COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: 107186

In the merger between:

ASPEN NUTRITIONALS, A DIVISION OF PHARMACARE LIMITED — **PRIMARY ACQUIRING FIRM**

And

THE SOUTH AFRICAN INFANT NUTRITION BUSINESS OF PFIZER INC. — **PRIMARY TARGET FIRM**

Panel	:	Andreas Wessels (Presiding Member) Imraan Valodia (Tribunal Member) Mondo Mazwai (Tribunal Member)
Heard on	:	09 - 13 December 2013
Order issued on	:	18 December 2013
Reasons issued on	:	

Decision non-confidential

Unconditional Approval

1. On 19 December 2013, the Competition Tribunal ("the Tribunal") unconditionally approved a proposed merger between Aspen Nutritionals, a division of Pharmacare Limited and the South African infant nutrition business of Pfizer Inc, which was sold by Nestlé S.A. ("Nestlé") pursuant to a divestiture order imposed by this Tribunal on Nestlé. The reasons for the approval follow.

Background

2. As described by the Competition Commission ("the Commission"), the proposed transaction is a sequel to a transaction approved by this Tribunal on 11 February 2013 subject to certain divestiture conditions. Part A to the sequel involved a worldwide acquisition of Pfizer Inc.'s infant nutrition business by Nestlé Inc, a Swiss-based nutrition, health and wellness group ("the *Nestlé/Pfizer* transaction").

3. The *Nestlé/Pfizer* transaction was notifiable in fifteen competition jurisdictions and was unconditionally approved in twelve. In South Africa, as in Australia and Mexico, the transaction was approved with divestiture conditions to address certain identified competition concerns. In particular, the competition concern in South Africa was the reduction in the number of competitors post the merger in certain relevant markets, from three to two (the so-called three-to-two merger) in already highly concentrated markets.

4. The conditions required Nestlé to divest of the infant nutrition business of Pfizer in South Africa to a third party yet to be identified, through a re-branding remedy. This was the first such remedy in South African competition law and was motivated by the peculiarities of the relevant markets as discussed later on in these reasons.

5. In terms of the divestiture, the third party purchaser would acquire the physical assets of Pfizer's infant nutrition business in South Africa as well as a ten year licence to manufacture and trade product under the Pfizer brand. Within this 10 year period the purchaser would be required to re-brand the Pfizer brands into independent brands of the purchaser's choice ("the re-branding period").

6. Following the 10 year re-branding period, Nestlé would be precluded for a further 10 year period from trading in the Pfizer brands ("the black-out

period").[1] The brands will revert to Nestlé after the rebranding and black-out periods who may then decide whether or not to re-introduce the Pfizer brands in South Africa.

7. The proposed transaction therefore originates from our divestiture order in the *Nestlé/Pfizer* transaction.[2]

The Parties, Transaction and Rationale

8. The primary acquiring firm is Aspen Nutritionals ("Aspen"), a division of Pharmacare Ltd ("Pharmacare"). Pharmacare is a wholly-owned subsidiary of Aspen Pharmacare Holdings Ltd ("Aspen Holdings"). Aspen Holdings is a public listed company with no controlling shareholder.

9. The primary target firm is the South African infant nutrition business of Pfizer Inc. As indicated above, Nestlé recently acquired the right to Pfizer's infant nutrition business in South Africa but was ordered by this Tribunal to on-sell it to a third party yet to be identified. A hold-separate manager (Pfizer Laboratories) and trustee were appointed in terms of our order to manage the Pfizer business until divested.

10. Nestlé has formed a new company, Blue-Knight Holdings (Pty) Ltd, which will on approval of this transaction, take transfer of the Pfizer business from the hold-separate manager prior to the onward transfer from Nestlé to Aspen.

11. Aspen will acquire the physical assets and a 10 year licence to import, manufacture and distribute the Pfizer brands in South Africa subject to the re-branding arrangement described in paragraphs 5 and 6 above. The proposed transaction constitutes a merger as defined in section 12(1)(b)(i) of the Competition Act, 89 of 1998 ("the Act").

12. Nestlé's rationale for the transaction is to *"give effect to the Tribunal's order"* which as indicated, required Nestlé to divest of the South African infant nutrition business of Pfizer.

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[1] Subject to allowing for minimum sales which Nestlé would be required to make to maintain its registered trademarks.
[2] Case number 65/LM/Jun12.

13. According to Aspen, it has been looking to globalise its infant milk formula ("IMF") business for some time. This transaction provides that opportunity. Moreover, Aspen has previously manufactured and sold a range of Pfizer's IMF products under licence from Wyeth from 1993-2009 and for a limited period (2009-2011) under licence from Pfizer. Aspen lost the licence due to a change of ownership clause in its licence agreement with Wyeth which provided for the licence to be terminated in the event of a change of ownership. Pfizer acquired the infant nutrition business of Wyeth in 2009, which triggered a change in the ownership of Wyeth. Pfizer gave notice of termination in 2010 and took over its brands in May 2011.

14. Aspen also believes that its local manufacturing capacity gives it the ability to manufacture product at a lower cost than fully imported products.

15. Prior to dealing with the current transaction it is necessary to briefly discuss our order in the *Nestlé/Pfizer* transaction and what it sought to achieve as it forms the backdrop against which to assess the competition aspects of this transaction.

Salient features of the Nestlé/Pfizer order and subsequent developments

16. We have already described the key features of the divestiture order above. The objective of the order was to maintain the competitive landscape that prevailed prior to the *Nestlé/Pfizer* transaction. As indicated, our concern with that merger was that it essentially would reduce the number of participants from three to two in markets which were already highly concentrated.

17. It was common cause in the *Nestlé/Pfizer* transaction as it is in this transaction that barriers to entry in the IMF market are high. In particular, the IMF market is characterised by high levels of brand loyalty as customers do not generally switch between brands. Parents, especially new parents, rely on the advice of health professionals who recommend certain IMF products. Only very rarely do consumers appear to change from one product to another.

18. Furthermore, there is a risk of fatality if a baby is fed infant formula that is not scientifically backed by Research and Development ("R&D"), which means that R&D capability is a significant requirement for entry.

19. There is also stringent regulation emanating from the World Health Organisation and adopted by the Department of Health which inter alia restrict the promotion and marketing of infant formula making entry difficult for new entrants with unknown brands.

20. In the *Nestlé/Pfizer* order, we specifically set the criteria for the prospective purchaser as follows:

    a. The purchaser should not have any affiliation, directly or indirectly to Nestlé.

    b. The purchaser should have the necessary financial resources, proven expertise and the incentive to maintain and develop the divested business as a viable and competitive force against Nestlé and other competitors in the relevant markets.

21. The merger conditions made provision for Nestlé to first inform the Commission of the identity of the purchaser to obtain the Commission's confirmation that the purchaser meets the criteria in our order, prior to formally notifying the Commission of the merger.

22. At the time of the *Nestlé/Pfizer* hearing, Nestlé indicated that a bidding process to divest of Pfizer's infant nutrition business in South Africa, Australia and Latin America had commenced.

23. As indicated, we approved the *Nestlé/Pfizer* transaction on 13 February 2013. We understand from the Commission that Nestlé informed it on 6 March 2013 that Aspen had been selected as the successful bidder for both the Australian and South African businesses. The Commission gave Nestlé the confirmation of Aspen's suitability on 18 March 2013.

24. Aspen then notified the Commission of the merger in May 2013 and following its investigation, the Commission recommended that the Tribunal should approve the merger without condition.

The Commission's Recommendation

25. As indicated, the Commission recommended the approval of the merger without condition. Consistent with its findings in the *Nestlé/Pfizer* transaction, the Commission found that the merging parties' activities overlapped in the broader infant milk formula market, which can be categorised into separate relevant product markets for: infant formula; follow-on milk; growing-up milk ("GUM"); and specialty milk.

26. The Commission found that although there was a horizontal overlap between the activities of the merging parties, they each focussed on different segments of the market, with Aspen focussing on the so-called "mainstream" segment whereas Pfizer's focus was on the "higher-end" segment of the market. According to the witnesses, as we will discuss later, the distinction between the mainstream and higher-end products is price. The latter enjoy premium pricing due inter alia to the additional ingredients in the formula.

27. Also consistent with its findings in the *Nestlé/Pfizer* transaction the Commission found that the South African infant milk formula industry was highly concentrated with only three participants in the infant, follow-on and GUM markets ("the non-specialty markets"), and only four participants in the specialty market.

28. What was different regarding the Commission's findings in this sequel is that it argued that although the number of participants in the non-specialty markets would reduce from three to two as a result of the proposed merger, a situation the conditions in the *Nestlé/Pfizer* transaction sought to prevent, there would be no substantial prevention or lessening of competition in the relevant markets as:

    a. Aspen and Pfizer are not close competitors in the identified mainstream and higher-end segments of the market. According to the Commission,

Nestlé and Pfizer are closer competitors than Aspen and Pfizer are. Therefore, although the proposed transaction will result in a three-to-two merger as the *Nestlé/Pfizer* transaction would have done, this transaction does not result in a substantial loss of competition since Aspen and Pfizer were not close competitors. On this basis the Commission concluded that it was unlikely that the merger would result in any unilateral effects (i.e. post-merger market power by Aspen) as Nestlé would remain a significant competitor to Aspen post-merger.

b. The transaction was unlikely to give rise to co-ordinated effects due primarily to the highly differentiated and segmented nature of the IMF markets. Moreover, the market share asymmetry between Nestlé as the leading IMF participant and its competitors argued the Commission, eliminates any incentive on the participants in the market to co-ordinate their conduct post-merger. If anything, the merger will provide Aspen a fighting chance to close the gap between itself and Nestlé which will nevertheless remain large.

c. The transaction raised no public interest concerns as defined in the Act.

29. The Commission therefore recommended an unconditional approval of the proposed merger. Our concern remained that post-merger certain IMF markets would in effect become duopolistic in structure. On the face of it, the proposed merger appeared to eradicate the state of competition that we sought to preserve through the divestiture conditions in the *Nestlé/Pfizer* transaction.

30. This concern was heightened by specific market events, supported by Aspen's strategic documents that showed Aspen's nascent entry into the higher-end segment of the market. Specifically, we saw Aspen, whose focus traditionally had been in the mainstream segment of the market, launching products (Infacare Nurture and Infacare Gold) in the higher-end segment of the market to compete with Pfizer, following the loss of the Pfizer licence. We also saw Aspen introducing a brand (Melegi) to compete with Nestlé in the

government sector. Nestlé had also repositioned its Lactogen brand in the mainstream segment around 2010 shortly before the launch of Aspen's Infacare Gold and the entry of Pfizer independently in the market.

31. This seemed contrary to the Commission's finding that Aspen's focus was on the mainstream segment and thus did not compete with Pfizer. The crux of our directive to the Commission therefore was for the Commission to investigate the issue of the effect of the proposed merger on future potential competition. In our view, the characteristics displayed by the relevant markets including the specific market events mentioned above warranted a closer analysis of the potential for competition between the merging parties absent this merger.

32. We directed the Commission to further investigate inter alia the following competition aspects:

    a. The "natural experiment" being the duopoly period when Aspen had the licence to the Pfizer brands as this merger would in effect revert to a similar duopolistic market structure. We requested the Commission to analyse the competitive situation during the licence period and the competitive situation following the termination of the licence when Pfizer entered the market independently.

    b. Whether or not the proposed merger met the objectives of the remedy imposed by the Tribunal in the *Nestlé/Pfizer* transaction. As indicated, the rationale for the divestment was to enable a third party purchaser to step into the shoes of Pfizer thereby maintaining the pre-merger market structure comprising three suppliers in the relevant markets.

    c. We also directed the Commission to further investigate the potential for co-ordination post-merger in certain markets which would in effect become duopolistic in structure post this merger. We specifically requested the Commission to assess the duopoly period when Aspen had the licence to the Pfizer brands, and the period post-the licence when Pfizer entered the market independently.

d. We also directed the Commission to investigate barriers to entry into the relevant markets, including the past failed entry of Tiger Brands with its *Purity* brand and expansion plans of existing competitors, if any.

e. The merging parties had claimed certain efficiencies which they alleged would arise from the merger. We directed the Commission to analyse these.

The Commission's Supplementary Report

33. The Commission conducted further investigations and filed a Supplementary Report recommending as previously, that the transaction should be unconditionally approved.

34. The findings of the Commission in respect of the matters it was directed to investigate and analyse were briefly as follows.

a. Regarding potential competition, the Commission's starting point in the context of this merger was that a counterfactual where Pfizer could continue to operate independently in the market was out of the question as Pfizer had decided to exit the market through its global sale. Neither was a counterfactual involving Nestlé controlling the Pfizer brands an option for the obvious reason that the Tribunal order precludes it.

b. The Commission argued therefore that there were two counterfactual scenarios. One involving a purchaser of Pfizer's licence who is not currently operating in South Africa, and the other a purchaser who does.

c. Given that Aspen falls into the latter category, the Commission analysed specific market events as per our directive and came to the same conclusion as previously that Aspen and Pfizer were not close competitors in the identified market segments. On this basis the

Commission concluded that there would be no substantial prevention or lessening of competition in the markets concerned.

d. Insofar as the effectiveness of the remedy is concerned, the Commission found that competition in the IMF markets takes place at brand level as consumers are not necessarily aware of who the manufacturers of the relevant products are. Thus, to the extent that consumers will still have a choice between the Aspen and Pfizer brands the pre-Nestlé Pfizer market situation would be restored.

e. Moreover, the Commission argued, it did not find any evidence that Nestlé's selection of Aspen as the winning bidder was motivated by self-interest on the part of Nestlé either financially or competitively. Nestlé's choice of bidder according to the Commission, was based on Aspen's interest in bidding for the South African and Australian businesses together, which some of the alternative bidders (and potentially new entrants in the South African market) were not prepared to make. It bears mention that it was not a requirement of our divestiture order that the successful bidder should bid for both the South African and Australian businesses. Naturally our interest in the merger was in addressing the competition concerns in South Africa.

f. The Commission assessed certain data pertaining to co-ordinated effects, and concluded that there was no evidence to show that this transaction would result in co-ordination between the market participants in the post-merger IMF world.

g. On barriers to entry, and specifically Tiger Brands' exit from the market, the Commission investigated that and accepted Tiger Brands' reasons for exiting.[3]

h. Another identified barrier to entry was the recently promulgated Regulations 991 which restricted the ability of IMF suppliers to promote infant formula on retailers' shelves.

[3] See record, page 165.

i. In conclusion the Commission found that barriers to entry were not insurmountable.

j. The Commission did not conduct a detailed assessment of the efficiencies claimed by the merging parties as the Commission argued that the assessment was relevant only if the merger is likely to substantially prevent or lessen competition, which the Commission found not to be the case.

The Hearing Process

35. Following the Commission's Supplementary Report, a pre-hearing was set down for 15 November 2013. We requested the Commission to indicate to us which witnesses it intended calling at the hearing that could speak to the relevant competition issues. On 11 November the Commission informed the Tribunal that it intended calling two expert witnesses (and an internal economist):

    a. Dr Kuban Naidoo, a Consultant Paediatric Intensivist, working at the Chris Hani Baragwanath Hospital; and

    b. Ms Marlene Gilfillan, the Chief Dietitian at the Kalafong Public Hospital. And

    c. Mr Tapera Muzata, internal economist at the Commission.

36. On 13 November 2013, the merging parties indicated to the Tribunal that they intended calling four witnesses (three factual and one expert):

    a. Mr Sean Capazorio, the Group Finance Officer of Aspen Pharmacare Holdings;

    b. Mr Stephen Saad, the Group Chief Executive of Aspen Pharmacare Holdings;

    c. Mr Phillip Mellor, Head of Legal M&A Competence Centre at Nestlé; and

d. Mr Richard Murgatroyd, Director of RBB Economics, as an economics expert.

37. It appeared to us that the witnesses intended to be called by the Commission and the merging parties would not be able to address us on certain key issues relevant to the assessment of the merger. While the Commission's witness list contained two industry experts that could speak to certain aspects it did not include (i) retailers, by far the largest channel for IMF product sales, nor (ii) pharmacies, the next largest channel to market, whose views on competition in the market and the proposed merger we considered relevant.

38. Additionally, given the highly differentiated and segmented nature of the relevant markets, with suppliers focussing on certain niche sub-markets, we were specifically interested in assessing the potential for entry into the markets through expansion by the other existing player (i.e. Abbott) and/or entry by potential new participants. As already indicated, we were also interested in hearing specifically from Tiger Brands as a party that had previously entered the IMF market, but had exited.

39. We also indicated to the merging parties that they should make available a witness from Pfizer (in addition to witnesses from Nestlé and Aspen).

40. We used our statutory powers in terms of section 52(2)(b) of the Act which allows us to conduct hearings in an inquisitorial manner, a model which was endorsed by the Competition Appeal Court ("CAC") in the matter between *Senwes Limited/the Competition Commission of South Africa.*[4] In the matter between *Momentum Group and others/Competition Tribunal and others*[5] the CAC found that there need not be a dispute before the Tribunal for the Tribunal to exercise its inquisitorial powers under the Act, as the function of the Tribunal is not merely to rubberstamp matters that come before it, rather it is to exercise a public function within section 27 of the Act.

[4] Case no. 87/CAC/Feb09.
[5] Case no. 58/CAC/Dec09.

41. As stated above, we indicated to the Commission and merging parties that we would need to hear from a number of additional witnesses to those proposed by them. Consequently, we issued subpoenas for witnesses from:

a. Pick n Pay and Spar as food retailers,

b. Clicks as a pharmaceutical retailer,

c. Tiger Brands as a former market participant, and

d. Abbott, as an incumbent firm in the speciality market that could potentially expand into other IMF markets.

42. Given the Commission's stance that the merger would not result in a substantial prevention or lessening of competition, the Commission elected to play a passive role in the Tribunal proceedings. There were also no third parties who were averse to the merger. However given the competition concerns explained above, we conducted the proceedings in an inquisitorial manner in terms of section 27 and put questions to the witnesses, particularly those called at the Tribunal's instance.

43. We ultimately heard sixteen witnesses over five days. They were (for ease of reference we repeat those initially proposed to be called and referred to in paragraphs 355 and 36 above):

a. Ms Lynne Bluff, a registered nurse and midwife;

b. Ms Marlene Gilfillan, Chief dietician at Kalafong hospital;

c. Mr Peter Arnold, the Food Merchandise Director at Pick n Pay;

d. Ms Kinty Peetz, the National Strategic Category Manager for Spar;

e. Mr David Sykes, the Key Accounts Manager at Clicks Retailers;

f. Ms Waheeda Ahmed, the Merchandise Executive for Baby and Personal Care at Clicks Retailers;

g. Ms Julia O'Grady, the General Manager South Africa and Region Africa at Abbott;

h. Mr Stephen Saad, the Group Chief Executive of Aspen Holdings;

i. Mr Sean Capazorio, the Group Finance Officer of Aspen Holdings;

j. Mr Ian Isdale, the Group Company Secretary and General Counsel of Tiger Brands;

k. Ms Amanda Ewan, Category Executive, Baby Business of Tiger Brands;

l. Mr Phillip Mellor, Head of Legal M&A Competence Centre at Nestlé SA;

m. Ms Pindelwa Mda, Infant Nutritional Business Head for Nestlé SA Sub-Saharan region;

n. Mr Paul Buckley, the Vice President of Pfizer Worldwide Business Development;

o. Mr Tapera Muzata, internal economist for the Commission; and

p. Mr Richard Murgatroyd, economics expert at RBB.

44. The Commission ultimately decided not to call Dr Kuban Naidoo who was initially on its list. Towards the end of the hearing we also decided to release Mr Irwin Juckes, the former Country Head of iNova Pharmaceuticals (Pty) Ltd from testifying[6].

The Relevant Product and Geographic Markets

Background

45. The Infant Milk Formula ("IMF") market comprises a range of products which serve different nutritional needs at different stages of a baby's development.

[6] Due to his availability, he was the last witness to testify.

According to the Commission, the range of products can be categorised as follows:

a. Infant formula (starter stage) for babies aged 0-6 months;

b. Follow-on formula for babies aged 7–12 months;

c. Growing-up milk ("GUM") for children between the ages of 12 months and 5 years; and

d. Specialty milks for babies and toddlers with special needs at all stages (e.g. allergies, digestive problems or reflux).

46. Within each of the categories listed above, there is further segmentation between products that are in the so-called mainstream segment and those that are in the so-called higher-end segment of the market. According to the witnesses, the key differences amongst products in these segments lie in ingredients and price. All infant formula must comply with certain basic nutrition standards from a protein, carbohydrate, fat and mineral content. What then distinguishes the higher-end segment from the mainstream segment are additional ingredients, such as fatty acids, which attract a premium price.

47. From a demand-side perspective, the Commission and the merging parties agreed that there is limited substitutability between each of the categories listed above. As mentioned, a baby's nutritional needs at its different stages of development determine the appropriate formula for the baby. However, there is no fixed point of switching between the different categories as this depends on the individual development of the baby. If a baby is growing relatively faster and is a hungrier baby, switching to the next category can happen sooner, and vice-versa i.e. a baby can stay in a category for longer than the prescribed age of the formula if they are growing slowly. Thus there may be limited substitutability on the fringes between categories.

48. A particular feature of the IMF market from a customer's perspective, which limits customer switching, is brand loyalty. The Commission's investigation

revealed that brand choice is generally made on recommendation by family, friends or a Health Care Professional ("HCP"). Once the choice has been made and the baby is doing well on the chosen brand, it is highly unlikely that it will be switched to a different brand.

49. By and large, the witnesses confirmed that consumers tend to be brand loyal. Due to brand loyalty, the evidence by these witnesses was that consumers tend to be price insensitive particularly in the higher-end segment of the market. In the mainstream segment however certain consumers are more price sensitive.

50. On the supply side, the Commission and merging parties differed on the feasibility of supply-side substitution. The merging parties contend that it would be relatively easy for an IMF supplier who produces a specific line of IMF product to start producing another line.

51. The Commission however stated that it had found no evidence that there was any incentive for IMF suppliers to switch their production, in the case of a hypothetical price increase post-merger. However, both the Commission and the merging parties agreed that it was not necessary to decide this point as it does not affect the overall assessment of this merger. We therefore do not consider supply-side substitution any further.

Activities of the merging parties

Aspen

52. Aspen has local manufacturing facilities where it produces IMF products in each of the categories listed above, which are supplied in South Africa and the export market. Aspen's brands in South Africa are Infacare, which comprises a range of products in the specialty and non-specialty stages; and Melegi, which was recently launched to satisfy a government tender. Aspen's brands in the various segments of the market are:

a. Infacare Regular; comprising starter, follow-on and GUM. According to Aspen, this range is focussed on the mainstream segment of the market.

b. Infacare Gold; comprising starter, follow-on and GUM, considered to be a higher-end product.

c. Infacare Nurture (discontinued in December 2012), considered a higher-end product.

d. The Infacare Soya range, considered a mainstream specialty range.

e. The Infacare Gold Soya range, considered a higher-end specialist product.

f. The Melegi product, considered mainstream and as indicated, specifically developed for the government tender market.

53. As mentioned earlier, Aspen was the licensee for the Pfizer brands in South Africa (from 1993 until 2011). Aspen manufactured the Pfizer brands locally and was the sole distributor of the brands until Pfizer terminated the license and took over its brands in May 2011 for the reasons explained in paragraph 13 above.

Pfizer

54. Pfizer does not have manufacturing facilities in South Africa. Its IMF products are imported, and as indicated above, were distributed by Aspen under license until 2011. Pfizer's brands include S-26 and SMA. More specifically, Pfizer's brands are:

a. The S-26 Regular range, comprising starter, follow-on and GUM. Whether S-26 Regular is a mainstream or higher-end product was a contentious issue between the Commission and the merging parties. Nonetheless; irrespective of the classification of S-26 Regular, the Commission and the merging parties agreed that the outcome of this merger assessment is not affected by this.

b. The S-26 Gold range, comprising starter, follow-on and GUM, considered to be a higher-end range.

c. SMA, a mainstream product targeted at hungrier babies between ages 0-6 months.

d. The Infasoy and S-26 lactose free ranges, which are specialty milks for children with therapeutic conditions.

e. Promise PE Gold for "picky" children between 2-10 years, considered a higher-end product.

f. Pre-term hospital products for low birth weight babies.

55. The brands that are particularly important for purposes of this merger assessment are Aspen's Infacare Regular range; the Infacare Gold Range; Infacare Nurture; and the Melegi brands. On Pfizer's side, the particularly important brands in this merger assessment are the S-26 Regular range; the S-26 Gold range; and SMA.

Relevant Product and Geographic Markets

56. As appears from the description of the activities of the merging parties, they are both active in the supply of IMF products and specifically in each of the categories of the IMF market mentioned above. The proposed merger is therefore a horizontal merger between IMF suppliers.

57. According to the Commission and the merging parties, although there is a horizontal overlap in the activities of the parties, they each focus on different segments of the IMF market, with Aspen focussing on the mainstream market and Pfizer on the higher-end market.

58. The relevant product markets are therefore the markets for the supply of IMF products as categorised above. We accept, based on the Commission and the merging parties' submissions which have been confirmed by the witnesses, that the market can be segmented further into the mainstream and higher-end segments.

59. Both Aspen and Pfizer supply their products nationally. The Commission therefore defined the geographic market as national. The merging parties insinuated that the geographic market could be international but did not argue this point in the proceedings. For purposes of this merger, we therefore consider the scope of the geographic market to be national.

60. According to the Commission and the merging parties, the main distribution channels for IMF products are general food retailers, which is the largest channel to market. This is followed by pharmacies and then hospitals which although relatively smaller represent a foot in the door for suppliers. Once their products are recommended to the consumer by HCPs in the hospital (or pharmacy) the consumer carries the choice into to the retail channel. Regulation 991, as discussed below, will reinforce the importance of the hospital channel as HCPs will become the only way to "advertise" infant formula.

Competitors

61. The Commission and the merging parties listed Nestlé as the leading IMF supplier in South Africa with a range of products in each of the IMF categories listed. Nestlé's brands include NAN; Lactogen; and NIDO. More specifically:

    a. The NAN range comprises starter, follow-on and GUMs and is considered a higher-end brand.

    b. The Lactogen range, also comprises starter, follow-on and GUMs, and is considered a mainstream product range.

    c. The NIDO range, which caters for children above 1 year and is considered a higher-end brand.

    d. NAN HA and NAN Pelargon, which are considered specialty products.

62. For purposes of this merger assessment Nestlé's relevant brands are NAN and Lactogen.

63. Abbott is also a supplier of IMFs in the South African market. However it focuses on specialty milks. Its brands are Isomil and Similac.

64. The merging parties also listed numerous smaller participants in the IMF market, including:

a. Pharmaco, focusing on the higher-end market for starter, follow-on and GUMs with its Novalac brand;

b. Nutricia, which focusses on the specialty segment with its Neonate and Pepticate brands; and

c. Hipp, which supplies organic starter, follow-on and GUM formulae.

65. It was common cause that the South African IMF market comprises three main participants in the non-specialty segments namely; Nestlé as the leading supplier, Aspen, and Pfizer. It was also common cause that the specialty market comprises four main participants, namely Nestlé, Aspen, Pfizer and Abbott.

Market Shares

66. The merging parties provided the following estimated market shares, prefaced on the basis that in differentiated markets, market shares may not be a reliable indication of the extent of competition amongst the relevant products or of the post-merger market power the merged entity will have, for the reasons discussed later on in these reasons.

Table 1: Pre-merger market share IMF volumes sold by product category 2012

	Starter	Follow-on	GUM	Specialty	Total IMF
Nestlé	72%	73%	74%	82%	74%
Aspen	21%	22%	20%	1%	18%
Pfizer	7%	6%	6%	1%	5%
Abbott	0%	0%	0%	15%	3%

Source: RBB calculations based on Nielsen data. (We note that the totals in columns three and five do not tally to 100%.)

67. It is clear that Nestlé is the leading participant with market shares in excess of 70% in each of the non-specialty markets; and in excess of 80% in the specialty market.

68. Aspen is the next largest participant with approximately 20-22% in the non-specialty markets and approximately 1% in the specialty market. Pfizer follows with between 6-7% market shares in the non-specialty markets, and 1% in the specialty market. Abbott features only in the specialty segment with a 15% market share.

69. As indicated, the market can also be segmented into the mainstream and higher-end segments. The merging parties provided the following estimate market shares for these segments respectively.

Table 2: Pre-merger market share IMF Volumes sold for mainstream products by product category 2012

	Starter	Follow-on	GUM
Nestlé	52%	53%	40%
Aspen	47%	47%	60%
Pfizer	1%	0%	0%
Total	**100%**	**100%**	**100%**

Source: RBB calculations based on Nielsen data

Table 3: Pre-merger market share IMF volumes sold for higher-end products by product category 2012

	Starter	Follow-on	GUM
Nestlé	87%	88%	90%
Aspen	2%	2%	2%
Pfizer	11%	10%	8%
Total	**100%**	**100%**	**100%**

Source: RBB calculations based on Nielsen data

70. We have indicated that the Commission and the merging parties differed on the classification of S-26 Regular which the Commission considered a mainstream brand whereas the merging parties classified it as a higher-end brand. The merging parties provided the market shares below indicating estimated market shares under both scenarios i.e. S-26 Regular as a mainstream and higher-end product.

Table 4: Major suppliers' volume shares, by price segment (non-speciality products only), 2012

	S26 Regular classified as higher-end		S26 Regular classified as mainstream	
	Mainstream	Higher-end	Mainstream	Higher-end
Nestlé	49%	88%	46%	93%
Aspen	51%	2%	47%	2%
Pfizer	<1%	10%	7%	5%
Total	100%	100%	100%	100%

Source: Nielsen data

71. It is clear from the market scenario depicted above that the proposed merger would in effect result in a duopolistic market structure post-merger in the non-specialty markets, and three participants in the specialty market. Ergo the merging parties' argument that in differentiated markets, the competitive assessment of a transaction should be on the closeness of competition between the relevant products rather than on the structural changes that the merger may bring about.

72. According to the parties, the argument for closeness of competition calls for an assessment of the extent to which the merging parties' products competitively constrain each other's behaviour in the market, such that if they do not then the structural change which will arise post-merger would be unlikely to lead to market power by Aspen. We consider this argument in more detail later on.

Theories of Harm

73. It is well established in competition practice that the main theories of harm in a horizontal merger are unilateral effects and co-ordinated effects. The theory of unilateral effects is concerned with establishing whether the merged entity will post-merger, have the ability to increase prices (which equates market power) beyond a competitive level without any constraint by market forces.

74. A co-ordinated effects theory is concerned with the likelihood of the merged firm's ability to co-ordinate its behaviour either tacitly or in a co-ordinated

manner with its competitors post-merger with the objective of avoiding any competition between them.

75. We consider each of the theories in turn.

Unilateral effects

76. It is widely accepted, as argued by the merging parties' expert economists that in commodity or non-differentiated product markets, market shares are a useful indication of the merged entity's likely market power post a horizontal merger. However, in differentiated markets there is ample jurisprudence to the effect that post-merger market shares are not sufficient as an indicator of the merged entity's post-merger market power.

77. Indeed the merging parties and the Commission argue that the post-merger market shares of Aspen which can be gleaned from Table 5 below cannot on their own be construed to mean that Aspen will have market power. This question they say can only be answered by testing the closeness of competition between Aspen and Pfizer given the differentiated nature of the IMF market.

Table 5: Aspen's post-merger market shares by IMF stage and market segment for the period January 2012 – August 2013

Segment	Starter stage	Follow-on stage	GUMs	Overall market
Mainstream	47% - 57%	46% - 54%	56% - 64%	**23%**
Premium	6% - 11%	6% - 12%	5% - 10%	
Speciality	1% - 2%			

Source: Commission analysis based on AC Nielsen data

78. As noted by the Tribunal in the *Massmart/Finromerger, "It is standard practice in differentiated-good markets to determine diversion ratios as a quantitative measure of the closeness of competition between the individual parties to a merger, and to then combine it with information about pre-merger gross*

margins to ultimately through economic modelling predict the potential price-raising consequences of a merger".[7]

79. The logic of diversion ratios as explained by the Tribunal is as follows: *"As the price of goods of Firm A...rises, some customers will shift from Firm A to Firm B...Prior to the merger these revenues would (due to customer diversion) be lost to Firm A. Post merger however Firm A and Firm B have the same owner and thus do not lose these revenues. As a result, the price increase is more profitable to the merged entity".*

80. Applying a framework similar to that described above, the merging parties and the Commission analysed a range of data to assess the extent of competition between Aspen and Pfizer. RBB analysed month-to-month sales share and volume shifts between the merging parties' brands and Nestlé's in both the mainstream and higher-end segments. It also analysed market share shifts between the three participants in the market upon the entry of Infacare Gold. RBB also analysed margins specifically pre- and post the licence period.

81. The Commission analysed market share shifts in the mainstream and higher-end segments and pricing developments in the context of certain market events, specifically the entry of Infacare Gold. The Commission also conducted a margin analysis.

82. We consider these analyses below.

RBB's Diversion Ratio Analysis
Month-to-month sales share/volume shifts

83. RBB conducted month-to-month sales share/volume shifts of the market participants for the period January 2010-January 2013 to determine the extent to which different brands were likely to exert competitive pressure on one another. On the logic described in *Massmart/Finro*, RBB argued that if Aspen and Pfizer are close competitors, then any increase in share/volume sales by

[7] Case no. 04/LM/Jan09.

Aspen's brands should correspond with a market share drop by Pfizer's brands, and *vice versa*.[8]

84. As previously discussed, the Commission and the merging parties did not agree on the classification of S-26 Regular. The Commission regarded it as a mainstream product whereas the merging parties considered it a higher-end product.

85. To address this difference, RBB conducted its analysis on the basis of S-26 Regular being classified on the one hand as a mainstream brand and on the other, as a higher-end brand. According to RBB, the results do not differ materially either way i.e. Aspen and Pfizer are not close competitors of each other.

86. RBB's observation in the mainstream segment is that by and large when Infacare Regular (an Aspen brand) gained market share, Lactogen (a Nestlé brand) lost market share. The opposite held true, when Lactogen gained market share, Infacare Regular lost it. By contrast, there appeared to be very little interaction between Pfizer's mainstream brands and Infacare Gold. RBB's conclusion then was that in the mainstream segment, Aspen's closest competitor was Nestlé not Pfizer.

87. RBB reached the same conclusion in respect of the higher-end segment i.e. that Aspen and Pfizer were not close competitors. In this segment, RBB found that by and large the shift in market share was mainly between NAN's NIDO and its Lactogen brands, with only small changes in the volume shares of Pfizer's S-26 Gold and Pharmaco's Novalac.

88. RBB also conducted an analysis of sales/market share shifts on the entry of Infacare Gold (an Aspen brand) in October 2010 (which as indicated above was launched when Aspen knew the Pfizer licence would not be renewed and thus introduced Infacare Gold to compete with Pfizer's S-26 Gold) and the period subsequently to determine whether Infacare Gold's entry brought with it

[8] According to RBB, month-to-month sales were used in order to differentiate between genuine demand and on-going volatility. RBB also assessed sales volumes and sales share shifts in order to abstract from any changes in sales shares that might be driven by exogenous demand expansions or contractions for particular brands.

a constraining influence specifically on the Pfizer brands. The analysis showed that by 2012 Infacare Gold had achieved a 2% share of the higher-end segment (excluding S-26 Regular). RBB also observed that Infacare Gold's sales were in decline in the period September 2012 to August 2013, having dropped from 2.2% to 0.9% which RBB argued, was inconsistent with Infacare Gold being a competitive force in the market.

89. RBB further observed that declines in Pfizer sales did not correspond with growth in Infacare Gold. This is because in 2011 when Pfizer took over its brands S-26 Regular and S-26 Gold declined by a magnitude of circa 15 000kg per month. In that period, Infacare Gold increased sales by approximately 3000kg. From January 2012 Pfizer's sales increased by *circa* 11 000kg per month while Infacare Gold sales in the corresponding period fell by circa 1 300 kg. RBB concluded that the analysis shows that the decline and growth of Pfizer is driven by factors other than competition from Infacare Gold. Significantly, RBB concluded that Pfizer is not Aspen's closest competitor.

90. RBB's overall conclusion was that this merger was unlikely to change the competitive landscape in the market as Aspen and Pfizer did not exert any competitive constraint on each other pre-merger and were unlikely to do so post-merger. Nestlé, who exercised a constraint on Aspen and Pfizer in the mainstream and higher-end segments respectively would remain to do so post-merger.

The Commission's analysis

91. The Commission conducted a market share analysis *vis-à-vis* corresponding price trends for the mainstream and higher-end segments, and particularly during Infacare Gold's entry.[9]

92. It assessed market share shifts in the period January 2006-July 2013. The Commission noted from this data that in the starter stage (of the higher-end market, since Infacare Gold was introduced to compete in this segment), from

[9] See the record, pages 105 -111.

October 2010 when Infacare Gold was launched both NAN (a Nestlé brand) and S-26 Gold (a Pfizer brand) lost market share, a response which RBB points out, is normal given new volumes in the market from Infacare Gold. The Commission's analysis shows that by July 2011, Infacare Gold had reached a 2.5% market share in the starter segment.

93. Consistent with RBB's analysis, the Commission's analysis shows that from March 2012 S-26 Gold started to gain market share. According to the Commission the market share gain came primarily from NAN who lost market share by approximately 5% and to a lesser extent, from Infacare Gold whose estimated loss was 1%.

94. In the follow-on stage, the Commission assessed market share shifts in the same period (2006-2013) and observed that prior to the licence reversion to Pfizer, there was more direct competition between S-26 Gold and NAN. Post the launch of Infacare Gold there continued to be more direct competition between S-26 Gold and NAN relative to Infacare Gold.

95. In the GUM stages, according to the Commission, Nestlé appeared to be cannibalising its market in the period 2006-2011 with market share shifts occurring between its NAN and NIDO brands, which together account for approximately 90% of the market.

96. According to the Commission, the market share shift that is observed from *circa* May 2011 when Pfizer took over the control of its licence reveals a market share gain by S-26 from less than 1% to approximately 7% in August 2013. This market share gain, according to the Commission, is at the expense of NIDO and/or NAN and less so at the expense of Infacare Gold whose share declines from 2.5% in May 2011 to less than 1% in August 2013.

97. The Commission concluded that although Aspen gained market share in the beginning, its plan to win market share specifically from Pfizer in the higher end segment did not materialise. If anything, the Commission concluded further, NAN's greater market share loss to S-26 compared to Infacare Gold's indicates that NAN and S26 were closer competitors than Infacare Gold is to S-26.

Our conclusions on market-share shift analyses

98. The work of the Commission and RBB on their respective variations of market share shift analyses is not without merit. However, the analyses fail to account for relative size. Nestlé is by far the largest participant in both the mainstream and higher-end segments, with Aspen and Pfizer each a distant second respectively.

99. Comparing Nestlé's 5% loss (in NAN) in market share to Aspen's 1% loss (in Infacare Gold) as the Commission does or comparing the decline and growth of Pfizer's sales volumes with those of Infacare Gold, as RBB does, without adjusting or controlling for Nestlé's significantly large presence in the market does not provide an accurate assessment of the extent of competition between the participants in the market.

100. Mr Murgatroyd could not disagree with this, save to say that ultimately the analysis of unilateral effects turns on closeness of competition between the parties.[10] The analyses have been useful in trying to determine the parameters of competition in the relevant markets, but are not entirely reliable.

Margin Analysis

101. RBB analysed gross margins earned over the financial period 2005-2013 which includes the period pre- and post the licence. RBB explains that it chose to analyse gross margins over prices as the latter can be subjected to external factors, such as an increase in input costs whereas margins are not.

102. According to RBB the licence period provides a natural experiment of the likely state of competition were this merger to be approved since Aspen will have control of its and the Pfizer brands, a situation that existed during the licence period. The logic of the margin analysis is if Aspen and Pfizer are close competitors, then one would expect Aspen to have earned higher margins during the licence period, than post the licence.

[10] See transcript, pages 612 - 616.

103. The analysis done however, according to RBB indicates that there was no reduction in the margins of Aspen's Infacare Regular or Infacare Gold in the post-licence period (2012-2013) compared to the period before. According to RBB, there is also no evidence of a reduction in Nestlé's margins for Lactogen or NAN post the licence period. RBB argues that the lack of a reduction in margins post the licence period is inconsistent with increased competition in that period.

104. Notably, RBB did not analyse Pfizer's margins and explains that the Pfizer margins during the licence period reflected the cost of manufacturing locally whereas post-the licence, the margins were based on transfer pricing, the products having been imported. This limitation in data RBB points out, would render the Pfizer margin analysis meaningless.

105. The Commission also conducted a margin analysis based on Aspen's, Pfizer's and Nestlé's variable margins per brand for the period 2005-2013. The Commission's conclusion from the data was that there was no discernible pattern of margins being higher or lower in the pre-licence period relative to the period post the licence.[11] The Commission however noted that not much stock should be put on this analysis as the data points used are not comparable. For instance, Aspen's margin data was provided on an aggregated basis, Pfizer's was disaggregated and Nestlé's was also disaggregated but did not contain details of specific items that contribute to its variable costs.

106. Nevertheless the overall conclusion reached by the merging parties and the Commission on the margins data was that the proposed merger was unlikely to result in any unilateral effects as the competitive situation post this merger would be no less competitive than that which prevailed during the licence period. Their argument, put differently, is that the lack of a decline in margins post the licence period speaks to the fact that there was no increase in the intensity of competition in the post-licence period.

[11] See Commission's Supplementary Report, page 259 and Appendix C, page 299 of record.

Our conclusions on the margin analysis

107. While we accept the logic of the margin analyses conducted by the Commission and merging parties, the data used in the analysis have limitations which we have already mentioned above.

108. Moreover, the use of margins in the context of this merger also has limitations as it does not take into account the significance of brand development and the associated R&D costs. Mr Murgatroyd could not disagree with the proposition that margins may be an inappropriate data point in assessing the competitive dynamics in the IMF market, given the significant R&D costs which are not covered in margins.[12]

109. Mr Murgatroyd also quite correctly pointed out that the time period over which Aspen's Infacare Gold margins can be observed is too short to properly assess the impact of Infacare Gold's entry in the market.[13] This is because Infacare Gold was introduced in October 2010. The Pfizer licence expired in May 2011. Infacare Gold's margins can therefore only be assessed over approximately eight months which in the context of the IMF market is brief.

110. Indeed the merging parties' arguments on how to assess the competitive effects of this merger using the limited post-licence period of three years fail to take into account the slow pace of developing a brand or new IMF product and gaining traction for it in the market. The approach taken by the merging parties to the competition analysis is therefore not sufficiently forward looking.

The entry of Infacare Gold

111. As per our directive, the Commission assessed the impact of Aspen's entry into the higher-end non-specialty market with Infacare Gold. We have already discussed the Commission's and merging parties' market share shift analysis in the market on the entry of Infacare Gold.

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[12] See transcript, pages 579-580.
[13] See transcript, page 594.

112. As already indicated, Aspen had been the sole licensee for Pfizer from 1993 until May 2011 when Pfizer took over control of its licence. During the licence period, Aspen had control over its Infacare brand and the Pfizer brands. It has already been indicated that the Infacare brand focussed on the mainstream segment while Pfizer's S-26 brands focussed on the high-end segment. In the mainstream segment, the Infacare brands competed with Nestlé's Lactogen brands. In the higher-end segment, the S-26 brands competed with Nestlé's NAN and NIDO brands.

113. According to Mr Saad's testimony, the termination of the Pfizer licence was a big loss to Aspen as the Pfizer brands constituted a material portion of Aspen's revenue. He explained the situation as follows:

> *"So we lost quite a bit of leverage there in the business. So, we left [sic] with the Infacare brand, which does not have margins that those products had. So we had to try and make a plan to try and fill this gap. We needed to fill this gap. We knew the margins were not sitting in the bottom end of the business where we were. We knew that the margins sat at the premium end and it was a real dilemma. Do you come up with a brand with a new name or do we extend Infacare...So we brought out this Nurture product and then we brought out an Infacare and brought out Infacare Gold in the hope of emulating S26 Gold".*[14]

114. Infacare Gold's launch in October 2010 was a few months before the Pfizer licence terminated in May 2011. The evidence of Mr Saad was that Aspen's pricing strategy when launching Infacare Gold was to increase the price of S26 by between 10 and 20% to create a gap in the market for Infacare Gold. The price increase was planned to coincide with the launch of Infacare Gold.

115. Mr Saad explained the rationale for the price increase as follows:

> *"So, the one advantage we thought we could have was to increase the pricing and we hoped by increasing the pricing it would create a gap for*

[14] See transcript, pages 269-270.

our product in the premium section for the introduction of our Infacare Gold product".[15]

116. He said the following about how Aspen's strategy worked:

"You know, initially we thought we had some success, because we got quite good sell-ins. So people like Dis-chem would take the product in. What we found subsequently and what we find today is that we had a good start, but we have not had what we call pull through in our terms".[16]

117. The reason for the failure according to Mr Saad is that Infacare Gold is a brand that's *"trapped in no man's land".*[17] In his view, the market perceived the brand as a mainstream product with the Gold name to it and therefore associated it with the Infacare mainstream products. Mr Saad's evidence was supported by Ms Mda, Ms Bluff and Ms Ahmed as discussed below.

118. We return to the launch of Infacare Gold and its future prospects under the discussion on potential competition below.

Introduction of Infacare Nurture

119. Further to our directive, the Commission also investigated the launch by Aspen of Infacare Nurture. According to Aspen Infacare Nurture was introduced in 2008 to compete with Nestlé in the premium segment across all stages and segments as Aspen perceived a gap in the premium segment. The evidence of Mr Saad regarding Infacare Nurture's performance was that Infacare was a *"non-starter".* Internal Aspen documents indicate that possible reasons for Aspen's failure included a lack of appropriate positioning in the market; unjustifiable premium pricing; and a lack of marketing budget. Mr Saad's evidence was that the brand was more of a premium product than a higher-end product, however consumers did not perceive it as such.

[15] See transcript, page 276.
[16] See transcript, page 272.
[17] See transcript, pages 271 and 273.

120. According to Aspen a decision to withdraw the Infacare Nurture brand was taken in December 2012. The Commission investigated whether the decision could have been motivated by this merger, but found no evidence to support this theory. According to the Commission, Aspen's internal documents show that the brand was failing consistently to meet budget. The Commission believed that the decision to discontinue it was therefore not merger-specific.

Introduction of the Melegi brand

121. According to Mr Saad, Aspen introduced the Melegi brand as part of its efforts in trying to fill the revenue gap arising from the termination of the licence by Pfizer. Prior to Aspen entering this market, Nestlé had been the only supplier of acidified product, which it produced under its Pelargon brand.

122. He explained that prior to the licence termination, Aspen could not put in more capacity based on a licence agreement and not knowing whether that licence would endure or not.[18] In 2010 as part of filling the revenue gap, Aspen decided to develop the Melegi brand in order to supply an acidified infant formula to the government in terms of a tender it had issued.

123. According to Mr Saad the tender market is driven by price.[19] Ms Gilfillan confirmed that in the public hospital sector, the lowest price bid generally wins the tender. Mr Saad's evidence was that Aspen's pricing strategy for Melegi was to price below Nestlé's Pelargon brand, which appears to have worked since Aspen won the tender.

124. According to the Commission the Melegi brand has not had a significant impact in the market as Pelargon still enjoys a 95% market share. Again, the time period of just under three years in our view is too short to assess the long-term impact of the Melegi brand.

[18] See transcript, page 282.
[19] See transcript, page 283.

Potential Competition

125. Potential competition is an issue which competition authorities worldwide have been applying to determine the loss of competition that would arise from a merger in markets which exhibit certain characteristics. The IMF market is characterised by *inter alia* high brand loyalty, product differentiation, strong segmentation, few suppliers, high concentration levels, and high barriers to entry, compounded by stringent regulation.

126. The US DoJ and FTC 2010 Guidelines, UK OFT and CC 2010 merger guidelines, EC 2004 merger guidelines and the ICN 2006 merger guidelines all contain a framework for the assessment of potential competition.

127. In the context of this case, our concern was the possible loss of potential competition in the longer term that would arise from Aspen's acquisition of Pfizer which would result in a three-to-two merger.

128. In assessing the loss of potential competition which may have been existed absent this merger, we took into account international jurisprudence on potential competition. The EC Merger Guidelines of 2004 provide a useful framework in the circumstances of this merger.

129. It states *"For a merger with a potential competitor to have significant anti-competitive effects, two basic conditions must be fulfilled. First, the potential competitor must already exert a significant constraining influence or there must be a significant likelihood that it would grow into an effective competitive force. Evidence that a potential competitor has plans to enter the market in a significant way could help the Commission to reach such a conclusion. Second, there must not be a sufficient number of other potential competitors, which could maintain sufficient competitive pressure after the merger".*

130. Against this framework we assessed the specific market events which have already been discussed above.

Potential competition from Aspen's Infacare Gold and Infacare Nurture brands

131. We have already discussed the circumstances surrounding the launch by Aspen of Infacare Gold into the high-end market segment. There is no doubt on the evidence before us that it was introduced to compete with Pfizer in a market in which Nestlé was the dominant participant. Aspen's strategy documents and the evidence of both Mr Saad and Capazorio are unequivocal on this.

132. The Commission and the merging parties argued that from the perspective of potential competition, there was no evidence that pre-merger, the parties exercised any competitive constraint on each other. They argued that the sales share/volume share and margin analysis indicate the lack of closeness of competition between Aspen and Pfizer. They argued further that there was no evidence that in future Aspen's Infacare Gold was going to become a significant competitive force against Pfizer's relevant brands.

133. We have already discussed the limitations of the market share shift and margin analyses and cannot come to any definitive conclusion on them. In any event, in our view there may be good reasons why historical data are a poor indicator of competitive dynamics in markets where potential competition is concerned.

134. What then do we make of Aspen's entry with Infacare Gold? Mr Saad and Mr Capazorio considered Infacare Gold's entry to have been unsuccessful. As already indicated above, Mr Saad testified that Infacare Gold was a brand that was trapped in no-man's land as it was perceived by customers as a mainstream brand mainly due to its association with the Infacare brand which had historically focussed on the mainstream segment.

135. Mr Capazorio shared this view. He said:

> "*You know our whole heritage is around value for money and I think there was a very strong linkage that customers drew to say, well, you know, Infacare, they are selling cereal boxes, because it's what we sell the Infacare Classics in, is in a cereal box and I don't think they could migrate that concept to this high level scientific formula at the top and*

they sort of dragged it back down into that and they said we would rather buy a NAN or a Pfizer product or a Nestlé premium product than a Gold. I think that's where we...we didn't anticipate it, but it certainly hasn't worked. I mean, if you looked, we have never made budgets. The sales are declining. It's just not working".

136. Ms Bluff, Ms Ahmed and Ms Mda confirmed the view that Infacare Gold was perceived by customers as a lower end IMF product offering. Ms Bluff said: "*Infacare has been a brand that has been associated with the lower LSM's. So, the brand isn't recognisable to the premium market.*"[20] Ms Ahmed said "*...if you look at the Infacare positioning, to me it's a lower level entry brand. The Infacare brand hasn't been successful. I feel it hasn't got the brand equity to move up into a more of a premium product.*"[21] According to Ms Mda "*...we had a product that was called Gold, but we didn't see anything Gold about it*"[22]. The evidence of the witnesses is thus consistent that Infacare Gold was unable to gain market acceptance with consumers.

137. We also asked Mr Saad and Mr Capazorio what Aspen's future plans were with regard to Infacare Gold. They were both unequivocal in their answers. Mr Saad said:

> "*It is a brand that is sort of trapped in the middle. It is not premium and it is not affordable. So, it is a bit of a tricky space for the brand to be in. Would we invest a fortune of money in it to try and get it to another level? Well, I mean my candid answer is no. Why? Because I think there is the easier opportunity is [sic] for Aspen globally in our infant milk formula and in our infant milk formula [sic] business than competing in the segment. We have tried with Nurture. We have not been successful. We have tried with Infacare Gold. We have got a space. A small space, but we have got a space. As I say, it is better than zero, but you know, I would rather go and sell in Nigeria. I would*

[20] See transcript, page 40.
[21] See transcript, page 182.
[22] See transcript, page 493.

rather sell in Kenya. I would rather sell in China. There is plenty of easier markets for us as Aspen to access…"[23].

138. He went on further to say:

"…the Infacare branding, although giving you a section of the market, is not giving you the section of the market that you hope to win over, namely the S26/NAN segment of the market. It's not, we're not there. And it's no use…you don't want to throw good money after bad, you know, you're just not going to keep pushing"[24].

139. Mr Capazorio echoed the same sentiment. He said:

"I think my own philosophy is experience is making the mistake once. We've made it a couple of times and they say if you make a mistake more than once and you keep doing it and making the same mistake, it's the first sign of insanity. So, I think we've learnt our lesson. We're going to stick with Gold it's a good product. It's got its place in the market. We've got a 2% share, but we are certainly not going to invest further money. I think we've invested about R9 million in this last launch. … It will play a maintenance role. I think it makes us money. It covers overheads. It makes a good margin and it is sort of…it was the entrée for our ready-to-drink launch. So, I think that's where we see it, but I don't see a big future in terms of growth etc. It will flatten and maybe a slight decline and hopefully we will try and address that decline, but certainly we would never cull the product. It's a great product. It's just unfortunately associated with the value-for-money segment"[25].

140. On this basis, the merging parties concluded that there is no evidence to show that Aspen's Infacare Gold previously exercised a significant constraining influence on Pfizer in the higher-end segment of the market nor

[23] See transcript, page 273.
[24] See transcript, page 55.
[25] See transcript, page 367.

was there evidence that it would do so in future. According to the parties, there was also no evidence to show that Pfizer would become a competitive constraint in the mainstream segment.

141. The evidence regarding Aspen's Infacare Nurture is that it is a brand that was launched in the high-end segment in 2008, some two years before Aspen received notice in 2010 of the termination of the Pfizer licence in May 2011. According to Mr Saad it was a premium product. In Mr Saad's words, Infacare Nurture was a "non-starter". It did not succeed. A decision was taken in December 2012 to withdraw the brand. We directed the Commission to investigate the withdrawal of Infacare Nurture. According to the Commission it found no evidence to indicate that the decision was motivated by the prospect of this merger, which as at that stage was already on the table.

142. As indicated above, Melegi is a brand that was introduced in an effort to fill the hole that arose when the Pfizer licence was lost. The evidence is that it was developed to compete with NAN's Pelargon brand (a Nestlé brand) in the government tender market and has done so successfully as put by Mr Saad:

    a. *"...we ended up winning quite a bit of chunk of the South African tender, maybe even much more than Nestlé for the first time ever because Nestlé had been unopposed in the South African tender market., because we couldn't put in more capacity based on a licence agreement that we didn't know whether it would or wouldn't endure.."* [26]

Our conclusions on Potential Competition

143. It is clear that the termination of the Pfizer licence spurred a level of competition in the IMF market as evidenced by the introduction by Aspen of the various brands mentioned. However as indicated above, the question from a potential competition perspective is whether the products introduced a) played any constraining role on products already in the market or were likely

[26] See transcript, page 282.

to grow into a competitive force in the market; and b) whether there is sufficient potential competition which would constrain the merged entity's behaviour post-merger.

144. We have already indicated that we are unable to draw any definitive conclusions from the market share shift and margin analyses for the reasons given above. That aside, the evidence of the factual witnesses regarding Infacare Gold's performance in its limited three year period since its launch in the market is that it has not gained market acceptance.

145. According to the Aspen witnesses, Aspen's hope to compete in the higher-end segment has not materialised despite its best efforts. Aspen got the retailers to support its product, which they did to a point, and recently Aspen re-launched Infacare Gold in an attempt to deal with the market perception that it was a mainstream brand. Mr Capazorio's evidence was that despite these efforts, Infacare Gold sales have just *"flattened and [are] effectively going down".*[27]

146. Moreover, the evidence given by Aspen was that it was not going to invest any further in Infacare Gold. According to Aspen's witnesses, Aspen will keep Infacare Gold as a brand as it contributes an income stream which was otherwise not there.[28]

147. We have no basis to doubt Mr Saad's or Mr Capazorio's evidence, save to say that their assessment has been done over a short term in a market which is regarded as slow moving and therefore requires a longer term perspective. Indeed this short term view is incongruent with the position of the parties in the *Nestlé/Pfizer* transaction where they considered 10 years to be a reasonable period to transition the Pfizer brands.

148. Furthermore, Mr Saad's evidence regarding Aspen's plans for transitioning the Pfizer brands should this merger be approved was that [redacted][29].

[27] See transcript page 366.
[28] See transcript, page 275.
[29] See transcript, page 297.

149. Aspen launched Infacare Gold some three years before the merger. This merger was on the table for approximately one year of that three year period which may suggest that assessing Infacare Gold's performance over three years may be generous. Regardless of whether the performance is assessed over three years or less, the period seems unduly short given the slow pace of building traction and effectively competing in the relevant markets.

150. A document that specifically bears mentioning here regarding the plans for Infacare Gold is Aspen's document titled *"Infacare/S-26 Brand Integration Discussion Document 05/08/2013.* The document considers various strategies regarding Aspen's plans for the future pricing and branding options for its brands and those it will acquire from Pfizer.

151. It is interesting to note that one of the options includes merging the S-26 and Infacare brands over time and eventually dropping the S-26 brand. However, we understand that Aspen has subsequently taken a decision not to merge the brands as per the mentioned document, but plans instead [redacted].

152. Again, there is no evidence to contradict the explanation given.

Barriers to Entry and Potential Entry

153. That barriers to entry are high in the IMF markets was not a controversial point in the hearing. Rather, the merging parties and the Commission argued that the barriers to entry were not insurmountable.

154. As mentioned, the identified barriers to entry in the IMF market include: brand loyalty; R&D capability; stringent regulation; and capital costs. We discuss each in turn.

Brand Loyalty

155. We have already discussed the significance of brand in the IMF market. Naturally, brand reputation increases the barriers to entry for a new entrant

with an unknown brand who would have to compete with established heritage brands.

R&D

156. The evidence before us is that R&D is the lifeblood of infant formula. Ms Mda's evidence puts the significance of R&D in perspective. Her evidence was that science is the main driver of Nestlé's business due to the sensitivity of the IMF market. This is because a mother who cannot breastfeed wants the comfort that her baby will not be nutritionally disadvantaged or suffer fatality due to a poorly formulated infant formula. Extensive research therefore goes into finding ways to mimic breastmilk as closely as possible.[30]

157. Abbott and Tiger Brands each also confirmed the importance of R&D.[31]

The Regulatory Environment

158. It is common cause that the IMF market is highly regulated. The World Health Organisation ("WHO") has adopted an international code for the marketing of breast-milk substitutes. The code restricts the promotion and marketing of infant milk formula. The rationale behind the code is to promote breast feeding as research has shown it to be superior to breast-milk substitutes.

159. The Minister of Health published the South African Regulations Relating to Foodstuffs for Infants and Young Children (the so-called Regulation 991) to give effect to the WHO Code. The regulation came into effect on 6 December 2013. Specifically, the regulation limits the ability of IMF manufacturers to communicate the benefits of IMF products to consumers. However, communication to HCPs which is limited to advising on the medical and nutritional value of product is permitted by the regulation.

[30] See transcript, page 479.
[31] See witness statement, page 1542 at par 10.1 of the record and transcript, pages 244 and 454.

160. In terms of this regulation manufacturers and retailers are precluded from promoting brands *inter alia* through offering free samples, discounts, rebates, and kickbacks.

161. The evidence of the witnesses by and large was that Regulation 991 will make it more difficult for new entrants to enter the IMF market as they will not be able to advertise their products directly to consumers. HCP's are therefore going to be the main avenue of introducing consumers to IMF products. According to Ms Mda, the restriction on advertising infant formula for 0-6 months has been in the WHO code since 1981.[32] According to her, Nestlé has voluntarily complied with the code since.

162. It appears from the evidence of Ms Ahmed that although the regulation has only recently come into effect, there has in any event been no promotional activity for the past three years on stages 1 and 2 (starter and follow-on) formula generally by all the participants, with advertising only taking place for stage 3 (GUM) formula. Ms Mda's evidence was that Nestlé does not advertise at all.[33]

163. The witnesses were unanimous that while Regulation 991 will impact on the ability of a new entrant to create awareness of its brand through advertising, there was nonetheless an avenue via HCP's who constitute an important route to market.

164. We understand from the Commission that it has had discussions with the Department of Health ("DOH") regarding the impact of Regulation 991 on competition in the IMF market. While the rationale for the Regulation is clear, there may be unintended consequences for competition. Not only does the regulation raise barriers to entry but it works in favour of the incumbents, especially since brand is important.

165. By way of example, Nestlé testified that in voluntary compliance with the WHO code it has not advertised infant formula since 1981. Indeed the

[32] See transcript, page 482.
[33] See transcript, page 174.

evidence of Ms Ahmed confirms this.[34] According to Ms Ahmed, although Nestlé does not advertise, Clicks was still seeing a consistent growth in the Nestlé brands, in spite of Clicks advertising other brands.[35] Such is the strength of the Nestlé brand.

166. Ms Mda's evidence was that Nestlé welcomed Regulation 991 as it would level the playing field on compliance in that Nestlé's competitors had prior to the regulation been promoting their brands directly to consumers and through retailers, which Nestlé was not doing as a result of its voluntary compliance with the WHO code.

167. She testified further that the regulation would lessen the *"share of voice"* of Nestlé's competitors as they would henceforth only be able to communicate through HCP's, a model which Nestlé had been employing for years.

168. While the playing field will be levelled for Nestlé by Regulation 991, Nestlé itself considers the regulation to be an advantage to it as it will give Nestlé its *"share of voice"* with HCP's whilst lessening that of Nestlé's competitors who have advertised through avenues other than HCP's. This tells us that a new competitor would no doubt be hamstrung in creating awareness of its brand while the incumbents enjoy a competitive advantage.

169. We appreciate the policy imperatives from the DOH which motivated the formulation of Regulation 991, however these policy objectives may inadvertently have an effect on competition in the market. The Commission has advised that it is engaging with the DOH in terms of its advocacy functions to address this issue. We encourage this process and urge the Commission and DOH to jointly find a balance in meeting the policy objectives emanating from their respective governing legislation.

[34] See transcript, page 174.
[35] See transcript, page 179.

170. We now turn to briefly discuss the evidence of Tiger Brands which was given in camera[36] and that of Abbott whom we summonsed to address the issue of barriers to entry.

Tiger Brands

171. We have already extensively covered the significance of brand recognition and loyalty in the IMF market. Both Tiger Brands and Abbott concurred with the evidence before us on this point.

172. Generally speaking new entry in the IMF markets can either take place through imports of IMF products or through local manufacture of these products. If a new entrant decides to take the local manufacture route it could either be *via* a joint venture with for example an existing dairy manufacturer or a start-up operation. Under the joint venture arrangement, the dairy producer for example could supply the base raw material, blend and package it. A start-up operation would require the building of a complete manufacturing unit at a significantly higher cost.

173. As indicated, Tiger Brands' evidence was given in camera. We heard from the two witnesses, Mr Isdale and Ms Ewan. Mr Isdale explained Tiger Brand's entry into the IMF market in 2006. His evidence was that Tiger saw entry into the IMF market as a natural progression from its existing and well-known Purity brand, which was already selling a variety of baby food products and is a strong brand. Tiger Brands entered the mainstream segment of the market with all three ranges of the non-specialty markets through imports. It competed with Nestlé, Pfizer's S-26 and Aspen's Infacare.[37] Its pricing strategy was a [redacted] discount to Nestlé.[38]

174. Tiger Brands' entry seemed a success. According to Ms Ewan, Tiger Brands achieved a market share of approximately [redacted] nationally in approximately

[36] See transcript, pages 439 to 466.
[37] See transcript page 444.
[38] See transcript page 445.

two and a half years. However, despite this success Tiger Brands decided to exit the IMF market in 2008 due to the reasons articulated in camera.[39]

175. We also heard testimony from the two Tiger Brands witnesses mentioned regarding Tiger Brand's potential future entry plans in the IMF markets in South Africa. Based on that evidence, we conclude that potential future entry by Tiger Brands cannot at this stage be excluded.

Abbott

176. We summonsed Abbott as we were interested in assessing the possibility of supply-side substitution or expansion by existing market participants into other segments of the market in the case of a hypothetical price increase post the merger.

177. As indicated, Abbott focusses on the specialty segment of the market which is targeted at infants with medical conditions such as colic, allergies or intolerances to certain ingredients. It competes with Nestlé, Pfizer, Aspen and other numerous smaller participants.

178. According to Ms O'Grady, Abbott supplies non-specialty products in other parts of the world.[40] As to whether Abbott would consider supplying those non-specialty products in South Africa, she said Abbott had looked into this but discounted it as Abbott's speciality area was in specialty formulas. Having said that she also said it was not impossible that this could happen. According to her, there is a possibility of supplying the non-specialty products if the time is right, taking into account Abbott's global investment opportunities.[41]

179. According to Ms O'Grady, the main limitation on Abbott's expansion plans is the uncertainty regarding Regulation 991. She considered Regulation 991 to

[39] See transcript page 446.
[40] See transcript page 247.
[41] See transcript, pages 242-243 and pages 247-248.

be more of a limitation than the exchange rate.[42] She further confirmed that entry through expansion by an existing participant rather than a start-up operation, would be more advantageous both from a cost perspective and relationships with retailers and HCPs.

Retailers' evidence

180. As indicated, the largest route to market for IMF products is through the general food retail channel.

181. Pick n Pay, Clicks and Spar each testified that Aspen's, Pfizer's and Nestlé's brands were *"must-have"* brands. In light of this, we interrogated the extent to which retailers may be price-takers, particularly since they are intermediaries between suppliers and the end consumer. We sought to establish the retailers' negotiating power against suppliers and *inter alia* the extent to which they absorb or pass-on price increases by suppliers to the consumer. We also considered the impact of Regulation 991 on the retailers' negotiations with suppliers.

182. The retailers testified that in as much as infant formula is a "must-have" item, so too is their retail footprint a "must-have" for the suppliers.[43]

183. Of concern to us was the 16% price increase on Pfizer's S-26 Gold brand which, as previously discussed, was introduced by Aspen to create a gap for its Infacare Gold brand. The retailers' acceptance of the price increase seemed to us to indicate a weak bargaining position, or at best, indifference on their part.

184. Mr Arnold was unable to explain how Pick n Pay accepted this price increase as it happened before his time.[44] Ms Peetz was also unable to talk to Spar's negotiations around the 16% increase as price negotiations fall outside her

[42] See transcript, pages 248-249, and also page 255.
[43] See transcript, page 116.
[44] See transcript, page 107.

portfolio.[45] Neither could Ms Ahmed or Mr Sykes talk to the increase from a Clicks' perspective.[46]

185. Mr Saad explained it by saying the retailers were aware that Pfizer would be taking its licence back as Pfizer had already started communicating this to customers. According to him, Aspen did not have a proper cost allocation during the licence period for the Pfizer brand which had been piggybacking on Infacare. With the imminent reversion of the licence back to Pfizer, a proper cost allocation was done and this was explained to the retailers who were sympathetic to Aspen's plight.[47]

186. He explained further that: *"I think also to be absolutely clear on this is that the retailers knew we didn't care. They knew we had four months left and we were going and leaving. ... We were quite happy to go away without S26, without having to promote it at that point"*[48].

187. Mr Buckley was unable to explain exactly when Pfizer became aware of the price increase but testified that the management team at the time knew *"pretty quickly that their prices needed to be adjusted and had to put in place the appropriate strategy..."* To his knowledge no discussions between Aspen and Pfizer took place on the contractual ramifications of Aspen increasing prices as it did.[49]

188. It is unfortunate that none of the retailers could talk to the negotiations relating to the 16% increase by Aspen on Pfizer brands and how this passed muster in their organisations as this may suggest that the retailers are not as strong as they might like to believe.

189. Be that as it may, the evidence from the retailers that is before us is that they pre-merger enjoy a balance of negotiating power with suppliers. At times they

[45] See transcript, page 417.
[46] See transcript, pages 181 and 225.
[47] See transcript, pages 278 and 319-320.
[48] See transcript, page 279.
[49] See transcript, pages 431- 432.

have been able to avoid the price increases and at other times they were able to push back against a price increase.[50]

190. We asked the retailers what the impact of Regulation 991 would be on their negotiations with suppliers given the restriction specifically on retailers offering discounts. The retailers were of the view that to the extent that they were able to negotiate discounts with suppliers, which would then be passed to the consumer in the form of a lower price, this would no longer be the case post Regulation 991. However, this would not impact on their negotiations with suppliers on other variables.

191. While the retailers confirmed that they cannot afford not to stock the main brands, they believed that they still had a relatively strong negotiating position on terms other than price such as shelf space allocation.[51]

192. There is no need however for us to come to a conclusion on countervailing power as it does not affect our ultimate conclusion.

193. Specifically regarding their views on the merger, none of the retailers had any objections. Although in his witness statement Mr Arnold had said the more the number of suppliers the better from a retailer's point of view, in oral evidence his view was that *"...a strong number two would be an ideal situation"*. According to him, a strong competitor against Nestlé who is regarded as the dominant participant was preferable to numerous fragmented participants.

194. Mr Sykes had a different opinion. He said while he accepted that there was merit in having a strong competitor to Nestlé, he preferred to have three to four suppliers instead of two.[52]

Other witnesses' views regarding the merger

[50] See transcript, pages 95-96.
[51] See transcript, pages 185, 99 – 100.
[52] See transcript page 234.

195. None of the other witnesses had any concerns regarding the merger.

196. Ms Bluff, Ms Gilfillan and Ms Ahmed were of the view that the merger would not change anything competitively as consumers generally choose infant formula by brand name, rather than by who the brand owner is. Since the Pfizer brands will remain present in the market post-merger, they had no concerns.[53] Moreover, according to Ms Bluff, the merger simply reverts to the position a few years ago when Aspen manufactured and distributed the Pfizer brands under licence.[54]

197. The above views were also accepted by the Commission in its analysis. However, customer choice is not limited to product availability on shelf. The issue was therefore not only whether both brands would still be available to customers post-merger, but what the effect on price and quality would be given that both brands would be owned by Aspen post-merger. As explained above, we questioned the witnesses on these aspects but found no conclusive evidence that these other dimensions of competition would be negatively affected.

Conclusions regarding unilateral effects

198. We accept as we did in the *Massmart/Finro* merger referred to above, that in differentiated markets it is necessary to assess the closeness of competition between the parties to determine whether the merger is likely to substantially prevent or lessen competition. We accept the Commission's and merging parties' arguments in this regard.

199. The merging parties' volume share diversion ratio on the entry of Infacare Gold shows closer interaction in market share movements between Aspen and Nestlé in the mainstream segment, than between Aspen and Pfizer. Similarly, in the higher-end segment, the diversion ratio shows closer interaction between Aspen and Nestlé than between Aspen and Pfizer.

[53] See transcript, pages 38, 66, 79, 176, 250, 252
[54] See transcript, page 38.

200. The merging parties reached the same conclusion based on the licensing natural experiment which analysed annual gross margins earned for Infacare Regular and Infacare Gold (from 2010 when it was introduced) in the period 2005-2013. They compared margins in the period prior to Pfizer taking control of its brands and margins in 2011-2013 when Pfizer had control of the brands. They observed no reduction in Aspen's margins and concluded that the Aspen and Pfizer brands were not close competitors.

201. The Commission analysed the merging parties' variable margins, including Nestlé's in the period 2005-2013 and observed no reduction in margins post-the entry of the Pfizer brands independently in 2011.

202. We have described the limitations of the data analyses relied on by both the Commission and the merging parties. We are unable to draw any definitive conclusions from it. Be that as it may, we have no empirical evidence before us to show that the merger is likely to lead to unilateral effects that will substantially prevent or lessen competition.

203. The assessment of the impact of the market events discussed on the potential competition between the merging parties has also not revealed any compelling evidence that the proposed merger from a potential competition perspective will substantially prevent or lessen competition. While the termination of the Pfizer licence seems to have induced a competitive response in the relevant markets, we do not have sufficient evidence to show that responses were competitively significant.

204. As imperfect as the volume share shifts and margin analyses done by the Commission and merging parties are, we do not have sufficient evidence to conclusively find that Aspen's entry into the higher-end segment exercised a significant constraint on Pfizer or on the market leader, Nestlé.

205. Nor is there evidence that Aspen's Infacare Gold or Infacare Nurture was likely to grow into an effective competitive force. We have traversed the evidence of Mr Saad and Mr Capazorio in this regard. We have no evidence

to the contrary. The evidence before us therefore fails to show that the potential competitor exercises a competitive constraint in the market or is likely to do so in future.

206. [redacted]

207. Furthermore, Mr Isdale's evidence was unequivocal that any plans that Tiger Brands' may have are not dependent on it acquiring the Pfizer brands.

208. Furthermore, as discussed more fully above none of the witnesses had any concerns regarding the merger.

209. In the absence of evidence of closeness of competition between Aspen and Pfizer, imperfect as the evidence might be; the absence of evidence that Infacare Gold exercised a significant constraint on S-26 Gold or would do so in the future, also imperfect as it might be for the reasons discussed above; the sufficiently credible threat of potential entry by Tiger Brands; we are unable to find that the proposed merger will lead to significant unilateral effects.

Co-ordinated Effects

[55] See the evidence of Ms Ewan, transcript at page 455.
[56] See transcript, page 456.

210. In our directive to the Commission, we had also requested the Commission to further investigate the impact of the proposed merger on the ability of the participants in the market to co-ordinate their conduct post-merger given that the transaction will result in effect in a duopoly market structure in certain IMF markets. We directed the Commission to analyse *inter alia* market shares, prices and margins over a specified period spanning the licence period and the post-licence period to determine whether the mentioned data points were higher or lower during the duopoly period as opposed to the period when Pfizer operated independently, post the licence.

211. The Commission and RBB contended that the characteristics of the relevant IMF markets are not amenable to tacit co-ordination. The Commission, relying on the ICN merger guidelines set out the following conditions as pre-requisites for successful co-ordination:

a. The firms involved must be able to tacitly identify the terms of co-ordination (be it prices charged, quantities produced or other dimensions of competition) and to reach a common understanding on what the terms should be.

b. It must be costly for the firms to deviate from the agreed understanding. In other words the firms involved in the co-ordination must be able to identify deviations from the agreed understanding (the monitoring aspect) and also be able to respond by punishing the cheating firm (the punishment aspect).

c. The competitive constraint by non-coordinating firms should be weak.

212. RBB utilised a framework similar to the one above, relying on the EC decision in the *Airtours/First Choice*[57] matter, with the exception that it also considered whether the prospects of co-ordination were merger specific. The

[57] See the Court of First Instance decision, Case T – 342/99, Airtours plc v Commission of the European Communities.

Commission and RBB concluded that co-ordination is unlikely given the market characteristics discussed below:

a. Due to the significant differentiation between Aspen's, Pfizer's and Nestlé's products a strategy of co-ordination would be difficult to formulate as the parties would have to develop a methodology first of all, to factor in differences such as product formulations for e.g. between NAN and S-26 as well as pricing levels between the two (where S-26 is priced at a premium to Nestlé) and to then work out e.g. what prices to charge to avoid competition between the respective products.

b. Factors that drive competition in the relevant markets are mostly intangible and include recommendations by family, friends, HCPs and brand reputation. A strategy of co-ordination would therefore be undermined by these intangible factors. Mr Murgatroyd explained that these intangible parameters of competition are slow moving in that *"...you can't essentially go overnight from having a strong brand to a very weak brand"*, or *"...go overnight from having very poor HCP recognition to having very good HCP recognition.*[58]

c. Since successful co-ordination requires that the firms involved must be able to identify deviations from the agreed understanding and then punish the cheating firm, the intangible parameters described make it, according to the merging parties difficult for firms in the first place, to monitor deviations from the agreed conduct. This is because it would be difficult e.g. to detect attempts by a party to the co-ordination strategy to influence HCPs to promote its brand over that of a competitor, given how slowly the HCP parameter moves. If detected, it would be after a long time. Unable to monitor such a deviation, the firms would not be able to adjust their behaviour quickly enough to punish the cheating firm.

[58] See transcript, page 652.

d. RBB added that the merger will not change the features of the market listed above.

213. The Commission also concluded from its analysis of market share shifts (discussed above) that sales shares were no less or more volatile during the licence period than post-the licence period. RBB reached the same conclusion.

214. The Commission and RBB also concluded that there was no evidence of parallel pricing during the licence period or after. Therefore it was unlikely that the proposed transaction would lead to co-ordinated effects post-merger.

215. The Commission also considered the possibility of a market allocation strategy whereby Nestlé would supply the retail channel where it has a stronghold and Aspen the pharmacy channel, Aspen's stronghold. However, the Commission concluded that such a strategy would be unlikely given the strategic importance of the pharmacy channel in introducing consumers to infant formula. Nestlé would be unlikely to agree to forego the opportunity to gain an introduction to consumers which the pharmacy market offers.

216. Similarly, the Commission considered and concluded that it was unlikely that Nestlé and Aspen would agree to focus on the higher-end and mainstream segments respectively as Aspen has made a significant investment in acquiring the Pfizer brands which Aspen intends to use to compete with Nestlé in the higher-end segment, as Aspen perceives this segment to yield higher margins.

217. Moreover, the Commission and the merging parties argued that the post-merger market share asymmetry between Nestlé and Aspen makes a strategy of tacit or co-ordinated behaviour unlikely.

218. We asked Mr Saad if it would not make commercial sense for Aspen being the second participant in a duopolistic market post-merger, to simply rely on Nestlé to put prices up and then for Aspen to follow. He said: *"...if we sit in a cosy relationship, we would not...what we as Aspen aspire to is to get to a*

number one position. So that's not the status quo".[59] *Why should you believe that? Well what we have we demonstrated to you as a company in pharmaceuticals, we could have sat in many cosy relationships, we do thousands of ...we've been involved in tenders, we're involved in the private sector across both markets from no base we've gone to number one point and that's ...even in Australia, we're number one in pharmaceuticals.*[60]

219. Further on he said: *"We believe we are offering a proper competitive environment, we're not fighting with one hand behind our back, which has been the history of our duopoly in the market. We've also in the duopoly never sat...we could have sat in a cosy arrangement, as you discussed it, we've never done that. So I don't think anything in our make-up or anything in the way we've transacted should ever give you the impression..."*[61]

220. Whether we believe Mr Saad's evidence or not there must be evidence before us to support a theory of competitive harm. We have no evidence before us to that effect.

Pro-competitive gains

221. The merging parties claimed that the merger will result in pro-competitive gains in the form of increased economies of scale; which in turn will result in cost savings that will enable Aspen to compete more effectively against Nestlé.

222. The scale economies as we understand will come from utilising the spare capacity of Aspen which will be used to manufacture product locally as opposed to importing it, as was the case with the Pfizer brands post the licence period. According to the merging parties, the benefits of local manufacture include increased downstream domestic activity in the form of local procurement of *inter alia* cans and labels; and employment.

223. Mr Saad was highly optimistic regarding Aspen's competitive strength post-the merger. According to him, the increased volumes will enable Aspen to

[59] See transcript, page 333 and 334.
[60] See transcript, page 334.
[61] See transcript, page 333-336.

compete globally.[62] At a local level, the volumes will enable Aspen to compete with Nestlé who have a strong market presence and volumes both in the higher-end and mainstream segments. According to Mr Saad the increased volumes from the merger will *"...help us to get some parity to be able to compete, not just in the affordable section of the market, but in the premium section, the tender section and ...into Sub-Saharan Africa..."*[63]

224. As indicated, Aspen expects certain costs savings to arise from the increased volumes. The increased volumes, submitted RBB will enable Aspen to spread its fixed costs over larger volumes while also benefitting from a reduction in variable costs, which will come mainly from savings in local procurement.

225. However, the Commission did not do any evaluation of the alleged efficiencies as its conclusion was that the merger was unlikely to substantially prevent or lessen competition. As we have ultimately come to the conclusion that there is not sufficient evidence before us of a substantial prevention or lessening of competition, we do not consider the merging parties' alleged efficiencies any further.

Public Interest

226. According to the merging parties there will be no adverse effect on employment as a result of the proposed transaction. A condition of approval in our order in the *Nestlé/Pfizer* transaction was that the Pfizer employees must be transferred to the purchaser of the Pfizer business. The merging parties confirmed that this will be the case.

227. In addition, the merging parties submitted that as a result of their plans to manufacture the Pfizer brands locally, 30 jobs will be created.

We conclude that the proposed transaction will have no adverse effects on the public interest.

[62] See transcript, page 263.
[63] See transcript, pages 282-283.

CONCLUSION

228. We have not been presented with any evidence that the proposed transaction will result in unilateral effects (market power in the hands of Aspen) or in co-ordinated effects. While the evidence presented to us in favour of the merger is not entirely robust, we do not have sufficient evidence to the contrary. Specifically, we do not have sufficient evidence that the proposed merger from a potential competition perspective will substantially prevent or lessen competition.

229. Moreover, the proposed transaction does not raise any public interest concerns.

230. We therefore approve the transaction unconditionally.

MONDO MAZWAI **24 March 2014**
DATE

Andreas Wessels and Imraan Valodia concurring

Tribunal Researcher:	Rietsie Badenhorst
For Aspen:	Adv D Unterhalter SC and Adv J Wilson, instructed by Fasken Martineau and Edward Nathan Sonnenberg
For Pfizer:	Bowman Gilfillan
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