Statement of the Federal Trade Commission
In the Matter of Reynolds American, Inc. and Lorillard Inc.
File No. 141-0168
May 26, 2015

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").[1] The settlement will allow the acquisition to move forward, subject to large divestitures by the parties to another major competitor in the tobacco industry.

The merging parties chose to present this acquisition to the Commission with a proposed divestiture aimed solely at securing our approval of the acquisition.[2] 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.

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 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

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[1] This statement reflects the views of Chairwoman Ramirez, Commissioner Ohlhausen, and Commissioner McSweeny.
[2] The only transaction before the Commission for purposes of Hart-Scott-Rodino review was the Reynolds-Lorillard transaction.

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.[3]

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.[4] 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.

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.[5] 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.

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

[3] 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.

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

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

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.[6] 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.

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.

[6] Dissenting Statement of Commissioner Julie Brill at 6-7.

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.[7]

[7] 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.