

Anticipated acquisition by FMC corporation of the alginates business of ISP holdings (U.K.) Limited

ME/3688/08

The OFT's decision on reference under section 33(2)(a) given on 30 July 2008. Full text of decision published on 7 August 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. **FMC Corporation (FMC)** is a US-based global diversified chemicals company, with interests in agricultural, industrial and consumer markets. Its business is divided into Agricultural Products, Industrial Chemicals and Speciality Chemicals. FMC's alginates business, which was acquired in 2000 and operates from two sites in Norway, falls within the Speciality Chemicals division's Biopolymer business.
2. **International Specialty Products Inc. (ISP)** is a supplier of specialty chemicals and performance-enhancing products for a wide variety of personal care, pharmaceutical, food, beverage, and industrial applications, which it markets and sells worldwide. ISP is selling its alginates business (the Target Business, as defined below). The Target Business has global revenues of approximately £[ ] million of which approximately £[ ] million are generated in the UK. Of this £[ ] million sold in the UK, approximately £[ ] million relate to alginates and the remainder relates to sales of other hydrocolloids including Xanthan gum and Carragean.

## **TRANSACTION**

3. The Target Business which FMC intends to acquire consists of those assets of ISP and certain of its subsidiaries related to the manufacture, marketing and sale of alginates and algin derivatives, as well as the distribution of propylene glycol alginate (PGA) and certain other hydrocolloids. The acquisition includes: (1) existing inventory, (2) ISP's joint venture interests in seaweed harvesting operations in both Iceland and Tasmania, and (3) ISP's production facility located at Girvan, including the associated blending, product development and business operations used in the Target Business. The transaction does not include any part of ISP's business related to the personal care or cosmetic markets.
4. An informal submission was received from the parties on 30 May 2008. The 40 day administrative timetable as extended expires on 30 July 2008.

## **JURISDICTION**

5. As a result of this transaction FMC and the Target Business will cease to be distinct.
6. The parties overlap in the supply of alginates in the UK. The parties' share of supply of alginates in the UK for all pharmaceutical applications 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **MARKET DEFINITION**

### **Product scope**

7. The parties overlap in the supply of alginates and also in the distribution of PGA.

Supply of alginates for food, industrial, speciality, and pharmaceutical applications

8. Alginates are a natural product derived from seaweed. They are a type of hydrocolloid (water-soluble biopolymers). The primary benefit of hydrocolloids is their moisture-absorption qualities, and they are often used to promote thickening, gelling, texture stabilisation and film formation. Alginates are used in certain food, industrial, speciality and pharmaceutical applications where these qualities are important.
9. The parties suggest that the narrowest market which the OFT should consider is that for the supply of all alginates. This is because customers – regardless of their required use for the alginates - are able (and likely) to switch to an alternative alginate supplier in the event of a price increase. The parties further submit that the market for alginates in general is constrained by the wider market for hydrocolloids, citing the Monopolies and Mergers Commission's report on the proposed mergers between FMC Corporation and Alginate Industries Limited, and Merck & Co., Inc. and Alginate Industries Limited dated 25 July 1979.
10. Third parties did not fully support the parties' arguments on this product market definition. Evidence received by the OFT showed that, whilst in relation to many of the industrial and food applications for which alginates are used a hydrocolloid substitute may be available, it is too simplistic to say that hydrocolloids are in general terms a substitute for alginates, such that customers would switch to hydrocolloids as a result of a five to ten per cent increase in the price of alginates.
11. According to third party competitors, alginates used for pharmaceutical applications are of a different 'grade' than those used for food, industrial or speciality applications. The parties argue that this higher grade is simply a reflection of customers imposing 'more demanding requirements of product consistency or process integrity than others'. However, third parties have stated that the range of specification or tolerance for these alginates is narrower than that used for food products and that there are stricter requirements on the permitted level of bacteria for alginate intended for pharmaceutical applications.
12. While competition concerns do not arise in relation to the supply of alginate for food, industrial or speciality applications, concerns have been raised by

third parties in relation to pharmaceutical applications. Accordingly, the OFT considered whether the transaction should be assessed against the supply of alginate for all pharmaceutical applications or through a narrower lens looking at specific pharmaceutical applications.

#### Supply of alginates for use in wound care, controlled release and anti-reflux products

13. Within the pharmaceutical segment, alginates are used in wound care, controlled release and anti-reflux products. The OFT has not seen sufficient evidence to conclude that alginates supplied for wound care and controlled release applications are immediately substitutable for each other. However, it considers that the same issues apply in relation to the competition assessment of the supply of alginates for each purpose. In relation to anti-reflux products, the know-how and regulatory requirements for producing alginate for anti-reflux products are different, and potentially more burdensome than those for controlled release and wound care, such that the OFT considers that anti-reflux should be assessed separately.
14. Third party evidence indicates that the know-how for producing an alginate product for an anti-reflux application is more complex than that for wound care and controlled release such that an existing supplier of alginate for wound care and/or controlled release could not easily switch to supplying alginates for an anti-reflux product<sup>1</sup>.
15. Third parties also provided evidence that the regulatory requirements imposed on suppliers of alginates for anti-reflux applications may be higher than those imposed on suppliers of alginates for wound care and controlled release applications. These regulatory requirements with which an alternative supplier would need to comply relate to matters such as the registration of product information with the Medicines and Health Regulatory Authority (MHRA) and the supplier's compliance with good manufacturing practice standards<sup>2</sup>.

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<sup>1</sup> The OFT received evidence that there are in fact two classifications or types of anti-reflux products. The British Pharmacopoeia identifies two separate monographs for alginate-based anti-reflux products, one for alginate raft-forming oral suspension (into which the OFT understands that Gaviscon and its equivalents fall) and one for compound alginate antacid oral suspension.

<sup>2</sup> The OFT received inconsistent evidence on exactly what these regulatory requirements are. It is not disputed that the regulatory requirements for supplying alginates which act as an active ingredient in the end anti-reflux product are higher than those which do not. [ ]

16. In the absence of any clear supply-side substitution, and given that, as described in more detail below, customer concerns have been raised particularly in relation to anti-reflux products, the OFT has considered the supply of alginate for anti-reflux products separately. Given the fact that the competition assessment does not turn on whether they are examined separately or together, the OFT has considered the supply of alginates for wound care and controlled release together.

#### Supply of PGA

17. PGA is an organic derivative of alginate, used for beer foam stabilisation and thickening salad dressing. The parties submitted, and third parties have confirmed, that other alginates are not substitutable for PGA from a demand-side perspective. Neither of the parties manufactures PGA. However, FMC distributes PGA for a Japanese company, Kibun, and ISP supplies PGA under its own brand which it purchases from another Japanese company, Kimica.

#### Conclusion on product market definition

18. In summary, the OFT has considered the impact of the transaction on the supply of alginates for food, industrial, speciality and pharmaceutical applications. In relation to the pharmaceutical segment, it has considered the impact on the supply of alginates for wound care and controlled release applications on the one hand and for the anti-reflux application on the other.
19. The OFT has also looked separately at the impact of the transaction on the distribution of PGA.

#### Geographic scope

20. Customers contacted by the OFT stated that they did not require their alginate supplier to have a national presence in the UK and most third parties considered that the market for the supply of alginates and the market for the supply of PGA were global. The costs of transporting these products are low, even over long distances. Some customers considered that the market may be European, because of the regulatory requirements to sell food and pharmaceutical products in Europe. However, there are a

number of non-European companies already selling alginates and distributing PGA into Europe. Therefore, to the extent that these regulatory requirements exist, they are not such as to represent a barrier for non-European companies to sell in Europe.

21. Therefore, the OFT has taken the view that the geographic scope of the market for the supply of alginates and the distribution of PGA is at least European and possibly global.

## **HORIZONTAL ISSUES**

### **Unilateral effects**

#### Supply of PGA

22. Neither party manufactures PGA but both act as distributors. FMC is the exclusive distributor of PGA for Kibun throughout most of the world. ISP has a [ ] arrangement with Kimica under which ISP supplies PGA produced by Kimica, although ISP brands the product as its own. The OFT considered whether the merger would result in the distribution of PGA in the UK becoming concentrated in the hands of the merging parties. Although the majority of customers for PGA distributed by the parties did not have any concerns, a small number did raise concerns in this respect.
23. The fact that the merging parties are only distributors of the product means that the OFT is less concerned than it would be if they were manufacturers. The barriers to entry into the distribution of PGA appear to be lower and the OFT believes there would be a competitive response by the upstream suppliers to any post-merger competition increase in prices by distributors. Although FMC is Kibun's exclusive distributor, this is on a short-term contract. ISP has a longer-term contract with Kimica, [ ]. Furthermore, additional evidence received by the OFT indicates that PGA produced by Kimica is already supplied to other European distributors and has also been supplied directly to UK customers. Finally, when contacted by the OFT, Kimica and Kibun both appeared willing to consider other supply routes, including the possibility of supplying customers directly. Further, the fact that neither manufacturer was concerned about the merger of the sole UK distributors, provides further supporting evidence that the merging parties will not have market power at the distribution level.

24. As such, the OFT has concluded that the overlap between the parties in relation to the distribution of PGA does not result in the realistic prospect of a substantial lessening of competition.

#### Supply of alginates for food, industrial and speciality applications

25. The parties were not able to provide meaningful market share data in relation to the supply of alginates in any of the narrower application segments. However, the parties provided an estimate that their combined share of the supply of all alginates based on production volume on a worldwide basis was [15-35] per cent (FMC [5-25] per cent and ISP [0-20] per cent). Given the evidence on how strong the parties are in relation to the supply of alginates specifically for pharmaceutical applications (as discussed below), it is reasonable for the OFT to conclude that their share of sales within the other applications - that is, food, industrial and speciality applications - is lower than this overall [15-35] per cent share.
26. The parties face competition from a number of alternative suppliers in relation to these other applications, including Cargill and Danisco in Europe, as well as a number of competing suppliers from outside Europe, in particular Kimica and Kibun in Japan and Bright Moon, Jie Jing and other companies in China.
27. The OFT did not receive substantiated concerns from third parties regarding the supply of alginates for use in food, industrial and speciality applications. Therefore, on the basis of the evidence it received, the OFT concludes that the transaction raises no competition concerns in relation to the supply of alginates for food, industrial and speciality applications.

#### Supply of alginates for pharmaceutical applications

28. The parties submit that there are no public industry sources providing market share or total market data in relation to the supply of alginates for pharmaceutical applications. However, the OFT saw internal documents from the parties which put their combined share of such sales on a worldwide basis at [65-85] per cent. This strong combined position in relation to sales of alginates for pharmaceutical applications was corroborated by third parties who confirmed that the parties are often

regarded as the two strongest competitors in relation to the supply of alginates for pharmaceutical applications.

29. The parties argue that there are a number of other companies which supply alginates for pharmaceutical applications and that these companies currently impose a competitive constraint on the parties and will continue to do so post-merger. These companies include Danisco, Cargill and Kimica, which already sell alginates for pharmaceutical applications in Europe.
30. The parties also argue that, although certain alternative suppliers may not currently sell alginates for pharmaceutical applications in Europe, Kibun, SNAP (in India) and also some of the Chinese alginate suppliers nevertheless represent a competitive constraint on the behaviour of current suppliers in Europe and will continue to do so after the merger because of the threat they represent in terms of potential future supply.

#### Alginates for controlled release and wound care applications

31. The OFT contacted a number of customers for alginates for wound care and controlled release applications. Of the few customers that did raise concerns, most were either not substantiated or were subsequently withdrawn. The OFT saw evidence that customers tend to prefer to source from a single supplier. The parties argue that the merger has no effect on customers that single source. While the impact of the merger may be more limited on the current supply arrangements of single-sourcing customers, the OFT considers there may nevertheless be an impact when those customers come to renew their contracts or when new customers seek sources of alginate supply for the first time.
32. The OFT identified at least one customer for each of the wound care and controlled release applications that either sourced from both parties (and felt they were competing on price) or saw them as the only available alternatives. These customers were concerned to the extent that there would be a reduction in the number of their current suppliers and/or that they may not be able to identify an alternative supplier of alginates.
33. However, on the basis of the evidence it received, the OFT believes that there are other companies which could supply these customers with the alginate they need for their wound care and controlled release applications.

Danisco and Kimica already supply alginates for wound care applications in Europe. Danisco is a significant alternative supplier of alginates for controlled release. The OFT also received evidence that Kimica supplies alginates for controlled release outside Europe. Further, these companies all expressed interest in developing their sales of alginates for pharmaceutical applications, because of the higher margins which it is generally possible to secure for these products.

34. Particularly persuasive in this regard was that some of the better informed customers had already identified alternative sources of supply as a direct response to the announcement of the merger. The OFT was satisfied that companies currently supplying alginates for wound care could reasonably easily start supplying alginates for controlled release, and vice versa, and that companies supplying alginates for anti-reflux applications could also start supplying alginates for both the wound care and controlled release applications.
35. The OFT received evidence of historical switching away from the parties to other alginate suppliers for these products. For customers currently sourcing the same product from both merging parties, the costs of switching demand between the parties are lower than the costs of switching to another source. However, there are no material regulatory barriers to switching from the parties and the OFT received evidence that other firms had similar levels of quality and sufficient manufacturing standards to supply alginates for wound care and controlled release. Entry into these segments might also be possible because the product specification for these applications, although higher than for alginates applications generally, was not significantly more demanding than for other higher-end applications such as food, cosmetic or dental impressions. Therefore, the OFT concluded that these competing alginate suppliers would be able to constrain the parties' behaviour post-transaction such that the merger would not lead to a realistic prospect of substantial lessening of competition in the supply of alginates for use in wound care and controlled release products.

#### Alginates for anti-reflux products

36. The parties each supply alginates for use in anti-reflux products. Cargill and Danisco also supply a small amount of alginate for anti-reflux products, although not to any UK customers. The customers of the parties for

alginates for anti-reflux products contacted by the OFT did not consider that they could switch easily to Danisco or Cargill. Most third parties contacted in the course of the OFT's investigation considered that the merging parties were the two main choices of supplier of alginates for anti-reflux products. Some customers expressed concerns that post-merger other suppliers would not be able to match the product they currently receive from the merging parties. Indeed, the OFT saw evidence that the only suppliers currently supplying alginates for a particular classification of anti-reflux product (alginates raft-forming oral suspension monograph, see footnote 1) are the merging parties. Some third parties submitted that the technical know-how relating to the development of this particular classification of product is even greater than that for the other main classification of anti-reflux products (compound alginate antacid oral suspension) and that it would be very difficult for a supplier currently not producing the former product classification to start supplying one.

37. There was some uncertainty about the precise regulatory requirements to supply alginates for anti-reflux applications. However, there were a number of third parties which considered that the merging parties were the only two suppliers which already complied with or were closest to complying with the relevant regulatory requirements. A number of customers did not consider that they could easily identify an alternative supplier of alginates for anti-reflux products which they could be confident complied with the regulatory requirements.
38. Moreover, third parties also indicated that there are significant barriers to qualifying a new supplier in terms of the customers' costs of switching suppliers. Such costs relate to the need for a customer to carry out quality and equivalency testing on an alternative supplier's product, as well as conducting a period of validation in order to demonstrate the stability of the alternative alginate source in the customer's end product. There were differing views on exactly how long this would take and how much it would cost. However, the OFT could not exclude that a customer would elect not to switch, even in the event of a significant (five to ten per cent plus) price rise, on account of such switching costs. A number of customers of alginates for anti-reflux products contacted by the OFT were familiar with and/or had already tested the parties' alginates products for this purpose and so considered that their switching costs would be much lower between the parties than between one of the parties and an alternative supplier. These costs of switching to an alternative supplier,

when judged against the value of the alginate purchases being made, raise significant doubts about whether for many customers any threat to switch away from the merging parties would in fact be credible.

39. Indeed, the OFT did not see any significant examples of customers switching their purchases of alginates for anti-reflux products away from the merging parties. The parties explained that, although examples of actual switching may be rare, alginate suppliers are constantly subjected to customers' threats to switch. The parties submit that they and other suppliers have no way of evaluating the credibility of these threats. The consequences of ignoring a threat which proves to be credible are that an entire customer contract may be lost for the next contract period or for a number of future contract periods (demonstrated by the normally long-term relationships in the industry).<sup>3</sup> These consequences are particularly serious given the small number of contracts available and, therefore, the parties take a customer's threat to switch very seriously. As such, the parties argue that a customer's threat to switch acts as an equally strong constraint as actual switching and that these threats exert constant pressure on the parties' pricing behaviour and will continue to do so after the merger. However, given the small number of contracts and the secret and relatively long-term nature of the relationships, there were also very few evidenced examples of such threats by customers to switch away from the merging parties. Moreover, given the costs involved for customers to switch suppliers, such threats to switch are only likely to work as an effective constraint for large customers.
40. The specific theory of harm identified in relation to anti-reflux products was that, as a result of the transaction, the price of alginate product currently supplied by one of the merging parties may go up and customers would not have an alternative supplier to which they could reasonably and quickly switch.
41. The OFT received significant concerns of this nature from a customer based outside of the UK. Because it is not a UK customer, the OFT did not consider that it was able to find a competition concern cognisable under the Act only on the basis of the concerns raised by this customer. The OFT's duty to refer under section 33 of the Act is limited to mergers that

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<sup>3</sup> The OFT saw evidence that these rolling relationships are often as long as ten years and sometimes much longer.

may substantially lessen competition “within any market or markets in the United Kingdom”. The OFT's statutory remit clearly focuses on the UK. Accordingly, the key issue is whether there is a realistic prospect that UK customers of FMC and ISP will suffer harm as a result of a lessening of competition caused by this transaction<sup>4</sup>. However, the OFT took full account of the concerns expressed by this customer to the extent it considered them to be probative of the general conditions of competition in the market such that they were used to inform the position of other existing UK (as well as future UK) customers in the same position.

42. In summary, on the basis of the evidence received during its investigation, the OFT believes that the transaction raises a prima facie competition concern in relation to the supply of alginates for anti-reflux applications. Accordingly, the OFT has gone on to consider whether the prospects and incentives for entry and expansion or customers' countervailing buyer power are sufficient to address these concerns.

#### **Barriers to entry and expansion**

43. The OFT's *Mergers - substantive assessment guidance*<sup>5</sup> 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.
44. In this case, the OFT has considered the issue of barriers to entry and expansion only in relation to the one area of concern, that is the supply of alginate for anti-reflux products.
45. As discussed in the market definition section above, the OFT considers on the basis of evidence received that it is unlikely that there will be *de novo* entry into the supply of alginates for anti-reflux products by a company that does not currently supply alginates for a different application.

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<sup>4</sup> See OFT decision *Anticipated acquisition by SBC Communications Inc of AT&T Corporation* 23 August 2005, paragraph 38.

<sup>5</sup> OFT 516 *Mergers – substantive assessment guidance*, paragraph 4.17.

46. Any company not currently supplying alginates for anti-reflux products would need to ensure that it complies with the relevant regulatory requirements before it could begin to supply. It would also need to have access to the requisite know-how to develop such an alginate product. Any non-pharmaceutical alginate suppliers would also face the additional barrier of needing to produce an alginate product to a more demanding specification (which would be easier for companies currently supplying alginates for higher end applications such as food).
47. The OFT notes that the competitive dynamic in the market for the supply of alginates is changing as a result of greater competition from non-European alginate suppliers for the lower margin applications (such as food). It also notes the possibility that these non-European alginate suppliers may over time move up the value chain and become direct competitors for the supply of alginates for pharmaceutical applications in general, and potentially even eventually anti-reflux products in particular. However, the OFT has not received sufficient evidence and therefore not reached the necessary level of belief to conclude that this entry will occur and be of a sufficient scope, nor that it will be sufficiently timely.
48. In relation to the potential for expansion, the OFT received evidence that current suppliers of alginates for other pharmaceutical applications may already be capacity constrained. While these potential suppliers may be willing and able to flex capacity away from production of lower-margin to higher-margin alginates, the OFT cannot exclude the possibility that those not already producing alginates for an anti-reflux product would also face know-how and regulatory barriers. Moreover, those alternative suppliers already producing an anti-reflux product (and, indeed, any other supplier seeking to supply a new customer with alginates for anti-reflux) would still be limited in their ability to win new customers because of the high switching costs. As such, any expansion may only realistically occur if it is sponsored by a large customer.
49. Accordingly, the OFT does not consider that any such entry or expansion in the supply of alginate for anti-reflux products would be sufficiently timely, likely or of sufficient scope to constrain the behaviour of the merging parties in the short-term post-merger.

## **Buyer power**

50. The parties did not raise any arguments as to countervailing buyer power in relation to this transaction [Endnote 1]. However, it is clear from the OFT's market investigation that FMC's main customer for alginates for anti-reflux products, Reckitt Benckiser (the manufacturer of Gaviscon), would enjoy a significant degree of buyer power. Reckitt Benckiser considered that it would be able to sponsor an entrant not currently supplying alginates for anti-reflux products to act as an alternative supplier [ ]. Reckitt Benckiser did not therefore have any concerns about the impact of the transaction on its ability to source alginates for its anti-reflux application.
51. Accordingly, the OFT considers that Reckitt Benckiser has sufficient buyer power such that it would not be adversely affected by any anti-competitive effects of the transaction. However, this does not dispel any competition concerns identified in relation to other smaller customers (or potential entrants) that are not able to exercise such countervailing power because of the costs of switching to products for which they have not already qualified the supplier.

## **VERTICAL ISSUES**

52. The OFT has received no substantiated concerns that this transaction would lead to any vertical competition law issues. The OFT saw no evidence that the transaction would raise any upstream vertical competition concerns, and the parties are not active in the downstream market<sup>6</sup>.

## **THIRD PARTY VIEWS**

53. Many customers were either neutral about the effect of the transaction or did not see that it would have any effect on them. There were, however, a small number of customers of alginates for wound care, controlled release and anti-reflux products which raised concerns about their supply of these

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<sup>6</sup> The OFT considered whether there were grounds to think that any customer of the merging parties would have sufficient influence over the merged entity to ensure that other customers for alginates for anti-reflux products would be excluded (partially or totally) from supply. The OFT saw no evidence that this was a credible theory of harm. Given this lack of evidence and the speculative nature of the theory of harm, the OFT was able to dismiss this concern.

products post-merger. These concerns have been dealt with in the OFT's analysis discussed above.

54. Competitors considered that the transaction represented the merger of the two leading global suppliers of alginates for pharmaceutical applications (that were particularly strong historically in the UK) and that this would create a significant competitor for these products.

## **ASSESSMENT**

55. The parties overlap in the supply of alginates. Alginates are used in industrial, speciality, food and pharmaceutical products. The OFT did not receive any substantiated concerns in relation to the supply of alginates for industrial, speciality and food applications. The OFT received evidence that the parties face sufficient competition from existing alternative suppliers in relation to the supply of alginates for these purposes. Therefore, the OFT has concluded that the transaction does not create a realistic prospect of a substantial lessening of competition in relation to the supply of alginates used for industrial, speciality and food applications.
56. The parties account for a high proportion of alginates supplied for pharmaceutical applications. Alginates supplied for pharmaceutical applications are used in wound care, controlled release and anti-reflux products. The OFT received a number of customer concerns in relation to the supply of alginate for each of these products. These concerns related to the availability to customers of alternative suppliers to the merging parties.
57. Therefore, the OFT focused its investigation on the supply of alginates for pharmaceutical applications, namely for wound care, controlled release and anti-reflux products. Although the OFT does not consider that alginates for wound care and controlled release are immediately substitutable, the issues which arise in relation to each are similar and, as such, the OFT has considered them together. A particular concern arises where customers of alginates for wound care or controlled release products source from both of the parties (and see them as competing on pricing) or see them as their only alternative suppliers. However, the OFT considers that there are sufficient alternative suppliers of alginates for wound care and controlled release and as such concluded that the transaction does not create a realistic prospect of a substantial lessening of competition in this area.

58. The know-how, regulatory conditions and time required to develop alginate for use in an anti-reflux product means that a supplier not currently producing such a product could not easily and quickly start supplying it. Therefore, the OFT is not convinced that customers of the merging parties for alginates for anti-reflux products could reasonably and quickly source alginates from an alternative supplier if the parties increased prices post-merger. There are competitors which currently sell a small amount of alginates for use in anti-reflux products although not currently to UK customers. However, the majority of third parties contacted by the OFT considered that the merging parties were the two most important suppliers of alginates for anti-reflux products and some customers had concerns that other suppliers would not be able to match the product they currently receive from the merging parties.
59. The OFT also believes that there are barriers to switching to one of the existing alternative suppliers of alginates for anti-reflux applications. These barriers consist of costs incurred by the customer on the one hand and the regulatory requirements with which an alternative supplier must comply on the other hand. The switching cost concern applies particularly for customers that are familiar with and/or have already tested both party's alginate products for this purpose and so consider that their switching costs would be much lower between the parties than between one of the parties and an alternative (untested or unfamiliar) supplier. A number of customers also felt that the merging parties were the two suppliers of alginates for anti-reflux products which already complied with or were closest to complying with the relevant regulatory requirements.
60. While the OFT considered that FMC's main customer, Reckitt Benckiser, has sufficient countervailing buyer power to offset any potential adverse effects from the merger, this would not protect smaller customers for whom switching costs away from the merging parties to an alternative (and non-qualified) supplier may be very significant, or even prohibitive, when judged against the value of the alginate purchases being made.
61. Therefore, the OFT believes that it is or may be the case that the transaction may be expected to result in a substantial lessening of competition in relation to the supply of alginates for anti-reflux products.

62. The parties also overlap in the distribution of PGA. While the parties would be the only current distributors in the UK post-merger, customers would still be able to obtain PGA from other suppliers operating elsewhere in Europe and also directly from the manufacturers themselves. As such, the OFT does not believe that the transaction will result in a realistic prospect of a substantial lessening of competition in relation to the distribution of PGA.

## EXCEPTIONS TO THE DUTY TO REFER

### Introduction

63. The OFT's duty to refer under section 33(1) is subject to the application of certain discretionary exceptions, including the markets of insufficient importance or *de minimis* exception under section 33(2)(a) and the undertakings in lieu exception under section 73(2).

64. The parties argued that the OFT should apply the markets of insufficient importance, or *de minimis*, exception to the duty to refer, as recently revised<sup>7</sup> on the basis that the value of the market for the supply of alginates for anti-reflux applications in the UK is less than £10 million. The OFT therefore considered whether it was appropriate to exercise its *de minimis* discretion.

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

65. As stated in the Dunfermline/BRN case,<sup>8</sup> and as explained further in the BOC/Ineos case,<sup>9</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, 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.

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<sup>7</sup> OFT 516 b, November 2007.

<sup>8</sup> OFT *Completed acquisition by Dunfermline Press Limited of the Berkshire Regional Newspapers business from Trinity Mirror plc* 4 February 2008.

<sup>9</sup> OFT *Anticipated acquisition By BOC Limited of the Packaged Chlorine Business and Assets carried on by Ineos Chlor Limited* 29 May 2008.

66. 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 parties have actually made any such 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.
67. 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 classical 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 addressed structurally by means of a divestiture package. In this case, the most obviously available structural remedy (divestment of ISP's production facility in Girvan) would constitute divestment of the major part of the overall transaction and without which the acquisition would not have proceeded. The OFT does not include what would amount to prohibition when considering whether clear-cut undertakings in lieu are available. Therefore, it would be wholly inappropriate for the OFT, at this stage of the analysis, to rule out an evaluation of the *de minimis* exception in this case on the grounds that it would be clearly open to the parties to offer a clear-cut – that is, effective and proportionate – undertaking in lieu.

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

68. The OFT has recently considered the *de minimis* exception to the duty to refer in some detail in its decision to refer the anticipated acquisition by BOC Limited of the packaged chlorine business and assets carried on by Ineos Chlor Limited<sup>10</sup> (the BOC/Ineos case). In that case, the OFT set out in further detail the considerations it takes into account when considering whether to apply the *de minimis* exception following the OFT's revised guidance<sup>11</sup> on this.
69. The BOC/Ineos case restated the OFT's position that 'the pivotal issue is whether the impact of the merger is likely to be particularly significant'. In BOC/Ineos, the OFT made it clear that, in placing the predicted impact of a

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<sup>10</sup> Decision dated 29 May 2008.

<sup>11</sup> Revision to *Mergers – Substantive assessment guidance*, OFT 516b, November 2007.

merger on the scale between limited (when the OFT is likely to apply the *de minimis* exception) and particularly significant (when the OFT will not use the exception), it takes the following factors into account:

- 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**

70. In the present case, the OFT's analysis of whether to exercise the *de minimis* exception focused on the following factors:

71. *Market size* - The value of the market in the UK for the supply of alginates for anti-reflux applications in the UK is less than £10 million (approximately £[less than 10] million). The vast majority of this is represented by sales to one customer, Reckitt Benckiser for its Gaviscon product. As discussed above under buyer power, the size of Reckitt Benckiser's alginate purchases, and its ability to sponsor new entry or expansion by existing suppliers means that Reckitt Benckiser exercises substantial countervailing buyer power of a wholly different nature and magnitude to that of other customers in the market. In line with the approach adopted by the OFT in National Express Group / East Coast<sup>12</sup> – where it exercised its discretion to exclude rail services from the calculation of the market size in the *de minimis* assessment because the theory of harm did not extend to rail services – the OFT considers that the exceptionally differentiated position of Reckitt Benckiser on this market means that its purchases should not be considered together with those of other customers in calculating the affected market size for the purposes of the *de minimis* exception. Therefore, a more accurate view is to consider that the actual size of the market affected by the substantial lessening of competition in this case is significantly smaller than £[less than 10] million). As such, the turnover of

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<sup>12</sup> OFT *Completed acquisition by National Express Group plc of the Intercity East Coast Rail franchise* 20 December 2007.

those customers capable of being significantly adversely affected was particularly modest (less than £[less than 2] million)<sup>13</sup>.

72. *Strength of the OFT's concerns* – The OFT has concluded on the basis of the evidence before it that it is or may be the case that the transaction will result in a substantial lessening of competition in relation to the supply of alginates for anti-reflux, in other words, the OFT's judgment in this case is that the probability of such an outcome is potentially as high as more likely than not (thus meeting the 'is the case' or balance of probabilities standard)<sup>14</sup>. The OFT considers that this substantial lessening of competition may result in anti-competitive price increases as a result of unilateral effects beginning in the short term post-merger.
73. *Magnitude of competition lost by the merger* - The evidence received by the OFT indicates that the parties are close competitors in relation to the supply of alginates for anti-reflux applications and, indeed, for some customers they are the only choice. However, this should be assessed in the light of the durability of the merger's impact, as discussed below.
74. *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 will be sufficient to counter an anti-competitive price increase by the merging parties. However, the OFT believes that it is possible that entry could take place in the medium to long-term (that is, after the two year period set out in the OFT guidance), and as such it does not consider that the negative impact of the merger will definitely persist for the foreseeable future. The OFT has received evidence that the competitive dynamic in the market for the supply of alginates in general is changing as a result of greater competition from non-European alginate suppliers for the lower margin applications. The OFT considers that this will have a knock-on effect of intensifying competition between existing suppliers of alginates for pharmaceutical applications. The OFT also notes the possibility that these non-European alginate supplies may over time move up the value chain and become direct competitors for the supply of alginates for pharmaceutical applications in general and anti-reflux products in particular.

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<sup>13</sup>It should be noted that, even if the purchases of the non-UK customer referred to in paragraph 41 were to be included, the turnover of those customers capable of being adversely affected would still be significantly less than £[less than 2] million.

<sup>14</sup>This differentiates this case from the three previous cases in which the *de minimis* exception was applied, where in each case the OFT's belief was at the 'may be the case' standard of belief only. See further, BOC/Ineos.

The OFT has seen evidence of this transition up the value chain occurring in relation to the supply of alginates for food applications.

75. *Transaction rationale and the value of deterrence* – The affected market in this case represents less than [0-20] per cent of the turnover of either party. The OFT notes that there is no suggestion on the evidence received by the OFT that any acquisition of market power in relation to the supply of alginates in the UK for use in anti-reflux applications forms a material part of the commercial rationale behind the wider transaction<sup>15</sup>.
76. Overall, the combination of these various factors suggest that the impact of this merger is best characterised as being very limited, rather than particularly significant. Accordingly, the OFT has decided to exercise its discretion not to refer this transaction to the Competition Commission because the market concerned is of insufficient importance to justify the making of a reference.

## **DECISION**

77. This merger will therefore not be referred to the Competition Commission pursuant to section 33(2)(a) of the Act.

## **END NOTES**

1. Although buyer power was not raised as a major argument, the parties have stressed that their submissions did draw the attention of the OFT to Reckitt Benckiser's buyer power. The OFT acknowledges that this is the case.

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<sup>15</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 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.