

## Statement of Preliminary Issues

### Henkel and Earthwise

4 May 2023

#### Introduction

1. On 12 April 2023 the Commerce Commission registered an application (the Application) from Henkel New Zealand Limited (Henkel) seeking clearance to acquire the Earthwise brand and business from Earthwise Group Limited (Earthwise Group), comprising the intellectual property in the Earthwise name, logo, bottle and formulas (the Proposed Acquisition).<sup>1</sup> The Proposed Acquisition does not include any manufacturing facilities or other brands that the Earthwise Group owns, namely Nourish and Glow Lab brands.
2. The Commission will give clearance if it 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.
3. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.<sup>2</sup>
4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **18 May 2023**.

#### The parties

5. Henkel is the New Zealand subsidiary of Henkel AG & Co KGaA, which is a multinational chemical and consumer goods company based in Germany.<sup>3</sup> Relevant to the Proposed Acquisition, in New Zealand it imports and wholesales the following laundry and home care brands:<sup>4</sup>
  - 1.1 Cold Power, Dynamo and Fab branded laundry detergents;
  - 1.2 Sard branded laundry pre-wash; and
  - 1.3 Bref branded toilet cleaner.

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<sup>1</sup> A public version of the Application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/>.

<sup>2</sup> The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

<sup>3</sup> The Application at [1].

<sup>4</sup> The Application at [2].

6. The Earthwise Group is a New Zealand company that manufactures a range of laundry, homecare and cosmetic products. It currently supplies products under the Nourish, Glow Lab and Earthwise brands, although the Nourish and Glow Lab brands are not being sold to Henkel.<sup>5</sup>
7. Earthwise-branded products are marketed as being environmentally friendly products because they are made from biodegradable, plant-based ingredients and supplied in sustainable packaging made from recycled materials.<sup>6</sup> The Earthwise-branded products that are being sold to Henkel include laundry detergents, laundry pre-wash aids, toilet cleaners, air fresheners, dishwasher detergents, and multi-surface cleaners.<sup>7</sup>

## Our framework

8. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.<sup>8</sup> As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.
9. We determine 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 competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).<sup>9</sup> This allows us to assess the degree by which the Proposed Acquisition might lessen competition.
10. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we will consider, among other matters:
  - 10.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
  - 10.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
  - 10.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

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<sup>5</sup> The Application at [7], [8], and [21].

<sup>6</sup> Earthwise “Our Story” <<https://earthwise.co.nz/our-story/>>.

<sup>7</sup> The Application at [8].

<sup>8</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, May 2022. Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz)

<sup>9</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

## Market definition

11. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act 1986, as a matter of fact and commercial common sense.<sup>10</sup>
12. Both Henkel and Earthwise Group supply a range of household cleaning products, although Henkel submitted that the Proposed Acquisition would only overlap in the supply of three of these products, namely laundry detergents, laundry pre-wash aids and toilet cleaners. Henkel submits that, because each of these three products have different end-uses, they can be assessed in separate product markets.
13. While we will test whether there are other relevant areas of overlap, our initial investigation will focus on the three products identified by Henkel being laundry detergents, laundry pre-wash aids and toilet cleaners.<sup>11</sup> This will involve testing, among other issues:
  - 13.1 the extent to which end users consider all the different types of products within each of the three product categories are substitutes for one another. For example, we will test whether:
    - 13.1.1 liquid laundry detergents are substitutes for powdered laundry detergents;
    - 13.1.2 products that have been accredited as sustainable, or as environmentally friendly, are substitutes for other cleaning products; and
  - 13.2 whether manufacturers can easily switch production between the different types of homecare products (eg whether a supplier of laundry detergent could easily switch to supplying a pre-wash aid or a toilet cleaner product).

## Without the Proposed Acquisition

14. We will consider what the parties would do if the Proposed Acquisition did not go ahead. Henkel submits that, absent the Proposed Acquisition, the status quo is the most likely counterfactual, where Earthwise Group retains the Earthwise brand.
15. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, such as a sale of the Earthwise brand to an alternative purchaser.

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<sup>10</sup> Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

<sup>11</sup> While Henkel imports all its products into New Zealand, Earthwise Group (as well as other suppliers) manufactures all of its products in New Zealand. At this stage, it appears likely that the geographic and functional dimensions are likely to be the national market for the manufacture/importation and wholesale supply for any relevant product.

## Preliminary issues

16. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant market (or markets) by assessing whether horizontal unilateral or coordinated effects might result from the Proposed Acquisition. The questions that we will be focusing on are:
- 16.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?<sup>12</sup> and
- 16.2 coordinated effects: would the Proposed Acquisition change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable?

### **Unilateral effects: would the merged entity be able to profitably raise prices by itself?**

17. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.<sup>13</sup>
18. Henkel submits that the Proposed Acquisition would not be likely to substantially lessen competition due to unilateral effects in any relevant market. While the Proposed Acquisition would result in an overlap in the supply of laundry detergent, laundry pre-wash aids and toilet cleaner, Henkel considers that:
- 18.1 Henkel and Earthwise are not close competitors, so the loss of competition between the two would not materially affect market/s dynamics. This is because Henkel is focused on supplying products to price/quality conscious consumers and Earthwise is focused on supplying products to "eco-conscious" consumers;
- 18.2 the merged entity would be constrained by the presence of many well-established competitors in New Zealand including:
- 18.2.1 for laundry detergents, Unilever New Zealand Limited (with its Persil and Surf products), Ecostore Company Limited (with its ecostore products), Quantum Pacific Limited (with its Eco Planet products) and PZ Cussons plc (with its Reflect products);
- 18.2.2 for pre-wash aids, Reckitt Benckiser (New Zealand) Limited (with its Vanish, Napisan, and Frend products), Ecostore Company Limited

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<sup>12</sup> For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, i.e. it could increase quality-adjusted prices.

<sup>13</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, above at n7 at [3.62].

(with its ecostore products), SC Johnson & Son (with its Shout products), Quantum Pacific Limited (with its Eco Planet products) Pental Limited (with its Martha products);

18.2.3 for toilet cleaners, Reckitt Benckiser (New Zealand) Limited (with its Harpic products), Ecostore Company Limited (with its ecostore products), Pental Limited (with its Janola products), SC Johnson & Son (with its Duck products); and

18.3 the vast majority of products are purchased from a supermarket operated by one of the major grocery retailers<sup>14</sup> and these retailers have countervailing power to push back against any price increase from the merged entity.<sup>15</sup>

19. For any products where there is overlap between Henkel and Earthwise-branded products, we will consider whether the merged entity would be able to profitably raise prices, reduce quality or innovation. The key issues that we will consider are:

19.1 closeness of competition: the degree of constraint that Henkel and Earthwise-branded products impose upon one another. To the extent that any constraint is, or would be, material, we will assess whether competition lost with the Proposed Acquisition could be replaced by rival competitors or other constraints on the merged entity;

19.2 entry and expansion: how easily rivals could enter and/or expand; and

19.3 countervailing power: whether the major grocery retailers have special characteristics that would enable them to resist a price increase by the merged entity.

#### **Coordinated effects: would the Proposed Acquisition make coordination more likely?**

20. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.<sup>16</sup>

21. Henkel submits that, for all relevant products, the Proposed Acquisition would not be likely to substantially lessen competition due to coordinated effects because

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<sup>14</sup> The major grocery retailers in New Zealand are Woolworths New Zealand, Foodstuffs North Island, and Foodstuffs South Island. The Woolworths New Zealand retail banners are Countdown, FreshChoice and SuperValue. The Foodstuffs North Island retail banners are PAK'nSAVE, New World and Four Square. The Foodstuffs South Island retail banners are PAK'nSAVE, New World, Four Square, Raeward Fresh and On the Spot.

<sup>15</sup> The Application at [89.2].

<sup>16</sup> *Mergers and Acquisitions Guidelines*, above n8 at [3.84].

there is no element in the Proposed Acquisition that will make it easier for Henkel and its competitors to:<sup>17</sup>

- 21.1 reach agreement on price and/or quality of wholesale laundry detergent supplied to retailers; and
  - 21.2 sustain any such hypothetical agreement by detecting deviations from that agreement and/or punishing any deviations from that agreement.
22. In addition, Henkel submitted that:<sup>18</sup>
- 22.1 the relevant markets are not controlled by a small number of competitors;
  - 22.2 market participants cannot observe each other's prices, volumes or capacity;
  - 22.3 suppliers do not interact; and
  - 22.4 the markets are not lacking innovation or dynamism.
23. We will assess whether any of the relevant market/s are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable.

**Other potential issues: would the merged entity prevent rivals from competing due to conglomerate effects?**

24. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.<sup>19</sup>
25. Henkel submitted that, as neither Henkel nor the Earthwise Group sell any 'must have' products, the Proposed Acquisition will not raise any potential conglomerate effects because the merged entity would not have the ability or incentive to bundle or tie its products anticompetitively.<sup>20</sup> At this stage, it appears unlikely that the Proposed Acquisition would enable the merged entity to prevent rivals from competing effectively with the merged entity, by bundling or tying its products together. However, we welcome evidence that interested parties are able to provide regarding the merged entity's ability and incentive to bundle or tie its different products together in ways that have this effect.

**Next steps in our investigation**

26. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **9 June 2023**. However, this date may

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<sup>17</sup> The Application at [94].

<sup>18</sup> The Application at [95].

<sup>19</sup> Commerce Commission, Mergers and Acquisitions Guidelines, above n7 at [5.1]-[5.5].

<sup>20</sup> The Application at [97].

change as our investigation progresses.<sup>21</sup> In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

27. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

### **Making a submission**

28. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference 'Henkel/Earthwise' in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **18 May 2023**.
29. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.
30. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

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<sup>21</sup> The Commission maintains a clearance register on our website at <http://www.comcom.govt.nz/clearances-register/> where we update any changes to our deadlines and provide relevant documents.