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Merger of Baxter Healthcare and Fannin Compounding

by **Marco Hickey**

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A Rare, and Successful, Application of a "Failing Firm" Defence

Introduction

The Competition and Consumer Protection Commission (CCPC) has approved Baxter Healthcare's proposed acquisition of Fannin Compounding.

The CCPC's Determination is a rare application of the so-called "failing firm" defence in accordance with section 9 of the CCPC's Guidelines for Merger Analysis. The CCPC accepted that Fannin Compounding and its associated assets were likely to exit the market if the proposed acquisition by Baxter was prohibited. According to the parties, Fannin Compounding had suffered historical and ongoing financial losses. In January 2015, DCC appointed PWC to find a suitable purchaser through a bid process and Baxter, its main competitor, was the only entity that submitted an acceptable bid.

The proposed transaction saw Baxter Healthcare Limited (Baxter) seek to acquire sole control of certain assets (the Target Assets) of Fannin Limited (Fannin). Fannin was controlled by DCC plc (DCC), an international sales, marketing, distribution and business support services group. The Target Assets consist of the assets that Fannin used exclusively in the manufacture and supply of aseptically prepared compounded medicines (Fannin Compounding).

Competitive Analysis

The CCPC's competitive analysis revealed significant horizontal overlap between Baxter and Fannin Compounding in the State with respect to the commercial supply of compounded chemotherapy medicines. Indeed, Baxter and Fannin Compounding were the only suppliers active in the State and, following the proposed transaction, Baxter will be the sole commercial supplier in the State.

Failing firm or division defence

Fannin Compounding's share of the supply of compounded chemotherapy medicines in the State declined from 40-45% in 2011 to 30-35% in 2014. According to the parties, this decline was partly attributable to Fannin Compounding's decision to prioritise other contracts which led to a significant number of operational issues in Fannin's compounding facility. A number of hospitals changed to a dual-supplier strategy, i.e. sourcing from both Fannin and Baxter, as a result of these issues.

The failing firm/division argument is a defence based on a counterfactual where the target firm and its assets would exit the market if the proposed transaction did not proceed. It provides a defence to a merger that would otherwise lead to a substantial lessening of competition. The onus rests with the merging parties to demonstrate that the firm meets the failing firm/division test by providing objective and detailed evidence to substantiate its argument.

There are four elements to the CCPC's failing division test:

1. The division must be unable to meet its financial obligations in the near future.

Fannin was ultimately owned by DCC, so a strict interpretation of this element of the failing division test would focus solely on whether DCC has the ability to continue supporting Fannin Compounding without jeopardising its financial survival. The CCPC considered that a more sensible approach, in this context, was to assess whether DCC had both the ability and incentive to meet Fannin Compounding's financial obligations in the near future; the CCPC here refers to the European Commission's approach in [COMP/M.6360 Nynas/Shell/Harburg Refinery](#). Based on all the available evidence, including the expert opinion of Grant Thornton, the CCPC accepted DCC's argument that there was no prospect of returning Fannin Compounding to profitability in the near future. It was therefore deemed economically rational for DCC to shut down Fannin Compounding in the absence of the proposed transaction.

2. There must be no viable prospect of reorganising the business through the process of receivership, examinership or otherwise.

Grant Thornton provided the CCPC with an expert opinion to the effect that Fannin Compounding's difficulties were not related to its balance sheet position and that examinership was not a viable option for Fannin Compounding.

3. The assets of the failing firm would exit the relevant market in the absence of a merger transaction.

DCC internal documents were relied on by the CCPC in concluding that it was highly likely that Fannin Compounding would close without the proposed transaction and that the assets would exit the relevant market if not acquired by Baxter.

4. There is no credible alternative outcome, which would be less anti-competitive, than the proposed merger.

In January 2015, Fannin appointed PWC to advise on and manage a sale process for Fannin Compounding. The CCPC interviewed representatives from third parties identified as potentially being interested in acquiring Fannin Compounding and concluded that Baxter is most likely to be the only undertaking that is seriously interested in acquiring Fannin Compounding. As a result, the CCPC concluded that there is no credible alternative outcome, which would be less anti-competitive, to the proposed transaction.

Conclusion

The CCPC also considered there to be credible reasons to believe that the competitive structure of the market was likely to deteriorate to an even greater extent in the absence of the proposed transaction. The CCPC considered that, in the absence of the proposed transaction, there would be a relatively significant reduction in supply capacity in the State for compounded medicines, which would be likely to lead to an increase in prices.

This Determination represents a rare example of the failing firm defence in Ireland or the European Union. The Determination allows Baxter to acquire the remaining 30-35% of the market held by Fannin, which amounts to transforming the market from duopoly into a monopoly. Moreover, the detail that is provided in the Determination is most welcome and will be very useful when considering any future potential applications of this provision. It shows that acquisitions of struggling businesses may be capable of obtaining competition clearance, even where large market shares may arise, if the acquisition meets the CCPC's criteria in relation to the failing firm/division defence.

For more information or clarification on any of the views expressed above, please feel free to contact [Marco Hickey](#), Partner and Head of the EU, Competition and Regulated Markets Team at mhickey@lkshields.ie. Marco is the author of [Merger Control in Ireland](#) published by Thomson Reuters.

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