

Statement of Preliminary Issues
GSK / Novartis Consumer Healthcare

16 October 2014

Introduction

1. On 23 September 2014, the Commerce Commission received an application from GlaxoSmithKline plc (GSK) seeking clearance for Leo Constellation Limited (a subsidiary of GSK) to acquire sole control of Novartis AG's (Novartis) consumer healthcare pharmaceuticals business.
2. The public version of the application is available on our website at:
<http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/839>
3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.
4. We are seeking comments from industry participants and interested parties on the proposed acquisition, and the issues we have identified in this Statement of Preliminary Issues. If you wish to make a submission, we ask that you do so by **Thursday 30 October 2014**.
5. All information we receive is subject to the principle of availability under the Official Information Act 1982.
6. However, we recognise that preserving the confidentiality of commercially sensitive information and providing protection against disclosure is necessary. If your submission contains confidential information, please clearly identify this.

The parties and the transaction

7. GSK is an international healthcare company active in over 150 countries worldwide. GSK's principal areas of operation are the development, manufacture and sale of pharmaceuticals, vaccines, and consumer healthcare products. In New Zealand, GSK operates consumer healthcare and prescription pharmaceutical divisions. GSK has no manufacturing operation in New Zealand.
8. Novartis is a global group of healthcare companies active in a range of areas including pharmaceuticals, eye care, animal health, vaccines and consumer health. In New Zealand, Novartis has a marketing, sales and distribution operation for its pharmaceutical and animal health products. Novartis' New Zealand consumer healthcare division is operated from Australia.

9. The proposed merger relates to the parties' activities in the wholesale supply of a range of over the counter consumer healthcare products. We understand that GSK and Novartis may overlap in the following product areas:
- 9.1 the supply of systemic pain relief products;
 - 9.2 the supply of topical cold sore management products;
 - 9.3 the supply of topical nasal preparations;
 - 9.4 the supply of anti-smoking products;
 - 9.5 the supply of dermatological anti-fungal products; and
 - 9.6 the supply of anti-viral products.

Our framework

10. As required by the Commerce Act 1986, we assess whether a merger is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.¹
11. We ask 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).²
12. A tool used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.³ A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of "fact and commercial common sense".⁴
13. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.
14. We analyse the extent of competition in each relevant market both with and without the merger to determine whether the merger would be likely to substantially lessen competition.

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

² *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

³ *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

⁴ Similarly, the courts have said that "[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices". See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

15. We assess the following three factors when considering whether this is likely to be the case.
 - 15.1 Existing competition – the degree to which existing competitors compete.
 - 15.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.
 - 15.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by a purchaser’s ability to exert substantial influence on negotiations.
16. A comparison of the extent of competition both with and without the merger enables us to assess the degree by which the proposed merger might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed merger.

Preliminary issues

17. The Commission will assess the following matters that might arise as a result of this acquisition.

Market Definition

18. Both GSK and Novartis supply a mix of pharmacy only and general sale medicines. Legislation provides that pharmacy only medicines (also known as restricted medicines) require oversight from a pharmacist before they can be sold. In contrast, general medicines can be purchased from non-pharmacy retailers such as service stations and supermarkets.
19. We will consider the extent to which pharmacy only and non-pharmacy products within the relevant product areas compete.

Existing competition

20. We will consider the closeness of competition between GSK and Novartis, and between the merging parties and other suppliers, in each of the product areas noted above.
21. GSK does not consider that it competes closely with Novartis in these product areas as its products have different active ingredients and are designed for different purposes. For example, GSK submits that its paracetamol based pain relief products are marketed for general pain relief while Novartis’ diclofenac based products are designed to treat pain through relieving inflammation.
22. We will consider the extent to which purchasers of these products view medicines with different mechanisms of action and different active ingredients as substitutes.

Potential competition

23. For each of the relevant markets, we will consider the entry and expansion conditions and whether entry or expansion is likely, timely and sufficient in extent to prevent a substantial lessening of competition.
24. Pharmaceutical markets are characterised by high levels of research and development with new products being developed continuously. We will consider whether or not the merging parties have relevant products in the research and development pipeline that could be expected to come to market within the short to medium term.
25. We will also examine whether or not any pipeline products (if identified) would be likely to materially alter the closeness of competition between GSK and Novartis, and whether the proposed acquisition will prevent these products emerging.
26. We will also consider whether other manufacturers of consumer healthcare products are likely to introduce competing products into New Zealand markets. We will assess whether entry is likely to occur when existing contracts expire, given the likely state of competition at that time and the expected profitability of any such entry.

Other competition issues

27. GSK submits that pharmacy wholesalers and grocery retailers have, and will continue to have, significant countervailing power when purchasing from the merged entity. We will consider whether the major purchasers would have any countervailing power, should the merged entity attempt to exercise any potential market power.

Next steps

28. We are currently aiming to make our decision by **Friday 28 November 2014**. However, this date may change as the investigation progresses.
29. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at <http://www.comcom.govt.nz/clearances-register/>
30. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above.
31. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference GSK/Novartis in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by 5pm on **Thursday 30 October 2014**.
32. If your submission contains confidential information, please clearly identify this.