ANTICIPATED ACQUISITION BY
RECKITT BENCKISER GROUP PLC OF
THE K-Y BRAND FROM MCNEIL-PPC INC.,
A SUBSIDIARY OF JOHNSON & JOHNSON

RESPONSE OF MCNEIL-PPC INC. TO
REQUEST FOR INITIAL SUBMISSION DATED JANUARY 8, 2015

January 30, 2015

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This submission is submitted on behalf of McNeil-PPC Inc. ("McNeil"), a subsidiary of Johnson & Johnson ("J&J"), in response to the request of the Competition and Markets Authority ("CMA") dated January 8, 2015 for an initial written submission. McNeil/J&J have provided this response on the basis of readily available documents and information. The companies are undertaking a search for any additional documents and information that may be responsive to the CMA's questions, and will provide any supplementary information in response to the CMA's market questionnaire.

Background on McNeil-PPC Inc.

1 A brief history of McNeil-PPC Inc., together with a chronology of significant events in the last five years that are relevant to the proposed acquisition of the K-Y Brand by Reckitt Benckiser Group PLC. This should include details of the organisation, financial structure and principal activities, including those outside the reference area, if appropriate.

1.1 McNeil is a corporation organised and existing under the laws of the State of New Jersey, United States of America, that is ultimately owned by J&J, a US-based multinational group offering health care products worldwide with more than 250 companies located in 60 countries around the world. The group is organized into three business segments comprised of (i) Consumer Healthcare; (ii) Medical Devices and Diagnostics; and (iii) Pharmaceuticals. For additional information on Johnson & Johnson's business, please see http://www.jnj.com/.

1.2 McNeil belongs to the Consumer Healthcare division, which provides over-the-counter products around the world, with a major focus on the US. Among their products, McNeil and its affiliates manufacture (partly through third parties) and sell personal lubricants under the K-Y brand.

1.3 In Europe, K-Y has insignificant sales. The total EEA-wide sales of K-Y in 2013 amounted to [✂] of which around [✂] was generated in the UK. The only personal lubricant sold under the K-Y brand in the UK is basic K-Y jelly.

Information about the transaction

2 A statement of the circumstances leading up to the proposed merger, together with the history of the previous relationship between the companies (if any) including relevant legal or financial issues. This should include details of the negotiations with Reckitt Benckiser and the timetable of events leading up to the proposed merger.

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2.1 Roughly ten years ago, J&J undertook what initially was the very successful introduction of "enhanced" K-Y products in the US, with total sales [✂] over the period 2002-2009. During the same period, worldwide sales grew from [✂] to [✂]. In 2009, when sales of K-Y branded products peaked, the US accounted for approximately [✂] of total sales.

2.2 However, sales of K-Y plummeted in the US after 2009, amounting to only [✂] (out of worldwide sales of [✂]) by 2013. This is due in large part to a decision by the US Food and Drug Administration ("FDA") to treat "enhanced" K-Y lubricants as "medical devices",

thereby requiring J&J to obtain premarketing approval on evidence that such lubricants are "substantially equivalent" to (*i.e.*, as safe and efficacious as) other lubricants on the market. This decision led J&J to recall half (10) of the 21 stock keeping units ("SKUs") it had placed on the market, to undertake costly remediation efforts, and to cancel various launches of other "enhanced" lubricants.

2.3 The regulatory hurdles erected by the FDA's decision to treat "enhanced" lubricants as "medical devices" – a decision that impacted roughly [✂] of J&J's total worldwide sales of K-Y – led the company to reconsider its previous commitment to this business. Because international K-Y product development/support have been managed as adjuncts to a business that was largely focused on the US market, the regulatory burdens that have been placed on these products in the US have significant implications for the entire business. Proposals made in the UK with respect to potential K-Y development must be read in light of this context.

2.4 J&J's deliberations about what to do with the K-Y product line outside the US have gone through three distinct phases in recent years, all leading to the company's current lack of interest or intention to continue operating the business anywhere in the world.

[✂]

2.5 In the period [✂], and particularly in [✂], J&J actively considered the possibilities of expanding K-Y globally as an "intimacy enhancement" product line.

2.6 In 2005, J&J launched *K-Y Warming Liquid* in the UK, with limited promotional support through television advertisements. This was followed in 2006 by a UK launch of both *K-Y Warming Liquid* and *K-Y Warming Jelly* [✂]

2.7 Several important points should be noted about this effort to expand the K-Y product line in the UK and elsewhere:

(a) Initiatives like the launches described above were prepared at the corporate level, as part of planning for J&J's global business. While such initiatives were also explored by the UK (and, potentially, other) local operating companies from time to time, approval and support at the corporate level was required to carry them forward.

(b) J&J prioritised countries for introduction of its "intimacy enhancement" products based on market potential, consumer attitude-and-usage ("A&U") studies, and other assessments of likely enthusiasm for the product in particular countries.[1] Thus, "enhanced" K-Y products were launched in some English-speaking regions (North America and the Sub-Pacific region) before they were launched in the UK.[2] Similarly, J&J planned to launch such products in the UK before it made them more widely available in other parts of Europe.[3] Given the very different sexual attitudes and product usage in different parts of the world, it is not correct to assume that expansion in, *e.g.*, Australia necessarily presages support for a similar launch in the UK.

(c) Finally, J&J brought its experience in the countries where it initially tried to expand K-Y to bear in planning for other countries. For example, the company formulated its plans for the UK in light of its initial experience in Australia and New Zealand, where an initial launch generated significant growth but sales rapidly fell off due to a lack of repeat purchases and inconsistency with widespread consumer perception that K-Y is

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1 [✂]

2 [✂]

3 [✂]

a functional ("problem-solving") product.[4] Given its plan to build on the image/use of a well-known brand, J&J concluded that effective expansion of K-Y necessitated a re-launch of the entire range (including basic jelly) and, consistent with that, required a relatively large promotional investment that other companies (unimpeded by the need to re-focus consumer perceptions) need not make.[5] [✂]

2.8 J&J's proposed date for launch of an "enhanced" line in the UK evolved in early autumn of 2008 into a proposed launch of K-Y *Yours+Mine* in 2009. However, the company's interest in pursuing this initiative had cooled considerably by then. [✂] Accordingly, all of J&J's "enhanced" lubricants were soon discontinued in the UK.

2.9 In September 2008, [✂], J&J's Global Operations Committee took up a recommendation to "*discontinue pursuit of aggressive K-Y expansion*" and to "*eliminate [the] global franchise*". [✂]

2.10 The CMA noted during its Phase I review that J&J's UK business generated several documents more recently which suggest that the company might be reconsidering its decision not to expand in K-Y. However, reliance on these documents is misplaced. [✂] However, these documents consist of nothing more than preliminary proposals – they are not plans that the company adopted or attempted to implement. None of these visions for what K-Y might be was approved by J&J's corporate brand management teams or carried forward.

2.11 It should be noted that J&J's experience in trying to expand the K-Y brand internationally is not indicative of the kind of experience another (presumably smaller) company might have if it tried to enter or expand into the supply of personal lubricants in the UK. [✂]

[✂]

2.12 In January 2010, following abandonment of its own efforts to expand the K-Y franchise, J&J undertook "Project Ridge" in an effort to find a partner in Europe who might take a license on K-Y and expand the brand into intimacy enhancement. [✂]

2.13 In light of these and other considerations, J&J ultimately was unable to find any potential partner who was willing to assume the costs and risks of commercialising the "enhanced" K-Y product line in Europe. Accordingly, the project was cancelled.

[✂]

2.14 As noted above, J&J extensively explored both independent expansion, and expansion with a partner, of its K-Y product line. Neither of these options proved to be attractive, and both were abandoned. Accordingly, in mid-2013, J&J initiated "Project Derby" (later carried forward as "Project Soy") to divest K-Y. J&J was motivated to do this for a number of reasons

[✂]

2.15 [✂] However, it is clear that J&J's decision to exit the K-Y business was driven primarily by corporate interests that did not depend on competitive circumstances.

2.16 J&J took the final management decision to divest K-Y in February, 2013, [✂]

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4 [✂]

5 [✂]

2.17 [✂]

2.18 [✂]

- J&J ultimately executed an asset purchase agreement with RB on March 10, 2014.[6] On April 24, 2014, J&J and RB also entered into a subsequent rest-of-world Asset Purchase Agreement and a side letter relating to certain provisions of the Asset Purchase Agreement.[7]

3 A statement explaining the rationale for undertaking this merger, including the benefits and financial synergies expected to be gained from the merger.

3.1 As described above, the divestiture of K-Y forms part of a wider strategic decision taken [✂]

<u>The relevant markets</u>

4 An explanation of what you consider to be the economic markets for this inquiry – both in terms of (a) the product and (b) the geographic market.

<u>Product market</u>

4.1 The parties overlap in the manufacture and supply of personal lubricants for retail sale (CIS Code 32990 (other manufacturing)). [8]Personal lubricants are products that traditionally have been used to relieve vaginal dryness and also are used to facilitate/enhance sexual activity.

4.2 The only personal lubricant that J&J supplies in the UK is K-Y jelly, a gentle (water-based) formula originally developed in 1917 for treatment of vaginal dryness. K-Y jelly originally was made available as a prescription treatment, and still is widely regarded as a functional/medicinal product with limited "sex appeal".

4.3 RB produces a range of personal lubricants under the Durex brand that are more generally associated with sexual activity (rather than medicinal relief of vaginal dryness). These products are generally packaged in brightly-coloured, consumer- (rather than physician-) oriented boxes/bottles, may have a less gentle formula with a strong "gliding" factor (with silicon-based as well as water-based formulae), and offer a variety of "pleasure enhancement" features (*e.g.*, additives for flavours or warming/tingling sensations). RB also supplies one product, Sensilube, that is a vaginal moisturiser designed to alleviate dryness.

4.4 While the products supplied by both K-Y and Durex can be used on similar occasions (*i.e.*, to provide lubrication during sexual activity), they have different customer/brand propositions and therefore are not particularly close substitutes for each other. In particular, K-Y is positioned and perceived principally as a "functional"/medicinal product, to alleviate dryness, whereas the Durex range of products compete more closely with products under the "pleasure enhancement" banner. The following bear emphasis in this regard.

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6 [✂]

7 [✂]

8 K-Y personal lubricants are also supplied to the NHS for distribution to end users through medical practitioners. Sales to the NHS in 2013 amounted to around [✂]. There is no material overlap between the parties in this regard since RB has a minimal role in selling personal lubricants to the NHS. Supply to the NHS is therefore not considered further in this submission.

- The K-Y and Durex ranges may be distinguished to some extent by their characteristics and performance differences. Consumers that use lubricants to alleviate vaginal dryness are likely to prefer a water-based product with a relatively gentle formula, and are unlikely to be concerned about the product's "glide" factor or added tastes/sensations. In contrast, consumers using the product mainly for sexual lubrication may attach less importance to a "gentle" formula and attribute greater importance to "glide" factor (which can be enhanced with silicon) and added features (such as flavours or special sensations).

- Personal lubricants are differentiated based on marketing and product positioning. Products range along a spectrum from a medicinal/functional image to a pleasure/fun image, and therefore tend to have relatively greater appeal to different customer demographics. In particular, K-Y is generally positioned at one end of the spectrum as a functional/medicinal product that is popular with relatively mature customers, while Durex is designed to appeal to a more youthful demographic for enhancement of sexual activity. This is evident in the products' packaging; K-Y is sold in a white/light blue box with clear clinical connotations, while most Durex products are packaged in brightly-coloured, consumer-oriented boxes/bottles.

4.5 Notwithstanding this product differentiation, J&J considers that the products supplied by J&J and RB may be assessed on the basis of a single product market that encompasses all personal lubricants, in light of the following factors:

- On the demand side, personal lubricants offer broadly similar performance in terms of vaginal moisturizing and lubrication for sexual activity. While the products are differentiated through marketing and, to some extent, their functional characteristics, there is a degree of substitutability along the product spectrum. It therefore may be appropriate to assess the relative constraints arising from these differentiated products within a single product market rather than in different product markets.

- On the supply side, the manufacturing process for all personal lubricant products is fundamentally the same (although ingredients will differ) and production is relatively straightforward with limited technical requirements. There is no significant intellectual property involved, and the process for obtaining required certifications for the product as a medical device is relatively straightforward in the UK.

4.6 J&J considers that it would not be appropriate to further segment the product market by retail channel. This is for the following reasons:

- J&J makes the same products available to all of the channels that it supplies, namely, wholesalers, larger retailers/pharmacies, and larger online retailers. (J&J does not supply any specialty ("adult") retailers, although it cannot exclude the possibility that some wholesalers may supply limited quantities of its products to such retailers.) This product is the basic K-Y jelly, which is the only product supplied in the UK and is available in two pack sizes (50 ml or 75 ml). The only exception to this is J&J's sterile prescription-only 82g package, which is supplied only to pharmacies and wholesalers, primarily for onward sale to hospitals and other professional users.

- J&J does not pursue different channel-based pricing or marketing strategies. J&J's wholesale prices are based on its forecasted sales volumes and target margins, without reference to sales channel. Likewise, J&J does not apply any offline/online distinction, as many of the larger supermarkets and pharmacies sell its products both in their shops and online, wholesalers resell its products to both offline and online retailers, and J&J does not know at the time it supplies its products how its customers will sell them on.

- Consumers can easily switch between in-store and online purchases, so that prices in one channel are likely to be influenced by prices in the other channel.

Geographic market

4.7 J&J considers that the relevant geographic market for the assessment of the transaction is the UK. This reflects the following factors:

- J&J is active at the wholesale level of supply, which is conducted on a national basis as buyers from large retail chains and wholesalers place their orders centrally and distribute the products nationally themselves. J&J has no control over where its products appear on shelf, as its customers are free to choose their own customers.

- The majority of sales conducted through the online channel are through the online portals of the mass market retailers and a limited number of larger online retailers (such as Amazon). These websites are all targeted at customers in the UK.

- J&J prices and markets its products for the UK as a whole, not for smaller regions.

- All products sold within the UK must comply with UK-specific regulations.

- Conditions of competition do not differ materially within the UK, as all major competitors are active across the UK.

5 Your views on competition:

(a) within the product and geographic markets identified in the terms of reference, including any competitive constraints from outside these markets; and

(b) within any other market definition you may consider relevant including any relevant segmentations within these markets and constraints from outside of these markets.

In each of the above, please state your views on the extent of product differentiation.

This should include comments as appropriate on your competitors, customers and suppliers in relation to the relevant markets, on the level of prices and variety and quality of products in the relevant markets, and on any capital structure and financing issues.

5.1 J&J considers that the transaction will not result in any substantial lessening of competition. This is principally for three reasons, each of which is discussed in more detail below.

- First, as K-Y and Durex products are not particularly close competitors, the transaction will have no appreciable impact on existing competition.

- Second, the merged entity will face strong competition from numerous competitors across the product spectrum, and from the threat of potential entry/expansion.

- Third, retailers have substantial buyer power and can readily ensure that they receive fully competitive terms.

The parties are not close competitors

5.2 The merging parties' brands are not particularly close competitors in terms of field of use, price, packaging or special features/ingredients.

- ***Field of use.*** K-Y jelly is marketed primarily as a functional product for vaginal dryness, whereas Durex's products are marketed at the pleasure/fun end of the spectrum for use during sex. While there is some degree of overlap as both products can be used to provide lubrication during sex, there is a clear difference in product focus.

- ***Special features.*** Durex's products include a range of products with additional flavours and sensations likely to be of interest to consumers using lubricant for sexual activity. K-Y jelly does not include any such additional features or ingredients.

- ***Packaging.*** K-Y jelly is sold in a relatively simple light blue tube inside a box, whereas Durex's products are marketed in a variety of brightly coloured and shaped bottles.

- ***Price.*** K-Y jelly and Durex lubricants are not particularly close in price. Moreover, while prices for K-Y jelly have remained relatively static in recent years, prices for Durex products have materially increased.

5.3 These factors reflect the different brand positioning of K-Y and Durex, something that is also highlighted in J&J's internal documents. For example:

- [✂]

- [✂]

- [✂]

- [✂]

5.4 Given this different brand positioning, there is no meaningful promotional competition between K-Y and Durex in the UK. In particular:

- K-Y does not compete for promotional slots or marketing funding with Durex; while Durex is heavily promoted through in-store displays, print media and the like, J&J does not engage in such efforts to promote K-Y at all.

- K-Y is marketed in white/light blue boxes that convey a distinctly clinical/functional image, while Durex lubricants are normally packaged in bright-coloured boxes/bottles that promote playfulness and sex.

- The marketing staff at J&J cannot recall any instances in the last 5-10 years (at least) in which retailers have tried to obtain promotional support or other benefits by playing off K-Y against Durex.

5.5 As J&J does not actively promote the K-Y brand, and has not done so for a number of years, J&J cannot be expected to engage in promotional activity in the near future. Accordingly, post-transaction there will be no loss of competition in negotiations with retailers over promotional slots or marketing funding.

5.6 For these reasons, J&J considers that there is not particularly close competition between K-Y and Durex products, and that the transaction may therefore be expected to have no appreciable impact on competition in the market for personal lubricants in the UK.

There are numerous competitors and scope for entry/expansion

5.7 While Durex and K-Y are prominent personal lubricants in the UK, there are many others, including products supplied by Ann Summers (Liquid Satin), BBI Healthcare (Balance Activ), Bodywise (Liquid Silk), Crescent Pharma (Replens), Essential Health Products (Woohoo), Harlow Lubricants (Astroglide), Herrco Cosmetics (Super Silk), Lovehoney Ltd (Sliquid, Swoon), Pasante (Pasante), Pjur Group (Pjur, Waterglide), Sylk Ltd (Sylk), Westridge Laboratories (ID), and Yes Yes Co (Yes!). A number of large retailers also carry private label products as discussed further below. These products range across the spectrum from functional/medicinal to pleasure enhancing.

5.8 This large (and increasing) number of products is widely available. Larger pharmacies and online sellers tend to carry a range of products as a means of differentiating their product offerings, and pharmacies are expanding into newer/smaller brands (*e.g.*, Ann Summers and Lovehoney brands have been introduced into Boots and Superdrug). Supermarkets more often tend to focus on the best-selling brands, but also are expanding their ranges (*e.g.*, Balance Activ and Replens have been introduced into supermarkets like Asda and Tesco).

5.9 Private label lubricants also operate as a significant competitive constraint, as a number of retailers already offer them and others can credibly threaten to introduce them. Sales of private label lubricants at Asda, Boots, Superdrug and Tesco account for a substantial proportion of total category sales, ranging from 14-26%. As these products are generally substantially less expensive than manufacturer-branded products, and are intended to closely copy manufacturer-branded products through similar packaging and features, J&J believes that consumers are likely to regard them as close substitutes for the branded products that they emulate. Indeed, the distinction between "functional" and "intimacy enhancement" products appears to be carried over to the private label space, as there are different private label products that emulate functional products like K-Y (offered, *e.g.* by Asda, Boots and Superdrug) as well as "pleasure enhancement" products that more closely resemble Durex.

5.10 J&J believes that retailers can credibly threaten to introduce private label products should they wish to do so. Within the healthcare segment generally, retailers regularly use private label products, and the existence of several private label lubricants that account for a meaningful share of sales shows that this is a credible option in this market. The introduction of private label products therefore may be expected to operate as an implicit threat in any discussions with retailers, and constrain any attempt by the merged entity to raise prices above the competitive level.

5.11 The increasing availability of such a broad assortment, in numerous outlets, helps to ensure that even lubricants sold in more limited assortments (*e.g.*, in smaller supermarket outlets) must be supplied on competitive terms.

5.12 The existence of such a large number of competing manufacturer-branded and private label products also provides significant opportunities for cross-channel expansion. Brands that are already present in mass market retail outlets could easily expand should an opportunity arise. For example, lubricants from Ann Summers and Lovehoney have been introduced into large pharmacies, and may gain even wider distribution through supermarkets once they have developed a following. Brands that are available primarily online also may expand into physical retail outlets, as has occurred with branded lubricants from BBI (Balance Activ), Essential Health (Woohoo), Lovehoney (Swoon), Pjur and Yes (all of which are now available in chemists). There is also considerable scope for private label expansion, for the reasons noted previously.

Retailers' buyer power ensures that pricing will remain competitive

5.13 J&J considers that the merged entity will be subject to significant countervailing buyer power from major retailers post-transaction. Major retailers are large, well-resourced organisations with sophisticated and well-developed buying strategies. In J&J's experience across the healthcare sector generally, there is constant pressure from retailers to justify listings and ensure that products remain competitive in terms of product offer and price. Retailers regularly assess the range of products that they purchase, taking into account factors such as cost, sales volumes, margins, and availability of other competing products.

5.14 Retailers are able to delist products at minimal notice without compensation if they believe that it would be profitable to do so. This is particularly true because personal lubricants are not a core category for retailers, and none of the relevant products are sold under a "must have" brand. Given the infrequency of lubricant purchases by most customers, retailers are unlikely to lose customers if they do not stock a particular lubricant brand (or if they do not stock lubricants at all), so threats to de-list products are particularly credible.

5.15 [✂]

5.16 However, for the purpose of assessing the impact of countervailing buyer power, J&J submits that the relevant question is not whether retailers have exercised buyer power in the past, but whether they may be expected to do so post-transaction in response to any hypothetical attempt to increase prices. Indeed, the CMA's Merger Assessment Guidelines note that the agency should consider the impact of the merger on any countervailing buyer power (para. 5.9.8) and the impact of the merger on the customer's ability and incentive to exercise buyer power (para. 5.9.4).

5.17 In this respect, J&J considers that the change in market structure brought about by the transaction may, if anything, be expected to increase retailers' incentives to exercise buyer power when purchasing personal lubricants. Indeed, given the wide range of alternative suppliers that are competing in this market, as noted above, any attempt by the merged business to increase prices in future above the competitive level almost certainly would be met with strong and effective resistance from its customers.

6 Please summarise your company's current strategy in relation to the supply of personal lubricants to the extent that it is not explained in the latest versions of your strategy documents submitted in response to the CMA's first phase 2 factual information request – see Annex C.

6.1 As discussed in detail the responses to Questions 2 and 3 above, J&J has taken a strategic decision at the global level to exit the supply of personal lubricants. [✂]

Barriers to market entry/exit

7 A description of all the barriers to entry and expansion and the barriers to exit for each of the markets identified in the terms of reference. In addressing this issue, please explicitly consider factors such as legal or regulatory barriers, patents or know-how, licences, the importance of economies of scale and/or scope, the minimum efficient scale for a business, access to sources of supply, access to customers (e.g. obtaining shelf-space in bricks and mortar retailers), the importance of brand positioning and building brand

awareness. Please also consider the role of incumbency advantages in the form of information, reputation and cost as a barrier to entry or expansion.

7.1 J&J considers that there are few barriers to entry for new suppliers or expansion by existing suppliers, as discussed further below.

7.2 ***No legal/regulatory barriers.*** There are no appreciable legal or regulatory barriers, as the process of obtaining certifications for the sale of lubricants as a medical device in the UK is straightforward. The majority of personal lubricants fall into Class IIa, for which the manufacturer is not required to contact the MHRA directly, but instead can obtain a certificate of approval from a Notified Body, which audits compliance every one or two years against ISO 13485.

7.3 ***No IP or technological barriers.*** There are no intellectual property rights or significant know-how requirements to manufacture the products, and manufacturing of personal lubricants does not require specialised equipment. The ingredients are simply placed into a basic mixer, and the resultant mixture is normally dispensed directly into tubes that are boxed for shipment. As the same basic equipment can be used to make other healthcare products, sunk costs in the production of personal lubricants are limited. For example, a line on which K-Y branded lubricants are produced for sale in Europe is also used to produce suntan lotion, and the plant switches between the two types of products [✂]

7.4 ***No barriers to accessing sources of supply.*** Access to product supplies poses little or no barrier to entry, as personal lubricants can be readily obtained from an independent contract manufacturer. Indeed, J&J uses contract manufacturing arrangements to produce K-Y jelly in [✂], and manufactures internally only in [✂]. In this circumstance, economies of scale do not operate as barrier to entry (as is confirmed by the existence of a large number of smaller brands on the market).

7.5 ***No barriers to accessing routes to market.*** A new entrant (or expanding incumbent) need not gain listings with mass market retailers, but can minimise its sunk costs and obtain a customer following through product launches online, which then provide a basis for growth into brick-and-mortar retail. To the extent that entrants wish to gain listings with large retailers, J&J considers that promotional spending, brand awareness and shelf space do not operate as barriers. In particular:

- Promotional spending and brand awareness is not a barrier, as illustrated by the many examples of expansion into mass market retail set out above (*e.g.*, Balance Activ, Liquid Satin, Pjur, Swoon, Woohoo, and Yes). This reflects the fact that specialist health and beauty retailers such as Boots and Superdrug carry a relatively wide range of personal lubricants, and can encourage entry by newer brands. This route can also facilitate entry into supermarkets, as brands become sufficiently well established in pharmacies and thereby attract interest from supermarkets.

- As K-Y offers only a single product in the UK, the addition of a new single competing product to replicate the lost competition from K-Y should have minimal impact on retailer shelf space. [✂] Indeed, the large number of smaller brands carried by national pharmacy chains clearly shows that smaller brands can support national distribution.

7.6 In light of these low barriers to entry/expansion, and the recent examples of successful launches, J&J considers that entry or expansion from the many smaller brands of personal lubricant would pose a significant competitive constraint on the merged business.

8 **Your views as to whether there will be any sizeable entry and/or expansion into each of the markets identified in the terms of reference in the next three years. Similarly, your views on whether there will be any sizeable exit in the next three years.**

8.1 J&J is not aware of any specific plans of competitors to enter, expand in, or exit the UK in the next three years. However, as noted above, a large number of existing companies already supply a range of outlets, including mass market retailers, online retailers, and adult retailers. J&J considers that these could rapidly expand their activities in response to an opportunity in the traditional retail sector.

Countervailing buyer power

9 **A description of how you perceive that buyers of personal lubricants (i.e. retailers) have been able to exercise countervailing buyer power in relation to each of the markets set out in the Terms of Reference, particularly showing how attempts to increase prices have been restrained due to the exercise of buyer power. To the extent possible, please describe how buyer power may differ across different sales channels (e.g. bricks and mortar retailers, online distributors, etc) and outlets (e.g. independent pharmacies, supermarkets etc.).**

9.1 For the reasons given in response to Question 5, J&J considers that retailers have the ability to exercise countervailing buyer power, and that they will have an increased incentive to do so post-transaction to ensure that they continue to obtain competitive prices from personal lubricant suppliers.

10 **A description, supported by data and/or examples, of the strategies adopted by each of the major retailers of personal lubricants, in the markets set out in the Terms of Reference, to ensure that they receive a competitive supply of personal lubricants.**

10.1 Please see the response to Question 5.

11 **How would the exercise of buyer power in each of the markets set out in the Terms of Reference be affected by the merger?**

11.1 Please see the response to Question 5.

The counterfactual

12 **A description of what would happen/would have happened, in the absence of the merger situation, to the supply and demand of lubricants in the UK.**

12.1 [✂]

13 [✂]

14 **A statement setting out the expected consequences of the acquisition on competition, including, in particular, the effect on customers. You may wish to cover in your answer the expected effects on prices, quality, availability and innovation. The submission should**

address the issues identified by the CMA in its decision that it is under a duty to refer the merger to a phase 2 inquiry.

14.1 The CMA determined that it was under a duty to refer the transaction because: (i) the parties are close competitors and so the transaction may result in the loss of competition; (ii) other actual and potential suppliers would not sufficiently constrain the merged entity; and (iii) the bargaining power of retailers would be reduced.

14.2 For the reasons set out in response to Question 5, J&J considers that each of these assertions is incorrect. In particular:

- There is not particularly close competition between K-Y products and Durex products, so the transaction may be expected to have little impact on competition in the market for personal lubricants in the UK.

- There are numerous suppliers of personal lubricants in the UK, and considerable scope for entry or expansion, particularly by the large number of suppliers that are active through online and specialty retailers.

- Large retailers have very substantial buyer power and, time and again, have shown their readiness to use it. Far from reducing such power, the transaction may, if anything, be expected to increase retailers' incentives to leverage it, so that they continue to receive supplies of personal lubricants on fully competitive terms.