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

RESPONSE TO THE CMA'S

NOTICE OF POSSIBLE REMEDIES

June 5, 2015

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Below are responses on behalf of Johnson & Johnson ("J&J") to the possible remedies that the Competition and Markets Authority ("CMA") has detailed in its Notice of May 22, 2015 (the "Remedies Notice"). Each of the options suggested by the agency is addressed in turn below.

I. Prohibition

As its first proposed remedy, the CMA has noted the possibility of prohibiting completion of the notified acquisition. For reasons discussed below, J&J believes that prohibition would not be appropriate. In particular, [✂], prohibition would lead to the foregoing of consumer benefit that would otherwise exist if the notified acquisition were approved[1].

The CMA (and its predecessors) have recognised that "Full prohibition of an anticipated merger will generally be an effective remedy as it necessarily maintains the competitive structure of a market that would have otherwise been changed by the merger"[2]. However, the CMA has questioned whether a prohibition would be effective here because "as J&J has completed the transaction in most jurisdictions, there is a risk that J&J would have a reduced incentive to continue to support and invest in the UK K-Y business such that it would be an effective competitor in the UK"[3].

For reasons discussed with respect to Option II, below, J&J respectfully submits that this concern misapprehends the proper scope of pre-merger review. In any event, however, to consider this a problem with Option I seems to turn the regulatory assessment on its head, treating grounds for clearance as grounds for intervention.

As the CMA is aware, [✂]. Likewise, for reasons explained at the main hearing, [✂].

The CMA's provisional counterfactual assumes J&J's sale of its K-Y interests worldwide to a company other than RB. For reasons to be discussed in its response to the agency's provisional findings, J&J respectfully submits that this is not correct, and that the proper counterfactual must take into account [✂] as noted above. The remainder of the discussion in this section (regarding possible prohibition) assumes the adoption of that counterfactual.

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[1] J&J also notes, as a matter of good order, that it does not believe the transaction can be expected to result in a substantial lessening of competition such that prohibition would be warranted in any case. However, that is not addressed further in this paper.

[2] CC8, *Merger Remedies: Competition Commission Guidelines* (2008), paragraph 2.3.

[3] Remedies Notice, paragraph 9.

Section 41(5) of the Enterprise Act 2002 (the "Act") provides that the CMA, in ordering remedial action, "may, in particular, have regard to the effect of [that] action on any relevant customer benefits in relation to the creation of the relevant merger situation". Such customer benefits are of paramount importance here. [✂], sale of the UK K-Y business to RB would ensure [✂] to consumers in the UK. [✂] within the meaning of section 30(1)(a) of the Act[4].

J&J considers it highly unlikely that RB would try to re-position K-Y or increase its price after acquiring the brand, given K-Y's unique consumer proposition, established price point, and lack of any material promotion. Similarly, J&J believes that the buying power of mass market retailers, and the ease with which rivals can enter or expand, are likely to constrain any such efforts by RB. However, even assuming that RB were able to take such action, that must have less impact on consumer welfare than [✂].

Under the CMA's Guidelines on merger remedies, consumer benefits foregone due to implementation of a remedy must be considered costs of the remedy[5]. Accordingly, prohibition of the notified transaction, [✂], is clearly disproportionate in relation to any lessening of competition that might be anticipated from RB's purchase of the UK K-Y business. Remedies other than prohibition (if, indeed, need for a remedy truly exists) almost certainly would be more effective in promoting consumer welfare and serving the policy aims of pre-merger review.

II. Divestiture by Johnson & Johnson

As an alternative to simple prohibition, the CMA has suggested that a requirement that J&J divest the UK K-Y business to a party other than RB might be appropriate[6]. For reasons discussed below, J&J respectfully submits that such a remedy cannot lawfully be imposed.

A. The proposed remedy would be *ultra vires*.

J&J believes that it would be both extraordinary and unprecedented for the CMA to attempt, by means of a pre-merger review, to restructure a market because it does not like how a company other than the party making the acquisition under review is operating (or plans to operate) its business. Divestiture may be ordered when a purchaser has completed an acquisition and its effects must be redressed — not when a regulator decides, on the basis of

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[4] For reasons discussed elsewhere, J&J does not believe that [✂] should give rise to serious concern, because at least five of the major retailers (Asda, Boots, Lloyds, Superdrug, and Tesco) have own-label products that are very similar to K-Y and can be expected to stock those more prominently if [✂]. Given the fact that consumers buy personal lubricants very infrequently (i.e. typically plan their purchase) and almost certainly visit one of these stores on a periodic basis (particularly one of the major pharmaceutical chain stores, regardless of where they shop for groceries), J&J believes that consumers who want a functional/medicinal lubricant can readily buy an own-label substitute [✂]. Retailers also can readily stock another very common, manufacturer-branded gel, *Replens*, that is sold in packages looking much like K-Y and identified as both a vaginal moisturiser and a "personal lubricant".

[5] CC8, *Merger Remedies*, paragraphs 1.9, 1.13.

[6] While the CMA has referred in the alternative to "divestiture" and "licensing" in discussing this proposal, these essentially amount to the same thing given the nature of the assets constituting the UK K-Y business.

information obtained in a pre-merger review, that it does not like what the existing owner intends to do with its business if a sale is prohibited[7]. For the CMA to depart from such well-established principles would create a host of complications (both procedural and substantive) in pre-merger reviews and would place the CMA on the fringes of internationally accepted practice.

Quite apart from the very troubling policy implications of such a remedy, J&J respectfully submits that the CMA would be acting outside its statutory powers in attempting to order divestiture by J&J. Such an order would be *ultra vires* both because proper construction of the Act excludes a remedy of that kind, and because imposition of such a remedy here would be outside the terms of reference and scope of the findings required by the Act.

1. <u>The terms of the Act exclude such a remedy.</u>

Section 36(1) of the Act establishes a basic framework for the assessment of anticipated mergers. In that basic framework, the CMA must decide two questions – first, whether "arrangements are in progress or in contemplation which . . . will result in the creation of a relevant merger situation" ("RMS") and, then, whether that RMS may be expected to result in a substantial lessening of competition ("SLC")[8].

An RMS is created, as a matter of law, when "two or more enterprises have ceased to be distinct"[9]. The CMA's provisional findings in this case establish that one of the relevant "enterprises" is "the business of supplying K-Y branded personal lubricants to retailers and wholesalers in the UK"[10]. No party has disputed this and, indeed, that finding appears to be unavoidable given reference of this transaction under section 33 of the Act (as an "anticipated merger") long after J&J completed the sale of its K-Y interests in most of the world.

Given its identification of the RMS, the CMA then must decide "whether the creation of *that situation* may be expected to result" in an SLC[11]. The linkage between these two points is sufficiently strong that the CMA's *Merger Assessment Guidelines* state that the agency "is not required to consider the second question if it decides that no relevant merger situation exists"[12].

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[7] It is instructive in this regard that commentators regularly cite the prevention of an anticipated merger (or divestiture of a business already acquired) as the most comprehensive remedy the agency is empowered to order in a pre-merger review. See, e.g. Parr, Finbow & Hughes, *UK Merger Control*, section 5.049 (remedies "may range from the giving of undertakings to behave in relation to the merged business in a [prescribed] manner . . . to the prevention in its entirety of a contemplated merger or the complete divestment of the business, the earlier acquisition of which has resulted in the reference").

[8] Enterprise Act 2002, section 36(1).

[9] Enterprise Act 2002, section 23.

[10] Provisional Findings, section 5.11.

[11] Enterprise Act 2002, section 36(1)(b) (emphasis added).

[12] OFT 1254/CC2, *Merger assessment guidelines (revised)* (2010), paragraph 2.11. See also, e.g. *British Sky Broadcasting Group plc v Competition Commission* [2010] EWCA Civ 2, paragraph 12 ("the duty of the [regulator] is to decide whether an RMS has been created, and *if so* whether the creation of *that situation* has resulted, or may be expected to result, in an SLC") (emphasis added); Parr, Finbow & Hughes, *UK Merger*

The Competition Appeal Tribunal ("CAT"), likewise, has consistently held that any remediable SLC must be causally connected to the RMS. For example, in *BSkyB*, the CAT stated that the regulator "must ultimately ask itself whether it is satisfied on the balance of probabilities that there will be an SLC *caused by the RMS*"[13]. In *Ryanair*, the CAT accepted that the regulator can properly consider only "effects that flow from the creation of the relevant merger situation"[14]. Likewise, in *Celesio*, the CAT emphasised that the regulatory assessment must address what competition may be lost as a result of the merger that is under review[15].

In short, the CMA is required to follow a clear chain of analysis in its pre-merger reviews. First it must identify the RMS; then it must determine whether an SLC is likely to result from that RMS; and, finally, it must decide how to remedy the SLC that has been so identified[16]. The fact that it is engaged in a pre-merger review does not empower the CMA to impose remedies for a potential lessening of competition that arises from anything other than the relevant RMS. As noted by the CAT:

> "Parliament has deliberately conferred upon the [regulator] a wide range of remedial powers from which it is required, *in relation to any RMS*, to select such powers as are appropriate to comply with its statutory duty under sections 35(4) and 41(4) of the Act. . . . *Plainly, that duty cannot require or justify the exercise of a remedial power that is not available in relation to that RMS*"[17].

In light of the foregoing, a remedial proposal that is meant to address J&J's "reduced incentive" to support the UK K-Y business is fundamentally flawed. Such a proposal rests on conflation of the statutory terms "arrangements" and "situation". The CMA has found that J&J's sale of K-Y worldwide constitutes "arrangements . . . in progress or in contemplation" that will result in an RMS[18]. It is these "arrangements" that have created the commercial incentives of concern to the agency. However, as noted above, the RMS itself is something different – a situation that is created as a result of the "arrangements", and not the "arrangements" themselves. That the Act distinguishes between "arrangements" and the "relevant merger situation" requires that

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Control: Law and Practice (2d ed. 2005), section 5.018 ("the terms of a merger reference require the [regulator] to report on whether a qualifying merger exists and, *if so,* whether *that merger situation* might be expected to result . . . in a substantial lessening of competition") (emphasis added).

[13] *British Sky Broadcasting Group plc v Competition Commission* [2008] CAT 25, paragraph 80 (emphasis added), *appeal dismissed*, [2010] EWCA Civ 2.

[14] *Ryanair Holdings Plc v Competition Commission* [2014] CAT 3, paragraphs 145-154, *appeal dismissed*, [2015] EWCA Civ 83.

[15] *Celesio AG v Office of Fair Trading* [2006] CAT 9, paragraphs 173-175.

[16] Thus, the CMA is empowered "to remedy, mitigate or prevent *the substantial lessening of competition concerned* . . . [and] any adverse effects which have resulted from, or may be expected to result from, the substantial lessening of competition" (Enterprise Act 2002, section 41(2) (emphasis added)).

[17] *Akzo Nobel N.V. v Competition Commission* [2013] CAT 13, paragraph 85 (emphasis added), *appeal dismissed*, [2014] EWCA Civ 482.

[18] Provisional Findings, section 5.10.

the CMA do likewise; the agency cannot apply a statute in ways that would render any of its terms superfluous[19].

Any effort by the CMA, in the context of a pre-merger review, to require that *a seller* dispose of *its own business* after the agency has prohibited a reviewable sale of that business must be *ultra vires*, because prohibition of the RMS eliminates any possibility of an SLC resulting from the RMS. Any other harms that might be identified necessarily flow from something other than the RMS and, therefore, cannot lawfully be addressed under section 41 of the Act.

2. The CMA's terms of reference and findings do not permit such a remedy.

Quite apart from proper construction of the statutory scheme, an order requiring divestiture by J&J would be *ultra vires* because it would not be properly grounded in the terms of reference or findings in this review, as required by the Act.

This review was undertaken pursuant to terms of reference made under section 33 (as an "anticipated merger") well after the CMA knew that RB had acquired K-Y in most of the world; the CMA defined the RMS with reference to J&J's "business of supplying K-Y branded personal lubricants to retailers and wholesalers in the UK"; and the CMA made a competitive assessment that was focused entirely on customers, competitors, conditions of supply, and consumer preferences in the UK[20]. In short, this review was undertaken and completed as an assessment of the likely competitive effects of combining the supply of K-Y and Durex personal lubricants in the UK.

The proposal that J&J divest the UK K-Y business focuses on an entirely different question – namely, J&J's likely commercial incentives following disposal of its K-Y interests outside the UK. That is wholly outside the terms of reference and was addressed in only a very tangential and incomplete fashion in the CMA's review[21].

In *Thomson Holidays* (1999), the Court of Appeal addressed the question of remedies after the Monopolies and Mergers Commission ("MMC") found that a tour operator infringed the competition laws in a contract that prohibited travel agents from offering other operators' holiday packages at a discount without offering an equivalent discount (for which it did not offer funding) on its own packages. In response to this finding, the Secretary of State made an Order prohibiting the tour operator from imposing any restriction in respect of its travel agents'

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[19] See, e.g. *Akzo Nobel*, [2013] CAT 13, paragraph 77 ("in some cases, section 86(1) necessarily precludes the making of an order that the [regulator] would, but for the presence of that section, be empowered and wish to make: if Parliament had intended otherwise . . . it could simply have excluded section 86(1) from the Act").

[20] Consistent with the foregoing, the CMA over the course of its review also sought (and received) periodic confirmation from the parties that assets relating specifically to the UK business have not been transferred.

[21] Further discussion of J&J's current and future commercial incentives, about which the CMA has neither sought nor developed substantial evidence in this review, is set forth in section II.B.2 of these comments below.

offer of other operators' packages. The Court of Appeal ruled that the Order was "on its face unlawful" because it exceeded the reach of the MMC's inquiry and findings[22].

The proposed remedy here would suffer from the same, irredeemable flaw – namely, it would be undertaken in order to address concerns (that is, J&J's current and future commercial incentives following *sale of the K-Y business outside the UK*) that were not the subject of the CMA's reference or findings (that is, the likely competitive effects of *combining the K-Y business in the UK with RB's business*). Such a remedy "travels far beyond the fulfilment of the [statutory] purpose"[23] and, therefore, would be *ultra vires*.

B. <u>The proposed remedy would be unreasonable and disproportionate.</u>

It is a commonplace in the law that the CMA, when fashioning its orders, "must exercise its powers reasonably and proportionately"[24]. For reasons discussed below, an order requiring J&J to divest the UK K-Y business would be neither reasonable nor proportionate.

1. <u>Such a remedy would be unreasonable and ineffective.</u>

An order requiring J&J to divest the UK K-Y business would be an unreasonable and ineffective response to the CMA's findings in this review, because it would not address an SLC arising from the RMS (as discussed in section II.A above). Such an order also would be unreasonable in light of the concerns about proportionality discussed in section II.B.2 below. In the interests of brevity, J&J does not reiterate those discussions in more detail here, but incorporates them by reference as matters that warrant the CMA's serious consideration.

2. <u>The proposed remedy would be disproportionate.</u>

The CAT has noted that an order of divestiture is "a seriously intrusive step" – indeed, one that engages a company's A1P1 rights under the European Convention of Human Rights[25]. Accordingly, the CMA must ensure that any divestiture it might order is truly proportionate to the problem being addressed[26]. This is generally understood as requiring, *inter alia,* that the remedy be no more onerous than is reasonably required to achieve a legitimate aim, and that the remedy be the least onerous of any equally effective measures.

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[22] *R v Secretary of State for Trade & Industry ex parte Thomson Holidays* [2000] U.K.C.I.R. 189.

[23] *Thomson Holidays*, slip op. p. 18.

[24] *Stericycle International LLC v Competition Commission* [2006] CAT 21, paragraph 130. See also Enterprise Act, sections 36(3) and 41(4) (requiring that any remedies adopted in current review must be "reasonable and practicable").

[25] *Ryanair Holdings Plc v Competition Commission* [2014] CAT 3, paragraph 195, *appeal dismissed*, [2015] EWCA Civ 83.

[26] *Ryanair*, [2014] CAT 3; *Groupe Eurotunnel S.A. v Competition Commission* [2013] CAT 30, paragraph 381 ("in deciding on remedy the [regulator] must comply with the principle of proportionality").

An order requiring J&J to divest the UK K-Y business cannot meet the requirement of proportionality because it would not serve a legitimate aim; for reasons discussed above, it would not remedy any SLC found to result from the RMS in this case. Further, such an order would impose harms on J&J far exceeding what is reasonably required to remedy any loss of competition between K-Y and Durex.

J&J opposes an order of divestiture, [✂], for several reasons.

First, a company's [✂] is very different from a regulatory order. Unconstrained by an order, [✂] its commercial interests and incentives in the future. For example:

- J&J might decide to preserve or restore its current income stream from the supply of K-Y, [✂] if a change in the performance or profitability of other products creates incentives for the company [✂].
- J&J might receive [✂][27].
- Production at the plant from which J&J has supplied the UK K-Y business might vary (given, e.g. adjustments in the product mix) in ways that incentivize [✂] in order to better utilise that facility.
- J&J might decide to re-enter the supply of personal lubricants at some time in the future and wish to use assets related to the UK K-Y business as a means of doing so.

J&J does not currently consider any of the foregoing to be likely. However, the possibility of some change in the company's commercial interests and incentives cannot be entirely excluded, and the current review cannot lawfully foreclose such possibilities through a forced divestiture of J&J's own business to a third party.

Second, a forced divestiture could impose other significant (potentially irremediable) costs on J&J, as noted at the hearing. For example:

- The process of preparing the business for sale, and then running the sale process itself, would require [✂] and would divert company resources from other, more important projects.
- Further, J&J might attempt to sell the business and find that the only available purchasers pose unacceptable risks to J&J's reputation as the previous owner. Various suppliers of personal lubricants position their products in ways that are entirely incompatible with J&J's reputation. For example, several companies that are active in or entering UK supply of personal lubricants employ brand names and packaging that clearly associate sex with violence/power (e.g. Pasante's *Bullet*® and Empowered Products' *Gun Oil*®). Others have brands that many would regard as crude or offensive (e.g. FP Company's *Fuck Powder*® and M&K Products' *FIST*®). The association of K-

[27] [✂]

Y with such a company though, e.g. co-branding or multi-product advertising, could offend many J&J customers who do not realise that J&J no longer owns K-Y[28].

In sum, an order requiring J&J to divest the UK K-Y business could impose serious costs – both immediate (in terms of the divestiture-related costs and potential harms to the company's reputation) and prospective (in a loss of commercial flexibility/opportunities). Whether J&J would actually take any of the foregoing actions, in principle, is immaterial. The fundamental point is that J&J, as the legitimate owner of a business, must be able to determine not only the operation of its business but also the terms on which and any acquirer to whom it might wish to sell that business. A pre-merger review that relates to a potential sale of that business can result in prohibition of the sale, or the establishment of obligations on the acquirer that remedy any loss of competition from completion of the sale. However, it may not lawfully result in the imposition of substantial costs on the seller over and above these measures[29].

III. Other potential remedies

J&J understands that RB proposed various undertakings in Phase 1 with respect to the pricing and/or licensing of K-Y in an effort to address the CMA's concerns. While J&J is not in a position to comment on such proposals, it respectfully suggests that these should be considered in light of the fact that the CMA's choice of remedies is governed by section 41(4) of the Act, which makes clear that "there are degrees of comprehensiveness, and that a less comprehensive solution may be chosen if a more comprehensive one would be unreasonable and/or impractical"[30].

J&J respectfully submits that various concerns expressed about other options in the Remedies Notice, while doubtless valid in many cases, appear to overlook some rather fundamental considerations in this case. For example, the CMA's suggestion that "it would be difficult to determine the correct starting price" for a price cap appears to be insupportable in light of the fact that the price of K-Y has not changed in at least three years (indeed, the CMA has repeatedly noted that it is difficult to assess the existence of buyer power precisely because J&J has not sought any price increase in the period under review). Likewise, while RB can comment more knowledgably about its commercial plans than J&J can do, it seems apparent that RB already has an extensive array of personal lubricants and is unlikely to make appreciable changes in the formula or packaging of K-Y; a good deal of the value in what RB proposes to acquire derives from the fact that K-Y is a product with a long heritage, with which customers are familiar and comfortable. Finally, it appears very unlikely that a behavioural

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[28] As J&J testified at its main hearing, the company has had cases where it sold a brand and had to field consumer complaints years later about how the brand was being used (Transcript, 9 April 2014, pp. 7-8).

[29] While the proportionality of a divestiture order may depend in some cases on the parties' ability to foresee and avoid the costs of potential divestiture (*Ryanair*, [2014] CAT 3, paragraphs 195, 214; CC8, *Merger Remedies*, paragraph 1.10), this transaction has been conditioned on CMA approval, and an unprecedented order that the seller divest its business to a third party cannot reasonably be regarded as foreseeable. Accordingly, the costs of divestiture must be taken into account in this case, and clearly demonstrate that any such remedy would be disproportionate.

[30] *BSkyB*, [2008] CAT 25, paragraph 317. While the CAT reached this conclusion in construing section 47(9) of the Act, the relevant statutory language there is identical to section 41(4).

remedy would require costly monitoring/enforcement, given the fact that K-Y is a homogenous product that is sold in two standard packages (so that any price changes would be immediately obvious) and there are no appreciable product development or promotional activities to be monitored or preserved.

While J&J does not have access to any remedy proposals that RB may be preparing, there clearly are significant costs and infirmities in any structural remedy that has been identified. Accordingly, J&J is of the view that such behavioural alternatives as might be proposed warrant serious consideration.

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J&J trusts that the foregoing views will assist the CMA in reaching a well-grounded and effective remedy (if one is ultimately found to be necessary) in this case. We stand ready to meet with the CMA and to discuss the foregoing, or any other concerns arising from this case, if that would be of assistance.