

Anticipated acquisition by Emerging Products Holding BV (a wholly-owned subsidiary of Japan Tobacco Int) of Zandera Limited

ME/6457/14

Summary

1. Japan Tobacco International (**JTI**) has agreed to acquire Zandera Limited, owner of the E-Lites e-cigarette brand (**E-Lites**) (the **Merger**). JTI is one of the UK's largest suppliers of tobacco products, with no current e-cigarette offering. E-Lites currently supplies e-cigarettes but does not supply tobacco products.
2. The Competition and Markets Authority (**CMA**) gave notice to the parties that their Merger Notice was satisfactory on 14 July 2014. The CMA's statutory timetable under section 34ZA(1) of the Enterprise Act 2002 (the **Act**) therefore expires on 8 September 2014.
3. As regards the product scope of the frame of reference, the CMA found that evidence from retailers and suppliers indicates that, although there is some degree of substitution between tobacco products and e-cigarettes, they are not currently close substitutes. As such, the CMA considers that they are likely to be in separate markets, although it was not necessary to conclude on this as no concerns arise on any basis. To the extent that there may be differences between the retail and online channels, the CMA has assessed the impact on them separately, while not concluding that they form distinct markets.
4. As regards geographic scope, the evidence received by the CMA indicates that it is likely to be at least as wide as national. The CMA has therefore assessed the impact of the Merger on the UK market.
5. The CMA considered the possibility of horizontal unilateral effects due to a loss of actual competition between JTI's tobacco products and E-Lites' e-cigarette products. It has found that there is no realistic prospect that the Merger will result in a substantial lessening of competition (**SLC**) on that basis due to a lack of competition pre-Merger between the parties, the small increment attributable to E-Lites and the continued existence of many strong competitors post-Merger.
6. The CMA also considered whether the Merger could result in a loss of potential competition. The CMA found that [§]. However, the CMA considers

that, if this was the case, due to the continued existence of many competitors who pose a strong constraint on it, there is no realistic prospect that the loss of JTI as a potential entrant will result in an SLC.

7. Finally, the CMA considered the possibility of conglomerate effects. The CMA received concerns from two third parties that JTI may be able to leverage a strong position in supplying popular tobacco brands to foreclose competitors of E-Lites, for example through product placement on shelves in gantries owned by JTI.
8. However, retailers told the CMA that they did not believe JTI would have the ability to influence the e-cigarette products they selected or foreclose other e-cigarette suppliers. They told the CMA that their product range was determined by customer preferences and noted that competitors also had 'must-have' tobacco brands. Therefore, based on the evidence available to it, the CMA considers that JTI's ability to foreclose, eg through product placement, is limited.
9. The CMA also considers that if JTI had the ability to foreclose, it would have had the opportunity to pursue foreclosure strategies in relation to its tobacco brands (where it would be facing the same competitors with a similar negotiating position). However, retailers told the CMA that JTI had never pursued similar strategies to support less popular tobacco brands in the past. The CMA considers that this suggests that JTI has no ability to foreclose.
10. Finally, the CMA notes that sales through online platforms and other retailers that do not sell tobacco products could provide e-cigarette suppliers with opportunities to continue to compete to supply e-cigarettes to end-consumers. Taking the evidence in the round, the CMA found no realistic prospect of an SLC due to conglomerate effects.
11. This Merger will therefore **not be referred** under section 33(1) of the Act.

Parties

12. JTI is the international trading division of the Japan Tobacco Group (**JT Group**), a multinational corporation headquartered in Japan engaged in the manufacture and supply of tobacco products. JTI achieved worldwide turnover of approximately £8 billion in 2013. JTI manufactures and sells more than 90 brands of tobacco products in more than 120 countries. The JT Group produces factory-made cigarettes, hand-rolled tobacco products and cigars. In the financial year 2013, the JT Group achieved worldwide turnover of approximately £16.7 billion.

13. Zandera, trading as E-Lites, is a UK supplier of e-cigarettes, and owner of the E-Lites e-cigarette brand. In the financial year 2013 it achieved a UK turnover of approximately £16 million.

Transaction

14. The Merger is an acquisition by way of the acquisition of shares. The consideration payable is [X]. The seller is Zandera (Finco) Limited, and the acquiring entity is Emerging Products Holding BV, a company incorporated under the laws of the Netherlands and established for the purpose of the Merger. Emerging Products Holding BV is ultimately controlled by Japan Tobacco Inc, the parent entity for the JT Group.
15. Following the Merger, Zandera will be a wholly-owned subsidiary of Emerging Products Holding BV.

Jurisdiction

16. The CMA considers that, as a result of the proposed Merger, JTI and Zandera will cease to be distinct. The UK turnover of Zandera does not exceed £70 million, so the turnover test in section 23(1)(b) of the Act is not satisfied.
17. The parties overlap in the supply of cigarettes and e-cigarettes and will have a combined share of supply of [40–50]% (see Table 1 below). The share of supply test in section 23(2)(b) of the Act is therefore satisfied.
18. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
19. The CMA gave notice to the parties that their Merger Notice was satisfactory on 14 July 2014. The CMA's statutory timetable under section 34ZA(1) of the Enterprise Act 2002 (the 'Act') therefore expires on 8 September 2014.

Counterfactual

20. The CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic, or where there is a realistic prospect of a counterfactual that is more competitive than prevailing conditions.¹

¹ *Merger Assessment Guidelines* (OFT1254/CC2, September 2010, adopted by the CMA as set out in Annex D to *Mergers: Guidance on the CMA's jurisdiction and procedure*, CMA2, January 2014), paragraph 4.3.5.

21. The parties did not submit that it was appropriate to assess the Merger against a different counterfactual to the pre-merger situation. JTI's internal documents indicate that [REDACTED]. While assessing the Merger against the prevailing conditions of competition, the CMA has therefore considered in its competitive assessment whether this could give rise to concerns resulting from the loss of potential competition.²

Frame of reference

22. JTI supplies tobacco products in the UK, including factory-made cigarettes, hand-rolled tobacco and cigars. It does not currently supply any e-cigarette products [REDACTED]. E-Lites only supplies e-cigarettes in the UK, and does not supply any tobacco products.
23. The purpose of market definition is to provide a framework for the CMA's analysis of the competitive effects of the merger. The relevant market contains the most significant competitive alternatives available to the customers of the merger firms and includes the sources of competition to the merger firms that are the immediate determinants of the effects of the merger.³
24. The boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.⁴

Product scope

Tobacco and e-cigarettes

25. As a starting point, the CMA considered the products where the parties currently overlap. The CMA considered whether tobacco products (or any subset of tobacco products) and e-cigarettes could be considered to form part of the same market. In this regard, the CMA considered whether a hypothetical monopolist of tobacco products would be able profitably to raise price, such that tobacco products and e-cigarettes are in separate markets, or

² As indicated in the *Merger Assessment Guidelines* (paragraphs 4.3.19 and 5.3.14), the loss of a potential entrant may alternatively be assessed by considering that entry would have resulted in a more competitive counterfactual than the prevailing conditions of competition.

³ *Merger Assessment Guidelines*, paragraph 5.2.1.

⁴ *Merger Assessment Guidelines*, paragraph 5.2.2.

whether such a price rise would be rendered unprofitable by switching to e-cigarettes.

26. The parties submitted that they do not overlap on a horizontal basis and considered it appropriate to assess tobacco products and e-cigarettes as separate markets. They noted that there are no third party organisations that categorise the tobacco products and e-cigarettes markets together, and submitted that this reflects the fact that there is no basis for concluding there is an overall market encompassing tobacco products and e-cigarettes in the UK.
27. A number of third parties told the CMA that e-cigarettes and tobacco products are substitutable on some level. They suggested that evidence of this was the high proportion of e-cigarette users that were, or are still, smokers. Third parties noted that smokers might decide to use e-cigarettes for a number of reasons, including health reasons, lower cost per smoke and the ability to smoke indoors.
28. In addition, a number of third parties told the CMA that many smokers consume both tobacco and e-cigarette products. Some retailers explained this as consumers using e-cigarettes in situations where they cannot use tobacco products (ie inside public places). One third party presented the CMA with evidence to show that around a quarter of its e-cigarette customers also purchase tobacco products, and other third parties suggested that the proportion was even higher.
29. However, while there was some evidence of customer switching between cigarettes and e-cigarettes (such as people switching from tobacco to e-cigarettes for health reasons), on the whole third parties suggested that e-cigarettes would not constrain tobacco suppliers from profitably increasing prices by 5%. One third party considered that while there would be a decline in customer tobacco volumes in the event of a 5% price increase, the value of the loss in traditional tobacco would significantly outstrip the growth in e-cigarette sales, because tobacco volumes and values are considerably higher. Another third party told the CMA that the tobacco market is declining by 8% year on year, but that this is affected by many factors, of which e-cigarettes is just one. Further, it added that a large proportion of the population continues to smoke and that the decline in the younger population smoking has not been matched by younger people using more e-cigarettes.
30. In general, third parties noted that whilst e-cigarettes popularity is increasing and that their growth will likely be somewhat at the expense of traditional tobacco consumption, no overall sales decline in traditional tobacco sales could be attributed primarily to them.

31. In view of the evidence set out above, the CMA considers that there are currently a number of competing suppliers of tobacco products who currently are likely to exercise a significantly closer competitive constraint on one another than the constraint from e-cigarettes. Accordingly, the CMA considers that the market is unlikely to be wider than tobacco products. However, for the purposes of the present assessment, the CMA considers that there is no need to conclude on this point as no competition concerns arise on any plausible basis.

E-cigarettes

32. The parties do not currently overlap in the supply of e-cigarettes. However, the CMA considers that absent the Merger, it is likely that JTI would have gone on to develop its own e-cigarette brand in competition with E-Lites (examined in detail below in paragraphs 58 to 94).
33. The revised Tobacco Products Directive (2014/40/EU) defines an ‘electronic cigarette’ as:
- a product that can be used for the consumption of nicotine-containing vapour via a mouth piece, or any component of that product, including a cartridge, a tank and the device without cartridge or tank. Electronic cigarettes can be disposable or refillable by means of a refill container and a tank, or rechargeable with single use cartridges.
34. The CMA considered whether a hypothetical monopolist of e-cigarettes could profitably raise prices. Third parties who responded to the CMA’s market investigation were unsure on this point, noting the limited period over which switching data was available and the fact that there have not been significant price increases on e-cigarettes which would give an idea of customer switching behaviour.
35. The CMA also considered the extent to which there may be further possible segmentations within e-cigarettes. The majority of third parties considered that different types of e-cigarettes, such as disposable, rechargeable and refillable, were substitutes on the demand side, but a minority considered they were not. On the supply side, e-cigarette suppliers told the CMA that switching production between different types of cigarettes was straightforward as they would typically be produced at the same factory and with little additional cost. A competitor noted that the key suppliers tend to produce all formats and that its e-cigarette product was available in both rechargeable and disposable formats. Similarly, another told the CMA that switching between different

types was very easy. It identified the only costs as marketing and inventory costs.

36. In this case, based on the evidence set out above, the CMA has assessed the merger for e-cigarettes as a whole. To address possible segmentations between different types of e-cigarettes, the CMA has found it appropriate to directly consider closeness of competition between them (as well as constraints from both within and outside the frame of reference) in the competitive assessment. However, the CMA has not needed to conclude on the exact market definition in this case as no competition concerns arise on any plausible basis.

Retail sales and online sales

37. E-cigarettes are currently sold through retail outlets (including pharmacies) and direct to the end-consumer via online sales. E-Lites' e-cigarettes are currently available through both channels.
38. The CMA considered whether, from a consumer's prospective, online sales of e-cigarettes could be considered within the same market as retail sales. The CMA also considered whether, on the supply side, the market could be segmented between these two types.
39. Third party responses suggested that online sales of e-cigarettes would not be considered as close substitutes for retail sales of e-cigarettes to consumers. One competitor explained to the CMA that the proportion of online sales for e-cigarettes has declined drastically over time and is probably around 40% of total sales compared to a few years ago where it was around 90% online. It also stated that it would be difficult for an e-cigarette supplier to maintain its brand position with an exclusively online offering. It also mentioned that it was aware of promotions for e-cigarettes being run exclusively online.
40. One retailer told the CMA that it did not consider itself in the same market as online stores. It added that it did not benchmark the prices of e-cigarettes against online offerings. Similarly, a major retailer told the CMA that it does not monitor its prices against online retailers of e-cigarettes.
41. On the supply-side, the CMA received limited evidence about the extent to which suppliers could switch between the different sales channels. In general, retailers told the CMA that they require high safety standards from their suppliers and certain marketing commitments before stocking e-cigarette brands.

42. The CMA has not concluded on segmentation between retail and online channels given that no concerns arise, but has rather considered this directly in the competitive assessment based on the evidence set out above.

Conclusion on product scope

43. The CMA has not found it necessary to conclude on the precise market definition in this case. For the reasons set out above, on a cautious basis, it has looked at narrow frames of reference such as e-cigarettes but also considered wider competition, taking into account JTI's position in tobacco products and E-Lites' position in e-cigarettes. For the purposes of its horizontal unilateral effects analysis, the CMA considered a wider product market definition which includes tobacco products and e-cigarettes together. However, when considering conglomerate theories of harm, the CMA has assessed JTI's position in the supply of tobacco products separately from e-cigarettes. This is consistent with the approach in previous cases involving branded consumer goods.⁵

Geographic market

44. The CMA considered what the appropriate geographic frame of reference should be in this case.
45. The vast majority of the parties' e-cigarette and tobacco customers (mainly retailers) told the CMA that they currently source their products from within the UK. Most added that this would be unlikely to change in response to small changes in price, due to the distribution costs involved and regulatory requirements. Several, however, noted that they did not need to consider obtaining supplies from abroad due to the number of suppliers active in the UK.
46. For tobacco, the requirement to have health warnings in the home language is a barrier to cross-border trade. Similarly, the existence of rights to distribute in different countries imply that there are national markets.
47. The CMA received no evidence that markets for either e-cigarettes or tobacco products should be narrower than the UK.
48. One competitor told the CMA that competition likely takes place at the national level, but that it is difficult to assess this for e-cigarettes given the age of the products. An e-cigarette producer told the CMA that e-cigarette

⁵ *Anticipated acquisition by A G Barr plc of Britvic plc*, ME/5801/12, 13 February 2013.

competition takes place on a global level, with only inventory and distribution investment needed to enter the e-cigarette market in the UK.

49. Given the mixed evidence, and given that no competition concerns arise on any basis, the CMA has not needed to conclude definitively in this case, but has on a cautious basis assessed the Merger on a national frame of reference for both tobacco and e-cigarette products.

Conclusion on frame of reference

50. For the reasons set out above, while not finding it necessary to conclude, the CMA has assessed the effect of the Merger in:

(a) the UK supply of tobacco and e-cigarettes; and

(b) the UK supply of e-cigarettes.

To the extent that there may be further possible segmentations within e-cigarettes and between retail and online sales, the CMA has considered these directly as part of its assessment of closeness of competition within the competitive assessment.

Unilateral horizontal effects

51. Unilateral effects can arise in a horizontal merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices on its own and without needing to coordinate with its rivals.⁶

Loss of actual competition between JTI tobacco products and E-Lites

52. Based on the evidence discussed above, the CMA considers that tobacco and e-cigarettes are currently unlikely to form part of the same product market. Nonetheless, on a cautious basis the CMA examined the possibility of unilateral horizontal effects, eg in the form of decreased quality or increased prices, arising in the UK as a result of loss of actual competition between JTI tobacco products and E-Lites.

⁶ *Merger Assessment Guidelines*, paragraph 5.6.13.

Shares of supply

TABLE 1 Estimated share of supply for tobacco products and e-cigarettes in the UK retail channel

Supplier	Estimated share %
JTI	[40–50]
E-Lites	[0–10]
JTI + E-Lites	[40–50]
Imperial Tobacco	[40–50]
British American Tobacco (BAT)	[0–10]
Philip Morris International (PMI)	[0–10]
Others	[0–10]
Total	100

Source: Parties' estimates, based on Nielsen Market Track and Scan Track data (2013) for tobacco products and e-cigarettes.

53. The parties submitted that the combined market share of the parties in the retail channel is [40–50]%, with a small increment of [0–10]%. This is partly due to the fact that the sales value of e-cigarettes is substantially lower than that of tobacco.
54. The CMA assessed the extent to which the parties' products could be said to be constraining each other. No third parties suggested that the E-Lites brand was constraining any of the tobacco products supplied by JTI in either the retail or the online channel, or that JTI's products were constraining E-Lites. Rather, third parties suggested that tobacco brands faced little competition due to customers' brand loyalty, and the strongest constraint on e-cigarettes came from other e-cigarette brands (where there is currently little brand loyalty). The evidence received during the course of the CMA's investigation does not indicate that the parties' products are close competitors in either the retail or the online channel.
55. Further, the CMA considers that post-Merger, numerous strong competitors will remain in both the retail and online channels. Imperial Tobacco will continue to be the largest player in the market, with BAT and PMI also present. Retailers noted that all four of the major tobacco suppliers supply 'must stock' brands. By contrast, E-Lites was not generally named as an important brand by customers, which is reflected in its small share of supply. Third parties commented that e-cigarettes are a novel product and have not yet established significant brand loyalty.
56. Given the evidence suggesting that e-cigarettes and tobacco products are not closely constraining one another, the existence of strong competitors and the very low incremental value of sales of E-Lites compared to JTI's sales, the CMA considers that there is no realistic prospect of an SLC as a result of loss of actual competition between JTI tobacco products and E-Lites.

Loss of potential competition

57. The CMA has also examined the effect of the Merger as a result of loss of potential competition between E-Lites and JTI [REDACTED].
58. Unilateral effects can arise from the elimination of potential competition, for example if the merger involves a potential entrant that could have increased competition. Such ‘actual potential competition’ is a constraint only if and when entry occurs.⁷ The CMA notes that it must have sufficient evidence, and a sufficiently careful approach, when applying theories of harm based on potential competition, given that such a finding necessarily involves a judgement about the likely future conduct of firms in the market rather than a conclusion based on observable actual competition.⁸
59. When assessing whether the merger leads to unilateral effects from a loss of actual potential competition, the CMA considers the following questions:
- (a) Would the potential entrant be likely to enter in the absence of the merger?
 - (b) Would such entry lead to greater competition?⁹

Likelihood of entry

60. The CMA considered the extent to which, absent the Merger, JTI would have been likely to launch an e-cigarette product.
61. The parties submitted that, whilst JTI was considering entering the market through the development of its own e-cigarette product, this was alongside its acquisition strategy and its development plans were not well developed.
62. The parties provided the CMA with a number of JTI internal documents prepared before the Merger. One such document was [REDACTED].
63. This document stated that [REDACTED].
64. [REDACTED]
65. The document shows that [REDACTED].

⁷ *Mergers Assessment Guidelines*, paragraphs 5.4.13–5.4.18. This could alternatively be considered as part of the counterfactual to the merger as it involves an assessment of whether one of the merger firms would have been likely to enter into the other merger firm’s market absent the merger (see *Merger Assessment Guidelines*, paragraph 4.3.19).

⁸ See, for example, *Thomson Reuters/Practical Law Company*, OFT decision of 28 March 2013, from paragraph 46.

⁹ *Merger Assessment Guidelines*, paragraph 5.4.15.

66. [REDACTED]
67. The parties told the CMA that, following JTI's decision to acquire E-Lites, these plans were dropped.
68. [REDACTED]
69. Overall [REDACTED] the CMA considers that JTI may have entered the supply of e-cigarettes absent the Merger and launched a brand in competition with E-Lites. However, given that no competition concerns arise on this basis, as set out below, the CMA has not needed to conclude on this point.

Effect of entry

70. The CMA considered the extent to which JTI's entry into e-cigarettes would, absent the Merger, have led to a greater level of competition that would deliver better outcomes for customers (and end-consumers) in terms of price, quality and innovation.

Shares of supply

71. The parties provided share of supply information in e-cigarettes over the last three years. The parties' estimate of shares of supply in the retail channel in 2013 is set out in Table 2 below.

TABLE 2 **Share of supply in retail sales of e-cigarettes in the UK by value, 2013**

<i>Competitor/brand</i>	<i>Estimated share %</i>
E-Lites	[20–30]
Nicolites	[30–40]
Ten Motives (to be owned by Victory)	[30–40]
OK	[0–10]
Blu SKYCIG (owned by Lorillard)	[0–10]
V-Lites	[0–10]
Others (including NJOY, Vype, Vapestick)	[0–10]
Total	100

Source: Parties, Nielsen Scan Track data, as of January 2014.

72. Besides the retail sales set out in Table 2 above, an estimated [REDACTED] of total E-Lites sales were attributable to online sales in 2013. The parties submitted that the e-cigarette market is extremely fragmented and that there are many suppliers that are only active in the online segment, suggesting that E-Lites' share in this area will be, if anything, lower than in the retail segments. The CMA saw no evidence that E-Lites' share of supply would be substantially greater in the online market. Evidence from third parties suggests that retail sales make up the majority of the sales of e-cigarettes, although other e-

cigarette suppliers also told the CMA that online sales account for a proportion of their overall revenue.

73. The CMA notes that, based on the parties' share of supply information, E-Lites' share of supply for e-cigarettes based on retail sales was [20–30]% in 2013 and 2012, but was [0–10]% in 2011. Competitors Nicolites (owned by PMI) and Ten Motives (owned by Victory) had a higher market share than E-Lites in 2013 and 2012, with shares of [30–40]% and [30–40]% respectively in 2013.
74. One third party told the CMA that it considered that E-Lites had already built itself up as a must-have brand and one of the main suppliers of e-cigarettes in the market. However, all other third parties told the CMA that there was currently very low brand loyalty in the e-cigarettes market. The CMA also notes that some retailers do not currently stock E-Lites, suggesting that it is currently unlikely to be a must-have brand for a retailer.
75. Retailers told the CMA that they stock a number of different e-cigarette brands, with most stocking at least three and some stocking many more. Two retailers told the CMA that they stocked at least seven brands of e-cigarettes.
76. The CMA considers that the share of supply figures indicate that, while E-Lites currently appears to be a significant brand, it faces competition from two suppliers with larger shares and several smaller competitors. The CMA also notes that the e-cigarette market is still developing, as shown by the fact that E-Lites has built up its current share since 2011. Accordingly, shares of supply need to be treated with caution¹⁰ and the CMA has considered closeness of competition below.

Closeness of competition

77. E-Lites is a 'cigalike' product (ie designed to be similar to cigarettes) which is supplied in both disposable and rechargeable forms. JTI's internal documents suggest that [X].
78. The CMA therefore considered the extent to which sufficiently strong and close competition from other products exists within the e-cigarette market such that the loss of JTI as a potential close competitor to E-Lites would not substantially lessen competition.

¹⁰ See *Merger Assessment Guidelines*, paragraph 5.3.2.

79. The parties submitted that the e-cigarette market is still a nascent and very fragmented market, with no single provider dominating the market. The parties pointed to a number of principal competitors in the UK as follows:
- (a) Blu (now to be owned by Imperial);
 - (b) Ten Motives;
 - (c) Nicolites (owned by Phillip Morris);
 - (d) OK; and
 - (e) Vype (owned by British American Tobacco).
80. The parties also noted a distinction between the following types of e-cigarette:
- (a) e-cigarettes with pre-filled and sealed cartridges, which are either rechargeable or disposable once the cartridge is exhausted; and
 - (b) Refillable e-cigarettes, which include separate refill containers. These containers can be re-filled when the supply is exhausted. These will also be rechargeable.
81. The parties submitted that these types are functionally substitutable and that both will provide a constraint to E-Lites, as they both provide a simulation of traditional tobacco smoking through producing a vapour resembling smoke. The parties noted that the major suppliers of e-cigarettes to the retail market in the UK typically provide both rechargeable and disposable e-cigarettes, and minimal alterations to their manufacturing processes are required to switch production from one category to the other.
82. The CMA received mixed evidence from retailers and suppliers of e-cigarettes on the extent to which disposable, rechargeable and refillable e-cigarettes constrain each other. Several third parties identified a distinction between disposable and refillable e-cigarettes.
83. One retailer told the CMA that after investing in a recharger kit it would be cost prohibitive for consumers to move products in the short term. It also noted that accessories are often brand specific and therefore customers would likely stick to those brands once they had begun purchasing them. This would indicate, for example, that the strongest constraint on E-Lites' disposable offering (and JTI's proposed disposable product) would come from other brands providing disposable e-cigarettes.
84. Other third parties, however, felt that customers would switch between different types of e-cigarettes if prices were to change. For example, one told

the CMA that customers currently preferred refillables due to the price and it felt that this would change if the prices increased and consumers would therefore switch. Another third party agreed with this.

85. The CMA also notes that the vast majority of other major e-cigarette producers supply both a disposable/rechargeable model and a refillable e-cigarette. In most cases, these are with similar or the same branding.
86. Internal documents from JTI and E-Lites support the parties' submission that there are a number of e-cigarette competitors in the UK market and that these appear to be competing closely with E-Lites. The documents do not indicate that any one type of e-cigarette presents a stronger constraint on E-Lites than others.
87. Overall, third parties told the CMA that the e-cigarette market is currently very competitive and that there were a number of different active suppliers. When naming the main competitors of E-Lites, they did not generally make distinctions between disposable, rechargeable and refillable e-cigarettes. The responses supported the parties' submission that there are several key competitors in the UK, with third parties also mentioning NJoy, Gamucci, VIP, Vapestick, Greensmoke and Skycig as important competitors.
88. Further, nearly all third parties confirmed that there are a number of close competitors to E-Lites. A competitor told the CMA that whilst it was too early in the market to see which suppliers were competing closely, it considered that there are many suppliers of 'cigalike' products that are all broadly comparable, of which E-Lites was one. Another competing e-cigarette supplier told the CMA that there were seven brands in the UK competing closely with E-Lites.

Retail and online sales

89. The CMA considered whether any adverse competitive effects might be felt separately in the retail or online channels.
90. As set out above, evidence from third parties and market shares suggests that a sufficient number of suppliers will exist post-merger in the retail channel such that the loss of JTI as a potential competitor will not lead to the loss of greater competition.
91. As also noted above (paragraph 72), third party evidence suggested that the online channel is even more competitive, with the main suppliers as well as a number of smaller suppliers competing.

Conclusion on potential competition

92. For the reasons set out above, the CMA considers that, absent the Merger, JTI may have developed its own e-cigarette product or products that could have competed with E-Lites for sales to retailers and to end-consumers through the online channels.
93. However, given the significant evidence of the large number of competitors remaining post-merger which will compete closely with E-Lites, the CMA considers that there is no realistic prospect of the Merger giving rise to a substantial lessening of potential competition in the UK supply of e-cigarettes in the retail or online channels.

Conglomerate issues

94. The CMA has considered the extent to which the Merger may raise fore-closure concerns associated with the combination of the range of products and brands supplied by the parties. The CMA considers that this may arise if the products and brands are complementary (so that a fall in the price of one good increases the customer's demand for another) or if there are economies of scale or scope in purchasing them (so that customers tend to purchase the products or brands together).¹¹
95. In this case, for example, the merging parties may increase the selling price of one of their products if it is sold on a stand-alone basis, but might not do so if customers buy both the parties' brands, giving customers an incentive to buy the second brand from the parties as well, putting rivals at a disadvantage. Similarly, the parties may be able to use their stronger brands as leverage in obtaining listings or greater shelf facings for their tertiary or newly-developed brands, at the expense of rivals.¹²
96. The CMA received complaints from two third parties that JTI may be able to leverage its strong position in tobacco products to foreclose other e-cigarette suppliers. The complaints were in relation to the retail channel only.
97. The CMA considered the extent to which the Merger would allow JTI to use strategies (such as tying or bundling of products or requirements for gantry space) to disadvantage other e-cigarette suppliers with the end result of increasing prices, lowering quality or worsening innovation in UK e-cigarette supply to retailers.

¹¹ See *Merger Assessment Guidelines*, paragraph 5.6.2.

¹² These theories would be termed mixed bundling and tying, respectively.

98. The CMA's approach in examining the possibility of such a scenario involves analysing:
- (a) the ability of the merging parties to undertake such strategies (would the merged firm have the ability to harm rivals?);
 - (b) the incentive of the parties to do so (would the merged firm find it profitable to do so?); and
 - (c) the effect of this strategy (would the effect be sufficient to reduce competition, for example by foreclosing access to shelf space of significant competitors?).¹³

Ability to undertake such strategies

99. The CMA considered the extent to which JTI would have the ability to pursue strategies that would disadvantage other e-cigarette suppliers such that it would lead to an increase in price, lessening of quality or reduction in innovation in the e-cigarette market in the UK.
100. Almost all retailers told the CMA that JTI offers a number of "must-have" tobacco brands with sufficient brand loyalty from customers such that they would be likely to continue to purchase even if the price increased. JTI has a market share of around [40-50]% in the UK for the supply of tobacco products (see Table 1 above). Third parties told the CMA that the other tobacco suppliers (Imperial Tobacco, BAT and PMI) also supply 'must-have' brands in the UK due to the high level of brand loyalty in the sector.
101. The CMA considers that the creation of advantages in the distribution of a product in itself is likely to be a positive effect of a transaction. Therefore, the CMA has focused on the extent to which the strategies would disadvantage, either through full or partial foreclosure, other suppliers of e-cigarettes such that the competitive offering of the E-Lites brand to customers worsens post-merger.

Planograms and supply of gantries

102. Both concerns received by the CMA related to JTI's strong position in tobacco products and in particular its ownership of gantries in a significant number of retailers in the UK. The gantry system sees a supplier provide a retailer with a gantry in which to display tobacco products, in exchange for the supplier having some say on where to display products on the shelves. The CMA

¹³ *Merger Assessment Guidelines*, paragraph 5.6.6.

understands that this system means that the supplier provides the retailer with a shelf layout (called a planogram) for where products should be displayed on the shelf. These include both the supplier's own and competitor products.

103. The two third parties told the CMA that JTI could use this system to gain a significant distribution advantage in the supply of e-cigarettes.
104. One told the CMA that JTI controls approximately half of the controlled gantries in the UK. Both concerned parties told the CMA that other competitors would still be able to get their product placed within stores, but either on lower shelves in a gantry or in other places in the store, which may be less visible than behind the counter.
105. Other third parties told the CMA that e-cigarettes are currently rarely displayed in the gantry, although this may change following upcoming regulatory changes. Instead, they are placed at the side of the gantry, on the till or elsewhere in the shop. Another supplier told the CMA that it thought there would still be opportunities to display e-cigarette products in gantries, as the planograms typically only cover the first two shelves of a six-shelf gantry.
106. A number of retailers told the CMA that they did not think that JTI would have the ability to have an impact on a retailer's ability to stock rival e-cigarette products. For example, one retailer told the CMA that it negotiates with JTI on a per-product basis and that JTI would not have any influence on the products stocked by it. Another told the CMA that whilst it is given planograms by suppliers, the final stocking decision is made by itself and it have always been able to stock rival products. In addition, four e-cigarette suppliers told the CMA that they were not concerned about the Merger.
107. The parties submitted that JTI has a number of newer (not yet as popular) product lines and that it does not try to promote these using its more popular brands. This was confirmed by several third parties. The parties further submitted that currently the large retailers do not stock all of JTI's products in all of their stores, instead selecting products based on consumer demand in that area. For independent retailers, the parties submitted that none of JTI's brands are in stock in all retailers and that, on average, they are in stock in less than [X] % of retailers. This suggests that JTI has only a limited ability to leverage its popular brands and gantry space to place its products in stores.
108. The CMA also notes that, in the event that JTI did have any ability to use its popular tobacco brands to help distribute E-Lites, there are three other tobacco companies in the UK with their own e-cigarette products, one of which (Imperial Tobacco) has a slightly larger market presence than JTI (although the other two have a substantially smaller presence). The CMA

therefore considers it unlikely that JTI could foreclose these suppliers, particularly the large one, from competing in the e-cigarette retail market.

109. Further, the CMA notes that there are alternative supply options in both the retail and online channels. The parties submitted (and the CMA confirmed with third parties) that there are a number of retail units that stocked e-cigarettes but no tobacco products, where the parties would not be able to employ a bundling strategy. Such stores represent only a small amount of the retail market. However, the CMA was told by e-cigarette suppliers that direct online sales account for a significant proportion of sales in e-cigarettes and this will allow an e-cigarette supplier to continue to supply in the UK even if it was foreclosed from the retail segment. The CMA considers that JTI would have no ability to foreclose competitors from competing to supply e-cigarettes through this channel.
110. On the basis of the evidence from retailers and other third parties, the lack of evidence that JTI has previously leveraged its popular tobacco brands to promote its less popular brands, and the availability of alternative channels to supply e-cigarettes, the CMA considers that JTI will not have the ability to significantly disadvantage other e-cigarette suppliers such that this has the effect of reducing their competitive offering.

Incentive and effect

111. Given that the CMA considers that JTI will not have the ability to leverage its position to significantly disadvantage rivals, the CMA has not needed to consider whether JTI would have the incentive to do so and what the competitive effect of such a strategy would be.
112. The CMA therefore considers that the Merger does not give rise to a realistic prospect of an SLC through JTI's potential ability to foreclose other e-cigarette suppliers using its position in tobacco products in the retail channel.

Barriers to entry

113. The CMA has briefly considered the barriers to entry that exist in the e-cigarette market.
114. Notwithstanding the number of competitors currently active in the UK market, the parties submitted that the barriers to entry are low. They pointed out that the market did not exist before 2006 and that the market has now grown to be worth approximately £2 billion in 2013. This was supported by JTI internal documents which highlighted the low barriers to entry in the e-cigarettes

market. This was also supported by the fact that E-Lites has achieved its current market position only since 2011.

115. According to the parties, all e-cigarettes are currently manufactured in China, where contract manufacturers have the capacity to produce large volumes of e-cigarettes, including for new entrants. The parties further submitted that changes in the regulatory environment in 2016 from the introduction of TPD2¹⁴ will not amount to a significant new barrier to entry.
116. Third parties generally confirmed that barriers to entry are currently low, and that it was easy to launch an e-cigarette product in the UK. Several third parties pointed to the large number of smaller suppliers active in the UK as evidence of this. However, a number of third parties told the CMA that increasing regulation of the market could create increased barriers to entry and favour larger, well-resourced companies at the expense of a large number of small companies.
117. However, given that no competition concerns arise in this case, the CMA has not needed to conclude on barriers to entry in the e-cigarette market.

Third parties

118. The CMA's market testing in this case received responses from a variety of third parties, including retailers, wholesalers, tobacco companies and independent e-cigarette suppliers. The vast majority of third parties did not raise concerns about the Merger. Comments have been incorporated throughout where relevant.
119. The CMA did not receive any comments from end-consumers of either tobacco products or e-cigarettes about the Merger.
120. Two third parties raised potential concerns about JTI being able to leverage its position in tobacco products to influence the e-cigarette brands stocked by retailers. These concerns are discussed above in the section dealing with conglomerate issues.
121. The CMA received two other general concerns, but these were not specifically related to the Merger.
122. Several third parties commented that the Merger would be good for the e-cigarettes market, as the marketing and distribution strength of JTI would

¹⁴ Tobacco Products Directive.

allow the market to continue to grow and help increase safety standards for e-cigarettes.

Decision

123. This merger will therefore **not be referred** under section 33(1) of the Act.

Competition and Markets Authority
2 September 2014