RÉPUBLIQUE FRANÇAISE

Autorité de la concurrence

Horizontal merger between Cofigeo and Agripole

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Some elements of context (I)

- Horizontal merger in the cooked meals (ready meals) sector

	French	Italian	Exotic	
Cofigeo (Turnover >150M in 2016)				**+ private labels**
Agripole (Turnover >150M in 2016)	 			**+ private labels**

- Agripole was insolvent and was risking bankruptcy
  - An emergency plan was put in place by the Ministry of Economy in 2017
  - Dedicated procedure to find a buyer for Agripole
    - The “best” candidate, Cofigeo, was approved by the commercial court of Paris, subject to merger control by the FCA
    - Practically Cofigeo took control of Agripole during the investigation (“dérogation” granted by the FCA in view of the context and the risk that assets would lose part of their value without such measure)

Some elements of context (II)

- The case law defines a national market for the production and commercialization of canned cooked meals (segmentations confirmed by the customers surveys)
  - distinct from other types of cooked meals (e.g. microwavable, freshly cooked or frozen)
  - segmented according to recipes (French, Italian and exotic)
  - Possible segmentation between branded products and private labels (open question).
- The parties were the two main actors leaders in each market (N°2 took over N°1)
- Post-merger, the parties would be a strong market leader in several segments of the market
  - Market share would be > 70% in the Italian segment and the exotic segment
  - The new entity owns almost all well-known brands in the market
  - Competitors would have limited market shares (no competitor over 10%).
- A case rich in terms of analysis
  - acquisition of a failing firm
  - competitive assessment based on internal documents, customer surveys and merger simulation
  - structural remedies
  - a phase III decision (first in France)

The failing firm defense and the relevant counterfactual scenario

- Cofigeo considered that Agripole would have disappeared from the market in the absence of the operation
  - However, at least two other credible candidates to buy Agripole's assets (whose MS are low)
  - → One of the cumulative criteria of the FFD not fulfilled
- Question of the relevant counterfactual scenario
  - Cofigeo argued against considering the pre-merger situation as a benchmark (questions the causality link between the merger and the increase in market share and prices)
  - The FCA considers that in absence of the operation, Agripole's assets would have been taken over by a third party
    - In the event that Agripole was taken over by [candidate A] : market structure similar to the situation before the merger (candidate A was absent from the Italian segment and his market share was negligible in the exotic segment + well-known brands owned by separate entities)
    - In the event that Agripole was taken over by [candidate B]: situation similar to the pre-merger situation (candidate B not active in the sector)
    - → The pre-merger market structure could be a good benchmark

Competitive assessment (I)

- Several elements showed that Cofigeo and Agripole are close competitors
  - Documentary evidence (notification, internal documents)
  - customer surveys
  - merger simulation

→ price increases triggered by the merger are likely

Competitive assessment (II)

Evidence from the parties' notification and internal documents

- According to the notification, a delisting by a retailer in 2010 of Agripole's products led to an "*almost perfect transfer between Panzani and Zapetti*" for that customer
- Internal documents show that :
  - parties monitor mutually each other's market position
    - But they rarely monitor brands of other competitors or private labels
    - No reference to other types of prepared meals (frozen, freshly made, kit, etc.)
  - trade-offs made by distributors among brands owned by the parties
    - e.g., an employee of Cofigeo relates a meeting with a retailer : "*we talk about Bolognese raviolis again; for him* [the client], *it's either us* [Cofigeo] *or PZ* [Panzani, Agripole]"

→ Parties are close competitors

Competitive assessment (III)

Customer surveys

- The FCA asked mass retailers about their reaction in case one of the parties increases the price of its **branded products** (separately for each type of recipes) (by 5%-10%) → quite high diversion ratios

	D1	D2	D3	D4	D5
French					
Cofigeo → Agripole	[60-80]%	[40-60]%	[80-100]%	[40-60]%	[60-80]%
Agripole → Cofigeo	[60-80]%	[40-60]%	[80-100]%	[60-80]%	[80-100]%
Italian					
Cofigeo → Agripole	[60-80]%	[60-80]%	[80-100]%	[60-80]%	[80-100]%
Agripole → Cofigeo	[60-80]%	[40-60]%	[80-100]%	[60-80]%	[60-80]%
Exotic					
Cofigeo → Agripole	[60-80]%	[60-80]%	[80-100]%	[80-100]%	[80-100]%
Agripole → Cofigeo	[60-80]%	[40-60]%	[80-100]%	[60-80]%	[60-80]%

- The diversion ratios are likely to be underestimated, as they are determined without taking into account that parties also produce private labels

Competitive assessment (IV)

Customer surveys

- In terms of GUPPI index (measures the incentives for unilateral price increase due to the internalization of the competitive constraint that parties to a merger exercise on each other before the merger) :

	D1	D2	D3	D4	D5
French					
Cofigeo → Agripole	[15-20]%	[10-15]%	[30-40]%	[15-20]%	[20-30]%
Agripole → Cofigeo	[30-40]%	[15-20]%	[20-30]%	[15-20]%	[20-30]%
Italian					
Cofigeo → Agripole	[20-30]%	[15-20]%	[30-40]%	[20-30]%	[30-40]%
Agripole → Cofigeo	[30-40]%	[15-20]%	[20-30]%	[20-30]%	[20-30]%
Exotic					
Cofigeo → Agripole	[15-20]%	[20-30]%	[30-40]%	[15-20]%	[30-40]%
Agripole → Cofigeo	[20-30]%	[10-15]%	[15-20]%	[20-30]%	[15-20]%

- To be compared to the 5-10% threshold mentioned in the French merger guidelines

Competitive assessment (V)

Consumer survey

- Cofigeo also produced a consumer survey
  - The results from this survey do not contradict the survey implemented by the FCA (suggest high diversion ratios between parties, lower diversion ratios between parties’ brands and private labels)
  - Those results suggested that parties are close competitors
  - However, the sample size obtained was too restrictive
    - Diversion ratios from Cofigeo to Agripole (or vice versa) were calculated on the basis of subsamples of less than 80 respondents
    - Wide confidence intervals

Competitive assessment (VI)

Merger simulation

- The parties produced a merger simulation to estimate the potential unilateral effects related to the merger
  - based on data on the retail sales of canned cooked meals
  - nested logit demand function
    - products are categorized in different groups (“nodes”) to reflect their similarity
    - 2 scenarios/specifications are considered
      - One-level structure with 3 nodes, corresponding to the 3 segments (French, Italian and exotic)
      - Two-level structure with 3 principal nodes corresponding to the 3 segments (French, Italian and exotic), each node is subdivided into two subgroups: branded and private labels products
      - Substitutability between branded products and private labels may be weaker
  - Calibration (instead of econometric estimation) is used to identified plausible parameters of the nested logit demand function
    - several sets of solutions are obtained, leading to a range of values for diversion ratios and price effects

Competitive assessment (VII)

Merger simulation – FCA's appreciation

- The simulation does not take into account that the parties also produce private labels
  - assumed that the merger only concerns branded products owned by the parties
  - price effects are likely to be underestimated
- The model does not take into account capacity constraints faced by competitors
  - Absence of verification that the simulated post-merger situation is consistent with available production capacity : if competitors are unable to meet the extra demand they face post-merger, price effects may potentially be higher
- Relevance of the one-level structure questionable
  - Implies diversion ratios between national brands and private labels proportional to market shares
  - Neglects the differences in quality or the potentially different demand between branded products and private labels
  - The two-level structure is likely to be more suitable : it does not assume similar competitive pressure (between national brands) and (between national brands and private labels)

Competitive assessment (VIII)

Merger simulation – FCA's appreciation

- In any case, price effects were far from negligible in both specifications, especially on the Italian and exotic segments

		Mean price effects	
		One level NL	Two level NL
Agripole	Exotic (Garbit)	[3-5]%	[5-7]%
	French (PJ/WS)	[1-3]%	[3-5]%
	Italian (Panzani)	[5-7]%	[7-9]%
Cofigeo	Exotic (Zapetti)	[8-10]%	[12-14]%
	French (R&R)	[6-8]%	[10-12]%
	Italian (Zapetti)	[10-12]%	[16-18]%

  - Price effects were more important for Cofigeo's brands (intuitive: Agripole has higher market shares than Cofigeo)
- The parties also realized a simulation taking into account potential efficiency gains from the merger
  - Those potential gains were insufficiently substantiated (only a preliminary estimate was available) and in any case limited
  - Price effects were slightly lower but remained important especially for Italian and exotic segments

Competitive assessment (IX)

Barriers to entry/Potential competition

- Barriers to entry:
  - Retailers would refuse to source from a company if its products do not respect specific norms in France
  - Heavy investments (marketing and advertising in particular) in a declining market : unlikely

- Absence of entry in the market for the past 10 years

Competitive assessment (X)

Countervailing buyer power

- While retailers are major customers, their bargaining power is not so strong here:
  - Post-merger, buyers would have few alternatives to the new entity
    - All high notoriety brands owned by the new entity
    - Competitors have limited available production capacity
    - Entry unlikely
  - No evidence that retailers would take retaliatory measures on other products by the new entity in case of price increases of canned cooked meals
    - Efficiency of such measures questionable (limited contribution of other products to the new entity's margin)
    - Risk for the retailers that the new entity refuses to sell them canned cooked meals if they implement such retaliatory measures (and no substitute to those products)
    - If the price increase is imposed to all retailers, it does not affect the relative competitive position of the different retailers
  - Evidence from the last round of negotiations in 2018 (Cofigeo had already taken control of Agripole) : the parties managed to obtain important price increases

Remedies

- Cofigeo’s main proposed commitment :
  - allow any third party to use the new entity’s production capacity to produce canned cooked meals (to be commercialized as branded products) in the Italian and exotic segment
- The FCA considered that the proposed commitments were insufficient
  - No brand cession in a context where brands’ reputation is a key parameter of success and entry is difficult
  - Commitments are silent on important issues such as protection of recipes
- The FCA decided to impose structural remedies
  - Cession of a reputable brand in the Italian and exotic segment and the corresponding production capacities to the benefit of a single third party operator
  - Those remedies still allow Cofigeo to be the market leader in the Italian and exotic segment, but they contribute to ensure the presence of a viable competitive force on those segments

A Phase III decision

- In France, the Minister of Economy has an “evocation power” on merger control by the FCA (article L430-7-1 of the code of commerce)
  - Used for the first time since it was introduced in 2008
  - The decision should be based on motivations different from competition (e.g. employment, industrial policy)

- The Minister decided to authorize the operation <u>without the structural remedies</u>
  - The Minister considered that innovation was needed to create growth in the market
    - The structural remedies would have prevented the new entity from a strategy of specializing the brands and production capacities which implies coordination
    - They would have deprived the new entity of synergies
  - The structural remedies would significantly affect the profitability of the new entity
    - Risk for the viability of Cofigeo, implying risks for employment (Cofigeo + its suppliers)

Concluding remarks

- Competitive assessment relies on a wide variety of information and methods
  - internal documents, customer surveys, merger simulation,…
  - complementary with each other, allowing to a better gauge of the likely effects of the operation

- Failing firm…
  - Calls for particular attention in the definition of the counterfactual scenario
  - does not imply an unconditional authorization : there are 3 cumulative criteria

- The FCA’s investigation solely focused on competition concerns
  - other legitimate policy/general interest considerations were taken into account by the Minister

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Thank you for your attention!