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COMMERCE COMMISSION

Decision No. 594

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

Johnson & Johnson

and

Pfizer Consumer Healthcare

The Commission:	David Caygill Donal Curtin Anita Mazzoleni
Summary of Application:	The acquisition by Johnson & Johnson of the Consumer Healthcare division of Pfizer Inc.
Determination:	Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
Date of Determination:	8 December 2006

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 was registered on 29 September 2006. The Notice sought clearance for the acquisition by Johnson & Johnson (J&J) of the stock, assets and business of the Consumer Healthcare division of Pfizer Inc (PCH).This was a global acquisition and clearance was sought from the Commission for markets that might be affected in New Zealand.

2. The Commission considered the relevant markets in this proposed acquisition to be the national markets for over-the-counter (OTC):

   - antifungal treatments; ("antifungal market");
   - allergy relief medications; ("allergy market");
   - worm treatments; and ("worm treatment market"); and
   - smoking cessation products ("smoking cessation market").

3. The Commission considers the likely counterfactual scenario would be that PCH is sold to a third party, assuming that the third party's acquisition would not give rise to a substantial lessening of competition.

4. In respect of both the antifungal and allergy markets the Commission is of the view that given the number of existing competitors in the market, the proposed acquisition is unlikely to result in a substantial lessening of competition in the factual scenario compared to the counterfactual scenario.

5. In the worm treatment market, the proposed acquisition would reduce the number of suppliers from three to two. Post-acquisition, however, the combined entity would be constrained by Multichem, an existing competitor, and by potential competition.

6. In the smoking cessation market, J&J would acquire two nicotine replacement therapy (NRT) brands, Nicorrette and Nictrol from PCH. Both brands sell NRT patches and gums. Post-acquisition, J&J would also through its existing subsidiary, ALZA, manufacture NRT patches which would then be supplied to GlaxoSmithKline (GSK) in New Zealand. GSK markets these NRT patches in New Zealand, under the Nicabate brand.

7. The Commission concludes that post-acquisition, the fact that J&J would acquire two NRT brands and would also be supplying a competitor in that market, namely GSK, there would be a loss of competition. As compared to the counterfactual, GSK's ability to compete would be reduced although the Commission found that the extent to which GSK's ability to compete would be reduced is unclear.

8. However, the Commission found that in the factual, J&J would be constrained by Novartis, a significant existing competitor and by PHARMAC in its role as a significant purchaser of subsidised NRT products. Therefore, it was not necessary for the Commission to conclude on the constraint that would be provided by GSK, as it considered that the constraint provided by Novartis and PHARMAC would be sufficient to prevent a substantial lessening of competition in the smoking cessation market.

9. The Commission is therefore satisfied that the proposed acquisition would not have, or be likely to have, the effect of substantially lessening competition in any of the affected markets.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 29 September 2006. The notice sought clearance for the acquisition by Johnson & Johnson of the stock, assets and business of the Consumer Healthcare division of Pfizer Inc. This was a global acquisition and clearance was sought from the Commission for markets that might be affected in New Zealand.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. Extensions of time were agreed between the Commission and the Applicant and a decision on the Application was made on 8 December 2006.

3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.[1]

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal would substantially lessen, or be likely to have the effect of substantially lessening, competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held;

> We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.[3]

7. In determining whether there is a change along the spectrum which is significant the Commission must identify a real lessening of competition that is not minimal.[4] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of

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[1] Commerce Commission, *Mergers and Acquisitions Guidelines, January 2004*.
[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.
[3] *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.
[4] Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

competition and the creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price or on non-price dimensions of competition, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any given case.

9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to access whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:

    - with the acquisition in question (the factual); and
    - in the absence of the acquisition (the counterfactual).

11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:

    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or supplies.

THE PARTIES

Johnson & Johnson (J&J)

12. J&J is the parent company of a global group of companies. J&J's activities are divided into three business segments: consumer; pharmaceutical; and medical devices and diagnostics.

13. In New Zealand, the consumer and medical devices businesses are operated out of one local J&J company, Johnson & Johnson (New Zealand) Limited, and the pharmaceutical division is operated out of Janssen-Cilag Pty Limited, an Australian company.

14. In 2005, J&J achieved a worldwide turnover of approximately US $50 billion.

15. In 2001 J&J acquired Alza Corporation. Alza is a wholly owed subsidiary of J&J, based in the US. It develops and manufactures transdermal drug delivery patches, including a nicotine patch.

Pfizer Inc.

16. Pfizer Inc. is a global pharmaceutical company that develops, manufactures and sells drugs for human and animal consumption as well as other consumer healthcare products.

17. The business that is being sold is the entire worldwide operations of Pfizer Consumer Healthcare (PCH) which is involved in consumer healthcare and OTC pharmaceutical products. In New Zealand, Pfizer Inc. operates as Pfizer New Zealand Limited.

18. In 2005, PCH achieved a worldwide turnover of approximately US $3.9 billion.

OTHER PARTIES

Manufacturers and Suppliers

GlaxoSmithKline PLC (GSK)

19. GSK is a large international manufacturer and distributor of prescription medicines and consumer healthcare products.

20. In New Zealand, GSK operates two separate divisions, GlaxoSmithKline Pharmaceuticals, which handles prescription medicines and GlaxoSmithKline Consumer Healthcare, which handles OTC medicines and grocery items, such as Panadol.

Novartis

21. Novartis is an international manufacturer and distributor, with core businesses in:

    - pharmaceuticals;
    - consumer health;
    - animal health.

22. Novartis was created in 1996 from the merger of the Swiss companies, Ciba-Geigy and Sandoz and now operates in more than 140 countries.

Other manufactures and suppliers

23. In addition to the suppliers listed above, there are a number of other suppliers of consumer health products. Some other suppliers in New Zealand include

    - Multichem Limtied;
    - Pacific Pharmaceuticals;
    - AFT Pharmaceuticals (AFT);
    - Douglas Pharmaceuticals; and
    - Procter & Gamble (P&G).

Regulatory Organisations

Medsafe

24. Medsafe is the New Zealand Medicines and Medical Devices Safety Authority. It is a business unit of the Ministry of Health and is the authority responsible for the regulation of therapeutic products in New Zealand.

PHARMAC

25. PHARMAC, the Pharmaceutical Management Agency, is a Crown entity established by the New Zealand Public Health and Disability Act 2000. The Agency is directly accountable to the Minister of Health. PHARMAC manages the "purchase" of a list of subsidised pharmaceuticals, the Pharmaceutical Schedule, on behalf of the Crown. Pharmaceutical suppliers may apply to PHARMAC to have a medicine listed on the Pharmaceutical Schedule for subsidy, usually following Ministry of Health approval of the product. Decisions on listing, subsidy levels, and prescribing guidelines and conditions, are made by the PHARMAC Board with input from independent medical experts.

INDUSTRY BACKGROUND

26. Medicines in New Zealand are generally divided into two categories: prescription and OTC medicines. Prescription medicines, as defined by Part 1 of Schedule 1 of the Medicines Regulations 1984, are only available from a pharmacy with a prescription from a doctor.

27. The proposed acquisition does not involve any prescription products. Accordingly, this category of products is not relevant to the present application.

28. OTC products fall into three categories determined by the degree of regulation imposed. These are:

    - **restricted medicines** which are medicines that can be sold under the direction of a pharmacist without a doctor's prescription but are not available for self-selection from the pharmacy shelves. Further, the sale must be made by a pharmacist. When selling these medicines, the pharmacist must fulfil certain requirements designed to ensure the consumer is properly informed about the safe and correct use of the medicine;
    - **pharmacy-only medicines** which are medicines that can only be sold through the pharmacy channel, but may be self-selected by end-users;
    - **'open' medicines** which can be sold in any retail outlet, such as pharmacies, supermarkets, service stations and department stores.

29. In this proposed acquisition there is an aggregation in the supply of the following OTC products:

    - antifungal treatment;
    - allergy relief medications;
    - worm treatment; and
    - smoking cessation products.

30. J&J and Pfizer had a number of other similar products, but these are distributed in different countries. Therefore the Commission is satisfied that the above four areas are the only areas of aggregation.

31. The majority of these products are sold in pharmacies and are predominately supplied to pharmacies through:

    - wholesalers such as Pro Pharma; or
    - a company's own sales representatives and distribution channels.

32. There are approximately 900 pharmacies in New Zealand. Most are independent operators although there is now an increasing trend for pharmacies to affiliate themselves with a buying group or banner group. The main banner groups include:

    - Amcal;
    - Unichem;
    - Radius; and
    - Life pharmacies.

PREVIOUS COMMISSION DECISIONS

33. The Commission previously considered the pharmaceutical industry in *Decision 567: Reckitt Benckiser PLC and Boots Healthcare International Limited, November 2005.*

34. In Decision 567 the Commission considered the relevant markets to be the national markets for the wholesale distribution of:

    - analgesics;
    - cold preparations;
    - throat preparations; and
    - antiseptics.

35. The Commission granted clearance for the acquisition on the basis that it would give rise to only minimal aggregation and that the combined entity would be constrained, in all relevant markets, by the strength of the existing competition.

MARKET DEFINITION

36. The Act defines a market as: "… a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them."[5]

37. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximizing, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Dimension

38. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.

39. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative (quality adjusted) prices.

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[5] Commerce Act 1986, s 3(1).

40. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change in relative prices.

41. The Applicant submitted that in New Zealand, the proposed acquisition would give rise to horizontal aggregation in the following three markets:

    - non-prescription allergy medication;
    - non-prescription products for the treatment of worms; and
    - non-prescription thrush treatments.

Over-the-Counter (OTC) Medicines

42. Although a doctor can prescribe OTC medicines, these are generally not substitutable for prescription-only medicines for three main reasons:

    - **Severity**. Prescription-only medicines are typically used to treat more severe illnesses than OTC medicines.
    - **Clinical Risk**. In instances where prescription-only and OTC medicines are indicated for the treatment of the same ailment, generally prescription-only medications are used only when OTC products have failed to provide relief. Prescription-only medications are often used in this way, as a 'measure of last resort', as these typically carry a greater level of clinical risk (i.e., contraindications, interaction with other medicines, and risk of overdose).
    - **Regulation**. Given the higher clinical risks associated with prescription-only products, these are generally more heavily regulated than OTC products. For example, Medsafe classifies OTC products as 'low-risk medicines'. The registration fees and clinical data requirements for these are significantly lower than those for prescription-only products ('high-' or 'intermediate-risk' medicines).[6] Further, OTC products are more accessible to consumers as these may either be self-selected or sold through pharmacist-referral. In contrast, prescription-only products can only be accessed on the advice of a medical doctor.

43. For these reasons, the Commission concludes that OTC products do not compete with prescription-only medicines, and therefore defined the latter as falling outside the boundaries of the markets relevant to the present Application. This is consistent with the Commission's approach in *Decision 567: Reckitt Benckiser & Boots Healthcare International Limited.*

Antifungal Treatments

44. Both J&J and PCH supply in New Zealand OTC medicines for the treatment of yeast and fungal infections such as tinea (e.g., athlete's foot), ringworm, or candidiasis (thrush).

45. Fungal and yeast infections can affect almost any part of the body, including external skin, nails, organs, mouth, throat and vagina. Antifungal medications work by killing the fungus or yeast, or preventing its growth. These treatments

[6] Medsafe (October 2001), *New Zealand Regulatory Guidelines for Medicines*, Volume 1: Guidance notes for applicants for consent to distribute new and changed medicines and related products, 5th Edition.

are available in a variety of forms, including topical ointments, lotions, creams, gels, shampoos, tablets and suppositories.

46. One group of antifungal products are those used for the treatment of thrush. Industry participants, including pharmacists and competitors, advised the Commission that although products indicated for the treatment of thrush contain exactly the same active ingredients (e.g., clotrimazole, miconazole, and fluconazole)—generally with identical dosage—as those found in non-thrush antifungal treatments, consumers tend not to substitute between these two product groups.

47. Thrush infections generally occur internally within the body in areas such as in the mouth, throat, intestines, and vagina. Consequently, medicines used to treat thrush generally require an internal delivery mechanism, such as a tablet (in the case of systemic fluconazole-based products), or special applicators for the delivery of creams and suppositories. The delivery mechanisms associated with thrush products distinguish these, and mean that consumers cannot readily substitute in favour of other antifungal products.

48. In addition, thrush indicated products are pharmacist-only medicines, meaning they cannot be self-selected by consumers. These are often kept behind the pharmacy counter and will only be dispensed once the pharmacist has explained the correct use of the product. Several pharmacists spoken to by the Commission viewed medicines indicated for the treatment of thrush as quite distinct and so do not dispense these for the treatment of other fungal ailments. In contrast, non-thrush antifungal products are displayed openly in pharmacies and therefore may be self-selected by consumers.

49. A number of pharmacists told the Commission that some minimal switching could occur in the other direction, i.e., consumers of thrush treatments (creams, especially) could use these products for the (topical) treatment of non-thrush fungal infections. However, such switching tends to occur (if at all) only at the margin in the case of very informed customers who are aware of the common efficacy of the active ingredient.

50. On these grounds, it may be argued that thrush treatments and non-thrush antifungal treatments should be defined in separate product markets.

51. However, an examination of PCH's and J&J's product lines revealed that the former specialises more in thrush treatments, whereas the latter is a more prominent supplier of non-thrush antifungal treatments. The minimal overlap of product lines implies that defining separate markets for these two product categories, as suggested above, would identify very little aggregation under the factual scenario.

52. In order to expose any potential competition issues in relation to the present Application, the Commission took the conservative approach of defining a broad product market encompassing all antifungal treatments (both thrush and non-thrush). The Commission is of the view that if no competition concerns are identified in the broader market, there are unlikely to be competition concerns under the narrower definition of the market.

Allergy Treatments

53. Allergic reactions result from the hypersensitivity of the body's natural immune system to foreign substances known as allergens (e.g., dust, pollen, insect venom,

and certain foods). Allergic responses may present either as localised or systemic symptoms. OTC products generally treat localised rather than systemic symptoms.

54. Several medicines are available to treat the localised symptoms described above. These are: antihistamines which operate to inhibit the production of histamine (which causes inflammation); corticosteroid treatments which work by suppressing the inflammatory response produced by a hypersensitive immune system; and decongestants which work by constricting the blood vessels surrounding mucous membranes around the nose or eyes.

55. The extent and nature of allergy symptoms can vary significantly across individuals and so consumers use allergy treatments in myriad of ways. For example, some individuals find nasal corticosteroid sprays as the most effective form of hayfever control, and do not view other treatments as viable alternatives. In the case of individuals suffering from hives, it is clear that substituting decongestant eye drops for antihistamine tablets (the usual recommended course of treatment) is not an option. Others will use immediate relief and prevention products together in a complementary fashion, depending on the severity of their symptoms. Still others may view the prophylactic properties of antihistamine and corticosteroid products as very close substitutes, and so could easily switch between these in response to a 5-10% price increase. Personal preferences and individual circumstances clearly are important in forming consumption decisions.

56. Recognising the variety of consumers' needs, suppliers of allergy treatments have developed an extensive and highly differentiated range of products in terms of, among other factors: packaging; mode of delivery; dosage and duration of effectiveness; and price. The high degree of product differentiation and the variety of ways in which users demand these make it difficult to assess whether for instance, products that provide immediate relief ought to be defined in a separate market to prophylactics.

57. The Commission is of the view that, for the purposes of the present Application, it is unnecessary to come to a firm conclusion on the precise definition of the markets concerning these OTC allergy treatments. As an assumption, the Commission will, for the purposes of analysing the present Application, define a broad market for all OTC allergy relief medications.

Worm Treatments

58. Worm treatments (anthelmintics) are used to treat the gastrointestinal infestation of parasitic worms. The two common active ingredients found in worm treatments in New Zealand are mebendazole (for the treatment of single or mixed infestations of threadworm, roundworm, hookworm or whipworm) and pyrantel embonate (for the treatment of threadworm, roundworm and hookworm).[7] The most popular of these in New Zealand is mebendazole as this covers a broader range of worm species, and products containing this active ingredient are available in more convenient doses than pyrantel embonate alternatives.[8]

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[7] *MIMS New Ethicals*, May 2005 (Issue 3), p. 254.

[8] Vermox, Deworm, and Combantrin-1 (three mebendazole-based products supplied in New Zealand) are all available in convenient single-dose (100mg) form, whereas a single course of the original pyrantel embonate-based Combantrin product requires consumption of 100mg per 10kgs of bodyweight.

59. Worm treatments have a specific use and cannot be substituted on the demand side for/by other medicines. Therefore, for the purposes of the present Application, the Commission defined a discrete product market for OTC worm treatments.

Smoking Cessation Products

60. Smoking cessation products act in a number of ways to limit the body's dependence on the nicotine in tobacco, thereby helping the smoker to break the smoking habit. By far the most widely-used smoking cessation products are nicotine replacement therapies (NRTs), which provide the smoker with nicotine and then attempt to wean individuals away from their dependence on the drug by gradually reducing the delivered dose.

61. NRT products are available in several forms namely transdermal patches, chewing gums, sublingual tablets, inhalers and sprays, and in a variety of doses. Significant inter-brand product differentiation also exists between the different NRT products. For example, some brands of patches offer 24 hours of nicotine delivery for all-day relief, whereas others offer only 16 hours of nicotine delivery to promote restful sleep. Some patch brands compete on the discreetness of their product (by offering small, skin-tone-matched or opaque patches). Finally, some brands of gums are differentiated by offering a variety of flavours.

62. Some NRT products are heavily subsidised by the New Zealand government. The Ministry of Health's Quit Group manages a telephone support programme called Quitline. In addition to providing free advice about smoking cessation, Quitline offers to registered users NRT patches and/or gums through pharmacies at heavily subsidised prices.[9] Suppliers of NRT products can compete to win the subsidy on one of their brands in a tender process managed by PHARMAC and funded by the Ministry of Health. The successful bidder for the subsidy can supply a product that has a low price to consumers and so price-sensitive consumers purchase the product when they might not have otherwise. Furthermore, the winner of the PHARMAC tender typically does not undertake expensive advertising campaigns, given that its product has a substantial price advantage. (In contrast, non-subsidised brands engage in significant marketing and tend to compete via product differentiation, i.e., by emphasizing unique product characteristics.)

63. To assess the relevant market in the supply of smoking cessation products, the Commission assessed substitutability between:

- transdermal NRT patches (a widely-used form of NRT) and other NRT products;
- subsidised NRT products and non-subsidised products; and
- NRT products and non-NRT products.

64. Transdermal NRT patches have properties that appeal to certain types of consumers. For example, patches are convenient as one simply applies the patch at the start of the day and forgets about it. Some suppliers claim that patches are

[9] Registered Quitline users pay $5 for four week's supply of NRT patches and/or gums, over a course lasting eight to twelve weeks. The remainder of the product's cost is paid for via a rebate from the Ministry of Health to the pharmacy. Users can take advantage of up to two courses per year (separated by a minimum 90 day interval), although there is no limit on the number of years over which the subsidy can be accessed by the same individual.

superior because the 'drug reservoir' and special 'rate-controlling membrane' built into the product allow greater delivery of nicotine early in the day, when cravings are generally at their peak, and a steady flow of nicotine thereafter. Similarly, some suppliers state that gums and sublingual (under the tongue) tablets are more suitable for light smokers as these allow individuals to alleviate occasional cravings with small, measured doses of nicotine; and that gums and inhalers allow individuals to occupy themselves with an activity (chewing or inhaling) as a substitute to the act of smoking.

65. The Commission considers that the different NRT products are means of differentiating essentially the same product (a mode of nicotine replacement) to suit various consumers' preferences and needs, and considers that transdermal NRT patches are likely to exert competitive constraint on non-patch products, and vice versa. The Commission, therefore, concludes that all NRT products fall within the same product market.

66. There is a significant price difference between the subsidised and non-subsidised NRT products. However, pharmacists advised the Commission that, even though subsidised and non-subsidised NRT products may not be economic substitutes, these do compete with (and constrain) one another on non-price characteristics. In any event the PHARMAC contract is a significant feature of the market and competition for the substantial proportion of the market that is subsidised takes place not at the pharmacist's shop counter but every three years in the bidding process.

67. As discussed earlier, users of smoking cessation products have greatly differing needs and preferences, and suppliers have responded to these by providing greatly varied product ranges. For a great many consumers, non-price factors (such as mode and efficacy of nicotine delivery, discretion, flavour, etc.) dominate price considerations. This is evidenced by the fact that non-subsidised brands (such as Nicorette) have a continued presence in the market. In addition, often the subsidised brand is also sold at non-subsidised prices, which suggests that some (less price sensitive) consumers are attracted by that brand's unique product characteristics (or that factors such as brand loyalty are important in the consumption decision) rather than price.

68. On this basis, the Commission is of the view that subsidised and non-subsidised NRT products do offer competitive constraints on one another, and defining separate markets for these two product groups would obviate important competitive interactions that ought to be considered in the analysis. Therefore, the Commission defined, for the purposes of the present Application, a product market for all smoking cessation products.

69. Less commonly used products are those that do not contain nicotine. These might claim to alleviate the craving for nicotine and calm nicotine withdrawal symptoms (Nicobrevin for example); or are applied to the filter of a cigarette and (it is claimed) block most of the harmful substances in tobacco smoke (Nicobloc for example).

70. Given that NRT and non-NRT products are used by consumers for the same reason, for the purposes of the present Application, the Commission considers these as falling within the same product market.

71. One further consideration is the temporal dimension of this product market. As mentioned earlier, PHARMAC runs a tender process for NRT products usually

every three years. The Commission typically conducts its competition analysis over a two year timeframe. As competition for the subsidy is a significant feature of the relevant market, it is important that the Commission's analysis captures this dynamic of the market. The Commission recognises that for a substantial portion of the market (that is supplied under the PHARMAC contract) the appropriate time horizon over which it should assess competition is three years.

Geographic Dimension

72. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

73. The Commission canvassed the views of several major distributors of OTC pharmaceuticals in New Zealand when forming a view on the geographic extent of the relevant markets. These firms' comments indicate that the supply of OTC allergy relief medication, thrush treatments, worm treatments and NRT products occurs nationally. All pricing is set nationally at the head-office (as opposed to the regional) level and applied uniformly across New Zealand. Occasionally, some suppliers will negotiate volume-based discounts with large customers (such as the pharmacy banner groups), but these price variations essentially reflect the scale of the purchaser's operations, not their geographical location; there is no evidence of regional price discrimination due to localised market power.

74. On this basis, the Commission concludes that markets relevant to this particular Application are national in geographic extent.

Functional Dimension

75. The production, distribution and sale of a product typically occur through a series of functional levels – for example, the manufacturing/import level, the wholesale/distribution level and the retail level. It is often useful to identify the relevant functional level in describing a market, as a proposed business acquisition may primarily affect one horizontal level.[10] Generally, the Commission will seek to identify separate relevant markets at each functional level affected by an acquisition and assess the impact of the acquisition on each.

76. None of the products supplied into the product markets defined earlier is presently manufactured in New Zealand. These products are manufactured overseas, imported into New Zealand (subject to regulatory approval from Medsafe), and supplied by distributors to retail outlets such as pharmacies.

77. The Applicant and PCH are local wholesalers. Therefore, the present Application relates to the importation and wholesale supply of OTC antifungal treatments, allergy relief medication, worm treatments and smoking cessation products.

Conclusion on Market Definition

78. On the basis of the above the relevant markets in this proposed acquisition are the New Zealand markets for the importation and wholesale supply of OTC:

    - antifungal treatments ("antifungal market");

[10] Although it is usually the case that functional levels do not function independently from one another. For an example of where this was outlined see *Singapore Airlines v Taprobane Tours WA* (1990) ATPR 41-054.

- allergy relief medications ("allergy market");
- worm treatments ("worm market"); and
- smoking cessation products ("smoking cessation market").

COUNTERFACTUAL AND FACTUAL

79. In reaching a view about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely difference in outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).[11] The difference in competition between these two future scenarios is the expected competitive impact of the acquisition. This difference is usually expressed in a difference in (quality adjusted) price between the factual and the counterfactual.

Factual

80. The Applicant submitted that the proposed acquisition of PCH would give it an opportunity to diversify its consumer healthcare portfolio. PCH informed the Commission that it does not perceive consumer healthcare to be part of its strategic business plan, and that it would rather concentrate its efforts into growing its prescription pharmaceutical business.

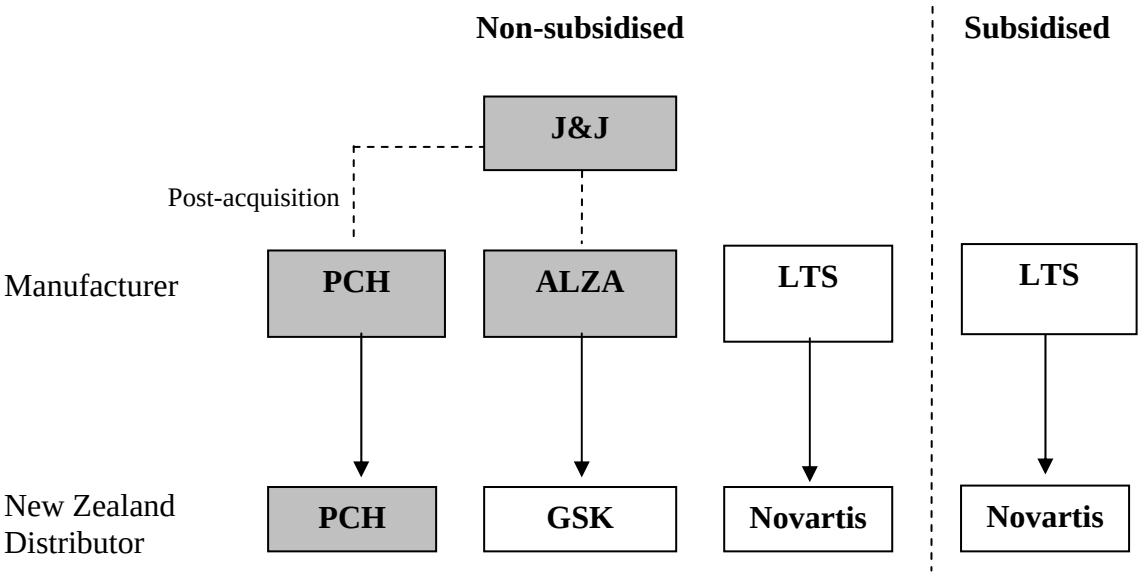
81. In the factual scenario, other than the combined entity, there would be a number of other companies supplying products in both the allergies market and the antifungal market.

82. For the worm treatment market, in the factual scenario, there would be only one other existing competitor, Multichem.

83. In the smoking cessation market, in the factual scenario, J&J would acquire two NRT brands, Nicorrette and Nictrol from PCH. Both brands sell NRT patches and gums. Post- acquisition, J&J would also through its subsidiary, ALZA, manufacture NRT patches which would then be supplied to GSK in New Zealand. GSK markets these NRT patches in New Zealand, under the Nicabate brand. (See Figure 1).

[11] Air New Zealand & Qantas Airways Ltd v Commerce Commission (No.6), unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

Figure 1: Supply Chain for NRT Patches in New Zealand



Note shaded area = parties to the acquisition

84. Other major industry participants in the smoking cessation market would be Novartis which sells subsidised and non-subsidised NRT products and PHARMAC which, in the factual, would continue to be responsible for awarding a contract for the supply of subsidised NRT products in New Zealand.

85. The Commission considered another possible factual scenario, namely that J&J would divest its subsidiary, ALZA, and so would not continue to supply NRT patches to GSK. However, at the time of reaching the decision on the application, there was significant uncertainty regarding such an outcome. The Commission, therefore, made its decision on a conservative basis, considering the factual scenario to be one where no divestment occurred.

Counterfactual

86. PCH stated that it intended to sell its Consumer Health care business and [ ] While J&J was the successful bidder in that process, [ ] were other interested buyers. PCH stated that [ ].

87. The Commission considers the relevant counterfactual to be that PCH is sold to a third party. Given that there were other parties interested in acquiring PCH, the Commission considers that it would likely be sold to one of these with the added assumption that such acquisition would not give rise to competition concerns.

COMPETITION ANALYSIS

The Antifungal market

Existing Competition

88. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

89. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

90. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

    - The three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected persons or associated persons) has less than, in the order of, 40% share; or
    - The three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

91. The Commission has measured market share by sales value, based on data obtained from IMS Health (NZ) Ltd, which is a research organisation specialising in the pharmaceuticals industry. The market shares represent sales made by pharmaceutical companies and wholesalers into the pharmacy channel directly.

92. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

93. The Commission has taken a conservative approach of defining a product market encompassing both thrush and non-thrush antifungal treatments. Consequently the main competitors in this market are Bayer Healthcare (Bayer) and Novartis. There also several smaller competitors active in this market.

94. Table 1 shows the estimated market shares for the antifungal market. Post-acquisition, the combined entity would have a market share of [ ] and the post-acquisition three firm ratio would be [ ]. This is inside the Commission's safe harbours.

Table 1: Market Shares for the Antifungal Market in 2006 (by value)

Company	2006 - $	2006
J & J	[ ]	[ ]
PCH	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**
Bayer	[ ]	[ ]
BristolMyer Squibb	[ ]	[ ]
CSL	[ ]	[ ]
David Sparks	[ ]	[ ]
Douglas	[ ]	[ ]
Ego	[ ]	[ ]
Galderma	[ ]	[ ]
ICN	[ ]	[ ]
AFT	[ ]	[ ]
Multichem	[ ]	[ ]
Novartis	[ ]	[ ]
Pacific	[ ]	[ ]
Alphapharm	[ ]	[ ]
Procter & Gamble	[ ]	[ ]
Revlon	[ ]	[ ]
Sigma	[ ]	[ ]
SSL	[ ]	[ ]
Valeant Pharma	[ ]	[ ]
Wilson	[ ]	[ ]
Total	**[ ]**	**100%**

Source: IMS Health data

95. In the factual, in the antifungal market, there would be a number of existing competitors that would constrain the combined entity. The most significant competitors would be Bayer and Novartis. Bayer has a very strong brand with the Canestan range, which has been available for a number of years. Further, [

].

Conclusion on the Antifungal market

96. The Commission concludes that given the strength and number of existing competitors, notably Bayer and Novartis, it is satisfied that there is unlikely to be a substantial lessening of competition in the antifungal market as a result of the acquisition.

Allergy Treatments

Existing Competition

97. Post-acquisition, in the allergy market the combined entity would have a market share of [ ]. This is shown in Table 2. The post-acquisition three firm ratio would be [ ]. This market share is inside the Commission's safe harbours threshold.

Table 2: Market Shares in the Allergy Market in 2006 (by value)

Company	2006	2006
J&J	[ ]	[ ]
PCH	[ ]	[ ]
Combined Entity	**[ ]**	**[ ]**
Alcon	[ ]	[ ]
Allergan	[ ]	[ ]
Apotex	[ ]	[ ]
Aspen	[ ]	[ ]
Boehringer	[ ]	[ ]
Douglas	[ ]	[ ]
GSK	[ ]	[ ]
Hamilton	[ ]	[ ]
HMG	[ ]	[ ]
Merck	[ ]	[ ]
Novartis	[ ]	[ ]
AFT	[ ]	[ ]
Reckitt	[ ]	[ ]
Sanofi Aventis	[ ]	[ ]
Schering-Plough	[ ]	[ ]
UCB Pharma	[ ]	[ ]
Wyeth	[ ]	[ ]
Total	**[ ]**	**100%**

Source: IMS Health

98. Post- acquisition the combined entity would have six allergy treatment products. J&J currently has only two products, both under the Livostin brand. Livostin is a topical anti-allergics, which comes either as an eye drop or nasal spray.

99. PCH currently has four products, Actifed, Sinutab, Sudafed and Visine Allergy. All of these products have an allergy relief element to them. Visine Allergy however is a topical product whereas the others are systemic products.

100. As shown in Table 2, traditionally GSK, Novartis, Schering-Plough and Sanofi Aventis have all been strong competitors in this category. Post-acquisition all four companies would have a larger market share than the combined entity.

101. This is a highly fragmented market with many competitors, offering differentiated products. There are also many generic companies, such as AFT and Douglas Pharmaceuticals that have also been able to enter the market and take a small amount of market share.

102. Industry participants did not express any concerns with the proposed acquisition in respect of the allergies market.

Conclusion on the Allergy Market

103. Accordingly, given the low level of aggregation that would occur as a result of the proposed acquisition and the number of existing competitors, the Commission is satisfied that there is unlikely to be a substantial lessening of competition in the allergies market as a result of the acquisition.

Worm Treatments

Existing Competition

104. Post-acquisition, the main supplier in the worm treatment market would be the combined entity. Table 3 shows that the combined entity would have a market share of [ ] (Oct 2006) and the post-acquisition three-firm concentration ratio would be [ ]. This is outside the Commission's safe harbours threshold.

105. In the factual, the combined entity would have two brands, Vermox, which is currently supplied by J&J, and Combantrin and Combantrin-1, which is currently supplied by PCH. Both brands have been in the market for a long time. J&J, however, has the stronger brand (in terms of brand history and reputation) and has had a [ ] market share over the past four years, although it has been [ ] during this period. PCH's market share during this time period [ ]

Table 3: Market shares in the Worm Treatment Market (by value) from 2002-2006

	Brand	**2002**		**2003**		**2004**		**2005**		**2006**	
		$	**%**	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**
J&J	Vermox	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
PCH	Combantrin	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Combined		**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Multichem	DeWorm	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Pacific	Mindol	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total		[ ]	100	[ ]	100	[ ]	100	[ ]	100	[ ]	100

Source: IMS Health

106. PCH's products under the Combantrin brand are in the form of chocolate squares which are targeted for children, while Vermox would be used by older children

as well as adults. However, Vermox and Combantrin contain the same active ingredient, mebendazole, which eliminates:

- threadworm;
- roundworm;
- hookworm; and
- whipworm.

107. Combantrin-1 contains the active ingredient pyrantel, which is used to treat threadworm in a single dose. Whilst Combantrin-1 treats only one type of worm and has a different active ingredient to Vermox, the Commission considers the product to provide some constraint to Pfizer as both can be used to treat threadworm.

108. Given the similarities between the two firms' brands there is likely to be some loss of competition between J&J and PCH in the factual scenario compared to that in the counterfactual.

109. In the factual scenario, there would only be one other existing competitor, Multichem, which entered the market in 2002 with the generic product, De-worm.

110. In 2004, Pacific Pharmaceuticals exited the market with its product Mindol. This product was discontinued [ ]

111. Over the past four years, Multichem's market share has grown from [ ] in October 2002 to [ ] in October 2006. Multichem, supported its brand De-worm by investing in advertising and carrying out both 'above the line advertising,' i.e. on television, radio and print media, and also 'below the line advertising,' such as product displays in pharmacies. For example, Multichem promoted its product by offering a free gift, which was a mini-spot light torch to check for threadworms.

112. Multichem stated that
[
].

Conclusion on Existing Competition

113. The Commission considers that in the worm treatment market, the combined entity would to an extent be constrained by the existing competitor, Multichem. This constraint on its own, however, may not prevent a substantial lessening of competition.

Potential Competition

114. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try.

Barriers to Entry

115. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of market conditions that impede entry.

116. The Commission identified a number of aspects of the market that might impede entry to the worm treatment market in New Zealand. These are:

- ability to source the product;
- access to distribution channels;
- marketing and advertising; and
- regulatory approval through Medsafe.

117. A new entrant into the OTC supply of worm treatments could either find a supplier of worm treatments or it could manufacture the product itself. For example, the majority of the multinational pharmaceutical companies, including J&J and PCH, have their own manufacturing facilities offshore. These overseas produced products are then distributed here in New Zealand. Multichem's supplier of worm treatment is [ ] Industry participants said that [ ] suppliers of worm treatments are Cardinal Health**,** Douglas Australia, Alphapharm in Australia (which is owned by Merk), API Consumer, ITCA Laboratories, Intes and Pharma.

118. Due to the small size of the New Zealand worm market, approximately [ ] it is likely that a potential entrant would need to enter the market with a broad product range, as opposed to a single stand-alone product. Therefore a new entrant would need to source not just a worm treatment product, but other pharmaceutical products too. Such products could be sourced by contract manufacturing or could be manufactured by the new entrant.

119. A new entrant could distribute its product through wholesalers, like Propharma, or through its own distribution networks. Some industry participants brought to the Commission's attention the use of "agency forces". These are businesses, for example Arrow Pharmaceuticals NZ Ltd and Douglas Pharmaceuticals, who distribute products and are responsible for the marketing strategies of new products. For example, Douglas Pharmaceuticals acts as an agency force in OTC products for overseas companies such as 3M and Ego. The Commission found that a new entrant would be able to access these existing distribution channels relatively easily.

120. In order to support a product in the OTC category a new entrant would need to invest in advertising. This can take the form of 'above the line advertising,' i.e. on television, radio and print media, or 'below the line advertising,' such as in-store product displays in pharmacies. The extent of advertising carried out would depend on whether the entrant chooses to enter by competing on product differentiation as a branded product (in which case heavy marketing is feasible and desirable) or whether it chooses to enter with a similar product that is already available where it will compete mainly on price. Information provided to the Commission suggested that the advertising costs associated with launching a product in the worm treatment market would be around $30,000 -$125,000.

121. A new entrant in the OTC supply of worm treatment would need to gain regulatory approval from Medsafe before it could sell products in New Zealand. A new entrant would need to submit its application to Medsafe, pay a fee and in some circumstances provide results of clinical trials, although for OTC products this is less common. There are a number of factors that will affect how quickly Medsafe can grant regulatory approval but if a product had the same active ingredient as existing products then this could be done within two years.

122. In any event there is an agreement between the New Zealand and Australian regulatory bodies that, when it is put into effect in 2007, is likely to reduce the entry difficulties significantly for suppliers already registered in Australia. [ ]

Conclusion on Barriers to Entry

123. The Commission came to the view that impediments to entry in the worm treatment market are not so substantial as to prevent new competitors entering.

The "LET" Test

Likely Entry

124. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:

- Likely in commercial terms;
- Sufficient in Extent to cause market participants to react in a significant manner; and
- Timely, i.e. feasible within two years from the point at which market power is first exercised.

125. The Applicant stated that there are several suppliers of OTC worm treatments in Australia that are a source of potential competition. This is because they supply products that contain similar active ingredients to the New Zealand products and treat the same types of worm.

126. The Commission contacted the following suppliers of OTC worm treatments in Australia:

- [ ]
- [ ]
- [ ]
- [ ]
- [ ]

127. The majority of these companies stated that they would not consider entering the New Zealand market as:

- it is a small market, only worth approximately [ ]; and/or
- it would not be worth entering the category with just one product.

128. The Commission believes that entry is more likely from pharmaceutical companies that are already supplying other OTC products in NZ, rather than de novo entry.

129. The Commission also assessed whether the following companies are potential entrants.

- [ ]
- [ ]

130. [

]

131. [

]

132. [ ] also informed the Commission that it would not wish to enter this market.
[

]

133. However, the Commission learned that
[

]

134. [

]

135. The Commission considers that entry in the worm treatment market is likely, post acquisition, from [ ]

Extent of Entry

136. Industry participants informed the Commission that it would be more common to enter this market with a wide product range, rather than a stand alone product. For example this view was expressed by [ ] a leading pharmaceutical retailer in Australia. It has an extensive product range for the OTC category, including a worm treatment.
[ ]

137. [

]

138. However, the extent of entry by [ ] worm product is unclear.
[

]

139. The Commission considers that the extent to which a product enters the worm treatment market would depend on the amount of advertising and support that is given to the product.
[
]. The Commission believes that [ ] would provide adequate support for its worm treatment product suggesting that the extent of entry would provide some constraint to the combined entity in the factual.

Timeliness of Entry

140. The Commission believes that [ ] entry into the worm treatment market would be timely. The Commission was told that
[

]

141. The Commission considers that entry in the worm treatment would be timely.

Conclusion on LET Test

142. The Commission concludes that whilst entry by [ ] into this market is likely, other entry is unlikely because the market is so small, and unlikely to be very visible. The likely entrant, however, is already supplying products into New Zealand and would bring in a product that is part of a branded range. The Commission concludes that entry is both likely and timely and sufficient in extent to some degree.

Conclusion on Potential Competition

143. The Commission concludes that, post-acquisition, the combined entity would face some constraint from potential competition. This is because barriers to entry into the worm treatment market are not significant and entry is likely and timely and sufficient in extent to some degree.

Conclusion on Worm Treatment Market

144. The Commission concludes that overall in the worm treatment market, the proposed acquisition would not result in a substantial lessening of competition. While the number of suppliers would be reduced from three to two, the combined entity would be constrained by Multichem, whose market share has grown over the past five years, as well as be constrained by potential competition from a likely entrant.

Smoking Cessation Market

145. As mentioned previously, post-acquisition, J&J would be a supplier of NRT patches to a competitor, namely GSK. It would also have ownership of two NRT brands which it would acquire from PCH. Other existing competitors would be Novartis, Pro Health and Douglas Pharmaceuticals (DP). Their products and brands are summarised in Table 4.

Table 4: Smoking Cessation Products in New Zealand

Company	**Brand**	**Distribution Channel**	**Type of product**		
			Patch	*Gum*	*Other*
PCH	Nicorrette	Pharmacy & Grocery	x	x	x
PCH	Nictrol	Pharmacy	x	x	
GSK	Nicabate CQ	Pharmacy	x		
Novartis	Habitrol		x	x	
Pro-Health	Nicrobrevin*				Capsule
Douglas Pharmaceutical	Nicobloc*				

* non-NRT product

146. Table 5 shows market shares (measured annually from the month of October) for the years 2002 to 2006 in smoking cessation market.

Table 5: Markets Shares (by value) in the Smoking Cessation Market

	2002 $	Market Share	2003 $	Market Share	2004 $	Market Share	2005 $	Market Share	2006 $	Market Share
PCH	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**	**[ ]**
Novartis	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
GSK	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Douglas	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Pro-Health	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Total	**[ ]**	**100%**	**[ ]**	**100%**	**[ ]**	**100%**	**[ ]**	**100%**	**[ ]**	**100%**

Source: IMS Health

147. Table 5 shows that in 2006
[

].

148. As mentioned before, a key feature of this market (which is absent in overseas jurisdictions) is the competition for a government subsidy on NRT patches and chewing gums, which is allocated via a tender process managed by PHARMAC. In the past competition for this subsidy has occurred at irregular intervals [ ] However, the Commission understands from PHARMAC that the intention is to run a competitive tender for the subsidy every three years, henceforth (so, the next tender round is due to be completed in early 2008).

149. A summary of the outcomes of past tender rounds is provided in Table 6 below.

Table 6: Summary of past PHARMAC tenders

[ ]	**[ ]**	**[ ]**
[ ]	[ ]	▪ [ ] ▪ [ ]
[ ]	[ ]	▪ [ ] ▪ [ ] ▪ [ ]
[ ]	[ ]	▪ [ ] ▪ [ ] ▪ [ ]
[ ]	[ ]	▪ [ ] ▪ [ ] ▪ [ ]

150. [ ] estimated that when it held the PHARMAC contract approximately [ ]% of its sales would have been attributable to its subsidised products. [ ] estimated that approximately [ ]% of its [ ] sales derive from the subsidy. Hence, the effect of the subsidy on the dynamics of this market is significant.

151. However, the Commission found that it is also possible to compete in this market with non-subsidised brands. [ ] submitted that [ ] the PHARMAC tender does not necessarily mean that a firm is "out of the market". Competition on

non-price factors, and the fact that some consumers prefer not to use the Quitline programme, make it possible to compete successfully without the subsidy. The strength of PCH's popular brand, Nicorette, which has never been subsidised, is evidence of this.

152. Nicorrette is a global brand with a relatively long history in New Zealand. PCH also has second brand, Nicotrol.
[

].

153. The Commission assessed competition in the smoking cessation market, by assessing the extent to which the following would constrain the combined entity in the factual compared to the counterfactual:

- existing competitors, namely, GSK, Novartis, Pro Health and Douglas Pharmaceutical (DP);
- potential competitors; and
- PHARMAC, as a purchaser of smoking cessation products.

Constraint from GSK

154. J&J, through its subsidiary ALZA, has a [ ] exclusive agreement to supply NRT patches to GSK for distribution in New Zealand. In New Zealand, GSK markets these NRT patches under the Nicabate brand. The contract was executed on [ ] and is due to expire [ ].

155. ALZA also supplies GSK with NRT patches in Australia and some European countries. GSK has historically been a strong player in these jurisdictions.

156. GSK was PHARMAC-funded in 2000 and 2001, but lost the subsidy in 2003 to PCH. Since 2003, Nicabate has been available as a non-subsidised product through the pharmacy channel.

157. Table 6 shows that GSK has
[
]. GSK advised the Commission that
[

].

158. [

].

159. [

].

160. [

]

161. For these reasons, the Commission concluded that GSK is likely to be a strong competitor under the counterfactual scenario.

162. In the counterfactual, the relationship between J&J and GSK, to date, may be described as one of mutual gain; they have enjoyed a supplier-customer relationship,
[

]

163. [

]

164. This alignment of incentives has been facilitated by the fact that J&J has not, to date, been in competition with GSK in the smoking cessation market. This situation would continue under the counterfactual scenario. However, under the factual J&J would acquire PCH's two NRT brands – Nicorette and Nicotrol – which compete directly with GSK's Nicabate patches. GSK has argued that this change under the factual would mean that, post-acquisition, J&J's incentives to work co-operatively in a supplier-customer relationship would diminish.

GSK concerns

165. GSK submitted that, post-acquisition, J&J would have the incentive and ability to materially restrict its ability to compete effectively in the smoking cessation market by:

- raising of prices.
- raising of manufacturing costs.
- interruption of supply.
- exploitation of private information.
- stifling of innovation.

166. [

]

167. [

]

168. In the smoking cessation market, the Applicant stated that there were:

- **alternative sources of supply**. GSK is not entirely dependent on ALZA. Other suppliers of NRT patches, such as Lohmann Therapy Systems, Aveva DDS, Watson Pharmaceuticals and Samyang Corporation, are available to meet GSK's needs. Further, manufacturers of generic transdermal patches (used for the delivery of other drugs, such as contraceptives or hormones) would be potential sources of supply. These manufacturers include Mylan Technologies Inc., Noven Pharmaceuticals Inc. and 3M Corporation.
- **contractual safeguards.** J&J is heavily constrained in its ability to misbehave in the manner outlined above by the contractual agreement in place between ALZA and GSK.
- **constraint from other smoking cessation products like gums and lozenges**
- **constraint from other sources**. J&J would face a constraint from other suppliers of NRT patches. In particular Novartis is GSK's closest competitor given that both their products are 24 hour patches in 21, 14 and 7mg strengths, while Pfizer's patches, which release nicotine over a 16 hour period, are available in 15, 10 and 5mg strengths ;

169. The Commission considered GSK's concerns and the arguments put forward by the Applicant. The Commission found that compared to the counterfactual, in the factual there would be likely to be a loss of competition in that GSK's ability to compete would be affected, particularly as GSK would provide commercially sensitive information to ALZA and to some extent is reliant on GSK as a supplier at least until the contract expires. However, the Commission was uncertain as to the extent to which GSK's ability to compete would be reduced. For instance, it may be that as highlighted by the Applicant, the contractual obligations under the agreement would be sufficient to enable GSK to continue to provide competition in the market.

170. As a result of the uncertainty, the Commission took the conservative approach and considered the worst case scenario, namely that GSK's ability to compete would be substantially reduced. The Commission, therefore, considered other sources of constraints on the combined entity post-acquisition. If the Commission could be satisfied that the combined entity would be sufficiently constrained by other industry participants, it would not be necessary for it to conclude on the constraint provided by GSK.

Constraint from Novartis

171. Novartis presently has one smoking cessation brand, Habitrol, in its product portfolio. In the past, Novartis has supplied Nicotinell [ ] in New Zealand. However, [ ] Nicotinell was withdrawn from the market in 2005 and replaced by Habitrol, [ ]

172. [ ]

173. [ ] As a result, Novartis's market share

quickly climbed [ ]% to [ ]% in 2006, demonstrating the significance of the PHARMAC subsidy in this market.

174. Table 6 shows that Novartis [ ] industry participants are likely to consider the threat of Novartis competing in future bidding rounds to be high, and are likely to adjust their bids accordingly. [ ] In addition, rivals are likely to recognise Novartis's incentive to bid strongly in the next tender round in order to preserve its status as the incumbent subsidy-holder, and this may encourage competitors to bid more keenly also.

175. Although not heavily marketed (as PHARMAC-subsidised brands tend not to be), Habitrol is also sold through pharmacies at a non-subsidised price, at prices significantly lower than other competing brands. Habitrol also competes on non-price terms by offering a variety of patch sizes and doses, as well as a variety of chewing gum flavours (although the extent of product differentiation within the Habitrol range is limited in comparison to those of other, more heavily marketed, brands, such as Nicorette and Nicotrol).

176. All these factors, taken together, suggest that Novartis is a significant existing competitor, who is likely to provide a strong discipline on the market, post-acquisition. The Commission reached the view that Novartis is likely to be a strong source of competitive constraint, both under the factual and counterfactual scenarios.

Constraint from Pro Health & DP

177. Pro Health is a New Zealand based company that sells the product Nicobrevin, a non-NRT product sold through the pharmacy channel. Nicobrevin is advertised on television and radio, instore at pharmacies, and has a telephone support line.

178. The Commission found that this product is viewed by some industry participants as an "alternative" therapeutic product. Table 5 shows that Nicrobrevin sales [ ].

179. DP supplies a product called Nicobloc – another non-NRT smoking cessation product sold through the pharmacy channel. [ ].

180. [ ]Nicobrevin and Nicobloc have [ ] to compete at non-subsidised prices, [ ].

181. On the basis of this analysis, the Commission concluded that Pro Health and DP are unlikely to provide any significant constraint in the smoking cessation market.

Constraint from Potential Competition

182. A new entrant into the supply of smoking cessation products would face similar barriers as those identified in the worm treatment market, albeit to different degrees. These barriers are:

- ability to source the product;

- access to distribution channels
- marketing and advertising; and
- regulatory approval by Medsafe.

183. The Commission considers that a new entrant in the smoking cessation market could enter via:

- the tender process to supply subsidised NRT products, where it would need to compete on price. It would have to have some economies of scale in order to be able to compete with existing competitors that are likely to have low cost structures due to scale advantages; or
- entry as a non-subsidised product, which could be a NRT product or non-nicotine product. Such a product would be need to be differentiated and would therefore require a greater level of investment in advertising its point of difference.

184. The Commission assessed whether the following potential entrants would consider entering the smoking cessation market:

- suppliers currently available in Australia;
- a large multinational pharmaceutical company; or
- a distributor in New Zealand securing a contract manufacturer overseas.

185. In Australia, there are two pharmacy house brands, Amcal and Guardian, of NRT patches and gums. Both brands are owned by Sigma.
[

].

186. [

].

187. The Commission found that there is potential entry from Sanofi-Aventis, with a new non-NRT
product.[

]

188. [

].

189. Entry from distributors in New Zealand [ ] seems unlikely. [ ] had considered smoking cessation products, namely a NRT patch, in the past, but found it difficult to source the product**.** [ ] said that it thought of entering a few years ago, however it came across a supplier that was already selling a brand in New Zealand and so there were issues surrounding intellectual property rights.

190. The Commission notes that, at present, the major suppliers of NRT patches, namely PCH, GSK and Novartis, represent a large proportion of the market. All

these are large multinational companies that have aimed at securing a supply of product - either through having their own manufacturing facilities (Pfizer), or having an exclusive contract (GSK) or through a shareholding (Novartis). Also, these suppliers of NRT patches are global companies that have invested the time and cost in developing strong brands in Australia and Europe. This suggests that current NRT patch manufacturers are likely to have the benefits of economies of scale by supplying distributors that supply several countries. Therefore current NRT manufacturers are likely to be tied up and are unlikely to be available to contract manufacture for a distributor in New Zealand.

191. It also appears that a non-nicotine manufacturer of transdermal patches could be difficult to obtain as the distributor would need to have the economies of scale to encourage a manufacturer to invest in the time and cost of producing a product. [ ] stated that it wouldn't approach a non-nicotine patch manufacturer as the manufacturer would not find it worthwhile to invest in the necessary technology required for NRT patches. Further, [ ] said that it found it difficult to find a supplier, [ ]

Conclusion on Potential Competition

192. The Commission concludes that post-acquisition, the combined entity is unlikely to be constrained by potential competition in the smoking cessation market as there are no likely entrants in the two year time frame.

Constraint from PHARMAC

193. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition.

194. In this case, the Commission assessed to what extent PHARMAC would constrain the combined entity post-acquisition. As previously mentioned, PHARMAC is responsible for the tender process and awarding a contract for a sole supplier of subsidised NRT patches and gums.

195. In the counterfactual there are likely to be [ ] credible potential bidders compared to the factual, where there could be, on a worst case scenario, [ ]. The reduction in the number of potential credible bidders is likely to have an impact on competition. [ ], in the previous tender, which took place in 2005, PHARMAC [ ]. Further, PHARMAC has stated that [ ]. (see Table 7 below).

Table 7: PHARMAC's Price per Unit

[ ]	**[ ]**			
	[ ]	**[ ]**	**[ ]**	**[ ]**
[ ]				
[ ]	[ ]	[ ]	[ ]	[ ]
[ ]	[ ]	[ ]	[ ]	[ ]
[ ]	[ ]	[ ]	[ ]	[ ]
[ ]				
[ ]	[ ]	[ ]	[ ]	[ ]
[ ]	[ ]	[ ]	[ ]	[ ]

[
]

196. [

].

197. Post acquisition, if the number of potential bidders reduced from [ ], and the unit prices submitted in the tenders were to increase, the Commission considers that there are options in which PHARMAC could use its countervailing power. For instance, PHARMAC stated that it would always look at the option of [

]

198. It should be noted that while PHARMAC can countervail with price pressure, it cannot insist that the market supplies specific products. Although given that the PHARMAC contract represents a significant part of the market and provides suppliers with economies of scale, potential bidders are likely to continue to have the incentive to bid for the contract.

199. Further, to-date PHARMAC has held tenders only for NRT products. The Commission was informed that
[

]. It is also noted that PHARMAC's tender documents state that it can list any new pharmaceuticals or delist all or part of a therapeutic group or sub-group[12] which suggests that PHARMAC could decide to list any new smoking cessation product if it meets its criteria and one was available.

200. Also, PHARMAC's Operational Polices and Procedures (OPP) states that it:

> **"**may adopt a range of strategies in order to achieve the core objective described in clause 1.1 or in pursuit of any other objective or its functions…..PHARMAC is not bound to pursue any particular strategy. PHARMAC may also modify or depart from a strategy previously adopted, including not applying the strategy the same way in all situations, or may adopt new strategies, provided that PHARMAC complies with its public law obligations, including consultation,

[12] Para 3.1 Operating Policies and Procedures of the Pharmaceutical Management Agency, (OPP) Third Edition January 2006

and that any new decision is made in accordance with PHARMAC's statutory objectives, functions and powers."

201. It should also be noted that PHARMAC sets the subsidy rules for pharmaceuticals products and the scale at which it "purchases" products affords it a significant degree of countervailing power.

202. For the reasons stated above, the Commission considers that post-acquisition, the combined entity would be constrained by PHARMAC.

Conclusion on Smoking Cessation Market

203. The Commission concludes that post acquisition, the fact that J&J would be active in the smoking cessation market and would also be supplying a competitor in that market, namely GSK, means that there would be a loss of competition, as compared to the counterfactual and GSK's ability to compete would be likely to be reduced. Although the Commission found that the extent to which GSK's ability to compete would be reduced is unclear.

204. However, the Commission found that in the factual J&J would be constrained by Novartis, a significant existing competitor, and by PHARMAC in its role as a significant "purchaser" of subsidised NRT products. Therefore, it was not necessary for the Commission to conclude on the constraint that would be provided by GSK, as it considered that the constraint provided by Novartis and PHARMAC would be sufficient to prevent a substantial lessening of competition in the smoking cessation market.

OVERALL CONCLUSION

205. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the following four markets:

- antifungal treatments;
- allergy relief medications;
- worm treatments; and
- smoking cessation products.

206. The Commission considers that the likely counterfactual scenario is that PCH is sold to a third party, assuming that the third party's acquisition would not give rise to a substantial lessening of competition.

207. In respect of the antifungal and allergy market the Commission is of the view that given the number of existing competitors in the market, the proposed acquisition is unlikely to result in a substantial lessening of competition in the factual scenario compared to the counterfactual scenario, in both of these markets.

208. In the worm treatment market, the proposed acquisition would reduce the number of suppliers from three to two. Post acquisition, however, the combined entity would be constrained by Multichem, an existing competitor, and by potential competition.

209. In the smoking cessation market, J&J would acquire two NRT brands, Nicorrette and Nictrol from PCH. It would also through its subsidiary, ALZA, manufacture NRT patches which would then be supplied to GSK in New Zealand. GSK markets these NRT patches in New Zealand, under the Nicabate brand. (See Figure 1). The Commission concludes that post acquisition, the fact that J&J

would acquire two NRT brands and would also be supplying a competitor in that market, namely GSK, means that there would be a loss of competition. As compared to the counterfactual, GSK's ability to compete would be reduced. Although the Commission found that the extent to which GSK's ability to compete would be reduced is unclear.

210. However, the Commission found that in the factual, J&J would be constrained by Novartis, a significant existing competitor and by PHARMAC in its role as a significant purchaser of subsidised NRT products. Therefore, it was not necessary for the Commission to conclude on the constraint that would be provided by GSK, as it considered that the constraint provided by Novartis and PHARMAC would be sufficient to prevent a substantial lessening of competition in the smoking cessation market.

211. The Commission is therefore satisfied that the proposed acquisition will not have, nor would be likely to have, the effect of substantially lessening competition in any of the affected markets.

DETERMINATION ON NOTICE OF CLEARANCE

212. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Johnson & Johnson (J&J) of the stock, assets and business of the Consumer Healthcare division of Pfizer Inc (PCH).

Dated this 22 February 2007

David Caygill

Division Chair
Commerce Commission