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Syngenta/Monsanto Sunflower Seeds – More Analysis, Please

Frederic Depoortere (Skadden, Belgium) · Monday, March 21st, 2011

The European Commission's Phase II decision of 17 November 2010 concerning Syngenta's acquisition of Monsanto's sunflower seeds business raises a number of questions.

First, it took the European authorities long to decide who should review the case. The transaction was signed in August 2009 – it did not have an EU dimension and was notifiable only in Spain and Hungary. The Spanish Comisión Nacional de la Competencia or CNC received the notification on 19 August 2009. Only on 1 October did the Commission receive the CNC's request for a referral of the case to the Commission, more than two weeks after the 15 working days post-notification deadline. The CNC argued that it had suspended the running of its own deadline to gather more information to verify whether a request for referral was justified. The Commission accepted the late request and considered that "a suspension of national time limits with a view to obtaining information necessary for the national competition authority to decide on whether an Article 22 request is justified suspends the time period of 15 working days laid down in Article 22." Note that Article 22 of the Merger Regulation does not mention the possibility of a suspension of the 15-day period.

The Hungarian authority sent its own request on 14 October. The Commission finally accepted the referral request on 12 November 2009, almost three months after Syngenta submitted its original notification to the CNC.

The Commission's Decision itself appears to be based mainly on a structural approach to the marketplace for sunflower seeds in Spain and Hungary. The Commission's main objections are that (i) post-merger, Syngenta's pool of seed varieties (its germplasm portfolio) would be too large compared to that of most competitors and (ii) that the combined firm would have a high share in the market for seed commercialisation in the two countries.

The first concern is based on the finding that there is a "common and generalised practice in the seed industry of exchanging and licensing genetic material between seed companies and between seed companies and public research institutes." The problem identified in the Decision is that "companies characterized by high market shares in the commercialisation markets, namely Syngenta and [its largest downstream competitor] Pioneer, are conversely less represented in the upstream licensing market than their market share in the downstream markets for commercialisation would suggest."

The Commission found that as a result of the transaction, Syngenta would have the ability and incentive to reduce its licensing activities to its competitors downstream or request higher royalty

fees. This despite the fact that, according to the Decision, pre-merger Syngenta (already the largest downstream player) represented 10-20% of the royalty fees received for outlicensing seed varieties, only slightly less than the largest licensor, Monsanto (15-25%) and in the same range as Novi Sad, Limagrain and Euralis.

While the decision discusses why Syngenta would have the ability and incentive to reduce licensing or increase fees, it could have provided more detail concerning the basis for its conclusion that this would result in the foreclosure of downstream competitors. According to the Commission, the merged firm would have “the largest and broadest germplasm portfolio in the Union” and become the “most important breeder.” However, based on the data described in the Decision, competitors represented more than 50% of royalty fees paid for outlicensing, including an R&D joint venture between Limagrain and Euralis which together represented a higher share than Monsanto. The Decision does not discuss whether, as a result of a reduction in licensing by the merged firm, smaller competitors could react and would have the incentive to increase their licensing activities. The Decision also does not suggest that the merged firm would have unique or must-have seed varieties, to which its competitors need to have access in order to remain competitive and whose disappearance from the licensing market could not be compensated by an increase in licensing of competing varieties. Last, it is not clear why an increase in royalty fees would necessarily lead to downstream foreclosure, as the effects of a possible royalty increase are not discussed. As an aside, the conclusion that royalty increases are “likely” appears to be based only on the statements of “some competitors.” Again, more analysis and/or stronger evidence would have been desirable.

Similar questions can be raised in relation to the discussion of competitive effects on the downstream market for commercialisation of sunflower seeds in Spain and Hungary. The Decision provides a detailed overview of the shares of the parties and their competitors, calculated in a number of different ways and for a number of different segments. Combined shares are high in some segments and it is clear from the Decision that Syngenta is probably the strongest player in these countries and Monsanto is one of its close and significant rivals. The Decision adds that Pioneer is also a large competitor and that there are a number of other smaller players.

While the description of the market structure is relatively detailed, the analysis of the transaction’s effects is not.

For Spain, the discussion of the competitive effects is very short. The Decision states that about half of the customers and a number of competitors who replied to the market investigation expressed concerns about the effects of the transaction, in terms of possible price increases, reduction in customer choice and innovation. In addition, given the parties’ high combined shares and level of vertical integration, there was concern that they would have the ability to block new entry. However, this is where the analysis stops. There is no discussion as to whether customers could counteract price increases by switching at least part of their demand to the parties’ competitors. The Decision also does not analyze whether the remaining competitors face any barriers preventing them from expanding output in the face of increased demand of customers. Instead, and judging from the text of the Decision, the conclusion that the transaction will have anticompetitive effects appears to be based exclusively on market shares and statements by customers and competitors.

For Hungary, the analysis of the transaction’s effects is worded in similarly general terms. Admittedly, one additional element is available for Hungary that provides more weight to the

analysis: given that the transaction had already been implemented during the Commission's investigation, the Commission could observe that after the closing, Syngenta had removed a number of Monsanto products from the market. But again, the Decision provides no discussion of possible demand-side or supply-side reactions to any anticompetitive behaviour by the parties.

The Decision also argues that entry is difficult, given that a new entrant would need access to seed varieties specifically developed for local conditions in Spain or Hungary. On the other hand, when the parties offered to divest Monsanto's business in Spain and Hungary, the Commission concluded that the buyer of the divestiture package should also be able to use the products in the rest of the EU as well as Turkey, Russia and the Ukraine, given the similar agro-climatological conditions between Spain and Turkey and between Hungary, Russia and the Ukraine and the similarities in the seed varieties used in those countries. Merely on the face of these arguments, it can be asked why the Decision does not contain an analysis of potential new entry from competitors in Turkey, Russia and the Ukraine into Spain and Hungary.

Based on the facts and the market structure described in the Decision, it is not inconceivable that the proposed transaction could have resulted in anticompetitive effects and that remedies were warranted. However, the Decision contains very little analysis of actual effects or why adverse effects are likely and could not be counteracted by other market players. The Decision appears to be based mainly or exclusively on responses received from third parties, and does not mention any economic (let alone quantitative) evidence supporting those statements or the Commission's conclusions derived therefrom. It is not clear from the Decision whether such evidence was gathered. If it was, it would have been preferable to discuss it in the Decision. If not, it should have been, especially given the length of the Phase II proceedings.

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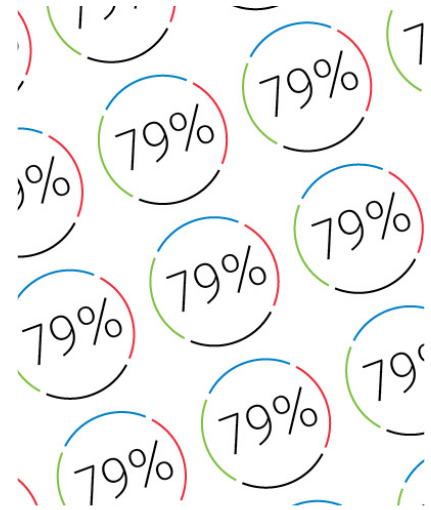
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