# [***80 FR 32374***](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5G5J-HM00-006W-80PR-00000-00&context=)

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Notices

**Reporter**

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***Federal Register* > *2015* > *June* > *Monday, June 8, 2015* > *Notices* > *FEDERAL TRADE COMMISSION (FTC)***

**Title:** **Reynolds American Inc. and Lorillard Inc.; Analysis of Proposed Consent Order To Aid Public Comment**

**Action:**  Proposed consent agreement.

**Agency**

FEDERAL TRADE COMMISSION (FTC)

**Identifier:** **[File No. 141-0168]**

**Synopsis**

**SUMMARY:** The consent agreement in this matter settles alleged violations of federal law prohibiting unfair methods of ***competition***. The attached Analysis to Aid Public Comment describes both the allegations in the draft complaint and the terms of the consent order--embodied in the consent agreement--that would settle these allegations.

**Text**

**SUPPLEMENTARY INFORMATION:** Pursuant to Section 6(f) of the Federal Trade Commission Act, [*15 U.S.C. 46(f)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ21-NRF4-41JV-00000-00&context=), and FTC Rule 2.34, [*16 CFR 2.34*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5HYR-92N0-008G-Y0W0-00000-00&context=), notice is hereby given that the above-captioned consent agreement containing a consent order to cease and desist, having been filed with and accepted, subject to final approval, by the Commission, has been placed on the public record for a period of thirty (30) days. The following Analysis to Aid Public Comment describes the terms of the consent agreement, and the allegations in the complaint. An electronic copy of the full text of the consent agreement package can be obtained from the FTC Home Page (for May 26, 2015), on the World Wide Web, at [*http://www.ftc.gov/os/actions.shtm*](http://www.ftc.gov/os/actions.shtm)*.*

You can file a comment online or on paper. For the Commission to consider your comment, we must receive it on or before June 25, 2015. Write "Reynolds American Inc. and Lorillard Inc.--Consent Agreement; File 141-0168" on your comment. Your comment--including your name and your state--will be placed on the public record of this proceeding, including, to the extent practicable, on the public Commission Web site, at [*http://www.ftc.gov/os/publiccomments.shtm*](http://www.ftc.gov/os/publiccomments.shtm)*.* As a matter of discretion, the Commission tries to remove individuals' home contact information from comments before placing them on the Commission Web site.

Because your comment will be made public, you are solely responsible for making sure that your comment does not include any sensitive personal information, like anyone's Social Security number, date of birth, driver's license number or other state identification number or foreign country equivalent, passport number, financial account number, or credit or debit card number. You are also solely responsible for making sure that your comment does not include any sensitive health information, like medical records or other individually identifiable health information. In addition, do not include any "[t]rade secret or any commercial or financial information which . . . is privileged or confidential," as discussed in Section 6(f) of the FTC Act, [*15 U.S.C. 46(f)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ21-NRF4-41JV-00000-00&context=), and FTC Rule 4.10(a)(2), [*16 CFR 4.10(a)(2)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5MH6-6J50-008G-Y1DH-00000-00&context=). In particular, do not include ***competitively*** sensitive information **[\*32375]** such as costs, sales statistics, inventories, formulas, patterns, devices, manufacturing processes, or customer names.

If you want the Commission to give your comment confidential treatment, you must file it in paper form, with a request for confidential treatment, and you have to follow the procedure explained in FTC Rule 4.9(c), [*16 CFR 4.9(c)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5MH6-6J50-008G-Y0Y0-00000-00&context=). n1 Your comment will be kept confidential only if the FTC General Counsel, in his or her sole discretion, grants your request in accordance with the law and the public interest.

n1 In particular, the written request for confidential treatment that accompanies the comment must include the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. *See* FTC Rule 4.9(c), [*16 CFR 4.9(c)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5MH6-6J50-008G-Y0Y0-00000-00&context=).

Postal mail addressed to the Commission is subject to delay due to heightened security screening. As a result, we encourage you to submit your comments online. To make sure that the Commission considers your online comment, you must file it at [*https://ftcpublic.commentworks.com/ftc/reynoldslorillardconsent*](https://ftcpublic.commentworks.com/ftc/reynoldslorillardconsent) by following the instructions on the web-based form. If this Notice appears at [*http://www.****regulations****.gov/#!home*](http://www.regulations.gov/#!home)*,* you also may file a comment through that Web site.

If you file your comment on paper, write "Reynolds American Inc. and Lorillard Inc.--Consent Agreement; File 141-0168" on your comment and on the envelope, and mail your comment to the following address: Federal Trade Commission, Office of the Secretary, 600 Pennsylvania Avenue NW., Suite CC-5610 (Annex D), Washington, DC 20580, or deliver your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., 5th Floor, Suite 5610 (Annex D), Washington, DC 20024. If possible, submit your paper comment to the Commission by courier or overnight service.

Visit the Commission Web site at [*http://www.ftc.gov*](http://www.ftc.gov) to read this Notice and the news release describing it. The FTC Act and other laws that the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. The Commission will consider all timely and responsive public comments that it receives on or before June 25, 2015. For information on the Commission's privacy policy, including routine uses permitted by the Privacy Act, see [*http://www.ftc.gov/ftc/privacy.htm*](http://www.ftc.gov/ftc/privacy.htm)*.*

**Analysis of Agreement Containing Consent Order To Aid Public Comment**

The Federal Trade Commission ("Commission") has accepted from Reynolds American Inc. ("Reynolds") and Lorillard Inc. ("Lorillard"), subject to final approval, an Agreement Containing Consent Order ("Consent Agreement") designed to remedy the anticompetitive effects resulting from Reynolds's proposed acquisition of Lorillard.

Reynolds's July 2014 agreement to acquire Lorillard in a $ 27.4 billion transaction ("the Acquisition") would combine the second- and third-largest cigarette producers in the United States. After the Acquisition, Reynolds and the largest U.S. cigarette producer, Altria Group, Inc. ("Altria"), would together control approximately 90% of all U.S. cigarette sales. The Commission's Complaint alleges that the proposed Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, [*15 U.S.C. 18*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GNT1-NRF4-426N-00000-00&context=), and [*Section 5*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GR01-NRF4-43MY-00000-00&context=) of the Federal Trade Commission Act, as amended, [*15 U.S.C. 45*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GSM1-NRF4-44DS-00000-00&context=), by substantially lessening ***competition*** in the market for traditional combustible cigarettes.

Under the terms of the Consent Agreement, Reynolds must divest a substantial set of assets to Imperial Tobacco Group plc. ("Imperial"). These assets include four cigarette brands, Lorillard's manufacturing facility and headquarters, and most of Lorillard's current workforce. The Consent Agreement also requires Reynolds to provide Imperial with visible shelf-space at retail locations for a period of five months following the close of the transaction. This Consent Agreement provides Imperial's U.S. operations with the nationally relevant brands, manufacturing facilities, and other tangible and intangible assets needed to effectively ***compete*** in the U.S. cigarette market. Reynolds must complete the divestiture on the same day it acquires Lorillard.

The Consent Agreement has been placed on the public record for 30 days to solicit comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will review the Consent Agreement, and comments received, to decide whether it should withdraw or modify the Consent Agreement, or make the Consent Agreement final.

**I. The Parties**

All parties to the proposed Acquisition and Consent Agreement are current ***competitors*** in the U.S. cigarette market.

Reynolds has the second-largest cigarette manufacturing and sales business in the United States. Its brands include two of the best-selling cigarettes in the country: Camel and Pall Mall. It also manages a number of smaller cigarette brands that it promotes less heavily. These include Winston, Kool, and Salem. Reynolds primarily sells its cigarettes in the United States.

Lorillard has the third-largest cigarette manufacturing and sales business in the United States. Its flagship brand, Newport, is the best-selling menthol cigarette in the country, and the second-best-selling cigarette brand overall. In addition to recently introduced non-menthol styles of Newport, Lorillard manufactures and sells a few smaller discount-segment brands, such as Maverick. Like Reynolds, Lorillard ***competes*** primarily in the United States.

Imperial is an international tobacco company operating in many countries including Australia, France, Germany, Greece, Italy, Turkey, Taiwan, the United Kingdom, and the United States. It sells tobacco products in the U.S. through its Commonwealth-Altadis subsidiary. Imperial's U.S. cigarette portfolio consists of several smaller discount brands, including USA Gold, Sonoma, and Montclair.

**II. The Relevant Market and Market Structure**

The relevant line of commerce in which to analyze the effects of the Acquisition is traditional combustible cigarettes ("cigarettes"). Consumers do not consider alternative tobacco products to be close substitutes for cigarettes. Cigarette producers similarly view cigarettes and other tobacco products as separate product categories, and cigarette prices are not significantly constrained by other tobacco products.

The United States is the relevant geographic market in which to analyze the effects of the Acquisition on the cigarette market. Both Reynolds and Lorillard sell cigarettes primarily in this country. U.S. consumers are in practice limited to the set of current U.S. producers when seeking to buy cigarettes.

The U.S. cigarette market has experienced declining demand since 1981. Total shipments fell by approximately 3.2% in 2014, with similar annual declines expected in the future. The market includes three large producers--Altria, Reynolds, and Lorillard--who together account for roughly 90% of all cigarette sales. Two smaller producers--Liggett and Imperial--have roughly 3% market shares apiece. All other producers have individual market shares of 1% or less. **[\*32376]**

***Competition*** in the U.S. cigarette market involves brand positioning, customer loyalty management, product promotion, and retail presence. Cigarette advertising is severely restricted in the United States: Various forms of advertising and marketing are prohibited by law, by ***regulation***, and by the terms of settlement agreements between major cigarette producers and the individual States. The predominant form of promotion remaining for U.S. cigarette producers is retail price reduction.

**III. Entry**

Entry or expansion in the U.S. cigarette market is unlikely to deter or counteract any anticompetitive effects of the proposed Acquisition. New entry in the cigarette market is difficult because of falling demand and the potentially slow and costly process of obtaining Food and Drug Administration clearance for new cigarette products. Expansion by new or existing cigarette producers is further obstructed by legal restrictions on advertising, limited retail product-visibility for fringe cigarette brands, and existing retail marketing contracts.

**IV. Effects of the Acquisition**

The proposed Acquisition is likely to substantially lessen ***competition*** in the U.S. cigarette market. It would eliminate current and emerging head-to-head ***competition*** between Reynolds and Lorillard, particularly for menthol cigarette sales, which is an increasingly important segment of the market. The Acquisition would also increase the likelihood that the merged firm will unilaterally exercise market power. Finally, the Acquisition will increase the likelihood of coordinated interaction between the remaining participants in the cigarette market.

**V. The Consent Agreement**

The purpose of the Consent Agreement is to mitigate the anticompetitive threat of the proposed acquisition. The Consent Agreement allows Reynolds to complete its acquisition of Lorillard, but requires Reynolds to divest several of its post-acquisition assets to Imperial.

Among other terms, the Consent Agreement requires Reynolds to sell Imperial four of its post-acquisition cigarette brands: Winton, Kool, Salem, and Maverick. These brands have a combined share of approximately 7% of the total U.S. cigarette market. Reynolds must also sell Lorillard's manufacturing facility and headquarters to Imperial, give Imperial employment rights for most of Lorillard's current staff and salesforce, and guarantee Imperial visible retail shelf-space for a period of five months following the close of the transaction. Finally, Reynolds must also provide Imperial with certain transition services.

This divestiture package, including the nationally recognized Winston and Kool brands, provides Imperial an opportunity to rapidly increase its ***competitive*** significance in the U.S. market. Imperial will shift immediately from being a small regional producer with limited ***competitive*** influence on the larger firms to become a national ***competitor*** with the third-largest cigarette business in the market. While Imperial's plans call for it to reposition the acquired brands, which have lost market share as part of the Reynolds portfolio, Imperial has successfully executed similar turnarounds with brands in other international markets.

Imperial will have greater opportunity and incentive to promote and grow sales of the divested brands because, unlike Reynolds, incremental sales of these brands are unlikely to cannibalize sales from more profitable cigarette brands in its portfolio. Imperial's incentive to reduce the price of the divestiture brands, in order to grow their market share, is a procompetitive offset to the reduction in ***competition*** that will result from the consolidation of Reynolds and Lorillard. Imperial's incentive to reduce prices and promote products in new areas likewise reduces the threat of anticompetitive coordination following the merger--as coordination on price increases and other aspects of ***competition*** may be relatively difficult given Imperial's contrary incentives. Ultimately, the divestiture package provides Imperial with a robust opportunity to undertake procompetitive actions to grow its market share in the U.S. cigarette market, and address the ***competitive*** concerns raised by the merger.

**IV. Opportunity for Public Comment**

By accepting the Consent Agreement, subject to final approval, the Commission anticipates that the ***competitive*** problems alleged in its Complaint will be resolved. The purpose of this analysis is to invite and facilitate public comment concerning the Consent Agreement to aid the Commission in determining whether it should make the Consent Agreement final. This analysis is not an official interpretation of the Consent Agreement, and does not modify its terms in any way.

By direction of the Commission, Commissioners Brill and Wright dissenting.

**Donald S. Clark,**

*Secretary.*

**Statement of the Federal Trade Commission**

*In the Matter of Reynolds American, Inc. and Lorillard Inc.*

The Federal Trade Commission has voted to accept for public comment a settlement with Reynolds American, Inc. ("Reynolds") to resolve the likely anticompetitive effects of Reynolds' proposed acquisition of Lorillard Inc. ("Lorillard"). n1 The settlement will allow the acquisition to move forward, subject to large divestitures by the parties to another major ***competitor*** in the tobacco industry.

n1 This statement reflects the views of Chairwoman Ramirez, Commissioner Ohlhausen, and Commissioner McSweeny.

The merging parties chose to present this acquisition to the Commission with a proposed divestiture aimed solely at securing our approval of the acquisition. n2 As proposed, Reynolds will purchase Lorillard for $ 27.4 billion and then immediately divest certain assets from both Reynolds and Lorillard to Imperial Tobacco Group plc ("Imperial") in a second $ 7.1 billion transaction. At the end of both transactions, Reynolds will own Lorillard's Newport brand and Imperial will own three former Reynolds' brands, Winston, Kool and Salem, as well as Lorillard's Maverick and e-cigarette Blu brands, and Lorillard's corporate infrastructure and manufacturing facility.

n2 The only transaction before the Commission for purposes of Hart-Scott-Rodino review was the Reynolds-Lorillard transaction.

As we explain below, we have reason to believe that Reynolds' proposed acquisition of Lorillard is likely to substantially lessen ***competition*** in the market for combustible cigarettes in the United States. We conclude, however, that the parties' proposed post-merger divestitures to Imperial would be effective in restoring ***competition*** in this market, and we therefore approve the divestitures as part of a consent order.

I. Reynolds' Acquisition of Lorillard Is Likely to Substantially Lessen ***Competition*** in the Combustible Cigarette Market

Today, the market for combustible cigarettes in the United States contains three major players and several additional smaller ***competitors***. Philip Morris USA, a division of Altria Group, Inc. ("Altria"), is the largest, with a share of about 51%, roughly twice the **[\*32377]** size of its nearest ***competitor***. Reynolds and Lorillard are the second- and third-largest firms, with shares of approximately 26% and 15%, respectively. Other players in the market include Liggett and Imperial, each with about 3% of the market, and roughly 50 other small players focused mainly on discount or regional business.

In light of their size and relative positions in the market, if Reynolds and Lorillard were attempting their transaction without any divestitures, the acquisition would likely substantially lessen ***competition***, with the post-acquisition Reynolds controlling 41% of the market and Reynolds and Altria together holding 92% of the market. In particular, we have reason to believe that the transaction would eliminate ***competition*** between Reynolds' Camel brand and Lorillard's Newport brand. For example, we found evidence that Camel has been seeking to gain market share from Newport. There is also evidence of discounting by Newport in response to Camel. In addition, our econometric analysis showed likely price effects resulting from the combination of Camel and Newport. n3

n3 While our main concern is with the transaction's likely unilateral effects, there is also evidence that the transaction would increase the likelihood of coordination by creating greater symmetry between Reynolds and Altria in terms of their market shares, portfolio of brands, and geographic strength in the United States. When the Commission last publicly evaluated this market in the context of the 2004 R.J. Reynolds Tobacco Holdings, Inc. ("RJR")/British American Tobacco p.l.c. ("BAT") transaction, we noted in our statement that conditions in the cigarette market at the time would make coordination difficult. The market has changed considerably over the last decade, perhaps most importantly in that the RJR/BAT transaction left the market with three major players relying on complex, differentiated product placement and pricing strategies. Unlike the combination of Reynolds/Lorillard, which would leave only two symmetric players with major national brands ***competing*** directly, the RJR/BAT transaction and market environment in 2004 presented a less pronounced coordination issue.

Having concluded that Reynolds' acquisition of Lorillard is likely to result in anticompetitive effects, we explain next why we believe the parties' proposed divestitures to Imperial are sufficient to restore ***competition***.

II. The Divestitures to Imperial Will Offset the ***Competition*** Lost From the Reynolds-Lorillard Merger

Imperial is an international tobacco company with operations in 160 countries and global revenues of roughly $ 11.8 billion. Today, Imperial is a relatively small player in the United States with a 3% share of the market. n4 Through the divestitures, Imperial is purchasing a collection of assets from both Reynolds and Lorillard. In addition to buying several prominent brands from both companies, Imperial is receiving an intact American manufacturing and sales operation from Lorillard, including Lorillard's offices, production facilities, and 2,900 employees. Lorillard's national sales force, which will be moving to Imperial, is an experienced team with knowledge of brands and customers.

n4 Imperial entered the United States market through its acquisition of Commonwealth's cigarette brands in April 2007.

We believe that these divestitures to Imperial will address the ***competitive*** concerns arising out of the Reynolds-Lorillard combination. Following the divestitures, Imperial will immediately become the third-largest cigarette maker in the country, with a 10% market share. n5 Imperial has a clearly defined strategy for the United States, and it will have both the capability and incentives to become an effective U.S. ***competitor***.

n5 After the divestitures to Imperial, Reynolds will have a 34% market share in the United States.

Winston is the number two cigarette brand in the world and will be the main focus of Imperial's strategy in the United States. Imperial's consumer research strongly indicates that Winston could see increased brand recognition and acceptance in the United States. Imperial plans to reposition Winston as a premium-value brand and invest in the growth of the brand through added visibility and significant discounting. Imperial also plans to refocus and invest in Kool through discounting on a state-by-state basis. The evidence shows that Imperial can grow the market share of these brands through discounting and other promotional activity.

In her dissent, Commissioner Brill questions Imperial's ability to restore the ***competition*** lost due to the Reynolds-Lorillard transaction, noting that the Winston and Kool brands have been declining for years. n6 In our view, however, Reynolds' track record with these two brands is not indicative of their potential with Imperial. As Commissioner Brill acknowledges, Reynolds made a conscious decision to promote Camel and Pall Mall aggressively as growth brands, and to put limited marketing support behind Winston and Kool. Going forward, Imperial will have greater incentives to promote Winston and Kool than Reynolds did because, unlike Reynolds, Imperial does not risk cannibalizing other brands in its portfolio. Moreover, Imperial is also acquiring Lorillard's Maverick, a value brand that ***competes*** well with Reynolds' Pall Mall.

n6 Dissenting Statement of Commissioner Julie Brill at 6-7.

Imperial has a successful record of repositioning cigarette brands in other jurisdictions and growing the market share of those brands. Although it has had a relatively small presence in this country, Imperial is acquiring an experienced, national sales force from Lorillard that will help it to grow the acquired brands and more effectively ***compete*** against Reynolds and Altria. Imperial has agreements in place with Reynolds to ensure continuity of supply of the acquired brands and to ensure their visibility at the point of sale. The agreements will enable Imperial to have immediate access to retail shelf space and give Imperial time to negotiate contracts with retailers.

Following the divestitures, Imperial's business in the United States will account for 24% of its worldwide tobacco net revenues, thus making it important for Imperial to succeed in the United States. The acquisition will enable Imperial to be a national ***competitor***, give it a portfolio of brands across different price points, and make its business more important to retailers, thereby enabling it to obtain visible shelf space and build stronger retailer relationships.

We are therefore satisfied that Imperial is positioned to be a sufficiently robust and aggressive ***competitor*** against a merged Reynolds-Lorillard and Altria, and to offset the ***competitive*** concerns arising from Reynolds' acquisition of Lorillard. Indeed, Imperial's incentives will stand in contrast to those of the pre-merger Lorillard, which has not been a particularly aggressive ***competitor*** in this market, having instead been generally content to rely on Newport's strong brand equity to drive most of its sales. We believe that Imperial will behave differently.

For these reasons, we are allowing the merger of Reynolds and Lorillard to go forward and accepting a consent decree to ensure that the divestitures to Imperial occur on a timely and effective basis. n7

n7 Although he agrees that the merger of Reynolds and Lorillard is likely to substantially lessen ***competition*** and that a consent order increases the likelihood that the divestitures to Imperial are properly and promptly effectuated, Commissioner Wright believes a consent order is unwarranted and on that basis dissents. We respectfully disagree with Commissioner Wright's suggestion that our action is improper under these circumstances. Our obligation under the Hart-Scott-Rodino Act is to take appropriate steps to ensure that any ***competitive*** issues with a proposed transaction are addressed effectively and that is precisely what we have done here. Indeed, we believe that our responsibility would not be fully discharged if we did not guard against the risks that Commissioner Wright himself acknowledges exist in the absence of a consent order. **[\*32378]**

**Dissenting Statement of Commissioner Julie Brill**

*In the Matter of Reynolds American, Inc. and Lorillard Inc.*

A majority of the Commission has voted to accept a consent to resolve ***competitive*** concerns stemming from Reynolds American, Inc.'s $ 27.4 billion acquisition of Lorillard Tobacco Company, a transaction combining the second and third largest cigarette manufacturers in the United States. Under the terms of the consent, Reynolds will divest some of its weaker non-growth brands--Winston, Kool, and Salem--as well as Lorillard's brand Maverick to Imperial Tobacco Group plc, a British firm that currently operates as Commonwealth here in the United States. n1 The Commission will allow Reynolds to retain its sought-after growth brands, Camel and Pall Mall, as well as Lorillard's flagship brand Newport. I respectfully dissent because I am not convinced that the remedy accepted by the Commission fully resolves the ***competitive*** concerns arising from this transaction. By accepting the parties' proposed divestitures and allowing the merger to proceed, the Commission is betting on Imperial's ability and incentive to ***compete*** vigorously with a set of weak and declining brands. For the reasons explained below, Imperial's ability to do so is at best uncertain. I thus have reason to believe that Reynolds' acquisition of Lorillard, even after the divestitures to Imperial, is likely to substantially lessen ***competition*** in the U.S. cigarette market. As a result of the Commission's failure to take meaningful action against this merger, the remaining two major cigarette manufacturers--Altria/Philip Morris and Reynolds--will likely be able to impose higher cigarette prices on consumers.

n1 Reynolds will also sell Lorillard's e-cigarette Blu to Imperial; that sale is not part of the Commission's proposed order.

I have reason to believe this merger increases both the likelihood of coordinated interaction between the remaining participants in the cigarette market, and the likelihood that the merged firm will unilaterally exercise market power. While both theories are presented in the Commission's Complaint, n2 I describe below additional facts and evidence not included in the Complaint that I believe illustrate why the transaction remains anticompetitive, notwithstanding the divestitures to Imperial.

n2 Complaint, [paragraph] 8, *In the Matter of Reynolds American Inc. and Lorillard Inc.,* File No. 141-0168, (May 26, 2015).

Coordinated Effects

Under a coordinated effects theory, as set forth in the 2010 Horizontal Merger Guidelines, the Commission is likely to challenge a merger if the following three conditions are met: "(1) The merger would significantly increase concentration and lead to a moderately or highly concentrated market; (2) that market shows signs of vulnerability to coordinated conduct []; and (3) the [Commission has] a credible basis on which to conclude that the merger may enhance that vulnerability." n3 Importantly, the Guidelines explain "the risk that a merger will induce adverse coordinated effects may not be susceptible to quantification or detailed proof . . .". n4 The Guidelines also instruct that "[p]ursuant to the Clayton Act's incipiency standard, the Agencies may challenge mergers that in their judgment pose a real danger of harm through coordinated effects, even without specific evidence showing precisely how the coordination likely would take place." n5

n3 U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 7.1 (2010) [*hereinafter* Guidelines].

n4 *Id.*

n5 *Id.*

I have reason to believe that the facts in this case demonstrate a substantial risk of coordinated interaction because all three conditions for coordinated interaction spelled out in the Horizontal Merger Guidelines are satisfied.

The first condition is easily satisfied. After the dust settles on the merger and divestitures, Reynolds and market leader Altria/Philip Morris will have over 80 percent of the U.S. market for traditional combustible cigarettes. n6

n6 As the majority notes, the relevant market is combustible cigarettes in the United States. Statement of the F.T.C., *In the Matter of* Reynolds American Inc. and Lorillard Inc., File No. 141-0168, May 26, 2015, at 1 [*hereinafter* Majority Statement].

The second condition is also easily satisfied. The Guidelines identify a number of market characteristics that are generally considered to make a market more vulnerable to coordination. n7 These include (1) evidence of past express collusion affecting the relevant market; (2) firms' ability to monitor rivals' behavior and detect cheating with relative ease; (3) availability of rapid and effective forms of punishment for cheating; (4) difficulties associated with attempting to gain significant market share from aggressive price cutting; and (5) low elasticity of demand. The cigarette market has many of these characteristics.

n7 Guidelines, *supra* note 3,. at § 7.2.

First, for the last decade, the cigarette market in the United States has been dominated by three firms--Reynolds, Lorillard, and Altria/Philip Morris--which together represent over 90 percent of the market. Over the same 10-year period, these "Big Three" tobacco firms have made lock-step cigarette list price increases unrelated to any change in costs or market fundamentals. n8

n8 In this context, it is worth noting that, in 2006, U.S. District Judge Kessler held Reynolds, Lorillard, Philip Morris, and a number of other cigarette manufacturers liable under the Racketeer Influenced and Corrupt Organizations Act (RICO). *United States v. Philip Morris, 449 F. Supp 2d 1 (D.D.C. 2006),* *aff'd* [*566 F.3d 1095 (D.C. Cir. 2009).*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:4WCN-4XW0-TXFX-H34X-00000-00&context=) In a lengthy decision containing over 4000 paragraphs of findings of fact, the district court highlighted the coordinated nature of the defendants' activities in furtherance of the racketeering scheme. The conduct involved was indirectly related to price, as the overarching purpose behind the scheme was to maximize the ***competing*** cigarette firms' profits. The district court explained that "[t]he central shared objective of Defendants has been to maximize the profits of the cigarette company Defendants by acting in concert to preserve and enhance the market for cigarettes through an overarching scheme to defraud existing and potential smokers. . . ." (*Philip Morris, 449 F. Supp 2d at 869).* The court also found that "[t]here is overwhelming evidence demonstrating Defendants' recognition that their economic interests would best be served by pursuing a united front on smoking and health issues and by a global coordination of their activities to protect and enhance their market positions in their respective countries." (*Id.* at 119). I find this evidence troubling when viewed in conjunction with the evidence in this case showing the U.S. cigarette market's vulnerability to coordinated interaction relating to prices.

Second, there is a high degree of pricing transparency at the wholesale and retail levels in the cigarette market, giving cigarette manufacturers the ability to monitor each other's prices and engage in disciplinary action necessary to maintain coordination. The major manufacturers all receive detailed wholesale volume information from firms collecting data. Reynolds and Lorillard also receive numerous analyst reports that track manufacturers' pricing behavior and project whether the industry will enjoy a stable or aggressive ***competitive*** environment as a result. These conditions will allow the new "Big Two" cigarette manufacturers to quickly detect volume shifts due to price cuts and other ***competitive*** activity, allowing them to monitor each other's prices, detect cheating, and quickly discipline each other--or threaten to do so. Third, many U.S. smokers are addicted to tobacco, resulting in fairly inelastic market demand, and rendering successful coordination more profitable for industry members. As the Guidelines **[\*32379]** describe, coordination is more likely the more participants stand to gain from it.

Apart from the market characteristics identified in the Guidelines that make a market more vulnerable to coordination, it is important to consider that the cigarette market in the United States has experienced an ongoing decline in volume for over 20 years. This creates pressure on manufacturers to increase prices to offset volume losses, potentially easing the difficulties associated with formation of coordinating arrangements by making price increases a focal strategy.

In 2004, the Commission elected not to challenge the merger of Reynolds and Brown & Williamson in part because it found that the cigarette market was not vulnerable to coordinated interaction. However, three key market dynamics have changed since then. These three changes have limited the market significance of the discount fringe and its ability to constrain cigarette prices, and increased entry barriers--both of which make the market more vulnerable to coordination. First, Reynolds' Every Day Low Price (EDLP) program, substantially modified in 2008 to reposition and grow Pall Mall as the EDLP brand, requires participating retailers to maintain Pall Mall as the lowest price brand sold in the store, creating an effective price floor that discount manufacturers are not allowed to undercut. Second, the vast majority of states that signed the Tobacco Master Settlement Agreement ("MSA") have enacted Non-Participating Manufacturer Legislation and Allocable Share Legislation, further diminishing the impact of discount brands. n9 Under this legislation, companies that do not participate in the MSA--typically the discount cigarette manufacturers--are required to pay an escrow fee to approximate the costs incurred by the participating cigarette companies, thereby eliminating much of the cost advantage that discounters had previously enjoyed. Third, the FDA's 2010 ***regulations***, n10 implementing the 2009 Family Smoking Prevention and Tobacco Control Act, n11 restrict tobacco advertising and promotion in the United States. Thus the 2010 FDA ***regulation*** limits the ability of new firms to enter the market, and limits the ability of existing fringe market participants to grow through aggressive advertising. The combined effect of these three, relatively new market dynamics has been a reduction in the ***competitive*** significance of the fringe discount brand manufacturers. Indeed, the number of discount brand manufacturers has fallen from over 100 in 2005, to around 50 today, now representing just two percent of the market.

n9 The Tobacco Master Settlement Agreement ("MSA") was entered in November 1998, originally between the four largest U.S. tobacco companies--Philip Morris Inc., R.J. Reynolds, Brown & Williamson and Lorillard--the original participating manufacturers ("OPMs"), and the attorneys general of 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas. The MSA resolved over 40 lawsuits brought by the states against tobacco manufacturers to recover billions of dollars in costs incurred by the states to treat smoking related illnesses and to obtain other relief. The OPMs agreed (1) to make multi-billion dollar payments, annually and in perpetuity, to the states and (2) to significantly restrict the way they market and advertise their tobacco products, including a prohibition on the use of cartoons in cigarette advertising or any other method that targets youth. In exchange, the states agreed to release the OPMs, and any other tobacco company that became a signatory to the MSA, from past and future liability arising from the health care costs caused by smoking. All MSA states subsequently enacted legislation requiring non-participating manufacturers ("NPMs") to make certain payments based on the number of cigarettes sold into the state. These payments are placed in an escrow account to ensure that funds are available to satisfy state claims against NPMs. Although all MSA states enacted this legislation, many NPMs were not making the required payments, or were exploiting a loophole by withdrawing their escrow deposits in a way that conflicted with the legislation's intent. To address those issues, many states adopted additional legislation to provide enforcement tools to ensure that NPMs make the required escrow payments ("complementary enforcement legislation"), as well as legislation to close a loophole in the state escrow statutes by preventing NPMs from withdrawing escrow payments in a way that was never contemplated when those statutes were enacted ("Allocable Share Legislation").

n10 ***Regulations*** Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco to Protect Children and Adolescents, *75 FR 13225* (March 19, 2010).

n11 [*21 U.S.C. 301*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GVH1-NRF4-425X-00000-00&context=) (2009).

The third and final condition identified in the Guidelines as leading the Commission to challenge a proposed merger based on a theory of coordination--that the Commission has a credible basis to conclude that the merger may enhance the market's vulnerability to coordination--is also satisfied in this case. Prior to the transaction, a large percentage of Reynolds' portfolio consisted of non-growth brands (including Winston, Kool, and Salem), and overall Reynolds' volumes were declining. In the years leading up to this transaction Reynolds also had a noticeable portfolio gap, as it lacked a strong premium menthol brand. Reynolds initiated new ***competition*** in the menthol segment with the introduction of Camel Crush and Camel Menthol, but Reynolds was still playing catch-up. Seeking to stop further volume loss to its ***competitors***' menthol brands--Lorillard's Newport and Altria/Philip Morris' Marlboro--Reynolds implemented a strategy of aggressive promotion of Camel and Pall Mall. The proposed merger eliminates many of Reynolds' incentives to continue these strategies. With Newport added to its portfolio, Reynolds will no longer face a gap in menthol and will not be subject to the same level of volume losses. Post-transaction, there will be greater symmetry between Altria/Philip Morris and Reynolds, bringing Reynolds' incentives into closer alignment with Altria/Philip Morris to place greater emphasis on profitability over market share growth. This increase in symmetry between Reynolds and Altria/Philip Morris thus enhances the market's vulnerability to coordination. n12

n12 *See* Statement of the F.T.C., *In the Matter of ZF Friedrichshafen AG and TRW Automotive Holdings Corp.,* File No. 141-0235, May 8, 2015, *available at* [*https://www.ftc.gov/system/files/document/cases/150515zffrn.pdf*](https://www.ftc.gov/system/files/document/cases/150515zffrn.pdf)*.* *See also* Marc Ivaldi, et al., *The Economics of Tacit Collusion* 66 & 67, Final Report for DG ***Competition***, European Commission (2003), *available at* [*http://ec.europa.eu/****competition****/mergers/studies\_reports/the\_economics\_of\_tacit\_collusion\_en.pdf*](http://ec.europa.eu/competition/mergers/studies_reports/the_economics_of_tacit_collusion_en.pdf)*.* ("By eliminating a ***competitor***, a merger reduces the number of participants and thereby tends to facilitate collusion. This effect is likely to be the higher, the smaller the number of participants already left in the market.") ("[I]t is easier to collude among equals, that is, among firms that have similar cost structures, similar production capacities, or offer similar ranges of products. This is a factor that is typically affected by a merger. Mergers that tend to restore symmetry can facilitate collusion.").

Unilateral Effects

This transaction also raises concerns about unilateral anticompetitive effects, because it eliminates the growing head-to-head ***competition*** between Reynolds and Lorillard. The Guidelines explain that "[t]he elimination of ***competition*** between two firms that results from their merger may alone constitute a substantial lessening of ***competition***." n13 As the majority explains, the Commission's econometric modeling showed likely price effects from the combination of the parties' cigarette portfolios. n14

n13 Guidelines, *supra* note 3, at § 6.

n14 Majority Statement, *supra* note 6, at 2.

The econometric analysis supports the substantial qualitative evidence of unilateral anticompetitive effects. For years, Lorillard's Newport brand has been able to rely on strong brand equity and brand loyalty to sustain its high market share and high prices for its menthol product line. As noted above, Reynolds, on the other hand, has been lagging behind Altria/Philip Morris and Lorillard in terms of profitability and pricing, with no comparably strong menthol product. As a result, in recent years Reynolds has been making efforts to challenge Newport's established leadership position and increase its share in menthol through increased **[\*32380]** promotional activity. Reynolds also engaged in the first innovation in this industry in many years with the introduction of Camel Crush, n15 which has generated strong sales growth for a new brand. Post-merger, with Newport in its hands, Reynolds will no longer need to innovate or increase its promotional activity to increase its share in menthol.

n15 Camel Crush allows consumers to change the cigarette from non-menthol to menthol or from menthol to stronger menthol by crushing a menthol capsule inside the filter.

   \*    \*    \*    \*    \*

In sum, I have reason to believe that this merger poses a real danger of anticompetitive harm through coordinated effects and unilateral exercise of market power in the U.S. cigarette market.

Adequacy of Divestitures To Imperial To Restore ***Competition***

As the Supreme Court has stated, restoring ***competition*** is the "key to the whole question of an ***antitrust*** remedy." n16 Both Supreme Court precedent and Commission guidance makes clear that any remedy to a transaction found to be in violation of Section 7 of the Clayton Act must fully restore the ***competition*** lost from the transaction, n17 and a remedy that restores only *some* of the ***competition*** lost does not suffice. n18 Because Clayton Act merger enforcement is predictive, it is hard to define what will precisely fully restore lost ***competition*** in any given case. The agency has on occasion allowed for remedies that are not an exact replica of the pre-merger market, usually when there is evidence that the buyer can have a strong ***competitive*** impact with the divested assets. Yet the focus of the inquiry is always on whether the proposed divestitures are sufficient to maintain or restore ***competition*** in the relevant market that existed prior to the transaction. n19

n16 [*United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316, 326 (1961).*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:3S4X-HHP0-003B-S36B-00000-00&context=)

n17 [*Ford Motor Co. v. United States, 405 U.S. 562, 573 (1972)*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:3S4X-D960-003B-S3X3-00000-00&context=) ("The relief in an ***antitrust*** case must be effective to redress the violations' and to restore ***competition***.' . . . Complete divestiture is particularly appropriate where asset or stock acquisitions violate the ***antitrust*** laws.").

n18 *See* F.T.C. Frequently Asked Questions About Merger Consent Order Provisions, *available at* [*https://www.ftc.gov/tips-advice/****competition****-guidance/guide-****antitrust****-laws/mergers/merger-faq*](https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/merger-faq)*.* ("There have been instances in which the divestiture of one firm's entire business in a relevant market was not sufficient to maintain or restore ***competition*** in that relevant market and thus was not an acceptable divestiture package. To assure effective relief, the Commission may thus order the inclusion of additional assets beyond those operating in the relevant market . . . In all cases, the objective is to effectuate a divestiture most likely to maintain or restore ***competition*** in the relevant market . . . At all times, the burden is on the parties to provide concrete and convincing evidence indicating that the asset package is sufficient to allow the proposed buyer to operate in a manner that maintains or restores ***competition*** in the relevant market.").

n19 *Id.* ("Every order in a merger case has the same goal: To preserve fully the existing ***competition*** in the relevant market or markets . . . An acceptable divestiture package is one that maintains or restores ***competition*** in the relevant market . . ."). *See also* Statement of the F.T.C.'s Bureau of ***Competition*** on Negotiating Merger Remedies, at 4, January 2012, *available at* [*https://www.ftc.gov/system/files/attachments/negotiating-merger-remedies/merger-remediesstmt.pdf*](https://www.ftc.gov/system/files/attachments/negotiating-merger-remedies/merger-remediesstmt.pdf)*.* ("If the Commission concludes that a proposed settlement will remedy the merger's anticompetitive effects, it will likely accept that settlement and not seek to prevent the proposed merger or unwind the consummated merger.").

Under these well-grounded principles, I have serious concerns about whether the divestiture remedy in this case is sufficient to restore ***competition*** in the U.S. cigarette market. As a preliminary matter, it is worth noting that, post-transaction, Imperial will be less than one-third the size of the combined Reynolds/Lorillard, with a 10 percent market share compared to the combined Reynolds/Lorillard's 34 percent market share. Prior to the transaction, Reynolds and Lorillard were more comparable in size to each other--Reynolds with a 26 percent market share and Lorillard with a 15 percent market share. And despite the divestitures, the HHI will increase 331 points to 3,809. Moreover, there is nothing dynamic about the cigarette market by any measure that could plausibly make these measures less useful in analyzing the likelihood of the divestiture to fully restore the ***competition*** lost from this transaction.

Beyond the resulting increased concentration, the question is whether Imperial can nonetheless maintain or restore ***competition*** in the market with the divested brands due to its own business acumen and incentives post-divestiture. I have reason to believe Imperial will not be up to the job. Indeed, I believe Imperial's post-divestiture market share may overstate its ***competitive*** significance. Through this transaction, Reynolds will obtain the second largest selling brand in the country (Newport), and keep the third largest selling brand (Camel). Imperial, on the other hand, will continue to have no strong brands in its portfolio. Reynolds' Winston, Kool, and Salem are declining and unsuccessful. Their combined market share has gone from approximately 14 percent in 2010 to 8 percent in 2013 (a 6 percent decline), and they are still losing share. It is no surprise that Reynolds would want to unload these weak brands, and refuse to provide a meaningful divestiture package that would replace the ***competition*** lost through its merger with Lorillard. I am not convinced that Imperial will have any greater ability to grow these declining brands. Indeed, I have reason to believe that Winston, Kool, and Salem, as well as Maverick, will languish even further outside the hands of Reynolds and Lorillard.

There is no doubt that Imperial hopes to make these brands successful and will make every attempt to do so. Imperial's strong global financial position will help. The Commission cannot rely on hopes and aspirations alone, however. We must base our decision on facts and demonstrated performance in the market. And it is by this measure that Imperial, with the added weak brands from Reynolds, comes up short. Imperial has a poor track record of growing acquired brands in the U.S. Imperial entered the U.S. market in 2007 by acquiring Commonwealth. n20 At that time Imperial also aspired to increase share. However, Imperial was not successful. Commonwealth's market share has declined since it was acquired by Imperial, and stands at less than three percent today. While in FY 2014 Imperial may have achieved modest growth with one of its other brands, USA Gold, that growth was only focused on limited geographic markets, and doesn't give me confidence that Imperial can implement a national campaign growth strategy. Reynolds, with much greater experience in the U.S. market, made numerous efforts to reinvigorate Winston, Kool, and Salem, but failed. n21 In light of Imperial's much worse track record here in the U.S., I am unconvinced that it will have *more* luck in making its wishful plans a reality.

n20 In 1996 Commonwealth acquired brands required by the Commission to be divested to resolve ***competitive*** concerns stemming from B.A.T. Industries p.l.c.'s $ 1 billion acquisition of The American Tobacco Company. B.A.T. Industries p.l.c., *et al,* [*119 F.T.C. 532 (1995).*](https://advance.lexis.com/api/document?collection=administrative-materials&id=urn:contentItem:3SF5-R030-0000-F38H-00000-00&context=)

n21 The majority interprets the evidence before us as showing that Reynolds emphasized Camel and Pall Mall but only put "limited marketing support behind Winston and Kool." *See* Majority Statement, *supra* note 6, at 3. In contradistinction to the majority, I believe the evidence before us demonstrates that on numerous occasions Reynolds sought--valiantly but without success--to grow Winston and Kool, even while emphasizing Camel and Pall Mall.

The majority notes that, outside the United States, Winston is the number two cigarette brand, and Imperial plans to make Winston the main focus of its strategy in the United States post-transaction. n22 But Winston's dichotomous position--a strong brand outside the United States and a weak brand in the United States--has held for many years. And Reynolds' multiple **[\*32381]** efforts to reposition Winston in light of its strong global position have not had any effect on slowing the dramatic decline of Winston in the United States. Indeed, by placing Winston at the center of its U.S. strategy, Imperial is demonstrating the same tone-deafness to the unique dynamics of the U.S. market that has caused Imperial to lose market share since it entered the U.S. market in 2007.

n22 Majority Statement, *supra* note 6, at 2.

My concerns about Imperial's ability to succeed where Reynolds has failed is heightened by the fact that Imperial will have no "anchor" brand to gain traction with retailers, and as a result will have limited shelf space available to it. The divestitures of Maverick from Lorillard and Winston, Kool, and Salem from Reynolds effectively de-couple each divested brand from a strong anchor brand. These anchor brands--Newport and Camel, the second and third best-selling brands in the country--gave Maverick, Winston, Kool, and Salem increased shelf space and promotional spending, helping to drive the limited sales they had. Maverick in particular benefits from Newport's brand success: Lorillard gives it a portion of Newport's shelf space, and when Lorillard advertises Newport, it advertises Maverick too. In Imperial's hands, the divested brands will not have the same shelf space or the benefit of strong advertising that comes with their anchor brands. I believe that the decoupling of the divested brands from Camel and Newport will serve to further exacerbate their decline.

Recognizing Imperial's shelf space disadvantage, the proposed Consent requires Reynolds to make some short term accommodations in an attempt to give Imperial a fighting chance in its effort to gain some shelf space in stores. First, the Consent envisions Reynolds entering into a Route to Market ("RTM") agreement with Imperial, whereby Reynolds agrees to provide Imperial a portion of its post-acquisition retail shelf space for a period of five months following the close of the transaction. Imperial will pay Reynolds $ 7 million for this agreement. Under the terms of the RTM agreement, Reynolds commits for a period of five months to continue placing Winston, Kool, and Salem on retail fixtures according to historic business practices, and to assign Imperial a defined portion of Lorillard's current retail shelf-space allotments to use as it sees fit. Second, Reynolds is also undertaking a 12-month commitment to remove provisions in new retail marketing contracts that would otherwise require some retailers to provide it shelf space in proportion to its national market share, where Reynolds national market share is higher than its local market share. The intent of this commitment is to increase Imperial's ability to obtain shelf space at least proportional to its local market share in many retail outlets for a period of 12 months.

I have reason to believe that these provisions are insufficient to make up for Imperial's significant shelf space disadvantage. The five-month RTM Agreement and 12-month commitment pertaining to Reynolds' allocation of shelf space according to its local market share are too short. While Imperial may be optimistic that it can establish sufficient shelf space in this limited time frame, nothing in the RTM Agreement and 12-month local market share commitment will alter retailers' incentives to allocate their shelf space to popular products that sell well when those time periods expire. Even if Imperial offers better terms and uses former Lorillard salespeople who have preexisting relationships with retailers to push for greater shelf space, it likely will still be in retailers' economic interest to allocate shelf space to the strong Reynolds and Altria/Philp Morris brands, not to Imperial's collection of weak and declining brands. n23 And at the end of Reynolds' 12-month local market share commitment, Reynolds will be able to squeeze Imperial's shelf space by requiring many retailers to provide it shelf space in proportion to its higher-than-local national market share. While Imperial may attempt to maintain its retail visibility by offering stores lucrative merchandising contracts, Reynolds and Altria/Philip Morris will no doubt counter those efforts with their own lucrative contracts. In the short run, arguably this may be beneficial for ***competition***, but in the long run, Imperial's market presence will diminish and the market will in all likelihood become a stable duopoly. n24

n23 The majority places its bet on Imperial in part based on the transfer to Imperial of "an experienced, national sales force from Lorillard." Majority Statement, *supra* note 6, at 2. I do not believe the transfer of some of Lorillard's sales staff to Imperial will transform Imperial into a significant ***competitor*** in the U.S. market. Lorillard's transferred sales staff will not be able to overcome the significant market dynamics described herein. Moreover, Lorillard's sales staff likely will be unable to fundamentally transform Imperial's lackluster ***competitive*** performance in the U.S. market because, as the majority itself acknowledges, "pre-merger Lorillard . . . has not been a particularly aggressive ***competitor*** in this market, having instead been generally content to rely on Newport's strong brand equity to drive most of its sales." Majority Statement, *supra* note 6, at 3.

n24 The majority relies on the fact that Imperial will have more favorable incentives as compared with those of the pre-merger Lorillard, since Lorillard was not a particularly aggressive ***competitor***. Majority Statement, *supra* note 6, at 3. But that comparison does not capture the full picture of the ***competitive*** harm from this transaction. Reynolds, not Lorillard, was the firm injecting some ***competition*** into the market. And as described herein, once Reynolds adds Lorillard's flagship Newport brand to its portfolio, Reynolds will have a portfolio of brands that is symmetrical to Altria/Philip Morris, resulting in a significant change in its incentives post-merger. In considering whether Imperial will fully restore the ***competition*** lost from this transaction, the majority seems to omit from its analysis Reynolds' changed incentives post-merger, and the effect that these changed incentives will have to substantially lessen ***competition*** in the U.S. market.

Conclusion

There is a great deal of discussion among academia, industry and other stakeholders about the negative impact on the market stemming from over enforcement of the ***antitrust*** laws. n25 There is consensus that over enforcement, also known as "Type 1 errors" or "false positives", can harm businesses and consumers by preventing what could otherwise be procompetitive conduct; many commentators believe Type 1 errors can also have a chilling effect on future procompetitive conduct. n26 However, failing to bring ***antitrust*** enforcement actions can also cause significant harms to consumers. As has been recently demonstrated by an in-depth study of merger retrospectives, harm from under enforcement, also known as "Type 2 errors" or "false negatives", can come in the form of significant price increases. n27 The Commission has always been very careful not to take enforcement action that turns out not to be warranted, an approach I fully support. This Commission also normally pays close attention when we are presented with insufficient divestitures or other remedies, to avoid under enforcement errors that can cause significant harm to consumers. Unfortunately, the majority has failed to do so in this case.

n25 *See, e.g.,* Christine A. Varney & Jonathan J. Clark, Chicago and Georgetown: An Essay in Honor of Robert Pitofsky, [*101 Geo. L.J. 1565 (2013);*](https://advance.lexis.com/api/document?collection=analytical-materials&id=urn:contentItem:59GV-RW70-02BM-Y130-00000-00&context=) Bruce H. Kobayashi and Timothy J. Muris, Chicago, Post-Chicago, and Beyond: Time to Let Go of the 20th Century, [*78* ***Antitrust*** *L. J. 147 (2012);*](https://advance.lexis.com/api/document?collection=legalnews&id=urn:contentItem:570R-BB00-00C2-M191-00000-00&context=) Alan Devlin and Michael Jacobs, ***Antitrust*** Error, [*52 Wm. & Mary L. Rev. 75 (2010);*](https://advance.lexis.com/api/document?collection=analytical-materials&id=urn:contentItem:51BR-S6G0-00CW-G0C5-00000-00&context=) [*Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004);*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:4BFM-T0F0-004C-001J-00000-00&context=) Frank H. Easterbrook, The Limits of ***Antitrust***, [*63 Tex. L. Rev. 1, 15-16 (1984).*](https://advance.lexis.com/api/document?collection=analytical-materials&id=urn:contentItem:3S41-3WC0-00CV-63SR-00000-00&context=)

n26 *Id.*

n27 John Kwoka, Mergers, Merger Control, and Remedies, A Retrospective Analysis of U.S. Policy, 2015.

For all of these reasons, I respectfully dissent. **[\*32382]**

**Dissenting Statement of Commissioner Joshua D. Wright**

*In the Matter of Reynolds American Inc. and Lorillard Inc.*

The Commission has voted to issue a Complaint and Decision & Order against Reynolds American Inc. ("Reynolds") to remedy the allegedly anticompetitive effects of Reynolds' proposed acquisition of Lorillard Inc. ("Lorillard"). I respectfully dissent because the evidence is insufficient to provide reason to believe the three-way transaction between Reynolds, Lorillard, and Imperial Tobacco Group, plc ("Imperial") will substantially lessen ***competition*** for combustible cigarettes sold in the United States. In particular, I believe the Commission has not met its burden to show that an order is required to remedy any ***competitive*** harm arising from the original three-way transaction. This is because the Imperial transaction is both highly likely to occur and is sufficient to extinguish any ***competitive*** concerns arising from Reynolds' proposed acquisition of Lorillard. This combination of facts necessarily implies the Commission should close the investigation of the three-way transaction before it and allow the parties to complete the proposed three-way transaction without imposing an order.

In July 2014, Reynolds, Lorillard, and Imperial struck a deal where, as the Commission states, "Reynolds will own Lorillard's Newport brand and Imperial will own three former Reynolds' brands, Winston, Kool and Salem, as well as Lorillard's Maverick and e-cigarette Blu brands, and Lorillard's corporate infrastructure and manufacturing facility." n1 Thus, this deal came to us as a three-way transaction. As a matter of principle, when the Commission is presented with a three (or more) way transaction, an order is unnecessary if the transaction--taken as a whole--does not give reason to believe ***competition*** will be substantially lessened. The fact that a component of a multi-part transaction is likely anticompetitive when analyzed in isolation does not imply that the transaction when examined as a whole is also likely to substantially lessen ***competition***.

n1 *See* Statement of the Federal Trade Commission 1, Reynolds American Inc., FTC File No. 141-0168 (May 26, 2015).

When presented with a three-way transaction, the Commission should begin with the following question: If the three-way deal is completed, is there reason to believe ***competition*** will be substantially lessened? If there is reason to believe the three-way deal will substantially lessen ***competition***, then the Commission should pursue the appropriate remedy, either through litigation or a consent decree. If the deal examined as a whole *does not* substantially lessen ***competition***, the default approach should be to close the investigation. An exception to the default approach, and a corresponding remedy, may be appropriate if there is substantial evidence that the three-way deal will not be completed as proposed. In such a case, the Commission must ask: What is the likelihood of only a portion of the deal being completed while the other portion, which is responsible for ameliorating the ***competitive*** concerns, is not completed? In this case, this second inquiry amounts to an assessment of the likelihood that Reynolds' proposed acquisition of Lorillard would be completed but the Imperial transaction would not be.

I agree with the Commission majority that the first question should be answered in the negative because the proposed transfer of brands to Imperial makes it unlikely that there will be a substantial lessening of ***competition*** from either unilateral or coordinated effects. n2 I also agree with the Commission majority that if Reynolds and Lorillard were attempting a transaction without the involvement of Imperial, the acquisition would likely substantially lessen ***competition***. n3 Thus, taken as a whole, I do not find the three-way transaction to be in violation of Section 7 of the Clayton Act.

n2 Statement of the Federal Trade Commission, *supra* note 1, at 3.

n3 Statement of the Federal Trade Commission, *supra* note 1, at 1. While I agree with the Commission's ultimate conclusion that Reynolds' proposed acquisition of Lorillard would substantially lessen ***competition***, I do not agree with the Commission's reasoning. In particular, I do not believe the assertion that higher concentration resulting from the transaction renders coordinated effects likely. Specifically, I have no reason to believe that the market is vulnerable to coordination or that there is a credible basis to conclude the combination of Reynolds and Lorillard would enhance that vulnerability. For further discussion of why, as a general matter, the Commission should not in my view rely upon increases in concentration to create a presumption of ***competitive*** harm or the likelihood of coordinated effects, see Statement of Commissioner Joshua D. Wright, Holcim Ltd., FTC File No. 141-0129 (May 8, 2015).

The next question to consider is whether there is any evidence that the Imperial portion of the transaction will not be completed absent an order. In theory, if the probability of the Imperial portion of the transaction coming to completion in a manner that ameliorates the ***competitive*** concerns arising from just the Reynolds-Lorillard portion of the transaction were sufficiently low, then one could argue the overall transaction is likely to substantially lessen ***competition***. I have seen no evidence that, absent an order, Reynolds and Lorillard would not complete its transfer of assets and brands to Imperial. While there are no guarantees and the probability that the Imperial portion of the transaction will be completed is something less than 100 percent, I have no reason to believe it is close to or less than 50 percent. n4

n4 I would find a likelihood that the Imperial portion of the transaction would be completed less than 50 percent to be a sufficient basis to challenge the three-way transaction or enter into a consent decree.

I fully accept that a consent and order will increase the likelihood that the Imperial portion of the transaction will be completed. Putting firms under order with threat of contempt tends to have that effect. I also accept the view that a consent and order may mitigate some, but perhaps not all, potential moral hazard issues regarding the transfer of assets and brands from Reynolds-Lorillard to Imperial. Specifically, the concern is that, post-merger, Reynolds-Lorillard would complete the Imperial portion of the transaction but more in form but not in function and artificially raise the cost for Imperial. Higher costs for Imperial, such as undue delays in obtaining critical assets, would certainly materially impact Imperial's ability to ***compete*** effectively. Given this possibility, a consent and order, including the use a monitor, would make such behavior easier to detect, and consequently would provide some deterrence from these potential moral hazard issues.

It is also true, however, that a monitor in numerous other circumstances would make anticompetitive behavior easier to detect and consequently deter that behavior from occurring in the first place. Based upon this reasoning, the Commission could try as a prophylactic effort to impose a monitor in all oligopoly markets in the United States. This would no doubt detect (and deter) much price fixing. Such a broad effort would be unprecedented, and of course, plainly unlawful. The Commission's authority to impose a remedy in any context depends upon its finding a law violation. Here, because the parties originally presented the three-way transaction to ameliorate ***competitive*** concerns about a Reynolds-Lorillard-only deal, and they did so successfully, there is no reason to believe the three-way transaction will substantially lessen ***competition***; therefore, there is no legal wrongdoing to remedy.

The Commission understandably would like to hold the parties to a **[\*32383]** consent order that requires them to make the deal along with a handful of other changes. But that is not our role. There is no legal authority for the proposition that the Commission can prophylactically impose remedies without an underlying violation of the ***antitrust*** laws. And there is no legal authority to support the view that the Commission can isolate selected components of a three-way transaction to find such a violation. In the absence of such authority, the appropriate course is to evaluate the three-way transaction presented to the agency as a whole. Because I conclude, as apparently does the Commission, that the three-way transaction does not substantially lessen ***competition***, there is no ***competitive*** harm to correct and any remedy is unnecessary and unwarranted. n5 Entering into consents is appropriate only when the transaction at issue--in this case the three-way transaction--is likely to substantially lessen ***competition***. This one does not.

n5 The Commission points to the HSR Act as providing the legal basis for the FTC to enter into consent orders "to ensure that any ***competitive*** issues with a proposed transaction are addressed effectively." Statement of the Federal Trade Commission, *supra* note 1, at 4 n.7. When a proposed transaction or set of transactions would not substantially lessen ***competition***, as is the case with the three way transaction originally proposed here, there are no ***competitive*** issues with the proposed transaction to be addressed, and the belief that a consent order may even further mitigate concerns regarding the transfer of assets is not material to our analysis under the Clayton Act. The HSR Act is not in conflict with the Clayton Act and does not change this result.

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**Dates**

**DATES:** Comments must be received on or before June 25, 2015.

**Contacts**

**ADDRESSES:** Interested parties may file a comment at online or on paper, by following the instructions in the Request for Comment part of the **SUPPLEMENTARY INFORMATION** section below. Write "Reynolds American Inc. and Lorillard Inc.--Consent Agreement; File 141-0168" on your comment and file your comment online at [*https://ftcpublic.commentworks.com/ftc/reynoldslorillardconsent*](https://ftcpublic.commentworks.com/ftc/reynoldslorillardconsent) by following the instructions on the web-based form. If you prefer to file your comment on paper, write "Reynolds American Inc. and Lorillard Inc.--Consent Agreement; File 141-0168" on your comment and on the envelope, and mail your comment to the following address: Federal Trade Commission, Office of the Secretary, 600 Pennsylvania Avenue NW., Suite CC-5610 (Annex D), Washington, DC 20580, or deliver your comment to the following address: Federal Trade Commission, Office of the Secretary, Constitution Center, 400 7th Street SW., 5th Floor, Suite 5610 (Annex D), Washington, DC 20024.

**FOR FURTHER INFORMATION CONTACT:** Robert Tovsky, Bureau of ***Competition***, (202-326-2634), 600 Pennsylvania Avenue NW., Washington, DC 20580.

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