ABF/GBI Business: coordinated effects baked again

Andrea Amelio, Pablo Asbo, Miguel de la Mano, Ruben Maximiano and Viktor Porubsky (1)

1. Introduction

Just a few months after the Court of Justice gave a key ruling in Sony/BMG v Impala (2), the Commission adopted its decision in the ABF/GBI Business case (3). This was the first case since Airtours in which the Commission intervened solely on the basis of coordinated effects. The case raised several interesting issues and may well help to pave the way for another era of Commission coordinated effects cases, in line with the latest case-law from the Court of Justice.

The case essentially concerned the acquisition of GBI’s yeast business in continental Europe (GBI was one of the main European yeast producers, owned by the Dutch private equity firm Gilde) by Associated British Foods (ABF). ABF is a diversified food company and one of the two worldwide leaders in the yeast industry. Gilde, the seller, was disposing of its yeast operations worldwide and, in another transaction, sold the remaining part of GBI (i.e. except operations in continental Europe, but including the UK activities) to the other leading yeast producer — the French company Lesaffre. This other transaction was notified under case No M.5020 — Lesaffre/GBI UK and cleared subject to commitments in the first phase, and will not be dealt with in detail in this article.

The ABF/GBI Business case did not have a Community dimension and thus arrived at the Commission after a post-notification referral from Spain, Portugal and France. Under the Article 22 referrals procedure (4), the Commission examines the impact of the concentration in place of the requesting Member States and analyses the effects of the merger within the territory of those Member States.

After an in-depth investigation, the Commission identified competition concerns on the Spanish and Portuguese national markets for compressed yeast. The decision concludes that there would have been coordinated effects on these two markets, but it cleared the transaction after having accepted appropriate remedies offered by the parties. The products concerned are quite familiar: yeast is an essential ingredient in the production of bread and other bakery products, basically enabling the dough to rise. While three separate product markets for yeast were identified (dry, liquid and compressed yeast), the focus of the investigation was on compressed yeast. Compressed yeast is perishable with a 3-4 week life time when refrigerated and is used in Spain and Portugal primarily by artisan bakers. The in-depth investigation supported the conclusion that the markets for compressed yeast are national in scope for the countries analysed.

The basic market structure was found to be as follows: in Spain, pre-merger ABF held about a 30-40% market share on the compressed yeast market, while GBI had 10-20% and the remaining big player Lesaffre 40-50%. In Portugal, GBI was the traditional leader with 40-50%, ABF 20-30% and Lesaffre 20-30%. Fringe players existed on both markets but their presence was very limited.

2. Where are we now with coordinated effects in Europe?

2.1. The economics of tacit collusion

The goal of merger control is to prevent the build-up, through mergers and acquisitions, of excessive market power which would give firms the discretion to raise prices above the competitive level with a negative impact on consumer welfare in the absence of any relevant efficiencies. Economic theory shows that mergers may reduce consumer welfare also by facilitating collusion (coordinated behaviour) in oligopolistic markets, in essence as the companies in the market reach a tacit (or explicit) understanding of how to coordinate their actions so as to eliminate or reduce the competitive pressure that they exert on each other.

Collusive arrangements may, however, be difficult to enforce given that explicit cartelisation by means of legally enforceable contracts is prohibited. In addition, the participating firms face a dilemma between adherence to the terms of coordination, thus collectively maximising profits, and deviation, which entails reaping high individual short-term profits at the expense of the others but obtaining less profits in future periods as a result of targeted punishment

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.
(2) Case C-413/06 P Bertelsmann and Sony Corporation of America v Impala, not yet reported; OJ C 223, 30.8.2008, p. 7.
by other firms or simply the breakdown of the co-
ordination. A large body of literature on the neces-
sary and sufficient conditions for rational collusive
firm behaviour has developed in industrial econom-
ics. The more the post-merger situation presents
these characteristics, the greater the likelihood of a
post-merger equilibrium where the companies will
engage in tacit collusion. However, the focus should
not be on the feasibility of tacit collusion, but rather
on the merger-specific influence on the potential for
tacit collusion to arise.

2.2. How collective dominance grew into
coordinated effects

In earlier years, the Commission dealt with the po-
tential collusive effects of mergers in narrow oli-
gopolies by drawing on the notion of a dominant
position “by one or more undertakings”. In the
Nestlé/Perrier case in 1992, the Commission con-
cluded with the finding that Nestlé and BSN would
acquire a collective dominant position on the market for
bottled spring water in France. The Commission
referred to a number of theoretically relevant fac-
tors such as high post-merger market shares, ca-
capacities, limited reaction of outsiders and increased
dependencies of wholesalers and retailers on the
parties. Despite this first successful application of
the concept, major uncertainties remained. In the
Kali+Salz/MDK/Treuhand case in late 1993, the
Commission, relying mainly on the existence of struc-
tural links, found the transaction would create a
dominant duopoly between the parties. In the Gen-
cor/Lorbo case in 1996, the Commission found that
the parties would have acquired a dominant duopoly
position in the worldwide markets for platinum and
rhodium. In this decision the Commission mainly
relied on the concept of homogeneity of products,
high transparency and increased symmetry in the
absence of structural links, which were deemed not
necessary. The next two important steps in the ap-
tract of collective dominance were the judgment by the Court of Justice in France v Commission in 1998 and, one year later, the CFI’s Generor judgment confirming and upholding the Commission’s decision.

A substantial development in the assessment of
tacit collusion took place when, in a second land-
mark judgment in 2002, the CFI in Airtours v Com-
mission annulled for the first time a prohibition deci-
sion under the ECMR. In 1999, the Commission in
Airtours/First Choice prohibited the merger of two
UK suppliers of foreign package holidays, because it
expected that the transaction would result in the
creation of a collective dominant position. On this
occasion the CFI clarified the standard for finding
collective dominance by rejecting the routine ap-
lication of a “checklist” approach (analysing the mar-
ket characteristics conducive to coordination) and
rather set out three cumulative conditions, reflecting
a more dynamic approach and looking at the sustain-
ability mechanism of tacit collusion. First, the mar-
ket must be transparent enough to allow monitoring
of other firms’ market conduct. Secondly, coordi-
nation must be sustainable, which means that the
participants must be deterred from defection by fear
of retaliation. Thirdly, the benefits of coordination
must not be jeopardised by the actions of current
or future competitors or customers. The CFI also
made it clear that these conditions require a “pro-
spective analysis” of the specific circumstances.

This landmark decision prompted the adoption of
the Horizontal Merger Guidelines, where the Com-
mmission opted for a more economic approach. The
Guidelines indicate that to assess the likelihood of
coordinated effects it is first necessary to identify a
plausible mechanism for coordination. Four cumu-
latve elements are considered necessary for coordi-
nation to emerge and be sustainable, namely, the
ability to reach an understanding on the terms of
coordination, the ability to monitor deviations, the
existence of deterrent mechanisms and the absence
of any ability or incentive for outsiders to destabilise
the coordination. The mechanical application of the
checklist was thus put aside and the facilitating fac-
tors would have to be discussed in the context of a
sound story based on the abovementioned four
building blocks. That paved the way for the most
important first steps from collective dominance to-
ward the concept of coordinated effects.

2.3. Implications of the ECJ’s Impala
judgment: coordinated effects as a
date of degree

When the CFI in Impala v Commission annulled the
Commission’s Sony/BMG decision, this was a re-
markable and somewhat surprising development for
many. The core of the judgment is a detailed review
of the Commission’s assessment of the strengthen-
ning of an existing collective dominant position by
the major record companies. On 10 July 2008, the
CFI judgment was overturned by the ECJ. In the
context of this judgment the ECJ fully endorsed the
economic model of tacit coordination, elaborating
on its most important aspects.

The ECJ’s Impala judgment highlights several el-
ements that the Commission should look at in detail
and analyse consistently. The ECJ recognises that
by its very nature and in contrast to cartel agree-
ments, tacit coordination can rarely be proven by
relying on hard evidence. By its very nature, tacit
coordination can be difficult to prove. Price-fixing
or market-sharing agreements in violation of Arti-
cle 81 EC Treaty can generally be proven by way
of hard evidence (generally written documents). In contrast, tacit coordination, as indicated by the Court of Justice, “is likely to emerge if competitors can easily arrive at a common perception as to how the coordination should work” (5). Tacit coordination can thus only be inferred indirectly from observing and adequately interpreting the actual conduct of market players in light of existing market conditions, affecting their ability and incentives to tacitly coordinate their actions.

Reaching an agreement, however, is not sufficient. The agreement should be sustainable over time: “having regard to the temptation which may exist for each participant in a tacit coordination to depart from it in order to increase its short-term profit, it is necessary to determine whether such coordination is sustainable” (6). The ECJ also refers to the need to identify a sufficient degree of sustainability. Monitoring to a sufficient degree, a credible deterrence mechanism and limited reaction of outsiders are the elements that the ECJ points to: “the coordinating undertakings must be able to monitor to a sufficient degree whether the terms of the coordination are being adhered to ... Furthermore, discipline requires that there be some form of credible deterrent mechanism that can come into play if deviation is detected. ... the reactions of outsiders, such as current or future competitors, and also the reactions of customers, should not be such as to jeopardise the results expected from the coordination.”

The ECJ also requires the Commission to link these aspects to the effect that the merger brings about. Thus, after having analysed these aspects, the Commission should further show, on the basis of a prospective analysis, the extent to which the “the alteration in the [relevant market] structure that the transaction would entail, significantly impedes effective competition by making coordination easier, more stable or more effective for the three firms concerned either by making the coordination more robust or by permitting firms to coordinate on even higher prices” (7).

It is precisely the change towards more likely, more stable or more effective coordination which lies at the very heart of merger control. What economic analysis has shown is that the concern should focus on the coordinated effects of the merger-specific change in the structure and dynamics of a market rather than solving the more prosaic dilemma of whether a merger is the triggering point for coordination (or collective dominance) which did not exist pre-merger, or whether it strengthens already existing collective dominance. The economic reality is more colourful: between black (coordination) and white (competition) there is something that could be called a sliding scale of coordination. When a market exhibits a certain degree of coordination, no matter whether this could already be described as collective dominance or not, the critical part of a merger analysis is to determine whether a merger creates a situation in which the coordination moves up the scale, to a higher degree. This has been clearly made possible with the introduction of the new Merger Regulation, as for its parallel, the so-called unilateral “gap cases” where no dominant position has to be created to justify an intervention. The new substantive standard of the 2004 Merger Regulation solves the dilemma by effectively shifting the focus towards the significant impediment of competition test, much closer to the economic analysis and the real world, to all intents and purposes getting more under the skin of a market.

The ABF/GBI Business case is the first example of this shift, embracing the change in the Merger Regulation and the very clear recent guidance from the ECJ on how to assess the coordinated effects arising through a merger.

3. The yeast story

3.1. Two in one: some background

The background to the transaction at issue is particular, so it is useful to understand it before placing the case in the context of the coordinated effects analysed by the Commission. GBI Holding was owned from 2005 by a private equity fund, Gilde, which acquired it from a strategic player, Gist-Bro- cadex. Evidence suggested that Gilde bought GBI with a view to re-selling the company in the very short term, seeing an opportunity to act as an arbitrageur in a situation where the previous owner wanted to sell the whole of the GBI company into one set of hands. As a buyer, it had a big advantage over the main established players in the industry such as ABF and Lesaffre, as it would be unlikely to run into merger control concerns buying the whole package. After less than two years of Gilde’s ownership of the company, negotiations both with Lesaffre and with ABF were initiated and the final agreements led Gilde to the effective split-up of the GBI assets and businesses throughout the world. Lesaffre would purchase the yeast businesses in South America and the United Kingdom, areas where it had a weaker market position than ABF, while ABF agreed to acquire the other European assets and businesses, increasing its position in Lesaffre’s traditional stronghold of continental Europe. The end result of the two deals was a significantly more sym-

(5) Paragraph 123 of the judgment in Case C-413/06 P Bertelsmann and Sony Corporation of America v Impala, not yet reported; OJ C 223, 30.8.2008, p. 7.
(6) Paragraph 123 of the judgment in Case C-413/06 P Bertelsmann and Sony Corporation of America v Impala, not yet reported; OJ C 223, 30.8.2008, p. 7.
metric presence in the various regions in the world of the two main players in the yeast industry.

3.2. Yeast: a good mix of “collusion-facilitating” ingredients

As mentioned above, economic literature on coordinated effects (based primarily on non-cooperative game theory), as well as the Commission’s Horizontal Merger Guidelines and the Community Courts, suggest looking at some key market characteristics that are conducive to firms colluding. In \textit{ABF/GBI Business}, these structural features of the Spanish and Portuguese compressed yeast markets strikingly hinted at the finding that the basic “coordination-friendly” ingredients were indeed present.

Consider the following market mix: a small number of active competitors (essentially three, which were reduced to two post-merger), with a high frequency of repeated interaction and without any large or bulky orders (predominantly weekly or twice-weekly orders of relatively small amounts of yeast via distributors to artisan bakers). These two/three firms are interacting on a relatively stable or slightly declining market which is very mature and shows a low risk of leap-frog innovation, while demand elasticity is low and the product is quite homogenous (a couple of brands of yeast in standard packaging for each competitor). There is a high degree of market transparency in competitors’ prices, volumes and capacity. The markets in question are protected from outside reactions by high barriers to entry or to expansion of fringe competitors (as fringe competitors have no local distribution networks, which tend to be very traditional and hard to establish; they are located relatively far away from the region and have little spare capacity and very limited incentives to enter/expand in Spain and Portugal) and, on the other hand, by the relatively low buyer power of customers (being typically smaller local distributors of bakery products for artisan bakers). To all this, add extensive multi-market contacts between the companies involved, who meet on a number of neighbouring product and geographic markets. With these market features revealed or confirmed by the investigation, it would be difficult not to take coordinated effects seriously.

3.3. How the cake is baked

On top of analysing the “checklist” of individual market features, the Commission went further and sought to understand how coordination would actually work in practice. That meant understanding the mechanism and variables on which the colluding partners would (tacitly) agree, the mechanism for detecting deviations and the means to punish them.

The essence of the investigation in this case was to understand the dynamics of the industry — not only at the level of the yeast market but also further downstream where distributors sell the yeast to bakers. To this end, the Commission conducted extensive interviews with competitors, and notably with a number of local distributors, which proved very fruitful. Information was also gathered at an industry trade show where all major market participants are usually present. It is perhaps interesting to note that extensive econometric evidence was not necessary to arrive at a robust standard of proof, even though transaction data were indeed analysed and served to supplement the qualitative findings in many instances. To step into the shoes of the main players, it was very useful to review their internal documents. A number of interviews and internal documents uncovered a great deal of market transparency and showed how competitors would be able to arrive at a common perception of each other’s behaviour. For example, some documents showed how price increases of competitors would be anticipated.

Price — and more precisely price increases applied more or less simultaneously — was indeed found to be the core focal point of the likely (tacit) collusion between the oligopoly members. This was also in line with some past cases of alleged cartel behaviour in the yeast industry. Holding significant excess capacity, all three main players would likely be in a position to react timely enough to punish deviations from the collusive behaviour. What turned out to be a very important element in implementing and monitoring the collusive mechanism were the local distributors.

3.4. How yeast is delivered: role of distributors

In both Portugal and Spain the compressed yeast market is essentially made up of artisan bakers — that is to say that most of the final customers of the compressed yeast producers are small, traditional, family enterprises and are many in number. These businesses are in some cases so small that it is not economic for them to own their own refrigeration systems to keep the compressed yeast in a usable condition for any significant period of time. So they have to be served on a nearly continuous basis by local/regional distributors operating refrigerated transport. These factors mean that over the years the producers actively selling in Portugal and Spain rely on a capillary network of distributors to make the rounds to serve these customers. One of the surprising aspects revealed by the investigation was the importance of the interpersonal relationship between the distributors and their customers, in certain cases extending over more than one generation.
It is therefore very clear that distributors play a fundamental role in the market.

Significant loyalty between the yeast producers and the distributors themselves also exists, as the stability of relationships over the years clearly shows. This was confirmed by the analysis of some written contracts (in Portugal in particular), many dating back many years or even decades. This stability is explained by the arrangements that are in place: distributors proved in the vast majority of cases to be either de facto or de jure exclusive for one supplier and for a given “allocated” region. This makes the whole distribution system a relatively simple one, with few changes possible as all the relevant producers are already “taken” in all regions in both Portugal and Spain.

What was also revealed during the interviews and by analysis of the contracts was that distributors have another important role in the Bakers Play: acting as collectors of information for the suppliers. They collect information about the market at their level, regularly reporting this information back to their relevant supplier of yeast. In some instances, distributors’ contracts with their supplier include a full reporting obligation.

Therefore the investigation showed that the way the distribution system is set up also enhances to a very significant extent transparency in both the Portuguese and Spanish markets for compressed yeast (8), thus making it easier for Lesaffre, ABF and GBI to monitor any deviation in prices or conditions, and facilitating the sustainability of tacit coordination.

3.5. Cake assortment: multimarket contacts

ABF, Lesaffre and GBI were the main worldwide players in the yeast production sector. They also had a significant presence in all three of the Member States subject to the Commission’s scrutiny, and in a number of other markets in Europe. Meeting across a multitude of different product and/or geographic markets may serve to increase the sustainability of coordination across markets, for example by adding another market on which retaliation can take place or by inducing coordination on a market closely linked with a neighbouring market on which cooperation may take place. These multi-market contacts may also serve to decrease asymmetries between the market participants. Overall, the presence of competitors on multiple markets enhances the interaction and the mutual interdependence of the oligopoly members.

An interesting feature which the investigation revealed in this context was the interplay between the Portuguese and Spanish compressed yeast markets. While the investigation concluded that they are still distinct geographic markets, in particular given the importance of demand factors, there are a number of links on the supply side between Spain and Portugal that would mutually enhance the likelihood of coordination. Despite highly asymmetric market shares in Portugal, the Commission identified coordinated effects on that market, taking the form of collusive price leadership (where one firm would lead the market and the other follow). When looking at the behaviour of the firms concerned, it was considered that any highly competitive action of the smaller player in Portugal (which was nevertheless much more strongly present in Spain) on this relatively small neighbouring market could lead to an undesired response of its rival in the geographically close and much larger Spanish market. In other words, there could be more to lose than to gain from such action. This may likely be an additional factor to incentivise the smaller player in Portugal to align its behaviour on that market with the local leader instead of taking a more competitive stance, in order to prevent tougher competition in Spain.

3.6. When a merger makes things worse

It is necessary to further show that the change in the relevant market structure that the transaction would entail constitutes a significant impediment to effective competition. While the investigation indicated that a certain degree of coordinated behaviour was already observable pre-merger on the markets concerned, the key to the analysis was to identify why and how the merger would make the coordination more effective or more stable. The Commission’s analysis showed that the merger of ABF and GBI Business would likely trigger a significant change towards more efficient and more stable coordination.

A merger from three to two main yeast suppliers would significantly change the market picture. For each of the remaining duopoly members, there would only be one competitor to (tacitly) agree on the terms of coordination. Transparency would be enhanced significantly, meaning that each firm would face only one competitor to be monitored and hence discovering the deviator would be much easier. Also punishing deviations would be much more effective, whereas there would be no doubt as to who should be the one taking the retaliatory measures compared with three players on the market. The fact of having only two players instead of three would also reduce the incentives to deviate, as there would be proportionally less to gain.

The investigation also showed that by removing GBI from the market, a potentially destabilising

(*) There were other factors leading to the finding that the markets in question were to a significant extent transparent, such as product homogeneity.
factor in the collusive game would be eliminated. GBI showed a number of asymmetries in comparison with the two other suppliers, which the merger would remove. Contrary to ABF and Lesaffre, who had local production plants in the region, GBI was serving Spain and Portugal from a greater distance, from its Italian facility. The different size of the Italian plant and its different location meant not only comparably higher transport costs, but may have prompted GBI to react differently to, for example, unanticipated supply developments in Italy or demand changes in all the other regions that it was serving. Also, by eliminating GBI from the game, spare capacities would become extremely symmetric between the two remaining players, making coordination between them much more sustainable. An aspect which weakened the retaliation potential against GBI (and hence increased GBI’s potential incentives to deviate) was that GBI was not present on some related product markets in Spain and Portugal (liquid yeast), where retaliation could effectively occur. GBI would thus be immune from counter-attacks on that related market, whereas the two remaining players were also the only ones active there. All in all, the merger would change the market structure in such a way as to reinforce the basic criteria favourable for more likely, effective and sustainable coordination in each of the basic building blocks of the collusive mechanism: in reaching a (tacit) agreement, in monitoring deviations and in the threat of retaliation.

4. Conclusion

The ABF/GBI Business case is a first example of how the new Merger Regulation together with the guidance from the ECJ in its Impala ruling is transposed into a coordinated effects case. The case encouragingly shows that in the context of the analytical framework set by the ECJ and applied by the Commission, a robust coordinated effects case can be arrived at with a common-sense approach: by examining how the merger would change the market structure and whether it would enhance the building blocks of a sustainable collusive mechanism.