CMA
Competition & Markets Authority

ANTICIPATED ACQUISITION BY RECKITT BENCKISER GROUP PLC OF THE K-Y BRAND IN THE UK

Summary of final report

Notified: 12 August 2015

1. On 7 January 2015, the Competition and Markets Authority (CMA), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred the anticipated acquisition by Reckitt Benckiser Group plc (RB) of the K-Y enterprise in the UK from McNeil-PPC, Inc., (McNeil) a subsidiary of Johnson & Johnson (J&J), for further investigation and report by a group of CMA panel members (the inquiry group).

2. The CMA must decide:

   (a) whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and

   (b) if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

3. RB is a global consumer goods company, headquartered in the UK, that manufactures and sells a range of health, hygiene, home, food, and pharmaceutical products with operations in 66 countries worldwide. RB is owner of the Durex brand.

4. The business of supplying personal lubricants under the K-Y brand is owned by McNeil-PPC, Inc., a subsidiary of J&J. J&J is the ultimate parent of a global group of companies with more than 100 brands and with operations in more than 60 countries.

5. RB and J&J (the parties) entered into an Asset Purchase Agreement on 10 March 2014, pursuant to which RB agreed to purchase, and J&J agreed to sell, the rights, liabilities, and assets relating to the K-Y brand globally (the K-Y business).

6. The acquisition has completed, following clearance (where required), in approximately 50 countries. The Commerce Commission in New Zealand has declined an application by RB to purchase the K-Y business in its jurisdiction. Completion of the acquisition in the UK is conditional on UK merger control clearance. The CMA understands that no assets have been transferred that are specifically related to the UK business.

7. We concluded that the CMA has jurisdiction to assess this merger as arrangements are in progress or contemplation which, if carried into effect, will result in enterprises ceasing to be distinct, and the parties overlap in the supply of personal lubricants in the UK, and as a result of the transaction RB's total share of supply will be greater than 25%.

8. We were told by J&J that had it not sold the K-Y business to RB, the K-Y business would still have been sold globally and the most likely alternative purchaser would have been the next highest bidder. This company confirmed to us that it had no specific plans for the K-Y business in the UK had it succeeded with its bid, and therefore we concluded that in the absence of this merger the conditions of competition prevailing in the UK in relation to the supply of K-Y would not have been materially different from the pre-merger situation, and that this was an appropriate benchmark for us to use as our counterfactual.

9. RB and J&J overlap in the supply of personal lubricants. These products are sold principally to grocery retailers and national pharmacy chains, independent pharmacies, online and in specialist (adult) shops. Grocery retailers and national pharmacy chains are supplied directly by RB and J&J, whereas independent pharmacies, online retailers and specialist (adult) shops are typically supplied by wholesalers.

10. Grocery retailers and national pharmacy chains sell only a small number of different personal lubricant brands (in many cases these retailers only stock the parties' brands or the parties' brands and their own-label products) due to limited shelf-space. We found that the decision of grocery retailers and national pharmacy chains as to which personal lubricant brands to source and put on their shelves is strongly influenced by consumer preferences, brand-awareness and/or marketing support behind the brand.

11. We conducted a survey to examine, among other things, the extent to which consumers substitute between supply channels. Given the limited evidence of switching and the differing nature of competition within different supply channels evidenced by our survey and other market information, we concluded that it is appropriate to define four principal product markets of interest on a UK-wide basis:

(a) Supply of personal lubricants to grocery retailers and national pharmacy chains.

(b) Supply of personal lubricants to online retailers.

(c) Supply of personal lubricants to specialist (adult) shops.

(d) Supply of personal lubricants to independent pharmacies.

12. The parties argued that the Durex and the K-Y brands do not compete with each other. Many of the retailers we spoke to regard the products as being in the same market but serving different customer needs. However, others indicated that the two brands do compete.

13. In addition, the parties' internal documents show, among other things, that both parties recognise each other as competitors within the personal lubricants market in the UK. They also show that both parties are aware that their products 'over-index' different types of consumer. Surveys commissioned by the parties show overlap between the consumers of Durex and K-Y and suggest that at least some consumers use these products interchangeably. They also show that RB has made significant investment in marketing and developing the Durex Play range, but J&J has made minimal investment in the K-Y brand in the UK.

14. Our consumer survey also showed evidence that, for some consumers, Durex products and K-Y are substitutes. There was also some further indication of substitutability in the reaction of consumers to the change in Durex retail prices in 2013. Some competitors also suggested that the two brands compete with each other.

15. Based on the evidence assessed in the round, we concluded that the Durex and K-Y brands are substitutes to some consumers and impose a competitive constraint on each other. Some competitive constraint is, in addition, provided by own-label products in grocery retailers and national pharmacy chains.

16. We found very little evidence of recent successful new entry into the market for the supply of (branded) personal lubricants to grocery retailers and national pharmacy chains. Although entry has occurred, it has been temporary or limited in distribution. This is not of a sufficient scale to impose a constraint on the parties' products. Reasons given by third parties included the lack of shelf space for personal lubricants in grocery chains and the need for significant investment in brand promotion by suppliers and contribution to marketing spend in-store.

17. In contrast, in the online and specialist (adult) shops markets, shelf-space allocated to these products is not as limited as in grocery retailers and national pharmacy chains, and there is a wide choice of products. In these channels, entry by new suppliers appears relatively unproblematic. We therefore concluded that the merger may not be expected to result in an SLC in relation to these two markets. We also concluded that the merger may not be expected to result in an SLC in the supply of personal lubricants to independent pharmacies as these are supplied by wholesalers, who carry a range of alternative brands.

18. We found very little evidence of grocery retailers and national pharmacy chains using buyer power to defeat cost price rises for personal lubricants in the recent past. In 2013, many retailers actually increased retail prices by a greater margin than the increase in wholesale prices introduced by RB purely to reflect the increase in the size of its bottles. Durex personal lubricant cost prices were increased in March 2015, and these cost price increases appear to have been accepted by retailers, although it is a still a little early to know what retailers will do with their retail prices in the longer term.

19. For the reasons set out above, we have concluded that the anticipated merger may be expected to result in an SLC in the market for the supply of personal lubricants to the grocery retailers and national pharmacy chain market in which the parties currently enjoy a combined market share of 60 to 80%.

20. Having found an SLC in the market for the supply of personal lubricants to the grocery retailers and national pharmacy chain market, we considered whether action should be taken for the purpose of remedying, mitigating or preventing the SLC and its adverse effects in the relevant market, having regard to the effect of any action on any relevant customer benefits that may result from the merger.

21. On 22 May 2015 we published a notice of possible remedies, seeking views on three potential remedies relating to the UK K-Y business: prohibition of the acquisition; divestiture to a party other than RB; and licensing of the relevant rights to a party other than RB. We stated that a behavioural remedy was unlikely to be an effective remedy.

22. We received comments from the parties and a number of third parties on these possible remedies. RB proposed two potential remedies: a short-term licence and a behavioural remedy. No third parties proposed alternative remedies.

23. We concluded that licensing would be an effective and proportionate remedy in this case and considered the terms that we would need to mandate to ensure the effectiveness of this remedy. Issues that we considered included:

(a) the scope of the licence;

(b) the length of the licensing period, including any blackout period; and

(c) the need for any transitional agreements.

24. We concluded that the licensing remedy should include the following elements:

(a) The licence for the K-Y brand and related IP rights should be exclusive, comprehensive and irrevocable. The licensee would be able to use the K-Y brand alone on existing K-Y branded personal lubricants and on a co-branded basis for these and other personal lubricant products.

(b) RB will not use the K-Y brand and related IP rights in the UK during the licence and blackout period.

(c) The licence will be for a period of eight years, of which at least the last year should be a blackout period.

(d) There will be a one-off payment with no annual fee for the licence.

(e) RB should, at the licensee's request, supply K-Y at cost for a transitional period.

(f) Existing supply contracts and all information and IP rights needed to carry on the business will be transferred.

(g) The licensee will have the right to supply the NHS.

(h) The licensee will be entitled to continue after the licence period to use the K-Y formula in perpetuity.

25. These elements are specified more fully in the remedies section of the report.

26. We decided that completion of the transaction would be conditional on RB agreeing a licensing agreement in line with the criteria set out in the report. The licensee would need to be approved by the CMA and conform to the criteria specified in the remedies section of the report. If RB has not achieved this within a specified period, then we reserve the right to appoint a trustee with a mandate to agree the terms of the licence.