

COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No: LM262Jan18

In the matter between:

British American Tobacco Holdings South Africa (Pty) Ltd

Primary Acquiring Firm

and

Twisp (Pty) Ltd

Primary Target Firm

Panel	: AW Wessels (Presiding member)
	: Enver Daniels (Tribunal panel member)
	: Prof Imraan Valodia (Tribunal panel member)
Heard on	: 5 and 6 August 2019
Last submission received on	: 8 August 2019
Order Issued on	: 13 August 2019
Reasons Issued on	: 13 February 2020

REASONS FOR DECISION

Introduction

- [1] On 13 August 2019, the Competition Tribunal (“Tribunal”) conditionally approved a transaction in terms of which British American Tobacco Holdings South Africa (Pty) Ltd (“BAT Holdings SA”) will acquire sole control of Twisp (Pty) Ltd (“Twisp”).
- [2] Our reasons for conditionally approving the proposed transaction follow.

Parties to the proposed transaction

Primary Acquiring Group

- [3] The primary acquiring firm is BAT Holdings SA, a private company incorporated under the laws of the Republic of South Africa. BAT Holdings SA is a wholly owned subsidiary of British American Tobacco Holdings (South Africa) BV (Netherlands) and is ultimately controlled by British American Tobacco PLC (“BAT”). BAT is a public company listed on the London Stock Exchange with a secondary listing on the Johannesburg Securities Exchange. It is not controlled by any single firm.
- [4] BAT Holdings SA controls the South African operating company of BAT, British American Tobacco South Africa (Pty) Ltd (“BATSA”). BATSA is a manufacturer of cigarettes and markets more than 20 cigarette brands in South Africa through marketing and distribution centres across the country.
- [5] BAT is an international cigarette manufacturer and supplier that supplies over 200 cigarette brands worldwide. In addition to traditional cigarettes BAT also produces and supplies other tobacco products including fine cut tobacco, snus and cigars.
- [6] Of relevance to the competition assessment of the proposed transaction is that BAT, outside of South Africa, also supplies products referred to in the industry as Potentially Reduced Risk Products (“PRRPs”) or Reduced Risk Products (“RRPs”).¹ We shall hereafter refer to these products as RRP.
- [7] The industry defines RRP as products that present, are likely to present, or have the potential to present less risk of harm to smokers than traditional cigarettes and include vaping and so-called heat-not-burn (“HNB”) tobacco products (“HNBs”). HNB products do not burn tobacco, but rather heat such to a temperature at which an aerosol is emitted as opposed to smoke.

¹ BAT also referred to these products as Next Generation Products (“NGPs”).

- [8] We pause momentarily to note that the abovementioned nomenclatures are those adopted by players in the tobacco industry and the Tribunal expresses no view on whether or not the products referred to as RRP's do in fact present a reduced risk profile when compared to conventional cigarettes.
- [9] We note that BAT does not currently supply any RRP's in South Africa but supplies vaping products including e-cigarettes² *inter alia* under the brand name *Vype*, as well as tobacco heating products such as *Glo* outside of South Africa.

Primary Target Firm

- [10] The primary target firm is Twisp, a private company incorporated under the laws of the Republic of South Africa. Twisp is controlled by the trustees for the time being of a trust registered in the Republic of South Africa.
- [11] Twisp supplies of a range of vaping products including various bespoke e-cigarette devices, flavours and accessories. In addition, Twisp sells device replacement parts such as batteries, cylinders, mouthpieces and coils, as well as accessories such as protective cases, power banks and travel chargers.
- [12] Twisp procures the hardware for the e-cigarette devices from international manufacturers who work with Twisp's design team to tailor the devices to its specifications. The flavours are created by Twisp's in-house flavour specialists and are produced by a third party on Twisp's behalf.
- [13] Twisp sells its products in South Africa through its own branded kiosks (in shopping malls across the country), through traditional retail outlets such as grocery retailers, service stations and certain pharmacies, as well as through online platforms.

² E-cigarettes are battery powered devices that typically heat a coil housed in an atomiser which transforms the liquid (referred to as flavour) into vapour. The liquid usually consists of nicotine, propylene, glycol, glycerine and water-soluble flavourings. However, not all liquids contain nicotine. Flavours containing nicotine are optional.

Proposed transaction and rationale

- [14] In terms of the share purchase agreement, BAT Holdings SA will acquire the entire issued share capital of Twisp. On completion of the proposed transaction, BAT Holdings SA will have sole control over Twisp.
- [15] Regarding the rationale for the proposed transaction, the acquiring group submitted that there is substantial growth potential for vaping products in South Africa and that they consider the acquisition of Twisp to be [REDACTED]. They further submitted that the proposed transaction would give rise to [REDACTED] in future and would give the merged business an opportunity to [REDACTED] of its product offerings in South Africa.
- [16] From the seller's perspective the proposed transaction was submitted to present an opportunity for investment realisation. Twisp further submitted that it would gain access to increased economies of scale through the proposed merger, a wider distribution network, global research and development and expertise on safety and quality issues.

Background

- [17] Before we consider the effects of the proposed transaction on competition in South Africa and on the public interest, we highlight certain developments and provide background information to contextualise our ultimate decision of approving the proposed transaction conditionally.
- [18] On 25 July 2018, the Competition Commission ("Commission") referred the matter to the Tribunal recommending that the proposed transaction should be prohibited.
- [19] The Commission's recommended prohibition was primarily based on the Commission's (initial) theory of harm that the proposed transaction would result in the removal of a potential competitor in the supply of e-cigarettes, including

devices, e-liquids and accessories, in South Africa. The Commission said that it had evidence showing that BAT had plans to enter the vaping market in South Africa and compete against Twisp. This was based on *inter alia* discovered strategic documents.

[20] The Commission noted that internationally BAT, through its *Vype* brand, is active in the supply of e-cigarettes. It further found that Twisp is a significant player in the supply of e-cigarettes in South Africa. It concluded that Twisp would likely be BAT's largest competitor in South Africa if BAT launched its brand of e-cigarettes in South Africa as planned pre-merger.

[21] Following the Commission's referral, the Tribunal on 17 August 2018 issued a directive regulating conduct in the matter. The timetable agreed on made provision for *inter alia* the filing of factual and expert witness statements. The matter was set down for a hearing from 15 to 30 April 2019 with closing argument scheduled for 16 May 2019.

[22] The Commission then filed factual witness statements from Mr Ismail Kahn of Gold Leaf Tobacco Corporation (Pty) Ltd ("GLT"), as well as from Mr Hugo Nico of Philip Morris South Africa (Pty) Ltd ("PMSA"). Both these firms made submissions to the Commission during its investigation of the proposed transaction. The merging parties filed their factual witness statements, as well as an expert report.

[23] However, on 29 March 2019, the Commission wrote to the Tribunal indicating that "*having considered discovery made in the above matter and the witness statements filed*" it no longer intended recommending a prohibition of the proposed transaction. It further indicated that it had agreed proposed conditions with the merging parties which addressed its remaining competition and employment-related concerns arising from the proposed transaction.

[24] On 10 April 2019, the Tribunal issued a directive requesting the Commission to file two further submissions by 24 April 2019.

[25] The first submission requested was the Commission's market testing of its proposed behavioural conditions relating to its theory of harm described by it

as “*exclusionary portfolio effects*”. The requested report had to provide details regarding the process undertaken in market testing the proposed conditions, a summary of the responses received from third parties and any remaining concerns, as well as the Commission’s assessment of the third parties’ responses to the proposed conditions.

[26] The second requested submission was a supplementary report by the Commission detailing:

- 26.1 the Commission’s final recommendation after the market testing of the proposed behavioural conditions and, if relevant, any revised conditions;
- 26.2 if the Commission persisted with the recommendation of a conditional approval, an analysis of how the Commission’s final proposed behavioural conditions address the competition concerns identified in its original report;
- 26.3 a motivation for why the proposed employment-related condition addresses the public interest concerns; and
- 26.4 if the Commission was no longer persisting with its theory of harm relating to the removal of a potential competitor in the vaping market(s) in South Africa, a detailed explanation of why it was not persisting with the latter theory of harm.

[27] The Commission filed the abovementioned submissions on 25 April 2019, clarifying that it was no longer pursuing a theory of harm related to the removal of a potential competitor. It said that having considered further discovery made and the factual witness statements filed, as well as the advice of its expert economist, it decided to recommend that the merger should be approved subject to conditions relating to an exclusionary portfolio effects theory of harm.

[28] In short, the Commission in its Supplementary Report concluded that it could not sustain its original theory of harm relating to the removal of a potential competitor since the additional information it now had showed that there were at least five competitors to Twisp in the South African vaping market (including Vape King, Vaperite, Vape Shop, Evolution Vape and Nico-E) that impose a

significant competitive constraint on Twisp. The Commission thus concluded that it was unlikely that the proposed merger would because of unilateral effects relating to the removal of a potential competitor substantially prevent or lessen competition in the vaping market in South Africa. We accept the Commission's decision not to persist with the latter theory of harm and do not deal with that theory any further in these reasons.

[29] On 7 May 2019 given *inter alia* that the Commission changed its recommendation in this matter from a prohibition to a conditional approval, PMSA and GLT brought applications to intervene in the merger proceedings. Both these parties were going to provide representatives to testify as factual witness on behalf of the Commission in the initial prohibition (see paragraph 22 above). The merging parties opposed these intervention applications.

[30] PMSA is a wholly owned [REDACTED] subsidiary of Philip Morris International Inc, a multinational cigarette and tobacco manufacturing company.³ Other than cigarettes PMSA also markets and distributes various other tobacco products including (since May 2017) RRPs through a heat-not-burn device (and related accessories) under the IQOS brand⁴ and consumable tobacco sticks under the HEET brand.⁵

[31] GLT is a cigarette manufacturer and distributor in South Africa. It classifies its products as 'Factory Manufactured Cigarettes' and controls brands such as Voyager, RG, Sahawi and Savannah. As at the time of the proposed merger, GLT was not active in the sale of RRPs in South Africa but indicated that it is a potential competitor in the sale of these products in South Africa in the near future.

[32] The Tribunal heard the intervention applications on 16 May 2019. On 21 May 2019, the Tribunal recognised both PMSA and GLT as participants in the

³ Domestically, PMSA's cigarette portfolio consists of Marlboro and Chesterfield, which it distributes domestically as well as to export markets in the region.

⁴ A reusable smokeless electronic device that heats tobacco units just enough to release nicotine containing vapour without actually burning tobacco.

⁵ Consumable heated tobacco units that contain a processed tobacco plug designed for heating, not for smoking. The tobacco plug is made from tobacco leaves, which are ground and reconstituted into tobacco sheets. These sheets are then crimped and make into a tobacco plug.

merger proceedings before the Tribunal, but with limited scope of participation with regards to the theory of harm advanced.

[33] Both PMSA's and GLT's participation was limited to potential portfolio / conglomerate effects of the proposed transaction and further limited to the following issues:

- 33.1 the incentive and ability of the merged entity to engage in exclusionary conduct at the retail level by:
 - 33.1.1 limiting tobacco-heated products ("THPs") and other potentially reduced risk products suppliers' access to retail shelf space, product visibility and promotional opportunities;
 - 33.1.2 bundling / tying and loyalty / rebate arrangements; and
 - 33.1.3 exclusive agreements or arrangements with retailers, and/or owners or administrators of retail space, in terms of which the latter parties are prevented or disincentivized from selling, or renting retail space for the sale of, any THPs or other RRP's other than those of the merged entity.
- 33.2 any conditions that should be imposed by the Tribunal in order to address the potential portfolio / conglomerate effects of the proposed merger.

[34] One additional issue was included in the scope of GLT's participation and that was any potential increase in barriers to entry as a result of the proposed transaction to the market(s) for the sale of e-cigarettes / RRP's in South Africa.

[35] In terms of further proceedings pursuant to the intervention applications being granted, a timetable was agreed for the conduct of the hearing, with the hearing scheduled from 5 to 8 August 2019 and closing argument on 19 August 2019.

[36] At a further pre-hearing on 01 August 2019, the Tribunal directed that if the merging parties intended on tendering further or revised conditions, such were to be provided to the Tribunal by no later than 2 August 2019. The merging parties submitted a proposed set of conditions.

- [37] On the morning before the start of the hearing, the merging parties' attorneys indicated that PMSA had proposed certain amendments to the merger parties' proposed set of conditions to which the merging parties were amenable. As such, at the commencement of the hearing, the merging parties and PMSA had largely agreed on a proposed set of conditions that addressed PMSA's competition concerns.
- [38] GLT at the hearing submitted that it no longer would argue for an outright prohibition of the proposed merger and made certain enquiries regarding the merging parties' proposed conditions. It indicated that it was aligned with the proposed conditions subject to augmentation as the Tribunal saw fit.
- [39] Given that, ultimately, a set of conditions were largely agreed to between the merging parties and the intervening parties, there is no reason for us to deal in any more detail with the intervention applications. We however note that the intervenors through their submissions and participation in the hearing assisted the Tribunal in gaining a better understanding of the characteristics and competitive dynamics of the relevant product market(s) in a potential exclusionary conduct / foreclosure context, how the proposed transaction potentially could lead to the exclusion of rivals / partial foreclosure in the sale of RRP's in South Africa and what remedies would be required to address the potential competition concerns.
- [40] With the above background, we turn to the assessment of the effects of the proposed transaction on competition with the focus on the tendered behavioural remedies.

Competition Assessment

Industry Overview

Cigarettes

- [41] In relation to the sale of cigarettes in South Africa, legislation restricts how tobacco products are to be packaged, labelled, advertised and marketed. The effect of the legislation is that consumers of cigarettes do not browse through

open self-serving shelves to find their own brand of cigarettes but are required to buy cigarettes from dedicated kiosks or points of sale (“POS”) within a retail store. Distributors / suppliers of cigarette products compete *inter alia* for shelf space in the retailer’s unitary (described in more detail below). In practice, use is made of planograms to indicate the space allocated in the unitary at the retail point of sale.

RRPs (including e-cigarettes)

- [42] In relation to the production of e-cigarettes, we note that there is currently no production of such devices in South Africa. The e-cigarettes suppliers in South Africa source the devices from overseas, specifically Asia (China and Korea) and the United States. The process of manufacturing the device involves the welding of principal components such as batteries, atomizers and cartridges. The design of the device is commissioned by the e-cigarette supplier who will typically work with the manufacturer to design a device which meets the supplier’s specifications, although devices can also be purchased off-the-rack from third party manufacturers. Currently most of the suppliers in South Africa (other than Twisp) do not have their own branded devices.
- [43] Currently there is no sector specific legislative framework that governs the manufacturing, importation, composition, labelling, promotion and sale of e-cigarettes in South Africa. E-cigarettes, because of the absence of regulated ingredients are only subjected to the Consumer Protection Act, 68 of 2008.
- [44] RRP’s are sold in South Africa through various channels. These channels include kiosks in shopping malls, retail outlets such as grocery retailers, service stations and health stores (such as Dis-Chem and Clicks) and online sales. The Commission submitted that online sales in South Africa are currently limited.

Retail outlets’ display of products, unitaries and planograms

- [45] Regarding the displays used in retail outlets, the merging parties submitted that cigarette products are separately displayed in the retail outlets in their own unitaries, while e-cigarette products are normally displayed with other products

such as pipe tobacco and cigars, razors and razor blades, batteries, condoms, lighters, pens and the like.

- [46] Suppliers such as BATSA and PMSA normally provide the retailers with the unitaries used for the sale of the products, subject to terms negotiated with the retailers. Alternatively, retailers can use their own unitary.
- [47] The merging parties submitted that BATSA provides retailers with unitaries used for cigarette products, but it also provides secondary unitaries that can be used for *inter alia* RRP's and associated products.
- [48] Certain of the retail stores' planograms for the unitaries make provision for an accessories bay or shelf. It is usually in the accessories shelf that Twisp's products and products such as IQOS and HEETS are displayed at the point of sale. Where there are no accessory bays, manufacturers have to find alternative solutions in these stores, where possible.
- [49] When a retailer chooses to use one supplier's unitary, the supplier would normally negotiate with the retailer the amount of space it will require to display its products in the unitary. The amount of space allocated to each competitor in the unitary is an important element of the marketing and sale of RRP's. A second important factor is the visibility of the products in the unitary to the end-consumer.
- [50] To contextualise the concerns raised by the intervening parties, we note that they argued that most unitaries in key account stores with which BATSA currently has Primary Trade Investment (PTI) Agreements are installed by BATSA and that this gives BATSA substantial negotiating power as to how products are displayed in the unitary, advertised and promoted on the back wall units and how much space is allocated for accessories and other products, if at all.

Relevant markets, impact on competition and remedies

- [51] The merging parties submitted that there is no horizontal or vertical relationship between the merging parties since cigarettes and e-cigarettes are in separate

relevant product markets and that BAT Holdings SA does not currently supply e-cigarettes in South Africa. As noted above, BAT does however supply RRP's including e-cigarettes outside of South Africa.

[52] The Commission found that BAT Holdings SA is active in the production and supply of cigarettes in South Africa and that Twisp is active in the supply of e-cigarettes in South Africa. It identified two relevant product markets: (i) the supply of cigarettes; and (ii) the supply of e-cigarettes, including devices, e-liquids and accessories. The Commission concluded that both these product markets have a national geographic scope.

[53] We note that during its investigation the Commission received concerns from *inter alia* suppliers of cigarettes, RRP's and the Vape Institute of South Africa. The RRP suppliers raised concerns regarding the proposed transaction's effect on their ability to compete effectively with the merged entity. The concerns included that BAT Holdings SA would use its financial position to post-merger ensure that it obtains preferential placement for its products in retail outlets, which would affect the competing firms since their products in the retail outlets would not be visible to end-customers.

[54] In relation to market concentration, the Commission found that BATSA has a market share of more than 60% in the supply of cigarettes in South Africa. The Commission further noted that there are instances in which BATSA has exclusive arrangements with the organised retail for the supply of BATSA's unitary. In these instances, BATSA stipulates the amount of space that must be allocated to BATSA's cigarette products and this ranges from ■■■% to ■■■%; rival cigarette suppliers get the remaining space.

[55] Given this high market share in the sale of cigarettes, the Commission assessed if post-merger BATSA will be in a position to leverage its existing dominant national market position in the cigarette market into the e-cigarette market and so require, influence or induce retailers such that rival cigarette and e-cigarette suppliers are foreclosed from the market. Put differently, the Commission considered the extent to which the proposed transaction may have exclusionary portfolio effects. The Commission, more specifically, considered

the extent to which post-merger exclusionary effects could arise through three mechanisms: (i) the foreclosure of rival firms by limiting their access to shelf space; (ii) the foreclosure of rival firms through expanding the existing exclusivity arrangements that are in place for tobacco products to include e-cigarettes; and (iii) incentivising or inducing shopping centre landlords not to provide retail space to rival e-cigarette suppliers.

[56] The Commission found that in order for a market participant to enter and / or expand and have a wide presence sufficient to constrain the merged entity in the supply of e-cigarettes in South Africa, it would incur significant costs to establish a retail network and a brand. The Commission further noted certain existing practices of Twisp which it said was aimed at limiting rivals' access to shopping centres, which has the effect of increasing barriers for new entry / expansion in the e-cigarettes market in South Africa. In its Supplementary Report the Commission however concluded that the barriers to entry into the supply of e-cigarettes in South Africa are not insurmountable since a number of players have either entered the market or have expanded (or currently have plans to expand). The Commission further noted that most e-cigarette sales are currently through the e-cigarette supplier's own stores and kiosks.

[57] In relation to e-cigarette sales through the traditional retail, the Commission found that e-cigarettes are currently stocked in the accessories unitary. The Commission said that post-merger BATSA could stipulate the amount of space that is allocated to its own e-cigarette products in the accessories unitary, which may affect the space that is available for rival e-cigarette suppliers.

[58] In relation to retail outlets in which both cigarettes and e-cigarette products are stocked, the Commission however submitted that the scope for the merged entity to make use of shelf space arrangements to foreclose rivals is limited as a consequence of the countervailing power exerted by grocery retailers. The intervening parties however disagreed and argued that BATSA currently uses significant incentive payments to retailers in relation to cigarettes to afford BATSA very high percentages of the available space and also positioning power at the retail points of sale. Post-merger this could potentially be extended to RRP's.

- [59] We cannot accept the Commission's latter argument based on the current evidence. We found no cogent evidence in the record of the alleged countervailing power that the Commission says the grocery retailers have – more specifically, there is no evidence in the record indicating and explaining how these retailers in the past have exercised the alleged countervailing power.
- [60] Furthermore, the Commission's argument ignores the common industry practice whereby cigarette suppliers (and potentially RRP suppliers) provide significant incentives to retailers. One has to question why these incentives are being paid to the retailers. The intervenors directed the Tribunal to examples in the record of current trade incentive agreements that BATSA has with retailers and the Tribunal asked questions about these incentives.
- [61] Also contained in the record were examples of current planograms used by retailers in accordance with which their unitaries are stocked. These planograms tell sellers how to stock the products and allocate space between competitors in the unitary. The intervening parties argued that post-merger BATSA potentially could, *inter alia* through agreements with and incentives provided to the retailers, reserve the majority and most visible areas in the unitary for its own RRPs and relegate the products of competitors to the bottom or in less visible parts of the unit.
- [62] It is further important to note that BATSA currently does not have an incentive to prescribe the use and display of products in the accessories bay or shelf where RRPs are displayed since it is not active in the sale of RRPs in South Africa. The proposed acquisition of Twisp however changes this. Here one also has to bear in mind that BATSA has a dominant position in the sale of cigarettes in South Africa and that it intends to acquire the largest player in the sale of e-cigarettes in South Africa.
- [63] We conclude that the abovementioned industry practice of providing significant incentives to retailers may materially influence the retailers' decisions in relation to the allocation of space to the products of a particular supplier, the positioning

of products within that space and promotional opportunities at the point of sale and ultimately competition between rivals in the market.

- [64] In relation to current agreements of an exclusive nature, the Commission found that BATSA currently has exclusive arrangements in place with certain independent retailers for cigarette sales. The merging parties argued that this exclusivity is necessary to [REDACTED]. The Commission was of the opinion that it was unlikely that such exclusive arrangements will post-merger extend to e-cigarettes since e-cigarettes are mainly sold in higher LSM areas whereas independent retailers are mostly located in lower LSM regions. The Commission was however also of the view that these current exclusivity arrangements, i.e. to exclude all other suppliers of cigarettes, were unnecessary to achieve the merging parties' stated purpose.
- [65] As already mentioned, the Commission further said that Twisp had been inducing shopping mall landlords not to provide retail space to rival e-cigarette suppliers. The Commission concluded that this practice likely limits competition particularly given that Twisp is the largest e-cigarette supplier in South Africa.
- [66] The Commission ultimately was concerned that the exclusionary conduct of BATSA and Twisp may become more extensive and entrenched after the proposed merger. It said that rivals' access to shopping malls via kiosks was crucial to ensure localised entry since this is where the localised entrants into the supply of e-cigarettes have been setting up kiosks. The Commission concluded that BATSA may use its strong market position in the sale of cigarettes in South Africa to influence retailers thereby foreclosing smaller players from access to retail space, specifically in relation to access to kiosks in high traffic shopping malls.
- [67] To address its concerns the Commission recommended (as agreed to by the merging parties) that the proposed transaction should be approved subject to the following two conditions:

67.1 in relation to exclusive agreements or arrangements with retailers,⁶ the merger parties shall not enter into exclusive agreements or arrangements with retailers in terms of which the merger parties require retailers not to sell any e-cigarette products other than those of the merger parties; and

67.2 in relation to exclusive agreements or arrangements with owners or administrators of retail spaces,⁷ the merger parties shall not enter into exclusive agreements or arrangements with owners or administrators of retail spaces in terms of which the merger parties require such owners or administrators not to rent retail spaces for the sale of any e-cigarette products other than those of the merger parties.

[68] We note that the Commission in its recommended conditions did not define e-cigarette products.

[69] Certain industry players, in particular PMSA and GLT, indicated that they were not satisfied with the Commission's proposed conditions arguing that the conditions would not address the post-merger competition concerns.

[70] On 8 April 2019, PMSA in a letter to the Tribunal indicated that its key concern from a competition perspective remains in that BAT is the dominant player in the cigarette market in South Africa and is acquiring the largest player in the e-cigarette business. PMSA, in essence, submitted that as a consequence of the proposed acquisition, there is a substantial risk that BAT will leverage its dominant position in the cigarette market in South Africa and its post-merger substantial presence in e-cigarettes, to limit competition by rival firms in the sale of RRP's.

[71] PMSA further submitted that the Commission's (narrow) market delineation was problematic from a post-merger potential exclusionary conduct /

⁶ "Retailers" were defined as "national grocery or liquor chains, pharmacies, convenience stores, service station forecourts, speciality tobacconists and specialist e-cigarette kiosks or stores not owned by or operating under any of the Merger Parties' brands".

⁷ "Retail Spaces" were defined as "any space within a shopping mall, strip mall, non-duty free airport shopping area or other shopping centre which can be rented for a kiosk or shop to sell e-cigarette products in South Africa".

foreclosure perspective since the Commission only considered e-cigarettes and not all RRPs. PMSA said that to prevent BAT from concluding exclusive agreements in respect of e-cigarettes as suggested by the Commission, would not address the competition concerns relating to potential exclusive agreements or inducements that may impact other RRP suppliers. PMSA submitted that e-cigarettes and its IQOS product are both RRPs as is BAT'S heat-not-burn product, GLO, which is available in countries other than South Africa. It further submitted that it is reliant on access to the same retail outlets for the sale of its [REDACTED] in South Africa as those from which BAT's e-cigarettes would be sold post-merger.

[72] We have already dealt with the intervention applications of PMSA and GLT following the Commission's ultimate recommendation of a conditional approval (see paragraphs 29 to 34 above). In short, both intervening parties indicated that the Commission's (limited) proposed conditions did not address their competition concerns in relation to portfolio / conglomerate effects. We next briefly summarise the competition concerns as articulated by the intervening parties at the hearing and their further submissions.

[73] PMSA's competition concerns related to potential conglomerate / portfolio effects resulting from the proposed transaction given that BAT is the dominant player in the traditional cigarette market in South Africa, whilst Twisp is a highly significant brand within the RRP sector. Its theory of harm related to the ability of the post-merger entity to leverage the power in each area to foreclose competitors from the sale of RRPs in South Africa. PMSA further submitted that the key channel for the sale of its relevant RRP products is the [REDACTED], in particular [REDACTED] and the like, as well as [REDACTED] such as [REDACTED] and the like. It argued that the promotion and visibility of the relevant products in those channels are particularly important and that the promotional power at the retail point of sale is significant.

[74] PMSA furthermore submitted that BATSA pays the traditional retailers in South Africa very large incentives allegedly to afford it control of a very significant proportion of the space that is allocated for the sale of cigarettes in the particular

outlets. It argued that the retailers could post-merger be incentivised by the merged entity to allow BATSA to control the available space for the sale of RRPs in relation to a number of aspects, (i) space allocation, in particular the volume / percentage of space; (ii) the positioning of the products, in particular the visibility of the products; and (iii) promotional opportunities at the point of sale. PMSA said that a range of behavioural conditions had to be imposed on the merged entity to *inter alia* constrain the reach of incentives that it could give to the retailers.

[75] GLT emphasised that its interest in the matter was as a potential new entrant in the sale of RRPs in South Africa. From that perspective it made common cause with the competition concerns raised by PMSA. It furthermore made submissions on certain aspects of the proposed conditions and specifically requested the Tribunal to give consideration, in a potential foreclosure / exclusionary conduct context, to the issue of the post-merger “relative placement” of RRPs in the retail stores.

[76] However, as indicated, prior to the commencement of the hearing, the merging parties and PMSA reached agreement on a revised, enhanced set of behavioural conditions that in principle addressed PMSA’s concerns. At the hearing PMSA confirmed that in the event that the agreed conditions were accepted by the Tribunal, it would not oppose the approval of the proposed merger. GLT stated that it in principle also agreed with the tendered conditions but raised certain questions regarding the substance of some of the conditions.

[77] In relation to the Commission’s abovementioned (limited) recommended conditions (see paragraph 67), we conclude that those conditions alone would not have been effective in a potential post-merger foreclosure / exclusionary conduct context since it did not consider all characteristics and the complex dynamics of the relevant markets. First, the Commission’s recommended conditions were limited to e-cigarette products only and did consider potential post-merger effects on the broader range of RRP products. Second, the Commission’s recommended conditions did not consider the variety of factors / dynamics that could affect competition from a foreclosure / exclusionary effects perspective, including issues such as potential post-merger financial

incentives to exclude or restrict competitors in the sale of RRP in South Africa, access by competitors to and the allocation of visible shelf space at the retail points of sale, displays, promotional opportunities and the like at the retail points of sale, as well as potential post-merger links between the supply of cigarettes and RRP.

[78] However, as we have indicated, the merging parties were responsive to the competition concerns raised by the intervening parties and the Tribunal and tendered a revised and enhanced set conditions.

[79] The Tribunal made further enhancements to the merging parties' tendered conditions *inter alia* by adding a definition for "Visible Space" to allow for and assist with enforcement of the conditions. The Tribunal further added the condition that the merger parties shall not require or incentivise retailers⁸ not to exercise their own discretion in the allocation of visible space for RRP⁹ to the merger parties and/or suppliers of RRP other than the merger parties (see paragraph 80.4 below).

[80] We ultimately approved the proposed transaction subject to the following set of behavioural conditions that would apply for a period of five years from the implementation date of the proposed transaction:

80.1 First, the Merger Parties shall not enter into agreements or arrangements with Retailers in terms of which the Merger Parties require Retailers not to sell any RRP products other than those of the Merger Parties, or incentivise Retailers on condition that they not sell any RRP products other than those of the Merger Parties.

80.2 Second, the Merger Parties shall not enter into agreements or arrangements with owners or administrators of Retail Spaces in terms of which the Merger Parties require such owners or administrators not

⁸ "Retailers" mean grocery or liquor chains, pharmacies, convenience stores, service station forecourts, speciality tobacconists and specialist RRP kiosks or stores not owned by or operating under any of the Merger Parties' brands.

⁹ "RRP" means a product that presents, is likely to present, or has the potential to present less risk of harm to smokers than traditional cigarettes and includes vaping and heat-not-burn tobacco products.

to rent Retail Spaces for the sale of any RRP products other than those of the Merger Parties, or incentivise such owners or administrators on condition that they not rent Retail Spaces for the sale of any RRP products other than those of the Merger Parties.

80.3 Third, the Merger Parties shall not enter into agreements or arrangements with Retailers in terms of which the Merger Parties require Retailers to allocate to the Merger Parties more than 70% of the Visible Space allocated to RRPs, or incentivise Retailers on condition that they allocate to the Merger Parties more than 70% of the Visible Space allocated to RRPs.

80.4 Fourth, the Merger Parties shall not –

80.4.1 require Retailers to prohibit manufacturers or suppliers of RRPs other than the Merger Parties from selling, displaying and/or promoting their RRPs or from being allocated shelf space for their RRPs, or incentivise Retailers on condition that they so prohibit;

80.4.2 require or incentivise Retailers not to exercise their own discretion in the allocation of Visible Space for RRPs to the Merger Parties and/or suppliers of RRPs other than the Merger Parties;

80.4.3 require Retailers to prohibit manufacturers or suppliers of RRPs other than the Merger Parties from bidding for or acquiring Slots, or incentivise Retailers on condition that they so prohibit;

80.4.4 require Retailers to prohibit manufacturers or suppliers of RRPs other than the Merger Parties from displaying communication, promotional, marketing or advertising material in relation to their RRPs, or incentivise Retailers on condition that they so prohibit;

80.4.5 require Retailers to purchase RRPs manufactured or supplied by the Merger Parties where those arrangements are linked

to volumes of the Merger Parties' traditional cigarettes purchased and/or sold by Retailers;

80.4.6 enter into any arrangements with Retailers relating to the supply of traditional cigarettes manufactured or supplied by the Merger Parties that are linked to any arrangements relating to the supply of RRP's manufactured or supplied by the Merger Parties; and

80.4.7 require Retailers to prohibit or discourage employees from providing assistance and/or information to customers relating to RRP's manufactured or supplied by firms other than the Merger Parties, or incentivise Retailers on condition that they so prohibit or discourage.

[81] We are satisfied that the above set of conditions, that will be applicable for a five-year period, adequately address and are proportional to the competition concerns that could result from the proposed transaction.

Public interest

[82] From a public interest perspective, the Commission identified a concern relating to employment. We only deal with this employment issue in these reasons.

[83] The merging parties submitted that the proposed merger will not have an effect on employment.

[84] During its investigation the Commission contacted the Food and Allied Workers Union (FAWU), representing employees working at BATSA's factory. FAWU raised no concerns regarding the proposed transaction. The Commission also contacted the employee representative at BATSA and again no concerns were raised. The Commission however received a concern from an employee of BATSA's Sales Division indicating that BATSA has commenced a retrenchment process in terms of section 189 of the Labour Relations Act, 66 of 1995. The employee indicated that the retrenchments were in relation to BATSA's sales representatives nationally and that ■■■ employees are likely to be retrenched.

- [85] The Commission said that it had not been informed of any retrenchment processes by the merging parties and it therefore requested the merging parties to verify this information. The merging parties then confirmed that BATSA had commenced a retrenchment process and submitted that the rationale for the proposed retrenchments was BATSA's need to review its sales model following a decline in sales volumes in the past four years. The merging parties submitted that they [REDACTED].
- [86] The Commission was concerned that the retrenchments may likely be as a result of the proposed transaction given that all of Twisp's sales representatives would post-merger form part of BATSA. It therefore requested BATSA to demonstrate whether a rational process had been followed in arriving at the decision to retrench employees.
- [87] According to the Commission, the merging parties did not provide a response to its questions but submitted that BATSA had decided to withdraw the section 189 process and that it would no longer proceed with the retrenchments. BATSA indicated that its reasons for withdrawing the retrenchment process include positive signs of the economy recovering and indications from Government to deal with the sale of illicit cigarettes.
- [88] The Commission however remained concerned about the risk of post-merger retrenchments since BATSA had planned to retrench approximately [REDACTED] and will as a result of the proposed transaction be acquiring Twisp's employees including its sales representatives.
- [89] In light of the above and the fact that the Commission was not able to determine whether the planned retrenchments were as a result of the proposed transaction and if so, whether BATSA had followed a rational process in determining the number of employees to be retrenched, it concluded that a moratorium on employment was required to prevent any potential retrenchments that may arise as a result of the proposed transaction. It therefore recommended a moratorium on merger-related retrenchments for a period of two years. The merging parties agreed to this condition.

- [90] We approved the proposed transaction subject to the condition that the merging parties shall not retrench any employees in contemplation of the proposed merger or as a result of the proposed merger for a period of two years from its implementation date.¹⁰ We note that the term “employees” includes employees under fixed term contracts of varying lengths who perform a specific role at the merging parties.

Conclusion

- [91] We conclude that the imposed conditions adequately address the potential competition and public interest concerns arising from the proposed transaction. The full set of conditions is attached hereto marked as **Annexure A**.

A W Wessels

13 February 2020

Date

Enver Daniels and Prof. Imraan Valodia concurring

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¹⁰ For the avoidance of doubt, retrenchments do not include (i) voluntary retrenchment and/or voluntary separation arrangements; (ii) voluntary early retirement packages; (iii) unreasonable refusals to be redeployed in accordance with the provisions of the Labour Relations Act 66 of 1995; (iv) resignations or retirements in the ordinary course of business; and (v) lawful and fair terminations in the ordinary course of business, including but not limited to, dismissals as a result of poor performance.