CT-99/

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Commissioner of Competition under sections 92 and 105 of the *Competition Act,* R.S.C. 1985, C. c-34;

AND IN THE MATTER OF the merger of British American Tobacco p.l.c. and Rothmans International B.V. whereby British American Tobacco p.l.c. will acquire, *inter alia*, indirect control of Rothmans Inc. and thereby the controlling interest of Rothmans Inc. in Rothmans, Benson & Hedges Inc.;

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

BRITISH AMERICAN TOBACCO p.l.c.

Respondent

CONSENT ORDER IMPACT STATEMENT

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1. This Statement is filed by the Commissioner of Competition (the "Commissioner") pursuant to paragraph 77 of the *Competition Tribunal Rules*. It describes the circumstances surrounding, and the anticipated effect on competition of, the draft consent order ("DCO") submitted by the Commissioner, with the consent of the respondent.

NATURE AND PURPOSE OF THE PROCEEDING

2. The Commissioner files this consent order impact statement, a notice of application, a statement of grounds and material facts and a DCO pursuant to sections 92 and 105 of the *Competition Act* (the "Act").

3. The DCO is designed to eliminate the substantial lessening or prevention of competition that, in the absence of the DCO, would be likely to arise in the market for manufactured cigarettes and in the market for fine cut tobacco throughout Canada. The Commissioner requests the Competition Tribunal's approval of the DCO pursuant to section 92 and 105 of the Act, in order to require British American Tobacco p.l.c. ("BAT") to effect a complete divestiture of the Rothmans Canadian interest (as defined in the DCO) that it will acquire, and thereby maintain the pre-merger competitive status quo in Canada.

EVENTS GIVING RISE TO THE POTENTIAL IMPACT ON COMPETITION

4. On January 11, 1999 the indirect shareholders of Rothmans International B.V. ("Rothmans International"), Switzerland's Compagnie Financière Richemont AG ("Richemont") and Rembrandt Group Ltd. of South Africa ("Rembrandt"), and BAT announced that they had reached agreement on the terms of a proposed merger of BAT and Rothmans International (the "agreement"). Under the terms of the agreement BAT will issue ordinary shares and convertible redeemable participating preference shares to Rothmans International Holdings S.A., a company jointly owned by Richemont and Rembrandt. On a fully diluted basis, the new shares will account for 35% of the enlarged BAT group, 25% in ordinary shares and 10% in convertible redeemable shares. Richemont and Rembrandt have agreed to restrict their voting rights to 25% of the shares of the enlarged BAT group. The proposed transaction is subject to certain regulatory approvals and is targeted for completion in the second quarter of 1999.

5. BAT is a company registered in England and Wales. BAT is a holding company with interests in a number of companies which manufacture, distribute and sell cigarettes and other tobacco products in Canada, Europe, the United States, Asia and other territories throughout the world.

6. BAT's current interest (before the merger) in the Canadian tobacco business is through its indirect ownership of 42% of the voting shares of the publicly traded company Imasco Limited ("Imasco") of Montréal, which is listed on The Toronto Stock Exchange, The Montréal Exchange and the Vancouver Stock Exchange. Imasco has three principal businesses with operations in Canada: (i) Imperial Tobacco -- a division of Imasco -- and Imasco's subsidiary Imperial Tobacco Limited (collectively, "Imperial") of which Imasco holds 100%; (ii) Imasco Financial Corporation, through which Imasco holds its interest in The Canada Trust Company and (iii) Shoppers Drug Mart Limited.

7. Imperial is the largest tobacco enterprise in Canada, with operations which range from leaf tobacco purchasing, processing and sales, to the manufacture of a full range of tobacco products. Imperial's brands, including *Player's, Du Maurier, Matinée, Cameo and Peter Jackson,* account for some 70% of the Canadian manufactured cigarette market and 37% of the fine cut or roll your own market.

8. Rothmans International is the world's fourth largest international tobacco group. It is incorporated under the laws of the Netherlands and it is a holding company of a group of companies which are engaged in the manufacture, distribution and sale of tobacco products, including cigarettes, "roll your own" or fine cut tobacco, pipe tobacco and cigars. The Rothmans group has a strong portfolio of international brands, including *Rothmans, Dunhill, Peter Stuyvesant, Winfield* and *Pall Mall*.

The Rothmans group is represented in Western Europe, Africa, Australasia and a number of Southeast Asian markets. Its products are manufactured in over 30 factories and sold in over 160 countries and territories. Rothmans International is an indirect subsidiary of Richemont, a Swiss public company which indirectly owns two-thirds of the Rothmans International share capital. The remaining one-third is indirectly held by Rembrandt, a public company in the Republic of South Africa.

9. Rothmans Inc. (“Rothmans”) is a public company with common shares traded on the Toronto, Montréal and Vancouver stock exchanges. Rothmans International, indirectly through wholly-owned subsidiaries, owns 71.2% of the common shares of Rothmans.

10. Rothmans manufactures and distributes a full range of tobacco products in Canada through its 60% owned subsidiary, Rothmans, Benson & Hedges Inc. (“RBH”). An affiliate of Philip Morris Companies Inc. owns the remaining 40% of RBH. RBH’s brands account for some 18% of the Canadian manufactured cigarette market and 44% of the fine cut tobacco market.

11. Pursuant to the proposed consent interim order (the “interim order”) BAT will be required, *inter alia,* to hold separate its ownership interest in the Rothmans Canadian interest (as defined in the DCO) and not knowingly take any action as an indirect shareholder of RBH to adversely affect the competitiveness, assets, operations or financial position of RBH until the final divestiture of the Rothmans Canadian interest as set out in the DCO.

THE ALLEGED EFFECTS OF THE MERGER ON COMPETITION

12. Manufactured cigarettes are the principal tobacco product sold in Canada,

representing some 90% of the sales of all tobacco products in Canada, while fine cut ("roll your own") tobacco represents some 8% of all tobacco sales. Pipe tobacco and cigars make up the remaining 2% of the sales of tobacco products, but because of their relatively small significance, limited substitution with cigarettes and because BAT has agreed to divest its entire interest in RBH, they are not considered in this analysis.

13. Manufactured cigarettes and fine cut tobacco constitute relevant product markets. Some cigarette smokers switch to fine cut tobacco in response to a significant increase in the price of manufactured cigarettes. The degree of switching is influenced by the absolute price levels of cigarettes and is more pervasive in provinces that levy high taxes on cigarettes. The proportion of all smokers willing to make this switch is too small to allow for the inclusion of fine cut tobacco in the same relevant market with manufactured cigarettes. There are no other close product substitutes.

14. Absent the divestiture by BAT of the Rothmans Canadian interest, BAT will have indirect control of RBH. The RBH cigarette brands, including *Rothmans*, *Craven "A"*, *Benson & Hedges*, *Number 7*, *Mark Ten*, *Viscount* and *Belvedere,* accounted for approximately 18% of the Canadian manufactured cigarette market in 1998. Imperial, in which BAT has an interest through its indirect ownership of 42% of the voting shares of Imasco, accounted for approximately 70% of the manufactured cigarette market in Canada in 1998 through such brands as *du Maurier*, *Players*, and *Matinée*.

15. In the Canadian fine cut tobacco market Imperial and RBH had market shares of approximately 37% and 44% respectively in 1998.

16. Imperial and RBH brands together accounted for approximately 88% of the

Canadian manufactured cigarette market and 81% of the Canadian fine cut tobacco market in 1998.

17. The only other significant competitor in the Canadian manufactured tobacco market is RJR-Macdonald Inc. ("RJR"), which in 1998 accounted for some 12% of manufactured cigarette sales and almost 18% of the fine cut tobacco market. RJR's brands include *Export A*, *Vantage*, and *Macdonald*. As with other tobacco companies, RJR is unlikely to be able to expand its market share substantially due to constraints on marketing and advertising.

18. The geographic market for manufactured cigarettes and fine cut tobacco made in Canada is national with the same brands of the same parties competing everywhere in Canada, but not having any significant sales outside Canada. The value of manufactured cigarettes and fine cut tobacco is high, relative to the costs of transportation, and a price increase in one part of the country could be disciplined by shipments from another region. Although there are some sales of foreign manufactured cigarettes and fine cut tobacco in Canada, market penetration by foreign manufactured cigarettes and fine cut tobacco is very low. Canadian smokers are unlikely to consider switching to foreign brands in response to a small but significant increase in the price of Canadian manufactured cigarettes and fine cut tobacco, primarily because Canadian manufactured cigarettes and fine cut tobacco use Virginia tobacco, which has a distinctive flavour compared to manufactured cigarettes sold in many other countries. This taste difference is significant when compared to U.S. manufactured cigarettes that are manufactured using a blend of tobaccos which may include flavouring additives. The geographic market does not include the U.S. and other countries.

19. Potential entrants are unlikely to enter the Canadian tobacco market in response to a significant but non-transitory price increase. There has been no new significant

competitive entry in Canada in 40 years. Brand image is very important in the manufactured cigarette and fine cut tobacco markets. A new entrant into the Canadian market would have to incur significant costs, mainly through advertising and promotion, to establish a brand. The success of a new brand is not guaranteed, and these costs would be sunk, as they could not be retrieved in the event of failed entry. Restrictions on tobacco advertising and on promotion of sports and cultural events by tobacco companies will make it even more difficult to establish a brand, and could increase the costs of entering the market.

20. The manufacture of cigarette and fine cut tobacco is also characterized by significant economies of scale which include significant start-up costs for manufacturing facilities. The combination of sunk costs, economies of scale and regulatory restraints makes entry into the market in response to a post-merger price increase very unlikely.

21. Post merger, absent the DCO, BAT's acquisition of control of RBH, having regard to its current interest in Imasco, would likely lead to a substantial lessening or prevention of competition in an already concentrated market characterized by significant entry barriers. Given BAT's stake in Imasco, there would be a financial incentive that could affect BAT'S decision making vis-a-vis RBH by virtue of its economic interest in one of RBH's competitors, i.e. Imperial. The DCO remedies that potential incentive by providing for BAT to divest the whole of its interest in RBH.

ANTICIPATED IMPACT OF THE DCO

22. The DCO involves the complete divestiture of the Rothmans Canadian interest acquired by BAT.

23. BAT will have one year, subject to a sixty day extension if it has entered into a legally binding sale agreement, within which to complete the divestiture in accordance with the terms and conditions of the DCO. If the divestiture is not completed within the allotted time period, the Competition Tribunal, on the application of the Commissioner, shall appoint a trustee to divest the Rothmans Canadian interest. In addition, a monitor will be appointed by the Commissioner to ensure compliance with the interim order and the DCO.

24. The objective of the interim order and the DCO is to eliminate a substantial lessening or prevention of competition in the Canadian manufactured cigarette and fine cut tobacco markets that will likely arise as a consequence of the merger. The Commissioner considers that the proposed divestiture, which provides for the complete divestiture of that which BAT acquired in Canada pursuant to the agreement, removes the risk that the merger could lead to competitive harm. The competitive status quo prior to the merger would be effectively preserved by the divestiture required by the DCO.

CONCLUSION

25. For the reasons presented herein, the Commissioner recommends the settlement and asks the Competition Tribunal to approve the DCO.

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