

## Bureau's Diaper Rash Concerns Soothed by New Remedy

SHAWN NEYLAN (sneylan@stikeman.com)  
STIKEMAN ELLIOTT LLP

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The Canadian Competition Bureau (the "Bureau") has released a "technical backgrounder" (the "Backgrounder") concerning its analysis of Johnson & Johnson's ("J&J") acquisition of the consumer healthcare business of Pfizer Inc. and the basis on which it had sought a remedy with respect to diaper rash ointment. The Bureau had previously announced (on December 20, 2006) that it had negotiated a remedy with J&J in the form of a consent agreement filed with the Competition Tribunal requiring the divestiture of Zincofax and related assets. The remedy was implemented by way of the sale of the Zincofax brand ointment to Shire Pharmaceuticals Inc.

In the Backgrounder, the Bureau explained that there were overlaps in eight distinct product markets, but in only one of these would the acquisition likely result in a substantial lessening of competition: the market for diaper rash ointments. J&J produced three such products and the acquired business produced two, one of which was Zincofax. Without a remedy, the merged firm would have had 4 of the top 5 brands in Canada, and a market share close to 60%.

The Bureau found that the relevant geographic market is Canada based on several factors, the most significant of which appear to have been (i) national brand presences, (ii) no barriers to the sale of the products within Canada, and (iii) significant regulatory barriers to the importation of product into Canada including obtaining a Drug Identification Number ("DIN") and providing bilingual packaging, labelling and instructions. Manufacturers were therefore able to segment the Canadian from the U.S. market and to and charge different prices in each.

The Bureau also found that there were significant barriers to the development of new products, finding that a new over-the-counter product generally takes 5 to 10 years to reach the market. Among other things, a DIN must be obtained and considerable effort must be expended in developing a brand name and obtaining shelf space at retailers. There was also a history of attempted new brand entry with fairly minimal success. The Bureau found that it was unlikely that a new entrant could enter the market and achieve any significant market impact within two years.

The Bureau concluded that there were no acceptable substitutes for diaper rash ointment and that private label competition did not constrain the price of the leading branded products,

due to a “quite significant” price spread between the two. Although purchasers included some large retailers, the Bureau found that they would have had very limited ability to constrain J&J from exercising post-merger market power.

The Bureau therefore concluded that, absent a remedy, the acquisition would have eliminated competition between the two leading suppliers of diaper rash ointment in Canada and leave J&J as the dominant supplier. As the demand for diaper rash ointment was thought to be highly inelastic, the Bureau concluded that the acquisition would likely result in higher prices for diaper rash ointment and a reduced incentive to innovate. Neither the fifth major brand, in the hands of a competitor, nor private label products would pose an effective competitive constraint on the merged entity.

The remedy negotiated with J&J to divest the Zincofax brand reduced J&J’s post-merger market share to the mid-30 percentile range, slightly above J&J’s pre-merger market share and, in the Commissioner’s view, ensured that the acquisition would not result in a likely substantial lessening or prevention of competition.

The Backgrounder provides helpful discussion of some currently important issues including regulatory market segmentation and the role of private label products. It appears that the Bureau will discount the competitive discipline provided by such products if there is a significant price differential with branded products. Also noteworthy is the Bureau’s agreement to permit J&J to retain one of Pfizer’s two leading brands, thereby adding to J&J’s pre-merger portfolio of three of the five leading brands, even though this appears to have left J&J with a market share near the 35% safe harbour.



## Shawn C. D. Neylan

5300 Commerce Court West, 199 Bay Street, Toronto, Canada M5L 1B9  
Direct: (416) 869-5545 Fax: (416) 947-0866 [sneylan@stikeman.com](mailto:sneylan@stikeman.com)

Suite 1700, Park Place, 666 Burrard Street, Vancouver, Canada V6C 2X8  
Direct: (604) 631-1320 Fax: (604) 681-1825 [sneylan@stikeman.com](mailto:sneylan@stikeman.com)