

Completed acquisition by Nufarm Limited of AH Marks Holdings Limited

ME/3699/08

The OFT's decision on reference under section 22(1) given on 29 August 2008. Full text of decision published 12 September 2008.

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**Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.**

**PARTIES**

1. Nufarm Limited (Nufarm) is an Australian-based manufacturer of crop protection products with operations worldwide. Its wholly-owned UK subsidiary, Nufarm Crop Products UK Limited, manufactures a range of herbicides, and chemical inputs into the manufacture of herbicides, at its factory in Belvedere, Kent. It also supplies the UK market with herbicides using inputs from the 'phenoxy' group of chemicals as their active ingredient. These inputs are manufactured at its factories in The Netherlands and Austria.
2. AH Marks Holdings Limited (AH Marks) is a manufacturer and supplier of herbicides and other chemicals to the agricultural sector. It manufactures a range of herbicides, and chemical inputs into the manufacture of herbicides, at its plant in Wyke, Yorkshire, which it supplies to the UK and overseas markets. In 2007 AH Marks had revenues of approximately £62 million of which approximately £[10-20] million were generated in the UK. Virtually all of its UK revenues were generated from the sale of herbicides belonging to the phenoxy group of chemicals.

## **TRANSACTION**

3. On 5 March 2008 Nufarm announced that it had acquired the entire business of AH Marks. The Office of Fair Trading (OFT) only became aware of, and subsequently initiated a review of the transaction in June when it was drawn to the OFT's attention by an overseas competition authority. The four month statutory timetable, as extended, expires on 1 September 2008.
4. Nufarm submitted an informal submission to the OFT dated 18 July 2008. While Nufarm was perfectly entitled to take the risk of completing the transaction without notifying it to the OFT, the practical implication of the particular sequence of events in this case - that is, the OFT only becoming aware of the transaction in June after it had completed in March - is that the OFT had a relatively (compared to its 40 working day administrative timetable) short period of time within which to review the transaction.

## **JURISDICTION**

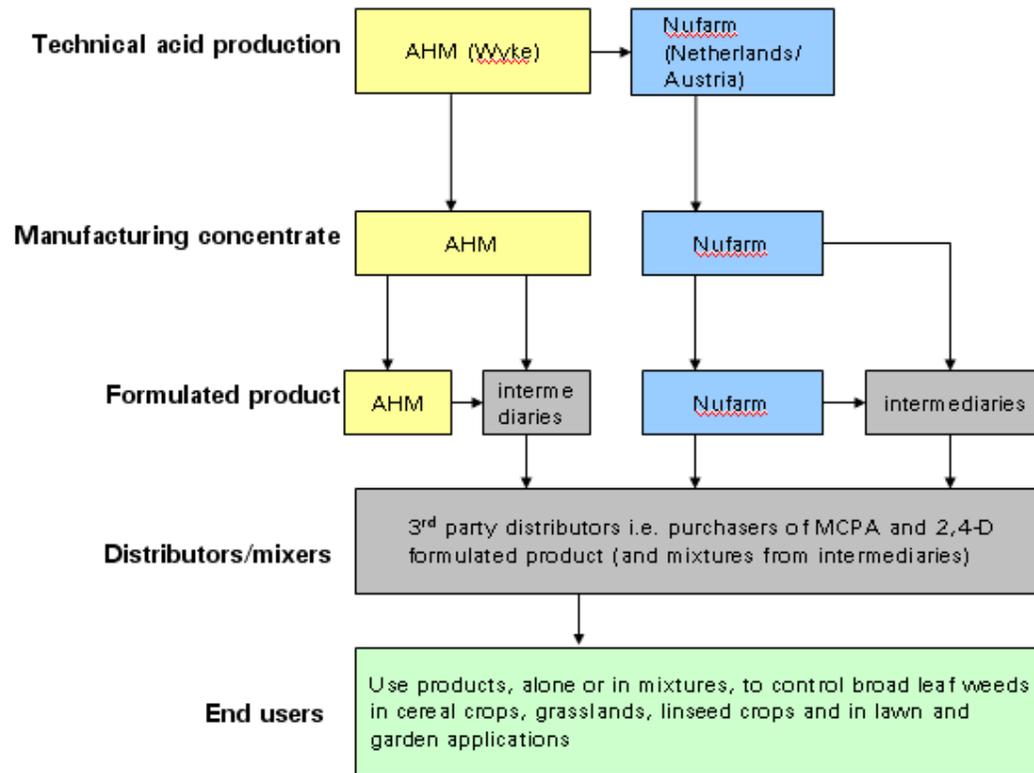
5. As a result of the transaction, Nufarm and AH Marks have ceased to be distinct.
6. The parties overlap in the supply of two phenoxyacetic acids: 2-methyl-4-chlorophenoxyacetic acid (commonly known as MCPA) and 2,4-dichlorophenoxyacetic acid (commonly known as 2,4-D). The parties' share of supply for each of these acids for all applications in the UK exceeds 25 per cent. Consequently, the transaction satisfies the share of supply test in section 23 of the Enterprise Act 2002 (the Act). The OFT, therefore, believes that it is or may be the case that the acquisition has resulted in the creation of a relevant merger situation.
7. The transaction has also been notified to, and subsequently cleared by, the Bundeskartellamt in Germany and is currently being considered by the United States Federal Trade Commission (FTC) and the Australian Competition and Consumer Commission (ACCC). The OFT liaised closely with the FTC and ACCC during the course of its investigation, receiving information from the ACCC pursuant to a confidentiality waiver provided by Nufarm. However, at the time of the OFT's decision, Nufarm had not provided a similar waiver to allow the OFT to take into account information Nufarm provided to the FTC.

## **MARKET DEFINITION**

### **Overview of the supply chain for MCPA and 2,4-D**

8. The parties overlap in the supply of MCPA and 2,4-D in the UK. These acids are supplied, or are capable of being supplied, by the parties in a number of forms, namely:
  - technical acid: the acids themselves.
  - manufacturing concentrate: the technical acid combined with other chemicals such as alcohol (to make esters) and amines.
  - formulated product: manufacturing concentrate that has been processed to make it suitable for use by end users.
  
9. Nufarm supplies manufacturing concentrate to intermediaries and also formulated product direct to agricultural distributors in the UK, whereas AH Marks predominantly supplies formulated product and manufacturing concentrate to intermediaries, which in turn, on-sell to agricultural distributors.

Diagram 1 – Nufarm and AH Marks MCPA and 2,4-D supply chains



**Approach to market definition in this case**

10. MCPA and 2,4-D are both predominantly used as active ingredients in the production of herbicides used in the post-emergence control<sup>1</sup> of broadleaf weeds. They are selective herbicides that target broadleaf plants only, making them suitable for use in grassland, cereal and linseed crops, as well as in domestic lawn and garden applications.
11. The parties contend that the appropriate level for the purposes of assessing this transaction is the supply of formulated herbicide products. The parties note the approach taken by the European Commission in past cases<sup>2</sup>, namely that it is appropriate to define markets in the crop protection sector by reference to:

<sup>1</sup> Post emergence herbicides are used to control weeds that have become visible, or 'emerged'.  
<sup>2</sup> COMP/M.2547 Bayer/Aventis Crop Science, COMP/M.1932 BASF/American Cyanamid, COMP/M.1806 Astra Zeneca/Novartis, COMP IV/M.1378 Hoeschst/Rhône Poulenc, COMP IV/M.1229 American Home Products/Monsanto.

- a. the type of crop protection product that is, herbicides, fungicides, insecticides
  - b. whether the herbicide is for agricultural or domestic use
  - c. whether the herbicide is selective or not
  - d. the crop the herbicide is suitable for, and
  - e. the category of weeds the herbicide can treat.
12. Thus, the parties submitted that the appropriate product markets in this case were for:
  - a. the supply of lawn and garden herbicides; and
  - b. the supply of selective herbicides for use against broadleaf weeds in each of the following:
    - i. grasslands
    - ii. cereal crops, and
    - iii. linseed crops.
13. Previous EC cases cited by the parties considered product market definition in the context of mergers at the end user level, rather than the manufacturing concentrate level. However, in this instance, the primary overlap between the parties occurs at the level of the upstream supply of manufacturing concentrate, and not at the downstream level.<sup>3</sup> Indeed, as noted above, AH Marks is not directly active as a reseller to distributors in the downstream market, preferring to supply through intermediaries.
14. At the manufacturing concentrate level of production, there is actual rivalry between the firms, with both Nufarm and AH Marks actively supplying third parties with both MCPA and 2,4-D manufacturing concentrate. The value of Nufarm's sales of MCPA and 2,4-D concentrate to customers in the UK is estimated at £[ ] million, while AH Marks' sales are £[ ] million. MCPA and 2,4-D concentrate are also used by the parties in the production of formulated products.
15. Given this level of actual rivalry, the OFT considered the manufacturing concentrate level of production to be the appropriate product scope for assessing this transaction. The parties have argued that end users

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<sup>3</sup> In terms of the technical acids themselves, while Nufarm supplies a very small amount to third parties, AH Marks does not supply any at all. As there is no material increment of market concentration at this level of the supply chain, this potential frame of reference was not considered to be relevant for the purposes of assessing this transaction.

downstream have the possibility of alternative herbicides that fulfil the same needs of phenoxy based herbicides. They argued that the ability for these downstream users to switch in response to an increase in price to the upstream concentrate provides a strong indirect constraint on their ability to increase prices.

16. The OFT considers that for the purposes of assessing the market for the supply of MCPA and 2,4-D in the UK, it is entirely correct to consider the strength of indirect downstream constraints. Conceptually, this could be done at either the market definition stage or at the market power assessment stage (under the 'Unilateral Effects' section). In the former case the defined market may include products that are not directly substitutable at the upstream level. In the latter case market power may be constrained in practice by products outside of the defined market. Therefore, in principle it should not matter to the overall market assessment which of these approaches is taken, provided the presence of indirect constraints is correctly reflected in the analysis. However, in practice, and in line with case precedent<sup>4</sup>, the OFT considers that it is generally preferable to include sources of indirect constraints at the market definition stage.
17. The remainder of this section is structured as follows. First, it considers direct constraints on MCPA and 2,4-D in the production of phenoxy based herbicides. Second, it examines the strength of indirect downstream constraints on both chemicals through the existence of alternative downstream herbicides for farmers.

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<sup>4</sup> See Office of Communications, *Consultation Paper: Review of the wholesale broadband access markets 2006/07*, 15 February 2007, *Schneider Electric SA v Commission of European Securities* (2003/C55/70).

### **Potential direct constraints on MCPA and 2,4-D**

18. During the course of its investigation, the OFT identified a number of alternative technical acids used in the manufacture of herbicides. These include:
  - a. Sulfonylureas (SU's)
  - b. Sulfonamides
  - c. Pyridines
  - d. Hydroxybenzotrioles (HBN's)
  - e. Benzoic acids
  
19. At the manufacturing concentrate level, the OFT considered that 2,4-D and MCPA are, respectively, essential inputs for their related downstream formulated product, and no other products outside 2,4-D and MCPA are able to be substituted for them as active ingredients to achieve the same formulated product. For this reason there are no direct constraints for 2,4-D and MCPA concentrate in the creation of 2,4-D and MCPA formulated product.
  
20. However, as stated previously, it does not follow from this that 2,4-D and MCPA are – each individually or collectively – a relevant economic market. This also depends on the extent to which the supply of 2,4-D and MCPA concentrate is constrained by competition at the downstream formulate level (that is competition from products other than 2,4-D and MCPA formulate).

### **Potential indirect constraints on MCPA and 2,4-D**

21. The OFT considered that in this instance the link between the concentrate and formulate levels is particularly strong as both MCPA and 2,4-D concentrate are the primary component, by value, of MCPA and 2,4-D formulate<sup>5</sup>. Given that downstream herbicide formulation is the only commercial use for these concentrates in the UK, the OFT considered that demand for MCPA and 2,4-D manufacturing concentrate could be derived, to a substantial degree, from demand for MCPA and 2,4-D formulate and that conditions of demand for the relevant formulated product were pertinent for assessing conditions of supply of the concentrate.

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<sup>5</sup> Based on information provided by the parties, the OFT understands that MCPA and 2,4-D manufacturing concentrate comprise approximately [ ] per cent, by value, of the formulated products they are used to make.

22. The nature and extent of factors at the formulated product level that indirectly constrain the merged entity upstream is therefore examined below<sup>6</sup>. First, however, the extent to which 2,4-D and MCPA manufacturing concentrate should be considered individually or collectively is examined, given the indirect constraints that may exist between them.

Are MCPA and 2,4-D manufacturing concentrate in the same market?

23. On the demand side, the parties submitted that MCPA and 2,4-D formulates are substitutes for each other at the end user level. They are interchangeable, according to the parties, because they target the same spectrum of weeds with a similar degree of efficacy. However, the evidence received by the OFT did not support this proposition.
24. First, third party comments, whilst mixed, were generally not supportive of this proposition. Although one large market participant stated that the two are 'broadly substitutable', some distributors stated that they would not recommend that end users apply them interchangeably due to differences in the spectrum of weeds controlled and the effectiveness of this control. For example, it was submitted that 2,4-D can be used to control nettles in grassland crops, whereas MCPA cannot.
25. Second, pricing and market share data also did not support the contention that MCPA and 2,4-D were substitutable at the end user level, with products using MCPA as an active ingredient tending to have a disproportionately higher share of sales than 2,4-D, despite often being 10-20 per cent more expensive. For example, data provided by Nufarm suggested that it costs approximately £8.10 per hectare to treat grasslands with an MCPA based product, but only £7 per hectare to treat the same crop with a 2,4-D-based product; this was despite 2,4-D based products having a weed spectrum twice as wide as MCPA based products<sup>7</sup>. However, Nufarm estimates that MCPA-based products accounted for nearly three times the sales of 2,4-D based products for treating grasslands in 2007. The OFT did not consider this to be consistent with the proposition that MCPA and 2,4-D formulate were close substitutes.

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<sup>6</sup> Given that distributors' and end users' (for example, farmers) preferences are virtually identical, for ease of reference these are used interchangeably throughout this decision.

<sup>7</sup> That is, it is effective against twice as many weeds: chickweed, thistles, nettles and docks. MCPA-based products only claim effectiveness against thistles and docks.

26. On the supply side, the OFT considered that MCPA and 2,4-D concentrate are unlikely to be substitutable. Separate regulatory licences are required for each of these acids before a company is able to supply them in the UK. Market enquiries revealed that a substantial amount of research, development and testing, unique to each chemical, is required before regulatory approval is granted. Further, and as discussed below, the requirements for gaining authority to distribute MCPA in the EU are materially higher for MCPA than 2,4-D, and will remain so until May 2011. Finally, Nufarm advised that the manufacturing equipment used to produce phenoxy chemicals can be configured to produce either MCPA or 2,4-D, but not both. Although Nufarm advised that it would take approximately one year to convert, for example, a 2,4-D plant to an MCPA plant, on the evidence before it the OFT was unable to confidently conclude that switching could occur within this timeframe and that it would be profitable to do so. The OFT therefore considered that a supplier of 2,4-D concentrate would not be able to easily switch to supplying MCPA concentrate, and vice versa.
27. The existence of mixed responses on substitutability from customers, combined with the relative price and share of sales evidence outlined above, led the OFT to conclude that, at the formulate level, MCPA and 2,4-D are not substitutes. In combination with supply side factors at the manufacturing concentrate level, such as the existence of separate licences and regulatory differences, the OFT did not consider MCPA and 2,4-D to be likely substitutes at the manufacturing concentrate level either.
28. Having reached this conclusion, the OFT considered whether Nufarm's ability to raise the price of each of MCPA and, separately, 2,4-D manufacturing concentrate, would be constrained by the competition from other products at the downstream formulated product level. The parties submitted that their ability in this regard would be limited because there are viable alternatives to both MCPA- and 2,4-D-based formulated products.

#### Indirect constraints on Nufarm's ability to raise the prices of MCPA-based products

29. MCPA-based products can be used to treat cereal, grassland and linseed crops. Given the very small value of MCPA used to treat linseed crops, combined with the lack of concern arising from its use in this context, however, this application is not considered further in this assessment.

30. In the cereals context, the parties claimed that MCPA-based products faced competition from other products that target similar weed spectrums, are more effective and cost less on a per hectare basis<sup>8</sup>. The parties identified a relatively wide range of potential substitutes within their submissions, which included those listed at paragraph 18.
31. Market enquiries, whilst mixed, tended to support the broad proposition that viable alternatives to MCPA-based products exist in the majority of circumstances within cereals, although some market participants identified factors that could partially limit any such switching, such as:
- a. Resistance: Over time weeds build resistance to herbicides. It is argued that a variety of weed killers are required and one cannot simply be substituted for another over time.
  - b. Product enhancement: Phenoxy-based herbicides are used as a mixer product to supplement the spectrum of other products, ensuring greater efficacy.
  - c. Quality: Phenoxy-based herbicides seem to be viewed by some customers as a low quality product in terms of efficacy.
32. In addition, some third parties considered that there were significant price differentials between MCPA-based and herbicides based on other chemicals for use in the cereals context. However, the parties' evidence provided reasonable rebuttal to this argument by identifying similarly priced alternatives to those based on MCPA.
33. In grasslands, however, third parties argued relatively consistently that non-MCPA based products<sup>9</sup> such as SU's and fluroxypyr are often significantly more expensive on a per hectare basis than those using MCPA as an active ingredient. Indeed, the parties own estimates suggested that the closest priced alternative was nearly than twice as expensive on a per hectare basis, than MCPA based products such as Nufarm's 'Agritox' product.
34. However, the parties argued that MCPA-based products still face competition from non-MCPA based herbicides even where substantial price

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<sup>8</sup> That is, the cost of treating one hectare of crop with a product.

<sup>9</sup> Excluding 2,4-D products which, as discussed earlier, were found to comprise a separate market.

differentials exist, such as in grasslands. The parties contended that more expensive products are more effective in controlling weeds and have longer lasting action, meaning that they are price competitive on a 'long run' basis. Nevertheless, market enquiries did not support this contention. The majority of market participants did not consider non-phenoxy based products, in general, to be substitutable for phenoxy-based products in grasslands, with most justifying their views with examples of price differences and differences in the spectrum of weeds targeted. A number of participants also commented that MCPA products are often used in less intensive grassland farming, where grass yield is not as critical<sup>10</sup> (where the approach is more to control rather than eradicate weeds) and were therefore not substitutable with more expensive, higher quality herbicides which are used by more 'sophisticated' end users in more intensive grassland settings. For example, it was contended that turf and dairy farmers are both more likely to use high quality products as this maximises the grass yield which, in turn, maximises their profits<sup>11</sup>. Few, if any, market participants (that is, distributors and intermediaries) considered it likely that they would switch from MCPA-based products following a 5-10 per cent price rise.

#### Indirect constraints on Nufarm's ability to raise the prices of 2,4-D-based products

35. 2,4-D products are used in herbicides that treat cereal and grassland crops, as well as in home and lawn applications<sup>12</sup>.
36. As with MCPA, the OFT considered the nature of competition at the downstream formulated product level when assessing whether this would constrain Nufarm's ability to raise the price of 2,4-D concentrate.
37. Similar to MCPA, market participants were of the view that 2,4-D-based products faced competition from comparably priced and more effective products in the cereals context, albeit with some or all of the same potential barriers to switching identified in paragraph 31 existing.
38. In grasslands, however, the general consensus again was that non-2,4-D-based products, such as those listed at paragraph 18, were not easily

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<sup>10</sup> Examples given included farmers owning hilly or rough pastures used for cattle grazing.

<sup>11</sup> The OFT understands that grass yield is proportionate to the number of cows that can be kept in a pasture.

<sup>12</sup> Given no concerns were raised regarding the home and lawn uses for 2,4-D, these applications will not be considered further in this decision.

substitutable for those based on 2,4-D in the functional context within which they are used. Key factors identified again included the lack of price comparability and differences in the weed spectrum and efficacy rates of products. In grasslands, the parties' submissions suggested that the cheapest comparable alternative to 2,4-D-based products was more than twice as expensive, implying a significant degree of product differentiation. Again, market participants also raised the issue that 2,4-D-based products are often used in less intensive grassland farming, where grass yield is not as critical, rather than in intensive settings where more expensive alternatives would be preferred. Few, if any, considered it likely that they would switch from 2,4-D products following a 5-10 per cent price rise.

#### Inability to price discriminate between cereals and grasslands end users

39. As outlined above, MCPA- and 2,4-D-based products appear to face constraints from other herbicides at the downstream level in the context of cereals, but not grasslands. The parties argued that regardless of differences in competition the same formulated products that are used in grasslands are also used in cereals. Therefore, the parties argued that they did not have the ability to price discriminate between products supplied to grasslands and cereal farmers.
40. On this basis, the parties submitted that, even if competition for both the supply of MCPA- and 2,4-D-based formulated products was insufficient to constrain a SSNIP<sup>13</sup> of 2,4-D and MCPA manufacturing concentrate in relation to grasslands end users, they would not have the ability to engage in such a strategy without also effectively raising the price paid by cereals end users. The parties argued that given the alternative to the parties' phenoxy-based products in cereals, a uniform price rise would be unprofitable. If correct, this argument could support a finding of a wider upstream market (that is, one that incorporates non-phenoxy manufacturing concentrates). However, this argument depends on the relative value of sales that grasslands and cereals farmers represent, and the relative rates of downstream switching.
41. Market enquiries revealed that the formulated phenoxy-based products used on grasslands were indeed the same as those used in the cereals context; the prices charged to distributors for these products also did not vary. Were price discrimination possible to any material extent, the OFT

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<sup>13</sup> A small but significant, non-transitory increase in price (usually 5-10 per cent), which is generally considered to be indicative of market power where it is profitable.

considered that the prices paid by grasslands end users would be higher as the parties would 'price up' to the next best alternative. As such, the OFT agreed with the parties in this regard.

#### Ability to profitably raise price on MCPA and 2,4-D manufacturing concentrate

42. The OFT then went on to consider whether, despite not being able to price discriminate between end users, Nufarm as the merged entity would nevertheless still be able profitably to implement a SSNIP for both MCPA and 2,4-D concentrate. The OFT considers that such a strategy would be profitable where the gains made via increased revenues are greater than the losses sustained by customers switching away.
43. In this respect, the parties argued that such overall price rises would not be profitable because a significant proportion of cereal farmers would be likely to switch away from phenoxy-based products and the increased profits generated from grasslands farmers would not compensate for this loss. Further, it was argued that intensive or more sophisticated grassland farmers, such as turf or dairy farmers would also switch away, further eroding Nufarm's incentives to raise prices.
44. The parties did not, however, provide any verification of the extent of any such switching, nor estimates of what levels of switching downstream would be required to constrain an increase in price upstream.
45. Nonetheless the OFT has looked at some raw data provided by the parties in order to examine whether such a price rise could be profitable. The OFT notes that the numbers provided by the parties are in many cases estimates and thus any implementation of a critical loss analysis will be a rough approximation at best. Nonetheless, the OFT believes that such an analysis provides a useful check against other evidence provided by third parties and customers regarding the strength of downstream constraints.
46. The OFT notes that retail prices for MCPA- and 2,4-D-based herbicides are comprised of a number of input costs, only one of which is the MCPA and 2,4-D concentrate. This means that a 10 per cent price increase in concentrate would translate into a price increase of less than 10 per cent for the end retail price depending upon both the concentrate's share of end

price to farmers and the level of cost price pass through.<sup>14</sup> Based on information provided by the parties the OFT estimates that a 10 per cent increase in upstream price would translate into a 5 per cent increase in downstream price to farmers.<sup>15</sup>

47. Based on the information provided by Nufarm, the OFT estimated that between 42 and 64 per cent of all end users would need to switch away to make a 10 per cent price rise<sup>16</sup> in MCPA concentrate unprofitable and between 39 per cent and 45 per cent would need to switch away to make a similar price rise in 2,4-D profitable.<sup>17</sup> The OFT did not consider such a high incidence of switching likely given the small downstream price increase, and therefore could not dismiss the possibility that Nufarm would have the incentive and ability to impose such a price rise.<sup>18</sup>
48. A further check can be provided based on the parties' estimates of actual loss in grasslands. The parties stated that phenoxy-based herbicides used in tank mixes are highly substitutable with other herbicides. According to the parties, farmers use between 65 per cent and 80 per cent of phenoxy-based herbicides in tank mixes within cereals, and 40 per cent to 50 per cent within grasslands. The parties contended that they would lose all of these sales if phenoxy-based concentrate was to increase in price. The OFT does not agree with the parties in the assumption that all sales used in tank

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<sup>14</sup> For a discussion of the impact of indirect constraints see Valletti T. And Inderst R., *Market Analysis in the Presence of Indirect Constraints and Captive Sales*, Journal of Competition Law and Economics, 2007, 1-25.

<sup>15</sup> The parties stated that the formulator price is 30 per cent higher than the concentrate price and 35 per cent higher again at the distribution level. Combined, this means the cost of concentrate represents 57 per cent of the final price. Making the conservative assumption of a 90 per cent cost pass through implies a 10 per cent increase in upstream price, translating to a 5.1 per cent increase in downstream price.

<sup>16</sup> As noted earlier at footnote 13, it is generally accepted that a small but significant, non-transitory, increase in price (SSNIP) of between 5-10 per cent is supra-competitive if it does not result in the firm losing a substantial number of customers to its rivals. As the OFT did not have all the necessary data before it to perform this analysis with a high degree of certainty, it has chosen the conservative figure of 10 per cent in this case.

<sup>17</sup> The parties submitted that Nufarm's upstream gross margins for Depitox (2,4-D) and Agritox (MCPA) for the financial year from August 2007 to July 2008 were [5-15] per cent and [10-20] per cent, respectively. The parties also submitted that AH Marks' upstream margins for Herboxone (2,4-D) and Agroxone (MCPA) for the financial year from July 2007 to June 2008 were [10-20] per cent and [10-20] per cent respectively. For a uniform SSNIP to all customers, the critical loss is  $s/(m+s)$ . The critical loss is therefore between 42.2 per cent to 64.1 per cent for MCPA and between 38.5 per cent to 44.8 per cent for 2,4-D.

<sup>18</sup> Nufarm stated that distributors earned approximately 25 per cent gross margins selling to farmers. Using the Lerner equation this suggests an elasticity of 4. A 10 per cent upstream price translates to a 5 per cent downstream price, which given the elasticity suggests a 20 per cent decrease in overall quantity. This 20 per cent is below the critical loss for both MCPA and 2,4-D.

mixes would be lost,<sup>19</sup> however even using these figures a 10 per cent price increase may be profitable in some cases.<sup>20</sup>

### **Conclusion on product scope**

49. In summary, and on the basis of all the evidence before it, the OFT considers that, at the manufacturing concentrate level, the relevant frames of references for each of MCPA and 2,4-D manufacturing concentrate do not include manufacturing concentrates or derived formulates of other chemicals.
50. This finding is based on a consideration of the potential direct constraints on MCPA and 2,4-D concentrates and indirect constraints from competition at the downstream level for formulated products. In particular, the OFT considered that there are no direct constraints for 2,4-D and MCPA concentrate in the creation of 2,4-D and MCPA formulated product on the basis that no products other than 2,4-D and MCPA concentrate are able to be substituted for them as active ingredients to manufacture the same formulated product.
51. As regards indirect constraints, MCPA- and 2,4-D-based products appear to face sufficiently strong constraints from other herbicides at the downstream level in the context of cereals, with a number of viable alternatives being available to end users. The situation was less clear in relation to grasslands, however, with the OFT considering that, while a number of more sophisticated end users may be able to switch away from MCPA and 2,4-D in the event of a SSNIP, for some grasslands farmers there are no viable alternatives.
52. While the OFT did not disagree with the parties' contention that they would not be able to price discriminate between grasslands and cereals end users (on the basis that the same formulated product is used in relation to both), it could not confidently conclude that an overall price rise for MCPA

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<sup>19</sup> The evidence provided shows that farmers do not view all herbicides as strict substitutes and different herbicides are used in different circumstances. Furthermore as stated any increase upstream is likely to result in a much lower price increase downstream, thus making it unlikely that all tank users of phenoxy-based herbicides would switch.

<sup>20</sup> The OFT noted that the revenues received by the parties in the grasslands context were £2.02 million and £0.59 million for MCPA and 2,4-D respectively. In the cereals context, the parties received £0.75 million for MCPA and £0.05 million for 2,4-D. Taking the midpoints from the parties' figures, and weighting by sales revenue, these losses translate into a 47 per cent loss of sales in MCPA and a 52 per cent loss of sales in 24D. The critical loss for MCPA and 2,4-D is 42-64 per cent and 39-35 per cent respectively.

and 2,4-D products would be unprofitable. Based on the information provided by the parties, the OFT took a conservative 'best case scenario' (from the parties' point of view) approach to assessing the profitability of an across the board price rise in both MCPA and 2,4-D, but was unable to satisfy itself that a sufficient number of cereals and grasslands farmers would switch away from MCPA and 2,4-D based products to make this unprofitable.

53. Finally, the OFT considered that 2,4-D and MCPA manufacturing concentrates are not substitutable based on a combination of supply side factors at the concentrate level and demand side factors at the formulated product level. At the manufacturing concentrate level, the OFT considered that a combination of the separate licensing requirements and differing manufacturing configurations for MCPA and 2,4-D, as well as the data protected status of MCPA, meant that it could not confidently conclude that manufacturers of one chemical could profitably switch to the other within a year. At the formulated product level, the evidence before the OFT suggested that MCPA and 2,4-D are not substitutable for each other because they target different weeds and with differing success rates. Market share and pricing data relating obtained by the OFT tended to support this conclusion.
54. As such, the OFT considered the relevant product markets in this case were the supply of MCPA manufacturing concentrate and the supply of 2,4-D manufacturing concentrate.

### **Geographic scope**

55. The parties argued that the relevant geographic scope was the UK. Citing previous European Commission decisions,<sup>21</sup> the parties contended that, inter alia, the national registration system in the EU, national parallel importing legislation, variations in use across Europe; and significant differences in price and market shares across European countries pointed to the relevant geographic scope being national.
56. While the OFT took a different approach to product market definition to the parties, it found that the factors relating to geographic market definition put forward by the parties, while directed at the formulated product level, were applicable to MCPA and 2,4-D at the manufacturing concentrate

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<sup>21</sup> See footnote 2.

level. In coming to this conclusion, the OFT noted that there are some overseas manufacturers that supply 2,4-D into the UK<sup>22</sup>, all of whom are registered to sell product in UK. The OFT placed particular weight on the national system of product registration and parallel importing legislation, and subsequently included only those suppliers with such registration. As such, the OFT concluded that competition should be evaluated at the UK level.

## **UNILATERAL EFFECTS**

### **Supply of MCPA manufacturing concentrate**

57. The transaction has resulted in the merger of the only suppliers of MCPA manufacturing concentrate to third parties in the UK, in other words a merger to monopoly.
58. A third company, [ ], is not currently actively supplying third parties in the UK with MCPA. However, it is party to two long term contracts with Nufarm that entitle it to require the supply of up to [ ] of MCPA manufacturing concentrate per annum for use in its own proprietary products ('[ ] contract'), and up to [ ] per annum of MCPA manufacturing concentrate which it is able to re-supply to third parties ('[ ] contract').
59. Under the terms of the [ ] contract [ ] is unable to supply third parties with MCPA manufacturing concentrate and therefore does not and cannot compete with the parties at this level using this agreement.
60. Resale to third parties is permitted under the [ ] contract. Of the [ ] contractual entitlement under the [ ] contract, [ ] is currently [ ] purchasing [ ] of its entitlement under this agreement ([ ]), with the result that the OFT considered whether [ ] could purchase additional manufacturing concentrate for re-sale in the UK in competition with the merged entity.
61. However, the [ ] contract contains provisions [ ] for MCPA manufacturing concentrate [ ]<sup>23</sup>. Therefore, the OFT did not consider that [ ] would be an effective constraint on Nufarm's pricing behaviour in this regard because its own costs and pricing behaviour [ ].

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<sup>22</sup> For example, Dow AgroSciences.

<sup>23</sup> [ ] This did not affect the OFT's analysis, however, given that even [ ] this arrangement would not allow for [ ] to compete wholly independently from Nufarm.

## Supply of 2,4-D manufacturing concentrate

62. The transaction has resulted in the merger of the two largest suppliers into the UK of 2,4-D manufacturing concentrate. Dow AgroSciences also supplies manufacturing concentrate to a handful of customers in the UK and the parties contend that, in the event of a price rise, customers would be able to source 2,4-D from Dow. [ ] The OFT therefore considered that current competition in the market was unlikely to constrain an exercise of market power by the merged entity.

## BARRIERS TO ENTRY

### MCPA

63. The OFT's *Mergers - Substantive Assessment Guidance*<sup>24</sup> (OFT Merger Guidelines) makes it clear that new entry must be sufficient in time, scope and likelihood to deter or defeat any attempt by the merging parties or their competitors to exploit the reduction in rivalry flowing from the merger.
64. The supply of MCPA concentrate (and all other forms of MCPA, including any mixtures containing MCPA) is regulated in both Europe and the UK, with suppliers requiring both EC<sup>25</sup> and UK approval<sup>26</sup> before being able to legally sell in the UK. MCPA is 'data protected' under Annex I of the Directive, meaning that only current authorisation holders, those that have negotiated an agreement with current authorisation holders, or those that reproduce and submit the protected data to the EC and are subsequently authorised, are entitled to be registered in a Member State and sell MCPA in the EC. Nufarm, AH Marks and Dow<sup>27</sup> are the only original authorisation holders in Europe, with all other sellers of MCPA-based products in Europe doing so pursuant to agreements with these companies.
65. Nevertheless, the parties contended that a Polish company, Sarzyna, had approval under Annex I of the Directive and would soon be obtaining registration in Poland. Following registration, the OFT understands that gaining UK registration would take up to 30 weeks, provided the PSD finds that the product is 'equivalent' to that which is approved under Annex I,

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<sup>24</sup> OFT 516 *Mergers – substantive assessment guidance*, paragraph 4.17.

<sup>25</sup> Via the 26 July 1993 Directive 91/414/EEC (the *Directive*).

<sup>26</sup> Via Registration with the Pesticides Safety Directorate (*PSD*).

<sup>27</sup> [ ] the OFT did not consider Dow to be a likely competitive constraint on the pricing behaviour of Nufarm [ ]. These considerations also apply to [ ]'s incentive and ability to initiate and expand supply into the UK in competition with Nufarm, a fortiori.

taking into account differences in climate and agricultural practice between the UK and Poland. However, at the time of assessment it was unclear whether and how soon Sarzyna would gain regulatory approval in Poland, or whether it would be able to provide 'equivalence' as regards the UK, [ ]. Therefore, the OFT did not consider it safe to conclude that Sarzyna's entry would be likely, timely and sufficient such that it would constrain the merged entity.

66. Data protection of MCPA is due to expire in May 2011. Although Nufarm contended that other manufacturers of MCPA could undertake the necessary testing to obtain registration, it conceded that the expense of doing so meant that any new entrant was likely to wait until data protection expires before applying for registration. After this time, Nufarm submitted that barriers to entry would be materially lowered and the threat of new entry would provide a competitive constraint on the merged entity. Nevertheless, the OFT's framework for considering whether new entry would be likely to constrain the exercise of market power involves an assessment of whether new entry will be timely, likely and sufficient. Generally, and consistent with the OFT's Merger Guidelines<sup>28</sup>, if new entry is not expected to occur within two years of the merger, the 'timely' aspect is not met. Therefore, even if new entry were guaranteed to occur post-May 2011 (which is not the case), such entry would not, of itself, remove the OFT's competition concerns in this matter.
67. Accordingly, the OFT does not consider that any entry or expansion in the supply of MCPA concentrate would be sufficiently timely, likely and of sufficient scope to constrain the behaviour of the merging parties in the short-term post-merger.

#### **2,4-D**

68. Like MCPA, the supply of 2,4-D concentrate, and all other forms of 2,4-D, is regulated in both Europe and the UK. Unlike MCPA, however, it is no longer 'data protected' under Annex I of the Directive, with data protection having expired in October 2007. As discussed earlier at paragraph 63, [ ].
69. However, Nufarm submitted that a Polish producer, Rokita, was a potential supplier into the UK. Although Rokita was not registered in the UK, it is an approved seller of 2,4-D in the EU under Annex 1 of the directive and would therefore only have to prove to the PSD that the product it

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<sup>28</sup> Paragraph 4.23.

manufactures is equivalent to the product approved for sale in the EU. Nufarm argued that it would cost between £2,000 and £6,000 to undergo the relevant regulatory process and take between 18 and 30 weeks.

70. With respect to Rokita, [ ] Further, although Rokita advised that it could not see any reason why it would encounter issues in getting PSD registration were it to apply for it, neither Rokita nor the PSD were able to confirm whether, and how much, additional information would need to be supplied by Rokita to the PSD that would extend the PSD's review period beyond 30 weeks. Comments from market participants also cast doubt on the likelihood of Rokita's entry, with many unaware of the company's operations.
71. Regarding non-Annex I registered parties, Nufarm also submitted that a number of companies without Annex I approval were also capable of supplying 2,4-D into the UK, with the costs associated being at most £25,000 (provided testing was undertaken in an approved laboratory) and taking between six months and two years. However, this was not supported by the OFT's enquiries which revealed that the costs and time associated with gaining the necessary approvals alone can run into the millions of pounds and take in excess of four years, due to the level of research, development and testing required. For companies that have already generated the necessary data, market participants advised that the approval process itself can take in excess of two years, depending on the quality of the data supplied. One company, [ ], advised that it was planning to submit data for UK registration in the first quarter of 2009. However, like Rokita, the OFT was unable to gauge with any degree of certainty how long it would take [ ] to get regulatory approval, [ ]. The OFT was aware of other producers in China that could potentially enter the UK market, however only a very limited amount of information was received with respect to these parties.
72. Given the level of uncertainty surrounding the prospects of new entry in this market in the short to medium term, the OFT was unable to conclude that such entry would be likely, timely and sufficient to constrain the merged entity in relation to the supply of 2,4-D manufacturing concentrate.

## **VERTICAL ISSUES**

73. The OFT was made aware of concerns from third parties that Nufarm may have the ability to foreclose downstream purchasers of MCPA and 2,4-D manufacturing concentrates, post-merger. Such input foreclosure could either take place in the form of increased prices, a restriction on the amount of product available to intermediaries (partial foreclosure) or an outright refusal to deal with intermediaries (total foreclosure). Nufarm would have the incentive to do this, it was argued, because these intermediaries compete directly with Nufarm in the supply of packaged MCPA and 2,4-D formulated product to distributors and the sales formerly made by these intermediaries would therefore be made by Nufarm. Thus, Nufarm would generate greater revenues, and face less competition, at the formulated product level.
74. However, Nufarm argued that it would not be in its interests to engage in such a strategy. Nufarm claimed that volume is an important driver in the industry and that these intermediaries provide an important source of sales volumes. Nufarm argued that intermediaries also have access to a distribution network that Nufarm is unlikely to be able to replicate and, because they often mix products of the parties with products from other manufacturers, they increase the number of applications for which the parties' products can be used. As such, Nufarm contended that it would not have the incentive profitably to engage in such a strategy.
75. While the OFT considered Nufarm's arguments in this regard to be plausible, it did not consider it necessary to form a concluded view on this issue. A finding of a realistic prospect of a substantial lessening of competition in this regard would be secondary to the OFT's concerns at the upstream, manufacturing concentrate, level. Given that the OFT has concluded that there is a realistic prospect of a substantial lessening of competition at the manufacturing concentrate level, it did not consider it necessary to draw a conclusion as to whether competition concerns arose by way of vertical foreclosure.

## **THIRD PARTY VIEWS**

76. Multiple third parties identified issues that were indicative of this transaction raising competition issues. All identified the parties as the only suppliers of MCPA and 2,4-D into the UK and the vast majority considered them to be each others' closest competitor. Despite this, many customers

were either neutral about the effect of this transaction or did not think it would have an effect on them. Given none of these customers were at the end-user level, however, the OFT did not consider that the absence of concern was likely to be a conclusive indicator of a lack of competition issues, particularly in light of comments regarding the lack of viable substitutes for the parties' products and barriers to entry.

77. Competitors of the parties noted that the merger represented the combination of two of the world leaders in the production of phenoxyacetic acids, and placed the merged entity in a very strong position in this segment of the UK market. Nevertheless, competitors noted that phenoxy-based herbicides represented a small part of the total herbicides industry and that, while they still played a role in the industry, newer, more effective chemistries had replaced phenoxy-based products in a number of applications.

## **ASSESSMENT**

78. The primary overlap between the parties occurs at the level of the upstream supply of MCPA and 2,4-D manufacturing concentrate. In assessing the impact on competition at this level of supply, the OFT first considered the potential direct constraints on MCPA and 2,4-D manufacturing concentrates, and second the strength of indirect downstream constraints on both chemicals through the existence of alternative herbicide formulations.
79. The OFT considered that there are no direct constraints for 2,4-D and MCPA manufacturing concentrate in the creation of 2,4-D and MCPA formulated product on the basis that no products other than 2,4-D and MCPA manufacturing concentrate are able to be substituted for them as active ingredients to manufacture the same formulated product.
80. Given that each of MCPA and 2,4-D comprised a high proportion of the total value of the formulated products they were used to make, the OFT considered that competition at the formulated product level could provide some guidance as to the level of competition upstream.
81. The OFT's market enquiries revealed that MCPA and 2,4-D based products, despite being used in similar applications, were not generally regarded by market participants as being substitutable for each other. Pricing and market share data provided by the parties tended to support this view.

While market participants considered phenoxy-based products faced competition from other non-phenoxy herbicides for the treatment of weeds in cereal crops, this was not the case for all applications in grasslands. Specifically, market participants did not consider there to be viable alternatives to phenoxies in low intensity grassland situations, despite the fact that higher priced products on the market were more effective and had longer lasting effects.

82. Nevertheless, the parties argued that, even if the merger did give Nufarm the incentive to effect a price rise with respect to grassland farmers, it would be unable to do so because it could not price discriminate between customers based on end use, and any across the board price rise to cereals and grasslands farmers, taken as a whole, would not be profitable. On the basis of the data provided by the parties, however, the OFT was unable rule out the possibility that such an across the board price rise would, in fact, be profitable.
83. The transaction has therefore resulted in the merger of the two leading suppliers of MCPA and 2,4-D manufacturing concentrate in the UK.
84. Barriers to entry in MCPA were found to be high, with MCPA being data protected in Europe until May 2011. Although the OFT considered that entry into the UK before this time would be theoretically possible, it was unable to identify any companies that it considered would be sufficiently likely to enter in the short to medium term and with sufficient capacity to constrain the merged entity.
85. With respect to 2,4-D, barriers to entry appeared less onerous, with data protection having expired in October 2007. Nevertheless, despite accepting that entry could occur in the short to medium term, it was also unable to conclude that the likelihood and viability of entry would be adequate to constrain a post-merger exercise of market power by the parties.
86. Therefore, the OFT believes that it is or may be the case that the transaction has resulted, or may be expected to result, in a substantial lessening of competition in relation to each of the supply of MCPA manufacturing concentrate and 2,4-D manufacturing concentrate in the UK.

## EXCEPTIONS TO THE DUTY TO REFER

### Introduction

87. The OFT's duty to refer under section 22(1) is subject to the application of certain discretionary exceptions, including the markets of insufficient importance, or *de minimis*, exception under section 22(2)(a) and the undertakings in lieu exception under section 73(2) of the Act.
88. Nufarm argued that the OFT should apply the *de minimis* exception to the duty to refer<sup>29</sup> on the basis that the value of the market for the supply of 2,4-D and MCPA in the UK was materially less than £10 million. The OFT therefore considered whether it was appropriate to exercise its *de minimis* discretion in this case.

### Undertakings in lieu of reference and *de minimis*

89. As stated in the Dunfermline/BRN case,<sup>30</sup> and as explained further in the BOC/Ineos case,<sup>31</sup> the OFT believes that it would be proportionate to refer a problematic merger (that is, not to apply the *de minimis* exception) where it is clearly open to the party or parties to offer a clear-cut undertaking in lieu of reference – but they choose not to do so - because the recurring benefits of avoiding consumer harm by means of undertakings in lieu in a given, and all future like cases, outweighs the one-off costs of a reference.
90. As set out in more detail in the Dunfermline/BRN case, the OFT makes this judgment on an objective or 'in principle' basis at the stage of considering whether to invoke the *de minimis* exception, without regard to whether the parties have actually made such an offer, or the content of any such offer, neither of which will in any event be known to the decision maker at the time that application of the *de minimis* exception is considered.
91. In this case, it was not clear to the OFT, based on its objective evaluation of the transaction, that this case was a clear candidate for undertakings in lieu. This case does not fit the classic profile of the OFT's undertakings in lieu cases: in other words, a small proportion of a larger benign or even beneficial transaction raises concerns, and those concerns can be

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<sup>29</sup> See OFT 516 b, November 2007.

<sup>30</sup> OFT Completed acquisition by Dunfermline Press Limited of the Berkshire Regional Newspapers business from Trinity Mirror plc 4 February 2008.

<sup>31</sup> OFT Anticipated acquisition By BOC Limited of the Packaged Chlorine Business and Assets carried on by Ineos Chlor Limited 29 May 2008.

addressed structurally by means of a divestiture package. In this case, the most obviously available structural remedy (divestment of AH Marks' single production facility at Wyke near Bradford) would constitute divestment of the entirety of the original acquisition. The OFT does not include what would amount to prohibition when considering whether clear-cut undertakings in lieu are available.

92. Therefore, the OFT accepts that it would not be appropriate, at this stage of the analysis, to rule out an evaluation of the *de minimis* exception in this case given that it would not appear to be open to the parties to offer a clear-cut – that is, effective and proportionate – undertaking in lieu.

### **Markets of insufficient importance (*de minimis*)**

93. The pivotal issue for the OFT in applying its *de minimis* exception is determining whether the impact of the merger is likely to be particularly significant (such that the *de minimis* exception should not be applied) or more limited (when the OFT may apply the *de minimis* exception). The factors that the OFT considers in making this determination were set out in detail in the BOC/Ineos case and were applied again recently (in favour of exercise of the discretion) in FMC/ISP.<sup>32</sup> Those factors are:

- market size
- strength of the OFT's concern
- magnitude of competition lost by the merger
- durability of the merger's impact, and
- transaction rationale and the value of deterrence.

### **Application of the *de minimis* exception to the present case**

94. The OFT considered each of the factors above in determining whether to exercise its discretion in this case.
95. Market size – The OFT has found that there is a realistic prospect of a substantial lessening of competition in the supply of 2,4-D and MCPA at the level of supply of the manufacturing concentrate in the UK. Without

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<sup>32</sup> OFT Anticipated acquisition by FMC corporation of the alginates business of ISP Holdings (U.K.) Limited 30 July 2008.

needing to conclude on this point, the OFT considers that there may also be a realistic prospect of a substantial lessening of competition at the downstream level, that is for the supply of formulated product to distributors, as a result of input foreclosure of the manufacturing concentrated product. The parties' own combined supply in the UK of 2,4-D and MCPA at the manufacturing concentrate level was approximately £[3-8] million, this is expected to be close to the total UK supply given that sales by the parties account for almost all of the total current market. To the extent that (alternatively<sup>33</sup>) market size was considered at the formulated level for sale of product to distributors, the parties estimate this figure to be approximately £[3-8] million. Regardless of which figure is used, the total size of the affected market is in the mid-range of the OFT's £0 – £10 million band meaning that whilst the *de minimis* exception is potentially applicable, the size of the market is nevertheless substantial.

96. Strength of the OFT's concerns – The strength of the OFT's belief that the transaction may be expected to result in a substantial lessening of competition (SLC) in relation to MCPA manufacturing concentrate is relatively high, that is one of an 'on the balance of probabilities' SLC rather than a 'realistic prospect' under the 'may be the case' standard. In relation to 2,4-D, the OFT's belief is not as strong, albeit that it considers that there is at least a realistic prospect of a substantial lessening of competition under the 'may be the case' standard arising. In considering this factor, overall, however, the OFT has had regard to the fact that [ ]. As a result, the relatively high strength of the OFT's overall belief that harm will result from the merger, although not in itself conclusive, points against exercise of the *de minimis* exception in this case.
97. Magnitude of competition lost by the merger - The evidence received by the OFT indicates that the parties are clearly each others' closest competitor in relation to the supply of 2,4-D and MCPA, with limited (if any) actual or potential competing sources of supply, particularly for MCPA (where the merger is effectively one to monopoly). As a result, any price increases resulting from the merger would be expected to be significant, pointing against the exercise of the *de minimis* discretion.
98. Durability of the merger's impact – The evidence received by the OFT has not persuaded it that entry or expansion by alternative or existing suppliers

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<sup>33</sup> It would not be appropriate to aggregate market size at the level of supply of concentrated product with the supply of formulated product given that this would involve a significant degree of double counting.

will be sufficiently likely to counter a supra-competitive price increase by the merging parties in relation to either MCPA or 2,4-D (that is: entry is not timely, likely and sufficient). However, the OFT believes that entry could take place in the short to medium term, particularly in the case of 2,4-D where the active substance no longer benefits from data protection under the Directive (in the case of MCPA, data protection will continue until May 2011). Overall, this factor is inconclusive: whilst entry is certainly plausible in the case of 2,4-D it is not possible to state with any degree of certainty that the adverse effects in relation to either product will not persist beyond two years.

99. Transaction rationale and the value of deterrence – Nufarm submitted that the acquisition was motivated by a desire to obtain cost efficiencies, rather than obtaining market power in relation to 2,4-D and MCPA. In particular, they argued that rising costs mean that manufacturers of phenoxyacetic acids need to increase scale and related efficiencies to remain competitive with newer technologies. Placing 2,4-D and MCPA in the context of the transaction, the OFT notes that AHM's combined UK sales of 2,4-D and MCPA at both the manufacturing concentrate and formulated product levels was estimated to be [ ] million out of its total global sales of £62 million<sup>34</sup> and out of total UK sales of £[10-20] million. The OFT notes that there is no suggestion on the evidence received by it that any acquisition of market power in relation to the supply of 2,4-D and/or MCPA in the UK specifically forms a material part of the commercial rationale behind the wider transaction – although it cannot discount the possibility that the transaction was motivated by the acquisition of market power at a wider, more global level. On this basis, the OFT considers it appropriate to apply normal levels of deterrent multiplier in this decision for the purposes of its *de minimis* assessment.

100. Overall, the OFT considers that the combination of these various factors point towards the impact of the merger being significant. Whilst the size of the market is below the £10 million threshold, it is of a very different magnitude to that relevant in FMC/ISP (where the turnover of those customers capable of being significantly adversely affected was particularly

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<sup>34</sup> It should be noted that where, in a UK market below £10 million, the potentially problematic UK element of a transaction is objectively capable of resolution via clear-cut undertakings in lieu, consideration of *de minimis* will effectively be precluded, as per the Dunfermline discussion, above. This would apply equally to cases where the UK overlap was a driver of the transaction as to cases where these issues are in a sense incidental or irrelevant to the economic rationale of the deal.

modest). Given also the OFT's conclusion that it is likely that competition will be lost (at least in relation to the major part of the affected markets, MCPA), the expected magnitude of that loss, and the OFT's inability to conclude that competitive constraints would be likely to emerge through entry even after two years, the OFT has decided to refrain from exercising its discretion not to refer this transaction to the Competition Commission.

### **Undertakings in lieu of reference**

101. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has resulted, or may result, from it.
102. As an initial point, the OFT notes that it is generally unlikely to consider that behavioural undertakings have sufficiently clear effects to address the competition concerns identified in a merger.<sup>35</sup> In addition, undertakings in lieu of a reference are appropriate only where the remedies proposed to address them are clear cut.<sup>36</sup> In this case, the OFT considers the test for reference is met in relation to the supply of 2,4-D and MCPA manufacturing concentrate, but has not ruled out competition concerns arising downstream through foreclosure of competing formulators.
103. In this case, Nufarm offered a series of potential undertakings in lieu in relation to MCPA but chose not to offer any undertakings in lieu in respect of 2,4-D. Given that undertakings in lieu offered by the parties must be sufficient to address clearly all the identified adverse effects (that is, all areas where the test for reference is met), Nufarm's offer of undertakings in lieu was, therefore, and on that basis alone, not sufficient to enable the OFT to suspend its duty to refer to seek undertakings in lieu.
104. The OFT considered whether this was an appropriate 'near miss' case in which to revert to Nufarm to reconsider (and potentially clarify) their original offer of undertakings in lieu in order to encompass 2,4-D. However, the OFT concluded that exercise of its procedural discretion to allow

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<sup>35</sup> OFT *Merger Guidelines*, paragraph 8.10.

<sup>36</sup> OFT *Merger Guidelines*, paragraph 8.3.

Nufarm to amend its original undertakings offer was not suitable in this case because:

- a. the possibility of competition concerns arising in respect of 2,4-D had been prominently highlighted in the issues letter and during the issues meeting, the OFT is therefore entitled to conclude that Nufarm's omission of undertakings in respect of this product overlap reflected a conscious and deliberate choice (rather than an oversight), and
- b. for the reasons explained in paragraph 107 below, Nufarm's offers in respect of MCPA were – regardless of the omission concerning 2,4-D – insufficiently clear-cut in any event to warrant suspension of the duty to refer.

105. The fact that Nufarm's undertakings offer did not extend to 2,4-D meant that the OFT was not able to suspend its duty to refer on the basis of the undertakings offered. However, for the sake of completeness, the OFT sets out below the reasons why even the most comprehensive undertakings in lieu package offered in respect of MCPA was likely to have been, in any event, insufficiently clear-cut to resolve the concerns identified in respect of MCPA.

106. The 'maximum' extent of the undertakings offered by Nufarm in respect of MCPA comprised all three of the following elements (although alternative remedy variants comprising a subset of the arrangements below were offered first):

- a. Short term supply agreement – to supply [ ] MCPA customers [ ]
- b. Amendment of [ ] supply contract – [ ]
- c. Disposal of [ ] MCPA label to [ ] – [ ]

107. The OFT welcomes the willingness of the parties to put forward remedies to seek to address competition concerns, but it does not consider that the remedies proposed in this case are capable of sufficiently removing the competition concerns arising from the merger in relation to the supply of MCPA. Specifically:

- a. the short term supply agreement is designed to remedy concerns prior to (and immediately after) expiry of data protection, however, the OFT is not able to conclude with confidence that entry is likely into the market even after expiry of data protection given the other barriers to entry and expansion that exist (see paragraphs 63-67, above), for this reason, extension of the current terms of supply cannot purely be seen as a 'stop-gap' measure until structural change will in any event occur on the market, further, notwithstanding the proposed appointment of an independent pricing monitor, enforcement of such pricing mechanisms raises concerns such that they will very rarely be regarded as meeting the clear-cut standard at the end of a first phase investigation
  
- b. although amendment of the pricing component of the [ ] contract could provide a comparatively better basis for [ ] to be able to compete with Nufarm/AH Marks post-merger, [ ] would never be able to compete wholly independently from Nufarm/AH Marks in terms of price, being wholly dependent on it for supply; [ ]'s dependence on Nufarm/AH Marks raises significant questions about whether it would be able to provide a sufficiently strong competitive constraint on Nufarm/AH Marks post-merger. In addition, the [ ] contract may be terminated by [ ] from [ ] and carries no certainty of renewal. Further, the OFT has concerns about relying heavily on such contractual provisions where at least one party has an apparent incentive to breach them, in particular, such a remedy would be vulnerable to Nufarm/AH Marks reducing the quality of product supplied or otherwise amending terms or treatment of supply to frustrate the purpose of the remedy. Such behaviour would be hard for the OFT to detect, raising problematic issues of monitoring and enforcement common to behavioural remedies in general, and
  
- c. disposal of [ ] label to [ ], although classifiable as a structural remedy, would not address the competition concerns identified by the OFT in respect of MCPA. To benefit from its 'ownership' of the [ ] brand in the UK, [ ] would still have to source MCPA from either the merged party or [ ] and, given the limitations of [ ] as an effective competitor (see paragraph 59 above), this remedy therefore does not address the creation of market power at the upstream manufacturing concentrate level.

108. For the reasons discussed above, the OFT does not believe that the remedies proposed by Nufarm meet the clear-cut standard for undertakings in lieu and, therefore, the duty to refer remains in relation to MCPA. In addition, the duty to refer remains also in relation to 2,4-D.

## **DECISION**

109. This merger will therefore be referred to the Competition Commission under section 22(1) of the Act.