In this issue:

Page 1: **Protecting the drugs of tomorrow: competition and innovation in healthcare**

In Novartis/GSK Oncology, the Commission extended its analysis of pipeline pharmaceutical products beyond those that are in advanced stages of development (phase III), to fully assess the impact of the merger on innovation competition.

The case also presented novel issues regarding the design of a remedy involving third party rights, and the consideration of lines of treatment as an indicator of the extent of closeness of competition.

Page 5: **INEOS / Solvay / JV: Yet another P(ractically) V(ery) C(omplex) merge**

Natural experiments are rare in merger assessment. However, previous mergers in the PVC industry made it possible in this case to analyse the effects of consolidation on competition and prices.

Understanding the impact of previous mergers in the industry was of crucial importance in assessing the effects of the INEOS / Solvay / JV transaction, and in designing effective remedies.

Page 9: **Airbus /Safran /JV: Launching competition into space**

In the Airbus/Safran/JV case, the Commission looked at the space industry. Several commitments were imposed to alleviate foreclosure concerns of competitors.

One of the vertical concerns identified required the structural exclusion of one of Safran’s activities from the JV.

The European Space Agency has an important role in the monitoring of the commitments.

Page 12: **Some like it hot! – coffee merger between DEMB and Mondelēz.**

Coffee products belong to a differentiated market where the evaluation of closeness of competition is key to the competitive assessment. Internal documents, views of market participants and economic analysis helped to establish the degree of closeness between single-serve coffee machines and their consumables.

Interrelation between primary market for single-serve machines and its aftermarkets for consumables (pads, pods, capsules) was another important element in the assessment of the proposed creation of the joint venture between DEMB and Mondelēz.
Competition merger brief

Protecting the drugs of tomorrow: competition and innovation in healthcare

Irene Mirabile, Michael Karl Pieber, Lluís Saurí and Arthur Stril

In January 2015, the Commission cleared the EUR 16 billion acquisition of a GlaxoSmithKline (“GSK”) portfolio of cancer treatments by Novartis, subject to conditions.¹ ²

One of the key roles of merger control in the pharmaceutical industry is to ensure that treatments remain available and their prices competitive. This is also true for innovative drugs still at R&D stage (the so-called ‘pipeline treatments’), which will, if successful, bring benefits to patients. The case Novartis / GSK Oncology had an important focus on such innovative drugs for the treatment of advanced cancers. By assessing the impact of pharmaceutical mergers on the availability of future treatments, and intervening when warranted, merger control aims at ensuring that markets work better for the benefit of future patients and their healthcare professionals.

This article focuses on three interesting issues raised by the transaction: the assessment of closeness of competition amongst innovative drugs, innovation competition in pharmaceutical mergers, and the complexity of a remedy involving a third party with pre-existing contractual rights.

Targeted therapies in oncology

A variety of therapies can be employed individually or in combination in the fight against cancer. The best known treatments include surgery, radiation therapy and chemotherapy. This case, however, concerns an innovative class of treatments called targeted therapies, which joined the more traditional forms of cancer therapies over the last two decades.

Targeted therapies work at the cellular level by interfering with specific molecules involved in tumour growth and progression.

They are used primarily when a tumour has reached an advanced stage, when surgery is no longer an option or when the cancer has spread to other parts of the body. Their goal is to slow down the cancer progression, and their success is often measured in terms of additional months of patient’s survival.

Two classes of targeted therapies proved of specific interest for the assessment of this transaction: first, targeted therapies that inhibit proteins carrying the signal for the cell to reproduce, such as B-Raf, MEK and mToR inhibitors; ³ and second, targeted therapies that inhibit proteins responsible for the creation of new blood vessels in tumours ("VEGF inhibitors").

Novartis’ oncology targeted therapies include Afinitor (an mToR inhibitor), also used in particular for the treatment of kidney cancer, as well as a B-Raf and a MEK inhibitor (LGX818 and MEK162). In order to strengthen its portfolio, Novartis agreed to purchase GSK’s portfolio which was composed in particular of three potential blockbuster drugs: ⁴ Votrient (a VEGF inhibitor), used in particular for the treatment of kidney and breast cancer; as well as Tarfinlar (a B-Raf inhibitor) and Mekinist (a MEK inhibitor), both used for the treatment of various cancers, including skin cancer. Because of their promising results in clinical trials and expected commercialisation potential, these three drugs formed a major part of the transaction rationale. The

² The transaction was part of a three-part inter-conditional deal. In a case separately approved with conditions by the Commission, GSK acquired Novartis’ global human vaccines business (excluding flu), and the two companies combined their global consumer health business in a new venture controlled by GSK (Commission Decision in case M.7276 – GlaxoSmithKline / Novartis Vaccines Business (excl. Influenza) / Novartis Consumer Health Business). See http://europa.eu/rapid/press-release_IP-15-3841_en.htm
³ B-Raf, MEK and mToR are the name of the proteins inhibited by these therapies.

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.

The authors would like to thank Alberto Bacchiega, Julia Brockhoff, Maria Despott and Martin Mevius for their helpful comments and suggestions.
Commission ultimately found that the transaction raised serious doubts in relation to B-Raf and MEK inhibitors.

**Lines of treatment and closeness of competition: the case of Votrient and Afinitor**

Both GSK’s Votrient and Novartis’ Afinitor are marketed to treat advanced kidney cancer. Pfizer, Roche and Bayer are also marketing competing treatments. The market investigation indicated that Pfizer, GSK and Novartis are the undisputed market leaders.

At first sight therefore, the transaction involved a three-to-two merger in relation to the treatment of kidney cancer. However, a closer inspection highlighted the role of lines of treatment in gauging closeness of competition between the merging parties. Establishing lines of treatment is a common practice in cancer treatment: when a person is diagnosed with cancer, the oncologist recommends a treatment plan that involves a sequencing of medical actions based on clinical trial evidence of what worked best for patients with similar conditions. The initial treatment is called a first line treatment. If this treatment does not produce the expected results, or when it stops working, the prescriber switches to a second line treatment. Lines of treatment are constantly evolving to reflect the current state-of-the-art therapies and the results of ongoing clinical trials.

### Marketed targeted therapies for the treatment of advanced kidney cancer

<table>
<thead>
<tr>
<th>First line of treatment</th>
<th>GSK</th>
<th>Votrient</th>
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<tbody>
<tr>
<td>Pfizer</td>
<td>Sutent</td>
<td>Torisel</td>
</tr>
<tr>
<td>Roche</td>
<td>Avastin</td>
<td></td>
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<tr>
<td>Second (and later) line of treatment</td>
<td>Novartis</td>
<td>Afinitor</td>
</tr>
<tr>
<td>Pfizer</td>
<td>Inlyta</td>
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<td>Bayer</td>
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GSK’s Votrient and Pfizer’s Sutent are the most successful drugs in first line treatments for advanced kidney cancer. In the past, Novartis aimed to challenge their position by running a clinical trial for Afinitor as first line. This trial failed and Afinitor was later approved as a second line treatment on the basis of a separate clinical trial which proved its efficacy following a treatment with Votrient or Sutent.

Therefore, if the market for advanced kidney cancer treatment were to be considered as being segmented according to lines of treatment, the Parties’ treatments would not be competing. Because lines of treatment are constantly evolving, and because they are not binding to doctors who prescribe the drugs, the Commission also assessed the case under a possible market including all targeted therapies for the treatment of kidney cancer, regardless of lines of treatment. Taking this perspective, the Commission’s investigation confirmed that GSK’s Votrient is predominantly prescribed in the same setting as Pfizer’s Sutent and Roche’s Avastin, whilst Novartis’ Afinitor is mostly prescribed in the same way as Pfizer’s Inlyta and Bayer’s Nexavar. The Commission concluded that Votrient and Afinitor are not each other’s closest competitors for the treatment of kidney cancer, and therefore the overlap raised no competition concerns.

**Competitive concerns regarding the development and commercialisation of B-Raf and MEK inhibitors**

B-Raf and MEK inhibitors have shown to be effective in the treatment of advanced skin cancer. Current clinical evidence indicates that they are expected to show efficacy in the treatment of a number of other cancers as well, including ovarian, lung and colorectal cancer. In a number of cancer types, the full potential of B-Raf and MEK inhibitors is attained by administering them in combination: this is in particular the case for advanced skin cancer, for which such combination is expected to become the standard of care. Similarly, B-Raf and MEK inhibitors are also expected to prove effective in combination for the treatment of other types of cancer, such as lung or colorectal cancer.

In its analysis, the Commission’s concluded that GSK and Novartis were direct competitors in the development and commercialisation of B-Raf and MEK inhibitors and raised two concerns with the transaction as originally notified, namely that it would:

1. reduce from three to two the number of companies developing and marketing both B-Raf and MEK inhibitors for skin cancer, and a MEK inhibitor for ovarian cancer;
2. reduce competition in innovation, with the likely abandonment of Novartis’ broader clinical trial program for its B-Raf and MEK inhibitors (including for lung and colorectal cancer).

(i) Lessening of potential competition in skin and ovarian cancer

Absent the transaction, Novartis and GSK’s B-Raf and MEK inhibitors would likely have constrained each other in the market for targeted therapies for the treatment of skin cancer and ovarian cancer.

Before they can be approved and marketed, candidate drugs in clinical development typically undergo three phases of development, referred to as phase I, phase II and phase III.

In phase I, researchers test a new drug on a small group of people for the first time to evaluate its safety, determine a safe dosage range, and identify side effects. In phase II, the drug is given to a larger group of people to see if it is effective and to further evaluate its safety. In phase III, the drug is given to large groups of people to confirm its effectiveness, monitor side effects, compare it to commonly used treatments and collect
information that will allow the drug or treatment to be used safely.5

For the treatment of advanced melanoma, there are only three companies holding both a B-Raf and a MEK inhibitor marketed or in phase III clinical trials: (Roche, Novartis and GSK). The same is true for ovarian cancer, in which case AstraZeneca, Novartis and GSK hold a MEK inhibitor. The market investigation indicated that Novartis and GSK are not constrained by B-Raf and MEK inhibitors developed by other companies which are still at earlier stages of development.

The Commission’s market investigation further indicated that the transaction would most likely have greatly reduced Novartis’ incentives to launch its own drugs, focusing instead in the marketing of GSK’s alternative drugs which were closer to the market. According to market participants, there was a risk that the transaction would lead to portfolio rationalisation, with Novartis choosing only the most promising B-Raf and MEK inhibitor pair, and discontinuing the other in order to focus on other projects.

The transaction would therefore have resulted in the loss of one of only three competitors active in the markets of B-Raf and MEK inhibitors for the treatment of skin cancer and ovarian cancer. Given the loss of a credible competitor and the existence of only one other company being able to exert competitive pressure on the merged entity (Roche or AstraZeneca), the Commission concluded that Novartis would be insufficiently constrained post-transaction.

(ii) Undermining incentives to develop Novartis’ B-Raf and MEK inhibitors for the treatment of other types of cancer

A concentration not only affects competition in existing markets, but also competition in innovation (developing improved or new products or technologies to replace existing ones) and new product markets (developing products for a new intended use to address a completely new demand).

In this case, both GSK and Novartis were engaging in clinical research programs regarding the use of B-Raf and MEK inhibitors for the treatment of a number of other cancers (besides skin and ovarian cancer), such as lung cancer and colorectal cancer. The respective treatments were being tested in Phase I and Phase II clinical trials.

Previous cases assessed by the Commission concerned the analysis of potential competition between products at an advanced stage of development (Phase III onwards). The Commission in this case focused in particular on understanding whether the transaction would decrease Novartis’ incentives to launch its own B-Raf and MEK inhibitors for skin and ovarian cancer, and the impact it would have on the entire clinical research program for these treatments. Besides being in similar stages of development, GSK’s and Novartis’ clinical research programs were based on the same mechanisms of action. Roche is the only other competitor besides Novartis and GSK with an alternative pair of B-Raf and MEK inhibitors, which means only limited research capacity existed capable of delivering similar results to GSK and Novartis’ clinical research. In other words, the transaction would have brought together two of the only three competing clinical research programs based on B-Raf and MEK inhibitors.

In assessing the impact of the transaction on innovation, the Commission looked at all phases of clinical research and assessed the transaction’s specific impact on innovation by examining the expected role of GSK’s and Novartis’ B-Raf and MEK inhibitor treatments. The results of on-going clinical research are uncertain, but it is still possible to assess the likely effects of a transaction on the development of pipeline products. Indeed, the abandonment of a clinical research program would have as a necessary consequence the failure in bringing the related products to market.

Both prescribers and competitors responding to the Commission’s market investigation raised concerns that the transaction would curtail R&D efforts by Novartis and would most likely reduce competition in innovation. The costs for Novartis to pursue research into its own B-Raf and MEK inhibitors would likely be disproportionate compared to the expected return on investment, in particular given the more advanced stage of development of GSK’s B-Raf and MEK inhibitors for the treatment of skin and ovarian cancer. On this basis, the Commission considered that, following the transaction, Novartis would most likely prioritise the development of GSK’s B-Raf and MEK inhibitors for other types of cancer at the expense of its own clinical research program. The net result would be a significant reduction of GSK’s and Novartis pre-transaction combined R&D efforts. By contrast, the counterfactual (a continuation of the pre-merger situation) showed the two companies’ competing clinical research programs progressing in parallel.

The reduced incentives post-transaction for Novartis to develop its clinical research program for B-Raf and MEK inhibitors would therefore likely have resulted in a decrease of competition in the future markets concerned, and a lower number of B-Raf and MEK inhibitor therapies being available to physicians and patients for the treatment of various cancers.

**Remedies to preserve potential competition and competition in innovation**

To address the competitive concerns identified by the Commission, Novartis committed (i) to divest Novartis’ B-Raf and MEK inhibitors; (ii) to provide transitional support to ensure completion of the phase III clinical studies trialling these drugs in skin and ovarian cancer; and (iii) to ensure the worldwide development and the EEA commercialisation of the broad clinical research programme relating to the drugs, including clinical studies in colorectal and lung cancer.

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5 Source: FAQ clinicaltrials.gov.
The objectives of the remedies are, first, to remove the overlap between B-Raf and MEK inhibitors (both alone and in combination) for the treatment of skin cancer and ovarian cancer; and, second, to provide for the continuation of the broader clinical trial programme of the two drugs from them to be developed for commercialisation in the EEA market.

The following section highlights how the remedies achieve these objectives.

Structuring remedies involving pre-existing contractual rights of a third-party

The structure of the remedies is influenced by the fact that Novartis’ MEK inhibitor is owned by a third party, Array BioPharma Inc. (“Array”), a US-based biotech company that exclusively licensed the drug to Novartis in 2010. Furthermore, the remedy design is influenced by the importance of the B-Raf/MEK inhibitor combination, in particular for skin cancer treatment, as the drugs are more likely to remain viable if they are developed and commercialised together.

Array appeared to lack the required expertise and scale to conduct the entire clinical research program for the two drugs alone. It also appeared to lack the ability to commercialise B-Raf and MEK inhibitors in the EEA, where it does not have sales and marketing capabilities.

In order to be effective, the remedies needed to ensure cooperation between Array and a suitable third party partner for the joint development and commercialisation of Novartis’ B-Raf and MEK inhibitors, on the basis of an agreement to be approved by the Commission.

The remedy package offered by Novartis was a post-closing remedy whereby Novartis committed return of the licensed MEK inhibitor to Array and to divest its B-Raf inhibitor to Array. The package also included Novartis' transitional support to Array in relation to the completion of existing clinical trials (notably the phase III clinical studies for the B-Raf/MEK inhibitor combination for the treatment of skin cancer).

As an important step in addressing the situation of pre-existing third party rights, Novartis and Array entered into an agreement mirroring the key steps provided for in the commitments which required the involvement of Array.

Post assignment of the inhibitors to Array, the commitments provide for an arrangement whereby Array would negotiate appropriate agreements with a partner for the worldwide development and EEA commercialisation of the two treatments. The Commission would have to approve both the partner and the partnership agreement within a prescribed time period following the clearance decision. The market test of the commitments indeed revealed that the success of the development of the two drugs critically depended on the partner’s skillset, experience in developing oncology products, motivation, financial know-how and market presence. Therefore, the commitments establish a tailor-made set of criteria against which the Commission will assess the suitability of the partner. The aim of these criteria is to ensure that Array would partner with a healthcare company of sufficient scale and scope, having the ability and incentive to develop worldwide and commercialise in the EEA the two compounds together with Array.

Should Array fail to partner with a suitable third party within the prescribed deadline, the commitments provide that some rights over the two compounds would then be sold to a suitable purchaser by a divestiture trustee. The commitments provide for this scenario by establishing that Array grants Novartis a licence for the two compounds, for the sole purpose of assigning that license to the divestiture trustee after the prescribed deadline. The divestiture trustee would in turn have an exclusive mandate to sell the license to a third party approved by the Commission.

Taking into account the overall positive feedback received from the market participants, the Commission concluded that the commitments would eliminate all serious doubts identified in relation to B-Raf and MEK inhibitors for the treatment of skin and ovarian cancer, as well as for other cancer treatments. In addition, through the partnership between Array and a suitable company, the commitments would ensure the worldwide development of existing and new clinical studies relating to B-Raf and MEK inhibitors and, subject to positive results of the clinical trials, their commercialisation in the EEA.

Conclusion

Merger control involves a prospective analysis of future market events. This task is somewhat facilitated in the pharmaceutical sector, where information on pipeline products – even those at early stages of development – is publically and readily available.

In Novartis/GSK Oncology, the Commission raised competition concerns on innovative cancer treatments known as B-Raf and MEK inhibitors regarding:

1. overlaps between a marketed product and a pipeline phase III product; and
2. overlaps between pipeline products at earlier stages of development (phase I and phase II).

The latter concern acknowledges the necessity, when warranted, to examine the potential competition concerns of pipeline products at various stages of clinical development – and not only those that are closest to the market. This case therefore provides an illustration of the Commission’s assessment of the impact of future pharmaceutical mergers on competition in innovation and new product markets.
INEOS / Solvay / JV: Yet another P(ractically) V(ery) C(omplex) merger

Andrea Amelio, Andrea Cilea and Massimiliano Kadár

1. Introduction

On 16 September 2013, INEOS AG (“INEOS”) and Solvay SA (“Solvay”) formally notified to the Commission their plan to merge their chlor- vinyl activities into a 50-50 joint venture (the “JV”). At the time of the transaction, INEOS and Solvay were the number one and two suppliers of commodity Suspension Polyvinyl Chloride (“S-PVC”), i.e. a relatively homogeneous and commoditised resin used to produce, amongst others, window frames, piping systems, cables, etc. The combination of the two top-tier players raised a number of competition issues, and was eventually cleared in the context of a phase II review upon submission of significant remedies.

The case is remarkable because of the use of “natural experiments”; that is to say the use of a large set of empirical evidence gathered from past events occurred in the industry, to carry out the competitive assessment. The use of such natural experiments is relatively rare in the Commission’s case practice due to several limiting factors. For example, empirical data may be difficult to collect under the time horizon of merger review or it may be of insufficient quality or quantity. Moreover, an industry may not offer events capable of generating the right type of empirical data such as recent consolidations.

The existence of previous mergers in the industry created in this case a rare opportunity for the Commission to engage in an ex post analysis of the effects that these mergers had on competition and prices. This ex-post analysis played a key of crucial importance in assessing the effects of the INEOS / Solvay / JV transaction, and in designing effective remedies.

2. Market definition

For the purposes of product market definition, the Commission largely relied on previous S-PVC-related cases. S-PVC can be segmented into commodity, speciality and extender. Since INEOS was only active in commodity S-PVC, the Commission focussed its competitive assessment on this market only. Within the commodity S-PVC market, the Commission addressed two main issues, namely: the possible segmentation of the market by molecular weight (the so-called K-value) and the competitive relationship between S-PVC and High Impact S-PVC (“HIS-PVC”).

When analysing customer purchasing patterns, the Commission found that customers could only switch between a limited number of K-values, without incurring significant costs and delays. In short, demand-side substitutability between different K-values was quite limited. S-PVC suppliers by contrast largely declared that their production capacity could be used to produce, in principle, any K-value. This led the Commission to consider that the market for commodity S-PVC featured a strong supply-side substitutability. For this reason, the Commission did not consider that a product segmentation by K-value was justified.

Based on the market investigation, the Commission concluded that commodity S-PVC and HIS-PVC belonged to distinct product markets. HIS-PVC is an impact resistant co-polymer, which is essentially used in the production of weather resistant window sections. Only a portion of commodity S-PVC customers showed any interest in purchasing this product. From a supply-side perspective, only one company (Vestolit) was producing HIS-PVC. Vestolit had the ability to “swing capacity” between commodity S-PVC and HIS-PVC. However, the Commission found that it lacked incentives to do so, one reason being the much lower sale price of commodity S-PVC compared to HIS-PVC.

Defining the geographic market proved less straightforward. In previous cases, the Commission had found that the geographic market for commodity S-PVC was wider than regional. However, it had left open the question as to whether this market covered only North Western Europe (“NWE”), 1 Western Europe or the

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1. The Benelux, Denmark, France, Ireland, Sweden, Norway and the United Kingdom.

The authors would like to thank the other members of the case team, and in particular Ana Garcia Castillo, Giulio Federico and Gabor Koltay for their valuable comments and suggestions.
whole of the EEA. In *INEOS / Solvay / JV*, the Commission used several different tools to reach a more precise conclusion. It addressed extensive questionnaires to customers and competitors, reviewed a significant amount of internal documents and analysed a very large dataset of transaction data provided by the parties. Eventually, in this case the Commission concluded that the commodity S-PVC market was as wide as NWE or NWE plus Austria, Finland, Italy and Switzerland ("NWE+").

The Commission's market investigation in this case focused on both quantitative and qualitative evidence.

At the request of the Commission, the parties submitted a large data set containing transaction data for the years 2007-12 covering sales to each of their customers. Based on this data, the Commission carried out an empirical analysis, which studied the evolution of pricing across different regions of the EEA. The results of this empirical exercise demonstrated that the price difference between NWE and non-NWE regions diverged and increased over time, even after controlling for costs and for customer composition effects. Despite this price trend, NWE customers did not react by diverting purchases to other geographic areas. Likewise, non-NWE suppliers did not divert their sales toward NWE to profit from the price increase.

This lack of arbitrage essentially meant that the price increase observed in NWE was profitable, suggesting that this geographic area constituted a distinct market. This could also be interpreted as a sort of “natural SSNIP test”, that is to say a SSNIP test based on recent empirical evidence generated by recent mergers. In fact, the candidate region, i.e. NWE, experienced a significant non-transitory increase in price relative to the non-NWE region. The empirical evidence collected showed that the price increase did not trigger customers to source commodity S-PVC outside this region, and therefore prices were not disciplined by any such arbitrage. Consistently, the price increase in NWE was profitable for a hypothetical monopolist and, according to the basics of the SSNIP test, the candidate market constituted a relevant geographic market.

The qualitative evidence broadly corroborated this quantitative analysis. First, the Commission reviewed a large amount of internal documents to understand how the parties segmented the EEA, analysed business opportunities and assessed their competitors prior to the planned transaction, that is to say before the plans for the JV could have affected their assessment. Second, the Commission found that the market for Commodity S-PVC was characterised by a combination of price barriers (primarily transport costs) and non-price barriers involving security and flexibility of supply. In particular, customers' business model was based on a “just-in-time” delivery. The combination of these barriers made proximity to suppliers a cornerstone for market definition. Finally, the EEA was characterised by asymmetric trade flows, suggesting that the NWE region - where most of the EEA production capacity was concentrated - constituted a self-standing cluster. According to Eurostat data, significant PVC volumes were shipped from NWE to Eastern Europe between 2008 and 2012, but not the other way round.

3. Competitive assessment

INEOS was already pre-merger the largest player in the commodity S-PVC market in NWE. INEOS’ position had been achieved as a result of its two earlier acquisitions of Kerling in 2007 and Tessenderlo in 2011.2 Solvay, on the other hand, was the second largest player in the market. The transaction would have therefore created a new market leader, with a market share of approximately 50-60% (both in terms of sales volume and of capacity). The Commission noted that market shares, increments and concentration levels are normally important factors in the assessment, even if they only provide ‘first indications’ of market power and increases in market power. This is particularly true in markets where the degree of product homogeneity is very high, such as commodity S-PVC.

The ex-post analysis of the effects of INEOS’ earlier acquisitions of Kerling and Tessenderlo was particularly useful in the competitive assessment, as it allowed the Commission to engage in a sophisticated analysis of empirical evidence.

Through such an analysis, the Commission was able to better qualify INEOS position in the relevant market. In particular, the Commission compared the evolution over time of the parties' transaction prices in NWE relative to other regions. This analysis was based both on a standard “difference-in-differences” analysis, comparing the prices of INEOS in NWE and in European countries outside NWE, and on a “triple difference” analysis, that also relied on Solvay's prices as a further control. The Commission showed that INEOS’ prices increased in NWE relative to other regions and that those price increases were higher than those of its competitor Solvay. The Commission also established a causal link between this price increase and the most recent merger in which INEOS was involved, that is to say INEOS’ acquisition of Tessenderlo. These results indicated that INEOS had acquired some degree of market power due to its acquisition of Tessenderlo, and were also confirmed by the Commission's analysis of INEOS’ internal documents, which reflected INEOS’ focus on price and margin increase following the Tessenderlo merger.

The Commission noted that in a context where INEOS already had some market power pre-merger, the disappearance of Solvay as an independent competitor would have likely harmed competition in a significant manner. In particular, Solvay operated multiple vertically integrated and cost effective plants, which granted the company a significant size, reputation and wide geographical coverage.

2 Case COMP M.4734 INEOS / Kerling; and Case COMP M.6218 INEOS / Tessenderlo Group S-PVC Assets. These two transactions were cleared unconditionally by the Commission.
The Commission’s quantitative analysis also showed that those customers who sourced from INEOS and Solvay suffered less from past price increases than customers of INEOS only.

This conclusion was all the more relevant because, based on the Commission’s analysis, other competitors active in the NWE market for S-PVC would not have disciplined the merged entity’s behaviour post-merger.

First, the Commission noted that most competitors were either running production facilities at full capacity, or only had limited spare capacity, with the exception of Kem One, a French supplier of commodity S-PVC, with an uncertain future in the S-PVC business. The Commission concluded that, in all likelihood, the parties’ competitors would not have had enough spare capacity to sufficiently offset a price increase by the merged entity.

Second, the Commission noted that competitors would have been unlikely to have incentive to increase output as a reaction to a possible price increase from the merged entity. First, during the Phase I investigation, the parties submitted a Bertrand-Edgeworth model (“BE Model”), which had also been used by the Commission in the Outokumpu / Inoxum case. The BE Model showed that, absent efficiencies and remedies, the substantial consolidation of capacities resulting from the merger would lead to a price increase. This meant that, according to the model, rivals’ reaction would not have been sufficient to offset a price increase. Second, as noted above, the Commission’s quantitative analysis showed that INEOS had increased prices in NWE following its acquisition of Tessenderlo. Competitor response, such as output expansions and repatriation of sales in NWE, did not stop the said price increase. According to the Commission, this constituted “direct evidence” confirming the lack of incentives of competitors to offset the anticompetitive effects of a merger.

Having established that the transaction would have led to competitive harm due to the elimination of Solvay as competitive constraint, the Commission assessed whether the synergies resulting from the merger could offset such competitive harm. Those efficiency claims were based on three main sources of variable cost savings: (i) procurement savings, (ii) product optimization and (iii) transport costs savings. The assessment of those claims showed that a significant majority of the alleged savings did not meet the cumulative requirements of benefit to consumer, merger specificity and verifiability contained in the Horizontal Merger Guidelines. In addition, the Commission engaged in a balancing test and concluded that the efficiencies computed by the BE Model, even if they were to be fully accepted, would not mitigate the anticompetitive effects of the merger.

All in all, the Commission concluded that the transaction as originally notified would result in a significant impediment to effective competition in the relevant market for commodity S-PVC in NWE.

4. Remedies

In order to address the competition concerns identified by the Commission, the parties submitted a number of structural remedy proposals. The latest of these proposals consisted of three alternative divestment packages, which are summarised in the table below.

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<tr>
<th>Package</th>
<th>Upstream</th>
<th>Downstream</th>
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<tbody>
<tr>
<td>Package I</td>
<td>VCM contract with third party</td>
<td>Schkopau</td>
</tr>
<tr>
<td></td>
<td>Tessenderlo</td>
<td>Beek + Masingarbe</td>
</tr>
<tr>
<td>Package II</td>
<td>EDC contract with INEOS (optional)</td>
<td>Wilhelmshaven</td>
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<tr>
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<td>Tessenderlo (optional: capacity expansion)</td>
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<td>Wilhelmshaven</td>
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<td>Tessenderlo</td>
<td>Beek + Masingarbe</td>
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The Commission formulated a number of criteria elaborated on the basis of previous cases, taking into account the specific characteristics of this case. As discussed above, the use of a natural experiment allowed the Commission to better qualify INEOS’ position in the NWE commodity S-PVC market and, consequently, to better gauge the effects of the merger under review. In short, INEOS already held a certain degree of market power pre-merger and Solvay constituted a significant competitive constraint on INEOS. In order for the transaction not to create a competitive harm, the Commission believed that an effective remedy package would have had to replicate the competitive constraint exerted by Solvay over INEOS pre-merger.

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3 Kem One entered into receivership proceedings in March 2013, which further compromised its reputation in a market where security of supply ranked foremost among customers. During the Phase II investigation, Kem One was able to ward off liquidation thanks to the partnership between an entrepreneur, Mr Alain de Krasnys, and OpenGate Capital. This however did not assure the Commission concerns, as the success of Kem One’s restructuring was still far from certain and potentially involved some State aid aspects. On 1 October 2014, the Commission opened an in-depth inquiry into the measures into some measures granted to aid Kem One.

4 Case M 8471 – Outokumpu / Inoxum.
More in detail, such remedy package had to meet the following criteria:

1. The remedies had to remove the overlap between the parties and create a competitor equivalent to Solvay in terms of capacity;
2. In view of the relative importance of transport costs and logistics, the divested plants had to be located at the heart of NWE to replicate Solvay’s advantageous location in this region;
3. The divested plants had to enjoy full vertical integration up to VCM, EDC and chlorine; and
4. The divested plants had to enjoy good access to key inputs, in particular ethylene, the most important input for producing S-PVC.

As can be seen in the table above, all the packages submitted by the parties included the upfront divestiture of the ‘Tessenderlo cluster’, composed by production assets in Tessenderlo (Belgium), Beek Geleen (the Netherlands) and Mazingarbe (France). The difference between the three packages related to the first part of the package.

Package I included, besides the Tessenderlo cluster, the upfront divestiture of the INEOS plant in Schkopau (Germany). The Schkopau site is based on a so-called ‘virtual’ vertical integration. INEOS only has ownership and control over the downstream S-PVC production assets, which are fed by upstream VCM assets controlled by a third party operator. According to the parties, the contractual relationship between INEOS and a third party was meant to mimic actual vertical integration and was effectively equivalent to a configuration in which a single operator controls the whole supply chain. However, the Commission concluded after an in-depth analysis that this business model did not provide the prospective purchaser with the pricing incentives of a fully integrated vertical S-PVC supplier.

In Package II, the divestiture of Schkopau was replaced by the upfront divestiture of INEOS’ S-PVC production facility at Wilhelmshaven. Given that Wilhelmshaven was also not fully vertically integrated, the parties proposed to either: (i) pay the cost of increasing capacity at Tessenderlo to allow the prospective purchaser to feed Wilhelmshaven with EDC coming from Tessenderlo; or (ii) enter into a 10-year EDC supply contract with the prospective purchaser. The Commission, however, concluded that the arrangements proposed by the parties would lead to (i) a commercially untested supply chain, in the event of Tessenderlo feeding Wilhelmshaven; or (ii) a situation of dependency of the prospective purchaser, which would have to rely heavily on the merged entity in the context of the 10-year EDC supply agreement.

Package III added to Package II the upfront divestiture of a number of upstream assets at Runcorn to feed Wilhelmshaven with the required EDC. The Commission found that the remedy was effective and met all the criteria it had identified: (a) the overall capacity divested was approximately equivalent to the increment brought about by the merger; (b) the location of the divested assets was at the heart of NWE; (c) the divestment of Runcorn addressed the lack of on-site vertical integration at Wilhelmshaven and constituted a supply chain that INEOS had been itself setting up pre-merger; and (d) the divested assets had good access to key inputs and, in particular, to ethylene.

In view of the above, the Commission decided to grant conditional clearance based on the parties’ full compliance with the remedies proposed in Package III.

After a one-year implementation process, the remedy package has been eventually sold, together with additional assets, to the International Chemical Investors Group. The Commission approved this transaction on 9 June 2015.5

5. Conclusion

The INEOS / Solvay / JV case represents an important step in the Commission’s analysis of mergers in homogeneous goods markets. More in general, it is a useful example of the approach taken by the Commission when making use of natural experiments in merger control. As noted above, an ex-post analysis of the effects of previous mergers can only seldom take place because of the rarity of such natural experiments and the potential difficulties related to data availability. However, the case shows that, where such an ex-post analysis is feasible, economic techniques can provide an invaluable contribution to geographic market definition, competitive assessment and remedies analysis.
Airbus /Safran /JV: Launching competition into space

Hélène Juramy, Belén Planas Martínez, Esther Torrente Heras and João Vareda

1. Introduction

In November 2014, the Commission cleared the joint-venture between aerospace companies Airbus and Safran, subject to several conditions.1

Airbus and Safran set up a 50/50 joint venture (the JV) to which they both contributed their respective activities in space launchers, satellite subsystems and missile propulsion.

The transaction took place in the context of the development of the new Ariane 6 launcher by the European Space Agency (ESA), aiming at a cost reduction of 20-30% per launch. The JV will be responsible for designing the configuration of the Ariane 6. On 2 December 2014, shortly after the case was cleared with conditions, the ESA Member States decided in favour of Ariane 6.2

The main feature of this case, apart from the specificities of the space industry, is that a structural remedy is put in place to alleviate vertical competition concerns.

2. Features of the space industry

The case involves space launchers, satellites and space transportation.

Space launchers use rocket engines to deliver space systems (satellite and space infrastructure elements) into orbit. In Europe, space launchers are ordered and developed by ESA, an intergovernmental organisation with 20 Member States. ESA has entrusted the exploitation of its launchers to the private company Arianespace, the European space launcher provider.

Satellites are delivered into orbit by space launchers. Satellite operators order satellites from satellite prime contractors (such as Airbus), which design, develop, manufacture and commercialise satellites.

Prime contractors usually source components of the satellites (such as the propulsion) from subsystem suppliers (such as Safran). Satellites are typically used for military, commercial or institutional uses.

In the case of European institutional satellites there is a strong preference to buy the components from European suppliers when these are available.

The propulsion subsystem consists of several parts and is essential for operating the satellite as it is used to raise the satellite in orbit once it is separated from the launch vehicle (orbit-raising) as well as to ensure that the satellite keeps its assigned orbit (station keeping). Propulsion can be based on different technologies: chemical, electric (ionic or plasmic) or hybrid.

In this case, Airbus and Safran intended to transfer their respective electric satellite propulsion activities to the JV. No horizontal competition concerns arose since Airbus was to transfer its ionic propulsion activities while Safran was to transfer its plasmic propulsion activities. The competition concerns in this case were of a vertical nature.

1 Decision in case M.7353 AIRBUS / SAFRAN / JV, 26 November 2014.
2 http://www.esa.int/About_Us/Ministerial_Council_2014/
3. Vertical concerns in satellites and space vehicles

The transaction, as initially notified, risked reducing competition in the supply of satellites and space vehicles.

**Plasmic propulsion: foreclosure of competitors and customers**

First, the Commission had concerns that the JV could shut out Airbus’ competitors or limit their access to plasmic propulsion for satellites. According to ESA, plasmic propulsion has been gaining prominence in telecommunication satellites. It is likely to outweigh chemical propulsion in the future, and will probably become the most relevant technology in the next five years. Safran is expected to take the lead for plasmic propulsion in Europe. Currently, European satellite contractors have no adequate alternatives to Safran propulsion systems.³ Despite the relative low cost of propulsion compared to the total value of a satellite, it is a critical input for the success of a satellite. The JV could significantly affect the competitiveness of Airbus’s rivals in the supply of satellites in several ways: Not only through price discrimination, but mainly by requiring rivals to pay for qualifications for plasmic propulsion, discriminating in the delivery schedule in favour of Airbus, or imposing priority for its own supplies to the detriment of its rivals. It goes without saying that barriers to entry and switching costs in such a high-tech industry are significant and that alternatives are unlikely to be readily available.

Second, the Commission had concerns that the JV could significantly reduce the customer base of Safran’s competitors. After all, Airbus is the most important satellite manufacturer in Europe representing a very significant share of the purchases of plasmic propulsion in Europe, and would have the incentive to buy plasmic propulsion exclusively from the JV.

³ The market investigation revealed that the main alternatives to Safran’s plasmic propulsion were not considered as a good option, Fakel (Russia) due to the geopolitical situation and ESP (UK-subsidary of Aerojet US) due to ITAR restrictions, i.e. restriction that exclude US contractors from prime competitions to supply satellites to operators in black-listed countries.
**Other components: foreclosure of competitors**
The Commission also found that the JV could limit the access of Airbus’ rivals to three other important components of satellites and space transportation, namely: (i) carbon-carbon cylinders for optical instruments for space applications, (ii) pressure sensors, namely standard accuracy pressure transducers (SAPT) and (iii) thermal protection systems made of silicon carbide for space vehicles re-entering atmosphere. Given the use of these three components in the production of satellites and space vehicles, restricting access to these products would significantly affect the competitiveness of Airbus’s rivals.

In contrast to plasmic propulsion, the Commission had no concerns about the JV negatively affecting the customer base of Safran’s rivals. This was mainly because of the presence of one significant customer of these components, other than Airbus.

**Exchange of confidential information**
Finally, there was a risk of confidential information exchanges regarding satellites and satellite components between the JV and Airbus to the detriment of competitors.

4. Remedies fit the specific nature of the space industry
The commitments offered by Airbus and Safran addressed all these concerns.

**Excluding activities from the scope of the JV**
To dispel the Commission’s competition concerns about access to plasmic propulsion and its customers, Airbus and Safran committed to exclude Safran’s activities in plasmic propulsion from the JV and to keep these parts of the business separate for 10 years following the clearance decision. This remedy maintains Safran’s incentives to sell plasmic propulsion to potential competitors of Airbus and Airbus’ incentives to potentially buy plasmic propulsion from other suppliers.

In the case of plasmic propulsion such a structural remedy was necessary given the additional concern about foreclosing customers. An access remedy, such as the one presented below, would not remove Airbus’s incentives to buy plasmic propulsion exclusively from the JV, with the objective of foreclosing Safran’s rivals.

**An open bilateral contract under the control of ESA**
To alleviate concerns in relation to the three other components, Airbus and Safran also committed to conclude a framework supply agreement with Safran’s current main customer on these. The principles of this agreement were set up in a memorandum of agreement, attached to the Commission’s clearance decision.

This agreement can serve as a basis for any third party contractor to obtain supplies of these three components on transparent and non-discriminatory terms. The framework supply agreement will be used as a benchmark under the monitoring of ESA’s Industrial Ombudsman.

As each agreement must include a confidentiality clause to protect information disclosed by third-parties to the JV, the framework supply agreement also removes the risk of transmission of confidential information.

5. The role of the European Space Agency
In view of its key role in the European space industry, ESA plays an important part in the monitoring of Airbus and Safran’s second commitment. First, ESA was involved in the monitoring of the negotiation of the framework supply agreement between the JV and its current main customer. The final framework supply agreement will be approved by the Commission based on ESA’s recommendation. Second, ESA acts as trustee and arbitrator in case of dispute between the JV and a third party prime contractor.

5. Conclusion
As illustrated in cases presented in other Merger Briefs, merger control involves looking at future market developments.

In this case, appropriate solutions were found in the first phase investigation to competition issues in a very specific industry in order to solve the vertical concerns identified by the Commission.

**A new case soon into orbit?**
At the time of writing it seems that another opportunity to look at competition in the space industry might arise soon. During the case, it appeared that Airbus and Safran intended to acquire, at a later stage, control over Arianespace. Airbus has launched negotiations to buy the stake of the French Space Agency (CNES) in Arianespace. However, this constituted a separate transaction and was therefore not taken into account nor prejudged in Airbus/Safran/JV.

The press has recently announced that an agreement was reached between the French government and Airbus/Safran on 10 June 2015.

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4 Centre national d’études spatiales.
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.

The authors would like to thank Hanna Anttilainen for her valuable contribution to this article.
product market. A consumer cannot buy Nespresso-compatible capsules and stick them in a Senseo machine or vice versa. Once a consumer has committed to a particular system, he or she is also committed to the type of consumable he or she buys.

Some single-serve machines work solely with dedicated consumables offered only by one supplier, thus forming closed systems. For other machines it is possible to use consumables from various suppliers (open systems). In particular, consumables for Dolce Gusto are produced only by Nestlé and those for Tassimo (T-discs) only by Mondelēz, while filter pads for Senseo can be produced by any coffee company. On the other hand Nespresso is a semi-open system and Nespresso capsules are offered not only by Nestlé but also by those coffee companies which manage to develop the necessary technology.

Single-serve machines produce not only simple black coffee but also a wide variety of milky or flavoured variations (lattes, cappuccinos, gingerbread-flavoured coffee and many, many others). Consumers feel that with a machine like that they can replicate coffee they normally enjoy in a cafe. They perceive single-serve machines as status symbols and more luxurious than the traditional multi-serve machines. These could be the reasons why the market for single-serve machines and markets for their compatible consumables are growing and have a large potential, despite the fact that the price per kilo of coffee is much higher in the single-serve sphere than in traditional R&G or instant coffee. Another reason for growth is most probably the strong promotional support offered by coffee companies for the single-serve systems, which makes these luxurious status symbols more affordable. In France already more than 50% of coffee sales are derived from single-serve products (that is various consumables for single-serve machines). On the other hand, in Greece only 5% of the coffee sales value comes from such single-serve products. It is clear therefore that the level of uptake of single-serve systems still varies significantly between various EEA countries (one of the reasons why the geographic scope of the market for single-serve machines and the markets for their consumables is national). This differentiation is partly a result of different coffee cultures. But it also implies that there are still markets to be converted from traditional coffee types to single-serve products.

### Two levels of competition

An interesting feature of this market is the cooperation of two partners: coffee companies (such as DEMB, Mondelēz, Nestlé or Tchibo) work together with machine manufacturers (such as Philips, Bosch, Magimix, SEB) to develop, manufacture, sell and promote the full single-serve system, that is, a single-serve machine and its compatible consumables. While the exact scope of this cooperation varies between the different single-serve systems, broadly speaking that the machine manufacturer has a stronger say regarding single-serve machines, while the coffee company is responsible for the consumable part of the business. For example, Mondelēz owns the Tassimo brand and all Tassimo machines are sold under the “Tassimo” brand. However, these machines also bear the Bosch brand and it is Bosch who manufactures and sells them, not Mondelēz. It is also Bosch who sets the wholesale price to retailers. Similarly, Senseo machines are produced, priced and sold by Philips and not by DEMB.

Despite this fairly straightforward division of tasks, coffee companies have a profound interest in pushing the sale of “their” single-serve machines. The more single-serve machines are sold, the greater the potential profits of coffee companies from selling consumables. In particular, Mondelēz and DEMB are both able, and in fact they do, influence the final price paid by the customer for Tassimo and Senseo machines respectively. This influence takes place through promotional support such as coupons, cashbacks, free consumables, etc. For this reason, the Commission analysed the effects of the transaction on the market for single-serve machines even though, as said, neither Mondelēz nor DEMB manufactures or sells these machines directly.

Moreover, in order to assess the impact of the transaction on competition, the intrinsic link between the market for single-serve machines and markets for their consumables had to be taken into account. Machines and consumables are complementary in that one cannot be used without the other. As such, the analysis of the primary market (i.e. the sale of machines) and that of the aftermarket (i.e. the consumables) are interlinked.

### Tassimo and Senseo – do they respond to similar consumer needs?

Consumer goods markets tend to be highly differentiated and coffee products (such as single-serve coffee machines and their consumables) are no exception. In such markets a key component of the competitive analysis is the assessment of whether a sufficient number of consumers regard these products as their first and second choices (closeness of competition). Hence, in this case, the Commission investigated if the Tassimo and Senseo single-serve systems are particularly close competitors and as such, a stronger constraint on each other than competing systems. Should this be the case, it would also be more likely that after the merger (absent this constraint) the merged entity would increase prices of consumables and/or single-serve machines (the latter in particular through decreasing the promotional support).

To determine this, the Commission analysed a number of things. First, the Commission reviewed the parties’ internal documents which exposed the current and intended positioning of Senseo and Tassimo (both machines and consumables) vis-à-vis their competitors. Second, the Commission sought the opinions of retailers, electronic goods retailers, single-serve machines manufacturers and competitors on their views on the positioning of the various single-serve systems.
Finally, the Commission also carried out a quantitative analysis to assess the degree of competition across coffee machines and to gather indications on the closeness of competition between coffee machines.¹

The analysis of all these elements indicated that the main competition takes place between four systems – Dolce Gusto, Nespresso, Senseo and Tassimo; with A Modo Mio, Cafissimo etc. remaining as fringe players. Among these four systems Dolce Gusto and Tassimo have the most similar selling proposition – they both offer various hot and cold drinks (in addition to black, milky or flavoured coffees also tea or hot chocolate), thus appealing to consumer need for diversity, variety, choice and indulgence. Marketing and promotional campaigns of both companies emphasised these needs and the customers indeed perceive Tassimo and Dolce Gusto as close alternatives. On the other hand Senseo is perceived by consumers as offering a simple black coffee that can be drunk every day, while Nespresso is viewed as a luxurious, high-end product. As a result, the Commission concluded that Tassimo and Senseo are not each other’s closest competitors. In fact, all four systems ultimately compete with each other and Tassimo and Senseo are no closer substitutes for each other than Dolce Gusto or Nespresso.

**Loss of competition between Tassimo and Senseo**

The finding that Senseo and Tassimo are not the closest competitors, however, does not necessarily imply that the merger could not result in a significant competitive effect.

The Commission therefore also had to assess the consequences of the disappearance of the current competition between Tassimo and Senseo and, in particular, whether this loss could lead to higher prices (of consumables or machines) or less choice for consumers (for instance through removing the open Senseo system from the market and promoting instead the closed Tassimo system).

Since it was established that the parties need to cooperate with machine manufacturers when designing their strategies as to the Tassimo and Senseo systems, it was clear that the parties alone would find it difficult to unilaterally remove a single-serve system from the market.

Moreover, the merged entity’s incentive to increase Tassimo machine prices would also be limited. First, if the Tassimo machine prices increased, part of the customers would switch from Tassimo to another coffee machine (or fewer consumers would buy Tassimo as their first machine). The merged entity would then benefit only from those customers who switch from Tassimo to Senseo. However, as Dolce Gusto is the system with the most similar selling proposition to Tassimo, it is highly likely that a large proportion of consumers would switch from Tassimo to Dolce Gusto. This risk greatly limits the incentive of Mondelēz to increase Tassimo’s prices.

Second, such a strategy would entail a loss of sales in the Tassimo consumables (T-discs) given that if fewer Tassimo machines are sold due to an increase in machine prices, fewer consumables are sold going forward. These lost sales could be made up by increased sales of Senseo pads. However, as Senseo is an open system (that is, the aftermarket of the consumables is open to several producers of filter pads, not only DEMB), the merged entity would benefit only from the share of consumers who, after switching from Tassimo to Senseo, would buy DEMB’s filter pads rather than competing pads for the same system.

Third, the Commission’s investigation showed that the market for single-serve coffee machines (and consequently also those for consumables) is still in a relative nascent stage. Consumers are switching into this form of coffee brewing from the more traditional coffee preparation methods. Coffee companies compete to capture these switching consumers by offering them cheap single-serve machines (through promotional support) hoping for profits from sales of consumables. The transaction is not likely to alter this market dynamic. Maintaining a high level of penetration of the machines of one’s single-serve system will remain a key success factor for players in this market, and particularly for those coffee machines that do not yet have a high penetration (e.g. Tassimo). Therefore, the parties will remain incentivised to promote their single-serve machines and keep the levels of promotional support, making post-merger price increases unlikely. Also competition from their strong rival Nestlé will contribute to maintaining this incentive and constrain their behaviour.

These various elements led the Commission to conclude that the combination of Senseo and Tassimo would not lead to a loss of competition enabling the merged entity to increase prices of their single-serve machines.

The following sections will present the results of Commission’s analysis with respect to the single-serve consumables markets.

**II. Consumables**

**Product market: each type of single-serve consumable constitutes a distinct market**

DEMB and Mondelēz offer coffee in different formats, both for multi-serve and single-serve segments. The main formats in multi-serve are R&G, consisting of coffee beans which have been pre-roasted and pre-ground for use in drip filter machines, and instant coffee. DEMB and Mondelēz compete in R&G (mainly) and instant coffee.

As regards single-serve consumables, each type of single-serve machine requires a specific format of consumable. Once a customer has bought a specific machine, that customer is bound

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¹ This quantitative analysis consisted of an “entry analysis” whereby data related to several entry events across several European countries by the different types of machines over the period 2004-2014 was analysed.
to this machine and its consumables. In closed systems such as Tassimo or Dolce Gusto, the customer has to buy consumables from a monopoly supplier enjoying intellectual property rights on consumables production (Mondelēz or Nestlé). In open or semi-open systems such as Senseo and Nespresso, the customer can buy consumables from various suppliers. The parties compete in consumables for open or semi-open systems, namely filter pads (Senseo) and N-capsules (Nespresso).

Product market: Filter pads (Senseo)
The Commission assessed first whether filter pads may be substitutable with other formats, notably R&G.

Filter pads are pre-packaged individual portions of R&G coffee for use in compatible appliances such as Senseo machines to produce a single cup of coffee at a time. Filter pads produce a long coffee with a smooth taste and larger serving-style than espresso coffee. The taste has some similarities with R&G coffee taste.

The Commission found that coffee companies market and promote filter pads as an upgrade from traditional brewing methods like R&G used in drip filter machines. It is sold as a more “modern” product. This strategy has proven successful: there has been a clear trend of some consumers switching from R&G to filter pads, with the key driver being convenience. Coffee drinkers value the diversity of tastes, the different strengths and the uniformity of each coffee dose brought by filter pads, even at a higher price per cup.

Once customers have entered the filter pads universe, they are reluctant to ‘downgrade’ their coffee experience to R&G even if they are facing a 5-10% price increase of their filter pads. As a result, the substitution is one-way only and no reverse trend from filter pads to R&G is taking place.

Product market: N-capsules (Nespresso)
N-capsules are Nespresso compatible coffee capsules with a solid shell. Coffee is prepared by placing the N-capsule in the machine which incorporates a mechanism whereby pressurized water comes into contact with the coffee in the capsule. Nespresso is a semi-open system 2 having recently had to allow other producers than Nestlé to N-capsules. Whereas Nestlé sells Nespresso products on the internet or through a small number of specialised retail shops, competing coffee manufacturers have introduced N-capsules for sale in supermarkets. These new players represent 14% of N-capsules sales in the EU.

The Commission ultimately found that despite these differences in distribution channels, all N-capsules (original and compatible) compete with each other. They both address the needs of Nespresso machine owners who are looking for a Nespresso coffee experience brought by original or compatible capsules. The purchase of compatible N-capsules is more convenient as they are often bought together with other grocery shopping. However, there is a clear price correlation (their prices change in the same direction over time) between Nespresso’s original capsules sold through Nespresso’s distribution channels and the compatible N-capsules sold through supermarkets.

Closeness of competition in filter pads and N-capsules

Filter pads (Senseo)
In the two countries where the parties compete in filter pads (France and Austria), the Commission assessed the degree of closeness of competition between the parties’ products. The closer these products are, the higher the risk that the parties will significantly increase prices of filter pads post-merger.

In France the Commission found that the parties’ combined market share was above 60% and that both parties had the widest range of products in the filter pads market with the remaining competition coming essentially from private label products. Moreover, the French filter pads market is highly driven by promotions and both DEMB and Mondelēz were strongly reacting to any promotion campaigns launched by the other party. In particular Mondelēz’ Carte Noire brand has in the last three years challenged the market leader Senseo and significantly increased its sales. Conversely, retailers’ brands have seen a decrease of their market shares between 2011 and 2014, as their involvement in promotional activity and advertisement have been much lower than those of the main branded players DEMB and Mondelēz. As a result, competition in the French filter pads was fuelled by intense rivalry between DEMB and Mondelēz, which would disappear after the merger.

In Austria, the parties held a combined market share above 70% and were the largest branded players in the Austrian filter pad market in terms of size and range width. The Commission also found that both DEMB and Mondelēz were constantly monitoring the promotion and marketing activities of the other party.

Closeness of Competition: N-capsules

Regarding N-capsules, DEMB and Mondelēz are in general the main market participants in the traditional retail channel (and as such close competitors) whereas Nestlé remains the clear market leader with its own capsules sold in a dedicated network. The Commission found that the merged entity will continue to compete against Nestlé. Moreover, given that this is a growing and lucrative market, it is likely to continue to attract new entrants.

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2 Pending the resolution of some legal challenges
An improved remedy proposal, but the same buyer in the race.

Early in first phase, the parties proposed remedies to address the Commission’s initial doubts concerning France (where doubts were also expressed as regards R&G products) and Austria. However, the Commission did not accept these remedies because the proposal (the divestment of L’Or and Grand’Mère brands in France) did not adequately address the issue in filter pads in France. The Austrian remedy (a short licence of the Senseo brand) was also deemed insufficient.

As DEMB and Mondelēz had solicited potential bidders for the French brands in September 2014, a binding offer for these two brands was submitted in January 2015 by Italian producer Lavazza, the market leader in Italy but with a limited market position in France.

The Commission, however, maintained its assessment that the divestment of L’Or and Grand’Mère were insufficient to eliminate competition concerns as regards filter pads in France. The parties finally decided to propose the divestment of the business currently operated in Europe by Mondelēz under the brand Carte Noire, including R&G, filter pads and N-capsules (to ensure viability of the brand although no concerns were found in N-capsules). As this remedy eliminates the overlap between the parties in R&G and filter pads in France and that specific provisions were put in place to ensure that the purchaser will have access to N-capsules technology (which is not owned by Mondelēz), the Commission considered this remedy as adequate to eliminate competition concerns in France.

According to press reports, Lavazza still appeared to be interested in the purchase of Carte Noire instead of L’Or and Grand’Mère and was granted a four-week exclusivity period to assess the feasibility of the purchase. This exclusivity period has now ended so the race is on.

As regards the Austrian licence remedy, the parties improved their original proposal by extending the licensing period of the Senseo brand to 5 years. The black-out period (period during which neither the parties nor the purchaser is allowed to use the brand after the licensing period) was also extended to 5 years. The Commission has accepted the principle of the licence instead of a full divestiture because the Senseo brand was widely used in other countries than Austria and a full divestiture of the brand on an EEA-wide basis would have been disproportionate.

Conclusion

This case touched upon many interesting topics which are worth a mention in the “brief” but here are the highlights:

- Consumer preferences and behaviour are crucial in defining the markets for Fast Moving Consumer Goods; while coffee seems, on the face of it, to be a pretty simple drink, the different “routes to cup” represent alternatives which are not really substitutable in the eye of the consumer. Try asking around who would trade an espresso for an instant coffee or a filter coffee for a cappuccino and you will see.

- Brands are essential assets in consumer-facing industries. Although most brands tend to be national, some span across several countries or even the whole EEA. Brands can cover a range of products and be “extended” to new products; in the coffee world this means that one brand is often present in several different formats. The strength of the brand is often behind the success of a wide portfolio and makes the extension into new products likely to be more successful. The interactions between a primary market (in this case coffee machines) and an aftermarket (in this case consumables) can get quite complex to assess, especially if the parties are directly active in only one of the two. In this case, the cooperation between the machine manufacturers and the coffee companies, as well as the influence of the coffee companies on the machine prices meant that the effects of the merger had to be analysed on both markets.

In conclusion this merger proved complex, pioneered DG COMP’s case law for coffee mergers and, to quote our Commissioner “[this] decision will ensure that consumers can continue to enjoy a variety of coffee brands and types at competitive prices”.

3 The Commission also concerns as regards the R&G market in Denmark and Latvia. These concerns were addressed through a remedy proposal given in Phase 1 and as such, the proposal was not modified in the course of the 2nd phase investigation.

4 Brand divestitures generally take place for the EEA rather than on a country-by-country basis.