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Dutch court rejects passing-on defence and awards cartel damages

The Gelderland District Court recently ruled¹² that Alstom should pay €14.1m – the full amount of damages claimed – to TenneT, the Dutch electricity grid operator. The Court dismissed Alstom’s passing-on defence because it did not consider it ‘unreasonable’ for TenneT to be overcompensated.

TenneT sought damages from Alstom following the European Commission’s decision in the *Gas Insulated Switchgear* cartel. In an earlier ruling, the District Court already confirmed¹³ the civil liability of the cartel participants and their group entities in the *Gas Insulated Switchgear* cartel and requested more information on the passing-on defence so that the actual damages could be assessed.

Because Alstom neglected to provide insight in its pricing policy, the District Court compared the prices of fellow cartel participant ABB during and after the cartel to calculate the overcharge paid by TenneT. The District Court estimated the overcharge at €14.1m, which should be paid to TenneT plus interest at the statutory rate starting 14 days from the due dates for payment of the overcharge around 1994. TenneT paid in seven instalments. Alstom’s argument that TenneT did not suffer any loss because it passed on the overcharge to its customers was rejected. Potential ‘benefits’ gained by a cartel victim may only be offset against the damage sustained ‘in so far as this is reasonable’. According to the Court, it was not unreasonable for TenneT to be

overcompensated, since: (1) it was highly unlikely that Alstom would face any cartel damages claims by TenneT’s customers; and (2) TenneT’s customers would ultimately benefit from the damages awarded to TenneT through lower energy prices or taxes.

Notes

- 1 See: www.debrauw.com/newsletter/pressure-time-acm-maintains-liberal-approach-vertical-restraints.
- 2 See: www.acm.nl/en/publications/publication/14197/Consumer-welfare-central-in-ACMs-enforcement-with-regard-to-vertical-agreements.
- 3 See: www.acm.nl/en/publications/publication/5827/NMA-imposes-fines-totaling-more-than-EUR-80-million-for-cartel-agreements-in-flour-industry.
- 4 See: <http://curia.europa.eu/juris/document/document.jsf?jsessionid=9ea7d0f130de610a3fc74f4b4852a41bb851e58a0c05.e34KaxiLc3eQc40LaxqMbN4ObhmQe0?text=&docid=59846&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=102223>.
- 5 See: <http://curia.europa.eu/juris/document/document.jsf?text=&docid=72629&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=165355>.
- 6 See: www.acm.nl/en/publications/publication/13716/ACM-imposes-fines-on-investment-firms-in-cartel-case.
- 7 See: <http://curia.europa.eu/juris/document/document.jsf?text=&docid=144943&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=333841>.
- 8 See: <http://deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:RBROT:2014:7824>.
- 9 See: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:61976CJ0085&from=EN>.
- 10 See: <http://deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:RBAMS:2015:1778>.
- 11 See: www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWCA/Civ/2010/1284.html&query=emerald+and+supplies&method=boolean.
- 12 See: <http://deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:RBGEL:2015:3713>.
- 13 See: <http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBGEL:2014:6118>.

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NZCC declines Reckitt Benckiser and Johnson & Johnson lubricant merger

On 24 April 2015 the New Zealand Commerce Commission (NZCC) declined an application from Reckitt Benckiser Group (RB), owners of the Durex brand, to purchase Johnson & Johnson’s (J&J) K-Y brand of personal lubricant and product assets (acquisition). Six weeks later the NZCC published its decision

setting out the reasons why it declined to grant clearance for the acquisition.

The NZCC investigated the acquisition for nearly a year, making it the longest merger investigation in recent memory. As many readers will be aware the acquisition had been approved by competition authorities in Australia, the US, Brazil and Colombia, and at

the time of writing a decision was scheduled to be made by the UK's Competition and Markets Authority (CMA) by 18 August 2015.

RB and J&J's products are predominantly supplied to supermarkets and, to a much lesser extent, pharmacies (through pharmacy wholesalers). There is a material and persistent difference in the price between lubricants supplied in supermarkets and pharmacies, with the latter being significantly higher. While the NZCC acknowledged that lubricants are differentiated along a spectrum, from basic to enhanced products, it considered it was unnecessary to define separate product markets as the products performed a similar function and are substituted by consumers along the spectrum.

Accordingly, the NZCC defined separate markets for the wholesale supply of lubricant to supermarkets (supermarkets market) and the wholesale supply of lubricant to pharmacy wholesalers (pharmacy market). The NZCC concluded that it was not satisfied that the acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in either market compared to a valid counterfactual (being either J&J or a third party continuing to supply the K-Y brand).

The key factors identified by the NZCC as leading to its decision to decline clearance included:

- *Two largest suppliers:* RB and J&J were the two largest suppliers in both markets and accounted for the 'vast bulk' of lubricant supply.
- *Brand recognition and loyalty:* RB's Durex brand and J&J's K-Y brand were the most recognisable brands in the market and enjoyed considerable customer loyalty. Trust and familiarity in the brand is important for consumers of lubricant and this could not be replicated easily by a supplier without significant investment, including sunk costs. The NZCC concluded 'brand recognition and strong customer loyalty... are conditions of entry and expansion that a supplier must navigate' and 'this creates a significant asymmetry between the incumbents and other suppliers seeking to enter or expand'.
- *Closest competitors:* RB and J&J are each other's closest competitors in both markets. RB submitted that there was limited competition between the parties' brands and Ansell, the number three supplier in the supermarket market, was its closest competitor. This was in contrast to other industry participants, including J&J who consistently acknowledged that the brands were close competitors. The NZCC concluded 'that Durex and K-Y impose a material degree of competitive constraint on each other'.
- *Lack of sufficient constraint from existing competitors:* Ansell was unlikely to replace the lost competition between Durex and K-Y despite being able to readily increase the range and volume it supplies to supermarkets. Ansell had only managed to have its product stocked in 37 per cent of supermarkets and did not have the brand recognition enjoyed by Durex and K-Y. The other smaller existing suppliers (including Sylk and FlowMotion) are unlikely to expand in a timely fashion and sufficiently in terms of extent to prevent a likely lessening of competition. In addition to overcoming the brand loyalty barriers, those suppliers would need to convince supermarkets and pharmacies to stock their product and allocate shelf-space. Supermarkets indicated that this would likely require significant promotional investment by suppliers with no guarantee of success. The NZCC placed weight on the fact that smaller suppliers had only managed to obtain a small market share in the supermarket market and that was off a zero base share.
- *Switching between markets unlikely:* Given the difference in the price between lubricants supplied in supermarkets and pharmacies, neither market seems likely to constrain the other. If the merged entity sought to increase prices there would unlikely be a material degree of switching between the markets.
- *Countervailing buyer power – supermarkets:* Supermarkets lacked an incentive to exercise countervailing buyer power. Supermarkets were not overly focused on lubricant as it was a minor category that did not drive customer traffic to supermarkets or pharmacies. Demand for lubricant was inelastic and any price rises would be market-wide. In support of this conclusion was the NZCC's findings that there was no evidence of supermarkets challenging RB in regards to previous price rises, and that there was evidence that supermarkets had in the past simply passed on wholesale price increases to consumers. The NZCC therefore concluded: 'the incentives of supermarkets are not necessarily aligned with those of consumers'.

- RB submitted that, if faced with a price rise post-merger, supermarkets could seek to counter RB by restricting its shelf-space for unrelated products in RB's portfolio and promoting a rival's product. However, the NZCC considered that this was unlikely given a lack of evidence. Nor did the NZCC consider it likely that the supermarkets would invest in a house-brand given the size of the category.
- *Countervailing buyer power – pharmacies:* Pharmacy wholesalers may not have sufficient countervailing power to negate the loss of competition. The third largest supplier in the pharmacy channel, Sylk, supplied a basic, natural product, which was priced at a premium. The NZCC concluded that Sylk was unlikely to place a significant constraint on Durex and K-Y post-merger.
- *Sale to another buyer not unlikely:* The NZCC considered that the K-Y business had value and that 'J&J has not discharged its onus of satisfying us that sale to another buyer is not likely particularly given that J&J has the necessary IP rights, and the sale of K-Y products in New Zealand is currently profitable'.
- *Flawed econometric analysis:* The NZCC considered that RB's expert's econometric analysis was flawed and was inconsistent with other available evidence.

The NZCC did not share the same concerns in respect of competition in the 'adult' and 'online retail' channels. In these channels the NZCC found 'a greater variety of lubricant brands [are] available to consumers'.

In respect to the merger's approval by other regulators, NZCC chairman Dr Mark Berry noted that 'New Zealand's market was unique due to the limited number of suppliers to main retailers. Durex and K-Y are the leading personal lubricant brands in New Zealand and enjoy strong customer loyalty'.

Since the NZCC's decision to decline clearance for the application, the CMA

issued a press release outlining its preliminary concerns with the UK aspects of acquisition (which was referred for an in-depth phase 2 investigation in January this year), and on 17 June 2015 accepted interim undertakings from RB and J&J in relation to the acquisition. The CMA's 22 May 2015 press release notes that an inquiry group of independent CMA panel members provisionally believed that 'on balance the merger could lead to a substantial reduction in competition, possibly through higher prices, making customers buying these products in grocery retailers and national pharmacy chains worse off'. No doubt the CMA will be interested in the NZCC's views on the acquisition.

Previous NZCC decisions have concluded that New Zealand's supermarket duopoly has sufficient countervailing power to prevent any likely lessening of competition. However, the NZCC emphasised in this decision that whether the supermarkets have an incentive to exercise that power will depend on the facts of each case. In this case, where the two products (1) were viewed as each other's closest competitors, (2) enjoy considerable brand loyalty and (3) are price inelastic, the NZCC was not convinced that the supermarkets had any real incentive to exercise that power. In the NZCC's view, passing wholesale price increases on to consumers was a likely commercial response by the supermarkets.

The decision confirms that in mergers involving grocery products, applicants cannot simply rely on the countervailing power of supermarkets to be a sufficient counterargument to any competition concerns. It also shows the difficulties applicants face when vendors have different views on market dynamics and the importance of providing good evidence to support any claims.