OFFICE OF FAIR TRADING

Anticipated acquisition by Luxottica Group S.p.A of Oakley Inc.

The OFT's decision on reference under section 33(1) given on 12 October 2007. Full text of decision published 22 October 2007.

Please note that square brackets indicate text or figures which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Luxottica Group S.p.A.** (Luxottica) is active worldwide in the design, manufacturing and distribution of sunglasses and frames for prescription glasses. Its brand portfolio includes its own brand Ray Ban and its licensed brands Bvlgari, Chanel, Dolce & Gabbana, Donna Karan, Prada, Versace and Polo Ralph Lauren. In the UK Luxottica is active as a wholesaler of sunglasses and frames for prescription glasses, and as a retailer of sunglasses and prescription glasses through its Sunglass Hut stores and through a 50 per cent stake in the David Clulow chain of opticians.

2. **Oakley Inc.** (Oakley) is active worldwide in the design, development, manufacturing and distribution of performance eyewear products, including sunglasses and prescription glasses, as well as Oakley branded clothing, footwear, watches and accessories. In addition to its owned Oakley and Oliver Peoples brands, its licensed brands include Paul Smith. In the UK Oakley is active as a wholesaler and retailer of these products. In 2006 Oakley's UK turnover was £[less than 70] million.

TRANSACTION

3. Luxottica proposes to acquire all of the outstanding shares of Oakley, subject, among other things, to clearance by the relevant competition authorities.

4. The parties filed a satisfactory submission on 22 August 2007. The administrative deadline is therefore 18 October 2007.

JURISDICTION

5. As a result of this transaction Luxottica and Oakley will cease to be distinct. The overlap between the parties' activities includes the wholesale distribution of sunglasses, for which the parties' combined share of supply exceeds 25 per cent. As a result, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

6. The parties overlap in the manufacturing and wholesale distribution of sunglasses and frames for prescription glasses and in the retail distribution of sunglasses. The parties also overlap in the retail distribution of prescription glasses, but as Oakley's retail sales of prescription glasses are negligible, the OFT has not further considered this. In addition, the parties are both active in the wholesale and retail distribution of watches, but as both parties' sales of watches are minimal on both levels, the OFT has not further considered the distribution of watches.

7. The OFT has considered wholesale and retail distribution separately, as they are distinct both in terms of their structure and scope and in terms of demand and supply side attributes. The OFT has also considered segmentation of the product scope for wholesale distribution in the same way as for retail distribution, as demand at the wholesale level (from retailers) is essentially derived from demand at the retail level (from end consumers).

Product market

8. The parties argued that sunglasses and frames for prescription glasses should be considered as separate product markets. No third parties disagreed with this segmentation.

9. On the demand side, the parties submitted that sunglasses and prescription glasses (frames and lenses) have different functions, with the former being vision protecting and the latter being vision correcting. Secondary drivers of demand for eyewear, particularly for sunglasses, relate to aesthetic (fashion-accessory) and sports-performance functions. The parties noted that the distinction in functionality between prescription glasses and sunglasses is mainly related to these products' lenses. For example, consumers may buy frames intended for sale with prescription lenses and choose instead to install non-prescription shaded lenses, and consumers may buy sunglasses with shaded prescription lenses. This results in some blurring of the distinction in functionality. However, the parties also noted that sales of these products are relatively small (for example, the sale of prescription sunglasses accounts for around 14 per cent of the sale of all sunglasses).

10. On the supply side, according to the parties it is common for wholesale suppliers of sunglasses and frames for prescription glasses also to manufacture these products. The OFT has found no evidence to indicate that manufacturers of prescription glasses (frames and lenses) or sunglasses face material costs in switching to manufacturing the other type of eyewear. Many manufacturers indeed make both prescription glasses and sunglasses. However, according to the parties, the distribution channels are to some extent different, with opticians as the main retail sales channel for prescription glasses, and department stores and fashion stores as the main retail sales channels for sunglasses.

11. The OFT has considered whether sunglasses and frames for prescription glasses should be further segmented. Some third parties identified different segments, in particular in relation to branded and premium sunglasses. Premium sunglasses were also treated as a separate segment in a Mintel market report, with premium sunglasses defined as sunglasses with a retail price from £70.[1]

12. The parties acknowledged that eyewear products have various consumer positioning, for example luxury, fashion, classic or sports. Such differences in positioning are reflected in significant price differences. However, the parties submitted that these differences do not warrant any further

segmentation in product markets, because the dividing lines between these differences are far from distinct, products tend to occupy a spectrum with considerable overlap at the margins and any segmentation of the market by price would need to take account of temporary retail price reductions. The parties also submitted that manufacturers tend to supply a broad range of eyewear with a variety of styles and sold at a variety of price points.

13. It is not necessary for the OFT to reach a conclusion about any distinction between different types of sunglasses and frames for prescription glasses, because, as set out below, the merger does not raise competition concerns in relation to any suggested separate segment.

14. The OFT has also considered whether the retail distribution of sunglasses and frames for prescription glasses should be segmented further, for example in relation to retail distribution channels. However, as the merger does not raise competition concerns in relation to any segmentation, it is not necessary for the OFT to reach a conclusion in this respect.

15. For the reasons set out above, the OFT considers that the manufacturing and wholesale distribution of sunglasses, the manufacturing and wholesale distribution of frames for prescription glasses, and the retail distribution of sunglasses form the relevant product frames of reference in this case, with possible further segmentations into different types of sunglasses and frames for prescription glasses and different retail distribution channels.

Geographic market

16. The parties argued that the geographic scope of the manufacturing and wholesale distribution of sunglasses and frames for prescription glasses is at least EEA-wide, as evidenced by the large volume of imports and exports. Both the parties and their competitors have manufacturing facilities outside the UK and to some extent also outside the EEA. For example, Luxottica has manufacturing facilities in Italy and China and Oakley in the USA and Ireland. Transport costs are low in relation to the value of the products. Also, product designs and marketing are similar across the EEA, and pricing, while not identical, is subject to broadly

---

[1] Mintel, *Sunglasses, Market Intelligence*, December 2006, page 2. The parties also submitted an earlier Mintel report (January 2006) that had been prepared for Oakley, which identified a price of £65.

comparable factors across the EEA. Regulations regarding technical and safety standards are set at the EU level. In addition, according to the parties it is not necessary for suppliers to have a presence in the UK. For example, Oakley uses a distribution centre in the Netherlands for its European distribution. Finally, brand licence agreements between manufacturers and brand owners are generally worldwide or at least EEA-wide.

17. These factors were broadly supported by third parties. However, one of the parties' competitors argued that it was fundamental for suppliers to have a presence in the UK, because they not only undertake the sale of their product but also supply a repair and substitution service, and because a network of representatives is needed, in particular for independent opticians.

18. It is not necessary for the OFT to reach a conclusion about the appropriate geographic frame of reference of the manufacturing and wholesale distribution of sunglasses and frames for prescription glasses, because, as set out below, the merger does not raise competition concerns on either the EEA or UK level.

19. In relation to the retail distribution of sunglasses, the parties noted that in past decisions the OFT viewed retail markets as local. As set out below, the merger does not raise competition concerns on either a local or a national level. Accordingly, it is not necessary for the OFT to reach a conclusion about the appropriate geographic frame of reference of the retail distribution of sunglasses.

HORIZONTAL ISSUES

Market shares

Manufacturing and wholesale distribution of sunglasses

20. Luxottica is the largest manufacturer and wholesale distributor of sunglasses, both in the EEA and in the UK. The parties estimated its share of supply by value to amount to [15-25] per cent in the EEA and [20-30] per cent in the UK. Oakley is a smaller supplier, in particular in other European countries. The parties estimated Oakley's share of supply by

value to amount to [less than 10] per cent in the EEA and [5-15] per cent in the UK. Accordingly, after the merger the share of supply of the merged company will be [15-25] per cent in the EEA, with a minimal increment, and [30-40] per cent in the UK.[2] The parties submitted that their shares by volume are substantially lower.[3]

21. The parties also submitted a Mintel report prepared for Oakley in January 2006, which estimates shares of supply of premium sunglasses in the UK (defined as sunglasses with a retail priced of at least £65[4]). This report gives shares for Luxottica and Oakley as [20-30] per cent and [10-20] per cent respectively, resulting in a combined market share of [35-45] per cent. It estimates the share of the parties' largest competitor, Safilo, at [5-15] per cent. These figures in relation to premium sunglasses were broadly supported by the only competitor of the parties that provided share estimates to the OFT.

22. A few third parties expressed concern that the parties will dominate the supply of sunglasses, and in particular premium sunglasses. However, the parties argued that the merged company will continue to face competition from many other suppliers, both in the EEA and in the UK. They submitted that their largest competitors are Safilo (including the Armani, Dior, Gucci and Yves St Laurent brands) in the EEA, with a share of supply of [5-15] per cent, and Fabris Lane and Safilo in the UK, with shares of [15-25] and [5-15] per cent respectively. Other important competitors are Marchon (including the Calvin Klein and Fendi brands), Marcolin (including the Tom Ford brand) and De Rigo (including the Police and Sting brands). All of these competitors are, like Luxottica, primarily active in the fashion-oriented premium segment, with the exception of Fabris Lane, which according to the Mintel report is primarily active in the mid-market price range and produces many retailers' own-label sunglasses. For the sports-performance premium segment, in which Oakley's products are primarily positioned, competitors include Marchon (Nike brand), Maui Jim, Rudy

[2] This includes Luxottica's intra-group sales, which amount to almost [40-50] per cent of its total sales. The parties submitted that their shares of supply would be lower if intra-group sales were excluded from the market, because their intra-group sales are higher than those of most competitors.

[3] The parties' figures for the UK are broadly supported by a report prepared for Luxottica by Growth for Knowledge (GfK) in 2007. However, as this report only considered sales at 'premium' opticians in the first four months of 2007, its value is limited, in particular in relation to sunglasses as according to the parties only 12 per cent of sunglasses are sold by opticians.

[4] This price is lower than the price identified in Mintel's public market report of December 2006, which was £70 (see at paragraph 11 above).

Project, Bushnell (Bollé brand) and Silhoutte (adidas brand).

23. The parties also submitted that Luxottica and Oakley are not each other's closest competitors. Luxottica is focussed on the fashion/luxury end of the market with brands such as Ray Ban, Bvlgari, Burberry, Chanel, Dolce & Gabbana, Prada and Versace. Oakley sells mainly sports and performance sunglasses under the Oakley brand. According to the parties, this difference is reflected in the parties' different marketing campaigns and in the monitoring of different competing brands, as shown by internal documents. Also, the parties submitted that their different positioning is shown by the different relative importance of their retail distribution channels, with most of Luxottica's sunglasses being sold through its Sunglass Hut shops and opticians and almost half of Oakley's non-airport sales being made in specialist sportswear shops (where only [less than 5] per cent of Luxottica's sunglasses are sold).

24. The parties acknowledged that despite the fact that their focus is different, they both have brands in the segment that the other focuses on. Oakley has three fashion brands, Oliver Peoples and Mosley Tribes (both owned) and Paul Smith (licensed), and Luxottica owns one sport-lifestyle brand, Arnette, but the parties submitted that sunglass sales of these brands are minor (both sales of Oakley's brands and sales of the Luxottica brand are [less than 5] per cent of the total sale of sunglasses in the UK). Also, Arnette sunglasses do not have the same performance features as Oakley sunglasses and its target market, style, price positioning and advertising are different.

25. Most third parties confirmed that they do not see the parties as each other's closest competitors. However, two third parties considered Luxottica's Ray Ban brand to be a close competitor of the Oakley brand in the male-oriented segment. This was also indicated by one internal document from the parties that related to the USA. The parties argued however that Ray Ban and Oakley are positioned differently ('classic' versus 'sports'), have functional differences (for example, in contrast with Ray Ban sunglasses, Oakley sunglasses have high impact resistant lenses) and are in different price bands, in addition to the difference in retail distribution channels identified above. On balance and also taking into account that Ray Ban is only one of Luxottica's brands, the OFT considers that Ray Ban's relative closeness to the Oakley brand is insufficient to establish the parties as close competitors.

26. The parties submitted that another constraint on them is the importance of brand licensing agreements. More than half of Luxottica's UK turnover is accounted for by licensed brands (for Oakley this is only a small part of its turnover). According to the parties, licence agreements generally give the licensee the right to manufacture and distribute sunglasses, as well as frames for prescription glasses, under the licensor's brand name. The licensor generally retains significant influence over the brand's commercial exploitation, including business plans and pricing ([ ]). Brand licensing agreements are of limited duration (typically five to 10 years). The parties gave a number of examples of licensors switching to different manufacturers. These factors were largely supported by third parties, including the licensors that responded to the OFT. Licensors also indicated that the cost of switching between manufacturers is small.

27. The parties also noted the increasing importance of brands in the sale of sunglasses, which, for example as a result of fashion trends, popularity of celebrities associated with brands and successes of sponsored athletes, results in a degree of volatility that contributes to competitiveness in the market. This was confirmed by Mintel's market reports.[5] Most third parties also emphasised the importance of brands.

28. The parties provided a list of brands licensed to different manufacturers. This list shows that there are a number of manufacturers with a significant portfolio of licensed brands (for example, in addition to Luxottica, there are nine other manufacturers with at least 10 licensed brands) and that there are also smaller suppliers with few or even no own brands who have licensed brands. As Oakley has relatively few licensed brands, the merger does not remove an important competitor for Luxottica in obtaining brand licences and a substantial number of competitors will continue to compete with the merged entity in obtaining brand licences.

29. In view of the importance of brand licensing agreements, the presence of a significant number of strong brands in the hands of the parties' competitors and the volatility of the popularity of brands, the OFT considers that historical shares of supply are less indicative of market power in the supply of sunglasses than generally in many other markets and that these factors exert a considerable competitive constraint on the parties' behaviour.

[5] Mintel, *Sunglasses, Market Intelligence*, December 2006, page 20 and Mintel's report for Oakley (January 2006), page 7.

Manufacturing and wholesale distribution of frames for prescription glasses

30. The parties estimated that after the merger their combined share by value will be around [5-15] per cent in the EEA, with an increment of [less than 5] per cent, and around [0-10] per cent in the UK, with an increment of [less than 5] per cent. A report prepared for Luxottica by Growth for Knowledge (GfK) in 2007, which considered sales at 'premium' opticians in the UK, estimated the parties' combined share by value at [5-15] per cent with an increment of [less than 5] per cent, and identified competitors that are not much smaller, such as Marchon and Safilo. GfK found that the parties' shares by volume were substantially lower. The difference between the parties' and GfK's UK share estimates may be explained by the parties' focus on premium frames, which according to the parties make up a relatively large share of premium opticians' sales. The only competitor of the parties that provided share estimates to the OFT believed that Luxottica's share of the sale of premium frames (defined by the competitor as priced over £100) was higher, at around [15-25] per cent. However, this competitor also believed that there was at least one other competitor with the same size as Luxottica.

31. The parties further submitted that in the distribution of frames for prescription glasses, like in the distribution of sunglasses, they are not each other's closest competitors and that brand licensing also contributes to the dynamics of the market.

Portfolio of brands

32. The merger will add a strong brand to Luxottica's portfolio and expand its portfolio into the sports-performance segment. One of the parties' competitors expressed a concern that this would make it easier for the merged company to force or incentivise retailers to purchase its weaker brands by linking these to its strong brands. No customers that responded to the OFT raised any concerns in this respect. According to the parties, customers are free to choose whichever brands, and products within these brands' product ranges, they buy and customers are not given an incentive, such as a discount, for buying more brands. Although two of the parties' competitors contradicted this, this was confirmed by customers' responses to the OFT.

Retail distribution of sunglasses

33. Luxottica owns Sunglass Hut, which has 64 stores in the UK that sell sunglasses. It also has a jointly controlling 50 per cent interest in the David Clulow chain of opticians in the UK, including the 10 specialised David Clulow stores that sell sunglasses. Oakley has four retail stores in the UK, two of which are Oakley-owned and two are franchises run by third parties. The Oakley stores only sell Oakley-branded products, including sunglasses.

34. The parties estimate that in the UK as a whole Sunglass Hut and David Clulow account for [5-15] and [0-10] per cent respectively of the retail distribution of sunglasses. They estimate Oakley's share at [less than 5] per cent.

35. On a local level, there are no Sunglass Hut or David Clulow stores in York and Portsmouth, where the two franchised Oakley stores are located. Oakley's owned stores are located in the Bluewater shopping centre in Kent and in Covent Garden in London. In both areas there are also both Sunglass Hut and David Clulow stores. However, in Bluewater shopping centre there are a number of competing retailers of sunglasses, including major opticians chains and department stores. In Covent Garden there are a number of sports specialty retailers that compete with Oakley, and in the wider Regent Street/Oxford Street area of London there are also a number of major opticians chains and department stores.

36. One of the parties' competitors expressed a concern that the growing retail presence of Luxottica as a result of the merger may make it more attractive for brand licensors. This concern is addressed below (see at paragraph 45). No other third parties raised any concerns about the merger in relation to the retail distribution of sunglasses.

Barriers to entry and expansion

37. The parties submitted that the sale of sunglasses has grown in the past few years and that this growth is expected to continue, due to increasing importance of the luxury and lifestyle aspects of sunglasses and increased consumer awareness of the dangers of sun exposure. In relation to frames for prescription glasses, while overall sales growth is low, consumers are increasingly trading up to higher-priced frames such as those supplied by

the parties. Third party comments in this respect were mixed, but a Mintel report confirmed that the sale of sunglasses was expected to grow.[6] The parties argued that these growth expectations are likely to attract market entry and expansion. They submitted that there are no material barriers to entry, as the production process of eyewear is well known and there is sufficient production capacity available worldwide, including in China.

38. The parties argued that entry is facilitated by brand licensing agreements and that new brand entry is quite common. For example, one of their competitors, Marcolin, recently launched the Tom Ford and Ferrari brands of sunglasses and Luxottica recently signed a brand licensing agreement with Tiffany. The appearance of new brands was confirmed by some of the parties' customers. However, the parties stated there were no recent examples of entry by a new manufacturer into the EEA, although they noted that new manufacturers have started production in Asia (in particular China) of products that meet European standards.

Buyer power

39. There is some evidence that larger customers have a degree of buyer power. Of the customers that responded to the OFT, three customers stated that they have some degree of buyer power, as it was important for the parties to have their products sold in their stores. However, one customer noted that there was little room for negotiation with the parties in relation to must-have brands. This customer also noted that brand licensors rather than the parties have the power to determine where the licencors' brands are sold.

VERTICAL ISSUES

40. Both parties are already active in manufacturing and wholesale and retail distribution of sunglasses. Hence, the merger will strengthen the parties' existing vertical links. The OFT has considered whether this could result in foreclosure of the parties' wholesale competitors by ceasing to buy from them at the retail level (customer foreclosure) or in foreclosure of the parties' retail competitors by restricting sales to them at the wholesale level (input foreclosure).

---

[6] Mintel, *Sunglasses, Market Intelligence*, December 2006, page 19.

41. In addition, both parties are active in the wholesale distribution of frames for prescription glasses. However, as only Luxottica is active in the retail distribution of frames of prescription glasses and the increase in Luxottica's share of the wholesale distribution of frames as a result of the merger is minimal, the merger does not raise competition concerns in this respect.

42. To assess whether a merger could have foreclosure effects as described above, the OFT considers both the ability and, if this is established, the incentive of the merged company to adopt a foreclosure strategy. For a vertically-integrated firm to have the ability to foreclose, it must have a degree of market power on at least one level of the supply chain.

43. As set out above, the parties' combined share of the retail distribution of sunglasses is [10-20] per cent. This is partly accounted for by sales by David Clulow, which is not solely owned by Luxottica. The merger will result in only a very small increase to Luxottica's existing share. In addition, the parties argued that there are a large number of retail competitors to which the parties' wholesale competitors can and already do supply. On this basis, the OFT does not consider that the merged company will gain the ability to engage in customer foreclosure as a result of the merger.

44. Although the merger will not substantially strengthen the parties' position in retail distribution, their position in wholesale distribution will be strengthened by a greater degree, in particular in relation to sunglasses, as set out above. However, as the parties argued, both sell a significant share of their products through third-party outlets (for Luxottica this share in the UK is nearly [45-55] per cent by volume and for Oakley it is significantly higher), and brand licensors will not have an incentive to allow a restriction of sales to third-party outlets. On this basis, the OFT does not consider that the merged company will gain the ability to engage in input foreclosure as a result of the merger.

45. One of the parties' competitors expressed a concern that Luxottica's growing retail presence may make Luxottica more attractive for brand licensors. However, the OFT considers that the growth of Luxottica's retail presence in the UK as a result of the merger is not sufficient to give rise to competition concerns in this respect, in view of Oakley's very small share of retail distribution nationally and very limited local presence.

THIRD PARTY VIEWS

46. The majority of third parties did not raise competition concerns about the merger.

47. Two customers expressed a concern in relation to the size of the merged company and its importance for their sales after the merger. One of the parties' brand licensors expressed a concern that the merger will increase the already large concentration of the market. The effects on competition as a result of the increase in size of the merged company after the merger are addressed above. No other customers and brand licensors raised concerns.

48. One of the parties' competitors raised concerns in relation to the addition to the parties' brand portfolio and increased retail presence as a result of the merger. These concerns are addressed above. No other competitors raised concerns.

ASSESSMENT

49. The parties overlap, as far as material for the competition assessment, in the manufacturing and wholesale distribution of sunglasses and frames for prescription glasses and in the retail distribution of sunglasses.

50. In relation to the manufacturing and wholesale distribution of sunglasses, Luxottica is currently the largest supplier and, while the merger will result in only a small increment to its share of supply in the EEA, in the UK the merger will increase Luxottica's share substantially. However, a number of competitors remain present and the merger will not remove Luxottica's closest competitor. Also, although the evidence on barriers to entry and buyer power was mixed, the importance of brands and brand licensing arrangements form considerable constraints on the parties' behaviour.

51. On this basis, the OFT does not consider that the merger raises competition concerns in relation to the manufacturing and wholesale supply of sunglasses. This conclusion is the same if the frame of reference is defined more narrowly. If the supply of premium sunglasses is considered separately, although the parties have a higher share of supply, the constraints identified apply equally. If different styles of sunglasses are

considered separately, the overlap between the parties is limited given Luxottica's emphasis on fashion-oriented sunglasses and Oakley's emphasis on sports-performance sunglasses.

52. In relation to the manufacturing and wholesale distribution of frames for prescription glasses, the parties' shares in both the EEA and the UK are smaller than in relation to sunglasses, and the increment as a result of the merger is very small. As, in addition, the same constraints apply as in relation to sunglasses, the OFT does not consider that the merger raises competition concerns in this respect.

53. Further, the OFT does not consider that the addition of Oakley's brands to Luxottica's brand portfolio raises competition concerns, in view of the fact that none of the parties' customers stated that they are forced or incentivised to purchase less important brands through a link with the purchase of strong brands, despite Luxottica's already strong brand portfolio, and in view of a degree of buyer power on the part of larger customers.

54. The increment as a result of the merger to the parties' share of the retail distribution of sunglasses in the UK as a whole is extremely small, and in the two locations where there is an overlap between the parties' stores there are a number of competitors in the local area. On this basis, the OFT does not consider that the merger raises competition concerns in relation to the retail distribution of sunglasses or in any retail distribution segment.

55. The OFT also considers that the strengthening of vertical links as a result of the merger will not give the merged company the ability to pursue a foreclosure strategy in view of its lack of sufficient market power at both the wholesale and the retail level.

56. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

57. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.