Competition & Markets Authority

Reckitt Benckiser and K-Y brand

A report on the anticipated acquisition by Reckitt Benckiser Group plc of the K-Y brand in the UK

12 August 2015

Website: www.gov.uk/cma

Members of the Competition and Markets Authority who conducted this inquiry

Phil Evans *(Chair of the Group)*

Marisa Cassoni

Roger Finbow

Andrew Popham

Chief Executive of the Competition and Markets Authority

Alex Chisholm

The Competition and Markets Authority has excluded from this published version of the report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

Contents

Page

Summary

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.

Findings

1. The reference

1.1 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 from McNeil-PPC, Inc., a subsidiary of Johnson & Johnson (J&J), (the merger), for further investigation and report by a group of CMA panel members (the inquiry group).

1.2 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.

1.3 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). The assets being acquired include, among other things, inventories, moulds, certain IP rights and data, designs, specifications and other documents and contracts relating to the K-Y brand.

1.4 The acquisition has completed, following clearance (where required), in approximately 50 countries, including the USA, Australia, Brazil, and Colombia, but 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. The anticipated acquisition in the UK by RB of the K-Y business in the UK forms part of the arrangements put in place for the global transaction.

1.5 Our terms of reference, along with information on the conduct of the inquiry, are set out at Appendix A.

1.6 This document, together with its appendices, constitutes our findings. Further information, including non-commercially sensitive versions of the merging parties' submissions and summaries of evidence from third parties can be found on the CMA's webpages.

2. The product

2.1 Personal lubricants are specialised lubricants used primarily during human sexual activity. They mainly fall within the wider sexual well-being (SWB) category of products, which includes condoms, personal lubricants, body and massage oils, sexual accessories and toys, pregnancy kits and pregnancy planning products.

2.2 The parties submit there are three basic categories of personal lubricants, which are:

- vaginal moisturisers;
- functional lubricants (problem solving); and
- pleasure enhancing lubricants.

2.3 J&J told us that K-Y is a water-based lubricant and the longest established brand of personal lubricant. K-Y is positioned at the functional/medicinal end of the product range for marketing purposes, according to the parties.

2.4 RB submits that it has a more extensive range of personal lubricants than K-Y in the UK and these 'have a different focus'. RB states that Durex products are marketed as pleasure enhancing products and focus on enhancing the sexual experience. The Durex products generally have a higher pH level than K-Y and have added features such as flavours, warming or tingling sensations, and some can also be used for massage. They are mainly water-based, though some premium products are silicone-based.

2.5 Other parties, including J&J, have suggested there is more of a spectrum across the product range, from 'functional/medical' at one end of the spectrum towards 'fun/pleasure' at the other. Some retailers and competitors saw the products as substitutable, and others as falling into the same product category but attracting different customers. The extent to which functional and pleasure enhancing lubricants are substitutable was a focus, among other things, of our consumer survey work carried on as part of the inquiry.[1]

Production process

2.6 RB manufactures all its personal lubricants at a manufacturing plant in Bangplee in Thailand, used since RB acquired the Durex brand from SSL International plc, (SSL), in 2010. [✂]

---

[1] See Section 8 below, pre-merger closeness of competition between Durex and K-Y.

2.7 From late 2014, when the sale of the K-Y business in the US was approved, RB has also used an RB factory in Hull to produce K-Y for the US market [✂]. J&J produces the K-Y that is sold in the UK on two production lines at its plant in Val-de-Reuil in Normandy, France. Although usage for K-Y is relatively low, the lines can be switched to other products. We understand that J&J is currently producing K-Y at this plant, but is winding down the level of production.

2.8 Finished products can be transported and stored in standard warehousing/freight facilities, and do not require specialised handling.

2.9 The parties told us that there are no particular difficulties in supplying personal lubricants in the UK, as there are third party producers available if a company did not want to manufacture itself. They said that the production of K-Y requires only limited capital investment and little specialised knowledge. Likewise, the product is made with ingredients that are common in the healthcare sector and widely available.

2.10 Personal lubricants are categorised as medical devices. Manufacturers of medical devices need to demonstrate that their devices comply with the provisions of the relevant European directive[2] by carrying out a conformity assessment that is approved by a 'notified body',[3] which would assess the quality and documentation for the device and audit compliance every one or two years.

2.11 The manufacturer must maintain an adequate quality system, supported by relevant documentation. Since July 1998, any medical device covered by the directive must carry a 'CE mark' (Conformité Européenne). The product can then be freely marketed anywhere in the European Union without further control.[4]

2.12 The parties suggest that it is straightforward to obtain the required certification. It is also possible to get a product manufactured by a certified producer. It would be more difficult to bring a product to market if the producer was uncertified or a new product required certification. This was highlighted by Pasante, a producer of personal lubricants, as a barrier. However, from the evidence we have seen, we do not consider the certification required to be a very significant barrier, though greater for a new uncertified producer or when a new product requires certification.

---

[2] European Directive on Medical Devices 93/42/EEC.
[3] UK notified bodies are: Amtac Certification Services Ltd, BSI Healthcare, Lloyd's Register Quality Assurance Ltd, SGS United Kingdom Ltd and UL International (UK) Ltd. See *UK notified bodies for medical devices*.
[4] See *Medical devices: conformity assessment and the CE mark*.

2.13 In addition to other operational and support costs, it is suggested that only a small team of employees (perhaps one or two) could handle marketing in the UK. [✂]

2.14 Further information on the industry is set out in Appendix B.

Product profitability

2.15 RB estimated that its variable profit margin based on 2013 sales for its 12 personal lubricants with net revenue higher than £100,000 was between [✂]% and [✂]%. This is not dissimilar from K-Y, which J&J suggested earns a gross profit margin of [✂]%.Using the RB figures, this suggests that the variable cost[5] of a product sold for a wholesale price of £[✂] would be between £[✂] and £[✂]. However this would exclude the retailer's or wholesaler's profit margin. If, hypothetically the retailer's profit margin was [✂]%, this would imply a sale price of £[✂] and the variable cost may then, for example, be only [✂]%[6] of the sale price. While it is recognised that the products would also expect to make a contribution, after marketing expenses, towards other costs, they appear to be highly profitable.

3. The companies

Johnson & Johnson

3.1 J&J is the ultimate parent company of a global group of companies with operations in more than 60 countries worldwide and more than 100 brands. Total global sales revenue for the 2013 financial year was US$71 billion (roughly £45 billion).

3.2 The direct seller of K-Y is McNeil, a company that is ultimately owned by J&J and belongs to its Consumer Healthcare division. McNeil markets a broad range of over-the-counter products for relief of pain and fever, cold, flu and allergy symptoms, digestive health and sleeplessness, including Tylenol, Sudafed and Benadryl products. McNeil manufactures (itself or through third parties) and supplies personal lubricants under the K-Y brand.

3.3 Introduced in the US in 1904 and initially available only on prescription, K-Y has been available over-the-counter in the US since 1980. K-Y had worldwide sales of around $[✂] in 2013. Five countries account for [50–80]% of K-Y's sales: US, Brazil, Canada, Australia and UK. However, sales in Europe are a

[5] Variable costs relate to costs that vary in relation to the volume of production, which would exclude marketing cost.
[6] Based on the combination of a £[✂] cost and £[✂] selling price.

relatively small proportion of global sales, amounting to $[✂] in 2013, with the UK $[✂] around [less than 5] % of global turnover.

Table 1: Financial indicators – J&J

				$ millions			*% growth*
	2011	*2012*	*2013*	*2014*	*2011/12*	*2012/13*	*2013/14*
Turnover	65,030	67,224	71,312	74,331	3	6	4
Gross profit	44,670	45,566	48,970	51.585	2	7	5
Profit before tax	12,361	13,775	15,471	20,563	11	12	33
Net assets (year-end)	56,589	64,826	74,053	69,752	15	14	-6

Source: J&J.

Reckitt Benckiser

3.4 RB is an international group active in the manufacturing and supply of a range of health, hygiene, home, food and pharmaceutical products with operations in 66 countries and selling to around 200 countries. Global net revenues (turnover) for 2013 totalled £10 billion. RB employs around 36,000 people and has 40 manufacturing sites. In total, RB has 106 brands.

3.5 RB has four core product areas – health, hygiene, portfolio brands and home – plus two non-core areas: pharmaceuticals and food. Health contributed 29% of core turnover in 2013 and includes major brands such as Durex, Gaviscon, Mucinex, Nurofen, Scholl and Strepsils. Hygiene represented 43% of core turnover and includes the brands Clearasil, Dettol, Finish and Harpic, among others. Home accounts for 22% of core turnover, and includes the Airwick, Calgon and Vanish brands.

3.6 RB's health and personal care division's products are designed to relieve or solve common personal and health problems, and they include antiseptic liquids, depilatory products, acne treatments, footwear and comfort footwear products, and medicines such as cold/flu treatments, analgesics and gastro-intestinal products. Within the range of SWB products, Durex's product range includes condoms, personal lubricants and other intimate enhancement products, such as pleasure toys.

3.7 RB had pre-tax profits of over £2.3 billion in 2013 and current market capitalisation of over £40 billion.

Table 2: Financial indicators – RB

	£ millions				*% growth*		
	2011	*2012*	*2013*	*2014*	*2011/12*	*2012/13*	*2013/14**
Turnover	9,485	9,567	10,043	8,836	1	5	-
Gross profit	5,449	5,538	5,969	5,096	2	8	-
Profit before tax	2,376	2,408	2,314	2,126	1	-4	-
Net assets (year-end)	5,781	5,922	6,336	6,834	2	7	-

Source: RB.
*2013 figures were before restatement for demerger of RB pharmaceuticals; change for 2013-14 not shown as a result.

3.8 The parties to the merger are described in more detail in Appendix C.

4. Sales of personal lubricants in the UK

4.1 Personal lubricants are sold through a range of channels in the UK. The majority are sold through bricks and mortar mass retailers – grocery retailers and national pharmacy chains such as Boots and Superdrug. Personal lubricants are also sold in specialist (adult) shops and online. In addition, independent pharmacies also sell a range of personal lubricants.[7]

4.2 In this section we first briefly describe the nature of the relationship (ie whether retailers are supplied directly by the parties or by wholesalers) and the nature of negotiations between the parties and the different retailers. This will provide useful background to the assessment of the relevant markets and the competitive effects in the following sections. Then we set out what the parties submitted as their understanding of the relative importance of the main supply channels and what we were able to confirm through checking these estimates with third parties and data captured at the point of sale.

4.3 In summary, we estimate overall sales of personal lubricants the UK of £28.5 million in 2013 with online sales amounting to £6.3 million. In contrast, RB estimates overall sales of £45–£55 million, of which online sales account for £23–£27 million. We have serious and significant reservations about the accuracy of RB's estimates of online sales, as set out below in paragraphs 4.11 to 4.19.

Relationship between the parties and retailers

4.4 RB and J&J supply directly to grocery retailers and national pharmacy chains and to a few major online suppliers[8] such as Ocado. Their products are

[7] Personal lubricants are also supplied to the NHS for distribution to end users through medical practitioners. However, there is no material overlap between the merging parties' activities in this regard.
[8] RB also has its own online sales site.

supplied to specialist (adult) shops, most online retailers and independent pharmacies by wholesalers.

4.5 As described in Appendix B, [✄] (promotional activity only accounts for [less than 5]% of sales compared with a current promotional spend-to-sales ratio of [15–25]% averaged across the J&J product portfolio).The negotiations over prices happen during a range review or as part of the negotiation over a Joint Business Plan. J&J also told us that it sets a per-unit cost price for K-Y regardless the type of customer.

4.6 RB told us that in general it sets cost prices to its customers on a per-unit basis. However, RB also makes [✄]. The negotiation of these payments and the planning of [✄] promotions take place on an annual basis in the form of joint business plans [✄]. For some retailers, this discussion will take place in the context of RB's relationship with the retailer as a whole, and will therefore cover a range of categories, brands and product areas (including but not limited to personal lubricants, although some of the payments may be brand-specific).

Market shares in grocery retailers and national pharmacy chains

4.7 Personal lubricants are sold through grocery retailers and national pharmacy chains. Data on sales in this part of the market is generally of good quality and is based on capturing information at the point of sale.

4.8 The CMA obtained evidence on sales of personal lubricants in this part of the market from Nielsen data. The Nielsen evidence suggested Durex sales of £[✄] and K-Y sales of £[✄] in 2013. The Nielsen data suggested total sales in the grocery retailers and pharmacy chains of £[✄],[9] suggesting the parties have a combined market share of [60–80]%.

4.9 The table below shows the brands stocked by the major grocery retailers and national pharmacy chains, the parties' share of sales in these retailers in 2013/14, and the share of outlets with only two or three personal lubricants. Durex and K-Y are the only personal lubricant products sold by most of the major grocery retailers. Other retailers only stock their own-label products together with the parties' brands. National pharmacy chains stock their own-label products and a (small) number of other brands, but these alternative brands are not available in all of their outlets.

[9] Online sales by grocery retailers and national pharmacy chains (around £[✄]) are also included in this figure.

Table 3: Market share of sales in grocery retailers and national pharmacy chains

	Own-label product	*Other brands*	*Durex/K-Y share (combined)* %	*Share of outlets with only K-Y and Durex*	*Share of outlets with K-Y, Durex and only one additional product* %
Boots	✓	Swoon, woohoo!, Balance Activ, Replens, Rephresh, Pjur	[✂] [✂]	[✂]*	[✂]
Superdrug	✓	Pasante, Ann Summers, Replens, Balance Activ, Gynomunal	[✂] [✂]	[✂]	[✂]
Lloyds Pharmacy	✓	Pjur, Sasmar, Balance Activ	[✂] [✂]	[✂]	[✂]
Tesco	✓	×	[✂] [✂]	[✂]†	[✂]
Asda	✓	×	[✂] [✂]	[✂]	[✂]
Sainsbury's	×	×	[✂] [✂]	[✂]	
Morrisons	×	×	[✂] [✂]	[✂]	
Waitrose	×	×	[✂] [✂]	[✂]	

Source: Nielsen data and data from retailers.
*[✂]
†[✂]

4.10 RB's analysis, using retail prices, also suggested RB and K-Y have a large ([70–80]%) share of grocery retailers and national pharmacy chains sales (excluding online). It suggested own-label suppliers – Boots, Tesco, Superdrug and Asda – have a [10–20]% share of this channel. The figures it provided are broadly consistent with [✂] in relation to sales in grocery retailers and national pharmacy chains and are shown in the table below.

Table 4: RB estimate of 2013 market shares in grocery retailers and national pharmacy chains excluding online*

	£	%
Supplier/Brand	*Retail sales*	*Share*
Reckitt Benckiser	[✂]	[40–60]
K-Y	[✂]	[10–30]
Parties combined	[✂]	[70–80]
Replens	[✂]	[5–10]
Boots	[✂]	[5–10]
Tesco	[✂]	[0–5]
Superdrug	[✂]	[0–5]
Asda	[✂]	[0–5]
Boots, Tesco, Superdrug, Asda private label total	[✂]	[10–20]
Others	[✂]	[5–10]
Total	[✂]	100

Source: RB.
*Based on RB estimates.

Market shares online

4.11 Robust information about sales of personal lubricants online is less readily available. We sought to confirm directly the level of sales with four of the leading websites actively selling personal lubricants – Amazon, eBay, Lovehoney and Ann Summers – in the absence of a published source.

4.12 Sales data from these major online retailers in 2013 is set out in Table 5.[10,11]

Table 5: Online sales of Durex, K-Y and other personal lubricants by Amazon, eBay, Ann Summers and Lovehoney

				£000
	Durex sales	*K-Y sales*	*Others*	*Total*
2013	730-805	105-115	2,705-3,000	3,500-3,900

Source: Amazon, eBay, Lovehoney and Ann Summers.

4.13 Grocery retailers and national pharmacy chains also sell personal lubricants online. These retailers told us that their online sales are typically between 2% and 5% of their total sales, and were below 10% even for the largest pharmacy chain. Based on this, we estimated that online sales of grocery retailers and national pharmacy chains are £1 million a year.

4.14 We acknowledge that our calculation does not include the sales of other specialist websites (eg Harmony) and suppliers' websites for direct sales. We

[10] These four websites, alongside Harmony and the Boots and Tesco websites, were presented as the benchmark websites in the 2013 research prepared by [✂] for RB in relation to the launch of the Durex website. The 2013 [✂] research also showed that these are the most popular websites among consumers.
[11] We asked Amazon to give an estimate of the size of the online market. Amazon, however, was not able to provide such an estimate (Summary of hearing with Amazon on 3 March 2015).

found it difficult to access reliable data, but Euromonitor suggested that Lovehoney and Ann Summers made up [✂]% of total specialist online sales. These two leading specialist shops told us they sold around £[✂] combined online in 2013. This would imply other specialist online sales amounted to around £[✂].

4.15 On this basis, we estimate the size of the UK online market to have been around £6.3 million in 2013.

4.16 In contrast, RB provided an assessment of the personal lubricants market in the UK commissioned from Euromonitor that estimated online sales accounted for more than half of all retail sales in the UK in 2013 at £[✂]. It said that the parties had a smaller ([15–35]%) combined market share for online retailers (RB [✂]% and K-Y [✂]%). It suggested three other suppliers have market shares greater than 10%: ID ([✂]%), Super Slik ([✂]%) and Liquid Silk ([✂]%), with two suppliers [✂].

4.17 RB told us that Euromonitor considered three sub-channels (online sex shops, online mass retailers and general online retailers) and carried out an audit of these sites to check product availability. Euromonitor then conducted interviews with industry experts and validated the estimates of the market size and market shares.

4.18 Data from and discussions with online retailers or retailers with significant online presence (such as Amazon, Lovehoney and Ann Summers) confirmed that there is a wide range of personal lubricants available online. Further, the parties' brands, in particular K-Y, are in a relatively weak market position in online retail. Table 6 below shows the parties' shares in terms of sales value within the total online sales of the four major retailers.

Table 6: Parties' share in the major online retailers

%

	Share of Durex/K-Y							
	Amazon		*eBay*		*Lovehoney**		*Ann Summers*	
	Durex	*K-Y*	*Durex*	*K-Y*	*Durex*	*K-Y*	*Durex*	*K-Y*
2013	[10–20]	[1–10]	[15–35]	[1–10]	[5–20]	[1–10]	[1–30]	[✂]
2014	[20–40]	[1–10]	[15–35]	[1–10]	-	-	[1–10]	[✂]

Source: Data from Amazon, eBay, Lovehoney and Ann Summers.
*Lovehoney's data covers the financial year 2013/14.

4.19 Overall, we estimate the parties' share of online sales, based on information from the four leading online sellers, to be around 15 to 25% of all online sales.

Market shares in specialist (adult) shops

4.20 Reliable data in relation to sales of personal lubricants in adult shops does not appear to exist. Even finding a robust estimate of the number of these shops proved difficult. According to the Economist, the number of licensed sex shops was 300 in 2004, but we have been unable to find any more up-to-date figures that suggest any change in the past decade. The trade body, the Adult Industry Trade Association, which could have been a good source, appears to have ceased operating in 2013.

4.21 In its initial submission, RB suggested that retail sales of personal lubricants in specialist (adult) shops such as Ann Summers and Harmony amounted to approximately £[✂] in 2013. It estimated the parties had a combined market share of [15–35]%, but four other suppliers have market shares [✂]%: ID ([✂]%); Super Slik ([✂]%); Sliquid ([✂]%); and Waterglide ([✂]%).

4.22 We note that, if 300 is a reasonable estimate of the number of adult shops in the UK, sales of £[✂] would imply that each shop sold £[✂] of personal lubricants per month in 2013. This seems to us to be somewhat unrealistic.

4.23 For the purpose of the analysis below, we note that in the TNS survey 8% of Durex consumers and 5% of K-Y consumers bought their personal lubricants in a specialist (adult) shop. We take into account that there are a wider range of personal lubricants available in these shops. Even if we believe 20% of all personal lubricants were bought in specialist (adult) shops in 2013, this would amount to sales of £5.7 million (assuming online, grocery retailers and national pharmacy chain sales amounted to £22.8 million).

4.24 Data from Ann Summers (which accounted for £3 million of specialist (adult) shop[12] sales of personal lubricants in 2013, including £0.5–£0.7 million of Durex products) is consistent with Durex and K-Y being relatively less important in the specialist (adult) market. Ann Summers sells a range of own-label products and brands such as ID or Pjur, but only sells Durex massage products and one of the premium Durex lubricants (Embrace).[13] K-Y is not sold by this retailer at all.[14]

4.25 We therefore have no reason to believe that RB's estimate of a [15–35]% market share for the parties in specialist (adult) shops is unreliable, although the limited evidence we received from specialist (adult) retailers suggested that they may have a lower market share in this segment.

---

[12] Including sales at Ann Summers parties.
[13] Previously, Ann Summers delisted Durex personal lubricant products and only recently reintroduced these SKUs (Summary of hearing with Ann Summers on 26 February 2015).
[14] Ann Summers did not think that consumers who wanted to buy K-Y Jelly would visit adult shops (Summary of hearing with Ann Summers on 26 February 2015).

Overall share of personal lubricant sales in the UK in 2013

4.26 Combining our estimates of sales in grocery retailers and national pharmacy chains, online and in specialist (adult) shops, we estimate that the overall value of personal lubricant sales in the UK in 2013 was around £28.5 million. The table below breaks this down by sales channel and gives our best estimate of the parties' share of sales by channel.

Table 7: Overall market for personal lubricants

	Channel	*Mass retail and pharmacy*	*Specialist adult shops*	*E-commerce*	*Total retail*
£ millions	Value of sales	[15–20]	[5–10]	[5–10]	[25–30]
% of total	Parties' share	[60–80]	[10–30]	[10–30]	[40–60]

Source: Nielsen, CMA estimates.

4.27 Overall, on the assumption that the parties have a [15–25]% share of the online market, this implies the parties' share of sales across the three channels amounts to around [40–60]%. This, it should be emphasised, is a lower bound estimate.

4.28 RB produced an estimate that in 2013 overall retail sales of personal lubricants in the UK amounted to almost £[✂] and that the merging parties, RB and K-Y, were the two largest suppliers, with a combined market share of [30–50]%. RB said that three other suppliers have a market share higher than 5%. In the case of ID ([✂]%) and Super Slik ([✂]%), their market share is based on the online and specialist (adult) store channels. RB stated that Boots, Tesco, Superdrug and Asda in aggregate have a [✂]% market share in respect of their own-label brands.

5. The anticipated merger and the relevant merger situation

Outline of the merger

5.1 On 10 March 2014, the parties entered into an Asset Purchase Agreement (APA) under which RB agreed to purchase from J&J, the rights, liabilities, and assets relating to the K-Y brand globally (as previously defined the K-Y business), for a consideration of US$[✂]. US$[✂] of this consideration was allocated to the UK business (subject to adjustment at the time of closing for local inventories).

5.2 Section 2.13 (b) (ii) of the APA indicates that [✂].[15]

[15] [✂]

5.3 The assets[16] being acquired at the global level include inventories, moulds, certain IP rights and data, designs, specifications and other documents and contracts relating to the K-Y brand. No staff or fixed assets are included in the sale.

5.4 The arrangements contemplated in the global APA were implemented through a series of agreements dealing with the disposal of the K-Y business in different geographic territories. RB told us that ‘the Anticipated Acquisition is part of a global transaction and the APA provided for completion on a country by country basis as and when the conditions (including obtaining competition clearances) in individual countries were satisfied’.[17] It is clear from the contractual documentation that these territorial agreements are intrinsically linked to the APA.

5.5 The acquisition has completed, following clearance (where required), in approximately 50 countries, including the USA, Australia, Brazil and Colombia. The Commerce Commission in New Zealand has declined an application by RB to purchase the K-Y business in its jurisdiction. Completion of the UK aspects of the K-Y business is conditional on UK merger control clearance. We understand that no assets have been transferred that are specifically related to the UK business.

Commercial background to the sale – vendor’s perspective

5.6 Introduced in the USA in 1904 and initially available only on prescription, K-Y has been available over the counter in the USA since 1980. K-Y had worldwide sales of around $[✂] in 2013. Five countries account for [50–80] % of K-Y’s sales: US, Brazil, Canada, Australia and UK. However, sales in Europe are a relatively small proportion of global sales, amounting to $[✂] in 2013, with the UK $[✂], [less than 5]% of global turnover.

5.7 A decade ago, J&J introduced some enhanced K-Y products in the USA alongside the traditional K-Y product. This was highly successful, resulting in total US sales increasing by over three times ([✂]) between 2003 and 2009, from $[✂] to $[✂].

---

[16] Assets include: inventories; moulds and other personal property; toll-free numbers; internet domain names; certain IP rights (such as copyrights and patent rights) in addition to formulas; compositions and technical data, designs, drawings and specifications related to the production of personal lubricants; regulatory information in relation to the marketing and sale of the K-Y products; governmental marketing authorisations; all business financial records and files; advertising, marketing, sales and promotional materials, [✂]; contracts relating solely to the K-Y business, including rights under purchase orders for raw material inputs; and rights under purchase orders and other contracts relating to the K-Y business. (Section 2.01 of the APA).

[17] RB’s initial submission of 28 January 2015, paragraph 3.2.

5.8 However, sales in the USA had fallen in recent years, and J&J's commitment to K-Y subsequently reduced. K-Y was no longer regarded as a strategic priority by J&J. A strategic decision to focus on 'key consumer needs states', [✂], was made. Also, a decision was made by the US Food and Drugs Administration (FDA) to treat J&J's enhanced lubricants as medical devices. From 2010, J&J recalled some of its personal lubricant products. As a result of the strategic review, the costs of complying with US-specific FDA directives and its consideration of the commercial environment, J&J took the decision in 2013 to divest the K-Y business globally.

5.9 In Europe in 2010 J&J explored the possibility of a licensing partnership to take the product into intimacy enhancement. [✂]

5.10 Some presentations from J&J's UK business suggested that it continued to explore the possibility of expansion locally. However, J&J advises that strategy was firmly the responsibility of the US strategy team and that these local propositions would not have changed the strategic decision to divest, particularly when the relatively small size of the European market was taken into account.

5.11 US sales of K-Y in 2013 were $[✂] ([20–50]%), compared with world sales of $[✂]. K-Y sales were less than [10]% of total J&J turnover in 2013.

Commercial background to the sale – purchaser's perspective

5.12 For RB, the transaction will improve RB's presence in the SWB category, particularly in the USA, [✂]. The USA is a mature market, with a higher consumption of personal lubricants per capita in the general population than in many countries. In a more mature market, RB told us that it had found it harder to grow market share. K-Y is a better established brand in the USA than Durex [✂].

5.13 RB is committed to the SWB category. RB states [✂][✂].[18]

5.14 RB highlights its particular focus on growing the global market for personal lubricants as a whole, with significant effort put into increasing the appeal of personal lubricants to the general public and making their use more widely accepted. [✂].[19] [✂].[20]

[18] [✂]
[19] RB's initial submission, paragraph 3.12.
[20] [✂].

5.15 In the UK, the K-Y product range is less well developed than in the USA. Conversely, in the UK, the Durex personal lubricant brand is better developed than in the USA, where Durex is a smaller competitor.

Jurisdiction

5.16 Under section 36 of the Act, and pursuant to our terms of reference (see Appendix A), we are required to investigate and report on certain statutory questions, the first being whether arrangements are in progress or in contemplation which if carried into effect will result in the creation of a relevant merger situation.

5.17 The concept of a relevant merger situation has two principal elements. These are set out in sections 23 and 26 of the Act. Firstly, a relevant merger situation will be created where the structure of the transaction involves arrangements in progress or contemplation, which if carried into effect will result in 'enterprises' that 'cease to be distinct'. Secondly, this transaction must have a sufficient nexus with the UK to merit the investigation. This is the case if either the 'turnover test' or the 'share of supply test' is satisfied.

Arrangements in progress or in contemplation

5.18 The parties have entered into a binding APA, and additional, standalone arrangements for the other jurisdictions have been negotiated and agreed. Moreover, the parties have publicly announced the global acquisition, which has completed in other jurisdictions, and there is a genuine consideration and real interest to close the sale under the Rest of World APA in as many territories as possible (including in the UK) within a reasonable time, and the acquirer has the ability to bring the transaction about. As a result, we conclude that the arrangements contemplated in those agreements are 'in progress or in contemplation' for the purposes of section 36 of the Act.

Enterprises ceasing to be distinct

5.19 The Act defines an 'enterprise' as 'activities or part of the activities of a business'. 'Business' is defined as 'including a professional practice and includes any other undertaking which is carried on for gain or reward or which is an undertaking in the course of which goods or services are supplied otherwise than free of charge'.[21] RB will acquire the necessary components to carry on the business of supplying K-Y branded personal lubricants to retailers and wholesalers globally (including in the UK), which would amount

[21] Section 129(1) and (3) of the Act.

to an enterprise for the purposes of the Act. RB will acquire outright ownership and full control of the K-Y business, allowing it to further its own strategic goals regarding the development of its personal lubricants business. RB also constitutes an enterprise within the meaning of the Act.

5.20 As a result, we conclude that enterprises carried on by or under the control of RB will cease to be distinct from enterprises currently carried on by, or under the control of J&J as a result of the anticipated merger within the meaning of section 26 of the Act.

Turnover test

5.21 The turnover test will apply where the value of the turnover in the UK of the 'enterprise being taken over' exceeds £70 million. According to data available to the CMA, the total UK turnover generated by the K-Y business is below the threshold of £70 million. Therefore the turnover test is not met.

Share of supply test

5.22 The share of supply test applies where, as a result of enterprises ceasing to be distinct, at least one quarter of goods or services of any description which are supplied in the UK, or in a substantial part of the UK, are supplied by or to one and the same person.[22] For this test to apply, both the enterprises ceasing to be distinct must be active in supplying or acquiring goods or services of the same description within the UK, or a substantial part of the UK.

5.23 The parties overlap in the supply of personal lubricants in the UK and are active in the same economic market. RB have submitted information on the estimated market shares based on Nielsen and Euromonitor data. With regard to the shares of supply in grocery retailers and national pharmacy chains in the UK in 2013/14, the parties had an estimated combined share (by value) of [60–80]% ([✄]% for Durex and [✄]% for K-Y) based on Euromonitor.[23] As both parties supply personal lubricants in the UK, the acquisition will result in the merged entity having a combined share of supply of personal lubricants in the UK in excess of 25%.

[22] Section 23(3) and (4) of the Act.
[23] According to the Nielsen data, the parties in 2014 had an estimated combined share (by value) of [✄]% and (by volume) of [✄]% (by value, [✄]% for Durex and [✄]% for K-Y and by volume, [✄]% for Durex and [✄]% for K-Y). We also obtained evidence on sales of personal lubricants in the relevant markets as set out in section 4 of our report to which we cross-refer.

Conclusion on jurisdiction

5.24 In light of the above, we conclude that arrangements are in progress or contemplation which, if carried into effect, will result in a relevant merger situation involving the acquisition of full control by RB of the K-Y business.

6. Market definition

6.1 The purpose of market definition is to provide a framework for our analysis of the competitive effects of the merger.[24]

6.2 While market definition is a useful analytical tool, it is not an end in itself, and identifying the relevant market involves an element of judgement. In assessing whether a merger may give rise to an SLC the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[25]

6.3 The *Merger Assessment Guidelines* also note that in practice, the analysis of the identification of the market or markets and the assessment of the competitive effects of the merger overlap, with many of the factors affecting market definition being relevant to the assessment of competitive effects and vice versa. Therefore, market definition and the assessment of competitive effects should not be viewed as two distinct analyses.[26]

6.4 In this section, we first set out the parties' views on the relevant markets and then we define the relevant product markets and the relevant geographic market. This provides a framework for our analysis of the competitive effects of the merger in section 8.

Relevant product market

The parties' views

Segmentation by product type

6.5 The parties told us that, due to demand-side and supply-side substitutability,[27] there is a single frame of reference for the supply of personal lubricants and did not segment this market further based on the type of product. However, the parties also submitted that there is significant product differentiation in this

[24] *Merger Assessment Guidelines*, paragraph 5.2.1.
[25] *Merger Assessment Guidelines*, paragraph 5.2.2.
[26] *Merger Assessment Guidelines*, paragraph 5.1.1.
[27] RB's initial submission paragraph 4.2, and J&J's initial submission paragraph 4.5.

wider market. In particular, K-Y was marketed as a ‘functional’ lubricant designed primarily to address medical needs, while most of the Durex range would fall into a ‘pleasure enhancing’ segment of the market, according to the parties’ views.

Branded vs own-label personal lubricants

6.6 The parties said that own-label personal lubricants are in the same market as branded products. This is based on the own-label products of Boots, Superdrug, Asda, Tesco and Lloyds Pharmacy being positioned similarly to branded lubricants, these products targeting the same customers and own-label products having significant sales in these retailers.

Segmentation by sales channel

6.7 While the parties submitted that the sales of personal lubricants could be segmented by some sales channels (adult or specialist retailers and other retailers (‘mass-market retailers’), they made no distinction between ‘mass-market retailers’ and online retailers. They argued that: (i) personal lubricant purchases are typically planned purchases; (ii) online accounts for a significant proportion of lubricant sales; (iii) consumers increasingly use multiple channels for groceries and household products; and (iv) there are no differences in supply-side conditions across channels. As a result, their view was that all sales channels were part of the same market.

Conclusion with regard to product market(s)

6.8 In our assessment of competitive effects, we address the possible segmentation of the personal lubricants product market in terms of the functionality and pleasure enhancing characteristics of particular products (see paragraphs 8.51 to 8.88). Based on this analysis, we conclude that while the products of Durex and K-Y (and of other suppliers) are differentiated, they are part of the same personal lubricants product market.

6.9 Moreover, we considered that it is appropriate to include own-label personal lubricants in the market and analyse the closeness of competition between own-label and branded personal lubricants as part of the competitive assessment at paragraphs 8.113 to 8.124.

6.10 Based on this analysis, we concluded that own-label products are part of the product market and that the supply of personal lubricants is an appropriate relevant market for the assessment of competitive effects.

6.11 Moreover, there are different competitive conditions in the supply to different retail channels, which in turn are affected by the different competitive conditions in the downstream markets. In the upstream markets, grocery retailers and national pharmacy chains are supplied directly by the parties (and other personal lubricant suppliers), whereas online retailers, specialist (adult) shops and independent pharmacies are typically supplied by wholesalers (see paragraph 4.4). The parties may be able to discriminate between grocery retailers/national pharmacy chains and the other sales channels which are supplied through wholesalers.[28] The sales channels also differ in terms of the number of brands competing (see Section 4) and the ease of entry (eg because of the shelf-space allocated to personal lubricant products).

6.12 In paragraphs 8.125 to 8.132, we assess the competitive effects from these sales channels on grocery retailers and national pharmacy chains, and in paragraph 8.5 we assess the competitive effects within these other channels.

6.13 Based on this analysis and that referred to in paragraphs 6.8 to 6.9, we conclude that the relevant product markets for the purposes of assessing the effects of the merger are as follows:

(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.

Relevant geographic market

The parties' views

6.14 The parties submitted that the narrowest geographic market to consider is national in scope.

Conclusion with regard to geographic market(s)

6.15 Even though many of the products sold in the UK are imported, grocery retailers, national pharmacy chains, specialist (adult) shops and independent

[28] For example, if all retailers were supplied through the same wholesalers, a proposed cost price increase by the parties to these wholesalers would be likely to affect all types of retailers. In contrast, by supplying grocery retailers and national pharmacy chains directly, the terms offered to these retailers may not affect terms of supply to other retailers.

pharmacies are supplied, either directly or indirectly (ie via wholesalers), by suppliers based in the UK. Personal lubricants from suppliers outside the UK may be available from some online retailers. We have found no regional differences within the UK.

6.16 As such, we conclude that the relevant geographic market for the purposes of assessing the effects of the merger for grocery retailers and national pharmacy chains, specialist (adult) shops and independent pharmacies is the UK. For similar reasons, we conclude that the geographic market for online retailers is not narrower than the UK, but given that a UK base is less important for online sellers, the geographic market may be wider than the UK.[29] Paragraph 8.159 discusses whether a wider market definition has an impact on our SLC decision for online retailers.

Conclusion on market definition

6.17 On the evidence available, our conclusion is that the appropriate markets to consider are the UK markets for the supply of personal lubricants to: grocery retailers and national pharmacy chains; specialist (adult) shops; online retailers;[30] and independent pharmacies.

7. The counterfactual

7.1 The application of the SLC[31] test involves a comparison of the prospects for competition with the merger against the competitive situation without the merger. The latter is called the 'counterfactual'. The counterfactual is an analytical tool used in answering the question of whether the merger may be expected to result in an SLC.[32] The choice of counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, as the Authorities need to predict the likely counterfactual with some confidence.[33] Given that the counterfactual incorporates only those elements of scenarios that are foreseeable, it is not necessary to make finely balanced judgements about what is and what is not the counterfactual.[34] Where the CMA considers that there were alternative purchasers for the

---

[29] For example, Lovehoney sells a K-Y SKU that comes from an American supplier. See Summary of hearing with Lovehoney on 27 February 2015.
[30] The geographic market for online retailers may be wider than the UK. However, this would not have an impact on our SLC decision.
[31] The term SLC is not defined in the Act. A merger may be expected to result in an SLC when it has a significant effect on rivalry between competing firms over time and therefore on the competitive pressure in firms to improve their offer to customers or become more efficient or innovative. A merger that gives rise to an SLC will be expected to lead to an adverse effect for customers. See *Merger Assessment Guidelines* paragraphs 4.1.1 and 4.1.3.
[32] *Merger Assessment Guidelines*, paragraph 4.3.1.
[33] *Merger Assessment Guidelines*, paragraph 4.3.2.
[34] *Merger Assessment Guidelines*, paragraph 4.3.6.

acquired enterprise, it will try to identify who the alternative purchaser(s) might have been and take this into account when determining the competitive conditions that would have prevailed in the counterfactual. The appropriate counterfactual will depend on the circumstances of each case.

Views of the parties on the counterfactual

7.2 J&J explained that its global management had taken a strategic decision to exit from the supply of personal lubricants globally. J&J noted that the UK business, unaware of this decision-making, continued to explore possible options for K-Y, including plans for expansion. However, these proposals could not proceed in light of the decision by global management to exit the business globally. Given this decision, J&J would not have retained the K-Y business in the UK. J&J confirmed that it would have sold it as part of the global business to a single purchaser, most likely to [✄].[35]

7.3 However, J&J argued that the counterfactual is the situation that it has effectively brought about by the way it has structured the transaction; namely a stranded UK brand. It claimed that the counterfactual is the situation without the relevant merger situation and that the relevant merger situation in this case relates only to the UK elements of the global transaction because the transaction was referred for an in-depth review as an 'anticipated merger' after the parties had completed in most of the world. J&J argued that because the creation of a relevant merger situation requires an accretion to share in the UK, we should look only at what will happen to the K-Y business in the UK in the event the merger is not completed in the UK.[36] As disposal of the global business is largely complete, in the absence of approval of the UK part of the transaction, J&J would wind down the UK K-Y business in an orderly fashion. In support of this, it pointed to its decision to wind down its operations in New Zealand following the decision of the New Zealand Commerce Commission to decline the parties' application to merge.

7.4 RB argued that J&J was better placed to provide a view on the counterfactual. However, according to RB, the counterfactual is what J&J is likely to do with the business in the UK alone.[37] RB argued that it is neither foreseeable nor most likely to be the case that the global K-Y business would have been sold to another purchaser given that the sale has completed in every jurisdiction (with the exception of the UK and New Zealand) and the completed transactions were not reversible. RB further noted that K-Y was a stagnant

[35] See paragraphs 7.20-7.30.
[36] J&J's response to the Provisional Findings, 14 June 2015.
[37] RB's response to the Provisional Findings,17 June 2015, paragraph 1.1 (a).

brand in the UK, with minimal promotional or marketing activity by J&J over the last few years. RB explained that [✂].

Views of other parties

7.5 A limited number of other parties have expressed views on the counterfactual, giving their view of what they would expect to have happened to the K-Y business if it had not been acquired by RB. The main responses are summarised as follows:

(a) Tesco's view was that '[✂]'.

(b) Sainsbury's said that if RB did not buy the K-Y brand in the UK, it did not expect the K-Y brand to change much.[38]

(c) Morrisons commented 'continue as part of the J&J portfolio', though it is not clear if it considered alternative purchasers.

(d) Boots' view was 'it would have remained a static but reasonable business'.

(e) Superdrug commented that 'if the K-Y brand had not been acquired by RB we would expect another supplier to buy it, or J&J to keep the brand, as there is a difference between the uses for the two products (ie K-Y and Durex)'.

(f) Ansell's view was if there had been no merger, the K-Y product would not have changed significantly; K-Y would continue to be offered, using its established distribution, based on K-Y's strong brand awareness.[39]

CMA assessment of possible counterfactuals

7.6 The anticipated acquisition of the UK activities of the K-Y business forms part of the arrangements that are in progress or in contemplation in relation to the global transaction.[40] J&J has confirmed that it has approached the sale of the K-Y business on a global basis and for all relevant jurisdictions. The binding legal agreements entered into by J&J and the evidence of discussions with other potential bidders demonstrated that J&J clearly contemplated and intended to sell the K-Y business, including the UK, as part of a global deal. None of the potential purchasers of the K-Y business was interested in

---

[38] Summary of hearing with Sainsbury's on 13 February 2015.
[39] Summary of hearing with Ansell on 4 March 2015.
[40] See Section 5 previously.

acquiring the UK business in isolation from the global K-Y business. The UK aspects of the transaction are intrinsically linked to the sale of the K-Y business globally.[41]

7.7 As stated, J&J's approach suggested that our assessment of the counterfactual should in effect be determined by the sequence of completion under the contractual arrangements put in place by RB and J&J. However, in our view the counterfactual cannot be conditioned by the particular transaction structure chosen by the parties in this way.

7.8 We consider that the relevant merger situation in this case results from the arrangements in progress or contemplation for the divestiture of the K-Y business at a global level. Those arrangements remain in progress or in contemplation in relation to the UK as the transaction has either completed, or been declined, in other jurisdictions. In support of this, we note that the agreement to purchase the K-Y business was a global transaction set out in the APA described at paragraphs 5.1 to 5.5 above, and the UK K-Y business forms part of this global deal. The fact that the implementation of the APA is effected in different jurisdictions through asset purchase agreements specific to those territories does not alter this global nature of the transaction. In our view, the counterfactual should be the situation that would have been most likely to have prevailed, had J&J not entered into the arrangements described above that give rise to the merger. Contrary also to RB's views, it was foreseeable and most likely to be the case that had it not been sold to RB, the K-Y business (inclusive of all jurisdictions) would have been sold to another purchaser, as explained in paragraphs 7.20 to 7.30.

7.9 Accordingly, in accordance with our *Merger Assessment Guidelines* (section 4), we examined several possible counterfactual scenarios in the absence of the global merger and as it impacts on the UK market. We selected the most likely scenario as the counterfactual based on the available evidence. This provided us with a benchmark for the competitive landscape against which the effects of the merger in the UK would be assessed.

7.10 In terms of assessing the counterfactual, we considered three possible scenarios for the K-Y business, in the absence of the global acquisition by RB:

(a) J&J retains the global K-Y business.

[41] See paragraphs 7.20-7.21.

(b) J&J strategically withdraws from the global K-Y business and closes it down.

(c) J&J sells the global K-Y business to a different purchaser.

J&J retains the global K-Y business

7.11 In 2003, J&J introduced some enhanced K-Y products in the US alongside the traditional K-Y product. This was highly successful. However, sales in the US have fallen in recent years and J&J's commitment to K-Y has subsequently been reduced. A strategic decision was made to focus on 'key consumer needs states', [✄].

7.12 In September 2008, J&J's Global Operating Committee accepted a recommendation to 'discontinue pursuit of aggressive K-Y expansion' and 'to eliminate the global franchise'.

7.13 In January 2010, following a decision to cease expanding the K-Y range, [✄]. Consequently, J&J was unable to find a partner willing to take on the risks and costs of getting the required approvals.

7.14 In mid-2013, J&J initiated a project to divest K-Y (initially Project [✄]; subsequently Project [✄]). This was driven by a strategic decision to divest [✄] unrelated product lines identified as falling outside J&J's 'key needs states'; ie core product lines. K-Y was one of these [✄] product lines. Project [✄] recommended divestment of the K-Y business globally.

7.15 On the basis of this evidence, we do not consider that J&J would have been likely to have retained or expanded the K-Y business in the counterfactual.

J&J closes down the global K-Y business

7.16 We considered whether J&J could have closed the K-Y business down. The exiting firm scenario is most commonly considered when one of the firms is said to be failing financially.

7.17 J&J had global turnover of $71.3 billion and profit before tax of $15.5 billion in 2013, and was certainly not a failing firm itself. The K-Y business is small relative to the total J&J business; K-Y turnover of $[✄] only accounts for [0–1] % of total J&J turnover. As a substantial parent, J&J would be well able to financially support the K-Y business. In addition, the K-Y business appeared to be highly profitable, after deducting variable costs. [✄]. Internal calculations by J&J to determine a possible sale price also underline the positive value attributable to the K-Y business. This is strong evidence that the K-Y business was not financially failing.

7.18 Project [✄] showed that there were potentially [✄] bidders for the global K-Y business. As there is evidence that there were alternative purchasers of the business, the exiting firm scenario can be rejected.

7.19 On the basis of this evidence, we do not consider that the most likely counterfactual is that J&J would have closed down the global K-Y business.

J&J sells the global K-Y business to a different purchaser

7.20 We asked J&J and RB if it was possible for the K-Y business to be sold on a country-by-country basis. J&J confirmed that it did not try to sell the K-Y business on anything other than a global basis. J&J has confirmed that it had approached the sale of the K-Y business only on a global basis and emphasised that a sale on a country-by-country basis would not have been an attractive option.

7.21 This is because none of the potential purchasers identified by J&J were interested in acquiring any part of the K-Y business that did not include the US business. J&J was unwilling to sell the US part of the business without realising an appropriate return on disposal of the business in the rest of the world as well. Any country-by-country disposal would have been complicated by the risk that actions taken by different owners of the same brand in different jurisdictions might undermine the K-Y brand equity. In addition, the brand owner would be limited in the locations in which the product could be manufactured; this would have to be either in the country of acquisition or in another country where the trademark rights or other IPRs held by a different brand owner are not infringed. RB also noted that the ease of management of the brand, if owned globally, [✄] were relevant considerations. [✄]

7.22 The final decision to divest the K-Y business globally was made at a Strategic Planning meeting in February 2013. At this point a taster document was sent to a targeted group of companies requesting an indication of interest. [✄] companies expressed interest.

7.23 All interested parties were asked to submit a preliminary offer by 10 January 2014. [✄] indicative offers were received from:

[✄]

7.24 In mid-January, J&J selected [✄] companies to proceed to the next round [✄] companies, [✄], were dropped from the process. Due diligence proceedings were opened (Project [✄]) and management presentations were given.

7.25 Binding bids were then required and received from the [✂] parties, including RB, by 5 March. [✂], J&J reduced the number of bids taken forward [✂]. Subsequently, a revised bid was accepted from RB for $[✂].

7.26 The evidence of the bid process confirms that there was value in the K-Y business and that there were a range of bidders willing to bid for it. It also provides further strong evidence of J&J's intention to dispose of the business globally and the purchasers to purchase globally.

7.27 We recognise that if RB had not been bidding, additional parties might have been included in the bidding process or shortlists. We are not able, however, to foresee which other parties may have been involved in that case.[42] However, we note that there appears to be some affinity between personal lubricants and other products in the SWB range of products, observed in positioning of displays in retail outlets. A company already engaged in the SWB market would appear to have a stronger competitive reason to purchase the global K-Y business.

7.28 On the evidence we have received, we conclude that the most likely counterfactual would have been the global K-Y business being purchased by a company within the SWB product area. In particular, on the evidence we have received, we conclude that the most likely alternative purchaser for the global K-Y business would have been [✂], and this was confirmed by J&J in the main party hearing.

7.29 [✂] also confirmed that it was interested in and bid for the global business, including all markets. It anticipated no obstacles to purchasing the assets. It valued the K-Y business as a global asset and did not look at individual markets. It indicated that the UK was only a small piece of the overall asset. It currently did not sell sexual health products in the UK and was not in a position to speculate on what it would have done if it had acquired the K-Y business.

7.30 As [✂] did not have any specific plans for the development of the UK business, and based on the available evidence, we have concluded that the competitive landscape under this counterfactual would not have been more competitive than the conditions of competition prevailing prior to the transaction between RB and J&J over the period that is foreseeable ie [✂] had no specific plans for the UK when it made its bid.

---

[42] *Merger Assessment Guidelines* paragraph 4.3.2: 'The description of the counterfactual is affected by the extent to which events or circumstances and their consequences are foreseeable, enabling the Authorities to predict with some confidence.'

Conclusion on counterfactual

7.31 On the evidence available, our finding is that the most likely counterfactual is that the global K-Y business would have been sold to an alternative purchaser. The most likely purchaser would have been a company within the SWB product area. On the basis of the available evidence, [✂] would have been the most likely purchaser. As [✂] had no particular plans to develop the brand in the UK at the time of its bid, we have no basis to conclude that it would have adopted an approach to marketing the K-Y brand in the UK that was materially different from the approach of J&J. Accordingly, under this counterfactual, the pre-merger conditions of competition are an appropriate benchmark for the competitive conditions in the counterfactual against which to consider the effects of the merger.

8. Assessment of the competitive effects of the merger

8.1 In this section we set out the competitive effects of the merger. We first set out our theory of harm[43] and then analyse the pre-merger competitive conditions, including the pre-merger closeness of competition between the parties' brands, the pre-merger competitive constraints from other personal lubricant brands and own-label products, and the competitive interaction between different sales channels. We then assess the effects of the merger, ie the loss of an independent K-Y, by examining the incentive of RB to try to increase cost prices to grocery retailers and national pharmacy chains post-merger. In doing this, we analyse consumer behaviour given the relationship between consumers' and retailers' choices, and the relationship between upstream and downstream prices, together with views from retailers.

8.2 The competitive effects of the merger will also depend on the constraint imposed by any new entry or expansion by existing competitors (including diversification of an existing personal lubricant supplier into new product categories or new retail channels), and the countervailing buyer power of customers. Therefore, we assess the extent to which any attempt to raise prices by RB would be mitigated by new entry or the expansion of competitors' lubricant offers (section 9), and/or by any countervailing buyer power (section 10), before we conclude on whether the merger is likely to lead to an SLC (section 11).

[43] In accordance with our *Merger Assessment Guidelines*, section 4.2, theories of harm are drawn up to provide a framework for assessing the effects of the merger and whether or not it could lead to an SLC.

Theory of harm

8.3 In our issues statement, we set out two possible theories of harm. The first is that RB would have the ability to increase the prices of its products, lower the quality of products, narrow the range on offer or would have a lesser incentive to innovate because it would face competition from one fewer competitor (horizontal unilateral effects).[44] The second is that the acquisition could result in a loss of potential competition from future development of the K-Y brand.

8.4 In the light of the evidence that future development of the K-Y brand in the UK was unlikely in the foreseeable future under the counterfactual,[45] we did not explore further the issue of the loss of competition from future development of the K-Y brand.[46,47]

8.5 We concluded that our first theory of harm is unlikely to arise in relation to the supply of personal lubricants to online retailers, specialist (adult) shops and independent pharmacies in the UK for the following reasons:

(a) The wide range of personal lubricants available online and in specialist (adult) shops, the small sales of K-Y and evidence from third parties suggest that barriers to entry to these market are low.

(b) Independent pharmacies stock many brands of personal lubricants and barriers to entry and expansion are low.[48]

8.6 As a result, we focused our assessment on the supply of personal lubricants to grocery retailers and national pharmacy chains in the UK. In this market, the parties' combined market share is 60–80]%, with an increment of over [✂]% (see paragraph 4.8). Durex and K-Y are the only personal lubricant products sold by some of the major grocery retailers, and other retailers only stock their own-label products together with the parties' brands. National pharmacy chains stock their own-label products and a (small) number of other brands, but these alternative brands are not available in all of their outlets (see paragraph 4.9).

---

[44] *Merger Assessment Guidelines*, section 5.4.
[45] See Section 7 previously.
[46] According to section 4.2.1 of the *Merger Assessment Guidelines*, we can revise the theories of harm as the assessment progresses.
[47] As mentioned in paragraph 4.1, personal lubricants are also supplied to the NHS for distribution to end users through medical practitioners. However, there is no material overlap between the merging parties' activities in this regard. Therefore, we do not assess the impact of the merger in relation to sales to the NHS.
[48] Independent pharmacies are typically supplied by wholesalers. One of the personal lubricant suppliers, Pasante, told us that independent pharmacies stocked many more brands of personal lubricants than grocery retailers and that it is easier for suppliers to get stocked in independent pharmacies.

Pre-merger competitive conditions

8.7 Where products are differentiated, such as in the case of personal lubricants, unilateral effects are more likely where the merger parties' products compete closely.[49]

8.8 Therefore, we first look at the pre-merger closeness of competition between Durex and K-Y. Second, we analyse constraints from existing competitors. We look at competitive constraints from other personal lubricant products (other branded products and own-label) and the competitive constraint from online retailers, specialist (adult) shops and independent pharmacies on grocery retailers and national pharmacy chains in the UK.

Closeness of competition between Durex and K-Y

8.9 One of the factors to consider for the assessment of horizontal unilateral effects is the closeness of substitution between the merger parties' brands. If the products are close substitutes, unilateral effects are more likely to arise because the merged firm will recapture a significant share of the sales lost in response to a price increase. This has the effect of making this price rise less costly to the supplier. Diversion ratios, as explained in paragraphs 8.84 to 8.86, may be a useful indicator of the ability of one product to constrain the prices of the other.[50]

8.10 As this is a merger between suppliers of personal lubricants, the customers are retailers and wholesalers. However, given the relationship between consumers' and retailers' choices and the relationship between upstream and downstream prices, we consider that data on consumer behaviour and the calculated diversion ratios, together with views from retailers, are informative for assessing the closeness of competition between the merger parties' brands.

8.11 In the following sections we first briefly explain the link between consumers' and retailers' choice and upstream and downstream pricing. We then set out the views of the parties about the extent to which the Durex and the K-Y personal lubricants compete in the UK personal lubricants market and within the grocery retailers and national pharmacy chains in particular. We also set out the evidence we have been able to gather from the parties' internal documents, the views of third parties including competitors and retailers, data analysis of sales and prices of personal lubricants and the implications of surveys of consumers conducted on behalf of the parties and a survey we

[49] *Merger Assessment Guidelines*, paragraph 5.4.6.
[50] *Merger Assessment Guidelines*, section 5.4.9.

commissioned from TNS. We set out our conclusions regarding the closeness of competition based on the assessment of the evidence in the round. We then consider the constraints imposed by other products.

Link between upstream and downstream

8.12 Evidence from retailers suggests that consumer behaviour in the personal lubricant market, and in particular, consumers' awareness of different brands, strongly influences retailers' choice of the products they stock (see paragraphs 8.98, 8.101 and 9.29). The parties' views were consistent with this. RB told us that 'retailer choice in this market is essentially driven by consumer preferences and the range and quantity of lubricant products that they wish to have in their store or on their website', and that 'retailer choice in this market is largely driven by consumer demand but the retailer also determines the amount of space it wishes to give to the personal lubricant category (compared to other healthcare products)'. J&J told us that 'the preferences of J&J's customers are linked to those of consumers'. This suggests that while retailers have some flexibility in determining how much shelf-space they allocate to personal lubricants overall, consumer preferences, which may be influenced by suppliers' investment and marketing effort behind the brand, play an essential role when they decide which brands to stock and sell.

8.13 Evidence also suggests that most retailers would pass through cost price increases by suppliers, which suggests that an increase in cost prices would be likely to translate into higher retail prices (see paragraph 8.63). We cover the role of retailers in more detail in the Countervailing Buyer Power section (section 10).

8.14 In its response to the CMA's Provisional Findings, RB submitted analysis by its economic advisers regarding the link between retail and wholesale prices arguing that no such link exists. To reach this conclusion, RB's economic advisers compared gross and net wholesale prices[51] with retail prices for Durex Play products in the large grocery and national pharmacy chains between January 2013 and May 2015 based on RB's profit and loss data [✄] and [✄]. In particular, RB's economic advisers calculated the correlation between monthly wholesale and retail prices and concluded that the correlation suggests limited pass-through (RB's economic advisers calculated that the correlation between net wholesale prices and the retail prices based

[51] Net wholesale prices were calculated as the difference between gross wholesale prices and trade investment for each month.

on [✂] data is 0.23). We consider that there are several weaknesses to this analysis.

8.15 First, there are some fundamental issues with the data used by RB's economic advisers that affect the robustness of the results. For example, [✂].

8.16 RB told us that [✂]. Such [✂] are likely to affect the reliability of the correlation analysis between the non-transaction based wholesale price data and the transaction-based retail price data. This is particularly the case with such a degree of aggregation across retailers and SKUs used by RB's economic advisers for the analysis. Therefore, we consider that the caveats around data issues and the comparability of the non-transaction based wholesale data with the transaction based retail data, undermine the robustness of RB's economic advisers' analysis and conclusion on the lack of link between wholesale and retail prices.

8.17 RB's economic advisers also emphasised that in 2013, when retailers increased the per ml price of Durex Play products, there was no gross or net wholesale per ml price increase, as visible in the figure submitted by RB's economic advisers (see Figure 1).

Figure 1: [✂]

[✂]

Source: [✂]

8.18 As discussed in paragraph 8.63, we observed that retailers increased the per ml retail price of Durex products in response to the bottle size increase (and corresponding unit cost price increase) of the products even though the per ml cost price did not change. We agree with RB that the increase in retailers' per ml price was not caused by a per ml increase in wholesale price as there was no such increase in wholesale price. However, the fact that retailers not only accepted a larger bottle size and higher per unit cost price but also increased the retail price by more than the increase in the unit based cost price demonstrates that retailers have the ability to raise retail prices which will reduce their incentives to defeat a wholesale price rise. This is consistent with retailers being likely to pass-through a per ml cost price increase.

The parties' views on the closeness of competition between Durex and K-Y

8.19 RB submits that Durex and K-Y personal lubricants are not close competitors for the following reasons:[52]

- The two brands are positioned on different points on the spectrum of personal lubricants and are designed for different purposes and both brands have 'more natural substitutes' than each other's products.
- Consumers view the different types of personal lubricants differently.
- Retailers with own-label personal lubricants often choose to produce two types of own-label products (one competing with K-Y and one competing with Durex) as these products are likely to appeal to different customer groups.
- There is no competition between Durex and K-Y for promotion events/promotional space.
- [✂]
- [✂]
- [✂]
- The shelf position of the products suggests that K-Y is different from Durex personal lubricants; K-Y products are often positioned with the female intimate healthcare products, whereas Durex personal lubricants are often positioned above or close to the condom shelf.

8.20 RB also submitted [✂] loyalty card data looking at cross-purchasing of personal lubricant products in the period between 3 February 2014 and 1 February 2015. In RB's view, this data illustrates that only a very small number of consumers within [✂] have purchased both Durex and K-Y in the course of a recent 12 months period. Specifically, the data showed that only 1% of K-Y customers also purchased Durex Play Feel, whereas cross-purchasing incidence between K-Y and the [✂] own-label products were 2% and 6%.[53] RB argues that during the 52-week period covered by the data, Durex was on promotion for [✂], and that one would have expected a significant number of K-Y users to switch to Durex if there was pricing constraint between the products. We assess this data in paragraph 8.54.

[52] RB's initial submission, from paragraph 8.1.
[53] RB's response to the Provisional Findings, paragraph 4.18.

8.21 J&J also argues that the parties are not close competitors because of:

- the field of use – although the products can both be used to provide lubrication during sex, there is a difference in product focus. K-Y is understood by consumers, and marketed by suppliers, as a functional product that is generally used as part of an ongoing treatment regime for vaginal dryness. Durex's products are understood by consumers, and marketed by suppliers, as 'pleasure enhancement' products for use in sexual activity and purchased more frequently with a view towards variety/experimentation;

- special features – in contrast to K-Y, which is supplied only in a clear, unscented, taste-neutral gel without added sensations, the Durex range includes a range of products with additional flavours, scents/aromas, and sensations (eg tingling and warming properties);

- differences in the packaging, consumer proposition (pharmaceutical or sexual 'image') and means of lubricant dispensing; and

- a lack of competition between K-Y and Durex for promotional slots.

8.22 J&J also submitted a UK consumer survey (K-Y Female Health Project from November 2013) which J&J commissioned in the ordinary course of business and highlighted the following findings:

- Typical K-Y users are older women, who describe K-Y as 'effective', 'clear', 'perfume-free', 'trusted', 'practical', and a product with 'medical connotations', while noting that 'it is not a sexy brand' and 'is not synonymous with sexiness or fun'.

- In contrast, consumers highlighted the 'sensual' connotation of Durex, and the fact that it is 'fun and sexy' with 'lots of different products to experiment with', as the brand opposite of K-Y.

- When consumers in K-Y's target demographic (older women) were asked which lubricants they had used, most said they had 'limited knowledge of other lubricant brands' and, to the extent they had tried other products as lubricants they identified a range of products including K-Y, Sylk, Replens, Wet Stuff, Ann Summers brands, Durex, Mates, and own-label (Boots and Asda).

8.23 In addition to this survey, J&J submitted data from Kantar Worldpanel showing that K-Y shoppers are likely to be female, with nearly 70% being older than 45, roughly 50% being older than 55, and around 30% being older than 65. In contrast, Durex shoppers skew toward males and are generally younger (with less than 15% being older than 55).

Evidence from the parties' internal documents

8.24 Both parties submitted recent internal documents relevant to the development of a marketing strategy for personal lubricants. They also supplied documents relevant to the anticipated acquisition which we also reviewed for evidence of the extent to which the K-Y brands and Durex brands compete. We are presenting evidence from the key relevant documents in chronological order – firstly RB's documents, and secondly J&J's documents.

8.25 [✄]

8.26 [✄]

8.27 [✄]

8.28 [✄]

8.29 [✄]

8.30 [✄]

8.31 [✄]

8.32 [✄]

8.33 [✄]

8.34 [✄]

8.35 [✄]

8.36 In general, J&J has adopted a passive approach to marketing K-Y in the UK in recent years, and this was reflected in the internal documents we reviewed.

8.37 We reviewed a paper from 2006 entitled 'WW Intimate Health Franchise: The K-Y Opportunity'. While this paper had a global perspective, it did highlight that in the UK 'Durex was proving that intimacy enhancement and promotion generates success,' and that by not consistently promoting, K-Y had 'lost significant share to Durex'.

8.38 In 2012, an internal document entitled 'Make love better in 2012' identified that K-Y had a [15–35] % category share with only one product, and Durex had a [30–60] % share with over ten products. The paper was a background piece to the consideration of a K-Y entry into ‘Play’ in the UK. This entry did not subsequently happen.

8.39 A Kantar Worldpanel study in April 2013 compared K-Y and Durex shoppers for J&J and found that K-Y shoppers were more likely to be female, older and retired, and that in contrast Durex over-indexed males, younger shoppers and pre-family shoppers (see paragraph 8.23).

8.40 A study by GroupM Primus in November 2013, ‘K-Y Jelly Female Health Project’, noted ‘K-Y Jelly’s share of the market was around [30–50]%’, but ‘large levels of investment and innovation in the market from Durex (through its Play platform) has eroded this over time’, and it also referred to some consumers using the products interchangeably.

8.41 In December 2013, The Cambridge Group carried out an ‘Intimacy Market Assessment’ for J&J. The focus of this work was global, but it did identify Durex, K-Y and Astroglide as the leading brands in the UK.

8.42 We were provided with a copy of the 2014 K-Y Business Plan, but this was mainly focused on the North American market and there was no mention of Durex.

8.43 A paper produced by J&J on the UK market, ‘K-Y 2014 Opportunity Sizing’, did however have numerous references to Durex and included a competitor analysis specifically of Durex. It gave Durex a market share of [40–70]% and K-Y a market share of [15–35]%, and put this position down to Durex strategy of ‘innovate, spend, in-store activation’. The analysis of shoppers showed that K-Y shoppers were on average older, female and more affluent.

8.44 A J&J paper entitled ‘G Factor Presentation’ (date not included) identified that ‘the 50+ market is growing and K-Y is a brand that could be better leveraged to better suit these consumers’ needs… Durex will struggle to reach the 50+ due to an over-index towards the younger consumer and this being their core bulls-eye target’.

8.45 [✄]

8.46 It is not the CMA’s contention that own-label products impose no competitive constraint on Durex products. The TNS survey commissioned by the CMA shows the importance of own-label products to many consumers. In some contexts, these own-label products impose arguably as significant a constraint on Durex products as does K-Y.

8.47 The parties also highlighted frequent references to products such as [✄]. While these products are potential substitutes for both parties’ brands in theory, the reality is that in the key market of interest – grocery shops and national pharmacy chains – their distribution is so limited that retailers pose little material competitive constraint.

8.48 Finally, RB also pointed to [✂] documents that illustrate a different positioning in the market between Durex and K-Y products. The CMA has concluded that there is product differentiation within this market and recognises these documents as evidence of that differentiation.

8.49 However, what is at issue is the extent to which internal documents also show that, in the context of considering their market strategies, both parties recognise the other's products as being potential substitutes. Taken in the round, the CMA believes that there is sufficient evidence to support the conclusions we draw below.

Conclusion based on internal documents

8.50 The overall picture presented by reviewing the internal documents highlights that both parties are aware of each other as competitors within the relevant market for the supply of personal lubricants in the UK. In addition, both parties are aware that their products over-index different types of consumer, and that while RB has made significant investment in marketing and developing the Play range, J&J has made minimal investment in the K-Y brand in the UK. Some surveys commissioned by the parties show some overlap between the consumers of Durex and K-Y and suggest that at least some consumers use these products interchangeably.

Evidence from third parties

8.51 We considered whether:

- retailers and competitors see the parties' brands as close competitors and whether they have any insights into consumers' choice and switching between the products;
- retailers play off the parties' products against each other in negotiations;[54] and
- the parties' products compete for promotions.

[54] The successful use of a strategy that plays off the parties' products against each other in negotiations could be indicative of retailers being able to substitute between the products without losing significant sales. This would be consistent with consumers switching between the parties' products.

Based on evidence gathered from third parties (retailers, including national pharmacy chains and grocery retailers, and competitors), we found that personal lubricants constituted a very small product category within grocery retailers' and pharmacies' product offerings (even within the health and well-being category) and we found that retailers have carried out no (or very limited) research or analysis to understand consumer behaviour in relation to the purchase of these products.[55] Notwithstanding, we took into account retailers' views and the limited analysis we received from third parties.

8.52 Most retailers view the parties' brands as falling into the same product category but attracting different customers; in their view, K-Y has a medical proposition, whereas Durex personal lubricants have a 'pleasure enhancing' profile. For example, Tesco said that the purchase of K-Y is more likely to be planned than that of Durex, and that K-Y sales are relatively resilient to changes of the pricing of other personal lubricants as K-Y meets a functional need. At the same time, Tesco also said [✂].

8.53 The [✂] loyalty card data submitted by RB is [✂]. Although the percentage of 'wealthy retired' consumers is slightly higher among K-Y purchasers than among Durex purchasers ([5–10] % of K-Y purchasers fall into this category compared to [0–5] % of Durex Play Gels, [0–5] % of Durex Sensilube and [0–5]% of Durex Premium Gel purchasers), this difference is marginal compared to what one would expect based on the parties' views. The same holds for 'young and affluent singles'; whereas one would expect a significant difference in the percentage of these consumers among Durex and K-Y purchasers based on the parties' views, the loyalty card data shows that this difference is negligible. Specifically, the share of these consumers among K-Y purchasers is [0–5]% compared to [0–5] % of Durex Play Gels, [0–5]% of Durex Premium Gels and [0–5]% of Durex Sensilube purchasers. The proportion of Durex and K-Y purchasers is fairly similar in the other categories[56] as well with 'affluent home owners' showing the biggest difference ([10–20]% of K-Y purchasers fall into this category compared to [10–20]% of Durex Play Gels, [10–20]% of Durex Premium Gels and [20–30]% of Durex Sensilube purchasers).

55 The CMA asked retailers, both in phase 1 and phase 2 of the inquiry, for any research or analysis that would provide insights into consumer behaviour (eg switching) in the personal lubricant market. However, retailers told us that they typically do not do any research or analysis specific to this area. We also asked whether retailers could provide any analysis based on loyalty card data but the only data we received is that mentioned in paragraph 8.56 and the [✂] loyalty card data submitted by RB (see paragraph 8.20).

56 The additional categories used by [✂] are the following: 'affluent home owners', 'smaller private family homes', 'comfortable mixed neighbourhoods', 'less affluent families', 'less affluent singles and students', 'poorer white and blue collar workers', 'poorer family and single parent households', 'poorer council tenants – many single parents'.

8.54 As mentioned in paragraph 8.20, RB also submitted [✂] loyalty card data on cross-purchasing, arguing that there is low level of cross-purchasing between K-Y and Durex Play Feel and that the data suggests a lack of switching from K-Y to Durex despite the latter being on promotion [✂]. We consider that there are some caveats to RB's analysis and conclusions:

- As RB notes, the dataset does not contain transaction level data (ie it is not possible to track a consumer's purchase over time) and the data also shows a very low level of purchase frequency.[57] This limits how useful such data can be to analyse switching behaviour – a point also made by [✂].

- There seem to be some further limitations to the data that affect its usefulness. The data on 'substitutability', which shows the percentage of product shoppers buying into the substitute product, only presents the first three 'substitute' personal lubricants to each product. The data shows that for most Durex personal lubricants, cross-purchasing with other Durex personal lubricants is fairly high. Given this, other Durex personal lubricants appear most frequently as 'substitutes', and hence the data does not show the percentage of shoppers who would buy into K-Y for most products.

- In its submission, RB only gives a partial picture of the cross-purchasing behaviour suggested by this data. For example, it is clear from the data that K-Y is the first 'substitute' to Durex Sensilube, with 14% cross-purchasing incidence. Moreover, as also pointed out by RB, the data shows some cross-purchasing between K-Y and Play Feel; namely, the three 'substitutes' listed for K-Y are the [✂] own-label products and Durex Play Feel (with a cross-purchasing incidence of 1%).

- RB argues that the data does not show switching from K-Y to Durex when the latter is on promotion. However, as discussed in Appendix E, a simple comparison of sales data to assess the impact of promotions without controlling for other factors that may affect sales has serious limitations.

8.55 The market positioning of most own-label personal lubricants is consistent with the view that K-Y and Durex personal lubricants are targeted at different consumer needseg Boots and Superdrug position one of their own-label products close to K-Y and another one or others close to Durex. Asda's own-label range has one item of each format to offer customer choice. Asda confirmed that the products in its own-label range are able to compete with

[57] The frequency of purchase of Durex and K-Y products in the dataset is between 1 and 1.3 per year.

both K-Y and Durex lubricants. Competitors such as Pasante or Lovehoney also saw Durex and K-Y personal lubricants as being different products.

8.56 Some retailers and competitors saw at least some of the parties' personal lubricants as competing products (and one of the retailers ([✂]) submitted data to support this view). In particular, Durex Play Feel, Durex Aloe Vera or Durex Sensilube were viewed as competing products to K-Y (eg by the Co-operative Group, Ocado, and three competitors (Ansell, Ann Summers,[58] and Yes Yes)). Sainsbury's also told us that Durex and K-Y personal lubricants compete with each other [✂]. Although the increase in K-Y sales could be as a result of factors other than the 2013 Durex retail price increase that the [✂] data does not control for (eg an increasing trend in K-Y lubricant sales in [✂]), the increase of K-Y sales in [✂] around the Durex bottle size change is consistent with our analysis of the overall sales data, which shows a statistically significant increase in K-Y sales after the Durex price increase when controlling for trends and seasonality (see Appendix E).

8.57 Retailers also told us that there is very limited competition between Durex personal lubricants and K-Y for promotional space. In particular, all retailers promote Durex personal lubricants on a regular basis (funded by RB) whereas J&J hardly ever funds promotions of K-Y. It was also pointed out that whereas the sales of Durex lubricants react to promotions, sales of K-Y remain fairly constant despite ranging and promotional activity in other areas of the category (Tesco, Morrisons, Boots).

8.58 We have found no evidence of retailers playing off the parties' personal lubricants against each other in negotiations, either to mitigate a cost price increase or to obtain better conditions in terms of promotional funding. However, it is also important to note that, apart from the recently proposed cost price increase by RB,[59] there have been no changes in the per ml cost price of Durex or K-Y in recent years.[60]

8.59 [✂]. Tesco was of a similar view. K-Y is not perceived as a direct competitor to Durex personal lubricants [✂].

8.60 [✂].[61] [✂][62] [✂]

[58] As Ann Summers does not stock K-Y, its views were based on the characteristics of the products ('Durex Play Aloe Vera has a gentle sales pitch').
[59] In March 2015, [✂].
[60] [✂]
[61] [✂]
[62] [✂]

Conclusion based on evidence from third parties

8.61 Many retailers view the parties' products as falling into the same product category, but attracting different customers. Others, however, suggested that the parties' products do compete, and data was provided in support of this argument.

Retail prices, promotions and sales – switching between K-Y and Durex

8.62 We have looked at retail prices of personal lubricants over time in the largest retailers based on Nielsen data submitted by RB. In general, the data shows less variation in the retail price of K-Y compared to basic Durex Play products. For example, the retail price of K-Y in Boots and Superdrug has been almost completely flat for the last two years, whereas the prices of Durex personal lubricants have been fluctuating as a result of promotional activity as shown by the graphs in the Data Analysis Appendix.[63]

8.63 Apart from short-term price variations due to promotional activity, there was a significant retail price change of Durex personal lubricant products in all major grocery retailers and national pharmacy chains in response to RB changing the bottle size of its Play range from 50ml to 60ml in March to April 2013. [✄].

8.64 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, may be consistent with the two brands not closely competing. A weak relationship between the prices of the parties' products was reflected by the results of the price-correlation analysis submitted by RB.

8.65 However, we found that while there was no price response from K-Y (which, in part, explains the price correlation results), there was a statistically significant[64] increase in K-Y sales around and after the time of the Durex retail price increase. For the 50ml product, there was a statistically significant increase in sales of around 8%. The change in sales in the 75ml size of K-Y was not statistically significant on its own, but on a combined 50ml and 75ml basis K-Y monthly sales showed a statistically significant[65] increase by 10%

[63] The lack of promotions on K-Y are confirmed by retailers' promotional calendars and promotion data [✄] submitted by RB. According to [✄] information from J&J, in the past two years K-Y has only been promoted by [✄], on two occasions, [✄]. However, [✄] said that it had run promotions on Durex personal lubricants but not on K-Y in the past 18 months. Other retailers have not run any promotions on K-Y Jelly, although its price decreased in Tesco around the same time as in [✄] (which is consistent with Tesco benchmarking against [✄] when setting prices). In contrast, Durex personal lubricants are promoted [✄] (eg price discounts, BOGOF), typically for [✄] each time.
[64] At the 99% level.
[65] At the 99% level.

around and after the time of the increase in Durex Play prices in 2013.[66] In carrying out the analysis set out in this and the next paragraph, we fitted a model to the monthly time series of sales volumes of each of the K-Y and Durex Play products controlling, where appropriate, for seasonality and trend. We ran a statistical test to identify whether, given the underlying pattern of the data, there was a sustained change in Durex and K-Y sales around and after the time of the Durex price increase. In response to the provisional findings, RB's economic advisers submitted a critique of our methodology and analysis. We took some of the points raised by RB's economic advisers on board and updated our analysis. However, we found that most of the arguments raised by RB's economic advisers were not well-founded. The details of our analysis and our response to RB's economic advisers' points are set out in Appendix E.

8.66 Besides the change in K-Y volumes, our analysis also showed a statistically significant decrease[67] in the monthly average sales of some Durex Play products (such as Durex Play Feel, Durex Aloe Vera), measured in millilitres, around and after the price increase.[68] For example, our analysis showed a statistically significant[69] decrease of 20% in the sales of Durex Play Feel and a statistically significant[70] decrease of 54% in the sales of Durex Aloe Vera, which are the most basic Durex Play lubricants and hence the most similar to K-Y.[71] These products account for 40 to 50% of total Durex Play sales. Results for other Play products were mixed, with no statistically significant change for total sales across the whole Play range.

8.67 The evidence on Durex Play Feel and Aloe Vera, on the 50ml K-Y product and on the combined 50ml and 75ml K-Y products, is consistent with some consumers switching from Durex Play products to K-Y in response to a change in the relative price. This pattern of changes is consistent with at least some Durex Play products and K-Y lubricants being substitutes. The analysis

---

66 K-Y is sold in both 50ml and 75ml sizes. However, while the 50ml size is sold in all retail outlets, the 75ml size is only sold in the major national pharmacy chains – ie in some branches of Boots and Superdrug – and not in grocery chains.
67 At the 99% level.
68 Our analysis took into account sales of both the 50ml and 60ml products. The methodology is explained in more detail in Appendix E.
69 At the 95% level.
70 At the 99% level.
71 We considered whether the drop in Durex Play sales could be a result of stocking effect. The end of line 50ml product was heavily promoted in some retailers before the bottle size change which could lead to consumers buying more during this promotional period and to a drop in sales after the promotion. However, we consider that any such effect was minimal. If consumers had stocked up on the product, we would observe a large jump in the sales of Durex before the bottle size change. The dataset does not indicate such a jump. In addition, any stocking effect would likely to last for a limited period of time. However, our analysis shows a sustained decrease in the sales level of Durex and not only a short term drop in sales.

should not be interpreted as demonstrating causation and needs to be considered in the round with other pieces of evidence.

8.68 In response to our analysis, RB's economic advisers submitted an econometric analysis aiming to test the impact of the Durex bottle size change and the consequent price increase on monthly volume sales of 50ml K-Y bottles. The results of this analysis show no statistically significant increase in K-Y volumes. However, RB's economic advisers' model uses a significantly shorter time period than the CMA's analysis of K-Y sales volumes. In particular, RB's economic advisers' analysis uses 18 observations of monthly K-Y sales data, as opposed to four years of monthly observations used in the analysis carried out by the CMA. Such limited number of observations are unlikely to be sufficient to estimate effects with enough precision to provide reliable results. For this reason, we concluded that the econometric analysis submitted by RB's economic advisers does not constitute a reliable source of evidence.

8.69 In order to assess whether there is likely to be switching from K-Y to Durex products, we sought to identify events when K-Y prices increased relative to Durex. Given that K-Y prices have been almost completely flat in the past, we used Durex promotion events as a proxy to assess what happens when K-Y is relatively more expensive.[72] In order to isolate and estimate the impact of promotions alone, we would have to account for changes in volume due to other factors (such as trends or seasonality). To do this, we compared sales of K-Y and Durex personal lubricants between retailers with and without promotions in a given period. The difficulties with identifying comparable retailers and periods were challenging, and we were only able to analyse three promotions in detail (see Appendix E).

8.70 Our analysis, as discussed in Appendix E, shows that we found a statistically significant negative impact (at the 10% level) on K-Y sales in one Durex promotional event (Durex Play Feel price promotion)[73] but statistically insignificant relationships for two other Durex promotions. However, given the limited number of promotion events where comparison between a 'with' and 'without' promotion situation could be made, and the limitations of the data and analysis, we cannot draw any strong conclusions from this analysis with respect to switching from K-Y to Durex.

[72] It is important to note that this analysis is not equivalent to analysing what would happen if K-Y prices alone increased by, say, 5 to 10% compared to all other personal lubricants sold by the retailers. Nevertheless, the impact of promotions on sales can be indicative of switching behaviour.
[73] 25% decrease of sales price.

Conclusion based on our data analysis

8.71 Bearing in mind the need to interpret the results carefully, the results from our data analysis are consistent with there being some competition between the parties' products.

Consumer surveys

- *The parties' surveys*

8.72 RB submitted a survey conducted by [✂] on its behalf for the [✂] and a survey by [✂].

8.73 J&J also produced consumer research, which was carried out by a market research company. However, this research specifically targeted women over 40 and was based on a very small sample with 20 participants as it was an in-depth focus group-based analysis.

8.74 However, the parties' surveys did not specifically address the key question of the extent of substitution between the parties' brands. Given this and the very limited evidence from retailers, we commissioned a consumer survey from TNS to gain a better insight into consumer behaviour within this market.

- *The TNS survey*

8.75 As mentioned in paragraph 8.10, understanding consumer behaviour is important in assessing retailers' options and the likely impact of the merger. The survey was conducted as part of TNS' regular face-to-face omnibus survey, while ensuring that respondents could complete the questions in confidence. We sought to ensure both the representativeness of the survey sample and the soundness of the methodology used in discussion with TNS. The survey was conducted by trained interviewers and was based on a representative sample of adults between the ages of 18 and 65.

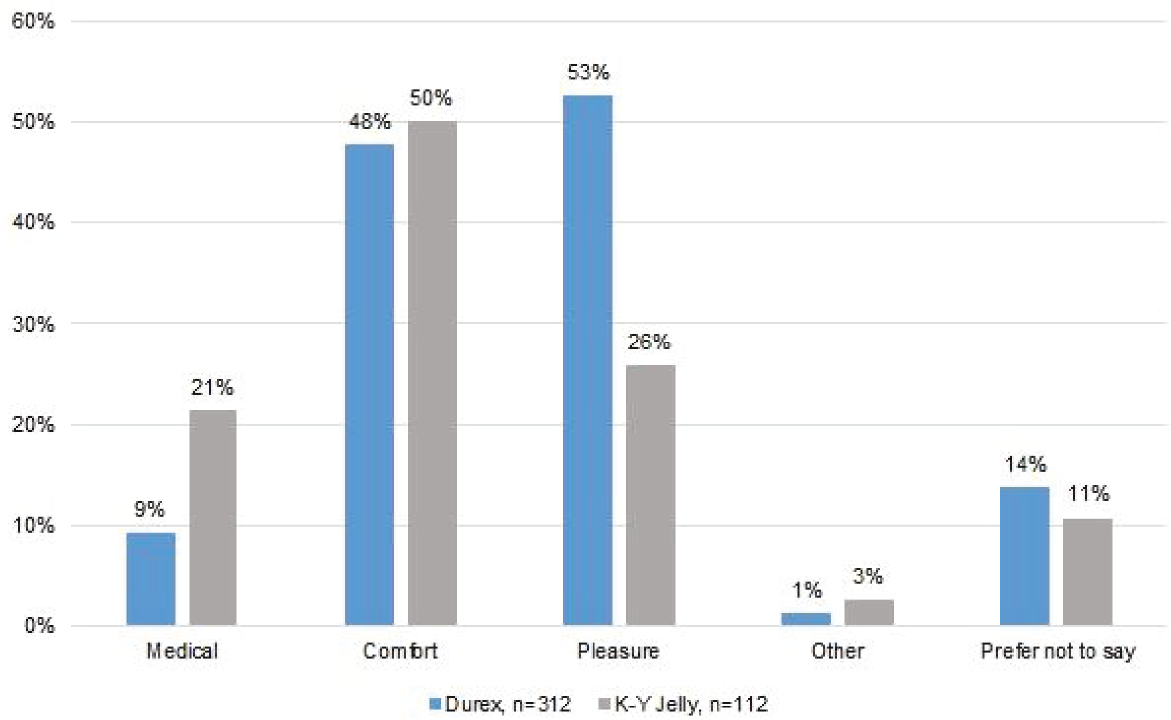
8.76 Our aim was specifically to test the closeness of competition between the parties' products (and other personal lubricants), to assess the degree of product differentiation within the market, and the strength of constraint on prices in grocery retailers and national pharmacy chains from specialist (adult) shops, online retail and potentially independent pharmacies.

8.77 RB's economic advisers made a number of criticisms of our survey and its findings, which we address in Appendix D. Our view is that the results of the TNS survey are sufficiently robust to support our conclusions drawn, including our estimates of consumer diversion ratios. We do, however, acknowledge that, by design our survey excluded people below the age of 18 or over 65 who had purchased the parties' products. Evidence submitted by J&J suggests that 30% of K-Y purchasers are above the age of 65 and their omission from the survey may have had an impact on our results. We test this in paragraph 8.86.

8.78 While the parties said that Durex personal lubricants and K-Y fulfil different consumer needs – in particular, that K-Y is typically viewed and used as a medical/functional product whereas Durex has a more 'fun' image – the results from the consumer survey provide a more nuanced picture.

8.79 Figure 2 summarises respondents' response to the question that TNS asked about the use of Durex/K-Y.

Figure 2: Use of Durex and K-Y (base: all who have bought K-Y or Durex)



Source: TNS consumer survey.

8.80 The results suggest that only one in five people buy K-Y for a medical reason, and that some Durex purchases are for this reason (9% of respondents). At the same time, there is a large overlap between the parties' brands in that both products were bought 'to make sex more comfortable' by around half of the respondents, which suggests that for many consumers Durex and K-Y are viewed as products that fulfil similar needs and could be used interchangeably.

8.81 TNS spoke to consumers in the 18 to 65 age range. There were differences in some of the age ranges between Durex and K-Y purchasers, with K-Y purchasers tending to be older than Durex buyers. 49% of K-Y buyers were aged over 45 (note our survey had an age limit of 65), while only 14% of Durex buyers were aged over 45. There is more overlap in the other age ranges: 34% of K-Y respondents were aged 18 to 34, compared with 70% for Durex purchasers; and the proportions in the age range 35 to 44 are very similar (17% and 16%).

8.82 The survey also asked Durex and K-Y purchasers which brands they would have chosen if Durex/K-Y had no longer been available in the pharmacy or grocery store where they last purchased the product. This 'switching' was tested by two different (but complementary) questions. First, consumers had the choice to buy a different product in the same store or website, or the same product (Durex or K-Y) in another store or online. Second, these consumers were subsequently asked what they would have done if the product had no longer been available anywhere.

8.83 We consider that respondents who chose to go to another store (or online) to buy the same product (Durex or K-Y) are likely to be more brand loyal than those who would switch to a different brand within the same store. The fact that 31% of Durex purchasers and 43% of K-Y purchasers would have purchased the same product somewhere else and that a further 10% and 4% would not have bought any other lubricant suggests that there is a fairly high level of brand loyalty. At the same time, a significant proportion of Durex and K-Y purchasers (41% and 39% respectively) would have switched to another brand within the same store instead of searching around for the same brand. In addition, 2% of Durex and 4% of K-Y purchasers would have shopped online for a different brand.[74]

8.84 In order to assess which brands (or own-label products) consumers consider as the closest alternative to Durex and K-Y personal lubricants, the survey asked respondents which brand of personal lubricant they would switch to if Durex/K-Y was no longer available in the store where they last purchased the product or was no longer available anywhere.

8.85 The survey shows that Durex is the first choice by K-Y customers (followed by Boots own-label) and K-Y is the second choice of Durex purchasers after Ann Summers (see paragraph 8.121).[75] We consider that references to Ann Summers are likely to overestimate what consumers would actually do as

---

[74] In its response to the provisional findings, RB argues that the TNS survey suggests that brand is not an important factor in Durex and K-Y buyers purchase decisions. However, as discussed in paragraph 18 of Appendix D, brand was a very important or essential factor for a significant proportion of K-Y and Durex purchasers.
[75] The third choice of Durex purchasers was Boots own-label.

Ann Summers is available only in one retailer – Superdrug – apart from the Ann Summers stores themselves.[76]

8.86 The closeness of substitution between products can be indicated by the diversion ratio.[77] We have calculated the following ranges of diversion ratios: 9 to 19% for Durex to K-Y; and 19 to 35% for K-Y to Durex.[78] These results suggest that Durex is a closer competitor to K-Y than K-Y is to Durex. When we test sensitivity to the under-coverage of the above 65 age group, making the extreme assumption that all purchasers of K-Y in this age group would divert to a third party product, we get diversion ratios for K-Y to Durex of 13% to 25%. As discussed in paragraph 8.146, we took this into account when assessing the potential upward pressure on prices post-merger.

8.87 When we assess the evidential weight to be placed on the diversion results as indicators of closeness of competition, we do take into consideration the following:

- The sample sizes could be regarded as being small for the diversion ratios. We explicitly took this into account by calculating confidence intervals for the diversion ratios.
- There exists a certain degree of under-coverage. However, we presented some sensitivity analysis to test the impact of this and found significant diversion between the parties' products even in the most extreme scenario.
- We also note the potential for response error and non-response bias, and the hypothetical nature of the diversion questions.

8.88 We consider the TNS survey is an important piece of evidence showing that the parties' products are substitutes for some consumers. This is based mainly on the diversion ratios, but is further supported by the overlap between the uses of the products (ie the proportion of respondents who use the products for the same purpose, eg comfort) and the age ranges of the users.

[76] Given that only one Durex purchaser and one K-Y purchaser who said they would switch to another brand would have gone to an adult store, the high proportion of people mentioning Ann Summers cannot be explained by consumers choosing to buy in an Ann Summers store in response to the non-availability of Durex/K-Y.
[77] A diversion ratio between Product A and Product B represents the proportion of sales that would divert to Product B (as opposed to Products C, D, E, etc) as customers' second choice in the event of a price increase for Product A. *Merger Assessment Guidelines*, paragraph 5.2.15.
[78] See Appendix F for the fuller discussion of these calculations.

Conclusion based on the survey results

8.89 Our conclusion is that the consumer survey results show that, for some consumers, these products are substitutes. The diversion ratios do however reflect a degree of product differentiation within the market.

Constraint from other brands

8.90 In this section, we consider the constraints offered by other brands, mainly based on the parties' views and evidence from third parties, and we also cross-refer to the findings from the TNS consumer survey (see paragraph 8.85).

The parties' views

8.91 The parties argued that there is a very wide range of personal lubricants for sale in the UK, and that these brands currently impose a constraint on the parties' pricing and the quality of their products.

8.92 [✂][79]

8.93 RB also said that it is not appropriate to assess competition within separate sales channels and, therefore, the availability of product offerings of competing suppliers in specialist (adult) shops and online retailers should also be taken into account.[80] In addition, RB said that national pharmacy chains such as Boots or Superdrug also list alternative brands that compete with the parties' products, and grocery retailers could do the same if they wished to do so.[81]

8.94 J&J also argued that larger pharmacies and online retailers tend to carry a range of products that compete with the parties' products. In addition, brands that are available primarily online also may expand into physical retail outlets.[82]

8.95 We consider that RB's argument about increasing competitive constraints once the market has reached a certain level of saturation is rather speculative and we would expect RB (and other suppliers of personal lubricants) to compete for existing customers as well as new ones. Therefore, we will focus

---

[79] RB initial submission, paragraphs 8.23-8.24.
[80] RB initial submission, paragraph 8.27.
[81] RB initial submission, paragraph 8.29.
[82] J&J initial submission, paragraphs 5.8 and 5.12.

on evidence of how strongly other brands have been competing and are currently capable of competing with Durex and K-Y personal lubricants.

Evidence from third parties

8.96 Third parties provided evidence in relation to:

- how other brands of personal lubricants are viewed and whether they are considered as close competitors to either K-Y or Durex;
- retailers' decisions to stock other brands of personal lubricants and their success in doing so;
- the impact of the introduction of other brands by retailers on the sales of Durex and K-Y;
- the use of other brands of personal lubricants by retailers as a lever when negotiating with RB or J&J; and
- competitors' views on the ease of entry into grocery retailers and national pharmacy chains.

8.97 As Table 3 shows, among major grocery retailers and national pharmacy chains, only Superdrug, Boots and Lloyds Pharmacy stock branded personal lubricants other than Durex or K-Y.

8.98 Retailers such as [✂], [✂], Superdrug [✂] considered Durex and K-Y as 'must-have' products or 'signpost brands' because of customer loyalty and the lack of competing brands, which would suggest that retailers do not consider other branded personal lubricants as strong alternatives to either Durex or K-Y. Sainsbury's also considered K-Y as a 'must-stock' product.[83]

8.99 Generally, when introducing new personal lubricant brands, grocery retailers and national pharmacy chains primarily look at 'filling gaps' and offering products that are somewhat different from Durex and K-Y. For example, Boots introduced woohoo! (an organic product) and Swoon to offer more premium products to consumers.[84] According to Boots, the introduction of these products did not have any significant impact on the sales of Durex personal lubricants, and the range of Swoon SKUs that Boots sells has decreased over time. Superdrug also informed the CMA that the introduction of Ann Summers personal lubricants did not have any impact on the sales of Durex products. Sales data from [✂] confirms that the sales of these products have remained

[83] Summary of hearings with Sainsbury's on 13 February and 11 March 2015.
[84] Summary of hearings with Boots on 24 February and 17 March 2015.

limited in the retailers that stock them, and Ann Summers also said that, based on the experience with Superdrug, it was not convinced that its products would sell well in the grocery retailers and national pharmacy chains.[85] Superdrug also stocked 50 Shades of Grey personal lubricants [✂].[86]

8.100 Another interesting example is that of ID Lubes, which is one of the strongest brands online and in specialist (adult) shops. [✂]. These examples suggest that none of these brands have managed to compete strongly with Durex or K-Y products in terms of attracting business away from them.

8.101 We have also been informed about examples when a retailer considered stocking a different brand of personal lubricant but decided not to do so. Some products were considered lacking enough marketing support or were not considered strong enough brands. For example, [✂] and, hence, would not have attracted new customers, which is in line with the argument that retailers typically look for personal lubricants that are differentiated from Durex and K-Y. [✂]

8.102 Retailers told us that they have not used alternative brands of personal lubricants as a lever in negotiations with either RB or J&J, although it should be borne in mind that cost price increases have very rarely been proposed. However, we found no evidence that retailers considered introducing alternative brands or threatened to do so in the context of the March 2015 proposed cost price increase by RB. In fact, evidence suggests that retailers such as [✂]. Retailers also emphasised the importance of branding, marketing and promotional investment when deciding to stock a particular personal lubricant brand, which may limit smaller suppliers' opportunities to compete for shelf-space with larger scale suppliers (such as RB).[87]

8.103 We have also gathered evidence from suppliers of competing personal lubricant brands to understand their ability to compete with Durex and K-Y in grocery retailers and pharmacies. Ann Summers, Yes Yes, Pasante and Lovehoney highlighted the challenges of competing with Durex in grocery retailers and pharmacies due to the strong brand and marketing support behind Durex. For example, Lovehoney managed to get its Swoon products stocked in Boots as a result of good personal relationships, but the range of

[85] Summary of hearing with Ann Summers on 26 February 2015.
[86] 50 Shades of Grey products could not be successfully introduced by grocery retailers and pharmacies despite the success of the film, which may be indicative of the difficulties of new brands to grow in this segment.
[87] Cost price is only one element of the negotiations between retailers and personal lubricant suppliers; the joint business plans (JBPs) are negotiated around, among others, promotional activities and funding by the suppliers.

products stocked on Boots' shelves has decreased since their introduction.[88] Lovehoney has not had any success with other retailers. Yes Yes also tried to approach Boots, but the only way of getting its products sold by the retailer was selling it on prescription. Pasante branded lubricants were only sold for a short period of time in Tesco until, in Pasante's view, Durex's promotion strategy led to the delisting of these products.[89] Since then, Pasante has focused on supplying retailers' own-label personal lubricants (for [✂]). Ansell has recently been successful in having two of its Skyn personal lubricant products being stocked by Boots and Superdrug. However, the products are, at present, [✂].

Conclusion on competitive constraints from other brands

8.104 The consumer survey commissioned by the CMA suggests that, aside from the parties' brands, Ann Summers enjoys the highest degree of brand awareness (see paragraph 8.85) and, hence, would likely to be the most credible option for retailers. However, evidence suggests that the strength of the brand has not been sufficient to get a real foothold in national pharmacies or grocery retailers. More generally, alternative brands have had limited success in ensuring that their brands are stocked and obtaining significant sales in national pharmacy chains and grocery retailers, in some cases because they were judged not 'retail ready'.

8.105 On balance, the evidence so far suggests that the competitive constraint on Durex and K-Y from alternative brands within the grocery/national pharmacy chain markets in the UK is weak.

Constraint from own-label products

8.106 In this section, we consider the constraints offered by own-label products. We consider the parties' views, internal documents, evidence from third parties, our data analysis and the survey results. It is noted that of the major retailers of personal lubricants, all the major grocery retailers and national pharmacy chains market sell own-label personal lubricants, with the notable exceptions of Sainsbury's, Morrisons and Waitrose.

[88] Summary of hearing with Lovehoney on 27 February 2015.
[89] Summary of hearing with Pasante on 25 February 2015.

The parties' views

8.107 Both parties argue that retailers' own-label products are designed to be close competitors to either Durex or K-Y, which is reflected in packaging and product positioning.

8.108 Boots, Superdrug and Asda offer functional as well as pleasure enhancing personal lubricants, Lloyds Pharmacy offers basic functional lubricant products, and Tesco offers pleasure enhancing lubricants. Own-label sales in these retailers account for 14 to 26% of all personal lubricant sales. Based on [✄] data, sales of own-label account for [5–15]% of all personal lubricant sales (in terms of value of sales) by grocery retailers and national pharmacy chains.

8.109 [✄]

8.110 [✄]

Internal documents

8.111 [✄]

8.112 [✄]

Evidence from third parties

8.113 We sought third parties' views on how strongly own-label personal lubricants compete with Durex and K-Y products, and whether own-label products have been and could be used as a lever in negotiations with RB and J&J.

8.114 Retailers could provide very limited information about the impact of the introduction of their own-label personal lubricants. This is largely because most of these products were introduced several years ago and the buyers we spoke to were not involved in the process at the time. Superdrug introduced its own-label personal lubricants [✄], Boots could not specify when it happened, and Asda introduced its products in 2008/09. Tesco introduced its own-label lubricants more recently, in November 2011, [✄].

8.115 Retailers with own-label personal lubricants considered that their products were closer competitors to Durex and K-Y than other branded personal lubricants. For example, Boots considered one of its own-label products to be a closer competitor to K-Y than Durex Play Feel, and another of its own-label products as the closest competitor to Durex Play personal lubricants. This was similar for Superdrug. However, Superdrug also informed us that when its own-label lubricants are on promotion, it sees a [✄]% increase in sales volume but no switching from branded personal lubricants. Our data analysis is consistent with this. Sales of Superdrug own-label personal lubricants are higher in promotion periods and react negatively to Durex promotions, but no obvious pattern of switching from Durex to own-label could be identified.

8.116 Tesco also thought that [✄], which is consistent with [✄].

8.117 We have found no evidence of own-label personal lubricants being used as levers in negotiations with either RB or J&J (although J&J has submitted that it has not sought any price increase, or engaged in active negotiations with retailers over the supply of K-Y, in a number of years). [✄], and Tesco also mentioned own-label personal lubricants as an alternative if there was any disagreement over prices with suppliers post-merger.[90]

8.118 We have also been informed that [✄] Superdrug are planning to reposition or expand their own-label personal lubricant range. For example, Superdrug recently introduced its strawberry flavoured lubricant (similar to one of Durex's SKUs), which may suggest that own-label personal lubricants could become more similar to Durex personal lubricants.

8.119 Sainsbury's does not have an own-label personal lubricant. [✄].[91] [✄]

Retail prices, promotions and sales

8.120 Sales data[92] suggests that when the branded lubricants are being promoted, consumers switch from own-label to branded lubricants, and at the end of the promotion the sales of own-label recover. However, this does not necessarily mean that consumers of branded lubricants would switch to own-label lubricants if the price of branded lubricants increased above the non-promotion level. The figures presented in Appendix E do not reveal any obvious pattern of such switching from branded personal lubricants to own-label products. Although this data can be illustrative, it does not allow us to draw any strong conclusions.

Consumer survey

8.121 The TNS consumer survey commissioned by the CMA suggests that a proportion of consumers consider own-label personal lubricants in aggregate and, in particular, Boots' personal lubricants[93] as their first choice if

---

[90] Summary of hearings with Tesco on 23 February and 18 March 2015
[91] Summary of hearings with Sainsbury's on 13 February and 11 March 2015.
[92] See Figures in Annex 2 of Appendix E.
[93] Boots accounted for the higher proportion of personal lubricant sales, which explains the high number of Boots own-label mentions.

Durex/K-Y was no longer available. 12% of Durex customers told TNS that they would switch to Boots if Durex's products were not available, which was the third highest response behind Ann Summers (15%) and K-Y (13%). 20% of K-Y customers told TNS that they would switch to Boots if K-Y's products were not available, which was the second highest response behind Durex (24%). Both of these responses were much higher than the next highest response (8% for Ann Summers).

8.122 Retailers thought that own-label products attract more price-sensitive customers than branded products and, as discussed above, they have not seen any evidence of switching from branded personal lubricants to own-label personal lubricants.

8.123 After the response hearing, RB submitted [✂] loyalty card data with demographic breakdown of lubricant purchasers [✂].[94] The figures show that any skew towards less affluent consumer groups for private label purchasers is small, and that there is a relatively balanced split across the groups by level of affluence, which suggests that own-label products are not necessarily bought predominantly by less affluent consumers.

Conclusion on competitive constraints from own-label

8.124 The views of some retailers and the findings from the survey show that own-label products are a competitor to K-Y and Durex. When branded personal lubricants are promoted, consumers switch from own-label to branded personal lubricants, and at the end of the promotion the sales of own-label personal lubricants recover. However, this does not mean that consumers of branded personal lubricants would switch to own-label personal lubricants if the price of branded personal lubricants increased above the non-promotion level. On balance, the evidence from the survey and the views of retailers suggest that own-label products are substitutes to Durex and K-Y.

Constraint from specialist (adult) shops, online retail and independent pharmacies

8.125 In this section we consider constraints from specialist (adult) shops, online retail and independent pharmacies. We consider evidence from third parties and our consumer survey to assess the strength of the current constraint from these sales channels.

[94] See paragraphs 8.53-8.54 for further discussion of this data.

The parties' views

8.126 RB told us that the availability of personal lubricants online and in specialist (adult) shops represented a significant constraint on their marketing of their products in grocery retailers and national pharmacy chains. RB referred to the impact that the availability of personal lubricants in independent pharmacies may have across the market.

8.127 RB submitted that online retailers closely compete with grocery retailers and national pharmacy chains.[95] RB, among other things, argued as follows:

- Purchases of personal lubricants are typically planned purchases; [✂]. Therefore, consumers will research the product, often online, before they buy.

- Online sales of personal lubricants have been and are expected to be growing. That may be why Durex launched its direct online retail site.

- The [✂] survey shows that [✂]% of consumers who purchase lubricants in the offline traditional channels (supermarkets, pharmacies, convenience stores and adult stores) also purchased online in the three months period in question. The [✂] survey also asked respondents which shops they would consider purchasing personal lubricants from, and showed that [✂]% of Durex purchasers who purchased in grocery stores or pharmacies would consider buying from Amazon or ebay, and [✂]% would consider buying from a specialist website. The same proportions for K-Y purchasers are [✂]% and [✂]%. A survey by [✂] in 2013 showed that [✂]% of those surveyed had bought SWB products online, and [✂] consumers who had only bought offline would probably or definitely buy SWB products online.

- Products with an established position online can enter into grocery retailers and national pharmacy chains.

8.128 RB also said that specialist (adult) stores are closely competing with other retailers. This is because the stigma associated with visiting a specialist (adult) store has diminished and that other retailers are likely to compete with high street adult chains such as Ann Summers.[96] RB submitted findings [✂] showing that a significant proportion of consumers ([✂]) would consider buying personal lubricant in a specialist store.

---

[95] RB initial submission, paragraphs 4.39-4.64.
[96] RB initial submission, paragraph 4.65.

8.129 J&J was also of the view that personal lubricants that are available in adult shops and online could enter grocery retail and national pharmacy chains.[97]

Evidence from third parties

8.130 Grocery retailers and national pharmacy chains were unambiguously of the view that they do not compete with specialist (adult) shops and that their customers would not switch to these shops to purchase lubricants even in case of a 5% price increase. They believe different customers go to these different retailers on differing shopping missions. Suppliers of competing personal lubricants had similar views.

8.131 Regarding online competition, we found that grocery retailers and national pharmacy chains mainly consider other grocery retailers and pharmacies when setting the prices of their personal lubricants and some of them even match the prices of other grocery and pharmacy retailers. Boots and Asda told us that they also have regard to online retailers. However, Asda said that its biggest competition came from 'bricks-and-mortar' retailers. Asda also thought that its customers (who usually bought the products as part of a grocery shop) may switch to other supermarkets rather than switch to online retailers if its prices became uncompetitive. In addition, the development of the online market for personal lubricants sales was not seen as a particular threat by any of the major retailers (such as Boots, Superdrug, Tesco).

8.132 Independent pharmacies were not mentioned by any of the retailers when asked about the retailers with which they compete.

Consumer survey

8.133 Consumers were asked about what they would do if the product (K-Y or Durex) they purchased was no longer available in the grocery store or pharmacy where they made the purchase. Only 1% of Durex purchasers and 2% of K-Y purchasers said they would buy the same or other product online (excluding the websites of national grocery and pharmacy stores), 4% of Durex purchasers and 2% of K-Y purchasers said they would buy from adult shops and 1% of Durex purchasers and 4% of K-Y purchasers said they would buy from independent pharmacies.

[97] J&J initial submission, paragraph 5.12.

Conclusion on competitive constraints from specialist (adult) shops, online retail and independent pharmacies

8.134 The surveys commissioned by RB were conducted online and, therefore, the results in relation to the willingness to use the online sales channels are likely to be biased. This could be a particularly strong issue in relation to certain age groups that might be the target demographic for at least some personal lubricant products.

8.135 Notwithstanding the potential bias of these surveys, the CMA recognises that some consumers do use multiple sales channels for personal lubricant purchases, and that the importance of online retail in general is increasing. The [✂] commissioned by RB also suggests that there are consumers who would consider buying personal lubricant in adult shops. However, the TNS survey suggests that consumers who purchase Durex or K-Y personal lubricants in grocery retailers or national pharmacy chains are much more likely to switch to brands that are available in these shops rather than switching to buy from online retailers, independent pharmacies or adult shops. This was also echoed by retailers. This suggests that the constraint from other sales channels on the retail prices set by grocery retailers and national pharmacy chains, and on the cost prices set to grocery retailers and national pharmacy chains is likely to be weak.

8.136 Furthermore, we believe the evidence suggests that the volume and value of online sales of personal lubricants is not as significant as RB suggested. Our estimate is that online sales amounted to no more than £6.3 million in 2013, in contrast to an estimate suggested by RB of £[✂].

8.137 Online sales may increase in the long run, but we have no evidence that this will occur within a time horizon relevant to this inquiry. Grocery retailers and national pharmacy chains informed us that the proportion of their personal lubricant sales online is currently only between 2% and 5%, although one retailer suggested it could be as high as 10%.

8.138 Regarding the ability of brands sold online or in specialist (adult) shops to enter into grocery retailers and national pharmacy chains, we found the evidence is not as strong as the parties suggest (see paragraphs 8.98 to 8.103 and Section 9).

8.139 In sum, the evidence from the consumer survey, together with evidence from retailers, suggests that specialist adult shops, online retailers and independent pharmacies are not likely to constrain grocery retailers and national pharmacy chains in the pricing of personal lubricant products and constrain the cost prices set by the parties to these retailers.

- *Potential for upward pressure on prices post-merger*

8.140 On balance, the evidence considered as part of the assessment of the pre-merger competitive conditions suggest that the parties' brands are competing in grocery retailers and national pharmacy chains (see paragraphs 8.50, 8.61, 8.72 and 8.89). The evidence also suggests that own-label competes with the parties' products in these retailers (see paragraph 8.124). In the following paragraphs, we discuss the likely impact of the loss of pre-existing competition between the parties' brands whereby the main pre-existing competition is reduced to own-label products. To this end, we summarise our analysis that shows the merger party's incentive to try to increase cost prices to grocery retailers and national pharmacy chains following the merger given consumers' stated preferences and what we know about manufacturers' margins.

8.141 When assessing horizontal unilateral effects of mergers with differentiated products, such as personal lubricants, the CMA may analyse the change in the pricing incentives of the merged enterprise, ie the change in incentives brought about by the bringing together of the differentiated products under common ownership or control.[98] In doing so, the CMA takes into account the closeness of substitution between the merger parties' products and the variable profit margins.

8.142 If the products of the merger firms are close substitutes, unilateral effects are more likely because the merged firm will recapture a significant share of the sales that would have been lost pre-merger in response to the price increase, making the price rise less costly to the merged firm. Likewise, if the variable profit margins of the products of the merger firms are high, unilateral effects are more likely because the value of sales recaptured by the merged firm will be greater, again making the price rise less costly.[99]

8.143 As discussed in paragraph 8.76, one of the aims of the TNS survey was to establish more clearly whether the two products are regarded as substitutes by end consumers, which feeds into the assessment of the merger party's incentive to increase the price post-merger. The results of the survey are presented in Appendix D and paragraphs 8.75 to 8.89.

8.144 The survey showed that Durex was identified as the closest substitute for K-Y by consumers, and that K-Y was identified as the second alternative to Durex after Ann Summers personal lubricants.

[98] *Merger Assessment Guidelines*, paragraph 5.4.6.
[99] *Merger Assessment Guidelines*, paragraph 5.4.9.

8.145 The TNS survey focused on consumer switching rather than diversion of retailers between the parties – an approach that was criticised by RB's economic advisers. Given the relationship between consumers' and retailers' choices and the relationship between upstream and downstream prices, we consider that data on consumer behaviour and the calculated diversion ratios (see paragraph 8.86) are informative for assessing the closeness of competition between the merger parties' brands and the incentive of the merger party to try to increase the cost price post-merger.

8.146 Using the range of diversion ratios we calculated from the TNS survey (see paragraph 8.86) and a range of variable margin estimates based on the parties' data (see paragraph 2.15), we computed an Indicative Price Rise (IPR) for Durex and K-Y personal lubricants. By estimating an IPR we are not predicting post-merger price rises, but this is an informative tool for analysing the incentives that Durex would have to raise cost prices after the merger. We did not carry out a full scale merger simulation as this would require an intensive modelling of demand for the two brands which would not have been possible to complete to the required standard in the time available to the inquiry.

8.147 Using a standard approach, we estimated that the IPR in this merger would be in the range of 4% to 12% for Durex products and 6% to 17% for K-Y products. Appendix F explains in more detail the assumptions and the methodology we used for our computation. In order to test the sensitivity of the results to limiting our survey sample to the population between 18 and 65, we also calculated the IPR with the diversion ratios that we calculated in the unlikely case that all consumers above 65 who purchase K-Y would switch to a brand different from Durex (see paragraph 8.86). In this extreme case, the IPR would be in the range of 3.7 to 10% for Durex products and 4 to 12% for K-Y.

8.148 As noted above, in our model we used consumer level data and did not take into account the negotiation between suppliers and retailers. In that sense, these results are indicative of the price rise we would expect (absent supply-side responses or other countervailing factors) if the suppliers were posting retail prices. While this is not the case in the market, we consider that these results are indicative of the merger party's incentive to try to increase cost prices post-merger, especially in light of the relationship between upstream and downstream prices which will lead to increases in retail prices.

8.149 However, the incentive to increase price post-merger does not necessarily translate directly into an ability to increase prices. There may be supply-side responses such as new entry, repositioning of currently available products, or exercising buyer power that could counter the incentive to increase price. We consider the extent of these supply side responses in sections 9 and 10.

Conclusion on the effects on competition

8.150 In this section we assess pre-existing competition between the merging parties' personal lubricants; pre-existing competition on the merging parties' personal lubricants from other branded products; own-label products and other sales channels (online, adult shops and independent pharmacies); the change in incentives from the loss of competition resulting from the merger; and an indication of what this may mean for post-merger prices. We have considered views from the parties; internal documents from the parties; views from third parties; data analysis; and results from our consumer survey.

8.151 The parties assert that the two brands do not compete with each other as they appeal to differing customer bases. However, the overall picture presented by reviewing the parties' internal documents is that both parties are aware of each other as competitors within the relevant market for the supply of personal lubricants in the UK. In addition, both parties are aware that their products over-index different types of consumer that RB has made significant investment in marketing and developing the Play range, and that J&J has made minimal investment in the K-Y brand in the UK. Some surveys commissioned by the parties show some overlap between the consumers of Durex and K-Y and suggest that at least some consumers use these products interchangeably.

8.152 TNS carried out an extensive consumer survey on our behalf. Our conclusion is that the consumer survey results show that for some consumers these products are substitutes. The diversion ratios do, however, reflect a degree of product differentiation within the market. We used price and sales data for personal lubricant sales to carry out various market analyses. Bearing in mind the need to interpret the results carefully, the results are consistent with there being some competition between the parties' products.

8.153 Many retailers view the parties' products as falling into the same product category, but attracting different customers. Others, however, suggested that the parties' products do compete and data was provided in support of this argument.

8.154 On balance, the evidence from the survey and from the parties' internal documents shows that K-Y and Durex lubricants are to some extent substitutes. Data analysis of the impact of the retail price change of Durex lubricants in 2013 is also consistent with this finding.

8.155 The evidence shows that that the competitive constraint on Durex and K-Y from alternative brands within the grocery/pharmacy segment is weak. This is not the case for own-label products; the evidence shows they are substitutes to Durex and K-Y and do impose some competitive constraint on K-Y and Durex lubricants in this segment.

8.156 The evidence from the consumer survey, together with evidence from retailers, suggest that specialist (adult) shops, online retailers and independent pharmacies are not likely to constrain grocery retailers and national pharmacy chains in the pricing of personal lubricants.

8.157 An IPR, calculated on the basis of the diversion ratios and information about the parties' profit margins on personal lubricants, suggests significant upward price pressure would occur post-merger for both Durex and K-Y products to grocery retailers and national pharmacy chains. This incentive to increase price post-merger would not necessarily translate directly into an ability to increase prices. For that, we have to consider whether any price rise would attract new entrants to the market or whether retailers have sufficient buyer power (and the incentive to use it) to resist any price increase.

8.158 Taking into account all of our findings, we concluded that in the market for the supply of personal lubricants to grocery retailers and national pharmacy chains there is competition between Durex and K-Y and between these two brands and own-label products. The merger will remove the competitive constraint between Durex and K-Y, leaving own-label as the main constraint on these products. We concluded that this reduction in competition would lead to an SLC unless prevented by entry, expansion or countervailing buyer power, which we discuss in the next two sections.

8.159 We have found no evidence of lack of choice for consumers or absence of competition to supply personal lubricants in the online, specialist (adult) shops or independent pharmacy markets. This finding for online sales would be the same with a wider market as there will be more competition.

9. New entry and expansion

9.1 We now consider whether we can expect new entry or expansion by competitors to be timely, likely and sufficient to deter RB from exploiting any increase in market power resulting from the acquisition of the K-Y business in the UK.[100]

[100] *Merger Assessment Guidelines*, section 5.8.

9.2 We considered whether there were barriers to entry and looked at examples of new entry in the UK market, with a focus on the grocery retail and national pharmacy chain channels, as there appeared little evidence of significant barriers into online channels or supplying specialist (adult) shops and independent pharmacies.

9.3 The parties assert there are no significant barriers to entry. On the basis of the evidence we have seen, there are no significant barriers to entry to the manufacturing of personal lubricants in general.

9.4 The parties also emphasised there are no intellectual property rights[101] or significant know-how requirements to manufacture the product, though there may be specific patents for individual products. They stated that the production process is simple[102] and does not require specialised equipment, and third parties such as Pasante are able to produce personal lubricants for others.

9.5 The parties highlighted that there is not an obvious minimum volume required to produce personal lubricants. Access to ingredients is required, but they appear to be freely available. Finally, the parties do not consider there to be strategic advantages in the personal lubricants market enjoyed by either RB or J&J.

9.6 On the basis of the evidence, we have seen there are no significant barriers to start supplying personal lubricants, as the ingredients are easily available, the manufacturing process is straightforward, without the need for specialised equipment, and the mixing equipment can be used for other products. However, while there has been some entry into national pharmacy chains in recent years, none of these new entrants expanded to become credible competitors to Durex and K-Y; they typically entered into niches not covered by Durex and K-Y (such as premium or organic products) and have achieved limited distribution (in terms of the number of outlets that stock them) and sales. Table 8 summarises entry of lubricants to national pharmacy chains and groceries over the last five years.

[101] RB initial submission, paragraph 5.2.
[102] RB initial submission, paragraphs 5.3-5.4.

Table 8: Entry of personal lubricants in grocery retailers and national pharmacy chains

Brand/product (Manufacturer)	*Launch date*	*Grocery or national pharmacy chain stockist*	*Description and strategy*
50 Shades of Grey (Lovehoney)	January 2015	Superdrug	To accompany the book *50 Shades of Grey*, launched in time to coincide with the release of a film of the same name. [✂]*
Swoon (Lovehoney)	January 2012	Boots	Lovehoney Swoon products stocked by Boots from November 2012. Initially 8-9 products; subsequently reduced to 5-6.†
Ann Summers (Ann Summers)	March 2013	Superdrug, Ann Summers	A large range of pleasure enhancement personal lubricants all with features such as flavours or sensations. Ann Summers brand also available in Ann Summers stores and online.
Yes‡ (The Yes Yes Company)	June 2013	Boots (only as pharmacy product)	A certified organic, plant-based natural range of intimacy products. Positioned neutrally, to offer both functional/ moisturiser and pleasure enhancement variants. Yes water-based products have been accepted by the NHS and are available on prescription for the relief of intimate dryness and related conditions.
Balance Activ§ (Inverness Medical Innovation)	April 2013	Boots, Superdrug, Tesco, Asda, Lloyds Pharmacy	A moisturiser product, which has used Boots as a gateway with trials in other grocery retailers.
woohoo!¶ (Essential)	May 2011	Boots	A water-based organic lubricant with a silky and sensuous feel, designed to enhance intercourse and intimacy. Only contains natural and organic ingredients. Brand positioned neutrally.
Skyn# (Ansell)	April 2015	Boots, Superdrug	Two premium personal lubricants, one water-based and one silicone-based, under the Skyn brand.

Source: Grocery retailers and national pharmacies.
*Based on hearing with Superdrug on 20 February 2015.
†Based on hearing with Lovehoney on 27 February 2015.
‡See the Yes website.
§See the Balance Activ website.
¶See the woohoo! website.
#Based on hearing with Ansell on 4 March 2015.

9.7 Superdrug and Boots were each involved in most of the five launches, but only one, Balance Activ, is stocked in some grocery retailers. Entry into groceries appears to be less likely than national pharmacy chains.

9.8 In addition to new branded personal lubricants, there has also been an increase in the number of retailers selling own-label personal lubricants. Currently, Boots, Superdrug, Tesco, Asda and Lloyds Pharmacy supply own-label products. At the moment, Superdrug is expanding its range with the introduction of a new SKU similar to one of the flavoured Durex personal lubricants, [✂].

Competitor views

9.9 Feedback from some of RB's competitors suggested that barriers to entry (into grocery retailers and national pharmacy chains) were already significant, with the strong position of RB creating a major competitive challenge. In their view, the merger would strengthen an already strong position, so the merger would make little difference. Others told us that the merger will make the competitive position more difficult. Pasante also identified the high cost of developing and launching a new formula in a lubricant, due to testing needed to get the necessary approval as a possible barrier.

9.10 Some comments from companies that have entered the market with personal lubricants are considered below.[103]

9.11 Lovehoney does not manufacture its own product, but buys it from a third party producer. It told us that it has supplied Swoon lubricants to Boots since November 2012.[104] The number of products stocked by Boots had fallen, however, from eight to nine initially to five to six this year. It has sought to get its products stocked by other retailers. However, it has faced major challenges, although it has sold via Amazon direct to the public. In its view, a supermarket or pharmacy will only tend to replace a product if they expect to make more money as a result. The groceries and national pharmacy chains already have a strong relationship with RB, which spends large amounts on advertising and on in-store promotions.

9.12 Ann Summers[105] considers itself to be competing against other adult shops rather than grocery retailers. Personal lubricants are a small part of its product range. While it supplies Superdrug on an exclusive basis, it does not consider the experience to be highly successful and had not approached further pharmacy chains or grocery retailers. However, it is in a different market position with its own retail shops where it has a strong service focus, staff willing to explain the products and a broad range.

9.13 Ann Summers told us that to get stocked by Superdrug took considerable negotiation and a long time, as it took about two years to achieve listing for a very small range of products. The process was 'long, very painful and not very successful', in its words. The main problem appeared to be the limited visibility of a small Ann Summers product range when set against the full Durex product range. Ann Summers also referred to the large amount that Durex spent on advertising.

9.14 Another of the five companies identified, Yes Yes, commented that 'the power of the bigger suppliers, such as Reckitt Benckiser, do make it nearly impossible to get our products in front of category buyers'. It also said 'should Reckitt Benckiser market K-Y Jelly brand with their own Durex brands, a difficult situation becomes impossible for small companies like us.' It sees the major retail stores as being very important to brand recognition, so intends to approach the major retail stores again. The significant listing fees and delayed

---

[103] Summary details for most of these entries are included in the preceding table.
[104] Summary of hearing with Lovehoney on 27 February 2015.
[105] Summary of hearing with Ann Summers on 26 February 2015.

payment terms required by the main retail chains are a further obstacle for smaller company suppliers, though this is not specific to personal lubricants. However, it considers it has little hope of success and is focusing its expansion plans on [✂].

9.15 Another third party providing feedback was Pasante,[106] which manufactures personal lubricant in the [✂] and also supplies own-label products for [✂]. It emphasised the cost of launching new lubricants with a new formula because of the research and development cost and skin testing required to get the CE mark approval, costing ‘hundreds of thousands of pounds’. Pasante said that it was ‘near impossible for it to launch its own personal lubricants’ because of these costs, and it was therefore tied into using other companies’ formulations for personal lubricants and their CE marks.

9.16 Pasante was concerned that a previous example of activity in the condoms market could be repeated in the personal lubricants market. In 2002, Pasante condoms and lubricants were listed in Tesco, but following strong competitor promotions, were delisted. [✂]. Pasante also emphasised RB’s use of television to advertise Durex, making it very difficult for a small company to compete.

9.17 A different perspective was provided by Ansell.[107] Ansell is a significant supplier of lubricants outside the UK and also produces and sells both the Skyn and Mates brand condoms. It also expressed initial interest in the K-Y sale, but ultimately did not make a bid. It does not face the same financial constraints as a small or medium-sized company.

9.18 Ansell launched two new lubricants in the UK in March 2015; a premium water-based lubricant and a premium silicone-based lubricant. [✂], from initial discussions and negotiations to the product going live in the stores, it managed to secure an agreement to have its product stocked in [✂]% of the Boots estate and around [✂]% of the Superdrug estate.

9.19 [✂]. Ansell stated that listing in the major grocery retailers was critical for its future success in the UK market.

9.20 Ansell saw the UK as unusual in Europe due to the very large market shares of Durex and K-Y. It said that suppliers of condoms have an advantage in selling personal lubricants as they can take advantage of brand awareness in the SWB category. Ansell considered that an extended product range would [✂]. It also saw a potential for increasing barriers to entry if, after the merger,

[106] Summary of hearing with Pasante on 25 February 2015.
[107] Summary of hearing with Ansell on 4 March 2015.

RB introduces a wider range of K-Y products that take over more shelf space in grocery stores.

9.21 In summary, competitors emphasised Durex's already strong position in the market. Ansell mentioned a concern that if the K-Y brand were extended then entry would become yet more difficult. Pasante told us that entering into independent pharmacies is easier compared to large chains and grocery retailers.[108]

9.22 Whether alternative brands could constrain a potential post-merger cost price increase depends on retailers' options to credibly and successfully introduce such brands. The evidence we heard from competitors suggested that retailers would only consider brands that consumers are aware of and when the supplier was able to offer the retailer sufficient marketing support.

Grocery retailers and national pharmacy chain views

9.23 Boots indicated[109] that it stocked Swoon and woohoo! personal lubricants as they filled a gap in the market, at the premium end of the market. It had not seriously considered stocking other brands as it had not seen any innovation in the market. However, as previously stated, Ansell has informed us that two new Ansell personal lubricant products are being stocked by [✄]% of Boots stores in March [✄].[110]

9.24 Boots said its broad criteria for considering stocking any new products included what customer needs would be served, whether the product was unique, and how much marketing support was available.

9.25 Although Superdrug initially stocked the Lovehoney '50 Shades of Grey' range, [✄].[111]

9.26 Tesco[112] said that to stock a new product, it would need to be convinced it would appeal to customers and offer them something new. Being competitive on price was not sufficient to secure a listing. [✄].

9.27 Sainsbury's [✄]. It said that any new lubricant brand would [✄].

9.28 Sainsbury's had [✄].

---

108 Summary of hearing with Pasante on 25 February 2015.
109 Summary of hearing with Boots on 24 February 2015.
110 Summary of hearing with Ansell on 4 March 2015.
111 Summary of hearing with Superdrug on 20 February 2015.
112 Summary of hearing with Tesco on 23 February 2015.

9.29 Asda stocks Durex and K-Y, but is not actively planning to include any other brands. Asda said that it might decide to sell another brand of personal lubricant if the supplier had good branding, had invested in the product, and offered a good cost price. Any new brand of personal lubricant would also need to sell well to its customers. It has stocked an own-label product, supplied by [✂], since 2008, and considers its own-label product to be the closest competitor to K-Y.[113]

9.30 Morrisons only stocks Durex and K-Y personal lubricants. While having being approached by other suppliers, Morrisons gave no evidence of having stocked other personal lubricant products in the [✂].

9.31 While the evidence we have seen suggests currently no alternative brands are credible competitors to Durex and K-Y personal lubricants, it could be that retailers would reconsider their options in the case of a post-merger price increase. The fact that currently retailers do not consider stocking similar products to Durex does not mean that they would not consider replacing at least some Durex lubricants or use the threat of replacing them with an existing alternative brand in case of a price increase.

Assessment of entry or expansion

9.32 The production process and the related costs do not appear to present a major challenge, unless a new product needs to be certified.

9.33 However, there is strong evidence that persuading grocery retailers and national pharmacy chains to stock alternative brands of lubricants is extremely challenging and involves convincing retailers that the supplier is willing to invest significantly in advertising and prepared to contribute to promotional spending within store.

9.34 Even larger companies such as Ansell have recently found it difficult to get listed. Financially, the position would be even more challenging for smaller firms and our responses suggest that while they may seek to get listings, their expectations of success are low. Faced with these challenges, at least one of the smaller suppliers has responded by looking instead at less difficult markets outside the UK.

9.35 Alongside entry, we have seen examples of delisting due to poor sales; evidence of failed entry and the risk of a strong competitive response from RB

[113] Summary of hearing with Asda on 9 March 2015

might make new entrants more cautious about entering, effectively creating a ‘reputational’ barrier to entry.

9.36 From what we have heard from the grocery retailers and national pharmacy chains, no firm is likely to sponsor entry. Retailers that already sell own-label personal lubricants could expand their range to compete more closely with Durex and K-Y personal lubricants as the expansion plans of Superdrug suggest.

Conclusion on new entry and expansion

9.37 From the evidence we have seen, therefore, it is unlikely that there will be significant new competitive entry that would be timely, likely and sufficient to prevent the merger resulting in an SLC. The best evidence of potential new competition appears to come from Ansell with its new lubricant. However, this is a premium product, and the product is currently only being stocked in [✄] Boots stores and [✄] Superdrug stores. While smaller scale entry in market niches cannot be ruled out, the number of available niches has been reduced by past entry and it seems unlikely that such small scale entry would offset any post-merger price rise. While retailers may in theory have the ability to sponsor entry, there is no evidence of this having been done in the past in this market, and we do not find it likely to occur in the future.

10. Countervailing buyer power as a post-merger constraint

10.1 The existence and exercise of countervailing buyer power[114] will be a factor in making the SLC finding less likely. In particular, in those circumstances where all customers of the merged firm possess it post-merger, an SLC is unlikely to arise. However, often only some – not all – customers of the merged firm possess countervailing buyer power. In such cases, the CMA assesses the extent to which the countervailing buyer power of these customers may be relied upon to protect all customers.

10.2 Countervailing buyer power can be generated by different factors. Customers can be in a stronger position when negotiating with suppliers if they can easily switch demand away from the supplier or constrain otherwise the behaviour of the supplier.[115]

10.3 If retailers have a strong position of buyer power, and sufficient incentives to exercise this buyer power, then they may be able to defeat any increase in cost prices RB would seek to impose due to the lessening of any competitive

[114] *Merger Assessment Guidelines*, section 5.9.
[115] *Merger Assessment Guidelines*, paragraph 5.9.1 and 5.9.2.

constraint currently imposed on K-Y prices by the Durex products, and vice versa. The main levers that the retailers could use are:

- sponsoring entry or expansion by rival brands;
- launching or extending own-label offerings;
- influencing consumer choice through the allocation of prominent shelf-space;
- altering the ability of the brands to promote themselves; and
- negotiating over a wider portfolio of products held by the parties, such that the retailer could threaten not to stock, to delist or to give less prominence to products in other categories supplied by the manufacturer.

10.4 We have found very limited evidence of retailers to date using any of these levers and exercising buyer power to constrain cost price increases across grocery retailers and pharmacy chains. As mentioned in paragraph 8.51, personal lubricants constitute a very small product category within grocery retailers' and national pharmacy chains' product offerings which is likely to affect retailers' incentives to exercise buyer power.

10.5 Evidence of the existence of buyer power comes primarily from the assertions of the parties and some retailers, and from past examples of the reaction of retailers to proposed cost price increases by RB. In particular, we asked large retailers how they would react to a proposed cost price increase by RB, of Durex and/or K-Y personal lubricants, post-merger. Then we looked at past and recent examples of proposed cost prices increases to assess whether retailers are able and willing to mitigate a cost price increase in practice.

10.6 As mentioned in paragraph 8.117, some retailers ([✂] and Tesco) said that own-label products could be used if there was a disagreement with RB over the cost prices of personal lubricants post-merger. However, we have not seen examples of own-label products being used in such a way, and some retailers do not have an own-label offering or would not introduce such products.

10.7 [✂] did not specify which brands could be credible alternatives and be used to challenge RB. As pointed out in paragraph 8.104, alternative personal lubricant brands, even the ones with strong brand awareness, such as Ann Summers, or the ones with a wider product range including condoms, such as Skyn, have had only limited success of obtaining significant sales in grocery retailers and pharmacy chains. This suggests that retailers have limited options in terms of alternative brands that could successfully replace Durex or

K-Y. A retailer said that lubricants were a small niche part of the market and that it had a much bigger relationship with RB than just looking at personal lubricants, which would explain why buyer power had not been used that much.

10.8 At phase 1 of the merger inquiry, Asda indicated that the merger might reduce its negotiating position with RB in the personal lubricant category. At phase 2, Asda also told the CMA [✂] Morrisons considered that their negotiating positions would be weakened by the merger as there were no effective alternative brands available. [✂].

10.9 J&J told us that Asda delisted K-Y personal lubricants in 2009, [✂].

10.10 J&J also told the CMA that large grocery retailers have made a systematic effort to identify commodity price movement [✂] and that retailers require a 'cast iron' rationale for any cost price increase. In J&J's view, this indicates that retailers would exert some price constraint on K-Y as well. However, J&J also told us that retailers have not specifically requested that J&J lower the prices for K-Y.

10.11 RB told us that [✂].

10.12 Looking at (the limited) examples of proposed cost price increases, we have found limited evidence that retailers could and would successfully exercise buyer power that would prevent a potential post-merger cost price increase.

10.13 In the past four years, RB changed the cost price of Durex personal lubricants twice. The first change was in March 2013, when the cost price of Durex lubricants was increased at the time the bottle size was increased (so the price per ml remained the same). Although the cost price change was per ml neutral, retailers not only accepted the increased unit cost price but most of them actually increased retail prices more significantly than necessary simply to maintain margins. The second change in March 2015, however, was an actual increase in the per ml cost price: alongside a change in the product formulation and packaging, RB proposed a cost price increase on Durex Play personal lubricants.[116] Although it is too early to fully assess the impact of this recent change, we have gathered evidence about retailers' reactions to the proposed cost price increase and looked at available pricing data. We consider that, in the absence of other previous per ml cost price increases of Durex personal lubricants, this event can be informative of the negotiations

[116] In March 2015, Durex reduced the bottle size of the Durex Play range from 60ml to 50ml [✂].

between RB and the retailers and of retailers' ability and incentive to exercise buyer power even if [✂].

10.14 RB told us that [✂]. The retailer concerned denied this allegation. Even if this threat had been made, we saw evidence that RB and the retailer had become fully aligned three months ahead of the proposed cost price increase and before RB told us that the dispute was still live. [✂].

10.15 [✂]. However, it is too early to say whether this is due to temporary promotions or a longer term pricing strategy of [✂]. As discussed in paragraph 10.27, [✂]. RB also provided screenshots of the Tesco website that also indicate that Tesco has kept the per ml price of the product unchanged (ie it did not accept the proposed RRP and reduced the price of the product). However, [✂].

10.16 We spoke to retailers to explore:

(a) whether they accepted the proposed cost price increase;

(b) whether they managed to secure additional promotional funding that would mitigate the cost price increase; and

(c) how the cost price increase affected the retail prices and promotions of personal lubricants.

10.17 [✂]

10.18 [✂]

10.19 [✂]

10.20 In order to better understand retailers' reactions, we looked at the change of the per ml price of Durex Play products over time in different retailers based on Nielsen data and sought information from RB on trade investment. The bottle size change happened only recently and therefore the data cannot tell us much about the longer term impact of this change. However, an immediate increase of retail prices in line with the cost price increase would be consistent with retailers accepting the cost price increase and not obtaining sufficient promotional funding to neutralise the price increase. This information, together with views from retailers and funding data from RB can give insights into retailers' ability and incentive to exercise buyer power in relation to Durex personal lubricants.

10.21 The graphs presented in Annex 3 of Appendix E suggest that most retailers increased the per ml price of Durex Play products. For example, [✂]. This would be consistent with retailers accepting and passing-through RB's cost price increase without pushing back and exercising buyer power.

10.22 As mentioned in paragraph 8.14, in response to the provisional findings RB submitted analyses by RB's economic advisers on retail prices, wholesale prices and buyer power. In this analysis, RB's economic advisers argues that [✄] and thus retailers are able to resist price increases through the exercise of buyer power.

10.23 However, there are some caveats to RB's economic advisers' conclusion. First, as pointed out in paragraph 8.15, there are [✄]. Therefore, RB's economic advisers' conclusion for at least part of the period in question is based on [✄]. Second, the fact that there [✄] does not imply that the same holds going forward. [✄]. In order to better understand the changes in trade investment in relation to the bottle size change and the potential implications of this on future prices, we asked RB to provide forward looking trade investment data and comparison with trade investment of previous years as well as sales forecasts if available. Finally, the analysis seems to contradict views from retailers as summarised in paragraphs 10.17 to 10.19.

10.24 On 20 July, RB submitted trade investment data for personal lubricants [✄].

10.25 We asked for forward looking estimates of trade investment per ml from RB in order to analyse any changes in trade investment relative to sales, which RB did not provide. In the absence of such data, we used volume data from 2014 to compare any trade investment with the additional cost that retailers are likely to incur because of the cost price increase. This comparison has some limitations as sales volumes are likely to change between 2014 and 2015 as result of the price change and any changes in promotional activity. Also, [✄]. Therefore, we carried out the comparison for all Durex personal lubricants and not only for the Play range to which the cost price increase applies. However, given that the Play range covers the majority of Durex personal lubricant products and a large proportion of Durex personal lubricant sales, we consider that this analysis is informative to assess whether any trade investment is likely to neutralise the cost price increase.

10.26 The comparison shows that for [✄].

10.27 RB also submitted emails [✄].

Conclusion on countervailing buyer power

10.28 We sought views from large grocery retailers and national pharmacy chains and looked at past examples of cost price increases in order to assess whether countervailing buyer power would be likely to prevent the merger resulting in SLC.

10.29 Retailers told us they do have buyer power and suggest that they could delist, de-emphasise, promote own-label or sponsor entry. However, we have found insufficient evidence of retailers exercising buyer power to neutralise the impact of the March 2015 cost price increase implemented by RB. Data and information from RB suggest [✂]. We note that this assessment has to be interpreted with care as it is only based on a small number of months of actual data and on assumptions with respect to future sales. However, this analysis together with views from the retailers (such as [✂]) [✂].

10.30 This evidence needs to be set alongside what retailers did in 2013 when in response to an increase in cost prices in line with an increase in volume (ie no cost price rise in terms of per ml), most retailers took the opportunity to raise retail prices beyond that justified by the increase in bottle size (ie raised their retail prices in terms of per ml). Therefore, while retailers told us they do have buyer power and suggest that they could delist, de-emphasise, promote own-label or sponsor entry, we have concluded that there is insufficient evidence that retailers would use any buyer power they may have to defeat price increases post-merger.

11. Conclusion on the SLC test

11.1 We have found that there are a wide range of personal lubricants on offer to consumers online and in specialist (adult) shops. Independent pharmacies also have access to a wide range of personal lubricants through wholesalers. We do not believe that the merger will significantly change that situation, and therefore conclude that the merger may not be expected to result in an SLC in relation to sales via those channels.

11.2 We have also found little evidence that sales online or in specialist (adult) shops constrain prices in grocery retailers and national pharmacy chains. In the grocery retailers and national pharmacy chains market, the parties currently enjoy a combined market share of [60–80]%, according to RB.

11.3 The scale of producer margins on these products and the extent to which consumers say they would switch between the K-Y and Durex brands in the absence of their preferred brand (the diversion ratios) suggests that post-merger there would be significant upward pressure on prices.

11.4 The evidence we have seen suggests that it is unlikely that there will be significant new competitive entry that would be timely, likely and sufficient to prevent the merger resulting in an SLC and that no new entrant can expect to be widely listed by grocery retailers and national pharmacy chains in the foreseeable future.

11.5 The evidence we have seen suggests that retailers have not to date exercised the buyer power they may possess in response to cost price increases in the past (eg the Durex per bottle increase in 2013 which was per ml neutral, and there is limited evidence in relation to the Durex per ml increase in 2015). In the absence of any alternative evidence, we consider that retailers would be unlikely to use buyer power to defeat a post-merger price increase in this market, especially given the lack of focus on the product we found amongst retailer buyers.

11.6 Therefore, for these reasons we have concluded that the merger may be expected to result in an SLC in the UK market for the supply of personal lubricants to grocery retailers and national pharmacy chains.

11.7 For the reasons set out above, we concluded that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation and the creation of this may be expected to result in an SLC in the market for the supply of personal lubricants in the grocery retailers and national pharmacy chain market in which the parties currently enjoy a combined market share of [60–80]%. We also concluded that the creation of the relevant merger situation may not be expected to result in an SLC in relation to the supply of personal lubricants in the online and specialist (adult) shops markets. Lastly, we concluded that the creation of the relevant merger situation may not be expected to result in an SLC in the supply of personal lubricants to independent pharmacies.

12. Remedies

Introduction

12.1 Under section 36 of the Act, where we have found that a merger may be expected to result in an SLC, we are required to decide whether action should be taken to remedy, mitigate or prevent the SLC or any adverse effect resulting from the SLC that we have found and if so, to report the actions to be taken and what they are designed to address.[117] We now consider possible remedies to the SLC in the market for the supply of personal lubricants in the grocery retailers and national pharmacy chain market.

[117] Merger Remedies Guidelines (CC8), paragraph 1.6.

12.2 On 22 May 2015 we published a Remedies Notice for this inquiry, in which we sought views on three potential structural remedies:

(a) Prohibition of the acquisition of the UK K-Y business by RB (prohibition).

(b) Divestiture by J&J to a party other than RB of the UK K-Y business (UK divestiture).

(c) Licensing of the relevant rights for the UK K-Y business to a party other than RB (UK licensing).

12.3 We stated that a behavioural remedy was unlikely to be an effective remedy.

12.4 We have received comments from the parties and a number of third parties on possible remedies, including Ansell, Pasante, Combe, Ann Summers, Boots, Superdrug, Tesco, 3 Peaks Group Ltd and the NHS Supply Chain. In response to the Remedies Notice, RB proposed a licensing remedy and a behavioural remedy. No other parties proposed an alternative remedy to those set out in our Remedies Notice.

12.5 Under Section 36(3) of the Act the CMA, when considering possible remedial actions, shall 'in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it'. To fulfil this requirement, the CMA will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will then select the least costly and intrusive remedy that it considers to be effective. The CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects. The CMA may also have regard, in accordance with Section 36(4) of the Act, to any relevant customer benefits arising from the merger.[118]

12.6 The approach taken by the CMA in making this assessment is described in detail in *Merger Remedies Guidelines, CC8* (the Merger Remedies Guidelines). As explained in those Merger Remedies Guidelines, the CMA's assessment of the effectiveness of a remedy option will cover four aspects:[119] the impact that the remedy will have on the SLC and its resulting adverse effects; whether the remedy will address competition concerns quickly and for the entire duration of the SLC; how practical the remedy is; and whether it has an acceptable risk profile.

[118] Merger Remedies Guidelines (CC8), paragraph 1.7.
[119] Merger Remedies Guidelines (CC8), paragraph 1.8.

12.7 Behavioural remedies are generally subject to higher risks than structural remedies and are therefore less likely to be effective and/or proportionate solutions to an SLC in a merger inquiry.

12.8 This section assesses the remedy options we discussed in our Remedies Notice, considering first the licensing and behavioural remedies, as these were proposed by RB. For each type of remedy, we consider first the parties' views, including any proposal made, followed by a summary of third party views and our conclusion concerning the effectiveness of the remedy. We then consider the proportionality of the proposed remedy before concluding.

12.9 The section is structured as follows:

(a) Assessment of the effectiveness of a licensing remedy.

(b) Assessment of the effectiveness of a behavioural remedy.

(c) Assessment of the effectiveness of a prohibition remedy.

(d) Assessment of the effectiveness of a divestiture remedy.

(e) Summary of the effectiveness of the remedies assessed.

(f) Proportionality of the proposed remedy.

(g) Relevant Customer Benefits (RCBs).

(h) Decision on the choice of remedy and implementation.

Assessment of remedy options

Assessment of the effectiveness of a licensing remedy

RB's proposal for a short-term licence to facilitate entry[120]

12.10 RB proposed a short-term licence to enable a third party to overcome barriers to entry and establish personal lubricant sales in the market under its own brand, with the K-Y brand returning to RB at the end of the licence period. The licensee was expected to be an existing or potential supplier of SWB products in the UK, which would be capable of supplying products under the licence immediately or after a short transitional period. Subsequently, RB suggested that suppliers with experience of supplying over-the-counter pharmaceutical

[120] RB Response to Remedies Notice 10 June 2015, paragraphs 4.5-4.13

or medical device products would also be able to supply lubricants relatively easily.

12.11 RB suggested that the scope of the licence should be limited to existing SKUs supplied in the UK, comprising the two SKUs in the consumer channel and two SKUs in the medical channel. If the K-Y brand was extended to other products, RB's view was that the K-Y brand should be only used with another brand (co-branded) and new products should be restricted to lubricant related products.

12.12 The details proposed by RB were as follows:

(a) The remedy would allow a licensee to supply the K-Y branded products currently sold in the UK for a period of four years, plus a blackout period of a further year during which RB could not use the K-Y brand in the UK.[121]

(b) RB would commit to procuring from J&J (or providing itself) certain transitional services and, if required, to contract manufacture the existing K-Y consumer products in the UK for the licensee for the period of the licence.

(c) Production of K-Y by the licensee would be allowed.

12.13 Once the K-Y brand has reverted to RB, the licensee would be entitled to continue to use the K-Y formula ([✂]).

12.14 The remedy would, in RB's view, create a new branded competitor in the grocery retailer and national pharmacy chain markets as the licensee would be able to compete with RB using the K-Y formula. RB considered that as the licensee would be taking over the K-Y brand and rebranding it over time, there would be no need for a new product listing, which would have taken time to negotiate. RB would expect that grocery retailers and national pharmacy chains would wish to continue to obtain supply of these K-Y products from the licensee during the period of the licence.[122] Relationships with retailers would, in their view, be helped by the blackout period.

12.15 RB suggested that the blackout period would be necessary to avoid consumer confusion, when a licensed K-Y product and RB-produced K-Y product might

[121] Subject to a possible exception for supply to the NHS.
[122] This is even more likely on the CMA's reasoning that K-Y is a 'must stock' brand, although RB disagrees with this conclusion.

appear together. It could also encourage development of a new brand, rather than only exploiting the existing K-Y brand.

12.16 In support of this remedy, RB quoted the Commission's remedies notice,[123] which envisaged that it is open for regulators to accept time-limited licences for a brand with the purpose of allowing the licensee to re-brand the product in the period foreseen.

12.17 RB believed that this remedy would be effective as the licensee could benefit from the relationships and infrastructure it developed through its access to the K-Y brand to move consumers across to its own brand and, potentially, promote the listing of other brands in the channel.

Views of third parties – licensing

12.18 Grocery retailers and national pharmacy chains emphasised the strength of the K-Y brand, which had secured customers' trust in the product. Although other suppliers could produce a personal lubricant with a similar formulation, they suggested that consumers would not have the same confidence in the product. Their main concern was to ensure continuity of supply; having a different supplier could be managed, but would require some administrative and process changes.

12.19 The views of current or potential competitors generally showed a strong preference for divestiture over licensing. This was not surprising where the responses came from potential acquirers of the K-Y brand, which were primarily interested in acquiring the business and for whom purchase would offer greater development opportunities. On this basis, licensing was considered to be less effective as the SLC could recur at the end of the licensing period when RB re-entered with the K-Y brand. In their view, the incentive to invest in the product could be more limited under a licence. However, some competitors expressed the view that licensing could become effective if designed in an appropriate manner to address the competition problems identified and if it was of the right scope and duration.

12.20 Pasante saw a risk of licensing resulting in 'milking a cash cow', this incentive partly depending on the length of the licence period. Pasante suggested that being able to supply the NHS was an advantage.

[123] Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004, paragraphs 39-42, Official Journal of the EU: Reference 2008/C 267/01.

12.21 If a licensing remedy was applied, the general view of these parties was that ten years was a minimum licence period, and several parties also suggested that there should be an option available to extend the licence.

12.22 Ansell and Combe highlighted the time it would take to establish a new brand, requiring investment in developing the brand, as well as for research, innovation and marketing, including market-testing. Customers were expected to require time to sample the product before changing, particularly given the intimate nature of the product. The six to 12 month gaps between retailer business plans and long shelf life of the product (up to 23 months) also extended the time needed to develop a new product, in their view.

12.23 Combe suggested that it would be difficult to prevent parallel imports, as sales by third parties independent of RB could not be effectively prevented under the rules of the EU single market. The issue related to exhaustion of IP rights by a licensor, stopping the licensor from preventing other parties from supplying K-Y to the UK.

12.24 The following summarises the issues or requirements identified by the third parties that would need to be considered in a licensing agreement, in which duration and scope were key elements:

(a) An exclusive licence for the K-Y brand and all related IP rights needed to carry out business, including details for formulation, specification and knowhow.

(b) Long term agreement (usually suggested to be at least ten years excluding any blackout period).

(c) Protection against imports from other territories.

(d) Possible option to take up licensing in any other territories.

(e) Access to any modifications and improvements in K-Y products and all new products (possibly including products available in the US).

(f) Ability to co-brand, expand brand to other products and/or move from K-Y and rebrand.

(g) Exclusivity of right to manufacture in the UK.

(h) No restriction on sourcing elsewhere.

(i) Provision of all details of manufacture and licence.

(j) Price at which product was made available, if supplied by RB, suggested to be at cost or supply price to RB.

(k) Access to information relating to distribution channels and customers.

(l) Contracts with retailers to be transferred.

(m) Whether payment by royalty or margin.

(n) Suitability of the licensee.

The CMA's assessment of the licensing remedy

12.25 The third party views we received (which were generally from parties potentially primarily interested in acquiring the brand) generally favoured divestiture over licensing, as ownership of the brand in the UK would be permanently transferred, rather than the brand reverting back to RB after a period. They also said that a smaller number of purchasers may be interested in licensing than for a divestiture.

12.26 However, some third parties were interested in a licensing arrangement as a way to get access to retailer shelf space to compete within this market and could view licensing as an effective remedy provided the necessary conditions were agreed to allow for successful entry in the market.

12.27 The support of these third parties for licensing, contributes to our findings that the proposed remedy is a practical and effective solution to the SLC. In addition, there are parties potentially interested in licensing [124] and a licensing remedy has also been offered by RB.

12.28 We note that the judgement of the General Court on BaByliss[125] held that although a sale of assets is often the most suitable corrective measure for easily remedying a competition problem, the possibility cannot be ruled out that a licence solution may be suitable.

12.29 We also note that the European remedies notice[126] suggests that a rebranding remedy may be acceptable in circumstances where the brand is widely used and a high proportion of turnover is generated in markets outside

[124] Judgement of the General Court in Case T-114/02, of 3 April 2003, *BaByliss SA v Commission*, (Babyliss judgement) paragraph 194.
[125] Babyliss judgement, paragraph 170.
[126] Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004, paragraphs 39-42, Official Journal of the EU: Reference 2008/C 267/01.

those where competition concerns arise.[127] This is similar to this case where a majority of K-Y turnover lies outside the UK. In addition, the brand is widely used and is a well-known brand.

12.30 We have considered a number of EU merger cases[128] and note that there is precedent for a rebranding remedy. This type of remedy is often of an initial period of at least five years of exclusive licensing with blackout periods of at least five years in addition to this.

12.31 A very long period of a licence could have the disadvantage of encouraging a licensee simply to derive income from the existing K-Y brand, rather than developing a new brand. The licence, however, should have the appropriate duration to allow the rebranding exercise and allow the licensee to enter the market to compete, and, therefore, contribute effectively to addressing the SLC in each case. The remedy needs to be defined in such a way as to ensure that the granting of the licence will effectively maintain competition in the market on a lasting basis and that the licensee will be an effective competitor after rebranding. This is the case despite the fact that a rebranding remedy carries higher risks than other remedies, such as divestiture.[129]

12.32 The European remedies notice[130] identifies a number of characteristics that could improve the viability of a rebranding remedy, including that:

(a) the brand to be transferred must be well-known and one of considerable strength to guarantee both immediate viability of the licensed brand and its economic survival in the re-branding period;

(b) part of the assets related to the production or the distribution of the products marketed under the licensed brand or the transfer of know-how may be necessary to ensure the viability of the remedy;

(c) the licence has to be exclusive and normally comprehensive, ie not limited to a certain range of products within a specific market, and has to include the intellectual property rights to ensure that customers will acknowledge the familiarity of the re-branded product. The parties will not be allowed

---

[127] Remedies notice, paragraph 40.
[128] For example. the Senseo coffee brand was licenced for five years followed by a five-year blackout: Case Comp/M.7292 DEMB/Mondelez/Charger OpCp; the Lutosa potato business was licenced for seven years followed by an eight-year blackout: Case Comp/M.6813 McCain Foods Group / Lutosa Business; case T-114/02, namely the Babyliss case previously referred considered an overall licensing period of 8 years (see paragraph 212 of the Babyliss judgement); see similarly the licence period in case No COMP/M.3149- Procter & Gamble/Wella; case No COMP/M.2337- Nestle/Ralston Purina (overall eight years); Case No IV/M.623- Kimberly- Clark/Scott.
[129] See remedies notice, paragraph 40.
[130] Remedies notice, paragraph 41.

to use similar words or signs as this could undermine the effect of the re-branding exercise;

(d) both the licence and the blackout period have to be sufficiently long, account being taken of the particularities of the case, so that the re-branding remedy is in its effects similar to a divestiture.

12.33 The CMA is of the view that the licensing remedy will allow the licensee to use the opportunity provided to develop a new product to compete within the market in the long term once the K-Y brand reverts to RB. While the licensing arrangements will be negotiated between RB and the licensee, a number of elements of the licence agreement are important and necessary to ensure that the remedy is effective. These include the following:

(a) **Exclusive, comprehensive and irrevocable licence** – the licence will need to be exclusive and comprehensive to allow for the exclusive use, (such as production,[131] marketing and sale) of the K-Y brand and related IP rights for the supply of personal lubricant products in the UK by the licensee during the licence period. The licence should permit the use of the K-Y brand and related IP rights for the supply of the existing SKUs, (basic K-Y jelly 50ml and 75ml packs and sterile 5g and 82g packs), alone under the K-Y brand or on a co-branding basis. The licence should permit the use of the K-Y brand and related IP rights on personal lubricant products, other than the aforementioned existing SKUs, provided that the licensee co-brands these other products with its own brand (ie use of the K-Y brand and related IP rights in the UK for personal lubricant products, other than the existing SKUs mentioned previously, in conjunction with another brand). This opportunity for co-branding is important to enhance the licensee's ability to establish its personal lubricants brand in the UK before the K-Y brand reverts to RB and thus ensure an effective remedy. The importance of covering a sufficiently broad product range is supported by the Commission's notice on remedies,[132] which suggests that a licence should not be limited to a certain range of products within a specific market.[133] For the same reason, the licence should cover all relevant supply channels in the UK and not be limited to the market for

[131] RB is only permitted to produce K-Y in the UK if either the licensee requires RB to supply it for a transitional period or RB were to supply the products outside the UK. RB is not permitted to market or sell any K-Y branded product in the UK during the licence period.
[132] Commission notice on remedies, paragraph 41.
[133] See also the Babyliss judgement referred to previously. See also case No. IV/M.623 Kimberly-Clark/Scott and case No. COMP/M.3149 Procter & Gamble/Wella.

grocery retailers and national pharmacy chains. The licence would also have to be irrevocable for the duration of the licence period.

(b) **The licence period/ the blackout period** – the licence period should support competitive entry and create incentives to develop a brand that would compete with K-Y in the longer term.[134] A short-term licence faces a significant risk that the newly introduced brand would not have sufficient time to become trusted and established in order to compete in the longer term once K-Y reverts to RB. Trust is important because of the intimate nature of the product. A short-term licence will not be sufficient to allow the licensee to establish or strengthen its own position as an effective competitor. Users may be reluctant to move from the safe 'tried and tested' K-Y brand to the new brand within a short period of time. As the product is generally purchased infrequently, eg annually, it is likely to take longer to persuade consumers to change their purchasing habits, particularly when the long shelf life of the product of up to 23 months could mean that it could remain on store shelves for a long time.[135] In addition, as analysed in section 9 previously, successful entry is particularly difficult in the markets under consideration. The Commission also favours licences that are overall of at least ten years duration including the blackout.[136] On the other hand it is important that the licence period is not so long that it creates a disincentive to re-brand over the relevant period. Most parties suggested that a licence of at least ten years was necessary, and a four-year licence period with a one-year blackout would not be long enough. Considering all the evidence, the licensing should cover a total period of eight years. In concluding on the duration of eight years in total, as opposed to a longer duration, we have considered that the licensee will be able to extend the use of the exclusive licence on other personal lubricants (other than the aforementioned existing SKUs) on a co-branding basis with the view to establishing its personal lubricants brand in the UK. The period of eight years in total will include a blackout period of at least one year to enable the licensee to successfully transition from the K-Y brand to its own brand. A longer blackout period, within the eight-year total, could be decided at the option of the licensee who will need to weigh up the relative merits of a longer over a shorter blackout period. A period of less than one year would be unlikely to be sufficient to consolidate the licensee's new brand given the product's life and the retailers' annual planning process.

[134] See also the Babyliss judgement and the findings of the Court with regard to duration, paragraphs 205 *et seq*.
[135] See the Babyliss judgement regarding reference to product life cycle, paragraph 216.
[136] See case law referred to previously.

(c) The granting of full rights to the K-Y brand and related IP rights in the UK such that RB is prevented from using the K-Y brand and related IP rights in the UK during the licence and blackout period and from introducing any products within the SWB range under the K-Y brand in the UK during the licence and blackout period. This type of a licence will prevent RB from undermining the licensee's attempts to become established by using the K-Y brand itself for personal lubricant products in the UK.

(d) **A one-off payment for use of the licence with no annual or other periodic licensing fee** – to be financially viable for a licensee and also to limit the extent to which the parties would have shared incentives, there should be no royalty or other periodic licensing fee. The licensee would then bid for the right to this licence and pay an upfront amount. The absence of ongoing financial links would also help ensure that the licensee's competitive conduct was not influenced by payments that were linked to the ongoing performance of the business. Although RB suggested there would be some ongoing administrative costs for the licensor, these are not expected to be significant, and we would expect allowance for these costs to be included in the calculation of the initial fee.

(e) In the event that the licensee wished RB to supply it with K-Y, at least initially, the K-Y product, including sterile K-Y, should be supplied at cost (including transport costs) during a transitional period of up to 12 months in order to allow the licensee to set up its own manufacturing or independent production arrangements, if required.

(f) Transfer of existing supply contracts and access to all necessary information and IP rights needed to carry on the business.

(g) The licensee will be entitled to continue to use the K-Y formula in perpetuity.

(h) Transfer of the right, but not the obligation, for the licensee to supply the NHS.

12.34 Moreover, we consider that to be an effective competitor, in addition to satisfying the purchaser suitability criteria set out in our Merger Remedies Guidelines[137] the licensee should have demonstrable expertise within the SWB market and presence on the market or ability to enter the market in the short term and be a viable and independent business with the necessary competence and motivation to provide effective competition in the UK market. The licensee should be capable of meeting the requirements of grocery

[137] See Merger Remedies Guidelines (CC8), paragraphs 3.15 *et seq.*

retailers and national pharmacy chains supplied under the licence agreement, in addition to supplying the other retail channels: independent pharmacies, online and specialist (adult) shops. The licensee should commit to establish a new brand or develop an existing brand for personal lubricant products and provide a business plan to explain its strategy during the licence period, including development of a brand to compete with K-Y when the licence ends. It should also have adequate finance in order to be an effective competitor.

12.35 Provided these issues were addressed in the licence, our conclusion is that a licensing remedy for the K-Y brand and related IP rights in the UK would be an effective remedy to address the SLC. The remedy would allow a new competitor to use the K-Y brand and related IP rights in the UK during the licence period, with the opportunity to build relations with retailers and gradually transition to its own brand. As previously stated, we recognise that there are risks in this type of remedy, but as the licence will provide for the necessary incentives and ability for entry, we would expect the licensee to be an effective competitor on a lasting basis and that the new brand would be able to compete with K-Y at the end of the licence period.[138]

Assessment of the effectiveness of a behavioural remedy

View of the parties – behavioural remedies

12.36 If a remedy was required, J&J proposed that behavioural remedies were used, and suggested that some of the CMA's initial reservations about behavioural remedies may be less relevant in this case. In its view, the stability of the K-Y price over the last three years made it easier to determine the starting price; RB was unlikely to make changes to K-Y's formula or packaging, and only limited monitoring would be required.

RB's proposal for a behavioural remedy[139]

12.37 RB set out a possible behavioural remedy in their response to the Remedies Notice. This remedy comprised an undertaking from RB not to alter the current commercial offering of K-Y for five years, with the following elements:

(a) RB would not implement a cost price increase (potentially subject to an allowance for inflation).

(b) It would maintain the existing pack sizes and formula of the K-Y products.

[138] See Commission's notice on remedies, paragraph 40.
[139] RB Response to Remedies Notice 10 June 2015, paragraphs 4.2-4.4.

(c) It would also commit not to introduce any new K-Y products.

12.38 RB suggested that the remedy would be effective because it would remove any incentive to raise prices for K-Y further,[140] while addressing any concern RB expanded the K-Y range, thereby raising barriers to entry. In its view, competitive conditions would develop sufficiently in five years to remove the need for a remedy because of growth of the personal lubricant sector, other market entry and the growth of multi-channel shopping, notably online.

12.39 RB questioned some of the reasons why a behavioural remedy might not be appropriate and suggested the following:

(a) The remedy ensured that the positioning of K-Y remained as it would in the CMA's counterfactual scenario (ie the K-Y brand continuing as it is today). Also, RB was prevented from exercising any perceived market power and would not increase barriers to entry.

(b) The current conditions of supply were clear and observable – the price of K-Y, the pack size and the formula were unchanged for a number of years. The commitment would remove the scope for price rises through reducing pack sizes or reducing the quality of the product.

(c) RB would expect monitoring to require no more than RB providing regular confirmation that the commercial conditions of supply of the two K-Y products were unchanged. Compliance could be verified with key retailers.

Views of third parties – behavioural remedies

12.40 Third parties considered that price caps were not effective and were difficult to enforce. Product quality could be reduced and stock levels could vary between stores when RB would be in the strongest position to respond. Monitoring was expected to be difficult.

The CMA's assessment of behavioural remedies

12.41 In the CMA's Remedies Notice, our provisional view was that a behavioural remedy, such as a price cap, was unlikely to be an effective remedy as it would not address the provisional SLC identified by restoring rivalry. Also, we said that it would be difficult to determine the correct starting price, while there was a risk of circumvention and it would be difficult and costly to implement.

[140] Provisional Findings, paragraphs 8.75 and 8.135.

12.42 Whereas the parties said that a behavioural remedy could be effective, third parties did not consider that a behavioural remedy would be appropriate. Several parties suggested that price controls did not work effectively and a high level of oversight would be required to ensure that the product quality was maintained.

12.43 In circumstances where the CMA selects behavioural remedies as the primary source of remedial action, one or more of the following conditions will normally apply:[141]

(a) Divestiture and/or prohibition is not feasible or the relevant costs of any feasible structural remedy far exceed the scale of the adverse effects of the SLC.

(b) The SLC is expected to have a relatively short duration (eg two to three years) due, for example, to the limited remaining term of a patent or exclusive contract.

(c) Relevant customer benefits are likely to be substantial compared with the adverse effects of the merger and these benefits would be largely preserved by behavioural remedies but not by structural remedies.

12.44 These circumstances do not apply in this case, as a licensing remedy is feasible; the SLC is not of a short duration and, as outlined later, there are not substantial relevant customer benefits.

12.45 The remedy proposed by RB would have the effect of ‘freezing’ K-Y in its current form, with no further development over the next five years. After this period the consumer would have no protection from possible price increases, while there would be no protection from Durex price increases at any point. While ensuring the product was available for the consumer, the possibility of enhanced K-Y products being developed would be removed.

12.46 We also have concerns over the costs and difficulty of monitoring and enforcing the price cap, which would relate to wholesale prices rather than retail prices, and specifically ensuring that RB was unable to circumvent the price cap or reduce the quality of service it provided.

12.47 More significantly, the remedy would not address the SLC. It would leave RB as the supplier of both K-Y and Durex, having a larger market share in the grocery retailer and national pharmacy chain market and hence a stronger bargaining position with retailers, with potential for upward pressure on Durex

[141] Merger Remedies Guidelines (CC8), paragraph 2.16.

prices. Once the price cap ended we expect that the adverse effects of the SLC would fully emerge.

12.48 In light of these issues, the CMA has concluded that this behavioural remedy would not be effective in addressing the SLC that we have identified in this case, and we have identified no other plausible behavioural remedies.

Assessment of the effectiveness of a prohibition remedy

Views of the parties – prohibition

12.49 J&J believed that prohibition would not be appropriate.[142] If the merger with RB was not permitted to proceed, J&J currently intended 'to wind down that business in an orderly fashion';[143] although it did indicate that it was possible that it might reconsider that decision. As a result, J&J suggested that prohibition would lead to reduced consumer benefit compared with a wider product range, including K-Y, than would otherwise exist if the acquisition were approved. It also suggested that prohibition would be disproportionate relative to the SLC that was identified.

12.50 RB suggested that the CMA conclusions in the Provisional Findings were finely balanced, and said that the market affected by the SLC was small, with total K-Y wholesale revenues in 2013 only marginally above £[✂] with [✂] of the revenue being derived from supply of 'sterile' K-Y to the NHS market, where there were not competition concerns. RB emphasised the need to consider the cost and the proportionality of any remedy option. RB suggested[144] that if the CMA needed to go as far as effectively prohibiting the transaction, then prohibition alone should be the appropriate remedy, avoiding further costs or obligations being imposed on J&J from divestiture or licensing.

Views of third parties – prohibition

12.51 Several of the grocery retailer and national pharmacy chains did not consider that there were other brands that they would stock if K-Y was not available. A number of third parties questioned how hard J&J would compete if the merger was prohibited.

12.52 Some competitors thought that prohibition would be preferable to the merger being approved. Two parties considered that divestiture was preferable to

[142] McNeil-PPC Inc. response to the CMA's Remedies Notice 5 June 2015.
[143] J&J also intended to wind down the K-Y business in New Zealand where the competition authority declined to approve the merger.
[144] RB response to Remedies Notice 10 June 2015, paragraph 3.3.

prohibition. Several parties expected that J&J would be less likely to support K-Y, potentially leading to the K-Y brand in the UK being lost. One party highlighted the strong competitive position of RB which was well placed to take advantage of any gap presented by the loss of K-Y.

The CMA's assessment of the prohibition remedy

12.53 Under the terms of the Asset Purchase Agreement, the UK brand would remain with J&J if the merger was not approved by the CMA. [✂].[145] J&J has confirmed that it was likely that it would wind down the UK business, if the merger in the UK was prohibited, though it said that it was possible it might reconsider that decision.

12.54 The high risk and strong possibility that J&J would close down the K-Y business (or failing that, would not actively promote it) could significantly reduce the effectiveness of the remedy. This is consistent with J&J also stating that it would wind down the K-Y business in New Zealand, where the competition authority declined to approve the merger. While prohibition and any subsequent withdrawal of K-Y from the market by J&J could potentially create 'shelf space' for alternative brands, any gain in potential competition within the market would have to be weighed carefully against the risk of K-Y customers losing access to a valued product.

12.55 Although RB would not own the K-Y brand, competition from the brand would be lost were J&J to cease producing and marketing K-Y in the UK and RB would be in the strongest competitive position to benefit from the removal (or diminution) of K-Y, given its strong existing relationships with the grocery retailers and national pharmacy chains in accessing shelf space. The risk of K-Y imports from outside the UK could also reduce the effectiveness of the remedy.

12.56 We therefore concluded that prohibition would not be fully effective in addressing the SLC identified or its resulting adverse effects.

Assessment of the effectiveness of a divestiture remedy

View of the parties – divestiture

12.57 A divestiture could take place either through J&J divesting the K-Y business in the UK to another party or through RB acquiring the business in the UK and

[145] [✂]

then divesting it to another party. The parties only gave views on J&J divesting the business. J&J suggested[146] that a remedy that required J&J to divest the K-Y brand in the UK would be inconsistent with law, unreasonable and disproportionate, and it would not address the SLC. While J&J's current intention was to wind down the business, it was possible that it would reassess that decision in the future. This possibility would be excluded if J&J was required to divest the business.

12.58 Divestiture would also impose significant, and in its view unreasonable, costs on J&J through the process of preparing and running the sales process and there would be a risk that the only available purchaser might use the brand in ways that were incompatible with J&J's reputation (which could be harmful to the extent that consumers erroneously believed that J&J still owned or controlled the brand).

12.59 RB also suggested that requiring J&J to sell (or license) the brand would require J&J to bear additional costs that were significant relative to the size of the market and extent of the SLC. Imposing the remedy on the seller was considered to be unprecedented. It also raised the possibility that no suitable purchaser could be found.

Views of third parties – divestiture

12.60 Based on the responses received, grocery retailers and national pharmacy chains appear prepared to deal with a different owner of the K-Y brand, although they were unable to identify likely purchasers.

12.61 The views of actual or potential competitors were that sale of the brand should be possible, though the attractiveness of the sale would be reduced by the market being limited to the UK. A buyer would need to own the formulation for the brand and have supply contracts with retailers.

12.62 The risk of imports or internet sales of K-Y was an important issue. Some parties emphasised a number of assets that would need to be included to compete effectively. These included IP rights (notably K-Y trademark), product information, distribution chain details, customer lists, market research, marketing plans, sales data, product formulations, manufacturing know-how and supply contracts in addition to transitional arrangements.

[146] McNeil-PPC Inc. Response to the CMA's Remedies Notice 5 June 2015.

The CMA's assessment of the divestiture remedy

12.63 As previously said, divestiture to another party can take place either by J&J or by RB after first acquiring the business in the UK. Divestiture would allow another competitor to enter the personal lubricant market with immediate access to shelf-space and existing supply arrangements with grocery retailers and national pharmacy chains. This could provide an incentive to the purchaser to compete with RB in the UK on a long lasting basis.

12.64 A number of third parties suggested that divestiture would be the remedy most effective in addressing the SLC.

12.65 Requiring either J&J to divest the K-Y business in the UK to another party or requiring RB to acquire the business in the UK first in order then to divest it to a third party is not a practical solution in this case. If the remedy is not practical in the first place, then it is not capable of effective implementation.[147]

12.66 Given the practical difficulties associated with a divestiture in this particular case, and the need for the choice of remedy to reflect the circumstances of each inquiry and the remedies effectively to address the SLC identified,[148] we concluded that divestiture would not be effective in addressing the SLC identified or its resulting adverse effects by restoring the competitive situation.

Summary of the effectiveness of the remedies assessed

12.67 We have considered four types of remedy, licensing and behavioural remedies, prohibition and divestiture and concluded that licensing would be effective in this case to address the SLC identified.

12.68 Licensing would give the licensee an incentive to develop a competing product by the end of the licence period, improving choice for the consumer. Licensing with a view to facilitating entry of a new competitor would specifically address one of the factors that we identified as leading to an SLC in this case (the inability of competitors to become successfully established in grocery retailer and national pharmacy chains). Licensing on the conditions and terms identified in paragraph 12.33 previously and in paragraph 12.78 below, will enhance significantly the licensee's ability to compete and thus address the SLC.[149]

[147] Merger Remedies Guidelines (CC8), paragraph 1.8 (c).
[148] Merger Remedies Guidelines (CC8), paragraph 2.13.
[149] Merger Remedies Guidelines (CC8), paragraph 3.29.

12.69 As set out in the CMA's Merger Remedies Guidelines, a divestiture seeks to remedy an SLC by either creating a new source of competition through disposal of a business or set of assets to a new market participant or strengthening an existing source of competition through disposal to an existing market participant independent of the merger parties.[150] The CMA's view is that an essential element of the licensing remedy would be to facilitate competitive entry through the development of a new brand that would compete with Durex, and ultimately K-Y (under RB's ownership), using K-Y as a means of entry and access to shelf space. Licensing should not simply allow the licensee to exploit the K-Y brand for a limited period, with the SLC re-emerging later.

12.70 We will need to satisfy ourselves that prospective purchasers are independent of the parties, have the necessary capability to compete, and are committed to competing in the relevant market(s), and that licensing to them will not create further competition concerns.[151] They would also need to satisfy the criteria identified in paragraph 12.34 previously and in paragraph 12.79below. We have held hearings with a number of parties that appear to satisfy these criteria, and therefore believe that there would be prospective purchasers for a licence for the K-Y brand and related IP rights in the UK.

Proportionality of the proposed remedy

12.71 The CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects.[152] In making the assessment of proportionality, it is necessary to consider the costs of a remedy and how intrusive the remedy would be.

12.72 In this case, we have identified licensing as the most effective in remedying the SLC. We expect the costs of licensing to be modest and note that RB will be paid for the licence. We therefore consider licensing to be a proportionate remedy.

Relevant customer benefits

12.73 RB suggested[153] that the supply of K-Y to the NHS was a relevant customer benefit (RCB) of the merger, as there was no guarantee that another purchaser or licensee of the K-Y brand would have the expertise or inclination to supply the NHS, because of [✂] and the difference in supply arrangements

[150] CC8, paragraph 3.1.
[151] CC8, paragraph 3.15.
[152] CC8, paragraph 1.9.
[153] RB Response to Remedies Notice 10 June 2015, paragraphs 2.1-2.2.

from the retail business. RB would continue to supply the NHS if the transaction went ahead. This was an RCB in RB's view as it was merger-specific and unlikely to arise without the transaction proceeding.

12.74 Two third parties suggested that RB might market K-Y more effectively. However, in general, third parties did not identify any RCB resulting from the merger.

12.75 NHS Supply Chain,[154] which acts as an intermediary in supplying the NHS with personal lubricants and other products, said that K-Y was only one of five sterile personal lubricant brands supplied to the NHS. K-Y sales in 2014 of £[✄] compared with total sales of £[✄] ie K-Y was [✄] of personal lubricant sales and the proportion had fallen in recent years. Any change in brand could be handled effectively if there was around six months' notice and the new brand owner met the required contract terms.

Conclusion on relevant consumer benefits

12.76 The only RCB suggested to arise from the merger was the continuity of supply of K-Y to the NHS. Supply to the NHS was not included within the SLC identified, as there was no material overlap in supply to the NHS. Although there would be a reduction in consumer benefit if the supply of K-Y to the NHS was removed, it appears that there are several other companies that are able to supply the NHS with an alternative personal lubricant. This was confirmed by NHS Supply Chain, which said that four other sterile personal lubricant brands are being used within the NHS.

12.77 We conclude that the supply of K-Y to the NHS is not an RCB of the merger that would arise only as a consequence of the merger. However, we require that the licensee is offered the option of taking over supply of K-Y to the NHS.

Decision on the choice of remedy and implementation

12.78 Our decision on a remedy for the SLC in the supply of K-Y to the grocery retailer and national pharmacy chain markets is that the merger should be allowed to proceed on condition that prior to completion, RB enters into an agreement to license the K-Y brand and related IP rights on an exclusive, comprehensive and irrevocable basis for a total period of eight years, including a blackout period of at least one year, to enable the licensee to successfully transition from the K-Y brand to its own brand. While the

[154] Summary of response hearing with NHS Supply Chain on 10 July.

licensing arrangements will be negotiated between RB and the licensee, the licensing arrangement shall, among other things, provide for the following:

(a) **Exclusive, comprehensive and irrevocable licence** – the licence will need to be exclusive and comprehensive to allow for the exclusive use, (such as production,[155] marketing and sale) of the K-Y brand and related IP rights for the supply of personal lubricant products in the UK by the licensee during the licence period. The licence should permit the use of the K-Y brand and related IP rights for the supply of the existing SKUs, (basic K-Y jelly 50ml and 75ml packs and sterile 5g and 82g packs), alone under the K-Y brand or on a co-branding basis. The licence should permit the use of the K-Y brand and related IP rights on personal lubricant products, other than the aforementioned existing SKUs, provided that the licensee co-brands these other products with its own brand (ie use of the K-Y brand and related IP rights in the UK for personal lubricant products, other than the existing SKUs mentioned previously, in conjunction with another brand). This opportunity for co-branding is important to enhance the licensee's ability to establish its personal lubricants brand in the UK before the K-Y brand reverts to RB and thus ensure an effective remedy. The importance of covering a sufficiently broad product range is supported by the Commission's notice on remedies,[156] which suggests that a licence should not be limited to a certain range of products within a specific market.[157] For the same reason, the licence should cover all relevant supply channels in the UK and not be limited to the market for grocery retailers and national pharmacy chains. The licence would also have to be irrevocable for the duration of the licence term.

(b) **The licence period/the blackout period** – the licensing should cover a total period of eight years, including a blackout period of at least one year, to enable the licensee to successfully transition from the K-Y brand to its own brand. A longer blackout period, within the eight-year total, could be decided at the option of the licensee.

(c) The granting of full rights to the K-Y brand and related IP rights in the UK such that RB is prevented from using the K-Y brand and related IP rights in the UK during the licence and blackout period and from introducing any products within the SWB range under the K-Y brand in the UK during the licence and blackout period. This type of a licence will prevent RB from

[155] RB is only permitted to produce K-Y in the UK if either the licensee requires RB to supply it for a transitional period or RB were to supply the products outside the UK. RB is not permitted to market or sell any K-Y branded product in the UK during the licence period.
[156] Commission notice on remedies, paragraph 41.
[157] See also the BaByliss judgement referred to previously. See also case No. IV/M.623 Kimberly-Clark/Scott and case No. COMP/M.3149 Procter & Gamble/Wella.

undermining the licensee's attempts to become established by using the K-Y brand itself for personal lubricant products in the UK.

(d) A one-off payment for use of the licence with no annual or other periodic licensing fee.

(e) In the event that the licensee wished RB to supply it with K-Y, at least initially, the K-Y product, including sterile K-Y, should be supplied at cost (including transport costs) during a transitional period of up to 12 months in order to allow the licensee to set up its own manufacturing or independent production arrangements, if required.

(f) Transfer of existing supply contracts and access to all necessary information and IP rights needed to carry on the business.

(g) The licensee will be entitled to continue to use the K-Y formula in perpetuity.

(h) Transfer of the right, but not the obligation, for the licensee to supply the NHS.

12.79 In addition to the standard criteria set out in our Merger Remedies Guidelines,[158] the licensee, which would need to be approved by the CMA, would need to conform to the following criteria:

(a) Demonstrable expertise within the SWB market.

(b) Presence in the market or the ability to enter it in the short term and be a viable and independent business with the necessary competence and motivation to provide effective competition in the UK market.

(c) The capability to meet the requirements of grocery retailers and national pharmacy chains supplied under the licence agreement, in addition to supplying the other retail channels: independent pharmacies, online and specialist (adult) shops.

(d) A clear commitment to establish a new brand or develop an existing brand for personal lubricant products.

(e) Provision of a business plan to explain its strategy during the licensing period, including development of a brand to compete with K-Y when the licence ends.

[158] See Merger Remedies Guidelines (CC8), paragraphs 3.15 *et seq*.

(f) Adequate finance for the acquisition and to be an effective competitor over the licence period as a minimum.

12.80 The commitment to license on this basis will be effected either by means of undertakings provided by RB or, if we are unable to agree a form of undertakings, then by an order. RB will need to agree on a licensing arrangement with a suitable third party within a period of [✂] from when final undertakings or an order are in place. If the remedy is not implemented to our satisfaction within this period, we reserve the right to require appointment of a trustee to oversee the licensing process to a suitable licensee at the cost of RB to ensure that an effective licensing arrangement is in place.