

Statement of Preliminary Issues
Reckitt Benckiser / Johnson & Johnson

11 June 2014

Introduction

1. On 16 May 2014, the Commerce Commission received an application from Reckitt Benckiser Group Plc (Reckitt Benckiser) seeking clearance to acquire the K-Y brand and product assets of Johnson & Johnson.
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/824>
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 invite interested parties to make comment on the likely competitive effects of the proposed joint venture and request that parties who wish to make a submission do so by **Wednesday 25 June 2014**.

The transaction and the parties

5. Reckitt Benckiser is a global consumer goods company which manufactures and sells a range of health, hygiene, home food and pharmaceutical products. Relevant to its application for clearance, Reckitt Benckiser's products include the Durex range of personal lubricants.
6. Johnson & Johnson is a global medical devices, pharmaceutical and consumer goods company. It produces consumer goods under 48 brands, including the K-Y brand of personal lubricants.
7. With the transaction Reckitt Benckiser would own both Durex and K-Y personal lubricant brands.

Our framework

8. As required by the Commerce Act 1986, we assess whether an acquisition is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.¹
9. We ask whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of

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

competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).²

10. A tool used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints a 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
11. We define markets in the way that we consider best isolates the key competitive constraints on the parties to an acquisition. In many cases this may not require us to precisely define the boundaries of a market.
12. We analyse the extent of competition in each relevant market both with and without the acquisition to determine whether the acquisition would be likely to substantially lessen competition.
13. We assess the following three factors when considering whether this is likely to be the case.
 - 13.1 Existing competition – the degree to which existing competitors compete.
 - 13.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.
 - 13.3 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.
14. A comparison of the extent of competition both with and without the acquisition enables us to assess the degree by which the proposed acquisition might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed acquisition.

Preliminary issues

15. The Commission will assess the horizontal effects that might arise as a result of this acquisition. In particular, we will consider:
 - 15.1 whether there are separate product markets for different types of personal lubricant;

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.

- 15.2 whether there are discrete markets for the various sales channels through which lubricants are sold;
 - 15.3 what would likely happen to the K-Y lubricant brand, absent its sale to Reckitt Benckiser;
 - 15.4 the ability of suppliers of competing lubricant brands to expand; and
 - 15.5 the extent of countervailing power of major retailers.
16. We discuss some of these issues further below

Are there separate product markets for different lubricants?

- 17. Reckitt Benckiser states that personal lubricant products are differentiated by reference to a range of factors, including base ingredient (eg, water or silicone based), functional attributes, end-use, flavour and target customer base.
- 18. While most suppliers of personal lubricants produce a range of differentiated lubricant products, Reckitt Benckiser submits that there is substitutability along the spectrum such that they fall within a single New Zealand market for the supply of personal lubricants.
- 19. Reckitt Benckiser further submits that K-Y and Durex have very different product positioning, with K-Y more towards the basic reassurance or medical end of the spectrum whereas Durex is positioned at the playful or adventurous end of the spectrum.
- 20. We will consider whether there is a single personal lubricants product market or, alternatively, separate product markets for different types or categories of personal lubricant. This includes whether there are separate markets for specialised lubricants (eg, sterile lubricants for use in medical applications).

Are there separate markets for different sales channels?

- 21. Reckitt Benckiser submits that the supply of personal lubricants occurs primarily through the grocery, adult retailer, pharmacy and online channels. It also submits that while supermarkets in New Zealand currently only stock three lubricant brands (Durex, K-Y and Ansell), pharmacies, adult retailers and online shops stock a wider range of personal lubricant brands. Reckitt Benckiser further submits that adult retailers and online shops are growing sales channels and that consumers are able to switch between the various sales channels.
- 22. We will consider whether customers readily switch between sales channels when buying personal lubricant. In particular, the extent to which consumers may switch between buying lubricant at supermarkets and pharmacies to buying lubricant at adult retailers and online shops. We will also consider whether the range or types of personal lubricants sold varies between the retail channels.

The ability of suppliers of competing lubricant brands to expand

23. Reckitt Benckiser submits that, post-acquisition, many strong and effective existing competitors would remain and could easily expand. It also submits that there is nothing preventing any personal lubricant supplier being able to sell their products in supermarkets or pharmacies (or increasing their sales through those channels). With specific reference to the grocery sales channel, Reckitt Benckiser further submits that there are a number of lubricant brands (including Ansell, Sylk and Wet Stuff) that New Zealand's two supermarkets chains could easily support and quickly grow in response to any exercise of market power post-acquisition.
24. When we assess the extent of existing competition, we will specifically consider the ability of suppliers of competing lubricant brands to expand into the supermarket and pharmacy channels. In doing so, we will also consider the importance of achieving brand recognition.

Countervailing power

25. Reckitt Benckiser submits that New Zealand's two supermarkets chains and major pharmacy wholesalers (which purchase on behalf of pharmacies) will have significant countervailing power. It further submits that in the event that Reckitt Benckiser tried to exercise market power post-acquisition, supermarkets could discipline it in ways such as offering less favourable shelf space to Reckitt Benckiser's wider product portfolio.
26. We will consider the extent to which Reckitt Benckiser would be constrained or disciplined by the countervailing power of the supermarkets chains and major pharmacy wholesalers.

Next steps

27. We are currently aiming to make our decision by **Thursday 17 July 2014**. However, this date may change as the investigation progresses.
28. 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/>
29. 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.
30. 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 Reckitt Benckiser / Johnson & Johnson in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **Wednesday 25 June 2014**. Please clearly identify any confidential information contained in the submission and provide contact details.