

RECKITT BENCKISER/K-Y BRAND MERGER INQUIRY

Summary of response hearings with Combe

Summary of response hearing on 12 June 2015

Views on the CMA's provisional findings and possible remedies

1. Combe agreed with the CMA that if the merger went ahead it would lead to a significant lessening of competition. Combe said structural remedies were preferable to behavioural remedies, and that amongst the available structural remedies a divestiture option was preferable. [✂]

Prohibition of the merger

2. Combe said if the merger was prohibited, Johnson & Johnson (J&J) might put less focus on the K-Y brand in the UK. Combe highlighted that J&J's sale of the Monistat brand and the K-Y brand globally indicated that J&J might at some point exit the intimate health market, so retaining the K-Y brand only in the UK would be immaterial to J&J.
3. Combe said even brands with great equity needed investment. If there was no investment in the K-Y brand over time, consumers would switch to Durex personal lubricants.

Divestment of the K-Y brand

4. Combe said it was hard to tell who else might want to buy the K-Y brand in the UK. Combe said the buyer should have some understanding of the dynamics of the personal lubricant market. Combe said retailers were good at offering consumers selection and a place to shop but were not proven as great innovators of products. Any buyer for the K-Y brand would need to be able to compete with Reckitt Benckiser (RB) in terms of resources.
5. Combe said any divestiture package would need to include measures to ensure the market position of the K-Y brand in the UK was transferred and maintained. All existing customer contracts for K-Y products should be passed to the purchaser. The package should also include transitional arrangements for the manufacture of the products and provision for co-branding with other products to exploit the brand recognition and create product innovation.

6. Combe said any potential buyer should have all the rights and assets to the K-Y brand that RB enjoyed in other markets to create the best competitive environment. Long-term manufacturing might not be required, but it might be helpful for any existing sourcing arrangements with third parties to be transferred as part of the divestment. Any regulatory constraints would also need to be addressed in relation to the transfer of manufacturing.
7. Combe said, generally speaking, intellectual property principles would control how the K-Y brand was operated by different owners in different countries. A divestiture could prevent RB from using the K-Y brand in the UK in any way because the purchaser would own the brand. Trademark rules could protect both the purchaser and RB on how the K-Y brand was used in different territories.
8. Combe said it imagined there were local laws that could protect the parties in relation to imports and exports of K-Y across the EU. Combe highlighted, as an example, that the brand 'Merck' was owned by one company in the USA and another company in Germany and this example might offer some lessons. The CMA asked Combe to provide further information on its view of the parallel imports issue.

Licensing of the K-Y brand

9. Combe said that a permanent divestiture of the K-Y brand was the preferred option. A purchaser would have more incentive to invest in the brand compared to a licensee, unless the licence was very long-term. Otherwise, a licensee could wind down its investment and commitment in the K-Y brand towards the end of the licence period. RB could then benefit by taking back the weaker K-Y brand and allowing it to die.
10. Combe said that even if the licensee was able to use the K-Y brand to build up another product through co-branding, the K-Y brand would return to RB at the end of the licence period. The licensee could then end up competing against a brand it had built up.
11. Combe said there was a big difference in divestiture compared to licensing. [✂] Combe could not imagine a scenario where licensing would address the substantial lessening of competition if the K-Y brand would revert to RB at the end of the licence period. Short-term licensing would also prevent investment to innovate the K-Y brand.
12. Combe said that no licensing tenure less than perpetuity would offset some of its issues. [✂] Combe said the provisional findings showed it was very difficult

for new players to enter the market, so a short-term licence would not be an appropriate solution.

Summary of response hearing on 1 July 2015

13. Combe outlined a two-part remedy package it considered workable. First, a full divestiture by way of a direct sale of the K-Y brand in the UK by J&J without any contractual/economic involvement of RB. The sale would include: all K-Y branded products (not just personal lubricants); product formulation and manufacturing know-how; 'trade dress' and other packaging; supporting material such as market research and consumer data; current product registration dossiers; existing distribution supply chain contracts, existing customer contracts; existing supply agreements; and any stock of existing K-Y products. Second, transitional arrangements dependent on the purchaser's needs but limited to a period of 18 to 24 months.
14. Combe suggested some practical difficulties if the remedy was limited in geographic scope to the UK. Some large customers, for example Boots and Tesco, sold the same products to the UK and Republic of Ireland so these customers might be able to buy K-Y products from RB in Ireland for sale in the UK. Combe said it understood that it would be difficult to protect against parallel imports of K-Y products to the UK under a licensing scenario because, according to Combe's understanding, the default position within the European Union single market was no restriction of parallel imports if the products were legitimately purchased from the brand owner or from that owner's authorised third party. Combe suggested that it understood that this issue could not be fully addressed by a licensing remedy, but that a permanent divestiture offered the best possible protection from parallel imports.
15. Combe explained its basic understanding of the principles relating to parallel imports in the European Economic Area (EEA). Based on Combe's understanding, when a trademark owner distributes or licenses its trademarked goods to another party, they were considered to have exhausted their Intellectual Property rights and could not, therefore, stop others from dealing in those goods, unless there was a clear territorial divestiture/assignment of the brand between parties. Combe mentioned the European Court of Justice (ECJ)'s judgement in the Ideal Standard case of June 1994 (case number B/9/93). As far as Combe understood, the ECJ held in that judgment that any brand split via assignment within the EEA fully separated and protected the brands by territory so long as there was no economic link between the two brand owners. A licensing arrangement was deemed to be an economic link. Combe also mentioned a European Union (EU) merger

inquiry concerning Bayer Healthcare and Roche (reference COMP/M. 3544) where permanent divestiture restricted to certain territories had been allowed. Combe suggested both cases might be relevant for the CMA's inquiry. Combe stressed that this was only based on its own understanding of the law, but invited the CMA to confirm this understanding with its own legal experts.

16. Combe said a licence would not solve the potential substantial lessening of competition identified by the CMA. K-Y was a strong brand that consumers wanted to buy, and it would not be possible to build up a new brand and transition customers to it under a five year licence period. Combe said brand equity was key, and there was a risk to this equity when trying to transition from one brand to another. Transitioning consumers between brands took a lot of effort and was not always successful. Combe also said it was difficult to quantify the business risk if the licensee was expected to transition to another brand. The licensee would put its own brands at risk.
17. Combe said that, based on its understanding of the legal framework/EU rules on parallel trade, a licensing agreement could never fully address the issue of parallel imports, and there might also be an issue with direct imports. While it might be possible to address any active sales of K-Y by RB through a non-compete agreement, this agreement might only be permissible for a limited period of time of a few years.
18. With regard to a licensing solution, Combe said that, if anything, five years was too short a period for a licensing agreement, and a black-out period would be helpful. Combe said any licence would have to be for a minimum of ten years with perhaps an option to renew unilaterally for another ten years. Combe said one year would be too short for a black-out period. K-Y products were still likely to be in circulation for a large part of that year as large retailers such as Boots and Tesco could have six months' worth of inventory in their warehouses. Combe said the K-Y products could also be present on the internet and in independent pharmacies' distribution systems for many years. Combe stressed once more that the preferable solution would, therefore, be a full-on divestiture of the K-Y brand.
19. Combe said it was important to consider the characteristics of the market when determining the duration of any remedy. Combe said it was difficult to gain entry in the personal lubricants market because retailers only had limited shelf space for these products and they preferred to stock only Durex and K-Y.
20. [✂]