



Competition *merger brief*

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Competition *merger brief*

Ball/Rexam: The beverage can merger – keeping an eye on the Ball

Hélène Juramy, Gabor Koltay and Marco Ramondino

1. Introduction

In January 2016, the Commission cleared the acquisition of Rexam PLC (Rexam, the United Kingdom) by Ball Corporation (Ball, the United States), subject to conditions.

Ball is a worldwide producer and supplier of metal packaging for beverage, food and household products, with annual sales above EUR 6 billion in 2015. Ball is the leading beverage can manufacturer worldwide and #2 in the EEA. Rexam's worldwide activities are focused mainly on beverage can manufacturing, with sales of over EUR 4 billion in 2015. Rexam is the #2 beverage can manufacturer worldwide and the largest in the EEA.

The transaction was initially announced in February 2015 when Ball made public its offer for all of Rexam's share capital against a consideration of approximately GBP 4.3 billion. It was notified to the Commission on 15 June 2015. After an initial investigation, on 20 July 2015 the Commission decided to open an in-depth investigation.

The transaction was set to take place in a highly concentrated European industry with only four main suppliers of beverage cans: Ball, Rexam, Crown, and Can-Pack. Moreover, it would have combined the activities of the two main suppliers and resulted in a new #1 supplier in Europe, producing approximately 2/3 of total beverage can supply in Europe.

In order to address the concerns raised by the Commission, Ball committed to divest 12 production facilities located in Germany, the UK, the Netherlands, Poland, France, Austria and Spain. Accordingly, the divestment business has a European-wide production network with a capacity that nearly matches the overlap created by the transaction.

A conditional clearance decision was adopted on 15 January 2016¹. On 25 April 2016, Ball and Ardagh announced that Ardagh would be purchasing the assets that Ball committed to divest in order to obtain regulatory approval for its acquisition of Rexam, including plants in Europe, the US and Brazil.

On 17 June 2016, the Commission approved (i) Ardagh as the purchaser of the divestment business and (ii) Ardagh's acquisition of the divestment business².

2. Understanding the beverage can industry

The beverage can industry in Europe is a highly concentrated one. Effectively, there are only four suppliers that have sizeable businesses: Ball, Rexam, Crown, and Can-Pack. Can-Pack and Crown each have fewer production facilities and a more limited geographic coverage of Europe than the parties. Moreover, the suppliers active in Europe have different abilities to compete in the market due to their differing scales and geographic footprints.

Barriers to entry and to expansion in the industry are high. Very high utilization rates are key to profits. Due to high plant set-up

In a nutshell

In January 2016, the Commission cleared the acquisition of the global #2 beverage can manufacturer Rexam by the global #1 Ball, subject to the divestiture of nearly the whole overlap in Europe.

A key feature of the phase 2 investigation is the adoption of customer-centric catchment areas as the basis for the geographic market definition and the competitive assessment.

When relevant for assessing the case and where the available data so permits, the Commission's analysis can encompass catchment areas and isochrones in a cross-border assessment of markets which may not coincide with national boundaries.

This article also explains the considerations in accepting a very large and significant remedies package.

¹ The public version of the decision and commitments is published on the Commission's website: [M.7567](#).

² See case [M.8048](#).

costs, suppliers are unlikely to implement material increases in capacity unless they can secure significant customer commitments. Indeed, the introduction of new capacity in the past few years has been limited and has often been accompanied by the closure of existing plants so that demand and supply in the market remain roughly in balance.

Moreover, in order for a beverage can manufacturer to be able to win significant business with high demand customers, it must be able to rely on a network of plants. A broad network of plants allows suppliers to (i) optimize their production by shifting volume across plants when needed to achieve optimal utilization; and (ii) offer customers guaranteed service in case of issues with the plant they are usually supplied from.

Finally, although some customers are large global soft drink, beer and energy drink manufacturers such as Coca-Cola, Heineken, Carlsberg, InBev, SABMiller, and Red Bull, countervailing buyer power is limited. Tight capacity and customer inability to obtain transparency on costs, as well as the fact that the parties benefit from scale and geographic footprint larger than those of their competitors and closely matching those of their main customers, are key indicators of the degree of market power they can exercise over large customers.

3. Assessing concentration in a geographically differentiated market

Customer-centric catchment areas

The investigation highlighted relevant features of the beverage can industry in Europe: (i) supply and demand conditions differ from one location to the next; (ii) customers tend to make most of their purchases within a maximum distance from their filling location plants; (iii) suppliers normally deliver the cans to customers' locations; and (iv) prices are generally negotiated at the level of filling plants.

These features of a geographically differentiated market suggested that catchment areas around customer locations are the most appropriate way to assess competition in the can industry, as they most closely reflect reality. More specifically, the Commission calculated concentration figures within a radius of a customer based both on competitors' capacities within the radius and sales by competitors to customers within that radius.

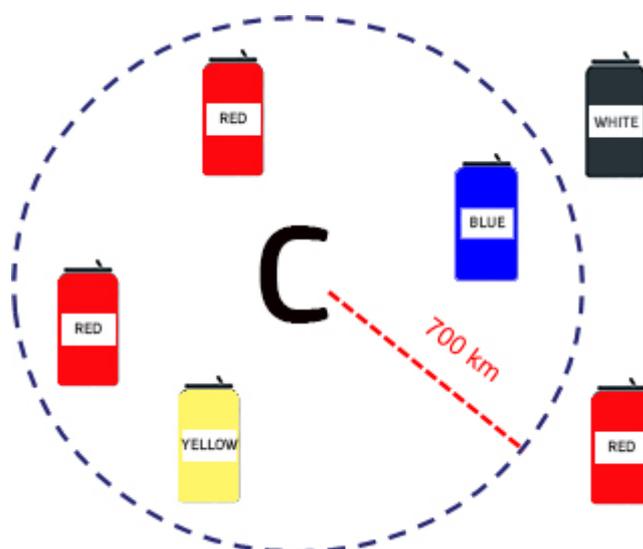
Figure 1 shows a mock-up example for defining catchment areas. There are four can suppliers in this area: Red, Yellow, Blue and White. Within the 700km radius of customer C there are three can suppliers: Red with two plants, Yellow and Blue with one plant each. Outside the radius there are two additional plants: one Red plant and one White plant. For simplicity, all plants have the same capacity and operate at full capacity.

The customer-centric capacity-based market shares focus on a customer and its potential suppliers. Potential suppliers are determined based on an assumption as to the feasible transport distance. They take into account all the capacity within the

catchment area and yield 50% market share for Red and 25% for Yellow and Blue. Capacity-based market shares are especially suitable for a capacity-constrained industry, where the level of capacity controlled by each market player is an important determinant of the competitive conditions faced by customers. Moreover, capacity shares are forward-looking: they can capture plant openings and closures, and are robust to any changes in the sales patterns after the merger.

Volume-based market shares change the market share calculation in two ways. First, this method subtracts volumes that are sold outside the catchment area from the capacity within the catchment area. Second, it adds the volumes outside the catchment area that are sold into the catchment area of C. Consequently, volume-based market shares provide an additional sensitivity analysis for the capacity-based shares by reflecting the actual geographical distribution of sales made by each plant. However, volume market shares have certain disadvantages. First, sales by distant plants may represent a less effective competitor compared to sales by plants located closer to a given customer. Second, volume shares take the actual sales patterns as given and cannot take into account the impact of plant closures/opening or the effect of the merger.

Figure 1 - Customer-centric catchment areas



For the purposes of the case, the radius was defined in terms of transport distance for cans sold by Ball, Rexam and their two main competitors in the EEA. 80% of all can sales take place within a maximum distance of approximately 700 km from a customer's filling location. The 80% cut was taken based on several elements such as replies of competitors and customers in the market investigation, and margin analysis. Moreover, the Commission conducted robustness checks based on a radius of 900 km and 500km.

4. Geographic market definition

In phase 1, the investigation suggested that, in addition to local elements, the size and geographic spread of a supplier's network had some relevance. For that reason the Commission initially considered whether the market for beverage cans could be EEA-wide. Following the phase 2 investigation, however, the Commission concluded that an EEA-wide market definition was not appropriate, and built the geographic market definition on the basis of the customer-centric catchment areas. Nevertheless, the network elements still needed to be taken into account in the competitive assessment and in remedy formulation.

In order to define geographic markets, the Commission took a catchment area with a radius of 700 km around each customer filling location as a starting point. The Commission then concluded that the catchment areas around individual customer filling locations could be clustered together in broader geographic areas (regions) where these catchment areas are subject to sufficiently homogeneous competitive conditions.

Eventually nine regions were defined: Central Europe (Austria and Germany), Benelux, France, Italy, Iberia (Spain and Portugal), North East Europe (Poland, Czech Republic, Slovakia, Lithuania, Estonia and Latvia), South East Europe (Hungary, Slovenia, Croatia, Romania, Bulgaria, Greece and Cyprus), the Nordics (Denmark, Norway, Sweden, Finland, and Iceland) and the UK and Ireland³.

In order to assess the concentration in a region, the Commission calculated average concentration figures by averaging the concentration levels in the individual catchment areas. These were based on the weighted average capacity/volume shares of suppliers in each of the catchment areas located in that region, where the weights are given by the total sales made to the filling location at the centre of each catchment area. Moreover, the Commission also considered that geographic differentiation might well exist within a given region. Such differentiation was taken into account in the competitive assessment by using not only the average concentration figures for a region as described above, but also concentration figures for a subset of customers with particularly significant concentration effects, within the region. The latter were defined as customers of catchment areas where both the combined market share and the market share increment of the parties are above certain thresholds⁴.

³ These regions were based on the parties' own understanding of local market conditions, the parties' sales patterns and other more qualitative elements from the market investigation.

⁴ A similar within-geographic-market assessment was carried out as part of the US Federal Injunction: *FTC v. Sysco, USF Holding Corp., and US Foods, Inc.* See the "Memorandum Opinion of United States District Judge Amit P. Mehta Concluding That the Commission Is Likely To Prove That the Proposed Acquisition Violates Section 7 of the Clayton Act", <https://www.ftc.gov/system/files/documents/cases/150623syscomemo.pdf>.

Competition concerns

When using the catchment-areas based clusters, the transaction would have led to high market shares and HHIs⁵ (calculated based both on volumes and on capacity) in all clusters, as can be seen in Figure 2 below. The effect on customers with particularly significant concentration effects are shown in Figure 3.

Figure 2 - Weighted average capacity market shares in each regional cluster (capacity-based, 700 km catchment areas)

Catchment areas around customer filling plants located in the region	Ball	Rexam	Combined
Benelux	[50-60] %	[20-30] %	[80-90] %
Central Europe	[30-40] %	[40-50] %	[80-90] %
France	[40-50] %	[30-40] %	[80-90] %
Iberia	[20-30] %	[30-40] %	[60-70] %
Italy	[10-20] %	[70-80] %	[90-100] %
North-East Europe	[20-30] %	[20-30] %	[40-50] %
Nordics	[5-10] %	[70-80] %	[80-90] %
South-East Europe	[20-30] %	[20-30] %	[40-50] %
UK and Ireland	[40-50] %	[20-30] %	[60-70] %

Figure 3 - Weighted average capacity shares for customer filling locations with particularly significant concentration effects in 2014 (700 km catchment areas)

Location of customer	% affected volumes in region	Average combined market share	Average increment
Benelux	[90-100] %	[80-90] %	[20-30] %
Central Europe	[90-100] %	[80-90] %	[30-40] %
France	[90-100] %	[80-90] %	[30-40] %
Iberia	[90-100] %	[60-70] %	[20-30] %
Italy	[60-70] %	[90-100] %	[20-30] %
North-East Europe	[60-70] %	[50-60] %	[20-30] %
Nordics	[40-50] %	[90-100] %	[20-30] %
South-East Europe	[50-60] %	[60-70] %	[20-30] %
UK and Ireland	[90-100] %	[60-70] %	[20-30] %
Total (EEA)	[80-90] %	[70-80] %	[20-30] %

Can-Pack and Crown, the only remaining main players in Europe, would not have placed a sufficient competitive constraint on the merged entity after the transaction. Moreover, the industry is characterised by high barriers to entry and expansion (importance of having a network of plants, sunk costs of building a new plant) and customers have limited abilities to switch supplier. Therefore, absent remedies, the merger would have significantly impeded competition in all the clusters of catchment areas concerned.

5. Designing the remedies package in Europe

In order to render the transaction compatible with the internal market, Ball submitted commitments on 18 November 2015, which were however deemed insufficient.

⁵ Herfindahl-Hirschman Index. The HHI is calculated by summing the squares of the individual market shares of all the firms in the market.

This initial proposal was to divest Ball's entire Metal Beverage Packaging, Europe segment save for certain excluded entities, assets and personnel (the exclusions mainly related to certain holding companies, three Ball can body plants, some key personnel and IP in pipeline products). In addition, it proposed to divest two Rexam can body plants. Together, the proposed divestiture package resulted in re-creating a new #2 player in the European beverage can market.

In spite of this, the initial remedy proposals had two significant shortcomings.

The North-East Europe issue

First, the Commission found that the commitments of 18 November 2015 failed to address the elimination of increased competition in the North-East Europe cluster. The investigation indicated that, absent the transaction, it was likely that Rexam would have increased capacity in the region and consequently reduced market concentration. Significant concentration effects for a sub-set of customers in the Central Europe cluster also remained.

To address these concerns, Ball added its Polish plant in the improved package submitted two weeks later.

A reverse carve-out

Second, ensuring the viability and competitiveness of the divestment business was key to successfully creating a new player in Europe. In that respect, the Commission noted that Ball had excluded a large number of key personnel from the scope of the 18 November 2015 commitments. Since the divestment business would have consisted of a very large network of plants across the EEA, resulting in a combination of assets of both parties, and operating in a highly concentrated and capacity-constrained industry, the Commission considered that a high degree of continuity of key staff would be crucial for the divestment business's ability to serve its customers and compete effectively in the market immediately after the divestiture. Moreover, from the beginning emphasis was put on the need for the package to be a "reverse carve-out", instead of a collection of assets, to ensure that the various legal entities, assets, and contracts (when applicable subject to customer consent) would transfer to the buyer as a going concern and be immediately operative.

To address these concerns, Ball added to the package further personnel, including management, R&D and sales staff. These proved to be important additions in turning the remedy into an attractive and self-standing package. In essence, the improved package consists of a full divestiture of Ball's current European business as a going concern (with the exclusion of two plants that Ball could retain, as well as the addition of three Rexam plants).

The Commission concluded that the improved commitments removed its competition concerns in their entirety.

The need for an upfront buyer

Ball and Rexam were not allowed to close their deal until the Commission approved the buyer of the assets. This was necessary because of the complexity and size of the package, as well as due to the strong concerns expressed by customers as to the identity of the buyer.

A global package

Throughout the investigation, the Commission cooperated with the US and Brazil. This cooperation was key also in designing the remedies package, and continued during the process of approving the proposed buyer. The buyer is purchasing plants and assets in Europe, the US and Brazil, making it the new #3 player globally. However, one challenge was the fact that the global package includes plants from both Ball and Rexam.

6. Conclusion

The *Ball/Rexam* transaction materially impacted competitive dynamics in the European beverage can industry, as it created a new market leader, the combined Ball/Rexam, as well as its closest competitor, the divestment business (Ardagh). Structuring effective remedies for transactions that transform entire industries is not easy, in particular when competition takes place at both catchment area and regional levels.

By tackling the geographic aspects of competition with the customer-centric approach while also assessing broader competition dynamics, the Commission has been able to assess the effects of the transaction and of the remedies proposed by Ball on the overall European beverage can industry as well as on local markets.

This shows that, when it is relevant for case assessment and the nature of the investigation and data collection permits it, the Commission's analysis of markets can rely on catchment areas and isochrones⁶ in a cross-border assessment of markets which may not coincide with national boundaries.

The substantial remedies offered, consisting essentially of a reverse carve-out of Ball's existing European business rather than a mix and match of different plants and assets, combined with the requirement of an upfront buyer, ensure that effective competition is maintained in the already concentrated drink can industry in Europe. Strong cooperation with the Federal Trade Commission in the US and CADE, the Brazilian competition authority, also ensured coherence in a remedies package that goes beyond Europe.

⁶ Measures of distance or travel time.

Competition *merger brief*

Staples/Office Depot: House of Paper

Marta Andres Vaquero, Daniele Calisti, Christos Tsoumanis

1. Introduction

On 10 February 2016, the European Commission (the Commission) conditionally approved the acquisition of Office Depot by its rival Staples. Both companies are US-based global suppliers of stationery and other office products to private consumers and businesses. The Commission cleared the transaction after an in-depth investigation subject to the divestment of Office Depot's contract distribution business (framework agreements for the supply of office products, generally entered with large business customers after competitive tenders) in Europe and its entire business in Sweden.¹ On 10 May 2016, the US federal courts granted the Federal Trade Commission (FTC)'s request for a preliminary injunction and the deal was subsequently abandoned.

Staples had previously attempted to acquire Office Depot almost twenty years ago, in 1997. At that time, the transaction was successfully challenged and blocked by the US FTC. Over the last few years, both companies had engaged in a number of acquisitions of other competitors active in the office supplies industry. These culminated in Staples' acquisition of Dutch based rival Corporate Express (2008), and Office Depot's acquisition of US rival Office Max (2013).

The deal was reviewed by the Commission, the US FTC, the Canadian Competition Bureau (CCB) and the Australian Competition & Consumer Commission (ACCC). While the ACCC approved the deal unconditionally, the US FTC and the CCB decided to go to court to block the deal and the Commission cleared the case conditionally. The different outcomes are due to the different market structure and the diverging remedies offered in the respective territories.

¹ See press release at http://europa.eu/rapid/press-release_IP-16-278_en.htm.

In a nutshell

In February this year, the European Commission approved the acquisition of Office Depot by Staples. Three months later, the US District Court for the District of Columbia granted the FTC's request for a preliminary injunction to block the acquisition and the deal was subsequently abandoned.

The case illustrates the challenges of defining product markets which concern a multitude of different products and provides insight into assessing competitive constraints in the absence of reliable market shares. The Commission examined other sources of evidence such as survey and bidding data.

The assessment carried out by the four competition agencies of North America, Europe and Australia was aligned in terms of market definitions and approach to the assessment. The different final outcomes are due to the different market structure and the diverging remedies offered.

The Commission's in-depth investigation found that the transaction would have significantly impeded effective competition in different markets, most notably in the market for the supply of office products through international contracts with large business customers in Europe. In order to remove competition concerns and obtain clearance, the companies undertook to divest Office Depot's relevant European assets in all the problematic markets.

In defining the relevant product markets, the Commission faced several challenges. The notifying parties ("the Parties") sell a multitude of products to different categories of customers through multiple sales channels.

The nature of the markets concerned, in particular, the fragmented product base and the customer and channel differentiation, also raised challenges for the competitive assessment. The lack of reliable market share data led the Commission to look for alternative qualitative and quantitative ways to assess the impact of the transaction.

Finally, as regards commitments, designing a suitable remedy depended on the viability of a business divestiture mostly based on a single sales channel.

2. Paperclips to toner: defining the relevant markets

Staples and Office Depot are active in several EU Member States in the supply and distribution of a wide range of office supplies. Several different consumable products fall under this broad label, including traditional office supplies such as stationery (pens, binders, staplers, paperclips etc.), cut sheet paper and ink & toner used in printers and copiers, but also other types of products that are used in an office context, such as office furniture, break-room supplies (coffee and snacks), cleaning products and others.

All these products are sold to a varied customer base which ranges from individual private consumers to large businesses. Furthermore, Staples, Office Depot and their competitors sell these products through a number of different distribution channels, such as retail sales through bricks and mortar shops, online sales, catalogue sales, contract-based distribution and wholesale distribution.

Because of the variety of products, customers and distribution channels, the relevant market definition was particularly challenging and a fundamental element to assess the competitive constraints faced by the Parties.

Distribution channels

The Commission first assessed whether the different channels through which office products are distributed should be considered as distinct relevant product markets. In a previous case, the Commission had already examined a possible sub-segmentation of the market based on distribution channels.² The Commission had recognised that different channels correspond to the needs of different customers, although certain customer groups can be served through different channels.

With regard to the contract channel in particular, the Commission had also previously assessed this channel as a separate product market.³ In this case, the Commission looked in more detail at the specific features of contract sales in its in-depth investigation. Without doubt, several channels are available to business customers for the purchase of office supplies. However, when their office supplies expenditure is significant, business customers generally run a competitive tender process to select

their contract stationer, with which they then enter into framework agreements. In order to fulfil the tender requirements, suppliers need to be able to offer a specific pricing model, to have sufficient logistic capabilities and to provide a range of services. Not all the companies active in the distribution of office supplies through other channels are able to meet those requirements.

Because of these findings on the demand and supply side, the Commission ultimately retained its previous distinction of the contract distribution of office supplies as a separate product market. Similarly, the Commission defined distinct product markets for the wholesale channel and for the direct distribution channel, which includes retail and online sales.

Product categories

The Commission also examined whether the large and differentiated range of products supplied by Staples and Office Depot has to be assessed as one market, or distinguished based on different product categories.

In line with precedents, the Commission drew a general distinction between traditional office supplies and other products. Traditional office supplies are all consumable products frequently sourced and used in offices and include stationery, ink & toner and cut sheet paper. The evidence on the Parties' commercial strategy and the customers' purchasing and switching behaviour enabled the Commission to differentiate the distribution of traditional office supplies from the distribution of office furniture or larger business machines and associated services, as well as from the distribution of cleaning products, food, IT and telecommunication equipment, although some of these are sometimes sold together with traditional office supplies.

Within traditional office supplies, the Commission explored whether the three different categories of stationery, cut sheet paper and ink & toner had to be assessed as a single market, or distinguished into different product markets. The Commission found that there are specialist suppliers that distribute only one category of these products under contract. Paper manufacturers, for instance, sometimes distribute cut sheet paper directly, while original equipment manufacturers of copy machines and printers offer Managed Print Services contracts ('MPS'), under which they provide a machine to the customer, service it and replenish ink & toner in exchange for a payment-per-page.

However, the Commission found evidence that customers in the contract channel have a strong preference for one-stop-shop purchases of all their traditional office supplies, pointing at the distribution of the full range of these products as an overall relevant product market. The question was ultimately left open, however, because the same competition concerns would have arisen irrespective of whether the Commission assessed the different categories together or whether separate markets by product categories were distinguished, in which case concerns would have arisen for contracts covering stationery.

² See in particular case M.2965 – Staples / Guilbert.

³ Case M.2286 Buhrmann / Samas Office Supplies.

International and non-international contracts

Both Staples and Office Depot are suppliers with activities in a number of EU Member States. A key question for the purposes of market definition was whether international contracts should be considered as a separate product market from national contracts.

Staples and Office Depot insisted that customers currently under international contracts have the choice to revert to separate contracts in different countries instead, and that therefore separate national contracts exert a competitive constraint on international contracts, thus belonging to the same relevant market.

The Commission found evidence of a broad trend among customers with offices in different Member States to source their office supplies under a single international contract with Staples, Office Depot or the competing international supplier Lyreco. The market investigation showed that sourcing office supplies centrally for different Member States generated a number of benefits for the customers, such as product and service homogeneity, substantive cost savings – including through volume rebates for all purchases made across different Member States – as well as internal cost savings due to the use of homogeneous ordering platforms and the need to manage only a single contract and a single procurement strategy. Overall, there was a considerable customer base of companies that, when choosing their contract stationer, requested quotes for different Member States under a single tender and awarded the contract to a company that could service their needs in most or all locations.

That trend among customers to source under centrally managed international contracts matched the strategy of the merging companies: the Commission found evidence that the companies were actively targeting international customers with a proposition based on the consolidation of their spending in different countries.

Despite these trends, the Parties argued that there would be no separate market for international contracts. The argument was based on the results of telephone surveys of international customers which Staples commissioned in 2013 and 2015 and which, according to the Parties, indicated that the vast majority of international customers would switch back to national contracts in the event of a small but significant non-transitory increase in price (the so-called SSNIP test).

The Commission considered the surveys submitted by the Parties as relevant information, given that they were conducted by an independent third party and without the Parties' interference. However, when assessing Staples' surveys in conjunction with its own market investigation, the Commission found that customers in this market had a tendency to overestimate their switching behaviour when asked about their reaction to a hypothetical price increase.

Against this background, the Commission contacted the persons responsible for procurement for a large number of the respondents of Staples' surveys. When asked to discuss switching behaviour in an open reply instead of selecting among pre-determined multiple answer choices, a large majority of customers provided more circumstantiated qualitative and quantitative evidence that switching to national contracts was not a suitable alternative in reaction to a small but significant non-transitory increase in the price of their international contracts.

The responses to these more detailed interviews provided strong evidence that international customers were likely to absorb such an increase in prices rather than switch to separate country by country procurement under national contracts. Therefore, the Commission defined for the first time two separate markets for international office supply contracts in the EEA and for non-international contracts at the national level.

The experience in this case shows that the analysis of customer feedback on switching conduct in reaction to price increases needs to be considered with great care and in conjunction with all other quantitative and qualitative evidence available.

Size of the business customers

The last segmentation considered by the Commission concerned specifically non-international contracts. These are typically concluded with customers of different sizes and with different levels of spending on office supplies.

The market reality as captured by the investigation suggested that larger customers need a different range and higher level of services than smaller customers. Therefore, in line with a previous case,⁴ the Commission defined a separate market for large business customers. In its previous case, the Commission had established a threshold for large business customers as those having at least 100-200 office workers. In view of the Parties' internal estimates and data availability in this case, the Commission finally included all customers with more than 250 total employees in the same market.

3. Competitive Assessment

The lack of reliable market shares was the main challenge the Commission faced when conducting the competitive assessment. In the absence of independent data on the total size of each product market, the Parties provided market shares using four different methodologies, each of which was subject to a large degree of uncertainty and sensitive to underlying assumptions. This was because the office supplies industry is characterised by a large and varied customer base, the absence of contemporaneous independent third party estimates of the size of the different markets, as well as large ranges of individual products in each product category. The market investigation could

⁴ Case M.2286 Buhrmann / Samas Office Supplies.

not confirm the correctness of the Parties' assumptions and indicated that their estimates were not sufficiently reliable and likely to understate the combined market shares of the Parties.

As a result, the Commission examined alternative ways to assess the competitive positions of the Parties and the credibility of alternative suppliers in its market assessment, including bidding data and qualitative evidence.

The evidence gathered during the market investigation, and in particular, the Commission's analysis of bidding data submitted by the Parties confirmed that the market for international contracts is very concentrated as only the Parties and Lyreco are capable of supplying customers through international contracts. Moreover, there are high barriers to enter this market as setting up new contract distribution operations in EEA countries or entering into an international business alliance are options that are not readily available to national suppliers without incurring significant costs or risks. Finally, the Commission discarded Amazon and other online suppliers as credible potential competition for international contracts in Europe as they are currently not active in the contract channel.

As a result, the Commission found that the transaction would have significantly impeded effective competition in the market for the supply of office products through international contracts.

The Commission also found that the transaction would have reduced competition in the markets for non-international contracts with large business customers in the Netherlands and Sweden, as well as in the wholesale supply of office products in Sweden. As regards non-international contracts, the Commission took into account the limited number of suppliers active in the contract market in these countries, their limited size compared to the Parties and Lyreco, their limited presence in tenders and the existence of barriers to entry in Sweden and the Netherlands. Moreover, the Commission used a list of the top 100 largest employers to whom the Parties and their competitors supply through contracts in all the overlapping countries. Out of these top 100 largest employers, the Commission selected those which are purely national entities and therefore only have non-international contracts in place for office supplies (in order not to overestimate the Parties' market power for non-international contracts at national level). The Commission found that the Parties and Lyreco have contracts in place with the vast majority of these entities, whereas other competitors served only a few.

4. Remedies

The concerns identified in the international contract market in the EEA as well as the non-international contract markets in Sweden and the Netherlands and wholesale market in Sweden required remedies which were crucially dependent on the viability of a business divestiture mostly based on a single sales channel. In order to address these concerns, the Parties offered to divest the whole of Office Depot's contract distribution business in the European Economic Area (EEA) and Switzerland. They also

offered to divest Office Depot's entire business operations in Sweden to address the competition concerns which the Commission had identified in the Swedish wholesale market.

The market test confirmed the viability of the divested business which was essentially a business consisting of a single distribution channel: the contract channel. The Commission observed that this business model was adopted by other suppliers active in the same market, including most notably by the international competitor Lyreco.

The Commission concluded that the commitments removed the entire overlap between the Parties in all markets where concerns were raised, thus ensuring that an important alternative supplier will remain available on these highly concentrated markets.

Given the size of the divestment business compared with the size of existing suppliers other than the Parties and Lyreco and given the need to ensure the viability of the package composed of a single sales channel, an upfront buyer clause was included in the commitments.

5. International Cooperation

The merger control processes of the four competition agencies assessing the transaction across the globe were aligned in terms of market definitions and approach to the competitive assessment. The agencies focused on the market for office supply contracts with large business customers and assessed the respective strengths of the Parties against their actual and potential competitors.

Throughout the process, the Commission cooperated closely with the three other agencies (in Australia, Canada and the US) and exchanged information on the basis of waivers provided by the parties. The teams held regular update calls on process and substance and discussed in particular the factual similarities and differences in the respective jurisdictions. The Commission and FTC case teams also discussed the remedies that the Parties had submitted in their respective jurisdictions as well as economic analysis.

Timing was aligned between the Commission's phase II proceedings and the FTC's decision whether or not to seek a preliminary injunction in court.

While the Commission approved the transaction subject to remedies, the ACCC approved the deal unconditionally and the FTC and CCCB decided to go to court to block the deal. These different outcomes are explained by the different market structure in the four jurisdictions and the different remedies offered by the parties in the jurisdictions where concerns were raised.

The relevant markets were defined as at most EEA-wide, Australia-wide, Canada-wide and US-wide in scope and different competitors with different strengths were active in those regional markets. The situation in Europe differed from the situation in the

other regions in that the merger would have at most reduced the number of suppliers from three to two, in particular in the international supply of office products to large business customers. This contrasted with the situation in the US and Canada, where the parties were the only players in this market and the transaction would have led to a monopoly. Moreover, the Parties offered the Commission a wide-ranging remedy by undertaking to divest all of Office Depot's activities in all of the problematic markets in Europe.

This case is therefore an example of how international cooperation among competition authorities fosters coherent assessment of competitive constraints and efficient review processes.

6. Conclusion

The Staples/Office Depot case illustrates the challenges faced when defining markets which involve a number of products sold through several different distribution channels to a varied customer base which ranges from individual private consumers to large businesses. It further shows the Commission's commitment to finding alternative evidence and information to assess the competitive positions of the Parties and the credibility of alternative suppliers when reliable market share data is not available.

In addition, this case is an example of seamless cooperation between four competition authorities on a world-wide basis which adopted similar approaches towards the definition of the relevant product markets and the competitive analysis. Different market dynamics and remedies offered gave rise to different outcomes. Ultimately, the two companies decided to call off their plan to merge.

Competition *merger brief*

Liberty Global/BASE: Fixing it first in the Belgian mobile market

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1. Introduction

On 4 February 2016 the Commission approved Liberty Global's acquisition of the Belgian mobile operator BASE, a subsidiary of the Dutch telecoms group KPN, subject to remedies. The acquisition was one in a string of deals in the European telecoms sector, which has seen a wave of consolidation in the past three years.

The acquisition brought together two providers of retail mobile services operating in Belgium. The Commission has recently reviewed mergers between mobile operators in Austria¹, Ireland², Germany³, Denmark⁴ and the UK⁵, and, at the time of writing, it is reviewing one in Italy⁶. However, unlike those mergers, Liberty Global's acquisition of BASE did not combine two full-fledged mobile network operators, meaning operators that own the physical infrastructure used for mobile communications, such as masts and antennas, which together make up a radio access network. Instead, the transaction brought together a mobile network operator – BASE – and a virtual operator, namely Liberty Global's majority-owned subsidiary Telenet. Virtual operators do not own a radio access network⁷ but rent space on the network of a mobile network operator. This was the first case in which the Commission looked in-depth at such a tie-up⁸. The horizontal effects resulting from this

combination are discussed in section 2 of this article, and the remedies to remove those effects are explained in section 3.

Another feature of the transaction was that it combined the activities of an operator owning a fixed network (Liberty Global's Telenet) with those of an operator owning a mobile network (BASE). Such "fixed-mobile" transactions⁹ are said to be driven by the prospect of convergence. The term convergence has no clear definition, but it is often used to describe the fact that telecom companies increasingly offer fixed and mobile services in a bundle to their customers. At a more profound level, it refers to the expectation that the boundaries between fixed and mobile networks will disappear and that consumers will be able to access content seamlessly using both networks, wherever they go.

Since fixed-mobile transactions combine operators in related markets, they can give rise to conglomerate effects. In the Liberty Global/BASE case, the Commission also investigated these effects. This is discussed in section 4.

In a nutshell

Liberty Global/BASE entailed the acquisition of a mobile network operator by a mobile virtual network operator.

The transaction prompted an in-depth investigation and was ultimately cleared with a fix-it-first remedy to preserve competition in the Belgian mobile market.

¹ Case M.6497, Hutchison 3G Austria/Orange Austria, 12 December 2012.

² Case M.6992, Hutchison 3G UK/Telefónica Ireland, 28 May 2014.

³ Case M.7018, Telefónica Deutschland/E-Plus, 2 July 2014.

⁴ Case M.7419, TeliaSonera/Telenor/JV, withdrawn by the parties on 11 September 2015.

⁵ Case M. 7612, Hutchison 3G UK/Telefónica UK, 11 May 2016. Prior to that case, in 2010, the Commission had also reviewed a merger between two mobile network operators in the UK: Case M.5650, T-Mobile/Orange, 1 March 2010.

⁶ Case M.7758, Hutchison 3G Italy/Wind/JV, pending.

⁷ Some virtual operators own a core network, but the core network is distinct from the radio access network.

⁸ Case M.7421, Orange/Jazztel also involved a combination of a mobile network operator (Orange) and a virtual operator (Jazztel) but the in-depth investigation in that case was not focused on concerns in the retail mobile market, given, among others, Jazztel's small market share (1.7% by revenue). See European Commission, Press release of 4 December

2014, Mergers: Commission opens in-depth investigation into Orange's proposed acquisition of Jazztel; Case M.7421, Orange/Jazztel, 19 May 2015, paras. 776-778.

⁹ The Commission has dealt with several fixed-mobile transactions in recent years. In 2013 and 2014, it unconditionally approved acquisitions by the mobile operator Vodafone of the fixed operators Kabel Deutschland in Germany and ONO in Spain (Case M.6990, Vodafone/Kabel Deutschland, 20 September 2013; Case M.7231, Vodafone/ONO, 2 July 2014). National competition authorities have also reviewed several major fixed-mobile transactions. In 2014, France's *Autorité de la concurrence* cleared the acquisition of mobile operator SFR by fixed operator Altice subject to remedies (Decision No 14-DCC-160 of 30 October 2014 on the acquisition of sole control of SFR by the Altice group). In 2016, the UK Competition and Markets Authority unconditionally cleared the acquisition of mobile operator EE by BT, the UK's largest fixed operator (Final report on the anticipated acquisition by BT Group plc of EE Limited, 15 January 2016).

2. Horizontal effects on the retail mobile market

BASE and Telenet both offered mobile services (voice, SMS and data) to consumers and businesses in Belgium. The transaction combined these two players and created an entity which, in number of subscribers, was a close second to market leader Proximus and, in revenue, a close third to Mobistar. The transaction removed competition between two dynamic players and the Commission found that it would therefore harm competition in the Belgian mobile retail market.

BASE was one of Belgium's three mobile network operators, the other two being Mobistar and Proximus. As the most recent network operator to enter the market, BASE was the third largest player by revenue in the Belgian mobile market, after market leader Proximus and the number two Mobistar. By subscribers, BASE had become the second largest player, behind Proximus but ahead of Mobistar.

The Commission found that BASE was considered by the market as the most aggressive mobile network operator, offering the lowest prices and the best "value for money".

Telenet entered the Belgian mobile market in 2006 as a virtual mobile operator hosted on the network of Mobistar. In 2011, it became a "full" virtual operator, meaning it started operating its own core infrastructure¹⁰. After that, Telenet grew rapidly and became the largest virtual mobile player by revenue and by subscribers, after the three mobile network operators. Its customer base was almost exclusively in the footprint of its cable network, which covers Belgium's Flemish Region and parts of the Brussels Capital Region.

In previous cases, the Commission found that virtual operators exert a weaker competitive constraint than full-fledged mobile network operators¹¹. In this case, the Commission found that, although its competitive constraint was not as strong as that of a mobile network operator, Telenet had nonetheless contributed to competition in the mobile market. Indeed, Telenet had contributed to bringing down retail mobile prices in Belgium, after it introduced its popular "King" and "Kong" tariffs in 2012. Telenet had tripled its market share in a short time and reached a market share between 5% and 10%.

Telenet's remarkable success as a virtual operator, ostensibly unique in Europe, was due to a combination of several factors. Telenet was a well-established cable operator, with a high market share in the market for TV and internet. It therefore had a loyal customer base, distribution channels and a well-recognized brand, all of which contributed to its competitiveness. Moreover, Telenet benefitted from access to the network of a mobile network operator under favourable conditions. Together, these factors made

Telenet an exceptionally competitive virtual operator and allowed it to obtain a sizeable market share in a short span of time.

3. A fix-it-first remedy to remove the horizontal anti-competitive effects

The Commission cleared the acquisition after Liberty Global submitted remedies to remove the anti-competitive horizontal effects generated by the acquisition. The remedies will create a new virtual operator to replace the competitive pressure exerted by Telenet. To achieve this, the remedies contain three elements.

First, BASE divested Mobile Vikings, a virtual operator partly owned by BASE, to a new entrant in the retail mobile market. Mobile Vikings had operated in the Belgian retail market as a so-called "light" virtual operator, meaning an operator that does not own its own core infrastructure. It had seen steady growth but was much smaller than Telenet. BASE had a 50% stake in the operator and the remaining shares were held by the founders of the company.

Second, BASE committed to transferring part of its customer base, namely the Jim Mobile customers, to the new entrant that acquires Mobile Vikings. The Jim Mobile customers are BASE customers that purchase their services under the Jim Mobile brand, which is owned by the Belgian media company Medialaan.

Finally, BASE committed to providing the new entrant with access to its mobile network, under a wholesale agreement that obliges the new entrant to transition from a light virtual operator to a full virtual operator. The new entrant has to pay for access to the BASE network based on its usage but it also has the option to purchase a sizeable part of the network's capacity in return for a fixed annual fee.

The divestiture of an existing virtual operator and customers to a new entrant is a novelty in the Commission's telecoms merger practice. By acquiring an existing entity, the new entrant can more quickly replace the virtual operator that is removed from the market. The divestiture of a legal entity also ensures that the entity's customers will be transferred to the new entrant, which contributes to its viability.

Another noteworthy feature of the remedy was the fact that it was a fix-it-first remedy. At the Commission¹², that term is used when the notifying party not only offers to divest a business but also finds a purchaser for it and signs a divestiture deal, all during the Commission's merger review process¹³. If the purchaser and the agreement are suitable, this allows the Commission to approve the purchaser and the agreement in the decision clearing the merger. A fix-it-first remedy gives the Commission certainty about the buyer of the divestiture and may be the only solution in cases where few

¹⁰ Although a "full" virtual operator owns its own core infrastructure, it still relies on the radio access network of a mobile network operator, which is why it is still a virtual operator. The core infrastructure is distinct from the radio access network (masts, antennas).

¹¹ See, e.g. Case M.7018, *Telefonica Deutschland/E-Plus*, Commission decision of 2 July 2014, paras. 567-576.

¹² The term has a different meaning in jurisdictions such as the United States. See Patricia Brink, Daniel Ducore, Johannes Luebking and Anne Newton McFadden, *A Visitor's Guide to Navigating US/EU Merger Remedies*, 12(1) COMPETITION LAW INTERNATIONAL 88 (April 2016).

¹³ Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004, para. 56.

potential purchasers are suitable or only specific purchasers can make the remedy effective.

In this case, Liberty Global identified Medialaan as fix-it-first purchaser and entered into legally binding agreements with Medialaan, transferring the ownership over the divestiture and giving Medialaan access to the BASE network as a new virtual operator. In the final decision, the Commission approved Medialaan as purchaser and also cleared the agreements between BASE and Medialaan. The divestiture transaction itself also had to be reviewed by the Belgian competition authority, which cleared the transaction shortly before the Commission's final decision¹⁴.

A fix-it-first remedy gives the Commission certainty about the buyer but it also offers advantages to the parties. Since they obtain all necessary approvals in the clearance decision, they can close their transaction and the divestiture shortly after the Commission's decision, which is what happened in this case¹⁵.

4. Convergence and conglomerate effects

The Commission also examined whether the transaction could lead to conglomerate effects. These could have stemmed from the fact that BASE and Telenet were active in closely related markets: BASE in the retail mobile market and Telenet in the markets for TV and fixed internet.

One of the possible theories of harm was that the transaction would allow the merged entity to foreclose competitors by offering more fixed-mobile bundles; that is, bundles combining fixed services such as TV and internet with mobile services. During the investigation, some market players expressed fears that such bundles would "lock in" customers, since customers who purchase several services from the same operator tend to switch less easily. As a result, rivals of the merged entity that offer only mobile services would be foreclosed from an increasingly large part of the market and ultimately become unable to compete, or would exit the market. The resulting market structure would be a duopoly between Proximus and Telenet, the only two players with both a fixed and a mobile network.

The Commission examined this theory, but found that the facts of the case and the specific circumstances of the markets involved did not support it. To begin with, the transaction changed little. Telenet was already active in the retail mobile market and therefore already offered both fixed and mobile services before the acquisition. The transaction did combine the mobile customer bases of Telenet and BASE and, hence, would give Telenet a better chance at cross-selling its fixed services to the merged entity's mobile customers. But the Commission did not consider it plausible that this would lead to foreclosure. Among other reasons, it found that this increased ability to cross-sell was rather limited, since many mobile subscribers of BASE either lived outside the footprint of

Telenet's cable network or already purchased fixed services from Telenet. Another factor that made foreclosure unlikely was the fact that a large majority of all consumers and businesses in Belgium still purchase their mobile services separately from their fixed services. Although fixed-mobile bundles are likely to become more popular in the coming two or three years, a large number of customers who purchase mobile services separately will still remain.

The Commission also considered that the merged entity's rivals would not have to sit by idly when faced with increased bundling by the merged entity. Proximus, Belgium's largest mobile operator and owner of a nationwide fixed network, already offered fixed-mobile bundles and effectively started the trend towards convergence in Belgium. Mobistar, the second-largest mobile operator by revenue, did not own a fixed network but could obtain access to one, for instance by relying on the wholesale access regulation which the Belgian regulators have imposed on the Belgian cable operators. Shortly after the transaction was closed, Mobistar effectively obtained access and started offering bundles of mobile and fixed services. Finally, competitors could keep their mobile prices low to prevent consumers from choosing fixed-mobile packages.

5. Conclusion

The Liberty Global/BASE transaction was the latest in a series of fixed-mobile transactions, spurred by the growing popularity of bundles of telecom services among consumers. The Commission thoroughly examined that trend as part of its assessment of the conglomerate effects. Ultimately, it found conglomerate effects unlikely.

However, the Commission did find that anti-competitive effects would result from the horizontal overlap of the two parties in the retail mobile market. The experience gained with telecoms mergers in the past two years enabled the Commission to accept, at an early stage of the procedure, a remedy package that included the divestiture of an existing virtual operator, a customer base and a wholesale agreement allowing for access to the merged entity's mobile network. The purchaser and the agreements entered into between BASE and the purchaser were approved by the Commission as part of its final decision, leading to the adoption of a fix-it-first solution.

¹⁴ Decision BMA-2016-C/C-03 of 28 January 2016, available at www.bma-abc.be.

¹⁵ Press Release, 11 February 2016, Telenet completes BASE Company NV acquisition.

Competition *merger brief*

Teva/Allergan Generics: An unprecedented generics merger

Marion Bailly, Ivan Gasperec, Arthur Stril and Noa Laguna-Goya

1. Overview

In March 2016, the Commission cleared the acquisition of the generic medicines business of Allergan (Allergan Generics) of Ireland by Teva Pharmaceutical Industries Ltd. (Teva) of Israel¹. Prior to the transaction, Teva was already the largest generic manufacturer globally and Allergan Generics was the fourth generics manufacturer worldwide, following Sandoz (a Novartis subsidiary) and Mylan. Allergan Generics comprised in particular its global generics unit (formerly known as Actavis) and its generics outlicensing business² operated by its subsidiary Medis³.

With a price tag of USD 40.5 billion and hundreds of generic medicines marketed and in development (pipeline products) by both companies across Europe, *Teva/Allergan Generics* was an unprecedented generics merger both in its size and number of overlaps. In addition, numerous vertical relationships arose due to Teva's Active Pharmaceutical Ingredients subsidiary (TAPI)⁴, and Allergan Generics' outlicensing subsidiary (Medis), both of which were active upstream of the sale of generic pharmaceuticals.

Over the last few years, the Commission has had significant experience in dealing with generic medicinal product mergers⁵, and it has developed a robust assessment framework⁶ resulting

¹ Commission Decision in case M.7746 – Teva/Allergan Generics. See http://europa.eu/rapid/press-release_IP-16-727_en.htm

² Outlicensing means licensing rights to use a dossier (upstream market) to obtain a marketing authorisation to sell a medicinal product in one or more countries (downstream market).

³ In November 2015, Pfizer announced that it would acquire the rest of Allergan, i.e. its innovative pharmaceuticals unit. This transaction was withdrawn in April 2016.

⁴ An Active Pharmaceutical Ingredient is the active substance (such as *paracetamol*) used in the manufacturing of medicinal products.

⁵ See for example M.7379 – Mylan/Abbott EPD-DM; M.6613 – Watson/Actavis.

⁶ The framework uses the Anatomical Therapeutic Classification (ATC) of drugs developed by the European Pharmaceutical Market Research Association (EphMRA) and the World Health Organisation (WHO) as a starting point for market definition. On a case-by-case basis and based

In a nutshell

While the Commission has had significant experience dealing with mergers in the generic medicines industry, the sheer scale of *Teva/Allergan Generics*, combining two of the top four players globally, posed a number of interesting challenges. The Commission assessed competitive dynamics beyond product-by-product overlaps at the level of the overall sale of generics in a Member State, and identified serious doubts in the UK, Ireland and Iceland. For the first time, it deemed certain vertical aspects of a generics transaction problematic. Finally, the remedy design and monitoring also brought their share of complexity, requiring innovative *ad hoc* approaches.

in all cases being cleared in phase I (with or without remedies). However, because of its sheer scale, *Teva Allergan Generics* presented novel issues, of which three are described here. First, beyond the traditional assessment of product-by-product overlaps, the Commission investigated whether country-wide concerns would arise in Member States where Teva and Allergan Generics were among the largest generics manufacturers. Second, the Commission thoroughly analysed the vertical relationships between the parties and raised serious doubts on a number of these for the first time in a generics merger. Finally, due to the number of markets for which competition concerns were found, the remedy design and subsequent monitoring (still ongoing at the time of writing) posed a number of challenges.

2. Looking at the big picture

In addition to analysing hundreds of product overlaps (typically at the level of the molecule) in the 31 EEA countries, the Commission investigated whether the consolidation of two major generics players could lead to country-wide competitive concerns,

on the factual evidence collected during the market investigation, the Commission defines the relevant product market at the level of molecule or group of molecules that are considered interchangeable so as to exert competitive pressure on one another, in particular due to overlap in therapeutic use and economic substitution patterns. The geographic market has consistently been found to be national for marketed generics and at least EEA-wide for pipeline generics.

entailing risks of higher prices and lesser quality of supply for the sale of generics overall.

The Commission identified a number of EEA countries where both companies were among the leading players. Teva and Allergan Generics were both active in all EEA countries, with a significant generics business in the Nordics and Eastern Europe. A very limited number of overlaps arose in Western Europe since, in 2014, Allergan Generics (then known as Actavis) had sold its commercial operations in seven Western European countries to Aurobindo of India⁷.

In some of the significant overlap countries, namely Sweden, Denmark and Finland⁸, the Commission concluded that no competitive concerns going beyond individual overlapping molecules would arise. This was justified first by the market structure: one generic player larger than the merged entity would remain (Sandoz in Denmark and Sweden and Orion in Finland). This was also linked to specific market features: in these countries, the prices of generics are regulated through a complex tendering process, whereby the company offering the cheapest product wins the entire market for a limited period of time (typically half a month to a month). Given that pharmacies are required to sell the product from the winning (cheapest) manufacturer, the ability for large generics companies to leverage the scope of their product offering was rather limited.

The situation was different, however, in other countries, namely the United Kingdom (UK), Ireland and Iceland. For these countries, the Commission raised serious doubts in relation to the sale of generics overall, i.e. beyond individual overlapping molecules. First, in these three countries, Teva and Allergan Generics were the two largest generics manufacturers. The merged entity would have been far ahead of its competitors in terms of market share and size of portfolio. Second, the market and regulatory specificities in each of these countries were such that the transaction would likely have an adverse impact on generics competition overall, for the country-specific reasons explained below.

In the UK, Teva and Allergan Generics were the only generics manufacturers selling directly to pharmacies. All the other generics manufacturers lack a sufficient product range for direct sales to be commercially profitable. Instead, the parties' competitors sell through wholesalers which act as aggregators of the generics manufacturers' offerings. To promote their direct sales, both Teva and Allergan Generics were incentivising pharmacies to purchase as much as possible of their generics needs from their portfolio through discount schemes (TevaOne for Teva, Accumulator for Allergan Generics) based on overall purchases. In addition, Teva and Allergan Generics had non-price competitive advantages over wholesalers, such as packaging

consistency (especially important for elderly patients, whereas the packaging of wholesaler supplies changes regularly according to which generic they stock) and reliability of supply (pharmacists value the direct relationship with the generics manufacturer, for instance in case of shortages). For these reasons, the Commission concluded that the merger would eliminate a unique competitive constraint on Teva, different from the one exerted by wholesalers. The merger would likely lead to lower discounts, thus resulting in higher prices than prior to the merger.

In Ireland, Teva and Allergan Generics both successfully challenged established players (such as Rowex, Wockhardt and Pinewood) over the past few years and gained market share to become market leaders. They both achieved leadership positions in the context of a recent Irish legislative change that has put pressure on generics' prices. Numerous market participants confirmed that Teva and Allergan Generics were each other's closest competitors, driving prices down in Ireland through attractive offers to pharmacies. Therefore, the merger would also lead to the elimination of a unique competitive constraint on Teva for the sale of generics overall to pharmacies in Ireland.

In Iceland, which is a small generics market of around EUR 20 million per year, Allergan Generics has been the dominant player for years. It benefits from a historical presence with its Actavis brand that originated in the country, and is the only generic manufacturer selling its products directly to pharmacies (instead of going through distributors). Following its entry in 2008 sponsored by a wholesaler (Lyfís), Teva became a key challenger in the market, driving prices of generics down. In view of Teva's wide generics offering and competitive prices, the merger would eliminate a key source of generics supply for Iceland, putting at risk the price pressure exerted by Teva/Lyfís on Allergan Generics for the sale of generics.

As evidenced by this case, consolidation in the generics space is closely scrutinized by the Commission, and possible "big picture" issues regarding the transaction's overall impact on competition are taken into account, in addition to the traditional analysis of individual product overlaps.

3. Foreclosure concerns in generics mergers

Outlicensing

Allergan Generics' Medis is active throughout the EEA and considered to be one of the most important outlicensors of pharmaceuticals in the EEA (upstream to the sale of pharmaceuticals)⁹. Teva does not have a strong position as regards outlicensing in general, but it has a significant market share for a number of downstream markets for which Medis is outlicensing pharmaceuticals. The Commission identified 103 vertically affected markets for which the merged entity would

⁷ France, Italy, Spain, Portugal, Belgium, Germany and the Netherlands.

⁸ Teva had decided to exit Norway independently of its acquisition of Allergan Generics.

⁹ In some cases, Allergan Generics is also active in the corresponding downstream market, putting it in direct competition with the licensees of Medis.

have the ability and incentive to foreclose the parties' outlicensees (input foreclosure).

As for ability, the Commission found that the merged entity would be in a position to terminate its supply relationship with its outlicensees without significant difficulties and that most outlicensees consider that changing their outlicensor would be too burdensome. The Commission was unable to identify a suitable alternative outlicensor for the given pharmaceuticals that would guarantee a sufficient level of competition on the relevant downstream markets.

Regarding incentive, on the basis of the trade-off between the profit lost in the upstream market due to a reduction of outlicensing sales to competitors downstream and the profit gain from expanding sales of pharmaceuticals downstream due to the loss of the foreclosed outlicensees, the Commission concluded that an input foreclosure scenario would be profitable for the given pharmaceuticals. Various assumptions for the profit gain were tested (from the merged entity gaining the entire market share of the foreclosed outlicensees downstream and possibly increasing its profit margins, to the merged entity only gaining a fraction of such market share corresponding to its pre-merger position)¹⁰.

Lastly, it became apparent that foreclosure of the access to a key input to compete downstream (the outlicensing relationship, and in particular the dossier) could have a detrimental effect on competition, leading to a risk of price increases on the downstream markets.

Active Pharmaceutical Ingredients (API)

Teva's TAPI is an important supplier of APIs with a portfolio of hundreds of APIs that are commercially available or under development. On the other hand, Allergan Generics was a very marginal API player.

Contrary to the outlicensing situation, the Commission concluded that an input foreclosure strategy by TAPI would be highly unlikely, as the downstream competitors of Allergan Generics relying on TAPI for their API supply represented only a very limited proportion of the overall demand, and could easily be covered by the remaining API competitors upstream.

While the Commission carefully assessed all vertical relationships stemming from the transaction, the distinctive features of the outlicensing and API markets led it to raise serious doubts only for the former.

¹⁰ According to the Commission's findings, the fact that Allergan Generics was already active pre-merger on the same market both directly (downstream) and indirectly (upstream, through its outlicensees), does not preclude the merged entity from having the incentive to terminate an outlicensing relationship post-transaction in view of Teva's position downstream.

4. Crafting suitable remedies

Given the significant number of markets on which the Commission raised serious doubts, the remedy design and monitoring (still ongoing at the time of writing) presented a number of interesting challenges. These included in particular (i) designing a remedy to address not only problematic molecule overlaps, but also the "big picture" impact of the transaction in particular on the British and Irish markets; (ii) striking a balance between structural and behavioural remedies in relation to the vertical issue of outlicensing; as well as (iii) monitoring the viability and competitiveness of hundreds of individual products scattered across the EEA, and managing the corresponding regulatory aspects (in particular regarding the transfer of marketing authorisations).

A comprehensive package in the UK and Ireland

The competition concerns to be remedied in the UK and Ireland extended beyond individual molecules, and were linked in particular to each party's scale and scope in these countries, as well as their ability to sell a wide offering of generics directly to pharmacies. This led to the need for a suitable remedy to include not only individual molecules where competition concerns were found using the traditional analytical framework, but the vast majority of one party's (Allergan Generics) marketed molecules in the UK and Ireland, in order to replicate the product range each party could bring to clients, in particular pharmacists, pre-merger. The investigation also made clear that an important competitive advantage of the parties was their capacity to bring pipeline generics to the market efficiently, typically at or close to the end of the exclusivity period (or possibly earlier in case of successful litigation). Therefore, to ensure that competition would continue in a dynamic setting, the remedy package also included a large number of pipeline generics to allow the purchaser to keep a competitive offering over time (while setting up or ramping up its own generics R&D activities). It should be noted that this approach led to the divestment of non-overlapping molecules (both marketed and pipeline) which will allow a purchaser to have the necessary scale and scope to compete effectively with the merged entity post-transaction.

Furthermore, given the sheer number of molecules to be divested¹¹, it was necessary for the remedy to cover all key components of the value chain that are needed to run the business. This is unlike previous generics remedies where fewer molecules were divested, which could be slotted into the purchaser's existing infrastructure. In this case, the key steps of the value chain from manufacture to supply and distribution of the products were covered by the remedy. Given that most of Allergan Generics' British and Irish products were manufactured at its facility in Barnstaple, UK, and that the majority of the plant's capacity was dedicated to the two countries, that factory

¹¹ 355 marketed and 104 pipeline, corresponding to a much larger number of products as each molecule may come in several galenic forms (presentations) and dosages.

was included in the remedy package. This limits the number of products for which the purchaser would need to rely on Teva's transitional supply and technology transfer to those that were neither produced in this manufacturing facility nor contract manufactured by a third party (in which case Allergan Generics would simply assign the contract to the purchaser). Importantly, the remedy included the British and Irish personnel of Allergan Generics (encompassing all key functions such as sales & marketing, covering the necessary know-how for direct-to-pharmacy sales, regulatory & medical, and finance), as well as the direct-to-pharmacy schemes of Allergan Generics and its characteristic pack design and artwork to ensure continued patient recognition.

Finally, in spite of the differences in regulatory frameworks, the UK and Ireland were closely tied in the commercial and supply organisation of Allergan Generics (in part due to geographic proximity and language commonality, in part through the Barnstaple manufacturing plant). The remedy in the UK and Ireland was accordingly designed as a single package which would be sold to one buyer.

Structural or behavioural?

While Commission policy favours structural over behavioural remedies, especially in phase I where a clear-cut standard must be met, the competition concerns related to outlicensing were resolved through both structural and behavioural remedies depending on the situation. For a number of molecules, the vertical relationship was due to Medis outlicensing to the company Aurobindo a molecule in a country (molecule which was sold by Allergan Generics to Aurobindo as part of their 2014 transaction) and Teva being itself active with that molecule in that country. However, this outlicensing relationship was expected to be limited in time as Aurobindo's intention was to take control of the manufacturing of the molecules it purchased from Allergan Generics, after a transitional period during which it would rely on Medis. Therefore, for these molecules, the (behavioural) remedy consisted of Teva committing to keep the outlicensing relationship with Aurobindo under the same terms as pre-merger, for a period of time which was deemed sufficient for Aurobindo to take over the manufacturing of the molecule. This would lead to a structural change in the market as the link between Aurobindo and the merged entity would eventually be severed, the former becoming an independent competitor against the merged entity for these molecules.

For the vertical relationships in outlicensing that are unrelated to Aurobindo, a structural remedy was offered, corresponding to either the upstream market (the divestment of the dossier and corresponding licensing rights across the EEA) or the downstream market (the divestments of rights and assets to manufacture and sell the molecule in the affected country). However, for the vertical relationships related to Aurobindo, the Commission could show flexibility based on the specific facts of the case, and accept a behavioural remedy that would eventually lead to a structural change in the market.

The case does not stop at the Decision

While the key output of the Commission's work in *Teva/Allergan Generics* was the conditional clearance decision, the scale and scope of the remedies led to the need to set up a number of post-clearance workstreams. This section focuses on two examples: monitoring the viability and competitiveness of the divested molecules, as well as the regulatory aspects of the divestiture.

Setting aside the UK, Ireland and Iceland, the remedy package included 159 marketed and 20 pipeline molecules in 26 additional EEA countries¹². Unlike the three countries for which all or the vast majority of the business of one party would be sold, in the other 26 EEA countries the molecules to be divested represented a small proportion of the parties' offerings and were embedded into their existing portfolios. Furthermore, given that Teva can elect, on a molecule by molecule basis, to divest either its own or Allergan Generics' products, the two businesses need to be monitored until the selling party is selected. To assist the Monitoring Trustee in that complex task, two Hold Separate Managers were appointed: one for Allergan Generics' products and one for Teva's products as well as the Icelandic business (the British and Irish divestment business being managed by a separate dedicated team). With adequate reporting tools similar to the ones used by the parties in their normal course of business, the Hold Separate Managers are able to alert the Monitoring Trustee of any material deviations.

Another complexity linked to the number of products to be divested comes from the health regulatory requirements for transferring them. In pharmaceutical mergers, for marketed drugs, the critical element to be transferred to the purchaser is the marketing authorisation, which amounts to the right to sell the product in a given country or EEA-wide. In Europe, marketing authorisations are not necessarily granted at EU-level, and the procedure can take one of three major forms: (i) the national procedure¹³ (ii) the decentralised or mutual recognition procedure¹⁴, or (iii) the centralised procedure¹⁵. Application for a

¹² They correspond to a much larger number of products as each molecule may come in several galenic forms (presentations) and dosages.

¹³ Purely **national authorisations** are more rarely sought today, but exist in particular for products that were approved before the other procedures were put in place (this is still the case for the majority of medicinal products marketed in Europe). They allow a given medicinal product to be marketed in one Member State only.

¹⁴ Both the decentralised and the mutual recognition procedures are based on the recognition by national competent authorities of an assessment performed by the authorities of one Member State (known as Reference Member State). In 1995, the **mutual recognition procedure** entered into force. It allows use of a national marketing authorisation granted by a Member State's national authority to support an application for its mutual recognition by other Member States. The **decentralised procedure**, introduced in 2004, is similar to the mutual recognition procedure but for products which have not received a marketing authorisation at the time of application. It is based on the recognition by national authorities of a first assessment

marketing authorisation is made through a dossier, which covers in particular the characteristics of the products, the (bio)equivalence studies (for generics to show their equivalence to the originator) and the manufacturing process. If a product is divested in a given country, while it is fairly straightforward to transfer a national marketing authorisation, it is more challenging to carve out that country from a marketing authorisation obtained for multiple Member States through a decentralised, mutual recognition or centralised procedure. The dossier may also need to be updated if the technology is transferred to the purchaser, to reflect any variation in the manufacturing process and site. An additional complexity lies in the different regulatory authorities responsible for each procedure: the Co-ordination Group for Mutual Recognition and Decentralised Procedures – Human (CMDh), composed of the national Medicines Agencies and the European Medicines Agency (EMA) for the centralised procedure. One of the difficulties in implementing the remedies in this case will therefore be to ensure smooth transfer of an unprecedented number of marketing authorisations to the purchaser(s), while respecting diverse regulatory frameworks.

In certain remedy cases, significant post-clearance work by the Commission can be required. *Teva/Allergan Generics* is a case in point, since specific aspects of the case (the scale of the remedy package and the complex regulatory framework of the markets at stake in particular) require careful follow-up and monitoring by the case team and Monitoring Trustee.

5. Conclusion

The *Teva/Allergan Generics* case is a prime example of the Commission's ability to clear complex transactions in phase I, in this case involving thousands of different pharmaceuticals marketed in the 31 EEA countries and two of the largest four generics companies. This is only possible with the constructive cooperation of the merging parties and their willingness to submit comprehensive and adequate remedies resolving the Commission's serious doubts. This case also required the Commission to go beyond its traditional molecule-by-molecule assessment of generics mergers in those countries where the merger would greatly change the structure of the generics arena overall, to assess on its merits the competitive significance and specificities of the merging parties. It finally illustrates that the Commission's role in a conditional clearance does not end with the decision, but can require a significant amount of post-clearance work. In particular, the viability and competitiveness of all divested products need to be monitored until they are transitioned to the purchaser(s), and the selection process of the purchaser(s) needs to be overseen to avoid any deadlocks at the time of the purchaser approval process.

performed by one Member State. Also harmonisation is maintained through the procedures for the examination of variations (i.e. variation of manufacturing site) and the use of the decentralised and mutual recognition procedures for extensions.

¹⁵ The **centralised procedure** came into force in 1995 and was amended in 2004. Applications for the centralised procedure are made directly to the EMA and lead to the granting of a European marketing authorisation by the Commission which is binding in all Member States (a Union authorisation). The centralised procedure is compulsory for some products and optional for others.