

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**Working Party No. 3 on Co-operation and Enforcement**

**ECONOMIC EVIDENCE IN MERGER ANALYSIS**

-- Chile --

**15 February 2011**

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## 1. Introduction

1. The use of quantitative economic evidence in merger analysis has become increasingly important in Chilean merger review. This can be appreciated in both the content of Fiscalía Nacional Económica's (hereinafter "FNE") non-binding decisions (so-called reports) and guidelines, and the Competition Tribunal's (hereinafter "TDLC") judgments<sup>1</sup>.

2. However, the FNE has faced important obstacles to carry out quantitative analysis. First and foremost, relevant public information in Chile is scarce – information is mostly private. The FNE has faced difficulties in obtaining data from the merging parties and other third parties. In a number of occasions they have opposed to the FNE's information requests<sup>2</sup> and or delayed the submission of the requested data. When information has been actually received, it is usually unclear. Considering the number of case handlers within the agency, the informational asymmetry problem is difficult to overcome.

3. The difficulties have been partially surpassed by the adoption of different measures, such as the commission of external market studies to build data bases, the training of FNE's economists and the hiring of external economists when needed.

## 2. Legal Framework

4. Chilean competition act<sup>3</sup> (hereinafter "the Act") aims to promote and defend "free competition"<sup>4</sup>, ordering its application to the TDLC and the FNE. The Act does not contain any particular provision governing merger control. However, several sections provide the substantive basis for merger control by both the FNE and the TDLC.

5. Merger control in Chile comprises two alternative procedures<sup>5</sup>. First, there is the voluntary procedure. Merging parties can voluntarily submit their transactions to *ex ante* or *ex post* review before the TDLC<sup>6</sup>. There are incentives to submit transactions to the TDLC's review prior to its implementation<sup>7</sup>. The

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<sup>1</sup> The *Auto Acordado* N° 12/2009 lists the information that must be included when parties submit a merger for review before the TDLC.

<sup>2</sup> Art. 39 h) of the Competition Act regulates a proceeding for opposition against information request: "(...) *Individuals and representatives of legal entities from which the National Economic Prosecutor needs information whose delivery may injury their interests or those of third parties may request the TDLC to dismiss the request totally or partially. This request must be justified and shall be submitted to the FNE within five days following the request this authority made, whose effects will be suspended from the moment the relevant presentation is carried out. The TDLC shall hear and resolve said request at its next meeting, with an oral or written report from the National Economic Prosecutor, and its ruling shall not be subject to appeal;*".

<sup>3</sup> Decree Law N° 211/1973 and its amendments, notably: Act N° 19.911/2004 which introduced institutional changes setting up the *Tribunal de Defensa de la Libre Competencia*, a specialized competition court and Act N° 20.361/2009 which increased the FNE's investigative powers when dealing with cartels and collusive agreements.

<sup>4</sup> "Free competition" is the wording used by Chilean law when referring to competition law.

<sup>5</sup> Arts. 3, 18 N°2 and 31 of the Act. The TDLC has issued instructions aimed at regulating the procedure in case of conflicting proceedings (adversarial and non-adversarial) regarding the same issue (*Auto Acordado* N° 5/2004) and about the information that parties must provide in these proceedings (*Auto Acordado* N° 12/2009), in order to provide guidance on its merger analysis.

<sup>6</sup> There is no mandatory pre-notification system in Chile.

FNE or any party with the right to make presentations in the proceedings may also request the TDLC's review. The TDLC may clear the merger, block it, or set conditions that the parties must comply with before the approval.

6. Secondly, there is an adversarial procedure. The FNE may file a complaint and request the TDLC the termination of *any* act or agreement that prevent, restrict or impede free competition, or have the potential of producing such effects. Mergers are certainly included.

### 3. Guidelines, procedures and tests applied

#### 3.1 Guidelines

7. The FNE adopted Horizontal Merger Guidelines (hereinafter "Merger Guidelines")<sup>8</sup> in 2006. In 2009, the agency began to assess possible amendments to the Merger Guidelines, with the aim to better reflect current procedural practices, increase transparency, and incorporate changes that had taken place after 2006 – including developments in economic methods of analysis. During the course of this year the FNE plans to launch a consultation of the new draft of the Merger Guidelines.

8. The Merger Guidelines describe the proceedings, substantive assessment and the tests the FNE uses in merger cases.

9. The Hypothetical Monopolist Test is the method used to define the relevant market. However, whilst the FNE uses the reasoning of Hypothetical Monopolist Test, in most cases cross-elasticities are not calculated because of the lack of relevant data. Despite this shortcoming, there are some cases where econometric analysis has been actually used to define the relevant market. In addition (or alternatively), the FNE relies on the case-law.

10. The Merger Guidelines mention the use of Herfindhal Hirschman Index (HHI) for the calculation of pre- and post- merger degree of market concentration. The FNE presumes a merger is not likely to affect competition if the HHI does not vary within certain thresholds:

- If the HHI post merger is lower than 1.000
- If  $1000 < \text{HHI} < 1.800$  y  $\Delta \text{HHI} < 100$
- If  $\text{HHI} > 1.800$  y  $\Delta \text{HHI} < 50$

11. These thresholds are now under review. The FNE is analysing whether different thresholds would be more appropriate for a small economy like Chile.

12. The FNE has carried out and commissioned cross-sectional and time-series studies which relate concentration to price or price/cost margins and show the effects on prices of entry, exit or horizontal merger. The FNE has used these studies both to substantiate its arguments and challenge counterparties' arguments and economic studies.<sup>9</sup> In *Alvi/D&S*, the FNE used a model with panel data to estimate the

<sup>7</sup> Parties obtain several advantages from the preliminary review procedure, which do not consider submission fees. If the transaction is approved and the parties comply with the conditions that the TDLC sets, there will be no further liability. Also, after a non-adversarial proceeding begins, the FNE or a competitor or customer cannot initiate an adversarial procedure.

<sup>8</sup> "Guía Interna para el análisis de Operaciones de Concentración Horizontales", October, 2006.

<sup>9</sup> The cases mentioned in the next paragraph are further explained in section V below.

effect that the presence of Alvi supermarkets had on prices of D&S (another supermarket chain). That is, the effect of entry and concentration on prices in the supermarket industry was measured. In *FNE vs. D&S and Cencosud*<sup>10</sup>, the FNE commissioned an external economic study. The study developed a dynamic model with panel data in order to estimate how concentration affected prices.

13. Private parties also use economic analysis widely. In *D&S/Fallabella*<sup>11</sup>, parties presented cross-sectional studies relating concentration to margins. Finally, in *Compañía Pisquera/Cooperativa Capel*<sup>12</sup> one of the parties presented a panel data analysis for market definition.

14. In *FNE vs. D&S and Cencosud* the FNE dealt with “creeping acquisitions”, whereby big companies seek to expand their market power by buying up smaller operations<sup>13</sup>. The FNE’s accusation was motivated by the aggressive growth strategy of both companies and not by a single acquisition.

15. The analysis of efficiencies has been performed under a qualitative perspective rather than a quantitative one. It is common practice to ask parties to quantify their efficiencies. However, the FNE considers that it is on the parties’ burden to provide the agency with enough quantitative evidence to calculate efficiencies, so that they can be assessed in relation to the anticompetitive merger’s effects. Unfortunately, in most cases parties do not submit the necessary data. Finally, the FNE’s efforts are focused on the analysis of whether the argued efficiencies are feasible in practice and can be effectively passed on to consumers.

16. The FNE has not yet run coordinated effects tests based on models of repeated oligopolistic interaction. The FNE takes into consideration a number of elements which are based on economic theory, but they are mostly analysed from a qualitative, not a quantitative approach<sup>14</sup>.

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<sup>10</sup> “*Requerimiento de la FNE contra D&S S.A. y Cencosud S.A.*” Case N° C 101-06 Ruled on May 8<sup>th</sup> 2008 by *Sentencia N° 65/2008*, latter appealed by Cencosud to the Supreme Court and terminated by a settlement approved by the Supreme Court on July 24<sup>th</sup> 2008. In this case the FNE carried out a quantitative analysis to demonstrate how the entry of a national chain of supermarkets affects prices in a certain location, versus the effects on prices by entry of a national chain via acquisition of a local chain.

<sup>11</sup> “*Consulta sobre Fusión de D&S y Falabella*” Case N° NC 199-07. Ruled on January 31 2008 by *Resolución N° 24 /2008*.

<sup>12</sup> “*Consulta de Compañía Pisquera sobre toma de control de activos de Cooperativa Capel*” Case N° NC 96-05, terminated on January 19<sup>th</sup> 2006 by *Resolución de término N° 27/2006*.

<sup>13</sup> “*Requerimiento de la FNE contra D&S S.A. y Cencosud S.A.*”: *Sentencia N° 65/2008*, appealed by Cencosud to the Supreme Court and resolved by settlement approved by the Supreme Court on July 24<sup>th</sup>, 2008.

<sup>14</sup> Listed in the 2006 Merger Guidelines in point 5.2: “a) *The characteristics of the product, for example, the level of obsolescence, technology refresh, degree of differentiation, structure and changes in costs, which may facilitate or hinder the sustainability of coordination. For example, very homogeneous products facilitate coordination, while the opposite is true subject to frequent product innovation; b) The behavior of the parties, evidence of past coordination; c) The profitability of the parties, which may indicate that they have exercised or are exercising market power; d) The characteristics of the merged entity such as its economic and financial strength; e) The performance, profitability and competitive features, of the eliminated competitor. For example, the elimination of a strong, non-aligned or innovative, competitor; f) The performance, profitability and characteristics of the remaining competitors, which may indicate that market power has been exercised, that previous coordination has occurred and or that coordination would be convenient or sustainable. For example undertakings with exposition in multiple markets can be more easily disciplined; it is easier for the cartel participants to sanction the cartel member that deviates. g) Evolution of market shares, and h) The flow of information between competitors, market transparency”.*

17. The FNE is considering whether the application of the *Upward Pricing Pressure* (“UPP”) test in horizontal mergers is appropriated. Up to date, the test has not been used in any merger investigation in Chile.

### 3.2 *Relationship with parties’ economists and the court economic assessment*

18. Given the design of the Chilean merger system, information exchanges between the FNE’s economists and the parties’ economists are quite low. However, a tighter relationship has been built when parties have approached the FNE – either because the FNE has opened an investigation *ex officio* or because they have requested the FNE to review the merger before submitting it for TDLC’s approval.

19. Parties have a chance to replicate the economic analysis carried out by the FNE before the TDLC. With this purpose, the FNE makes available to the TDLC and parties the files that contain data and the economic models applied.

20. By law the TDLC is composed of three lawyers and two economists, and have a supporting staff that also includes economists. Being a specialised tribunal, the TDLC is well-prepared to perform economic analysis, considering the evidence, reports and records the FNE and the parties submit. The TDLC has been very careful in its assessment of quantitative evidence. In some cases it has even commissioned external economists to audit the databases and econometric reports that either the FNE or parties have presented.

21. The TDLC’s final decision on a merger may be appealed to the Supreme Court. Although the Court has specialised chambers, none of them deals exclusively with economic matters. The constitutional and administrative chamber reviews competition law cases. Judges are “generalists”, having no specific economic training. Thus, when a merger case reaches this stage, there may be difficulties in transmitting economic reasoning to the Court and hence less value or importance is given to empirical economic evidence. However, up to date the number of merger cases reviewed by the Court has been relatively low.

### 3.3 *Access to and processing of data*

22. The FNE determines the data it needs depending on the specific case, the markets affected and the theory of harm applied to the case. Coordinated and non-coordinated effects are the risks more often considered in the analysis of a merger. If the FNE has more concerns regarding unilateral effects, it requests more information on prices and costs from the merging parties. If more there is more concern regarding coordinated risks, similar data is required, but additional and more specific information (such as daily prices during a long period, precise location of premises and others) may also be requested. Other particularities of the industry may need additional information.<sup>15</sup> As mentioned, parties’ information may not be enough or timely delivered.

23. In occasions third parties have been reluctant to collaborate with the FNE’s investigations. An example was *D&S/ Fallabella*<sup>16</sup>, where the FNE sent information requests to several banks and some of them presented an opposition to the TDLC<sup>17</sup>.

<sup>15</sup> For instance, if there have been periods of entry or exit of competitors, the FNE requests specific information of those periods in order to assess the likelihood of future entry or exit.

<sup>16</sup> “*Consulta sobre Fusión de D&S y Falabella*” Case N° NC 199-07, Ruled on January 31<sup>st</sup> 2008 by *Resolución N° 24/2008*.

<sup>17</sup> *Banco del Estado*’s opposition was ruled by the TDLC on June 27<sup>th</sup>, 2007 by *Art. 39 h) Resolución N° 13/2007*, the ruling confirmed the Banks obligation to provide information to the FNE and that Banco del

24. A further difficulty is the obtaining of data from market research companies. For instance, in the same *D&S/ Fallabella* merger, the firm A.C.Nielsen denied the provision or even the selling of information to the FNE, arguing that the companies that provided the information would refuse to work with A.C.Nielsen if they knew that the information could be later sold to the competition authority. The TDLC upheld the opposition based on the argument that selling or giving this information to the FNE could prejudice A.C. Nielsen's business<sup>18</sup>.

25. In some cases, the FNE has tried to overcome the lack of access to data by carrying out or commissioning market studies and surveys in order to generate data<sup>19</sup>.

#### 4. Efforts towards better quantitative analysis

26. The FNE has adopted important steps to improve economic analysis in merger cases.

27. First, every case team is composed of at least one economist and one lawyer. This means that economists are always responsible for the cases. A senior economist and a senior lawyer support and review the work of the case team. The head of the Investigation Division (who is also the Chief Economist) also revises all merger cases. In addition, some economists integrate the litigation team, supporting the work of the litigator.

28. Second, the FNE has focused on recruiting economists specialized in industrial organization, with extensive experience in econometrics, or with knowledge in specific sectors such as energy, telecommunications, and others.

29. Third, the FNE encourages its economists to participate in training programs for specific sectors and advanced econometric techniques<sup>20</sup>. The FNE also encourages economists (and the staff generally) to participate in academic activities.

30. Fourth, the FNE participates actively in the ICN Merger Working Group and, as far as possible, uses ICN work products as guidelines for procedure and analysis in current merger cases.

31. Finally, in most complex and/or relevant cases, external economists may be hired to elaborate models and studies or act as counterpart of FNE's economic studies. For example, in *FNE vs. D&S and Cencosud*<sup>21</sup> (a merger concerning the supermarket industry), the FNE hired external economists to measure the impact of concentration on prices.

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Estado did not require excessive efforts to produce the information in the format required by the FNE; but specified that the bank cannot be compelled to produce information that it does not already have, and deemed the time given by the FNE to answer the information request too short. The TDLC ruled in the same way regarding Banco Bice's previous opposition on June 20 2007 by *Art. 39 h) Resolucion N°12/2007*.

<sup>18</sup> Upheld by the TDLC on April 18<sup>th</sup>, 2007 by *Art. 39 h) Resolucion N° 11/2007*.

<sup>19</sup> In "*Consulta de Compañía Pisquera sobre toma de control de activos de Cooperativa Capel*" Case N° NC 96-05, terminated on January 19 2006 by *Resolución de término N° 27/2006* the FNE has commissioned a survey to the Consumer Protection Agency (SERNAC).

<sup>20</sup> For example, economists participate every year in specific conferences on industrial organization (e.g. the "TOI" or "Taller de Organización Industrial").

<sup>21</sup> *Requerimiento de la FNE contra D&S S.A. y Cencosud S.A.* Case N° C 101-06 Ruled on May 8<sup>th</sup> 2008 by *Sentencia N° 65/2008*, latter appealed by Cencosud to the Supreme Court and resolved by settlement approved by the Supreme Court on July 24<sup>th</sup>, 2008.

32. Also in the supermarket industry, in *Alvi/D&S*<sup>22</sup> (a case pending of resolution by the TDLC) the FNE hired external economists to arbitrate the FNE's economic studies and results.

## 5. Case Law

### 5.1 *Alvi/D&S(Walmart) (2010)*<sup>23</sup>

#### 5.1.1 *Facts*

33. The FNE submitted to the TDLC the takeover by D&S (Walmart in Chile) – the leading supermarkets chain in the country – of Alvi, the largest wholesale distributor for supermarkets in Chile. There are significant overlaps in some segments of the industry. In particular, the wholesale format is frequently used by lower-income consumers who buy products in bulk for family supply. Wholesale distributors have therefore adapted part of their offer to the needs of these consumers. In this particular segment Alvi exerts competitive pressure on D&S. Without that pressure D&S would be able to significantly raise its prices. The FNE is arguing that for this reason and the concentrated market structure, the merger would have anticompetitive effects.

#### 5.1.2 *Economic analysis*

34. The FNE carry out a study to estimate the rise in prices of a basket of products assuming that Alvi will not be market player after the merger<sup>24</sup>.

35. Alvi' ability to discipline D&S' prices was estimated with data of the city of Santiago. The econometric model related an index of D&S's selling prices with three dummy variables indicating: the presence of Alvi in the vicinity – i.e. within different radius or "isochrones" fixed by journey time by car (considering 5, 10 and 15 minutes) from each of the premises used as dependent variables; concentration levels for each local area (with a pre-defined geographic market and 10 min. isochrones) and format of store (convenience store, hypermarket, etc.); and district (borough, town), etc.

36. In the analysis, the FNE used an unbalanced panel with monthly D&S sales data from January 2006 to June 2010. There was a negative effect on the pricing policy applied by each local D&S supermarket, caused by the presence of a near Alvi supermarket. The estimations were done using OLS, Random and Fixed effects. The effect was significant and robust to different specifications used in the study. The presence of an Alvi supermarket 5 minutes away from D&S made D&S's selling price index fall a 1.5%. The presence of an Alvi supermarket 10 minutes away from D&S made the selling price index fall a 1%. The effect on the same price was even lower in a 15 minute isochrones.

37. Based on the coefficients obtained, the FNE estimated the effect of the merger. The conclusion was that the new entity would have the ability to increase prices of certain stores between 2% and 3.4%.

<sup>22</sup> "Consulta de FNE sobre toma de control de Alvi Supermercados Mayoristas S.A. por Distribución y Servicio D&S S.A." case N° NC 383-10, Pending.

<sup>23</sup> "Consulta de FNE sobre toma de control de Alvi Supermercados Mayoristas S.A. por Distribución y Servicio D&S S.A." case N° NC 383-10, Pending.

<sup>24</sup> The economic analysis developed by the FNE in this case used as primary reference the paper developed by Orley Ashenfelter, David Ashmore, Jonathan Baker, Suzanne Gleason and Daniel Hosken (2004) "Econometric Methods in Staples" to examine the possible effects the acquisition of Alvi will have on sales prices of supermarket chain D&S.

38. An index of selling prices in Walmart supermarkets was required for the analysis. The index considered 48 categories of products, including more than 6,000 products sold. As a first step for the construction of the mentioned price index, a representative basket of goods was assembled for each local D&S's supermarket. In order to assess the robustness of the econometric model, three ways to build the basket were tested<sup>25</sup>. The results of the model using price indexes derived from the three baskets were consistent

### 5.1.3 *Ruling*

39. The case is pending of resolution.

## 5.2 *FNE vs. D&S and Cencosud (2008)*<sup>26</sup>

### 5.2.1 *Facts*

40. The FNE filed a complaint against the two major supermarkets chains in Chile, D&S and Cencosud. Both chains had initiated a growing strategy consisting in the acquisition of rather small, regional supermarket chains. The complaint requested the TDLC to impose both firms the duty to consult any further supermarket acquisition in which they directly or indirectly participate. It also aimed to agree on a "code of good practices" that ruled the relation with suppliers. The FNE based its request on the firms' position in the market, the market structure, and the effect of entry caused by their growing strategy. Additionally, the FNE requested the establishment of a convention on general contractual terms with small and medium-sized suppliers.

41. The FNE questioned the aggressive and publicized growth strategy of both D&S and Cencosud, which was based on the (hostile) takeover of competitors and acquisition of suitable land for location of supermarkets. The strategy had resulted both in the elimination of competition and the creation of artificial barriers to entry.

42. Moreover, the FNE argued that both chains had abused their market power in their relationships with suppliers, imposing subjective, arbitrary and unpredictable buying conditions, altering conditions previously agreed upon and frustrating contract expectations.

### 5.2.2 *Economic Analysis*

43. During the trial, the economic discussion centred on whether greater concentration in the supermarket industry resulted from actual price increases. The FNE hired external consultants to determine to what extent market concentration was linked to increase in prices<sup>27</sup>.

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<sup>25</sup> i) the first basket was constructed by weighting the different categories of products, from the weights used by the National Statistics Institute (INE) to construct the basket used to calculate the Consumer Price Index (CPI), ii) the second basket, used as weights the relative weight of each product lines in total sales for D&S; iii) the third basket was constructed using as weights the relative weights of each of the product lines in the sales of the supermarket format aimed at low socioeconomic segments (this, since Alvi is a supermarket frequented mainly by people belonging to this segment socioeconomic status).

<sup>26</sup> "Requerimiento de la FNE contra D&S S.A. y Cencosud S.A." Case N° C 101-06 Ruled on May 8<sup>th</sup>, 2008 by *Sentencia* N° 65/2008, latter appealed by Cencosud to the Supreme Court and resolved by settlement approved by the Supreme Court on July 24<sup>th</sup>, 2008.

<sup>27</sup> The empirical work of the case is contained in two reports: "*The relationship between food prices and the concentration of supermarkets in Chile: evidence from a dynamic panel model and analysis of the impacts of proposed mergers Industry*", (commissioned by the FNE and available at



44. The study considered a dynamic panel model to explain how market concentration affects a basket of food prices (for a sample of 24 cities in Chile). Market concentration was measured by the HHI and controlling factors, such as local costs and market size, among others, were used. The results indicated that market concentration has a significant positive effect on food prices. The model took into account constant effects for all cities and a lag in the price of the food basket. Monthly data from January 1998 to March 2006 was used for 52 food products in 24 cities. In the model, each city was considered as the relevant geographical market.

45. A second model estimated the influence that high market prices might have on entry. A panel model with fixed effects was estimated, using the HHI as the dependent variable, and as independent variables the same lagged index and 24 lags of the price index of the food basket. The results obtained indicated that prices do not affect future market concentration, which is an indication of the existence of barriers to market entry.

### 5.2.3 Ruling

46. Before the ruling, one of the defendants, D&S, settled with the FNE and committed to pre-notify future acquisitions and implement general contractual terms agreed with small and medium-sized suppliers. Due to the settlement, the trial continued only with Cencosud as defendant.

47. In its judgement, the TDLC only partially upheld the FNE's position. The TDLC ordered the undertaking to pre-notify any future merger in the supermarket industry in which Cencosud wishes to participate, either directly or indirectly. However, it did not accept the creation of a "code of good practices" that ruled the relations between Cencosud and its suppliers.

48. The ruling considered the increase in market concentration, the perceived entry barriers, Cencosud's position in the analyzed relevant markets, and the negative effects on competition due to Cencosud's acquisition of competitors. The TDLC concluded that growth strategies by the defendant based on takeovers of rival companies may in some cases restrict or hinder competition significantly.

49. The FNE appealed the TDLC's decision. However, the parties reached a settlement before Supreme Court's final hearing. In the settlement, Cencosud committed itself to consult with the FNE any future acquisition in the supermarket market.

50. As a result, the case resulted in *de facto* mandatory notification system applicable to both Cencosud and D&S.

## 5.3 D&S-/Falabella (2008)<sup>28</sup>

### 5.3.1 Facts

51. The procedure was initiated by a voluntary consultation by D&S and Falabella. Both companies participated in several types of retail businesses. The main business of Falabella was sales through

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[http://www.tdlc.cl/DocumentosMultiples/Informe%20Aldo%20González%20y%20Andrés%20Gómez%20Lobo%20\(final\).pdf](http://www.tdlc.cl/DocumentosMultiples/Informe%20Aldo%20González%20y%20Andrés%20Gómez%20Lobo%20(final).pdf); and "The concentration-price relationship when an industry changes supermarkets in Chile 1998-2006" (commissioned by Cencosud and available at: <http://www.tdlc.cl/DocumentosMultiples/Informe%20Díaz%20Galetovic%20y%20Sanhueza.pdf>). The main text only refers to the former.

<sup>28</sup> "Consulta sobre Fusión de D&S y Falabella" Case N° NC 199-07 Ruled on January 31 2008 by Resolución N° 24/2008.

department stores and the main business of D&S was sales through supermarkets. Both parties participated in the supermarket industry, where D&S was the dominant player.

### 5.3.2 *Economic analysis*

52. FNE's economic analysis centred on identifying the risks the merger would produce in the supermarket industry, considering that Falabella participated in a set of businesses that gave rise to economies of scope significant enough to defy D&S in that industry. On the other hand, the player with more possibilities of expansion in the supermarket industry was Falabella, which would have the ability of bringing to an end the follow-the-leader structure prevailing in the market due to D&S's expansion (D&S had a market share of 33.5%. Its post-merger market share would increase up to around 38.5%).

53. The merger between Falabella and the biggest player in the supermarket industry was found to eliminate important competitive pressure in the relevant market. There were both unilateral and coordinated competitive risks.

54. The merging parties commissioned a study to external economists which included an econometric model that tested the effect on D&S's margins in the areas where Falabella's supermarkets were present. The study built a cross section data base for all the national territory, using monthly data of sales, quantity sold, and costs for D&S from November 2006 to February 2007, and total sales from the other supermarkets (distinguishing each establishment). For each of the 99 relevant markets<sup>29</sup> the data base reflected D&S's margins, HHI, number of establishments, number of supermarket chains and market shares of each of the supermarket chains.

55. Estimating a simple model through the OLS method, the study found that the presence of a single Falabella store in the relevant market had the effect of reducing D&S's margins. This conclusion supported the FNE's view of the industry. Thus the FNE argued that the supermarket business should be excluded from the merger and, for that purpose, Falabella should sell to a third party its supermarket business prior to the merger.

56. The TDLC gave a different definition of the relevant market. It considered that both companies were relevant in a number of businesses such as real estate, home centers, supermarkets, travel agencies, shopping centers, business banking and credit. Their presence in these industries allowed them to benefit from important economies of scope. Competition in some of niches depended on the simultaneous presence of strong and integrated players in several of these businesses.

57. Consequently, the merger concerned a wider relevant market than the mere sum of relevant markets where an overlap was found. The TDLC called this market "integrated retail". In the TDLC's opinion, the merger would have meant the creation of a dominant player in the integrated retail and in virtually all its segments. Also, the merged entity would have had the ability to leverage its market power to other areas of retail business in which it decides to participate in the future.

### 5.3.3 *Ruling*

58. The TDLC blocked the merger. First, the TDLC sustained that the merger would allow the creation of a dominant undertaking in the integrated retail market (dominant in virtually all segments of the market). The dominant firm would also have the ability to use its market power in other business areas in which it may participate in the future.

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<sup>29</sup> The relevant market was defined as all the supermarkets that were within a 5 KM around each D&S supermarket.

59. Given the size of Chilean economy and the existent entry barriers in the integrated retail market, the TDLC found that enough entry by a new defiant competitor was unlikely.

60. The TDLC also held that the merger would substantially reduce competition in the relevant market (which, in addition, is of significant importance to final consumers).

61. The efficiencies the merging parties suggested were not sufficiently proven. When they were proved, the TDLC deemed the efficiencies did not have the ability to compensate the anticompetitive risks produced by the merger.

62. Finally, the TDLC considered that no remedies were sufficient or adequate to compensate or minimize the competitive risks that the merger entailed.

#### 5.4 *Compañía Pisquera/Cooperativa Capel (2006)*<sup>30</sup>

##### 5.4.1 *Facts*

63. Cooperativa Capel, the biggest Chilean producer of “pisco”<sup>31</sup>, was looking for a strategic partner. With that aim, it carried out an international tender in which only Compañía Pisquera (“Control”) participated. Control was the only competitor that elaborates pisco in Chile. Control requested the TDLC to decide whether the merger would hinder competition in the Chilean market.

##### 5.4.2 *Economic Analysis*

64. The FNE carried out a market study in order to obtain the necessary data to run the hypothetical monopolist test. External economists also estimated cross-elasticities to gauge the degree of substitution between pisco and other “spirits”.

65. In order to estimate the effects the merger would have on competition, the analysis focused on the possibilities of substitution amongst different alcoholic beverages (i.e. this was the relevant market).

66. The FNE analyzed the relevant market based on a survey commissioned to the Consumer Protection Agency, which related the demand for pisco and potential increases in prices, and the substitution levels with other alcoholic beverages<sup>32</sup>. The survey consisted of an internet survey to be answered voluntarily by e-mail<sup>33</sup>.

<sup>30</sup> “*Consulta de Compañía Pisquera sobre toma de control de activos de Cooperativa Capel*” Case N° NC 96-05, terminated on January 19 2006 by *Resolución de término* N° 27/2006, the consultant *Compañía Pisquera*, withdrew its consultation on January 16 2006 (because *Cooperativa Capel* did not want to go forth with the merger).

<sup>31</sup> Alcoholic drink based on a distillate of grapes.

<sup>32</sup> Additionally, the FNE analyzed: i) foreign case law on market definition for alcoholic beverages; ii) statistic and economic studies on the national pisco market provided by third parties in the trial; iii) the behavior of undertakings producing alcoholic and non alcoholic beverages; and finally iv) the opinion of supermarkets and wholesale distributors of those products.

<sup>33</sup> 570 answers were received, and they can be classified in the following way:

- Sex: 55.9% masculine and 44.1% feminine
- Socio economic income: 57.4% was classified with a monthly income over us\$1,400; 35% was classified with a monthly income between us\$500 and \$1,400

67. Taking the survey as starting point, it was determined that a hypothetical monopoly controlling the total of pisco production could raise prices near a 20% without taking into account other alcoholic beverages. Thus, substitution levels with other alcoholic beverages would be insufficient to consider them in the same relevant market.

68. In addition, parties elaborated a report with a model that also estimated crossed elasticity between pisco and other alcoholic beverages. To make the simultaneous estimation and taking into account that the errors of the demand functions were most likely correlated, a Seemingly Unrelated Regressions (SUR) model was estimated. According to the study, in this case the SUR was more efficient because there were unobserved shocks that simultaneously affect the demand for the considered five drinks.

69. Demand studies carried out by the merging parties reaffirmed this conclusion. They produced results consistent with SERNAC's study. In the same way, the organizational structure of CCU (the parent company of Control), which has separate business units for alcoholic beverages such as beer, wine, liquors and pisco, served as confirmation to what was already detected by consumer surveys. Likewise, it was argued that the information used by the industry to compete was disaggregated by type of alcoholic beverage, which wouldn't make sense if the levels of substitution were such that they belonged to the same relevant market.

70. Finally, one last element supported the FNE's market definition: foreign case-law defined markets very narrowly, mainly including one specific type of alcoholic drink.

71. The narrow market definition, along with the existence of entry barriers (such as the need to incur in sunk costs for the production and commercialization of pisco, strong investments in publicity and difficulties in acquiring appropriate land<sup>34</sup>), supported the FNE's view that the merger should be blocked because it would create a hardly contestable monopoly.

#### 5.4.3 *Ruling*

72. The case was concluded without a ruling on substance, since the consultant withdrew its consultation.

### **6. Final Remarks**

73. In Chile, quantitative economic evidence in merger cases has significantly improved. This can be observed both in recent merger judgments by the TDLC and decisions and reports issued by the FNE.

74. The FNE is currently deepening its efforts to carry out better quantitative analysis by hiring economists specialized in specific industries or that have econometric skills; working with external economists; and standardizing and updating procedures and guidelines.

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• Age: 39.7% adult (41 to 60 years), 37.9% young adults (30 to 40 years) and the 20.9% young (19-29 years).

<sup>34</sup> Appropriate land for the production of grape distillates that can be called "pisco" must have water rights and municipal permits and should be produced within a specific geographical zone delimited for it.