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BILL STALLINGS: Welcome to the ICN Curriculum Module on Merger Review. I am Bill Stallings of the United States Department of Justice Antitrust Division. The Division co-chairs the ICN Merger Working Group, along with the competition authorities of Ireland and Italy. Since 2001, Merger Working Group members and NGAs together have produced useful work product on merger notification and procedures, investigative techniques, and the analytical framework for merger review.

This module of the ICN's Curriculum Project provides an overview of much of that work. During the module, you'll hear about the basic principles of horizontal merger review. The module also provides important, practical investigative pointers, including planning an investigation, conducting interviews, and obtaining and analyzing relevant information.

The module also includes a helpful demonstration based on a hypothetical merger. It tracks a format used by the working group in its training workshops for case handlers.

We hope you find this introduction to merger review useful and encourage you to consult the ICN's website where the full range of the Merger Working Group work product is available. Thank you.

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ANDREW GAVIL: The ICN's Curriculum Project is divided into two sets of modules. Today's module on mergers is one of the advanced group that focuses on particular kinds of conduct. But we recommend

that you first look at some of the foundation modules, competitive effects, market definition and market power.

As global enforcement has moved towards a greater focus on competitive effects, these core concepts, driven by economic analysis, have become more important across the globe.

I'll be working on the competitive effects module. And in that one, we'll look at the kinds of conduct that can lead to different types of competitive effects, using economic analysis. We'll look at coordinated effects, as well as exclusionary effects and also evaluate efficiencies.

All of those, of course, are very relevant to the analysis of mergers, but this module on mergers will not go into as much depth on those particular topics as you might find in the foundation modules.

Thank you for listening and we hope the merger module proves to be of value and interest. Thank you.

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RICHARD WHISH: When conducting an analysis of a merger, an important part of the process is market definition. Market definition is something that I explained with Adrian Majumdar of RBB Economics in Module II of the ICN Curriculum Project. We explain there that an important part of market definition is to define, firstly, the relevant product market and, secondly, the relevant geographical market.

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RICHARD WHISH: I gave examples. For example, when defining the relevant product market, I took, as an example, a bottle of mineral water. Is a popular foreign fizzy drink a substitute for mineral water? Or a sports drink? Or even a bottle of milk?

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RICHARD WHISH: Similarly, when thinking about the geographical market, I asked whether a builder's merchant, faced with higher prices in his country, Arcadia, might either look for alternative supplies in Valhalla, might even be prepared to go so far as Ruritania.

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RICHARD WHISH: When we define the relevant product and the relevant geographical market, we ask ourselves, what is the narrowest market that a hypothetical monopolist would consider to be worth monopolizing? In thinking about this in practice, we have applied the so-called SSNIP test. We take a hypothetical product, for example, widgets, which, at the moment, cost 100, and we ask ourselves, what would happen in the event of a SSNIP?

That is to say, what would happen if there was a small but significant non-transitory increase in price? In that eventuality, would customers for widgets divert their demand to blodgets, even perhaps to sprockets? And we apply the SSNIP test in order to identify a market worth monopolizing.

In Module II, I explain the theory of market definition. I explain what is meant by the hypothetical monopolist and I explain the SSNIP test, which is used to decide what is the relevant product and the relevant geographic market.

However, much more important is how is this done in practice? In Module II, Adrian Majumdar explains various empirical techniques that can be used in order to identify the relevant market.

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TERRY CALVANI: Another important tool when assessing competition issues is the concept of market power, and it's particularly important when analyzing mergers. Indeed, in the United States, to just take one example, the leading treatise says that "the principal concern with mergers is the creation or the enhancement of market power." To take Ireland as just another example, their guidance states that "the objective of merger analysis is the identification of an increase in market power than can be sustained over time." So, it's a very important issue when you analyze mergers critically.

Now, different jurisdictions define market power in different ways, but the bottom line is that it is the exercise of power over price or, put differently, the ability to price above a competitive level over a period of time.

Now, in looking at mergers, obviously, what you're going to be interested in is whether the combination either creates or enhances market power. Very important to your work. And if you are not perfectly comfortable with the concept of market power, I strongly encourage you to take a look at Module IV where we go through, in some depth, and analyze the concept. I think it will be useful to you.

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BILL STALLINGS: throughout this module, we will join a case team during various stages of its investigation of a hypothetical merger. For some background on that merger, let us turn to Joseph Wilson from the Competition Commission of Pakistan.

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JOSEPH WILSON: So, in a hypothetical case, here's what we know from the notification. Just Soy, the firm to be acquired, is one of the largest manufacturers of soy foods in the country. Several years ago, Just Soy introduced a refrigerated soymilk product under the brand name "Thrive." "Thrive" was the first refrigerated soymilk sold in the dairy case and has since brought a dramatic increase in the popularity of soymilk.

Fantasy Dairy, the acquirer, is the nation's leading processor and distributor of fresh milk and other dairy products and a leader in the specialty food industry. Fantasy product mix is weighted heavily toward fluid milk.

In 2006, Fantasy expanded into the milk alternative category with the acquisition of a regional soymilk producer. The integration of soymilk proved difficult, and due to stagnant sales, Fantasy ended its brand in 2008.

About two years ago, however, Fantasy introduced its FantaSoy brand soymilk. Since then, the FantaSoy brand has gained a 15 percent market share.

Let's join the staff of the competition authority in its

initial meeting discussing the proposed acquisition.

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LEAD INVESTIGATOR: Good afternoon and thanks for joining me today. We're meeting today to discuss Fantasy Dairy's proposed acquisition of Just Soy for \$300 million. And we've all had the opportunity to review the merger notification forms and the attached documents, along with the white paper that was submitted by the parties. We've also had an initial meeting with the parties to discuss the transaction, and based on the preliminary information, I'd like to get your initial thoughts on this transaction and the issues that we might have to look at as part of an investigation or a preliminary investigation.

ATTORNEY: Well, it appears that there is only one product overlap between the parties, and that is soymilk. Soymilk is designed as an alternative to dairy animal milks. It is designed for people who have allergies or a lactose intolerance or just prefer to drink soymilk for health reasons.

Just Soy's "Thrive" product appears to have 69 percent of the soymilk market and Fantasy Dairy's "FantaSoy" product has approximately 15 percent of the market. So, this would mean a combined share of 84 percent. This high level of concentration does indicate that the merged entity may be able to exercise market power unilaterally as a result of this transaction.

LEAD INVESTIGATOR: In fact, isn't there a board presentation that indicates something to that effect?

ATTORNEY: There is. There's a board presentation in which Fantasy Dairy states that the combination of "Thrive" and "FantaSoy" would allow it more leeway to set market prices.

LEAD INVESTIGATOR: Pat, from an economic standpoint, what are your thoughts?

ECONOMIST: So, I think the important thing to worry about here or to ask about is whether there are other products other than soymilk that might constrain the possible exercise of market power on the part of the merged entity? So, it might be the case that cow's milk actually constrains the pricing or it might be the case that other alternative milks, such as the lactose-free milk or rice milk or even coconut milk might constrain the pricing.

So, we need to determine what the size of the market is or what the other products in the market is. Even if some of these other alternative milks are in the market, there still might be an issue here as 40 percent -- as the soymilk will be 40 percent and that still might be enough to let them raise price.

LEAD INVESTIGATOR: So, it definitely sounds as if product market is going to be a pretty critical issue that we need to investigate in order to really ultimately determine the transaction's ultimate effect on the market by virtue of finding out what the ultimate market shares are.

Are there any other dispositive issues that we need to consider?

ATTORNEY: I think we need to consider the conditions of entry. Even if we assume a narrower soymilk only market, the

possibility of new entry or expansion by existing firms could still deter or counteract any potential anticompetitive harms that may result from the merger.

We are aware that there has been some recent entry by some soymilk producers. So, I think it will be important to determine how significant that new entry is and also to determine what impact new entry or expansion could have on this market.

LEAD INVESTIGATOR: Now, in addition to other soymilk producers, is it possible that large customers, like large grocery stores, might opt to offer their own private label soymilk product that would ultimately compete with these?

ATTORNEY: Yes, we are hearing that and that is something else that we will need to determine in our investigation.

LEAD INVESTIGATOR: It also seems as if there could be an issue with regards to geographic market. At this stage, it's not clear whether this is really a national market or it's one that's broken up into smaller, more regional markets. We have had indications from the parties and from their documents that regional distribution is more cost effective for them. So, even though that they sell throughout the country, they still do so almost on a regional basis.

At the same time, it seems as if there are some smaller players that do not compete nationally. Ultimately, however, there also seem to be national customers that purchase on a nationwide basis. So, either way, we're going to need to determine the market concentration levels both nationally and within various regions just



to be sure.

Pat, are there any other thoughts?

ECONOMIST: Right. We probably also want to look at efficiency issues. This merger could combine either production facilities or distribution facilities that could lower the cost of producing the soymilk. But we'll need to determine whether these cost reductions could be big enough to outweigh any anticompetitive effects of the merger.

LEAD INVESTIGATOR: Well, I think that that certainly gives us a lot to do and a lot to work on and a lot to consider over the next few weeks. And, so, why don't we meet back in a few weeks after we've had a little more time to analyze some of this and really consider this more fully and we will have more consideration then.

ATTORNEY: Sounds good.

ECONOMIST: Yep.

LEAD INVESTIGATOR: Thanks so much.

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BILL STALLINGS: now that we have seen the initial meeting of the case team to review the merger filing, let us now turn to Jaime Barahona from the National Economic Prosecutor's Office of Chile for some more background on planning a merger investigation.

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JAIME BARAHONA: Quantitative and qualitative studies are used in order to demonstrate the risk or anticompetitive effects of a

merger. According to our experience at the Fiscalía, planning the investigation is very important for us. Experience suggests, also, that it is important for economists to be organized with respect to the investigation team from the beginning. Economists have to work side by side with lawyers to determine what data is going to be obtained from third parties or the merging parties to assess the merger.

The kind and amount of information is very important. Public information in countries like Chile is not thorough enough and doesn't include enough information so you can do a thorough analysis of the merger. So, you have to rely . . .

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JAIME BARAHONA: Another aspect that is important for the team to work on is the hypotheses with respect to the markets that are being affected by the merger, also with respect to the -- the hypotheses with respect to the effects of the merger or the eventual -- the remedies that can be applied. It is important to have a hypothesis so the line of work can be structured by the team.

Now, with respect to the interests that are involved in the analysis of mergers, the authorities have a point of view that rely on assessing what are the possible effects of the merger and the remedies. And on the other hand, the parties want to rely on the efficiencies that they can prove and also on the synergies of the transaction. All these issues have to be dealt with and have to be balanced when you're analyzing a merger.

There are specific aspects of an investigation that are

very important to make -- to take a good use of your time to be efficient. One of them is, for example, what we did at the Fiscalia, that we're now recording our depositions, the interviews with the general manager, managers or the persons that are directly involved in the product lines that are being assessed are interviewed and their -- and their depositions are recorded to be more efficient and have more time to conduct other work with respect to the analysis.

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JAIME BARAHONA: So, when planning the investigation, it is important to determine what are the sources of the data. One of the sources are the merging parties. They have a lot of information relying on -- with respect to sales, quantities and pricing. It is important to obtain all this information from the parties. You have to also realize that it could be biased, so you have to balance it with information and the conclusions of other sources.

Also, it is important to obtain information from market participants, from customers, suppliers, et cetera. All of them have important -- have important information that can be assessed for analyzing the merger.

Also, it is important to obtain information from sector regulators. They have information that has been provided by the parties because of duties that are legally binding for them to report or inform information that is -- that is needed because of these sectoral regulations.

Now, other sources include independent research and

opinions by experts from academia. This information is very important because it can also be balanced with the points of view of the experts that the parties have.

Other types of merger -- of information can also be relied on when you're analyzing cases that were handled in other jurisdictions and findings from other authorities across the world. It is important to assess that information when making an assessment of a merger control operation.

Finally, all this information is needed and this source of information is needed for a useful quantitative analysis -- quantitative analysis of a merger. So, you can have -- you can provide yourself with elements so you can conclude what are the risks and what are the effects of the merger with respect to the mergers involved.

Finally, we think at Fiscalia that it is very important that you can rely on the ICN Handbook of Investigative Techniques so you can help out your case handlers in working out and assessing mergers.

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LEAD INVESTIGATOR: And we need to identify the types of information necessary to develop the theories of possible harm that could result from the transaction. In particular, we should focus on the issues of product market, entry and competitive effects. We should probably start by requesting documents and data from Fantasy Dairy and Just Soy. Does anyone have any thoughts on what should be

included in this type of request?

ATTORNEY: I think it's always useful to get strategic business plans and marketing plans from the parties. It helps us understand how they view this market.

ECONOMIST: And I think that we would like to get at least market level sales data and price data. This -- at least that stuff is -- it's not dispositive, but at least it will give us some ideas as to whether -- how the market is moving.

LEAD INVESTIGATOR: Interesting. And I think, at a minimum, we're going to need to talk to various market participants. And, so, at that point, we need to get lists of competitors or who the companies think are competitors, as well as detailed customer lists, including contact information so that we can contact these customers and competitors and find out what -- how they view the market and what they think of a transaction like this.

ECONOMIST: Right. We'd like to get data or sales data or reports -- sales reports from grocery stores, right, because -- since they're the intermediaries, they both have to decide what products go on the shelf and what products don't go on the shelf, and they'll also have a sense of how customers will switch between the products as prices change.

LEAD INVESTIGATOR: Interesting. And to the extent that geographic market is an issue, I think the parties should -- we should request from the parties to provide a map of manufacturing and distribution facilities to help us analyze the various geographic market issues.

ATTORNEY: Agreed. I think once we receive the customer contact lists from the parties, we can then start to interview those customers as they are the companies that are most likely to be affected by this transaction. During those interviews, we should be able to find out from customers whether they view any other products as legitimate substitutes to soymilk. This will help us understand what the relevant product market should be. Customers are likely to be able to tell us whether or not they would be able to switch to another product in the event of a 5 to 10 percent price increase in the price of soymilk.

Also, I think customers could be very helpful in understanding the competitive dynamic between Fantasy Dairy and Just Soy. They should be able to tell us whether or not these companies are competing aggressively for their business.

LEAD INVESTIGATOR: Interesting. In terms of conducting interviews, we should also conduct interviews with the companies that the parties identify as competitors, as well as companies that may be poised to enter into the market that are not currently competitors. These interviews will help us to determine the conditions of entry. We should also ask them what assets and capabilities are necessary to enter the market as a viable competitor. In addition, these companies should provide us with documents and sales data that will help us calculate our own market shares and concentration figures, as well as to analyze the current competitive landscape.

ECONOMIST: Also, I think that we would try to get scanner data from the individual grocery stores. This will give us an idea as

to how customers switch between products as the retail prices change. So, this will help us decide whether FantaSoy and Thrive are close competitors and it will also let us see if customers switch between, say, soymilks and alternative milks as the relative prices of those products change over time.

LEAD INVESTIGATOR: Interesting. Well, we have 90 days to conduct our investigation. Let's divide these initial assignments so that we can complete them in a timely manner.

Stephanie, could you please draft a request for information that we could send to the parties and for other soymilk producers?

ATTORNEY: Yes, no problem.

LEAD INVESTIGATOR: And, Pat, could you please draft a request for the grocery store scanner data, as well as any other data that you would need from the parties in order to analyze the transaction from an economic perspective?

ECONOMIST: I'm already working on it.

LEAD INVESTIGATOR: Thank you. And I think we should all begin to schedule interviews with customers and competitors and we can break those out ourselves.

So, as always, we'll just continue to revise our investigational plan throughout the period. One thing that someone should take care of is contacting other international competition authorities so that we can make sure that if they have concerns, that we can coordinate our activities in any way possible.

ATTORNEY: I can work on that.

LEAD INVESTIGATOR: Thank you. Well, thanks again, guys, and let's get to it and we'll meet back again when we have more information.

ATTORNEY: Okay.

ECONOMIST: All right.

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MARGARET BLOOM: We now turn to how to obtain evidence from third parties. Customers can be a very useful source of information as they have a similar interest in competition as do agencies. Both customers and agencies, of course, favor a competitive market. However, customers may only have limited information. Competitors, on the other hand, generally have good information. But this needs careful analysis as competitors are likely to favor an anticompetitive merger and to oppose a procompetitive merger.

Let's now look at what information is useful. There are various categories of information. Firstly, there's factual information, for example, the number of units produced. Another category of information is predictions. An example here is what would customers do if prices, after the merger, went up by 5 to 10 percent? A third category of information is analysis. Why did customers choose one product rather than another? And yet another category covers impressions and opinions. Let me give you an example for a customer, that is whether the merger will or will not cause harm. An example for a competitor would be whether the competitor supports or opposes the merger.



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MARGARET BLOOM: Let's now turn to looking at how to obtain the information that you require. Well, there are broadly two ways of doing this. One is through written requests and the other way is by interview. When we're looking at written requests, it's very important to be careful with the wording. Be precise. Focus on facts, but give sufficient time for a response to your request.

Interviews can be by the telephone or in person. Here, it's useful to use open-ended questions such as who, what, why, when, where and how.

Let me remind you of the ICN Handbook of Investigative Techniques. This handbook has a wealth of information on how to obtain evidence from third parties.

We're now going to look at two interviews. One is with a customer and the other is with a competitor.

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LEAD INVESTIGATOR: I'd like to talk to you about Super Grocery's purchases of soymilk products, but mostly in the context of how they purchase their dairy products and non-dairy products in general. Could you describe for me what your purchasing policies are?

SUPER GROCERY BUYER: Well, Super carries a variety of different dairy products and different brands,

including Thrive, FantaSoy, Star Soy, MediSoy, Soy Day.

We have national brands as well as regional brands.

LEAD INVESTIGATOR: And could you describe for me, do you feel like there are certain customers themselves that really prefer soymilk to regular milk or do customers purchase back and forth between regular milk and soymilk, for example?

SUPER GROCERY BUYER: I think that the majority of our customers do stick with the classic dairy milk. However, we do have a nice offset that prefer to purchase soymilk and it's a growing -- it's a growing industry, so we're seeing more and more people interested in soymilk products.

LEAD INVESTIGATOR: Now, you had mentioned that there were national and regional brands. Who do you -- what are the brands that Super Grocery carries on their shelves?

SUPER GROCERY BUYER: We carry Thrive. We also carry FantaSoy, and FantaSoy has a number of offsets like Just Soy, and we also carry Ambrosia and their dairy products and we're looking into carrying their soymilk as well.

LEAD INVESTIGATOR: Now, are certain of these products, are they must-have products or national brands? Which ones are the national brands and the regional brands?

SUPER GROCERY BUYER: Thrive and it's also called Just Soy, that's the national brand. Our regional brands are Ambrosia or

Star Soy and those are very popular at the moment.

LEAD INVESTIGATOR: Oh, very good. So, it sounds as if you feel like the regional brands still exert some influence on the national brands.

SUPER GROCERY BUYER: That's definitely the case.

ECONOMIST: So, are there -- do customers differentiate between the soymilk products and the alternative -- the other alternative milk products, like the lactose-free milk products like New Milk?

SUPER GROCERY BUYER: I think for the most part people are more interested in soymilk than the New Milk products, if they're interested in anything other than traditional dairy milk.

ECONOMIST: Okay. Have you thought about entering into the soymilk market with a private label product of yourself -- yourselves?

SUPER GROCERY BUYER: Yes, Super has been looking into this for about the past year, and we are planning to enter the soymilk industry with a private label product in the fourth quarter of this year. However, we're currently still looking for the product that has the right price as well as the right quality. So, we haven't found the right product yet.

ECONOMIST: But it sounds like this is something that you're planning on doing in the future?

SUPER GROCERY BUYER: Yes.

ECONOMIST: Have you thought at all about the effects of the merger and how that will affect your selling of soymilk?

SUPER GROCERY BUYER: I think that the merger is going to cause an increase in our sale of soymilk. I think that the merger is trying to crowd out the smaller brands from the market, but I don't think it's going to be effective because of the customers' brand loyalty to their regional soymilks.

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ATTORNEY: Now, Mr. Kloden, I understand that Ambrosia recently entered the market for refrigerated soymilk. What I'd like to do is just discuss what assets and capabilities are required to enter this market. Can you please describe Ambrosia's manufacturing capabilities for its soymilk products?

COMPETITOR: Well, we needed a plant and we needed some lines where we could bottle the soymilk. So, we looked into whether or not we would use one of our existing plants and decided that it would be better to build a plant centrally located in the middle of the country and we set it up with five different lines so that we could produce milk -- soymilk that comes in different size bottles and different flavors.

ATTORNEY: Okay, thank you. Can you please describe Ambrosia's distribution network for its soymilk products?

COMPETITOR: Well, we're lucky there because we already have the distribution network that's in place from our parent company, Elysium. So, we were able to use the trucks that Elysium uses and the refrigeration warehouses that Elysium has in different parts of the country. The refrigeration plants is an important part of the distribution mechanism.

ATTORNEY: Interesting. Do you believe that Ambrosia's entry into the soymilk market was made easier given the fact that it could rely on Elysium's existing distribution network rather than having to establish a distribution network from scratch?

COMPETITOR: Sure.

ATTORNEY: Okay. How long did it take for Ambrosia to enter the market for soymilk?

COMPETITOR: Oh, I guess I'd say a grand total of about 20 months. We had to get the technical manufacturing equipment and that -- some of that was imported. That took about nine months or so to have imported. And we had to construct the whole facility that we built, that took a while. And, you know, advertising and all those other things that go with marketing the product, about 20 months.

ATTORNEY: Okay. And how much did it cost for Ambrosia to enter the market for soymilk?

COMPETITOR: Once I did the grand total for that, I think it was around 60 million. I think it was around 24 million or so for the -- for the manufacturing equipment, another \$6 million or so for the plant that we built. I think it was -- we signed a \$6 million agreement with a bottling company to make the plastic bottles. Let's see, another \$5 or \$6 million

administrative costs and then there was about a \$5 million slotting fee. I think that comes up to about 60 million. Maybe I've missed one thing or so, but I'm pretty close to there.

ATTORNEY: Okay, okay, thank you.

ECONOMIST: When you were entering, did you feel the need to differentiate your product from the incumbent soymilk products, and if so, how did you do that?

COMPETITOR: Sure. We wanted to enter the market as a special product, and the main thing that we do that's different is we have a technology that allows us to dry the beans first and then we rehydrogenate them afterwards and that results in a much less beany taste in the soymilk. So, one of the objections that people have to soymilk is that it leaves a beany taste in their mouth afterwards and we were trying to reduce that taste.

ATTORNEY: Okay, thank you. We have no further questions.

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MARGARET BLOOM: As you can see, third parties such as customers and competitors can provide a lot of useful information. But there's another important source of information and that is information that comes from documents. We'll look at documents next.

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NICHOLAS BANASEVIC: What is considered an important document will depend on the case and for each different aspect of the same case as well. As a rule, contemporaneous evidence such as strategic emails or presentations to the board will generally receive

more weight than a document produced after the merger has been announced. Such evidence can also be corroborated during the procedure, for example, through minutes of an interview with a key customer regarding substitutability or third party evidence on input foreclosure, for example.

While reviewing documentary evidence, the documents in question should not necessarily be taken at face value and there should be no hesitation in asking for clarification of the meaning or substance of anything in the documents.

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NICHOLAS BANASEVIC: In practice, there is work conducted in case teams with one case manager responsible for the overall management of the case, and depending on the size and complexity of the case, several case handlers, members of the chief economist team and other support staff as relevant.

Review is allocated within the case team with tasks generally subdivided by product and where relevant, according to the different elements of the case, such as product market definition, competitive assessment, entry, efficiencies and so on.

The languages of the documents need to be kept in mind, of course, and these can influence the task allocation, depending on the language resources within the case team. At the same time, the tools used to review the evidence must allow access simultaneously to the entire case team. So, examples of this are e-discovery tools, databases where all the evidence is uploaded and available to the whole case team and a document management system for the filing of

documents.

Now, as regards to the review of economic evidence in particular, the European Commission has issued best practices for the submission of such evidence. These include recommendations regarding the content and presentation of economic or econometric analysis as well as guidance to respond to Commission requests for quantitative data to ensure that reply is timely and relevant. There is also information on this in the ICN Investigative Techniques Handbook in Chapter 4.

Professional secrecy and business secrets should also be kept in mind. Business secrets are confidential information about a company's business activity, the disclosure of which would cause serious harm to that company. For example, this could be information relating to know-how, production secrets, supply sources and so on.

A decision must rely on all relevant information which, of course, should be made accessible to the parties throughout the procedure. And efficient management of the case file, therefore, throughout the procedure from the very beginning is crucial. All in all, therefore, whilst every case is, of course, different, the efficient management of the case is greatly facilitated by both its proper organization and planning from the very earliest stage.

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BILL STALLINGS: Let us now rejoin the case team as it meets to discuss what it has learned from its initial review of the documentary evidence and interviews with market participants, including customers and competitors.



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LEAD INVESTIGATOR: Thank you for attending this meeting. The purpose of this meeting is to take stock in a lot of the evidence and data that we've received as a part of our investigation -- that we developed in our investigational plan from the last meeting. In particular, what I'd like to do is talk about particularly instructive evidence that we've received so far and explain how that's really instructing our analysis into the proposed transaction between Fantasy Dairy and Just Soy. In particular, for example, I'd like to talk about some of the interviews that we've conducted with customers and competitors.

Stephanie, were there any particular interviews that you found to be instructive?

ATTORNEY: Yes, I thought that the interview with Elysium Foods was particularly instructive on understanding the conditions of entry. Elysium Foods recently launched a new soymilk product called Ambrosia into the market and it quickly gained about 7 percent of the market. So, they've had some relative success here.

The executives of that company told us that they believe that entry barriers in this market are relatively low and that the market is rapidly growing and is attractive for new entry. That said, they did acknowledge that it was easier for them to launch the Ambrosia product than it would be for most companies because they could take advantage of Elysium's existing manufacturing and distribution infrastructure. Other companies would have to develop

those from scratch and that could be very costly and time consuming.

Also, the Ambrosia product was only rolled out in a couple of regions rather than on a national scale. They do hope to roll out the product nationally by sometime next year, but they admitted that their current limited geographic coverage has put them at a disadvantage when bidding against Thrive and FantaSoy for shelf space with national grocery store chains.

LEAD INVESTIGATOR: Well, I also found an interview that we conducted with a company called New Milk to be very instructive. In particular, New Milk, if you recall, produces a lactose-free milk alternative product. So, it's not soymilk, but it still, at the same time, could potentially have some of the same attributes that an alternative milk product would have. In this case, the producers of New Milk really said that they did not view themselves really as a significant competitor to either Fantasy Dairy or to Just Soy. In particular, they found that their customers are purchasing lactose-free milk products for a slightly different reason, even though it's a related reason, a slightly different reason than soymilk products, to the degree that really they found any competition or replacement of sales to really only be marginal.

At the same time, they also discussed the difficulties of entry and that they would prefer to enter other alternative milk products other than soymilk than to try and enter into the soymilk product, which, to me, indicates a lack of competition as well.

Were there any -- what were some of the learnings that you had either from documents or from data?

ECONOMIST: So, the grocery store interviews were sort of mixed, like some of the grocery stores certainly thought that soymilk and other alternatives weren't in the same market. One or two thought that there was some possible competition at the margin.

The data, on the other hand, is pretty consistent with soymilk being a separate market. The store level data indicates lots of switching between soymilk brands as the prices of those brands differed over time. But much less switching between soymilk and other milk alternatives as those relative prices changed.

Also, the industry level data that shows soymilk growing market share and alternative milks losing market share is really more consistent with the idea that soymilk is growing the market, and so, they're bringing new customers into the market and that's why their share is growing. New Milk, on the other hand, while losing share isn't really losing total sales, it's actually gaining a little bit in total sales, and that suggests that customers aren't leaving New Milk and going over to soymilk. So, these products don't seem to compete very well.

LEAD INVESTIGATOR: Now, in terms of documents, Stephanie, were there any particularly instructive documents for you?

ATTORNEY: There were a number of helpful documents. In particular, I found a board presentation that was submitted by Fantasy Dairy, and in that presentation, they discuss how the combination of FantaSoy and Thrive is going to strengthen their position in the market and actually allow them more leeway in setting market pricing. I find that to be very indicative of the merged firm's ability to

exercise market power unilaterally as a result of this transaction.

LEAD INVESTIGATOR: Well, I found the documents, particularly the company's documents, to be particularly instructive as well. One thing that you had asked for as part of your document request from the parties is emails, and I found the emails to provide a contemporaneous view of how these companies view the market and there was, in particular, a Fantasy Dairy email that indicated that they viewed the market, themselves, quite narrowly and that they assigned the combined entity, or the merger of Just Soy and Fantasy Dairy, to have a 90 percent share. At that point, it seems that they do not view alternative substitutes, things that are not soymilk, to be a competitor to soymilk. And I found that to be very instructive.

So, based on all these -- based on all this, I think that we certainly have reason to continue our investigation and to ask for additional documents, continue to conduct industry interviews with customers and competitors so that ultimately we can come to a conclusion and make a recommendation to our director. So, thank you.

ATTORNEY: Thank you.

ECONOMIST: Thank you.

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BILL STALLINGS: As the case team discussed, market entry and expansion and efficiencies are two important considerations in analyzing the competitive effects of a merger. For more background on these issues, let us turn to Sean Ennis of the Competition Commission of Mauritius.

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SEAN ENNIS: Entry is often cited as a reason that even if a merger places firms in a situation in which they could profitably raise price, that they would not be able to sustain the price increase. The entry of new firms can take the form of new producers of equivalent products, producers of new but substitute products, or entry by moving products from one geographic area to another. The likelihood of entry should be serious -- seriously investigated when there's a potential anticompetitive effect or prior to large investigations that would be stopped in the presence of likely entry.

Entry barriers can be defined in the following way. A cost of producing at some or every rate of output which must be borne by a firm which seeks to enter an industry, but is not borne by firms already in the industry. That definition is by George Stigler.

There are a number of factors to consider when thinking about the effect of entry on a merger.

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SEAN ENNIS: One of the first ones is whether the potential entrant is committed. Another is how long would effective entry take. Another is what are the cost characteristics of entry, in particular, are there any sunk costs? These are investments that could not be recovered upon a firm exiting that business. Are there economies of scale? If there are economies of scale, what is the minimum efficient scale? And then the final factor to consider is are there any external investors willing to finance entry?

What is the entry test that can be used when you're thinking about mergers? Well, the basic answer is that the entry test would ask whether entry is likely, timely and would be sufficient to deter or defeat anticompetitive effects of a merger.

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SEAN ENNIS: The entry test is not whether one or more entrants would be able to achieve sufficient presence to equal the business capacity of the smallest firm.

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SEAN ENNIS: Efficiencies can sometimes be an important consideration when evaluating mergers. Merging parties may claim that the merger will result in a more efficient operation of the company afterwards, which would allow them to lower the price of goods to consumers. But efficiency analysis is relatively new and untested. So, it's worth learning about some of the approaches that have been advocated. The ultimate goal in efficiency analysis is to incorporate considerations of efficiency into the overall evaluation of a merger.

Efficiencies are categorized in several types. There are productive efficiencies, allocative efficiencies and dynamic efficiencies.

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SEAN ENNIS: Where would efficiencies come from? They would come from economies of scale, economies of scope, reallocation of production, combining hard-to-trade assets, increasing buyer power

of companies, and potentially from innovation.

How frequently are efficiencies achieved? This is unclear. There have been event studies, accounting studies and case studies of mergers that have had mixed results in terms of showing the extent to which efficiencies really are achieved. Sometimes they are; sometimes they are not. So, we can't make any broad generalizations on the frequency with which they are achieved.

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SEAN ENNIS: So, what we would ask in thinking about mergers is when should efficiencies actually be considered? And the answer is when the efficiencies are merger specific, likely to be achieved and not simply speculative, verifiable, timely, and they would impact the relevant standard for evaluating the effects of the merger.

What you could have is that the price to consumers would fall even though the margin would increase. And then under the consumer welfare test, the efficiencies would justify a merger that allowed margins to increase.

How can efficiencies be identified? How can they be measured? It's important to identify the efficiencies largely with the parties suggesting what the efficiencies would be, and then the efficiencies can be evaluated one by one.

Measurement of efficiencies can be difficult, however. It is -- they can often be claimed to be quite large when they are relatively small or uncertain. And so, what's important is to find an effective way of evaluating and measuring the efficiencies that would

exist. The burden of proof for this evaluation should probably lie with the parties themselves cause they have the best access to the evidence about efficiencies and, moreover, it's difficult to disprove false claims.

One of the factors that's considered when thinking about efficiencies is how much would the efficiency be passed through to consumers? What's called consumer pass-through is the extent to which those lower costs are actually given on to the consumers. Knowing the industry-wide pass-through does not tell you what the firm-specific pass-through would be. Firm-specific pass-through can be directly estimated using econometric methods, but then the data needs are somewhat substantial.

The important point, though, is that you're not likely to have both high anticompetitive effects and low pass-through rates. If you have a high anticompetitive effect, it's likely that the pass-through of efficiencies would also be high.

Now, how do you take efficiencies into account in the overall merger evaluation? You think about what the potential harms would be and then you think about the reduction in costs that might come about from efficiencies. If the harms would likely outweigh the efficiencies, then the decision procedure would probably be that you would challenge the merger. On the other hand, if the efficiencies outweighed the harms, the merger is likely to benefit consumers overall so you would not challenge the merger.

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JOSEPH WILSON: In some cases, although not our soymilk case, the parties claim that mergers should be permitted because one of the firms is failing. A failing firm is a firm that is consistently losing market share to such an extent that it is likely to go out of business.

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JOSEPH WILSON: In assessing claims of the failing firm defense, competition agencies should determine first whether the firm would be forced out of the market in the near future because of financial difficulties, if not taken over by another undertaking; second, whether there would be no serious prospect of reorganizing the business; third, whether there would be no credible less anticompetitive alternative outcome than the merger in question; and, finally, whether in the absence of the merger, the assets of the failing firm would inevitably exit the market.

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BILL STALLINGS: Let us now rejoin the case team as it meets with its senior management to discuss what its initial review of the proposed merger between fantasy dairy company and just soy has found.

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AGENCY HEAD: Why don't we get started. I'm very interested in hearing from both a legal and economic perspective what you found about this proposal.

LEAD INVESTIGATOR: Yes, I think firstly we should perhaps

provide you with a brief summary of the case and what we found. These -- this transaction involves two producers of soymilk products, specifically Fantasy Dairy and Just Soy. And the issues here were, in terms of product market, what does soymilk compete with? Does it compete with milk products generally or other alternative milk products like lactose-free milk or is it really a narrow market? And I think, in this case, we found that it was a narrow market that really only existed among soymilk producers as opposed to any other types of products.

AGENCY HEAD: What's the basis for that tentative conclusion?

LEAD INVESTIGATOR: The way that we came to that conclusion was mostly through interviews with customers and competitors, as well as through obtaining various scanner data from the parties and from the various customers. And the customers seemed to feel that there was very little -- very little interplay between the alternative products and the soymilk products. Certainly, the Bureau of Economics or certainly our economists have some opinions on that as well.

ECONOMIST: The store level data showed the price effects between soymilk products, the changes in prices gave you changes in the quantity of different brands sold, but there was very little price effect between soymilk products and alternative milk products.

AGENCY HEAD: And is the quantity and the quality of the data such that we're confident in these conclusions?

ECONOMIST: Yes, the store level data is -- seems pretty

solid. Also, the macro level data, the data that gets purchased from outside vendors is also consistent with the soymilk products basically growing their own separate market and having very little effect at the market level on sales of alternative milk products.

AGENCY HEAD: Now, one of the things that I like to see when we're going to go forward with enforcement is a situation where all of the evidence seems to point generally in the same direction from different sources so that the economic analysis, the views of market participants, and what we've learned from the parties' own documents all suggest the same conclusion. Is that the case here?

LEAD INVESTIGATOR: There's always going to be a case of mixed information, particularly in terms of different opinions from market participants. What we can indicate is certainly that the documents have indicated that these products compete only amongst themselves. One email, in particular, describes the market share as being 90 percent and describes the company's products really within their own market.

At the same time, the other documents indicate competitive effects where these are particularly close competitors. At the same time, we've also discussed entry with the various competitors in order to determine what they feel. And that's where I think some of the evidence is slightly mixed, but nonetheless definitely indicates that entry would -- entry barriers are high in this area.

AGENCY HEAD: And is that consistent broadly with the economic analysis as well?

ECONOMIST: Yes, yes. There are -- there seem to be scale

economies needed in distribution and production. It seems to be much easier for, for instance, a dairy that's already producing high shelf-life dairy products to convert over to the production of soymilk. If they have a national distribution system already in place, then the soymilk can free ride on -- or piggyback on that existing system. It seems like de novo entry is much more difficult for a number of reasons.

LEAD INVESTIGATOR: And Stephanie actually has some points on entry as well that she prepared, I believe.

ATTORNEY: Well, just to follow up on what Mike and Bob have already said about entry, there does seem to be some mixed evidence there. We have heard that this is a rapidly growing market that should be attractive for new entry and we are aware of some recent new entry into this market, in particular, the Ambrosia product that entered and had some success in the market. We've also heard rumors that there are some large food producers that may be interested in entering the soymilk market, but we've been unable to substantiate those rumors. So, I don't know how much credibility we'd give to those at this time.

The new entrant into the market, Ambrosia, was uniquely positioned and they were able to take advantage of some manufacturing and distribution infrastructure that I think other new entrants would not have access to. And, so, that's one way to kind of distinguish their story from the other stories that we've heard from other competitors and customers in the market.

What we've heard consistently is that the smaller fringe

players in this market, such as MediSoy and Star Soy, they are not viewed as significant competitors and that they have limited ability to expand.

AGENCY HEAD: Well, assuming that there's going to be some entry, do we have any sense as to whether it will be of a scope that's sufficient to ameliorate potential anticompetitive effects here?

LEAD INVESTIGATOR: I think there's two points. Firstly is that -- firstly, no, it would not be sufficient to defeat competitive effects from what would create an almost 90 percent share by the merged entity. And I think an example of that would be where some of the customers have indicated that they could enter or even are potentially planning on entering with private label products. And while that arguably is entry at the same time, much of the discussions about various entry barriers include the fact that first to market is important and branding is important, and these are things that private label traditionally can't offer. And, so, as this product is expanding and becoming new to the customers, at the same time, private label is insufficiently positioned to capitalize on these new customers.

AGENCY HEAD: Okay, there's two other topics I think we need to make sure we touch on. The first is whether there are any plausible claims of efficiencies that we should be taking into account and then, secondly, assuming that it looks as though this may be headed for enforcement, is there a remedy that has been considered that we believe could solve this problem?

ECONOMIST: So, the efficiencies documents definitely

indicate that there will be cost savings by combining these two firms, but there are no documents that suggest that there will be any benefits to customers. While they mention cost savings, there are no indications from the documents that they would use these cost savings to lower price to expand the market to produce new products. So, much of the savings are administrative, which typically don't lower marginal costs.

There are some savings in distribution by combining distribution networks, but, again, there's no suggestion here that this would allow them to lower their prices to stores to enter into new stores or any other way expand their output.

AGENCY HEAD: And remedies?

LEAD INVESTIGATOR: Remedies, there is -- there has been a proposed remedy and it -- as part of that remedy, FantaSoy assets would be divested to an independent purchaser. It would include all assets solely or predominantly related to the FantaSoy business, including the production plant, raw materials, final products and dedicated distribution vehicles. It also includes assignment of various FantaSoy retail and wholesale contracts. That said, there are some particulars to this that do have some concerns and I believe Stephanie has some points regarding that.

ATTORNEY: Well, the first point is the divestiture would include some royalty payments and the FTC has consistently had concerns about royalty payments being involved in divestitures because of the ongoing entanglements that it creates and also the incentives to price anticompetitively and share information between competitors.

So, here you have the licensing of patents and trademarks and the production formula and that is tied back to a 5 percent annual royalty fee. So, I think we would need to get some more information about that and possibly work that out so that we didn't have concerns about it.

Also, there are some interim agreements, an interim capacity agreement and an interim transport agreement that we have some concerns about. They would be in place for 18 months, but the question is, what would happen at the end of that 18 months and would the divestee be in a position to take over those functions without having those interim agreements? It's just very unclear at this time.

Finally, the parties have argued that they don't believe that an up-front buyer is necessary in this situation because of -- there have been several expressions of interest from numerous parties. Star Soy, which is the fourth largest player in this market, has expressed an interest in acquiring these assets and we've also heard that there are numerous dairy milk producers that are interested in getting into the soymilk market, and so, they have also had some expressions of interest from those companies.

But given the fact that this is not a stand-alone business, as evidenced by these interim agreements and the royalty payments, and it's not even clear that a full production plant would be divested here, I think that we'd be very uncomfortable not having an up-front buyer in order to move forward.

So, I think sort of our bottom line position on this is, you know, Fantasy Dairy has certainly made a serious divestiture

proposal that requires some consideration, but there are still some issues we would need to resolve before we'd be comfortable moving forward with it. But I think it's possible that we could get there.

AGENCY HEAD: Okay. Well, my sense, based on what I've heard, is that there's a fairly strong basis for moving forward with a challenge to this transaction. Before we make a final decision about that, it seems to me we should continue to vet the potential remedies so that we can get comfortable with whether or not they would be sufficient to replicate the competition that appears otherwise will be lost. Thank you very much.

ATTORNEY: Thank you.

ECONOMIST: Thank you.

LEAD ATTORNEY: Thank you.

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BILL STALLINGS: This concludes the ICN Curriculum Project's Overview of Merger Review. We hope you found the content and format useful. If you would like to learn more about the Merger Working Group's existing work product, including recommended practices on merger notification procedures and on merger analysis, we encourage you to visit the working group section on the ICN website. If you would like to become more involved in the Merger Working Group, including its training style workshops for case handlers, please contact the Merger Working Group Chairs. Thank you.