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
PROVISIONAL FINDINGS REPORT

June 14, 2015
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Below are responses on behalf of Johnson & Johnson (“J&J”) to the Provisional Findings Report that the Competition and Markets Authority (“CMA”) released on May 22, 2015 (the “Provisional Findings”). For reasons discussed below, J&J respectfully submits that the provisional findings are based on an unsustainable counterfactual and propose conclusions that are not reasonably supported by the evidence.

I. The provisional counterfactual is not an appropriate basis for assessment.

The CMA states in its provisional findings that it “examined several possible counterfactual scenarios in the absence of the global merger” and has provisionally concluded that “the most likely counterfactual is that the global K-Y business would have been sold to an alternative purchaser”¹. J&J respectfully submits that this is in error, for three reasons.

First, the provisional findings are predicated on the adoption of a counterfactual that does not relate to the relevant merger situation (“RMS”) in this review. Second, the proposed counterfactual ossifies the assessment, ignoring current competitive conditions that must inform any assessment whether the RMS may result in a substantial lessening of competition (“SLC”). Finally, use of the proposed counterfactual would be inconsistent with the statutory purpose pursuant to which this review is being conducted, under the Enterprise Act 2002 (the “Act”), converting a regulatory process that is meant to have practical effects into a largely academic exercise.

1. The provisional counterfactual does not relate to the relevant merger situation.

As discussed in J&J’s Response to the Notice of Possible Remedies (“Remedies Response”), the CMA’s terms of reference, and consequent identification of the relevant merger situation (“RMS”), delimit the scope of this review. This case was referred as an anticipated merger under section 33 of the Act, long after J&J had disposed of nearly all of its K-Y interests around the world². Consistent with this, the CMA also defined the RMS with reference to “the business of supplying K-Y branded personal lubricants to retailers and wholesalers in the UK”³.

¹ Provisional Findings, sections 7.9, 7.31.

² The CMA was clearly aware of this, and sought (and received) over the course of its review periodic confirmation from the parties that assets relating specifically to the UK business had not been transferred.

³ Provisional Findings, section 5.11.
Having identified the RMS, the CMA must decide “whether the creation of that situation may be expected to result” in an SLC\(^4\). As discussed previously, an SLC must be causally connected to (i.e. must “result” from) the RMS. The Competition Appeal Tribunal (“CAT”) has held that the regulator can properly consider only “effects that flow from the creation of the relevant merger situation”\(^5\) and “must ultimately ask itself whether it is satisfied on the balance of probabilities that there will be an SLC caused by the RMS”\(^6\). Other authorities cited in the Remedies Response likewise support this fundamental principle.

Given these basic principles, any SLC in this case must relate to disposal of the UK K-Y business (not disposal of J&J’s K-Y interests elsewhere in the world). Accordingly, the provisional findings are misdirected, because the CMA has substituted the concept of a “global merger” for the “relevant merger situation”. The counterfactual that has been provisionally identified here cannot legally form the basis for this assessment.

2. **The counterfactual does not reflect a realistic prospect of future conditions.**

Identifying and assessing an SLC is a *predictive* exercise, concerned with future competitive conditions. “The correct comparison is between the situation post-merger, and the situation which, on the balance of probabilities, is the situation which *would* have developed in the market in the absence of that merger. It therefore involves a forward looking, hypothetical exercise”\(^7\). Legal commentators regularly note the point:

This ‘loss’ [SLC] is properly assessed not against the competitive circumstances before the merger, but against the future competitive circumstances that will exist if the merger does not take place. Thus it requires a comparison between two predicted outcomes\(^8\).

Consistent with the foregoing, the CMA’s Merger Assessment Guidelines provide that the counterfactual is meant to reflect the situation that is “likely to arise without the merger”\(^9\). It

\(^4\) Enterprise Act 2002, section 36(1)(b) (emphasis added).


\(^7\) Stagecoach Group plc v. Competition Commission, [2010] CAT 14, paragraph 20 (italics in original). See also, e.g. Ryanair [2014] CAT 3, paragraph 150 (identifying an SLC “essentially requires . . . an assessment of the world without the [relevant merger situation] and the world with the [relevant merger situation]” (bracketed language in the original)); Celesio AG v Office of Fair Trading [2006] CAT 9, paragraphs 107, 174 (“We agree that the SLC test requires the OFT to consider what competition may be lost as a result of the proposed merger. . . . The question is ‘How much competition is lost?’ rather than ‘How much was there in the first place?’”).

\(^8\) Charles Bankes & Morven Hadden, *UK Merger Control* (2006), section 4.24 (emphasis added). See also, e.g. Nigel Parr, Roger Finbow & Matthew Hughes, *UK Merger Control* (2d ed. 2005), section 6.103 (“The analysis in merger cases is ‘forward looking’, in the sense that the relevant question is how competition will develop going forward”).

must be a “realistic prospect”\textsuperscript{10} and the CMA will use “only the most likely scenario”\textsuperscript{11}. This requires that the agency “foresee future developments” and incorporate into the counterfactual “only those elements of scenarios that are foreseeable”\textsuperscript{12}.

Even if a provisional counterfactual might have appeared to be appropriate at an early point in the assessment, it must remain open to correction or replacement in light of subsequent developments. The courts have noted repeatedly “the danger of a too ready assumption that nothing has changed”\textsuperscript{13}:

\begin{quote}
[T]he identification of a counterfactual does not mean that possible changes in the market cannot be considered in the assessment of SLC. The identification of the counterfactual does not ossify the SLC analysis. . . . Competitive conditions can and do change over time, and it is important to take into account the potential for change in the market in order to consider as fully as possible the level and intensity of the competition without the merger\textsuperscript{14}.
\end{quote}

Three basic facts are undisputed here:

\begin{itemize}
\item J&J has disposed of nearly all of its K-Y interests worldwide, [\textsuperscript{[\textless\textless]};
\item [\textsuperscript{[\textless\textless]}]; and
\item For reasons explained at the main hearing [\textsuperscript{[\textless\textless]}].
\end{itemize}

[\textsuperscript{[\textless\textless]}]

Given these facts, the CMA’s adoption of a counterfactual which assumes the sale of J&J’s global K-Y interests to a different purchaser would border on irrational decisionmaking. It would be wholly inconsistent with the agency’s obligation to make a “careful prospective analysis” that reflects “a prediction of events which are more or less likely to occur in future if a decision prohibiting the planned concentration or laying down the conditions for it is not adopted”\textsuperscript{15}.

\begin{footnotesize}
\textsuperscript{10} Merger Assessment Guidelines, section 4.3.5.

\textsuperscript{11} Merger Assessment Guidelines, section 4.3.6.

\textsuperscript{12} Merger Assessment Guidelines, sections 4.3.2, 4.3.6 (emphasis added).

\textsuperscript{13} Office of Fair Trading v. IBA Health Ltd [2004] EWCA Civ 142, paragraph 49.

\textsuperscript{14} British Sky Broadcasting Group plc v Competition Commission [2010] EWCA Civ 2, paragraph 54. See also, e.g. R v. Monopolies and Mergers Commission ex parte Argyll Group Plc [1986] 1 W.L.R. 763, 774 (upholding a decision to lay aside a reference in light of a change in the acquirer’s intentions, since “Good public administration is concerned with substance rather than form”); R v. Monopolies and Mergers Commission ex parte Air Europe Ltd [1988] 4 B.C.C. 182, 187 (Lloyd, L.J.) (dismissing claims that the OFT wrongly considered proposed undertakings in deciding that the RMS would not be against the public interest, because the regulator is “entitled to take account of the developing situation. It must not shut its eyes to what is going on”).

\end{footnotesize}
3. The provisional counterfactual is inconsistent with the statutory purpose.

Perhaps most importantly, adoption of the proposed counterfactual would contravene the fundamental purposes of pre-merger review under the Act. Adoption of a counterfactual that envisages the sale of J&J’s former K-Y interests worldwide to a third party would convert this review into an academic exercise that does nothing to protect competition and would be contrary to consumer welfare in the UK.

As the CMA is aware, J&J has disposed of nearly all of its K-Y interests worldwide. The CMA has acknowledged that none of the potential acquirers of K-Y showed any interest in purchasing the UK business alone\(^\text{16}\). An assessment in which the counterfactual does not take these considerations into account is not a reasoned assessment.

The CMA’s Guidelines make clear that there can be “no realistic prospect of an SLC arising” if it is shown that the target business will exit the market absent the transaction under review. However, in addressing that possibility, the provisional findings apply the criteria for the CMA’s general “exiting firm” scenario in a fundamentally misdirected manner, for several reasons.

• First, the provisional findings reject the prospect that the UK K-Y business will be wound down on the basis that neither J&J nor the K-Y business are failing financially\(^\text{17}\). However, neither party has ever suggested that they are, and the provisional findings simply set up a straw man whose dispatch is irrelevant to the question at hand. \(^\text{[※]}\). The CMA’s own Guidelines expressly recognize that as a different, but entirely valid, kind of “exiting firm” scenario\(^\text{18}\).

• Second, the CMA has provisionally concluded that there were alternative purchasers, and that “the most likely counterfactual would have been the K-Y business being purchased globally by \(^\text{[※]}\)\(^\text{19}\). However, that is essentially irrelevant, for reasons already discussed.

Proper recognition of the concerns that underlie the “exiting firm” scenario demonstrates that this transaction fits within the bounds of the classic paradigm. However, even if the CMA were to conclude that this is not so, that cannot foreclose meaningful consideration of the facts at hand. “The methodologies of merger analysis cannot be applied in a rigid and mechanistic way. The Authorities will therefore consider each merger with due regard to the particular circumstances of the case\(^\text{20}\). Whether this transaction falls squarely within the four corners of

\(^{16}\) Provisional Findings, section 7.6.

\(^{17}\) Provisional Findings, sections 7.16-7.19.

\(^{18}\) Merger Assessment Guidelines, section 4.3.9 (while the “exiting firm” scenario most commonly entails financial failure, “exit may also be for other reasons, for example because the selling firm’s corporate strategy has changed”). See also \textit{id.}, section 4.2.2 (noting that the CMA seeks to understand the “commercial rationale” of each of the parties and “how the transaction fits within the firms’ wider commercial strategies”).

\(^{19}\) Provisional Findings, section 7.28.

\(^{20}\) Merger Assessment Guidelines, section 1.5.
the “exiting firm” scenario or not, rational decisionmaking requires an acknowledgement that the alternative of a sale to RB [21].

It is axiomatic that a regulator must use its regulatory discretion to reach decisions that advance the underlying purposes of the statute under which the agency is acting. The seminal Padfield case declares unequivocally that “Parliament must have conferred the discretion with the intention that it should be used to promote the policy and objects of the Act”22. Accordingly, basic textbooks on administrative law routinely note that “the decision-maker must exercise his or her choice according to the purpose of the law that gave rise to the discretion”23.

Further, in deciding what evidence will form the basis for its decision, the regulator must decide what is relevant, and what is irrelevant, in light of the general purposes of the statute:

When a public authority exercises a statutory discretion, it must consider all of the relevant factors and exclude all of the irrelevant factors before reaching its decision. Parliament confers power for specific reasons and expects a public law decision-maker . . . to make use of its discretion fairly and sensibly, having regard to Parliament’s intention in granting the power24.

These fundamental principles apply equally in the realm of competition law. The Court of Appeal has held that the Act’s provisions for pre-merger review must be read with regard to “the general purposes of the legislation in question”25. Likewise, the CAT has admonished

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21 As noted previously, [21], 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 K-Y becomes unavailable. Retailers also can readily stock another very common, manufacturer-branded gel, Replens, that is sold as a “personal lubricant” in packages looking much like K-Y. However, a wind-down of the K-Y business could reduce consumer welfare insofar as medical/professional use is concerned, because sterile lubricants are less commonly produced and can best be supplied by a company that has established distribution capabilities in that channel.

22 Padfield v. Minister of Agriculture, Fisheries and Food [1968] AC 997, 1030 (Reid, L.J.) (emphasis added). See also id., p. 1060 (Upjohn, L.J.) (“In exercising their powers the [ministry] must act lawfully and that is a matter to be determined by looking at the Act and its scope and object in conferring a discretion upon the Minister”).

23 Lisa Webley & Harriet Samuels, Public Law: Text, Cases, and Materials (Oxford Univ. Press 2d ed. 2012), p. 485 (emphasis added). See also, e.g. H.W.R. Wade & C. F. Forsyth, Administrative Law (Oxford Univ. Press 11th ed. 2014), p. 297 (“Discretion must be ‘used to promote the policy and objectives of the act’”); D. J Galligan, Discretionary Powers: A Legal Study of Official Discretion (Clarendon Press 1986), p. 291 (“it is both a sign of discretionary powers and one of its characteristics that the matters to be taken into account are left open to be settled under the broad guidance of purpose; and what is taken into account then depends on the policies and goals being sought”) (emphasis added).

24 Webley & Samuels, Public Law, p. 500. See also, e.g. Peter Leyland & Gordon Anthony, Textbook on Administrative Law (Oxford Univ. Press 7th ed. 2013), pp. 276-77 (consistent with regard to the statutory purpose, it must be determined “whether all relevant considerations have been taken into account by the decision-maker and irrelevant ones have been ignored”); Galligan, Discretionary Powers, p. 308 (“testing whether the reasons for a decision are sufficiently related to general purposes . . . [usually] is referred to as an inquiry into the relevance or irrelevance of the matters taken into account”).

25 Akzo Nobel N.V. v Competition Commission [2014] EWCA Civ 482, paragraphs 20-24. See also, e.g. Argyll Group [1986] 1 W.L.R. at 782-783 (“the purpose of the legislation” is amongst the factors that are to be considered when addressing a change in circumstances).
that the regulators must reach their decisions “taking account of all, but only, relevant considerations”26.

The Enterprise Act 2002 envisages pre-merger reviews that deliver practical outcomes which effectively promote competition and consumer welfare. Use of a counterfactual that has no “realistic prospect” of fulfilment would convert regulation in the public interest into empty theorising. While J&J understands that the CMA may regard current circumstances as less than wholly satisfactory27, that does not justify the adoption of a counterfactual that would likely harm, rather than advance, consumer welfare28. The CMA should adopt findings and methodologies that serve the purposes of the Act, and that the Act requires.

II. The Provisional Findings Are Not Supported by a Balance of Probabilities.

As the CMA is aware, [35]. The company defers to RB in its assessments of market structure and performance because RB has made personal lubricants a commercial priority (and therefore has a better understanding of the business) and also has benefitted from the work of various economists and other consultants that it retained in connection with this transaction. Nonetheless, J&J considers that a number of the CMA’s provisional findings are surprising, and not what J&J would have expected from its general experience in supplying consumer healthcare products.

The CMA’s findings in a second-stage review must be supported by a balance of probabilities, given evidence that is “taken as a whole” and, so considered, is “reasonably capable of supporting the finding”29. Mere speculation, or the recognition of various possibilities without an abiding conviction about which of them are likely to be true, cannot suffice. J&J respectfully submits that the provisional findings do not satisfy these standards. While J&J does not address herein all of those findings, a few of the more significant points about which J&J has serious doubts are noted below30.

1. The evidence shows that K-Y and Durex are not close competitors.

J&J has explained that personal lubricants are highly differentiated products, and that consumers’ purchases (at least after an initial period of sampling) are likely to be governed by strong personal preferences. In this regard, J&J has also noted that personal lubricants fall along a spectrum, from “functional/medicinal” products like K-Y to “pleasure enhancement”

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27 This is through no design of the parties, who have voluntarily suspended closing (despite the absence of any undertaking or obligations to do so) for over fourteen months in order to respect the CMA’s process and cooperate in its review.

28 To put the matter another way, the CMA should not stumble into the kind of error against which courts often caution in noting that “hard cases make bad law” (originally attributed to *Winterbottom v Wright* [1842] 10 M&W 109 (Rolfe, L.J.)).


30 In foregoing comment on other points, J&J does not mean to express its agreement with them, but defers to RB as the company that is more knowledgeable about this business and better placed to comment.
products like Durex. Any competition between K-Y and Durex therefore is very attenuated, and each of these products is sold in competition with closer, widely available substitutes.

The CMA has received from J&J a number of market studies and other materials which support this view. These materials are both credible and important, because they were prepared in the ordinary course of business when the company had strong incentives (wholly independent of the merger or this review) to develop as meaningful and reliable an understanding of the business as possible. Indeed, even if the CMA were to conclude that these views were incorrect, they would be extremely important in assessing how competition actually works, because they reflect the commercial perspectives with which the business has been operated.

The views set forth in J&J’s internal documents do not stand alone in the record, but accord with the positions taken by J&J’s customers and competitors. The CMA has noted that “[m]ost retailers view the parties’ brands as falling into the same product category but attracting different customers” and “serving different customer needs”. The agency also has noted that competitors like Pasante and Lovehoney regard Durex and K-Y as “different products”. These companies all have a genuine commercial interest and longstanding experience in how the products perform, and no discernible interest in seeing this transaction cleared; accordingly, their views should carry substantial weight in any balancing of probabilities.

In short, the evidence from market operators is compelling that K-Y and Durex are widely separated on the continuum of personal lubricants, each of them facing a number of products that are closer competitors. However, the CMA has questioned this in its provisional findings, placing heavy reliance instead on an isolated consumer survey and a few econometric assessments that are based on very limited data. For reasons noted below, J&J respectfully submits that the CMA cannot reasonably rely on these very ambiguous bits of evidence to reach conclusions that are wholly at odds with the experienced and considered views of the companies, their customers, and their competitors.

- The TNS survey does not reliably measure the likelihood of switching.

31 A collection of these materials was provided in the Response from McNeil-PPC Inc to Initial Factual Information Request (16 Jan 2015).

32 Provisional Findings, Summary paragraph 12, and id., sections 8.42-8.43, 8.46, 8.49, 8.141. In particular, “Asda said it did not see these two brands of personal lubricant as readily interchangeable” and testified that customers were unlikely to switch to K-Y if Durex prices rose because “it is a different type product” (Summary of hearing with Asda on 9 March 2015, paragraph 16). Boots likewise testified that Durex and K-Y “served different customer needs” (Summary of hearings with Boots on 24 February and 17 March 2015, paragraph 3). Sainsbury testified that although Durex and K-Y can be used interchangeably, “the two brands were positioned differently to customers (Durex as fun and K-Y as functional)” and that “encouraging customers to switch products would require a lot of education” (Summary of hearings with Sainsbury’s on 13 February and 11 March 2015, paragraphs 6, 19). Superdrug testified that Durex . . . and K-Y are “different products” that are stocked in different categories, and that it “saw products such as Replens and Balance Activ as competitors for K-Y jelly rather than personal lubricants aimed at sexual enhancement” (Summary of hearing with Superdrug on 20 February 2015, paragraphs 1, 12-14). The public summary of Tesco’s hearings likewise indicates that that retailer thought Durex and K-Y met different “customers’ need states” (Summary of hearings with Tesco on 23 February and 18 March 2015, paragraph 27).

33 Provisional Findings, sections 8.42-8.43.
In its provisional findings, the CMA has placed heavy reliance on a single consumer survey, commissioned in this review, that purports to show some appreciable degree of switching between K-Y and Durex. However, that survey does not enable the CMA to make any reliable assessment of the likelihood of switching, for a number of reasons.

- First, the survey included a significantly greater proportion of relatively young consumers than is found in the overall population of lubricant consumers. In the TNS survey population, only 49% of the K-Y users and 14% of the Durex users were over 45 years of age, while data from Kantar Worldpanel (that is, data showing consumers’ actual purchases over a very substantial period of time) show that roughly 70% of K-Y users and 45% of Durex users are over 45 years of age. Because consumers often begin to use personal lubricants in middle age and may be expected to try different brands before they establish a personal preference, a survey that skews toward younger users almost certainly exaggerates the extent of switching. Likewise, the sample excluded consumers over age 65 – that is, persons who account for almost one-third of all K-Y users. The survey therefore violates CMA Guidelines that it should “be representative of the relevant consumer population” and that there not be “un-planned excessive participation of one type of consumer over another”.

- The survey appears to have elicited responses based on consumers’ familiarity with various brands, rather than their actual intention to purchase those brands. Indeed, the CMA has admitted to the same concerns, discrediting its own survey by suggesting that “mentions of Ann Summers [the manufacturer brand that Durex customers identified as their first-choice substitute] are likely to overstate what consumers would actually do”. Consumers are likely to have identified Durex and K-Y as very well-known brands even if they would not buy those products when confronted with an actual purchase occasion.

- The survey assessed consumers’ choices in several hypothetical cases where their preferred brand was entirely unavailable. This almost certainly overstates the extent to which consumers would be willing to switch in response to a price increase, given the fact that lubricant users are relatively insensitive to price and cannot be expected to respond to price differentials the same way they respond to complete unavailability.

- The survey mis-identified consumers’ first-choice substitutes, in listing store brands by individual marques. Fragmentation of the store brands’ collective

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35 OFT 1230/CC2com1, Good practice in the design and presentation of consumer survey evidence in merger inquiries (2011), sections 2.5-2.9, 2.15, 3.6-3.7.

36 CMA Working Paper – Competitive Effects, paragraphs 54 and 71 n.38; see also Provisional Findings, sections 8.74, 8.93.

37 See Provisional Findings, pages E7-E8.
share is likely to reflect consumers’ choice of retailers – not of lubricants. When store brands are considered collectively, it is apparent that these were consumers’ first-choice substitutes for each of K-Y and Durex.

In addition to these concerns, the CMA itself has conceded that its survey suffers from numerous weaknesses (e.g. small sample sizes, under-coverage, response error, and the hypothetical nature of the diversion questions). In the circumstances, it appears to be a very poor evidentiary substitute for the market research and insights that J&J, its customers, and its competitors have developed over years in actually supplying and reselling personal lubricants.

- The econometric analyses indicate that K-Y and Durex are not close competitors.

In addition to the TNS survey, the provisional findings discuss at length a few econometric assessments which show – if anything – that K-Y and Durex are not “close competitors” of each other. Thus, the findings show that during the only “significant” cost-price adjustment RB was able to make (two years ago), “the retail price increase in Durex did not have any impact on K-Y prices.” The provisional findings indicate that there were statistically significant changes in sales volumes at this time (given debatable controls for “seasonality and trend”), but acknowledge that various factors (not limited to seasonality and trend) might account for those changes and that “[t]his analysis should not be interpreted as demonstrating causation.”

The CMA also has examined instances when Durex was on promotion to determine whether that had any effect on sales of K-Y. The agency acknowledges that it found “no obvious patterns of switching between Durex and K-Y” and that it “cannot draw any strong conclusions from this analysis.” In fact, its assessments show that there

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38 The distortion is readily apparent when one recognises, for example, that the share of Durex reflects the views of all consumers in the survey, while Tesco’s share reflects the views only of the (necessarily smaller number of) consumers who shop at Tesco. In the circumstances, this yields an apples-to-oranges comparison in which manufacturer brands will always rate disproportionately high unless store brands are considered collectively.

39 Based on the data published by the CMA, as adjusted to exclude respondents who preferred not to say what brand they would buy instead, 42% of K-Y purchasers and 28% of Durex customers said they would buy a store brand if their preferred brand was unavailable (Provisional Findings, page D19).

40 See, e.g. Provisional Findings, section 8.76 and Appendix D paragraphs 43 (noting likely respondent error), 46 (noting likely overstatement of the overlap and diversion ratios as a result of bias), 48 (noting that the constraints of the small sample size required use of sub-optimal questions), 49 (noting an inability to assess price diversion given the small sample size), 51 (noting that small sample sizes, under-coverage, response error, problems in hypothetical diversion questions, and non-response bias reduce the evidential weight of the results), 53 (noting the potential for respondents to conflate brand familiarity and survey design with their true choice of alternatives), 55 (noting unavoidable response bias), 57 (noting that “most” respondents would understand allegedly vague questions), 58 (noting the inherent weakness in relying on stated rather than revealed preferences), 61 (noting a mistake in scripting of the survey and a failure to ask all questions of all respondents).

41 Provisional Findings, page E-2; see also Provisional Findings, section 8.51 (noting the “lack of price reaction from K-Y, both in terms of the cost price set by J&J and the retail price set by the retailers”).

42 Provisional Findings, sections 8.54-8.55, 8.58.

43 Provisional Findings, section 8.59 and pages E2, E6-E14.
was no statistically significant relationship between Durex promotions and K-Y sales volumes in two out of three instances. This is certainly not what would be expected if the two products were close competitors and, to the extent any meaningful conclusions might be drawn, a simple balancing of probabilities would indicate that the parties’ products are not close. Further, the CMA has acknowledged that, in any event, the assessment of promotional impacts “is not equivalent to assessing what consumers would do if the price of K-Y increased above the current price level . . . and whether Durex would constrain any such price increase (or vice versa)”\textsuperscript{44}.

In sum, the CMA’s econometric assessments are taken from such a small data set it is difficult to draw any firm conclusions from them. However, to the extent they show anything, they show that K-Y and Durex are not “close competitors” of each other.

In light of the foregoing, J&J respectfully submits that the CMA cannot rationally conclude that Durex and K-Y are “close competitors” of each other. Given the limited and inconclusive evidence obtained from the TNS survey and econometric assessments, it is only reasonable to credit the views of the companies, their customers, and their competitors – the great preponderance of which consistently point in the opposite direction.

2. **The evidence shows that K-Y and Durex face substantial competition.**

The CMA has noted that, in the mass market channel, “only” Boots, Lloyds and Superdrug stock manufacturer-branded lubricants other than Durex or K-Y\textsuperscript{45}. J&J might put the point slightly differently: *All of the national pharmacy chains – which account for roughly half of all sales of personal lubricants – stock at least six manufacturer-branded lubricants*\textsuperscript{46}. In addition, *all of the national pharmacy chains have own-label personal lubricants*. Further, *two of the five national grocery chains have own-label personal lubricants* – and the two that have them (Asda and Tesco) together account for more than half of all supermarket outlets in the UK\textsuperscript{47}. Given the foregoing, it is indisputable that Durex and K-Y face a significant number of competing products, and that consumers can readily find a variety of personal lubricants in mass market outlets.

The CMA appears to be concerned that, notwithstanding the facts noted above, the mass market retailers may stock only K-Y and/or Durex in their smaller outlets. However, this should not give rise to any competition concerns, for several reasons:

\textsuperscript{44} Provisional Findings, page E1.

\textsuperscript{45} Provisional Findings, section 8.86.

\textsuperscript{46} Provisional Findings, section 4.9 (listing brands stocked). For evidence that mass market pharmacies must account for roughly half of all sales of personal lubricants, see the TNS survey, which shows that Boots alone accounts for more than one-third of all sales of each of Durex and K-Y, and that Boots and Superdrug together account for 44% of sales of the two brands (data for Lloyds are not given in the public version) (Provisional Findings, page D8).

\textsuperscript{47} IGD/William Reed Business Media, *Grocery Retail Structure 2015* (as of 31 March 2015).
First, the record clearly shows that lubricants are infrequent purchases\(^{48}\) and are likely to be planned in advance\(^{49}\). Consumers therefore can easily plan to buy a personal lubricant when they are in a relatively large outlet that offers substantial choice.

Second, the fact that mass market retailers have the product variety and established supplier relationships noted above demonstrates that they can readily expand the ranges in their smaller (convenience) outlets if they believe consumers want that. Where a grocery outlet stocks only K-Y and Durex, this is not evidence that the two products are close competitors of each other — to the contrary, it is evidence that grocers are trying to meet different consumer needs for different groups of consumers in a product category to which they do not want to devote much shelf space.

The provisional findings suggest that some manufacturer brands are relatively “weak” constraints on sales of Durex and K-Y, but that “this is not the case for own-label products; the evidence shows that they are substitutes to Durex and K-Y and do impose some competitive constraint on K-Y and Durex”\(^{50}\). Thus, the CMA has found that both Boots and Superdrug consider their own-label products to be closer competitors to Durex and to K-Y than Durex and K-Y are to each other\(^{51}\). The TNS survey shows that many consumers consider own-label lubricants to be their first choice if their preference for Durex or K-Y cannot be met (and, in fact, own-label lubricants altogether are selected more often than another manufacturer brand)\(^{52}\). Further, the CMA’s econometric analyses show that consumers switch from own-label to branded lubricants when the latter are on promotion\(^{53}\). While the CMA questions the significance of this, such switching is entirely consistent with consumers stocking up on an infrequently-purchased item when it is priced to meet competition from own-label lubricants.

In short, J&J respectfully submits that the record is replete with evidence that K-Y and Durex face significant competition from a variety of other personal lubricants, and that customers can readily switch to other products if RB attempts to raise prices post-merger.

3. The evidence shows that buyer power will constrain any price increases.

\(^{48}\) Over 85% of consumers buy personal lubricants no more frequently than once-per-quarter. See Provisional Findings, page D5 (TNS survey shows that 86% of consumers buy lubricants quarterly at most); Annex 26.4 of the Response from McNeil-PPC Inc to Initial Factual Information Request (16 Jan 2015) (Kantar Worldpanel data show that 88% of consumers buy lubricants quarterly at most).

\(^{49}\) “Boots said it thought customers planned purchases of personal lubricants” (Summary of Boots hearings, paragraph 36). Superdrug said that while it did not have much hard data about lubricants “it thought these were more planned purchases” (Summary of Superdrug hearing, paragraph 37). “Tesco said it thought purchases of Durex personal lubricants were both planned and unplanned” while “for K-Y jelly it was likely to be more planned” (Summary of Tesco hearings, paragraph 47).

\(^{50}\) Provisional Findings, sections 8.143, 8.146.

\(^{51}\) Provisional Findings, section 8.104; see also Summary of Boots hearings, paragraph 26.

\(^{52}\) Provisional Findings, section 8.110 and pages D-17-D19.

\(^{53}\) Provisional Findings, sections 8.109, 8.112.
Retailers have told the CMA that “they do have buyer power and suggest that they could delist, de-emphasise, promote own-label or sponsor entry” if they were unhappy with RB’s pricing. Nonetheless, the CMA has “provisionally concluded that there is insufficient evidence that retailers would use any buyer power they may have.” J&J respectfully submits that this is not a position the regulator can reasonably maintain.

As a preliminary matter, it is suggested in the provisional findings that some retailers regard Durex and K-Y as either “must have” products or “signpost brands.” However, these are not at all the same thing; a “must have” product is something that a retailer feels it must carry at the risk of losing shoppers, while a “signpost brand” is simply a brand that is familiar to customers in a category (which the retailer need not carry at all). As J&J has pointed out, personal lubricants typically are not part of the “shopping mission” that brings customers to a grocery store. Because lubricants are purchased infrequently, are not emergency items that must be bought immediately, and are the kind of healthcare product most commonly associated with pharmacies, consumers are unlikely to change their choice of grocery store if lubricants are not carried there. Consistent with this, mass market grocers can – and very often do – decide not to carry any personal lubricants at all. When lubricants are stocked (typically in the grocers’ larger outlets), the retailers give them very little shelf space, offering a small selection that is meant to meet different customers’ differing needs – not to offer a choice among close substitutes. In sum, personal lubricants cannot reasonably be regarded as “must carry” items for grocery retailers.

The CMA appears to be troubled by the fact that it has found “very limited evidence” of retailers exercising buyer power. However, the reason it has found so little direct evidence of buyer power is that suppliers have sought very few price increases over a number of years. In short, there has been no occasion for retailers to exert (in direct negotiations) the buying power they doubtless possess. To consider a somewhat crude analogy, when a property owner alarms his building and posts notice of that, the fact that he suffers no attempted break-ins is not evidence that the alarm and posting were ineffective – to the contrary, such absence may be compelling evidence that the owner’s measures are very effective.

In the absence of attempted cost-price increases that might demonstrate retailers’ power in direct negotiations, the CMA states that “Evidence of the existence of buyer power comes

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54 Provisional Findings, sections 10.17.
55 Provisional Findings, sections 10.17, 11.5.
56 Provisional Findings, section 8.87.
57 Sainsbury’s apparent suggestion to the contrary is compellingly rebutted by its own testimony that it places personal lubricants “on the top shelves” (where they will not draw unwanted attention) and that it does not believe an own-label lubricant would be consistent with its image as a retailer (Summary of Sainsbury’s hearings, paragraph 16).
58 Provisional Findings, sections 10.4, 10.10.
59 See Provisional Findings, section 8.45.
primarily from the assertions of the parties and some retailers”\textsuperscript{60}. However, another word for those “assertions” is “testimony” – and the CMA has received a great deal of that, under statutory guarantees of reliability. Asda testified that “if cost price increases were proposed by RB after the merger, it would negotiate and try to mitigate any cost price increases to its customers”\textsuperscript{61}. Boots testified that “it could challenge RB by bringing alternative brands into the stores”\textsuperscript{62}. Superdrug told the CMA that “it would use its own-label products to mitigate a potential post-merger cost-price increase by RB”\textsuperscript{63}. Tesco testified that if RB tried to increase prices post-merger, “it would wish to examine in detail why it was proposing such increases and would expect to see justification for the increases” and “could decide not to buy the products”\textsuperscript{64}. Tesco “also mentioned own-label personal lubricants as an alternative if there was any disagreement over prices” with its suppliers\textsuperscript{65}.

All of this is consistent with testimony provided by J&J about the vigorous cost-cutting efforts that are now underway across the board in the mass market retailers. That testimony is uncontradicted, and the CMA has suggested no reason why personal lubricants should be uniquely immune from such efforts.

Further, even given the paucity of evidence from past negotiations over prices, the CMA has clear evidence that the retailers exert very real and effective constraints on the sale of personal lubricants. In particular, Boots launched new own-label personal lubricants in 2008/09, Tesco launched new own-label personal lubricants in late 2011, and Superdrug is now planning to expand its range of own-label personal lubricants\textsuperscript{66}. These are not steps taken by companies that would passively accept cost increases from their suppliers. Nor are they actions that evidence “a lack of focus on the product” the CMA claims to have found amongst retailers\textsuperscript{67}. Such launches provide compelling evidence that the mass market retailers are actively focused on this product category and will ensure that consumers are supplied on fully competitive terms.

Retailers in the UK have no apparent interest in completion of the proposed transaction, and would doubtless express concerns if they had them. However, at least four (Asda, Boots, Superdrug and Tesco) have testified that they do not have any concerns about the proposed

\textsuperscript{60} Provisional Findings, section 10.5.

\textsuperscript{61} Summary of Asda hearing, paragraphs 5-6.

\textsuperscript{62} Provisional Findings, section 10.7.

\textsuperscript{63} Provisional Findings, section 8.106.

\textsuperscript{64} Summary of Tesco hearings, paragraphs 8, 26, 30.

\textsuperscript{65} Provisional Findings, section 8.106.

\textsuperscript{66} Provisional Findings, sections 8.103, 8.107. The CMA also appears to have found that Asda and Lloyd’s could readily expand their own-label ranges (Provisional Findings, section 9.36). In light of these recent and ongoing product launches, the statements in the provisional findings that “there has been no significant new competitive entry in recent years” (Provisional Findings, section 11.4) and “it is unlikely that there will be significant new competitive entry” (Provisional Findings, sections 9.37) are simply inexplicable.

\textsuperscript{67} Provisional Findings, section 11.5.
The only retailer that appears to have expressed some concerns – Sainsbury’s – accounts for a very small per cent of lubricant sales (according to the CMA’s survey, only 5% of Durex and 4% of K-Y), made clear that it does not regard personal lubricants as an important product line, and expressed views that were markedly inconsistent with the other retailers’ views on many points. Accordingly, it is reasonable to assume that Sainsbury is not as knowledgeable about personal lubricants as are other retailers who place greater emphasis on this product category and responded more positively to the CMA’s inquiries.

Customers’ views and actions must be taken “in full and in context.” The CMA has acknowledged that it is difficult to assess how retailers might respond to a price increase because there have been so few of them. However, retailers have largely expressed confidence in their ability to constrain any effort to raise prices and a lack of concern about the transaction. They likewise have launched – and are continuing to launch – an increasing number of own-label lubricants which place them (as the “gatekeepers” for their suppliers’ access to consumers) in direct competition with RB and other independent lubricant suppliers. In the circumstances, any concern that the retailers do not have, or will not exercise, buying power is extremely difficult to maintain.

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J&J trusts that the foregoing views will assist the CMA in reaching a well-grounded assessment. 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.

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68 See Summary of Asda hearing, paragraphs. 1-2 (“Asda said it did not have any concerns about the proposed merger”); Summary of Boots hearings, paragraph 1 (“Boots said it did not have concerns about the proposed merger”); Summary of Superdrug hearing, paragraph 1 (“Superdrug said it did not have concerns about the proposed merger”); Summary of Tesco hearings, paragraph 1 (“Tesco said it did not have concerns about the proposed merger”).

69 Thus, Sainsbury’s testified that it stocks lubricants “on its top shelves” so they will not draw unwanted attention, and that it has decided not to supply an own-label lubricant because it believes that “Sainsbury’s brand should not be associated with such products” (Summary of Sainsbury’s hearings, paragraph 16).

70 Stagecoach, [2010] CAT 14, paragraph 131(c).