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Case No IV/M.1415 - BAT / ROTHMANS

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
Date: 17/03/1999

Also available in the CELEX database
Document No 399M1415

Office for Official Publications of the European Communities
L-2985 Luxembourg

Brussels, 17.03.1999

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sirs,

Subject: Case No IV/M. 1415 - BAT/ROTHMANS
Notification of 16.02.1999 pursuant to Article 4 of Council Regulation No 4064/89

1. On 16.02.1999, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89 by which the companies British American Tobacco plc ("BAT"), registered in United Kingdom, and Rothmans International B.V. ("Rothmans"), incorporated in The Netherlands, notified their intention to merger of their respective tobacco business.

I. THE PARTIES' ACTIVITIES

2. BAT is the holding company of a multinational group which is active in the tobacco industry. BAT's group companies manufacture, market and sell primarily cigarettes, and to small extent, other tobacco products in Europe, America, Asia and others territories throughout the world. BAT's most famous cigarette brands include State Express 555, Lucky Strike, Kent, and Barclay.

3. Rothmans is a multinational company engaged in the manufacture, distribution and sale of tobacco products, including cigarettes, fine tobacco, pipe tobacco and cigars throughout the world. It is owned by the Compagnie Financière Richemont AG, incorporated in Switzerland (which owns two third of Rothmans) and Rembrandt Group Limited, incorporated in the Republic of South Africa (which owns one third of Rothmans), these both effectively controlled by the Rupert family. Its most famous brands include Rothmans, Winfield, Belga, Peter Stuyvesant, Dunhill and Lord Extra.

II. THE OPERATION

4. Richemont and Rembrandt will contribute their tobacco business, Rothmans, to BAT in exchange for shares representing 35% of the capital and 25% of the voting rights of the new enlarged BAT group. Richemont and Rembrandt have agreed to a standstill agreement by which they define the manner in which they will hold their shares in the new entity, which

concerns restrictions on voting and on acquisition and disposal of shares or of voting rights in the merged entity. On completion, Rothmans will become a subsidiary of BAT.

5. The transaction involves a change of control over Rothmans tobacco business from the Rupert family to the enlarged group BAT, so that it is a concentration within the meaning of article 3(1) of the Merger Regulation.

III. COMMUNITY DIMENSION

6. BAT and Rothmans have a combined aggregate worldwide turnover in excess of EUR 5,000 million (BAT, EUR 10,559 million; and Rothmans IBV, EUR 4,683 million). Each of them has a Community-wide turnover in excess of EUR 250 million (BAT, EUR 1,334 million; and Rothmans IBV, EUR 1,543 million), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension within the meaning of Article 1(2) of the Merger Regulation.

IV. COMPETITIVE ASSESSMENT

Introduction

7. The tobacco industry exists on three levels: farming (leaf tobacco growing and curing), manufacturing and distribution. In Europe, BAT and Rothmans operate essentially at the manufacturing level. Manufacturing means processing and blending the cured tobacco and converting it into the final tobacco products. The main final manufactured products are manufactured cigarettes (91% of EU tobacco consumption), roll-your-own tobacco (RYO) (7% of EU tobacco consumption), cigars and cigarillos (1%) and pipe tobacco (1%). Others forms of consumption include snuff and chewing tobacco, though consumption of these is negligible.

8. The proposed concentration affects both the manufactured cigarettes and, to a lesser extent, the RYO tobacco.

9. The main tobacco companies operating in the Europe can be classified as follows : a) international companies such as BAT and Rothmans, Philip Morris (US) ("PM"), RJ Reynolds (US) ("RJR") and Japan Tobacco; b) European, regional-based companies who are present in several European countries such as Imperial, Gallaher, Reemstma, Seita, and Skandinavisk Tobakskompagni and c) national companies such as those operating in Austria, Greece, Italy, Norway, Sweden and Spain. Many of these companies are seeking to expand their geographic reach.

10. Large companies have a great number of brands (BAT has over 240 brands of cigarettes) covering a wide range of cigarette types. The twelve most important brands of manufactured cigarettes in the EEA are PM's Marlboro, which has a market share of 21.3% - that is largely ahead of all others -, Seita's Gauloises (4.1%), RJR's Camel (3.1%) and Winston (1.4%), Gallaher's Benson&Hedges (3.0%) and Silk Cut (1.7%), Reemtsma's West (2.5%), PM's Philip Morris (2.1%) , L&M (2.1%) and Chesterfield (1.8%) Rothmans/Reemtsma's Peter Stuyvesant (1.5%) and BAT's Lucky Strike (1.5%).

A. Relevant product markets

a) Manufactured cigarettes.

11. Manufactured cigarettes are products similar in outward appearance and with the same intended use. They are essentially a "white stick" for smoking. On the one hand, they combine a large number of common external characteristics related to their presentation, i.e. packsize, length, packaging, diameter. On the other hand, they are offered in the market in various combinations of internal characteristics related to the tobacco blend, taste and flavour, tar content, nicotine level which are normally identified within a brand (or member of a brand's family). Brands are linked to an image and quality level and are supported by *ad hoc* advertising and promoting actions.

12. The manufactured cigarette market may be segmented according to a number of different criteria relating to the above characteristics. However the investigation carried out by the Commission shows that a sub-division of the manufactured cigarette market along with a particular criterion (or combination of them) would in most cases be arbitrary and not meaningful. In fact, most of the above criteria are combined in different ways in any given brand (or family brands) of manufactured cigarettes with the view of meeting all types of a consumer's selection. All major competitors cover a large proportion of the various product characteristics, manufactured in a small number of factories, by means of a comprehensive portfolio to meet all the range of consumer preferences. The ingredients, methods of production, packaging, technology are largely similar for all types of cigarettes as well as distribution methods.

13. A clearer distinction seems to be drawn between blond and black cigarettes; however the question whether they are or not in the same product market can remain open, given that the parties and their main competitors (PM, Reynolds, Imperial, Gallaher, Reemtsma and STK) are not significantly involved in black cigarettes and that demand for black cigarettes (a product typical of the Mediterranean countries) is declining in the market concerned. In one affected market (France) there is a significant consumption of black cigarettes accounting for over 20% of the cigarette market. However, this does not modify the final assessment even if the narrowest market is retained.

14. Similarly, the question can remain open of whether further segmentation according to taste and flavour and/or tar content and/or by the perception of brand image should be made, as there are no indications that the new entity would be dominant in any such segments.

15. It is furthermore noted that the importance of any of the above-mentioned criteria for the purpose of market segmentation may vary substantially between different countries. The Commission found that customer preferences, brands' perception, price dynamics follow different patterns in different Member States. Thus any such segmentation might not be applicable to certain countries or regions.

b) RYO tobacco.

16. "Roll your own tobacco" (RYO) is a product offered as a pack of tobacco with which consumers can roll cigarettes themselves. Its physical and technical characteristics are different from cigarettes, and it is generally taxed at a lower level than manufactured cigarettes. Whilst it is used to perform the same function as manufactured cigarettes and

hence some RYO smokers do switch between them, the degree of substitutability between the two products seems to be limited in most European countries.

c) Conclusion.

17. For the purpose of the present decision it is not necessary to decide whether there are separate markets for manufactured cigarettes and RYO, nor whether further segmentation would be appropriate, since the market investigation has given no indication of segmentation by which the concentration would lead to serious competition concerns.

B. Relevant geographic market

18. The parties have submitted information at both national and European level. They consider that there are strong trends (convergence of consumer preferences and EU-wide sourcing) towards a European tobacco market, but that various restrictions still exist confining the markets to a national level such as taxation, regulation, retail prices, advertising restrictions, and differing distribution channels.

19. The largest cigarette markets by volume (1997 figures) in the EEA are Germany (23.6%), Italy (15.1%) France (14.4%), UK 13.2%, Spain 13.2% and Greece 5.2%. The other countries account each to a share below 2.7%.Traditionally, most national markets were dominated by national monopolies (France, Italy, Portugal, Spain, Austria, and Sweden) or by strong national tobacco companies (Denmark, Germany, Ireland, United Kingdom and Norway). Along with the general convergence towards a common European market there has been a strong tendency by international companies (Philips Morris, BAT, RJ Reynolds and Rothmans) to increase their market shares at the expense of national companies. At the same time some European-based competitors expanded their presence in several European countries. This is notably the case for Imperial, Gallaher, Reemstma, Seita, Skandinavisk Tobakskompagni and Austria Tabak. However, the investigation carried out by the Commission has confirmed that the factors put forward by the parties as relevant for a separation between national markets still prevail, in spite of pan-European trends. The national dimension of the relevant geographic market can therefore be confirmed in this case.

20. This conclusion applies both to manufactured and to RYO. As regards the latter, it is furthermore noted that consumption varies substantially between different countries. Countries like Norway, Netherlands, Denmark, Sweden, Germany, Belgium and Luxembourg have a relatively high level of consumption of RYO tobacco. By contrast this consumption is very low in countries as Italy, Spain, Greece and Ireland.

C. Assessment

21. BAT and Rothmans are the second and the fourth largest manufactured tobacco companies in the world (not including the China tobacco monopoly) with shares of 13% and 3% to 4% respectively. PM is the largest with 17% of sales. In Europe BAT and Rothmans rank in the seventh and second place respectively with shares of 5.7% and 7.9%, PM being the undisputed leader with 34.5%.

a) Manufactured cigarettes

22. For manufactured cigarettes the BAT/Rothmans combined market share in volume for 1997 will exceed 15% in the following countries:

In **Belgium** they will have a market share of **38.7%** (BAT 11.7% and Rothmans 27%). The main competitor is PM with 39.9%, followed by Reemtsma (10.3%), Seita (5.4%), RJR (5.2%) and Van Landewyck (0.1%).

In **France** they will reach a share of **18.8%** (BAT 2.4% and Rothmans 16.4%). Main competitor is Seita with 34.6%, followed by PM (30.2%), RJR (9.5%), Imperial (3.1%) and Gallaher (2.3%). Excluding the black cigarette segment the market share of the parties will be 23.5%.

In **Germany** they will have a market share of **19.9%** (BAT 13.1% and Rothmans 6.8%). Again, market leader is PM with 41.9%, followed by Reemtsma (22.8%) and RJR (4.7%).

In **Greece**, the parties will reach a share **with 16.7%** (BAT 2.5% and Rothmans 14.2%). PM leads the market with 23.3%, followed by Papastratos Cigarette Manufacturing Company (13.9%), RJR (10.6%), Sekap (10.4%), Karelias Tobacco Company (9.8%), Reemtsma (3.7%), Ethnos GA Keranis (2.6%).

In **Luxembourg** they will have **29.1%** of the market (BAT 11.5% and Rothmans 17.6%), the main competitor being PM with 28.4%, followed by van Landewyck (16.1%), Reemtsma (10.4%), RJR (7.9%) and Seita (6.5%).

In the **Netherlands** the new entity will lead the market with a share of **47%** (BAT 19.2% and Rothmans 27.7%), the main competitors being PM with 34.4%, RJR (13.4%) and Reemtsma (2.1%).

In **Norway** the parties will have a market share of **18.3%** (BAT 16.3% and Rothmans 2%), the main competitors being STK (62.8%) and PM (17.4%).

23. The above figures lead to the following conclusions.

In certain countries there will be a relatively minor addition of market share resulting from the concentration (**France**, **Greece** and **Norway**) or the combined share will be under 20% (this applies to **Germany**). In all these markets the new entity will not be the market leader and there will be several important competitors, so that any competitive concern can be excluded.

In each of the countries where the new entity will have substantial shares and be market leader (**The Netherlands**, **Luxembourg**) or very close (**Belgium**), the presence of a powerful competitor such as PM (leader in Belgium and with a strong and increasing presence in the other two countries while BAT/Rothamns' market shares are in decline) as well as the presence of several other competitors (at least one with a market share above 10% in each market) allows to exclude the possibility for the new entity to achieve sole dominance.

The situation in these countries can be said to be similar to that of the EU market as a whole. Here, both at a manufacturer level as well as at the level of individual brands PM has been in the last 12 years the notable exception amongst tobacco producers, achieving substantial growth against a general decline of the tobacco market as a whole and of all major competitors, including the BAT and Rothmans. PM's total share at EU level has more than doubled since 1986 (it was 35% in 1997), whereas BAT and Rothmans have both declined (combined share from approx. 16% in 1986 to 14% in 1997). Marlboro, the leading European brand is largely ahead to all competing brands and in particular to the main brands of the parties: 21.3% (it was 11.3% in 1986) against BAT/Lucky Strike's 1.5% and Rothmans/Peter Stuyvesant's 1.5%. PM also places three other brands ahead to the parties' ones, that is Philip Morris (2.1%), L&M (2.1%) and Chesterfield (1.8%).

As regards possible risks in terms of collective dominance, notably with the other strong player PM, the findings of the Commission lead to the conclusion that the conditions for such a situation are not met. In particular the position of the parties and PM in the market is not symmetrical and has been far from static in the last ten years, as the picture described above demonstrates. Again, the situation in the Benelux mirrors that at European level. Under these circumstances, and if moreover the presence of other rather important competitors such as RJR and Reemtsma is considered, there is no margin for the functioning of collective dominance.

24. The market investigation carried out by the Commission provided no indications that the above conclusion would be contradicted for particular segments of the market. In particular, given that tobacco producers are generally present across the whole spectrum of cigarette types, the market share analysis in various (possible) segments does generally support the same conclusion as that of the overall national markets.

b) RYO

25. For RYO tobacco the BAT/Rothmans combined market share will exceed 15% in the following countries:

- Belgium (30%), the main competitors being Imperial (37.%), Gallaher (11.1%), Seita (1.9%);

- Luxembourg (32.4%), the main competitors being Imperial (27.3%), Gallaher (7.4%), Seita (5.5%) and RJR (1.5%);

- France with 23.3% (BAT 10% and Rothmans 13.3%), the main competitors being Seita (42.9%), Imperial (14.62%), Baelen s.a. (9.5%), Gryson (4.3%) and Gallaher (1.9%);

- Germany with 30% (BAT 3.8% and Rothmans 26.2%), the main competitors being Imperial (17.5%), Aldi (11.1%), Alois Poesschl (9.2%), Reemtsma (4.5%), Jakordia (2.9%), PM (2.3%), Nelson (1.9%) and Seita (1.8%).

26. The above combined market shares in those countries and the existence of several important competitors, Imperial in first line, in each of those markets exclude any competitive concern. In Germany there will be a relative minor addition of market share from BAT (3.8%) to the new entity. The market shares of the parties have been undergoing a progressive and significant reduction in Luxembourg (falling from 44.6% in 1996 to 28.1% in 1998), in Germany (falling from 29.2% to 27.1%) and in Belgium (falling from 32.6% to 26.9%). Finally RYO is subject to competitive pressure from lower priced cigarettes. RYO sales have grown constantly in the last years in the above affected markets (from 1996 to 1998 the sales in Luxembourg have doubled, in Belgium they have increased by approximately 20%, in Germany by approximately 9% and in France by approximately 5%) while the sales of manufactured cigarettes have stabilised or declined.

c) Conclusion

27. Consequently, the proposed concentration does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or any substantial part of that area. This conclusion applies to manufactured cigarettes, RYO tobacco and naturally to the combination of the two markets.

V. ANCILLARY RESTRICTIONS

28. The parties have requested that the pre-closing undertakings contained in the Transaction Agreement that are intended to preserve the value of the transferred assets to the new entity for the period prior to completion be assessed in conjunction with the concentration, and declared as ancillary. These undertakings cover in particular changes to the share capital and constitutional documents, declarations of dividends, changes to the business, shareholder contracts and changes of employees.

29. In accordance with the Chapter II, paragraph 3, of the Commission notice regarding restrictions ancillary to concentration, the “restrictions” meant are those agreed on between the parties to the concentration which limit their own freedom of action in the market.

30. The pre-closing undertakings to the extent that they can act as a restriction of competition can be considered as directly related and necessary to the implementation of the operation.

VI. CONCLUSION

31. 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,