COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 16.02.1998

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sirs,

Subject: Case No IV\M.1065 -NESTLE/ SAN PELLEGRINO

1. On 19 November 1997, Nestlé S.A. ("Nestlé") notified the proposed acquisition of the San Pellegrino Group. The notification was declared incomplete on 15.12.1997. The parties provided the further information required on 14.01.1998. On that date the notification became effective according to Article 4(2) of Commission Regulation (EC) no. 3384/94.

I. THE OPERATION AND THE PARTIES

2. The concentration is the proposed acquisition by Perrier Vittel S.A., a 100% subsidiary of Nestlé, of 51% of the shares of Compagnie Financière du Haut Rhin S.A. (CHFR), which controls the San Pellegrino group. With this acquisition Nestlé will have sole control over the San Pellegrino Group.

3. Nestlé is a Swiss company. It is the ultimate parent company of the Nestlé Group. The Nestlé group is primarily involved in the production, marketing and sale of a large variety of nutrition products.

4. CFHR is a Luxembourg company (a holding company) which controls the San Pellegrino group, which is mainly active in the bottling and sale of mineral water, soft drinks and aperitifs.

II COMMUNITY DIMENSION

5. The combined world-wide turnovers of all the undertakings concerned exceeds 5.000 million ECU. The Community-wide turnover of at least two of the undertakings concerned is more than 250 million ECU. Each of the undertakings concerned does not achieve more than two thirds of its turnover in one and the same Member State. Therefore, the operation has a Community dimension.

III THE RELEVANT MARKETS

A. Relevant product markets

6. Both Nestlé and San Pellegrino are active in the area of production and sale of non-alcoholic refreshment beverages, including bottled water and other soft drinks. In the notification, Nestlé considered that the relevant market should include all 'non-alcoholic refreshment beverages'. However, the Commission has already made clear in the past the unacceptability of such an approach based on mere functional substitutability. In fact, the reasons stated by the Commission in its previous decisions in the area of beverages[1] remain valid. In Italy (i.e. the only country where the parties' activities overlap significantly), it is necessary for the purposes of the assessment to distinguish at least between (a) bottled water, and (b) soft drinks. It is not necessary to decide whether this applies also to the other two countries where affected markets have been identified (France and the UK), since the addition of market shares is not significant even in the narrowest possible market (see assessment below).

a) Bottled water

7. The bottled water sector comprises a certain number of different types of still and sparkling waters, such as mineral water, spring water and treated water. Spring waters may be labelled as mineral water provided they fulfil certain requirements regarding their composition and their quality. Treated water usually consists of purified tap water. However, in Italy the market presents only one type of product, mineral water.

(i) Competition among brands

8. The Commission has investigated the extent to which small mineral water brands are regarded as substitutable for the large national brands by the Italian consumers, and it has found that there is sufficient degree of substitution to consider that they belong to the same product market. The products' characteristics and use are largely similar. There is no significant difference either in terms of packaging, sizes or labelling. This was confirmed by the majority of the Italian regional and local competitors contacted by the Commission, which considered that a price increase for the large national brands would produce a significant switching of demand to regional or local brands. This is not in contradiction with the existence of a certain price variation within this sector, due to the fact that these are relatively non-expensive products that enjoy a certain degree of brand loyalty.

(ii) Sparkling and flat mineral water.

---

1 Cases IV/M.190 Nestlé / Perrier; IV/M.585 Orkla / Volvo; IV/M.794 CC / ABGB et al.

9. The question of whether flat and sparkling mineral waters would belong to the same market is more unclear. From the demand side, it seems that the majority of the flat water consumers would not switch to sparkling water in response to a significant and permanent price increase. However it has to be noted that apparently consumers of sparkling water would switch more easily to flat water. Since flat water amounts to a growing approximate 60 % of the Italian demand (1996), it could be considered that from the demand point of view a distinction between flat and sparkling water could be reasonably sustained.

10. By contrast, the high level of supply-side substitutability militates very clearly in favour of a single product market. It seems that almost the whole body of Italian bottlers can bottle both still and sparkling water, and a large number of them seem to use the same brand for both. The parties have given a full description of the relatively low production switching costs involved in a change from sparkling to flat water or viceversa. It is clear that in terms of time and financial expenditure, these costs do not amount to any significant barrier.

11. In any case it is not necessary to take a final view on this matter since even at the narrowest level the operation will not create or strengthen a dominant position.

(iii) Distribution channels

12. Bottling companies sell their products to both the Retail and the Wholesale trade sectors. In turn, wholesalers supply to the HORECA[2] sector but also to smaller retailers and family consumers (through Door-to-Door and drink shops). Retailers sell directly to consumers, but other sales to HORECA cannot be excluded. According to the parties, this overlap in the distribution channels makes difficult any division by channel. However, they provided the following break-down of the distribution channels for mineral water in Italy, which has been generaly confirmed by the main competitors:

a) Large Retailers, which represent around 48 % of the total domestic consumption.

b) HORECA, which is generally agreed to constitute around 35 % of consumption.

c) Door-to-door. Most beverage wholesalers operate also in this channel, which amounts to 17 % of consumption.

13. It is true that certain reasons argued in previous decisions in support of a separation by channel do not seem to apply in this case, e.g. there is not any generalized dispensing equipment to serve water and the difference in the size of the packaging or bottles seems to be less important. In this line, the notifying party argued that there is no distinction between the mineral water product in the different distribution channels, that no distinctive services are offered nor different marketing and communication strategies applied. It is true that in the case of Retail and Door-to-Door trade, it is reasonable to consider that the terms and conditions for the supply of mineral water are mutually influenced to a significant degree, so that they can be considered to constitute only one channel for competition purposes.

14. However, the extent to which such an arbitrage would be possible between on-premises (or HORECA) distribution and take-home consumption (Retail and Door-to-Door) seems to

---

[2] i.e. the hotel, restaurant and catering sector

be much more limited. Thus, it seems that a different pricing policy would be possible in principle at least for those two different distribution channels. This is in line with the findings of the Commission's previous decisions, in which it concluded that for certain beverages there was a separate relevant product market for on-premises consumption[3]. Accordingly, it would seem appropriate to distinguish between (a) the Take-home channel, which comprises all mineral water taken to the home, and the (b) On-premises channel, comprising all consumption in the HORECA sector.

15. In any case this latter point can also be left open since even at the level in which the parties would enjoy their highest market shares (i.e. the Retail level), no dominant position will be created or strenghtened (see below under 'assessment').

16. Accordingly, it is concluded that the relevant product market to be taken into account for the assessment of this operation is not wider than bottled mineral water. It is not necessary however to decide whether this market could be further subdivided in flat and sparkling bottled water or by distribution channels, since even at the narrowest level no significant competition concern has been identified.

b) Soft drinks

17. Soft drinks can be distinguished not only from the above but also from other products such as fruit juices by the reasons of price, characteristics and intended use described in previous decisions of the Commission. Furthermore, it could be argued that cola flavoured carbonated soft drinks are also to be excluded from the scope of this product market. However, and similarly to the above described situation, it is not necessary to decide on this latter issue since even if the narrowest product market definition was to be adopted, the operation would not present any anticompetitive concern with respect to this group of products.

B. Relevant geographic market

18. According to the notifying party, the markets for the above products are at least EEA-wide. In particular, Nestlé supported this position arguing that major manufacturers are active in almost the whole EEA, that all major brands are distributed in many Member States and that there are no barriers to trade between Member States. The Commission has however found ample evidence that this conclusion can not be satisfactorily sustained. Firstly, there are significantly large differences in market shares for each company in the different Member States, as well as very important price differences. Thus, e.g. the notifying party's average price level for bottled water in 1996 vary widely, from 0.29 ECU / litre to 1.93 ECU / litre (665 %).

19. Besides, as Nestlé recognises in its notification, the intra-Community trade of bottled water is small, of about 5 % of total EEA consumption. This is explained by the fact that bottled water is a bulky product whose transport costs are significant. One large Italian competitor estimated that the average transport costs between EU Member States range from a minimum of 30 % to a maximum of 50 % of the product's costs. Other barriers such as access to distribution, labelling, and different consumers' preferences also support a national market definition. Finally, the views of market players (customers and competitors) with respect to this question also militate in favour of this definition.

---

[3] Case IV/M.582 Orkla / Volvo

20. In view of all that, it is concluded that the relevant geografical market to be taken into consideration for the purposes of the assesment of this case is national.

IV. ASSESSMENT

21. The operation concerns the sectors of mineral water in Italy, France and the United Kingdom and that of soft drinks in Italy. The major impact of the operation is in the sector of mineral water in Italy; for this reason, more attention has been dedicated to this sector.

<u>Mineral Water</u>

<u>Italy</u>

Structure of the market - Prior to the operation

22. The current structure of the Italian market for mineral water is the following. There are five companies which, depending on the exact product market definition adopted, hold the following market shares:

	Volume		*Value*	
Company /Product	*all bottled water - all channels*	*retail only still water (1)*	*all bottled water - all channels*	*retail only still water (1)*
S. Pellegrino	14 %	20 %	14 %	26 %
Nestlé P.	9 %	11 %	9 %	12 %
Fiuggi (2)	0,7 %	1 %	2 %	4 %
Italaquae (Danone)	10 %	3 %	n.a.	4 %
CO.GE.DI	n.a.	9 %	n.a.	14 %
San Benedetto	14 %	24 %	n.a.	16 %
Other	n.a.	32 %	n.a.	24 %

(1) 1997 data.
(2) S. Pellegrino's distribution agreement with Fiuggi's was terminated on 31st December 1997.
Source: Parties / Nielsen

The rest of the market is split between 161 companies.

23. All the five major players on the market sell both sparkling and still water; they often do offer the two versions under the same brand. In particular, the most important brand of these companies, with the only exception of the Ferrarelle brand of Italacque, is sold in both versions (Levissima for S. Pellegrino, Vera for Nestlé, San Benedetto for San Benedetto, Rocchetta for CO.GE.DI.).

24. The same is true for the smaller competitors: the investigation carried out has shown that most of them do sell both sparkling and flat water, often under the same brand.

25. All major companies operating on the market have sales in the whole national territory. Overall, they are however more represented in the retail channel than in the HORECA and door to door. The investigation carried out has shown that this is mainly due the costs involved in the distribution (big number of wholesalers to deal with and returnable glass bottles) which do not permit consistent coverage at the national level. These companies are however to a lesser extent also present in the horeca and door to door channels. These

companies are stronger in the retail channel where brands play a major role (which is however not a determining factor in the Italian market as explained below).

26. Smaller competitors are on the contrary more represented in the HORECA and door to door channels. This is due to the fact that these companies can take better advantage of their proximity to a certain number of wholesalers in order to service them better. These companies have normally a local/regional presence and a distribution network organised at the regional level. Many of these companies are however to a lesser extent present also in the retail channel, where they compete with the national brands.

27. The Italian market for mineral water is currently a highly competitive market. In terms of procapita consumption, Italy is by far the largest consumer of mineral water, with 127 litres in 1996, against 34 litres for Portugal, 82 litres for France, 62 litres for Spain, 90 litres for Germany and 8 litres for the United Kingdom. Because of the high consumption (which is to a minor extent due to the seasonal absence of water in some Southern regions) the Italian market for mineral water is very price-sensitive. Competition on prices is the driving factor of the market. There is a certain brand-loyalty (for both national and local brands, for different reasons); however, prices and competition on prices are the driving factors of the market.[4] As to this aspect the situation is different from France, where main consumption share is concentrated on a few brands for which there is a strong brand-loyalty.

Effects of the operation

28. The combined entity will become the largest operator on the Italian market. On the narrowest possible market definition its highest combined market share will be 30% in volume and 38% in value (retail only, flat water). These shares exclude the brand Fiuggi which was distributed by San Pellegrino until 31st December 1997. The distribution agreement being terminated, the share represented by Fiuggi's sales has not to be taken into account in San Pellegrino's share of the market.On any other possible market definitions the combined market shares of the parties are substantially lower.

29. The parties will face competition from important companies operating on the market. They include San Benedetto, Italacque and CO.GE.DI., which are strong competitors operating at the national level. The low market share of Italacque as indicated in the first table below does not change this conclusion, to the extent that Italacque's position is important in sparkling water, on the basis of sales of the brand Ferrarelle (which is the brand obtaining most sales in Italy in absolute terms), and quite weak in flat water and globally Italacque, which belongs to the Danone group, is a valid competitor effectively competing on the market. All these companies are represented in all distribution channels, even if they are better represented in the retail channel than in the door to door and horeca channels, for the reasons indicated above. These companies have sufficient availability of important financial resources, expertise in the sector of mineral water and brands which are known at the national level in order to counteract any action which may be undertaken by Nestlé/San Pellegrino. In particular, they will be able to exert pressure on price levels, given the characteristics of the market, where, given a high competition on prices, they will be able to offer prices competitive to those offered by the new entity. The investigation has indeed shown that prices in this market tend to go down and that an increase of prices is quite

4 See Marcam, "Usage and Attitudes Study" sul mercato delle acque minerali.

unrealistic in this market. On the market segment where Nestlé/San Pellegrino is strongest, retail only for flat water, these companies hold the shares indicated in the table on page 5.

30. On the mineral water sector as a whole (including both flat and sparkling water), the position of the main competitors in retail only will be the following:

	VOLUME	VALUE
Nestlé / S. Pellegrino	24%	31%
San Benedetto	26%	17%
CO.GE.DI	8%	12%
Italacque	10%	14%

Source: Nielsen

31. Smaller competitors will continue operating on the market, even if their position could be weakened in the retail segment in particular, where the national brands are stronger. The business of these companies is globally focused in the HORECA and door to door segments. In both these segments they effectively compete with major brands, taking advantage of their local/regional structure rather than national. These companies generally enjoy a strong position in the area where they mainly operate, and the investigation has shown that consumers of a given area tend to be loyal to "their" mineral water, especially given the fact that prices of "regional water" are not higher than prices of national waters. These companies will continue to be mostly represented mainly in the door to door and HORECA channels and to a lesser extent in the retail channel, where they are generally positioned in the range of cheap waters ("primo prezzo"). As for take home consumption consumers tend to buy both from big retailers as from smaller shops, this will continue to allow local/regional waters to be effectively sold on the market. In addition, Italy has very recently increased private labels. These companies therefore have a chance to expand their business in this respect.

France

32. The French market for bottled water was carefully examined by the Commission in the Nestlé/Perrier decision.[5] In that decision, the Commission found the creation of a duopolistic dominant position between Nestlé/Perrier and the BSN Group (Danone Group). In order to restore effective competition, the parties in that case proposed commitments consisting of the sale of brand names (Vichy, Thonon, Pierval, Saint Yorre plus others) and sufficient capacity of water for bottling to a third competitor. The Commission attached conditions and obligations to the final decision in this sense. The sale of these brands was made to the Groupe Castel-Neptune, a group which was already active on the market.

33. Some changes have taken place in the French market since 1992. Although the market remains concentrated, the market shares of the mature top brands decreased. In the meantime, the market shares of the cheaper brands experienced a certain increase. The Groupe Castel-Neptune's activity is focused on this segment of the market and indeed its global market position has increased over time. In addition, following the implementation of the commitments proposed by the parties in the Nestlé/Perrier case, the Groupe Castel-Neptune was afforded the opportunity to operate more intensively on the still water segment of the

[5] See footnote 1

market, where leading brands are stronger. The prices of bottled water did not change substantially. The main surprising event since 1991 is the rapid reduction in demand which reinforced competitive intensity.

34. These factors have resulted in some increased competition on a market which tends to be highly concentrated.

35. In order to assess the impact of the present operation it is necessary to establish what is the change that it brings into the market. The San Pellegrino Group sells bottled water in France only under the brand San Pellegrino, which is sparkling mineral water only. On the narrowest product market definition, sales of this brand have represented 1% (both in volume and value) of the market. Virtually all sales of San Pellegrino currently take place in the HORECA channel, while it is practically inexistent in the retail channel. Therefore, the present operation results in no material overlap at the retail level only, which was at the core of the Nestlé/Perrier case. As to the customers of companies operating in this market, almost all major retail groups questioned by the Commission have indicated that they do not do not consider the San Pellegrino brand has a "must-have" brand and that they do not currently sell San Pellegrino. Indeed, it appears that while San Pellegrino is a generally well-known brand, as far as France is concerned it is not included within the leading national brands to which consumers generally appear to be loyal.

36. For all the above reasons it is considered that this acquisition, which does not imply any significant change in the structure of the market, will not lead to the creation or strengthening of a dominant position in the common market.

United Kingdom

37. The UK is a very competitive market. On the narrowest product market definition, the combined market share of the parties is 20% both in volume and in value. Other players include major competitors like the Danone Group (with approx. 19%), Campsie (approx. 10.5%), Wells (approx. 10%). On the narrowest product market definition San Pellegrino represents 3% of the market.

Soft Drinks, Italy

38. The operation was assessed on the basis that soft drinks exclude colas and fruit juices. The only affected market is Italy, where the parties' combined market share is 16% in value and 17% in volume. Other competitors include major companies like Coca-Cola, (around 16% market share) Pepsico Food and Beverages International (around 6% market share), San Benedetto (around 13% market share). If the market was to include colas, the parties' market shares would be even smaller. On the basis of the combined market share of the parties, the market shares of competitors and the kind of companies from which the parties face competition it is concluded that the operation will not create or strengthen a dominant position in the common market.

V. CONCLUSION

39. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission,