is, likely to be passed-on to them in the form of lower prices).

Such principles are relevant in the case at hand, as they inform the FNE's decisions about which efficiency claims can be accepted and which cannot.

4.2 Efficiency claims in the Ideal/Nutrabien merger

4.2.1 Efficiencies are claimed only for Nutrabien's products

As a preliminary consideration, note that the merging parties claim efficiency gains only on the side of Nutrabien -- such potential gains fundamentally reflecting an alignment of Nutrabien's higher costs with Ideal's lower ones. This feature of the efficiency claims deserves two initial but important observations.

First, *since the parties do not claim that Ideal's products will benefit from cost savings*, it is incontestable that any incentive to raise Ideal's product prices post-merger will not be outweighed by efficiency gains. In other words, unless the analysis of the current and potential rivals' reactions will determine that the parties will be disciplined by entry or expansion of competitors, *it is reasonably certain that the merger will result in Ideal's products being sold at higher prices*. The precise magnitude of the price increase is difficult to predict, since – as discussed in the previous Section - it will depend on the degree of pass-through, but it would likely not be insignificant, in particular for some of Ideal's biscuit brands (notably Pingüinos and Mankeke) and for Ideal's alfajores (whose IPR is estimated by the FNE to be of the order of 3.9% in supermarkets and 5.8% in the traditional channel).

Second, it implies that *the merger does not entail synergies*, that is, it does not modify the parties' operations in such a way to lower prices of both parties, but at best will bring the cost of one party down to the same level as the other. This has important implications, as emphasised by Farrell and Shapiro (1990).[47] These authors distinguish between synergies, which are defined as a situation in which the merging firms *both* enjoy higher levels of efficiencies, and asset re-

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[45] See for instance the European Commission "Horizontal Merger Guidelines", para. 76 and ff.

[46] Parties may be in good faith in expecting efficiencies which will never realise. Recall that, after all, at the origin of the transaction at issue there is the fact that Grupo CCU did not attain the synergies it had expected with Nutrabien. This is an additional reason to look for independent and unambiguous evidence of the cost savings claimed by the parties.

[47] Joseph Farrell, and Carl Shapiro, (1990), "Horizontal Mergers: An Equilibrium Analysis," *American Economic Review*, 80(1), pp. 107-126.

optimisation, where at best there is a shift in production from less efficient to more efficient plants. The latter appears similar to the situation in the Ideal/Nutrabien merger, where Nutrabien may benefit from (some of) Ideal's more efficient practices, but there is no claim that Ideal will benefit from any efficiencies. As Farrell and Shapiro (1990) show, whenever there are no synergies (in the sense just described) a horizontal merger will harm consumers.[48]

It should be added that Farrell and Shapiro (1990) proved this result only for mergers in homogenous goods industries. However, recent work by Nocke and Schutz (2018b) shows that in a market characterised by multi-product firms selling differentiated goods (which reflects the industry under investigation) – as in the homogenous goods model used by Farrell and Shapiro - for a merger to increase consumer surplus it must involve synergies.[49]

It is also worth noting that (even before the recent theoretical advances showed that the Farrell and Shapiro's result also holds for differntiated goods industries), the European Commission had applied the "synergy" principle to a setting where differentiation arose in geographical terms. In *Ineos/Solvay*, the Commission rejected efficiency claims arising from a re-optimisation of outputs leading to lower transportation costs.[50]

4.2.2 Efficiency claims

A detailed discussion of all the efficiency claims made by the parties and of the FNE's decision to accept or reject them is beyond the scope of this report. In what follows, I will limit myself to commenting upon the main arguments made by the FNE when *rejecting* efficiency claims (since there is little point in dwelling upon issues which are not controversial), and discussing them within the framework of the principles stated above.

The Informe de Prohibición considers efficiency claims under four different categories: (i) logistics and distribution; (ii) sales personnel; (iii) production

[48] "Intuitively, this result hinges on the observation that savings of this type do not improve the choice set of suppliers available to consumers relative to the pre-merger situation, since consumers could also have purchased from the firm with lower cost absent the merger. Similarly, the low cost firm could have expanded its output pre-merger, and it does not need to merge with another firm in order to serve more customers. Savings due to output reallocation across merging firms therefore are not capable of offsetting the anti-competitive effects of a horizontal merger between suppliers of homogenous goods." See Benno Bühler and Giulio Federico (2016) "Recent developments in the assessment of efficiencies of EU mergers", *Competition Law & Policy Debate*, Volume 2, N°1, p.68.

[49] Volker Nocke and Nicolas Schutz (2018b), "An Aggregative Games Approach to Merger Analysis in Multiproduct-Firm Oligopoly", NBER Working Paper No. 24578, May. This paper builds upon previous path-breaking work of the same authors: Volker Nocke, and Nicolas Schutz (2018a): "Multiproduct-Firm Oligopoly: An Aggregative Games Approach," *Econometrica*, 86(2), 523-557.

[50] See INEOS/ SOLVAY/ JV, CASE M.6905, at the (heavily redacted) paragraphs 1197-1211. See also Bühler and Federico (2016), page 69.

personnel; (iv) input savings. I will briefly discuss each of these categories in turn.

(i) Efficiencies in logistics and distribution

One of the main claimed efficiencies for Nutrabien's products in the supermarkets channel would come from avoiding costs of distribution so far incurred and relying instead on Ideal distribution network, which would have a lot of spare capacity and could therefore accommodate the distribution of Nutrabien's products as well.

In my view, the FNE is correct in being sceptical about this claim, and I agree with the reasons mentioned in the Informe de Prohibición at paragraphs 164-171. In particular, it is incorrect for the parties to aggregate over time and routes all the existing spare capacity and observe that it would be sufficient to accommodate the distribution of Nutrabien's products. This aggregation hides differences at the level of times and routes (as showed by the FNE in Table 21 of the Informe de Prohibición, in [redacted] of the trips made by Ideal's distribution fleet, the degree of capacity utilisation was in excess of 80%, and in [redacted] of cases it was in excess of 90%), and therefore it cannot be assumed that spare capacity exists to accommodate the distribution of Nutrabien's products at the time and over the routes where such distribution is needed.

Moreover, it is to be presumed that some of the spare capacity may be the result of a precautionary decision by Ideal, so as to be able to accommodate unexpected demand (for biscuits or any other products that the company sells).

Therefore, this efficiency claim seems to me generic, and it does not meet the criterion of verifiability. Accordingly, I doubt that most antitrust agencies, and notably the European Commission, would have accepted any savings associated with this spare capacity argument. The FNE has none the less decided to accept part of these efficiencies, which is conservative and will represent an "upper bound" of the efficiency gains.[51]

In the supermarket channel, the parties claim various efficiencies related to savings in logistics and sales personnel, as well as on IT expenses. Generally, such expenses are considered to be fixed costs, and are therefore not accepted because they do not meet the criterion of benefit to consumers (fixed costs savings are typically not passed on to consumers in the form of lower prices). For instance, in its Hutchison 3G/Telefónica Ireland decision, the European Commission states:

"(781) The Commission agrees with the Notifying Party[...] that the claimed scale efficiencies essentially relate to fixed cost savings. They relate to personnel, IT, marketing, customer operation, general and administrative ("G&A"), retail operations and network costs. The

[51] If the parties have not estimated all of the costs which may be saved in a reliable way and with at least a reasonably disaggregated breakdown of routes and times, then in my view the criterion of verifiability will not be complied with, and the associated efficiencies should not be accepted.

> Commission therefore does not consider that these cost elements are likely to be, in any material manner, variable or marginal costs.[…]
> According to the Horizontal Merger Guidelines, fixed-cost savings are generally less likely than marginal or variable cost savings to be passed on to consumers.[…] This is because, unlike changes in marginal costs, fixed costs savings have no direct effect on firms' pricing incentives and are therefore unlikely to result in lower prices to the benefit of consumers."

Finally, I find correct the decision of the FNE not to accept claims associated with the Ideal's lower costs of distributing Nutrabien's products in the traditional channel relative to the amount that Nutrabien pays to Grupo CCU pre-merger. Since Nutrabien is 100% owned by Grupo CCU, the price paid by Nutrabien is quite simply a transfer price, which -- like all transfer prices within a corporate group -- does not necessary reflect market price. As such, this efficiency claim fails the verifiability test.[52]

(ii) Efficiencies related to sales personnel

The parties claim that there will be efficiency gains due to the change in the remuneration of the marketing and sales personnel: [redacted] which would result – according to parties – in variable cost savings.

I agree with the FNE that there are several problems with these arguments. First of all, modifying the remuneration scheme of workers is hardly a merger-specific change: if it was optimal, it could be modified without the merger. The parties' argument that a higher fixed/variable compensation ratio makes sense only because of the larger scale of Ideal is at best doubtful, given that Nutrabien is itself part of a larger group, which could implement a similar strategy.[53]

Secondly, it is not clear to me why for a smaller company it should be optimal to have a lower fixed/variable ratio. Smaller scale would likely imply that a worker may worry about not reaching the necessary acceptable wage, and risk aversion would push workers to demand a higher fixed compensation and a lower variable one, not vice versa.[54]

Thirdly, if any adjustment of this type did take place, it should be expected to have competitive repercussions. [redacted].
Therefore, if one accepted this cost savings claim, one should also acknowledge

[52] The correct approach in this respect should have been to compute the actual *cost* of this service by Grupo CCU, and then compute the difference relative to Ideal's cost.
[53] Verifiability is also an issue, since I understand from the Informe de Prohibición that there is no evidence of internal documents of the merging parties explaining the exact rationale behind the different remuneration schemes for sales personnel, nor assessing the different policies at hand.
[54] I would also expect that smaller business scale may entail more variability in the remuneration, which would further raise the demand for a bigger fixed component of the wage.

that it will determine a change in market conduct, and weaker competition for Nutrabien's products, thereby creating additional competitive harm.

(iii) Efficiencies related to production personnel

The FNE also rightly dismisses efficiency claims related to possible investments made by Ideal in order to increase the productivity of Nutrabien's production processes. Given the lack of supporting documents, such claims fail the verifiability criterion. Further, it is not clear why such investments could only be made through the merger. Accordingly, the merger-specificity criterion is not met either.

(iv) Efficiencies in the purchase of inputs

According to the parties, the larger scale of Ideal allows it to obtain lower prices from input suppliers, and Nutrabien products would enjoy such lower prices as well after the merger.
It is indeed possible that stronger buyer power may result in lower prices. However, the FNE rejected these efficiencies because they were not substantiated and quantified:[55] indeed, if – as I understand being the case -- Nutrabien and Ideal's products do not have the same ingredients, or have similar ingredients but of different quality, then one cannot infer that Nutrabien will post-merger pay the same price paid by Ideal for any given input. Absent a more detailed breakdown by quantity and quality of the input, indeed such claims do not meet the verifiability criterion.

4.3 Balancing anti-competitive effects and efficiencies for Nutrabien's products

As a result of the consideration of the claims of the parties, the FNE has accepted efficiencies for Nutrabien's "bizcochos individuales" of the order of 4.4% in the supermarket channel, and 1.8% in the smaller stores channel, the percentages being expressed in terms of prices.[56] For the above-mentioned reasons, these efficiencies should be considered as the upper bound of the acceptable efficiencies. For Nutrabien's "Bizcochos" (including familiar format) the FNE accepted 5,1% in the supermarket channel and 2,3% in the traditional channel. For Nutrabien's alfajores, the recognised efficiencies are 6.4% and 2.5% for supermarkets and smaller shops respectively.

These efficiencies should be compared with the GUPPIs or the CMCRs we have discussed above. Table 24 of the Informe de Prohibición, which I reproduced below as Table 5, summarises GUPPIs and efficiencies for Nutrabien products

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[55] Recall the wording of the abovementioned US HMG: "it is incumbent upon the merging firms to substantiate efficiency claims so that the Agencies can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved…"
[56] The economic consultants for the parties, BC, estimated them to be respectively 8.8% and 7.6%. The parties had also commissioned another report, which does not however distinguish between distribution channels, and is therefore not useful.

when using Activa Research diversion ratios: Table 25, reproduced here as Table 6, those when using Cadem data.

Table 5- GUPPI and efficiencies for main Nutrabien products (Activa Research data)

		Supermarkets			Traditional Channel		
		Mean	Confidence interval 95%		Mean	Confidence interval 95%	
Braunichoc	GUPPI (Tabla 17)						
	Efficiencies						
	GUPPI-EF						
Brownie	GUPPI (Tabla 17)						
	Efficiencies						
	GUPPI-EF						

Tabla 6- GUPPI and efficiencies of "bizcochos" and alfajores (Cadem data)

	Supermarkets			Traditional Channel		
	GUPPI - Efficiencies (mean)	Confidence interval 95%		GUPPI - Efficiencies (mean)	Confidence interval 95%	
Bizcochos Nutrabien						
Alfajores Nutrabien						
Bizcochos Ideal						
Alfajores Ideal						

As discussed above, GUPPIs underestimate the pricing pressure. When using CMCR (which indicate the efficiencies necessary to outweigh any pricing pressure), the result that actual predicted efficiencies (even at their higher bound used conservatively by the FNE) are insufficient to ensure competitive neutrality emerges even more strongly, as it appears from the following two tables.

Table 7- CMCR and efficiencies of "bizcochos" and alfajores (Activa Research data)

	Supermarkets		Traditional channel	
	CMCR (% price)	Efficiencies (% price)	CMCR (% price)	Efficiencies (% price)
Brownie				
Braunichoc				
Gansito				
Rayita				
Pingüino				
Mankeke				
Otros Ideal				
Otros NB				

Table 8- CMCR and efficiencies of "bizcochos" and alfajores (Cadem data)

	Supermarkets		Traditional chanel	
	CMCR (% price)	Efficiencies (% price)	CMCR (% price)	Efficiencies (% price)
Bizcochos Nutrabien				
Alfajores Nutrabien				
Galletas Nutrabien				
Bizcochos Ideal				
Alfajores Ideal				

We can therefore conclude that, on the basis of the assessment carried out so far, the merger is predicted to lead to a significant price rise of all the Nutrabien and Ideal products considered.

5. Dynamic considerations, expansion and entry

The competitive assessment developed so far has not taken into account dynamic considerations, either in the qualitative or in the quantitative assessment.[57] In other words, it has been so far implicitly assumed that both merging parties and outsiders will continue to produce the same product varieties, that such products will continue to have the same quality, that innovation and investment will not substantially modify the production processes, that there will be no entry by new market participants, and so on.

In the case at hand, some of these assumptions may be appropriate. For instance, I understand that this is not a high R&D intensity industry, so the impact of the merger on innovation outlays may probably be safely ignored. However, some of the other dynamic considerations are worth discussing. They will be the object of this Section. In particular, it will be important to assess the likelihood of expansion and entry by current or new market participants, because they might in principle discipline the merging parties, and offset the incentives to raise prices.

5.1 Dynamic efficiencies

The merging parties claim dynamic efficiencies consisting of (i) increasing the geographical coverage of Nutrabien's products in the traditional channel, and (ii) Ideal product's benefiting of the secondary distribution network of Nutrabien.

The FNE rejects claim (i) not as a matter of principle, but rather because, despite its potentiality, the parties have neither proved that such efficiencies will materialise with sufficient likelihood, nor have they attempted to quantify them (in the sense of showing how many retail outlets may be newly served). Further,

[57] The UPP-like quantitative analysis is static in nature, and does not allow taking into account dynamic considerations such as those being discussed in this Section.

it appears that Nutrabien's products have in some cases been distributed through the Grupo CCU network in retail points not reached by Ideal. After the merger, such points may not be supplied any longer. Note that, even if it was certain that the distribution of Nutrabien products increased to some extent, this would not be sufficient to offset the anticompetitive harm created by the transaction. As we have seen, the merger would raise Nutrabien products' prices in a significant way, and it is not the possibility that some new customers may have access to these products that could outweigh the detrimental effect of higher prices that all consumers will have to pay for Ideal and Nutrabien products.

As for claim (ii), I understand that the FNE rejects it because the parties have not supported with sufficient evidence.

Given the principle of verifiability, and that the burden of proving of efficiencies falls upon the parties, it seems appropriate that the FNE rejects such claims if indeed it has not received sufficient and detailed supporting information.

5.2 Product suppression, product repositioning, and product expansion by rivals

As mentioned above, the competitive assessment has so far not considered that parties and rivals alike may reposition, suppress, or introduce new products in the markets at hand after the merger. Admittedly, this is a topic on which there is very little guidance from either the theoretical or the empirical literature, among other things because there may be a number of strategic effects which may move in opposite directions, and because it is very difficult to identify how strategic decisions (such as those concerning product variety) -- which are typically neither decided nor implemented from one day to the other -- would be affected by a merger. Nevertheless, let me try to reason about the possible effects of a merger on product offerings in abstract terms.[58] I shall then discuss them in the context of this particular merger.

5.2.1 Theoretical considerations

First, it is possible that – at the moment of merging – the parties have products that overlap or are positioned too close to each other. After the merger, this would not be optimal any more, because these products would aim at the same

[58] I am aware of two papers which analyse theoretically the effects of mergers upon product repositioning: Amit Gandhi, Luke Froeb, Steven Tschantz and Gregory J. Werden (2008), "Post-Merger Product Repositioning". *The Journal of Industrial Economics*, Vol. 56, 1, pp. 49-67; Michael Mazzeo, Katja Seimz and Mauricio Varela (2016), "The Welfare Consequences of Mergers with Endogenous Product Choice", Working paper, Kellogg School of Management, Northwestern University. Both of them study the issue within very specific models, and (perhaps inevitably given the complexity of the issue) lack of generality. My discussion here echoes some of the points they make, particularly those which in my view are more relevant for the case under discussion. Mazzeo et al. (2016, at pages 3-7) also briefly discuss related empirical literature, also pointing to ambiguous effects.

target. The merged entity may then want to either *suppress* some products to get rid of the overlap, or to modify the position of some of them.

While product suppression would clearly be detrimental to consumers, because the number of varieties available to them would be lower (thereby reducing consumer surplus), the effect of *brand re-positioning* is a priori less clear. On the one hand, by increasing differentiation some consumers may be better off because they may find some products closer to their ideal variety; it may also be that the merging parties choose to move products closer to their competitors, thereby alleviating some of the price-rising effects we have mentioned in the previous sections; on the other hand, the repositioning may also be done in such a way as to *pre-empt* entry or expansion by rivals.

The latter point emphasises one of the difficulties of the discussion, which is that there will typically be a strategic interaction of product choices among merging parties and their rivals. There again, it is difficult a priori to predict the likely product configurations in the post-merger industry, since all market participants (and not only the merging parties) may want to reposition their product offering.

If we consider a dynamic world, we should also consider the firms' incentives to introduce new products or new brands over time. To understand the way in which the merger impacts upon such incentives, we could borrow from the recent literature on the effects of mergers on investment (where the investment either reduces production costs or increases quality)[59] and innovation (where innovation affects the probability that a new product or technology is discovered).[60] A reasonably general conclusion from this literature is in my view that – unless the merger allows firms to incur fewer costs for investing or innovating, or allows them to internalise spillovers (neither condition being relevant in the industry at hand) – a merger will result in fewer incentives to invest.

In the case of investment aimed to introduce new brands/products, the main effect at work would then be the following: when considering the introduction of a new product absent a merger, a firm will of course not care about the fact that the new product will steal business from its rivals; but if it merges with one of its rivals, then it will internalise this effect, and hence will invest less. Note that, as for price effects, the incentive for a party to introduce one less product will be the higher the closer the substitutability with the other party's products

[59] See Massimo Motta and Emanuele Tarantino (2016), "The effect of a merger on investments". CEPR Discussion Paper 11550; Marc Bourreau, and Bruno Jullien (2017), "Mergers, Investment and Demand Expansion", TSE Working Paper, n_ 17-880.

[60] See Giulio Federico, Gregor Langus, and Tommaso Valletti, (2017a), "A Simple Model of Mergers and Innovation", *Economics Letters*, 157, 136-140; Vincenzo Denicolò and Michele Polo (2018), "Duplicative Research, Mergers and Innovation", *Economics Letters*, forthcoming; Giulio Federico, Gregor Langus, and Tommaso Valletti, (2017b), "Horizontal Mergers and Product Innovation", *International Journal of Industrial Organization*", forthcoming. For a policy discussion and a summary of the formal models, see Giulio Federico (2017), "Horizontal Mergers, Innovation, and the Competitive Process", *Journal of European Competition Law and Practice*, forthcoming; Bruno Jullien and Yassine Lefouili (2018), "Horizontal Mergers and Innovation", Working Paper, Université de Toulouse.

(because most sales lost due to the product suppression –or missed introduction - will be "redirected" towards another product now sold by the newly merged entity), and the larger the profit margin these products will command (the "recaptured" sales will be more profitable.

5.2.2 Product suppression and repositioning, in the case at hand

As we have seen, it is very difficult a priori to identify all the possible effects that a merger may have on product positioning of both the merging parties and rivals. Now that we have made some general, if theoretical, considerations, let me discuss what we could expect from the merger at hand, on the basis of the documents of the parties and of declarations of rivals. In this Section, I discuss what we know about the merging parties' possible product choices. In the next one, what we know about their rivals'.

Paragraphs 135 to 142 (and in particular Figure 1) of the Informe de Prohibición discuss the existence of internal documents showing plans for product [redacted] by Ideal after the purchase of Nutrabien.[61]

Firstly, these documents witness of Ideal's intention [redacted] after the merger. The perspective of *product suppression*, therefore, seems quite concrete, and coming from Ideal's own documents. As mentioned above, this would *exacerbate the anti-competitive effects* already identified by the (static) competitive assessment.

Secondly, Ideal seems to plan the [redacted]. As discussed above, the impact of [redacted] and it would likely depend on the interactions with rivals' decisions.[62]

5.2.3 Expansion by existing rivals

Conceptually, it is useful in my view to separate plans of likely repositioning of products or introduction of new ones by existing rivals (such as Carozzi), from possible entry by firms not currently active in the products which are likely to be affected in an anti-competitive way by the merger, but which may active in more or less related markets (such as Nestlé) or different markets (such as firms not currently active in Chile). In this Section, I will deal with the former. In Section 5.3, with the latter.[63]

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[61] We also briefly discussed this point in Section 3.2, when considering the closeness of competition between the parties.

[62] The importance of the interaction with rivals' strategies is also revealed by the cited documents. [redacted]

[63] The order of the discussion is slightly different from the Informe de Prohibición, but it is just a matter of presentation. My preference also comes from the fact that I lean towards considering

I understand from the Informe de Prohibición and from declarations of third parties that the only firm currently active in the market of "bizcochos individuales and alfajores" and with possible expansion plans is Carozzi.

According to the information provided by Carozzi,[64] the company is considering the launch of: (i) a " and (ii) a

As for (i), the company has declared that the project is still under evaluation, . However, I understand that name, logo, and ingredients are still not defined. As for (ii), this project is also under evaluation and the company estimates

I also understand that there has been no application yet for the inscription of the brands of these new products in the registry for the protection of industrial and intellectual property (INAPI).

Overall, therefore, it seems to me that these expansion plans are still far from showing that they are reasonably certain, and since there has been no commitment by the company they could reconsider the launch of such products.

Nevertheless, even if such plans did materialise, I do not believe they might in any way offset the competitive risks of the transaction. Firstly, there is no guarantee that these products would be successful. Carozzi clearly has assets, knowledge and reputation, but these are necessary, not sufficient, conditions for success, as the experience of Ideal with the Fuchs brownies also shows. Secondly, I agree with the FNE's arguments that one should expect much more aggressive conduct from new market participants than from one of the leading companies in the market: when a company has a large market share and a wide customer base, the incentive to behave aggressively is muted, because a low price would lead to a cannibalisation effect, since it would steal sales from other products of the same company. Instead, a new entrant would have an incentive to enter with lower prices because any new customer would be stolen from rivals.[65] In other words, even if Carozzi has the *ability* to market a new product aggressively, it will not have the *incentive* to do so.

"galletas dulces" as not being part of the relevant market, while the FNE does not take a stance on this.

[64] See also "Respuesta Carozzi a ORD_178-18"; "Respuesta Carozzi a ORD_742-18".

[65] Consider the costs and benefits of decreasing the price of a product. For a firm with a large market share in the industry, the price cut will win some marginal sales but it will entail losing the profits on all the infra-marginal units. For a new entrant, only the former effect will matter; the latter will not exist, since it has no current sales. This will result in a stronger incentive for the new entrant to decrease prices.

5.3 Likelihood of new entry which may offset the anti-competitive risks of the merger

Before discussing possible new entry in the market, I think it is important to recall the relevant principles that need to be taken into account in this discussion. The US Horizontal Merger Guidelines state:

> "As part of their full assessment of competitive effects, the Agencies consider entry into the relevant market. *The prospect of entry into the relevant market will alleviate concerns about adverse competitive effects only if such entry will deter or counteract any competitive effects of concern so the merger will not substantially harm customers*." (US HMG, page 28; italics added.)

Indeed, antitrust practice all over the world stresses that entry must be not only *likely* and *timely*, but also *sufficient*. To use again the words of the US Horizontal Merger Guidelines:

> "Even where timely and likely, entry may not be sufficient to deter or counteract the competitive effects of concern. For example, *in a differentiated product industry, entry may be insufficient because the products offered by entrants are not close enough substitutes to the products offered by the merged firm to render a price increase by the merged firm unprofitable*. *Entry may also be insufficient due to constraints that limit entrants' competitive effectiveness, such as limitations on the capabilities of the firms best placed to enter or reputational barriers to rapid expansion by new entrants*. Entry by a single firm that will replicate at least the scale and strength of one of the merging firms is sufficient. Entry by one or more firms operating at a smaller scale may be sufficient if such firms are not at a significant competitive disadvantage." (US HMG, page 29; italics added.)

Therefore, the FNE is in my view right – and certainly aligned with standard practice of the main competition agencies - in introducing its discussion on the role of entry by recalling the principle of sufficiency. Even if entry was likely (and in this case it is far from clear it would, see below), it should also be of such a scale and from one or more companies whose products will be likely to replace the loss of an independent competitor of the caliber of Nutrabien.

In this light we should also read the history of recent actual entry into the market. Since it concerns firms which have entered particular market niches (and with products that do not appear close with those at issue),[66] such entry episodes are unlikely to show ease of sufficient (in the above-mentioned sense) entry. Rather, as the FNE argues, they may even show the difficulty of entering at a scale which may somehow constrain the main market players.

Similar considerations apply to imports as well as to the possible entry or expansion of own-label goods (which by their nature may be of interest only and exclusively in the supermarket channel). On the latter in particular, not only does it appear that there is only one supermarket chain that may have projects of launching new products in the market, but also, on the basis of the diversion ratios of the survey conducted by the FNE, it appears that consumers do not

[66] See inter alia the discussion in the Informe de Prohibición at paragraph 230.

perceive own-label products as close substitutes of the merging parties' products.

Finally, I understand that there is no other firm currently operating in adjacent markets that has plans of launching products belonging to the segments at issue. This is likely also due, as [redacted] declared to the FNE, that entering in this market would require additional investments in machines and personnel.

Possible reasons for lack of new entry: brand image

The absence of strong indications of likely, timely and sufficient entry is in my view already enough to discard that entry may in any way discipline the merging parties and offset the incentives to raise prices that we have identified in the previous Sections. Still, the FNE discusses the possible reasons behind the unlikely sufficient entry of new players.

In particular, the FNE identifies brand image and brand loyalty as an important competitive advantage possessed by the leading firms in the market that new entrants may not be able to easily replicate. The Informe de Prohibición reports a number of arguments witnessing of the importance of brand loyalty, and of the consequent likely difficulties for a new entrant. In particular, there is evidence on file of some of the existing brands to be considered as "must-have" by supermarket chains, and of the importance of brand loyalty and brand recognition for consumers.[67]

The importance of brand image and reputation in food-related industries is hardly a novelty. For instance, the path-breaking work of John Sutton (1991), now one of the classical studies in industrial organisation, stresses the importance of brand image and "perceived quality" (usually determined by advertising outlays) in shaping food and drink industries in several countries.[68]

I would also add that – beyond the necessary advertising and promotion outlays to successfully establish a recognised and reputed brand – it appears that there are specific investments to be made in the production of "bizcochos individuales

[67] The Parties object that brand recognition may be a deterrent to entry, and cite one of the answers in the Activa Research survey in support of their argument. However, the question at issue was: "¿Estaría dispuesto a comprar un producto de similares características al producto adquirido, pero de una nueva marca desconocida por usted?" (Tabla 15, Annex I of Informe de Prohibición). The absence of a reference to the price at which such new products would be sold makes in my view the answers completely irrelevant (if for free or well below market price, as sometimes happens when new products are introduced to consumers, who would not try them?). Furthermore, the question could be read as whether the consumer would be willing to try once the new product, which of course would be quite different from readiness to substitute products which are repeatedly purchased. With all respect for those who have designed this question, but I fail to understand what it intended to achieve.

[68] John Sutton (1991), "Sunk Costs and Market Structure. Price Competition, Advertising, and the Evolution of Concentration", Cambridge, Mass.: The MIT Press.

and alfajores" which raise the cost of entry also for firms which do have an established brand image.[69]

Entry barriers: What we learn from the rationale of the transaction

The motivations behind the proposed transaction may also reveal some information about possible entry barriers. I understand that the main reason why Grupo CCU intends to sell Nutrabien lies in the insufficient synergies obtained with the rest of its activities. If one considers that Nutrabien has managed to attain a considerable market share and a certain scale of activities, and that it could benefit of (at least some) distribution synergies with Grupo CCU, this observation appears to suggest that it may even be easy to enter in a market niche, but very difficult to attain the scale and scope of business which is needed to be competitive with respect to firms such as Ideal and Carozzi.[70]

Ideal's motivations behind the proposed acquisition -- which include the incorporation of Nutrabien's brands within Ideal's portfolio, with a view to expand its sales in new markets and new products – are also themselves suggestive that brand value matters and cannot be easily obtained from one day to the other, even for a large multinational group as Grupo Bimbo.

5.4 Product repositioning, entry and expansion: summary

In this Section, I have discussed a number of dynamic considerations that had not been captured by the previous (static) assessment of the competitive effects of the merger. As I have argued above, it is difficult to predict what are the likely effects of the merger on brand repositioning of the merging parties and in particular of other current market participants, since they involve a number of strategic interactions. Perhaps the most likely result of the merger is that the merging parties will suppress one product (which would further increase the competitive risks of the merger) and reposition others (with effects which are more ambiguous, but possibly benign). As for current rivals, we have seen that Carozzi has been considering for some time the launch of two new products, but no made firm commitment towards it yet. Even if it did take place, though, it is very unlikely that it may offset any pressure to raise prices: first, there is no guarantee that such new products will be successful; second, due to Carozzi's market position, it is unlikely that it will price such products aggressively because of the risk of cannibalising sales of some of its other products.

As for new entry, there appears to be no indication of likely, timely, sufficient entry. (In this respect, it is worth noting that there is growing awareness from competition agencies that it is crucial to abide by the criteria of likelihood,

[69] [redacted] mentioned investments in specific product lines as a difficulty (see para. 225 Informe de Prohibición); Carozzi made similar remarks about launching a new product in [redacted]

[70] Like for other mass consumer products, it is very likely that to have a broad portfolio of products would also allow to improve the seller's bargaining power, particularly with supermarket chains. This would also point to small-scale entry not being sufficiently competitive.

timeliness and sufficiency of entry in a strict manner. It does happen that mergers are approved in the belief that entry will discipline market power, only to realise later that such entry never materialises.[71]) Recent entrants, in particular, have been confined to some niche products, and there is no evidence of bigger players having intention to enter. This should not be surprising, given also the importance of brand recognition, and hence the necessary investments to introduce new brands, as well as of other investments to launch new products.

6. Competitive assessment: conclusions

To summarise, the competitive assessment made by the FNE in its Informe de Prohibición is in my view correct, and consistent with economic analysis and standard antitrust practice. Both qualitative and quantitative arguments indicate that the merger is likely to significantly raise prices, and neither efficiency gains nor dynamic considerations (such as product repositioning or new entry) are likely to offset to any extent the incentives to raise prices.

7. Remedies offered by the parties

7.1 Preliminary considerations: structural v. behavioural remedies

If a merger is expected to give rise to anti-competitive effects, the parties may seek to offer remedies resolving the competition concerns, in order to gain approval from the antitrust authority. Remedies are usually classified as *structural* – where the parties typically divest some of their physical assets – and *behavioural* – where they commit to limit their conduct in some respect.[72]

International antitrust practice is adamant that for competition concerns in horizontal mergers, structural remedies are the most appropriate measure, whereas behavioural remedies may be suited for vertical mergers. For instance, the US Guidelines on merger remedies recite:[73]

> "In horizontal merger matters, structural remedies often effectively preserve competition, including when used in conjunction with certain conduct provisions. Structural remedies may be appropriate in vertical merger matters as well, but conduct remedies often can effectively address anticompetitive issues raised by vertical mergers."

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[71] See for instance the report commissioned by the UK Competition and Markets Authority: "Entry and expansion in UK merger cases. An ex-post evaluation", KPMG LLP, April 2017 (available at: https://www.gov.uk/government/publications/evaluation-of-entry-and-expansion-in-uk-merger-cases).
[72] As in all classifications, there may be some remedies which escape this clear distinction, or contain elements of both, being called hybrid, quasi-structural (such as permanent licensing of intelectual property rights) complex, and so on.
[73] "Antitrust Division Policy Guide to Merger Remedies", US Department of Justice, June 2011; page 2.

The same principle is affirmed in the European Commission Notice on merger remedies. For instance, on behavioural remedies the Notice states:

> "Commitments relating to the future behaviour of the merged entity may be acceptable only exceptionally in very specific circumstances.[...] In particular, commitments in the form of undertakings not to raise prices, to reduce product ranges or to remove brands, etc., will generally not eliminate competition concerns resulting from horizontal overlaps. In any case, those types of remedies can only exceptionally be accepted if their workability is fully ensured by effective implementation and monitoring in line with the considerations set out in paragraphs 13-14, 66, 69, and if they do not risk leading to distorting effects on competition."[74]

Nor is there a sign of a change in policy in more recent times:

> "[T]he Commission has a clear preference for structural remedies, i.e. remedies that change the structure of the market, normally through the divestiture of a business. *There is a clear logic to this: a merger by definition results in a lasting structural change in the market, so the remedy also should have a lasting effect. Furthermore, a divestiture is normally a one-off intervention. This means a divestiture does not require long-term monitoring, with all the risks associated with this. It is also a more proportionate interference with the merging firms' freedom to conduct their business than remedies that impose specific conduct over a longer period*.
> This preference for structural remedies is clearly reflected in our statistics. During the last two years, the Commission required a divestiture in 75% of all remedies cases. In only 25% of those cases were other types of remedies imposed, such as access remedies or removal of links with a competitor."[75] [Italics added]

This clear preference for structural remedies is not limited to the US and EU authorities. A recent OECD publication discusses merger remedies and reports submissions on the use of merger remedies by the member states' competition authorities.[76] The submissions confirm the preference of structural over behavioural remedies, with the latter being typically used to solve competition concerns in vertical or conglomerate mergers. They often are of a quasi-structural type (for instance, irrevocable IPR licenses), are aimed at guaranteeing access to inputs, or are considered appropriate only when exceptionally structural remedies are for some reason not available.

The reasons behind the preference for behavioural remedies are manifold. It is impossible to draft them in such a way to include all the possible relevant states of the world; they are typically limited in time and – unlike structural remedies - do not solve a competition concern once and for all; they require constant monitoring, effectively turning the antitrust authority into a "regulator" (and delegation of tasks to a monitoring trustee does not overcome the problem,

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[74] "COMMISSION NOTICE on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004", 2008, pp. 6-7. Interestingly, the omitted footnote relative to the exceptional circumstances in which such remedies may be accepted, refers to a conglomerate merger case.

[75] Carles Esteva Mosso (Deputy Director General for Mergers, Directorate General for Competition of the European Commission) (2017), "EU merger control: how to remove anti-competitive effects?", speech delivered at Paris, 5th Global Merger Control Conference, 8 December 2017.

[76] "OECD Policy Roundtables. Remedies in Merger Cases". Paris: OECD, 2011.

because the latter may have conflicts of interest, or not having enough resources and information to control the compliance with the remedies); they are interfering with the regular market functioning, and thus create possible distortions, in that they limit the business strategies available to the merged entity.

7.2 Merger remedies should be effective and resolve competition problems

Before turning to the analysis of the remedies offered by the parties in the case at hand, I think it is useful to recall another basic principle for merger remedies, that is, that an antitrust authority should be fully confident that they will resolve the competition concern created by the merger. In the words of the US Guidelines on merger remedies:

> "Once the Division has determined that a merger is anticompetitive, the Division only considers remedies that resolve the competitive problem and effectively preserve competition. As the Supreme Court has stated, restoring competition is the "key to the whole question of an antitrust remedy."[…] *Where a remedy that would effectively preserve competition is unavailable, the Division will seek to block the merger*."[77] [footnote omitted, italics added]

Antitrust authorities have to be extremely cautious when reviewing proposed remedies, and ensure that there is reasonable certainty that they will correct any competition problem created by the merger:

> "[E]xperience has taught us that the potential for things to go wrong is high.[…] When this happens, it is the consumer that ends up suffering the ineffectiveness of the remedy. This is why one of the key principles of our policy is that these risks have to be borne by the parties to the merger, not by the customers."[78]

7.3 The remedies offered by Ideal

In this case, as remedies for the competition concerns, the parties have offered to: (i) establish a price freeze for three years; (ii) guarantee a minimum quality; (iii) commit to innovate (by maintaining the same innovation ratio) for a period of two years; (iv) not use certain vertical agreements with Nutrabien (such as exclusivity provisions or tying); (v) limit its investment in advertising and market studies; (vi) increase the distribution of Nutrabien's products to new areas and points of sale; (vii) nominate an independent party with the task of monitoring compliance with such remedies and inform the FNE.

These are all purely behavioural remedies, which – as discussed above – are usually not even proposed – let alone accepted - in horizontal merger cases. Beyond this general remark, though, let me discuss the proposed remedies more specifically.

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[77] "Antitrust Division Policy Guide to Merger Remedies", op. cit. page 3.
[78] Esteva Mosso (2017), page 2; op.cit.

(i) Price freeze

Given that the FNE has identified the main competitive risk of the transaction in its price-rising effects, I presume that in the intention of the merging parties, this remedy should be the main tool for correcting the competition concern. To start with, note that a merger affects the industry in a structural and permanent way, whereas the parties offer this remedy for three years. Even assuming it is an appropriate remedy (which is not, see below), any correction power this remedy may have will evaporate after three years.

Some of the drawbacks mentioned above for behavioural remedies clearly apply for a price freeze. For instance, this would oblige the FNE to devote resources to the monitoring and enforcement of the remedy and it would distort market signals. Other drawbacks are more specific to the measure itself. For instance, a price cap would not help if there were a trend (or particular circumstances) for prices to fall in this specific market, a price cap would not be binding. Next, the existence of maximum prices, and common knowledge of them within the industry, may act as a focal point thereby raising the risk of collusive conduct.[79] Furthermore, in an industry characterized by product differentiation as the one at issue, the price cap may be circumvented by changes in the availability of products, for instance by restricting supply of products at the lower end of the price scale.

Not surprisingly, for all these reasons, antitrust authorities do not rely on price measures in horizontal mergers,[80] and the FNE is right in rejecting this remedy.

(ii), (iii), (vi) Commitments to minimum quality, innovating, and increasing distribution of Nutrabien's products

Similar considerations as at point (i) can be made for the remedies which deal with quality, innovation and distribution. Among their other drawbacks, they are temporary, hard to specify in precise and implementable terms, require monitoring, and may interfere with the regular functioning of the market and of the competitive process. And, obviously, they cannot solve the main competition concern, which is the incentive to raise prices.

(v) Limit investments in advertising and promotion

It is not clear to me what is the competition concern that this remedy is supposed to solve. No doubt, it may help Ideal's competitors, but remedies should aim at eliminating *competition* concerns, not favouring rivals. Furthermore, as discussed above, brand value – and hence advertising outlays –

[79] The FNE has not analysed the risk of coordinated effects, but in such a concentrated market like the one that would be created by the merger, this risk may be far from irrelevant.

[80] Interestingly, the US Guidelines include a long list of behavioural (or "conduct") remedies, such as firewall, nondiscrimination, mandatory licensing, transparency, and anti-retaliation provisions, as well as prohibitions on certain contracting practices, but price measures are not even mentioned. See "Antitrust Division Policy Guide to Merger Remedies", op. cit., p. 12 and ff.

are a very important part of the competitive process in this market, so this measure, whatever its intention, would interfere with the normal functioning of the market. Incidentally, I notice that in markets where brand value, image and reputation matter, the relevant quality parameter is *perceived quality*: hence, this measure also appears to be inconsistent with the commitment not to decrease quality.

(iv) Commitment not to use certain vertical contracts

I understand that this measure would restrain certain conducts of Ideal, notably with respect to its dealing of Nutrabien's products, preventing it from using exclusivity provisions or obliging customers to accept bundled offers. Again, some of the above comments would also apply here. Above all, though, it is unclear what is the competition concern that this remedy is supposed to fix. This kind of commitments may be appropriate in some circumstances, notably if there were concerns that there is an abuse of dominance behaviour after the merger. However, I understand that the FNE has not raised any such concern in this case. Moreover, whatever the merit of such remedy in that respect, it certainly does not contribute to eliminate or alleviate the concern that prices will rise after the merger.

To summarise, for all the reasons given above, it is in my view appropriate, and fully aligned with standard international practice, that the FNE has rejected the parties' proposed remedies.

8. Conclusions

In this report, I have assessed the likely competitive effects of the Ideal/Nutrabien merger, and explained that the arguments used by the FNE in its Informe de Prohibición are consistent with economic analysis as well as antitrust practice in the main international jurisdictions.

In summary, the merger would result in a pressure to increase prices, which would not be offset (and possibly not even alleviated) by efficiency gains. Similarly, there appears to be no indication of likely, timely, and sufficient entry which may discipline the incentives to raise prices. Finally, the parties' proposed remedies, which are behavioural in nature (and therefore unsuitable to correct competition concerns in horizontal mergers) fall well below the required principles of being comprehensive, effective, and eliminate competition concerns entirely.[81] Accordingly, and particularly in the light of the absence of suitable proposed remedies, it is in my view appropriate – and fully aligned with standard international practice - for the FNE to prohibit the merger.

[81] See e.g. "European Commission Notice on merger remedies", page 4-5.