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Determination

Coty Inc. and The Procter and Gamble Company [2016] NZCC 4

The Commission:	Dr Mark Berry Sue Begg Sarah Court
Summary of application:	An application from Coty Inc. seeking clearance to acquire a significant part of the global hair care, colouring and styling, colour cosmetics and fragrance businesses from The Procter and Gamble Company.
Determination:	Under s 66(3)(a) of the Commerce Act 1986 the Commerce Commission determines to give clearance to the proposed acquisition.
Date of determination:	22 February 2016

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

Contents

The proposed acquisition

Summary of the proposed acquisition

1. On 23 December 2015, the Commerce Commission (the Commission) registered an application from Coty Inc. (Coty), seeking clearance to acquire a significant part of the global hair care, colouring and styling, colour cosmetics and fragrance businesses from The Procter and Gamble Company (P&G).

2. Coty has applied for clearance to acquire a number of fragrance brands, including Dolce & Gabbana, Gucci, and Hugo Boss. Also included in the application are cosmetics brands Cover Girl and Max Factor, as well as a number of professional hair products.

3. On 12 January 2016, Coty announced that the Dolce & Gabbana and Christina Aguilera Perfumes brands would not be included in the transaction.[1]

Our decision

4. The Commission gives clearance to the proposed acquisition, as it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

5. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[2]

The substantial lessening of competition test

6. As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

7. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[3]

8. We make a pragmatic and commercial assessment of what is likely to occur in the future with and without the acquisition based on the information we obtain through our investigation and taking into account factors including market growth and technological changes.

9. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a

1 For more information, see http://investors.coty.com/phoenix.zhtml?c=251569&p=irol-newsArticle&ID=2128461.

2 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz.

3 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

competitive market (the 'competitive price'),[4] or reduce non-price factors such as quality or service below competitive levels.

When a lessening of competition is substantial

10. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[5] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[6]

11. There is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

The clearance test

12. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[7] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.[8]

Key parties

Coty

13. Coty is a publicly-traded, global beauty products manufacturer, incorporated under the laws of the State of Delaware and with a registered office in New York City, USA. Coty's main products are fragrances, colour cosmetics, and skin & body care products. In 2014, Coty's global turnover amounted to approximately USD 4.7 billion.

14. Coty does not have employees in New Zealand. All of Coty's products are imported, distributed, and marketed in New Zealand by CS Company Limited (CS Company), an independent firm that manages a number of cosmetics, fragrance, and toiletry brands for a variety of manufacturers.

P&G

15. P&G is a publicly-traded, global manufacturer of consumer goods, headquartered in Cincinnati, USA. In 2014/2015, the P&G business units relevant to this transaction had sales of approximately USD 5.51 billion.

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4 Or below competitive levels in a merger between buyers.

5 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

6 Ibid at [129].

7 Commerce Act 1986, section 66(1).

8 In *Commerce Commission v Woolworths Limited* (CA), above n 2 at [98], the Court held that "the existence of a 'doubt' corresponds to a failure to exclude a real chance of a substantial lessening of competition". However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

16. Although P&G does maintain a small New Zealand sales office, the P&G brands relevant to this transaction are imported, distributed, and marketed in New Zealand by CS Company.

CS Company

17. CS Company is one of the largest independent cosmetics distributors in New Zealand. CS Company has longstanding relationships with both Coty and P&G, and is currently the New Zealand distributor for both parties.

18. [ ]

19. Approximately [ ] of CS Company's revenue arises from the sale of Coty and P&G products.[9]

Industry background

20. The present application concerns a variety of cosmetic products, including:

    20.1 fragrances;

    20.2 nail products;

    20.3 colour cosmetics;

    20.4 hair care; and

    20.5 deodorants, shower gel, and other body care products.

21. In particular, Coty has sought clearance to acquire the following brands from P&G (the Relevant Brands): Alexander McQueen, Bruno Banani, Escada, Gabriela Sabatini, Gucci, Hugo Boss, James Bond 007, Lacoste, Mexx, Stella McCartney, Cover Girl, Max Factor, Wella, Clairol, SEBASTIAN, VS, Londa, NIOXIN, and Silverkin. These brands contain products from across the categories detailed in paragraph 20.

22. The only categories that we have considered in detail are fragrances and nail products. We consider that any New Zealand overlap in colour cosmetics, hair care, and body care products is limited and so does not raise any likely competitive concerns for the Commission.[10]

23. We understand that the development, manufacture, and distribution of cosmetics products are often outsourced. For fragrances, in particular, independent "noses"

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[9] Interview with [ ] on 21 January 2016.

[10] See, for example, interview with [ ] on 9 February 2016.

are available to develop scents, and third-party contract manufacturing is available for both incumbents and new entrants.[11]

24. Cosmetics suppliers may or may not own the brands associated with their products. Where the brand owner is distinct from the cosmetics supplier (eg, fashion icons, celebrities), the brand owner will typically contract with a cosmetics supplier to develop, manufacture, and market branded cosmetics products.

25. A number of independent cosmetics distributors operate in New Zealand (such as CS Company, BDM Grange, and Wilson Consumer Products), but many cosmetics suppliers instead choose to self-distribute (eg, L'Oréal).[12]

26. Cosmetic products are retailed through a variety of channels, including supermarkets, pharmacies, department stores, and boutiques. For the purposes of this transaction, the most significant channels are pharmacies and department stores.[13]

With and without scenarios

27. To assess whether competition is likely to be substantially lessened in any market, we compare the likely state of competition with the acquisition to the likely state of competition without the acquisition.[14]

With the acquisition

28. This transaction will initially transfer the Relevant Brands to a new P&G subsidiary, which will then be acquired by Coty in exchange for Coty shares. P&G shareholders will control, in aggregate, a small majority of Coty following the transaction.

29. However, as P&G is widely held, no individual P&G shareholder is expected to control more than 5% of Coty's shares following the transaction. This will keep the current majority shareholder of Coty, JAB Cosmetics, as the single largest shareholder following the transaction (although its position will be diluted to approximately 35% of the total shares).

30. Following the transaction, Coty will control the Relevant Brands. We consider that CS Company will likely continue to operate as the distributor of Coty and P&G products in New Zealand.

Without the acquisition

31. Absent the acquisition, we consider that the status quo would likely prevail, with CS Company continuing to distribute both Coty and P&G products.

11 Interview with [ ] on 27 January 2016.
12 Interview with [ ] on 21 January 2016.
13 Ibid.
14 Mergers and Acquisitions Guidelines above n 1 at [2.29]; *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

Market definition

Our approach to market definition

32. Market definition is a tool that helps identify and assess the close competitive constraints the merged entity would face. Determining the relevant market requires us to judge whether, for example, two products are sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market.

33. We define markets in the way that best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products which fall outside the market but which still impose some degree of competitive constraint on the merged entity.

Coty's view of the relevant markets

34. Coty submits that the relevant geographic market is all of New Zealand.

35. Coty also submits that all nail products should be considered as part of the same relevant product market.

36. Finally, Coty submits that the relevant functional product market is the wholesale distribution of fragrances to retail outlets. However, Coty has also considered more narrow product markets, including wholesale distribution of the following categories:

    36.1 male mass market fragrances;

    36.2 female mass market fragrances;

    36.3 male prestige fragrances; and

    36.4 female prestige fragrances.

37. Of these sub-markets, Coty argues that significant horizontal overlap only occurs in male prestige fragrances.

The Commission's view of the relevant markets

38. We agree with the applicant that national geographic markets are appropriate in this instance.

39. We note that in the past, the European Commission has distinguished between nail products, male prestige fragrances, female prestige fragrances, male mass market fragrances, and female mass market fragrances.[15]

[15] Commission des Communautes Européennes, *Cas n˚ COMP/M. 5068 – L'Oreal / YSL Beaute* (non-opposition: 17/06/2008). [Only available in French]

40. Although there does not appear to be a single defining characteristic separating mass market fragrances from prestige fragrances, the European Commission identified a number of relevant factors. These include price, brand, packaging, marketing strategy, and retail channel.[16] In particular, New Zealand prestige fragrances tend to be more expensive, have more luxurious brand images and are offered for sale in higher-end retail channels (such as luxury department stores and some pharmacies).[17]

41. However, we do not consider that precise product market definitions are necessary to analyse the competitive constraints relevant to this transaction. We have proceeded along the lines of the narrower European Commission approach, on the basis that competition concerns are more likely to arise in narrowly-defined markets. That being said, we consider that our analysis and conclusions would be largely unaffected were we to adopt broader product market definitions.

42. As discussed in more detail below, we agree with the applicant that the only significant overlap in fragrances occurs with respect to the wholesale supply of men's prestige fragrances.

Competition analysis

How the acquisition could substantially lessen competition

43. There are two main ways in which this acquisition could lessen competition:

    43.1 reductions in product range; or

    43.2 increases in product prices.

44. Post-acquisition, Coty could choose to eliminate some of its brands (either globally or in New Zealand), to avoid cannibalisation of sales between overlapping products. If other companies were not well-placed to pick up those brands, and customers would not easily substitute away from those products, the narrower range may result in lower quality choices for consumers.

45. Post-acquisition, Coty could also attempt to increase its margin with respect to CS Company, either through higher wholesale prices or the offloading of additional marketing or advertising costs. If CS Company passed on some of those cost increases, this could increase prices to retailers and, potentially, consumers.

46. However, no market participant with whom we spoke expressed any potential concerns regarding this acquisition. Instead, we consistently heard that this transaction would be unlikely to have any significant effect on any relevant market.[18]

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16 Ibid.

17 Interview with [ ] on 27 January 2016.

18 See, for example, interview with [ ] on 9 February 2016.

Competition analysis: nail products

47. The aggregation within nail products that would arise from this acquisition is limited. Although Coty is the largest supplier of nail products in New Zealand, with 27.5% of the market, P&G is only the fifth-largest player, with a market share of 6.5%.[19]

48. We consider that the increase in share that Coty would obtain as a result of this transaction is unlikely to significantly affect Coty's market power with respect to nail products.

49. All of the market participants with whom we spoke considered nail products to be highly competitive, with a multitude of brands and low manufacturing costs.[20] Post-merger, a number of large, well-known, and well-resourced competitors (such as L'Oréal, Revlon, and Avon Products) would continue to constrain the merged entity. In total, nine significant suppliers would remain, with an additional 14.5% of the market comprised of smaller participants.[21]

50. Given the small degree of aggregation, as well as the range of effective competitors remaining post-acquisition, we do not consider that a substantial lessening of competition among nail products is likely to result from this acquisition.

Competition analysis: men's prestige fragrances

51. The men's prestige fragrances market is diverse, with a number of significant players. Coty and P&G are, respectively, the second and third largest suppliers, but their individual market shares are relatively low: Coty has a 19% share, while P&G has a 15% share.[22]

52. The market leader, L'Oréal, has a 36% market share, which is slightly larger than Coty's post-acquisition market share of 34%. There are also a number of other sizeable competitors, including Shiseido (8% share) and Elizabeth Arden (6% share). In total, seven significant suppliers would remain post-acquisition, with an additional 10% of the market comprised of smaller participants.[23]

53. As discussed above, we consider that there are two main avenues by which anti-competitive effects could arise from this merger: reductions in product ranges or increases in wholesale price.

Reduction in product range

54. If Coty were to attempt to reduce its range of products, either by ending a relationship with a brand owner or otherwise eliminating products, we consider it likely that the considerable number of other suppliers (or new entrants) would engage with those independent brand owners or introduce new products of their own.

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19 Euromonitor International, *Retailing Global Passport* (2014 data).
20 See, for example, interview with [ ] on 21 January 2016.
21 Euromonitor International, *Retailing Global Passport* (2014 data).
22 Ibid.
23 Ibid.

55. Although fragrance products tend to be associated with recognised brands, and developing a recognised brand may require significant investment, we consider it unlikely that a supplier of a new fragrance product would necessarily have to shoulder this expense itself. Brand owners would typically be expected to have already made such investment, as part of their independent business activities.

56. We understand that a significant proportion of fragrance products are replaced each year.[24] We also have anecdotal evidence that successful, small-scale entry is not uncommon in fragrance markets.[25] [ ], in particular, sees some benefits from dealing with smaller suppliers, as they tend to integrate better with its existing supply chain.[26]

57. In any event, given the number of effective competitors operating within New Zealand's fragrances markets, we do not consider it likely that any gaps in product lines would remain underserved for long.

Increase in wholesale price

58. CS Company is Coty's only direct customer in New Zealand. [ ][27] Even if Coty were to attempt to raise its wholesale prices to CS Company, we do not consider it likely that CS Company could pass those higher prices onto retailers.

59. CS Company already distributes all Relevant Brands for both Coty and P&G. As such, it is not apparent that the transaction would alter competitive dynamics in the retail market. According to one retailer, [ ].[28]

60. As we do not consider that the marketing of the Relevant Brands is likely to change, we do not consider it likely that CS Company would be able to extract higher prices from retailers as a result of this transaction. If CS Company were to attempt a wholesale price increase to retailers, we consider that retailers could likely resist the pressure. For example, they may be able to credibly threaten a switch to alternative sources of supply, for similar brands, or engage in parallel imports, for the brands specific to CS Company.

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24 See, for example, interview with [ ] on 21 January 2016.

25 Interview with [ ] on 27 January 2016, where he mentioned that[ ].

26 Interview with [ ] on 9 February 2016.

27 Interview with [ ] on 21 January 2016.

28 Interview with [ ] on 9 February 2016.

61. [
][29] We have no reason to consider that such a response would be any less effective following this transaction.[30]

62. If CS Company were to nonetheless attempt a price increase, we consider that retailers and consumers could readily substitute to other similar products. This is because there are a wide variety of men's prestige fragrances available in New Zealand, from a large number of different suppliers, and we consider that market participants could effectively discipline any attempted price increase by taking their business elsewhere.

63. Consequently, we do not consider that a substantial lessening of competition among men's prestige fragrances is likely to result from this acquisition.

Competition analysis: other fragrances

64. Within women's prestige fragrances, the aggregation resulting from this transaction would be limited. The combined entity would possess a 13.4% market share. Strong competitors will remain to constrain the merged entity, including Elizabeth Arden (26.5% market share), L'Oréal Groupe (13.6% market share), and a number of others.[31]

65. Within men's mass market fragrances, both Coty and P&G occupy strong positions. However, P&G's market share mostly consists of the Old Spice brand, which is not included in the transaction.[32] Consequently, we do not consider that any aggregation within this segment would be significant.

66. P&G does not have a significant presence in women's mass market fragrances, leaving minimal potential for aggregation.[33]

67. We therefore do not consider that a substantial lessening of competition within these fragrance categories is likely to result from this acquisition.

Overall conclusion

68. We are satisfied that the proposed acquisition is unlikely to substantially lessen competition in any relevant market. Coty will continue to face considerable competition from existing manufacturers in all relevant markets.

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29 Ibid.

30 [
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31 Euromonitor International, *Retailing Global Passport* (2014 data).

32 Ibid.

33 Ibid.

Determination on notice of clearance

69. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

70. Under s 66(3)(a) of the Commerce Act 1986, the Commission gives clearance to Coty Inc. to acquire the Relevant Brands, as described at paragraph 21 of this determination.

Dated this 22nd day of February, 2016

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Dr Mark Berry

Chairman