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COMMERCE COMMISSION

Decision No. 552

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

FORTUNE BRANDS, INC

and

PERNOD RICARD S.A.

The Commission: P Rebstock
D Bates
P Taylor
G Pickering

Summary of Application: The acquisition by Fortune Brands, Inc. of certain brands and assets from Pernod Ricard S.A.

Determination: Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.

Date of Determination: 8 July 2005

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EXECUTIVE SUMMARY

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 13 June 2005 (the Notice). The Notice sought clearance for the acquisition by Fortune Brands, Inc., or one or more of its majority-owned subsidiaries, to acquire certain assets and shares from Pernod Ricard S.A. (Pernod) or one or more of Pernod's subsidiaries.
2. The Commission considers that the relevant market for analysis is:
   - the national market for the importation or production of bourbon for distribution (the bourbon market).
3. The Commission considers that the relevant counterfactual is that Pernod has been granted clearance to acquire the brands that are subject to this determination from Allied, and that those brands will remain with Pernod at least in the short term.
4. The Commission considers that in the factual scenario Fortune will acquire all legal and equitable rights to the assets and brands that are the subject of this application, and that Fortune and Pernod are deemed to be associated for a period of six months following the transaction.
5. The Commission is of the view that the degree of existing competition in the factual scenario compared to the counterfactual, given the minimal aggregation that results from the acquisition, is sufficient to prevent a substantial lessening of competition in the bourbon market post-acquisition.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 13 June 2005. The Notice sought clearance for the acquisition by Fortune Brands, Inc., or one or more of its majority-owned subsidiaries, to acquire certain assets and shares from Pernod Ricard S.A. (Pernod) or one or more of Pernod's subsidiaries. A list of the assets and shares to be acquired is contained in Appendix 1. This acquisition is conditional upon Pernod acquiring 100% of the share capital of Allied Domecq plc (Allied).

2. [ ]

PROCEDURE

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 8 July 2005.

4. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.

5. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Merger and Acquisition Guidelines.[1]

STATUTORY FRAMEWORK

6. Under s 66 of the Act, the Commission may grant a clearance for an acquisition where it is satisfied that the proposed acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in a market. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

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[1] Commerce Commission, *Mergers and Acquisition Guidelines*, January 2004.

[2] Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission (1992) 4 TCLR 713-722.

7. The Commission considers that it is necessary to identify a real lessening of competition that is not minimal.[3] Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis, the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and able to be sustained for a period of at least two years.

ANALYTICAL FRAMEWORK

9. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
   - with the acquisition in question (the factual); and
   - in the absence of the acquisition (the counterfactual).

10. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual scenarios, in terms of:
    - existing competition;
    - potential competition; and
    - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Key Parties

Fortune Brands Inc (Fortune)

11. Fortune is a publically traded corporation on the New York Stock Exchange, with no single stockholder holding more than 5% of the shares.

12. Fortune is a consumer products holding company with subsidiaries engaged in the manufacture, production and sale of home and hardware products, spirits and wine, golf and office products.

[3] See Fisher & Paykel Limited v Commerce Commission (1996) 2 NZLR 731, 758 and also Port Nelson Limited v Commerce Commission (1996) 3 NZLR 554.

Pernod Ricard S.A (Pernod)

13. Pernod is a publicly listed French company which produces and distributes wine and spirits. Pernod's primary wine brands in New Zealand include Jacob's Creek, Wyndham Estate and Framinghams.
14. Pernod's spirit brands include Ricard, Pernod, Chivas Regal Scotch whisky, Jameson's Irish whiskey and Seagrams gin.
15. Pernod's New Zealand subsidiaries include the Framingham Wine Company Limited, Tylers Stream Wine Company Limited and the Red Hill Wine Company Limited.

Other Parties

Allied Domecq plc (Allied)

16. Allied is a publicly listed English company that produces and distributes wine and spirits. Allied's wine business in New Zealand is operated by its subsidiary, Allied Domecq Wines (NZ) Limited. Allied's spirits portfolio is presently distributed in New Zealand by Lion Nathan Wines and Spirits Limited.
17. Allied's primary brands in wine include Montana, Corbans, Church Road and Chasseur, while its spirits brands include Teachers Scotch whisky, Beefeater gin, Seagers gin, and the Tia Maria and Kahlua liqueurs.
18. Allied also produces and distributes a range of sparkling wines including Lindauer, Aquila, Chardon and Italiano.

Glengarry Hancocks Limited (Glengarry)

19. Glengarry imports, distributes and retails wine and spirits in New Zealand. Its importation and distribution business operates under the 'Hancocks' name and accounts for [ ] of its turnover. It also has 13 'Glengarry' retail outlets in Auckland and Wellington. Glengarry distribute the Brown Forman brands, including Jack Daniels in New Zealand.

Independent Liquor (NZ) Limited (Independent)

20. Independent is a privately owned and operated producer of alcoholic beverages established in 1987. Independent have a range of wine, beer and ready to drink brands which are consumed domestically and exported worldwide.

INDUSTRY BACKGROUND

21. Information on the spirits and wine industries is covered in Decision 553. The comments and observations recorded in that Decision are relevant to the consideration of this application.

PREVIOUS COMMISSION DECISIONS

22. The Commission has previously considered the spirits industry in Decision 306[4]. In that case the Commission defined four markets for the supply to licensed distributors within New Zealand of whisky, gin, vodka and tequila.

[4] Decision 306, *Guiness PLC / Grand Metropolitan PLC*, 8 September 1997.

23. In Decision 306 the Commission determined that the acquisition would not lead to the acquisition or strengthening of a dominant position due to the degree of existing competition in those markets.

24. The Commission has also granted clearance to the acquisition of Allied by Pernod[5], upon which the proposed acquisition in this case is reliant. In that decision the only spirit market considered was the national market for the importation or production of gin. The Commission cleared that application on the basis that the degree of existing competition in the gin market was sufficient to prevent a substantial lessening of competition in the factual scenario compared to the counterfactual scenario.

MARKET DEFINITION

25. The Act defines a market as:

    "… a market in New Zealand for goods or services as well as other goods or services that as a matter of fact and commercial common sense, are substitutable for them."[6]

26. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

27. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.

28. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.

29. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

30. The Applicant has submitted that the relevant markets are, at their narrowest, those for the supply of whiskey, gin, tequila, brandy, ready-to-drink spirit mixes, fortified wine, and liqueurs to licensed distributors in New Zealand.

31. Despite the acquisition involving brands in all of those categories listed in the preceding paragraph, no aggregation occurs in respect of any types of liquor other than whiskey. Accordingly, the Commission is of the view that, for the purposes

[5] Decision 553, *Pernod Ricard S.A ./ Allied Domecq plc*, 13 July 2005.
[6] s 3(1) of the Commerce Act 1986.

of the analysis it appropriate to take a narrow view and limit the analysis to whiskey only.

Whiskey

32. In Decision 306 the Commission adopted a distinct product market for each of whiskey, gin, vodka and tequila. As discussed, the Commission considers that the only relevant market in this case is the whiskey market. Further, the salient question is whether an aggregated whiskey market is appropriate or whether it should be broken into separate markets based on different types of whiskey.

33. Industry participants were mixed in their views as to the appropriate product market for whiskey. Many expressed that the degree of substitution will vary according to the age and demographic of the consumer and also a number of other factors.

34. Some industry participants considered that consumers of Scotch whisky would not consider a switch to bourbon or Irish whiskey even if a ssnip was applied to the price of Scotch whisky. These participants expressed that the whiskey market was generally viewed as consisting of three distinct variants being Scotch, American whiskey (or 'bourbon') and 'others' such as Irish.

35. Conversely some industry participants informed the Commission that it is not appropriate to define narrow markets with the variants of whiskey forming part of a broad whiskey market.

36. From a supply perspective the variations of whiskey are different in terms of where they are produced (for instance a Scotch whisky must be produced in Scotland). The method of manufacture is also different. Scotch whisky is made from barley and permeated with peat smoke, whereas bourbon is made from corn.

37. Based on these considerations the Commission considers that it is difficult to define the market precisely. However, as aggregation only occurs in respect of bourbon as a result of this acquisition, the Commission considers it appropriate to adopt a conservative approach and define narrow markets.

38. The European Commission has also considered whether whiskey should be further segmented into categories such as Scotch and bourbon, concluding that such segmentation was justified and appropriate based on taste, price and industry views.[7]

39. As Fortune currently only have bourbon products, no aggregation will occur in respect of Scotch whisky or other whiskey. Accordingly the Scotch whisky and other whiskey markets will not be considered further.[8]

Conclusion on Product Markets

40. The Commission concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product market is the market for bourbon.

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[7] European Commission decision of 15 October 1997 in Case No. IV/M.938 – *Guiness/Grand Metropolitan*, and decision of 8 May 2001 in Case No. IV/M.2268 – *Pernod Ricard/Diageo/Seagram Spirits*.

[8] The Commission has included Canadian Club brand whiskey within the market for American whiskey. It was considered by industry participants as essentially an American whiskey rather than forming part of the other whiskey market.

Functional Markets

41. For the reasons outlined in Decision 553 the Commission is of the view that it is appropriate to define the functional markets as that for the importation or production for distribution.

Geographic Markets

42. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

43. For the reasons outlined in Decision 553 the Commission is of the view that it is appropriate to define the market as being national in extent.

Conclusion on Market Definition

44. The Commission concludes that the relevant market is:

    - the national market for the importation or production of bourbon for distribution (the bourbon market).

COUNTERFACTUAL AND FACTUAL

45. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a "with" and "without" comparison rather than a "before" and "after" comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).[9] The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

46. As the proposed acquisition is contingent on the brands being first acquired from Allied by Pernod, the Commission considers that for the purposes of the analysis, it is appropriate to assume that the Pernod/Allied transaction will occur. The Commission has granted clearance to the first acquisition by Pernod in Decision 553.

47. Accordingly, the Commission considers that it is appropriate to assume that Pernod has full legal and equitable rights in the brands subject to this transaction in the counterfactual and in the factual for the purposes of being able to sell them.

48. The Allied brands and businesses that will be acquired by Fortune Brands pursuant to the Framework Agreement (the 'FB Brands' and the 'FB Businesses', respectively) are as follows:

    FB Brands:

    - Teachers (Scotch whisky);
    - Laphroaig (Scotch whisky);
    - DYC (Spanish whisky);
    - Canadian Club (Canadian whisky);
    - Maker's Mark (US whiskey);

[9] Commerce Commission, *Decision 410: Ruapehu Alpine Lifts/Turoa Ski Resorts Ltd (in receivership), 14 November 2000*, paragraph 240, p 44.

- Sauza (Tequila);
- Courvoisier (Cognac);
- Centenario (Other brandy);
- Fundador (Other brandy);
- Jacobi (Other brandy);
- Castellana (Aniseed);
- Kuemmerling (Bitter);
- Cockburn (fortified wine/port);
- Harvey's (fortified wine/sherry);
- Clos du Bois (still wine);
- Callaway (still wine) (expressly conditional on Pernod being able to procure all or substantially all of the property and assets relating to the Callaway brand including, in particular, the extensive intellectual property existing in relation to this brand); and
- Other US still wines.

FB Businesses:

- Distribution businesses of members of the Allied Domecq group located in Germany, Spain and the UK comprising the distribution of spirits and/or wines finished goods (and including associated administrative services, supporting sales, local and trade marketing, logistics and back office support).

49. The Applicant, submitted that in respect of the assets and brands to be acquired, that none of them are sold in any significant quantity in New Zealand and that the businesses have no operation in New Zealand.

50. [ ]

51. [ ]

52. The Applicants have suggested that the manner in which the transaction is structured gives rise to the possibility that Fortune Brands and Goal Acquisitions could be regarded as associated persons for the purposes of s 47 of the Commerce Act. The Commission recognises that if Goal Acquisitions and Fortune Brands were considered to be associated, the duration of their association would be limited to the transitional period before full ownership rights were transferred to Fortune Brands.

53. The Commission considers that it is appropriate to assess whether clearance should be given to the transaction assuming (for the purposes of analysis) that the transaction does result in Fortune Brands and Goal Acquisitions being associated during the period after issuance of the tracker shares and B shares to Fortune and prior to transfer of the Fortune Assets to Fortune. If the proposed acquisition can be cleared on the basis that Fortune Brands and Goal Acquisitions are associated, then it would also be cleared if the Commission concluded they were not associated. If the Commission is unable to clear the proposed acquisition on the basis of the companies being assumed to be associated, it will be necessary to review the arguments and evidence in relation to the issue of association and determine whether the relationship is such that one party is able to exert a substantial degree of influence over the activities of the other.

54. Accordingly, the Commission considers that in the factual scenario Fortune will acquire all legal and equitable rights to the assets and brands that are the subject of this application as set out in paragraph 49. The acquisition will not reduce the number of competitors in the bourbon market, but will result in changed market shares of certain existing competitors. Further, the Commission will assume for the purposes of the analysis that Pernod and Fortune are associated persons in the factual for the reasons outlined above.

Counterfactual

55. [ ]

56. [ ]

57. Accordingly, the Commission will assume that the appropriate counterfactual in this case is the status quo with Pernod retaining the brands, at least in the short term.

58. The Commission considers that the status quo is a conservative approach from a competition perspective as it is assumes that the acquisition of Allied by Pernod has proceeded.

COMPETITION ANALYSIS

Existing Competition

59. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

60. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a

market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

61. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
    - the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of 40% share; or
    - the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

62. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

The Bourbon Market

63. The major competitors in the bourbon market include Fortune, Glengarry, Independent Liquor and Pernod.

64. The Applicant submitted estimated data based on 2004 volume figures collected by the International Wines and Spirits Record Limited (IWSR). Industry participants were unclear on the total size of the bourbon market because industry surveys, such as those conducted by the IWSR and the Distilled Spirits Association, are incomplete because several key competitors do not contribute.

65. The Commission surveyed various industry participants to provide an estimate of the size of the bourbon market based on their own sales data and industry experience. All industry participants stated that volume data was the most appropriate measurement of market share in this market. Based on these estimates, the Commission has estimated the bourbon market to be approximately 175,000 nine litre equivalent (9le) cases.

66. Table 1 indicates the estimated market shares for the importation or production of bourbon in the factual. Table 2 indicates the estimated market shares for the importation or production of bourbon in the counterfactual.

Table 1: Estimated Market Shares in the Bourbon Market in the factual

Manufacturer	Brands	Volume (9le) 2004	Market share
Fortune	Jim Beam, Old Crow, Knobs Creek	[ ]	[ ]
FB Brands (assets being acquired from Pernod)	Marker's Mark, Canadian Club	[ ]	[ ]
Pernod (other)	Wild Turkey	[ ]	[ ]

Associated Entities		*[ ]*	*[ ]*
Glengarry (Brown Forman brands)	Jack Daniels, Early Times	[ ]	[ ]
Independent	Woodstock	[ ]	[ ]
Fosters/Southcorp	Cougar	[ ]	[ ]
Other		[ ]	[ ]
Total		**[ ]**	**100**

Source: Supplied by industry participants.

Table 2: Estimated Market Shares in the Bourbon Market in the counterfactual

Manufacturer	Brands	Volume (9le) 2004	Market share
Fortune	Jim Beam, Old Crow, Knobs Creek	[ ]	[ ]
Pernod	Wild Turkey, Marker's Mark, Canadian Club	[ ]	[ ]
Other		[ ]	[ ]
Total		**[ ]**	**100**

Source: Supplied by industry participants.

67. As discussed, in the factual analysis Pernod and Fortune are considered to be associated persons in the factual for a period of 6 months. As illustrated in the table, the associated entity would hold [ ] of the market.

68. In the counterfactual (illustrated in Table 2) Fortune will continue to have a market share of [ ] whilst Pernod will hold [ ] of the market.

69. The Commission is of the view that the association with Pernod in the factual has very little impact on competition given that the aggregation is minimal, the association is temporary, and strong competition exists in the market from Glengarry and Independent Liquor.

70. Industry participants did not express any concern regarding the proposed acquisition or the impact on the bourbon market. It was expressed that the Maker's Mark and Canadian Club brands have very little market penetration compared with Fortune's portfolio and that the acquisition would not effect the current level of competition.

71. Accordingly, given the minimal aggregation that would occur as a result of the proposed acquisition, and the degree of existing competition in the market, the Commission is satisfied that there is unlikely to be a substantial lessening of competition in this market as a result of the acquisition.

OVERALL CONCLUSION

72. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in:

- the national market for the importation or production of bourbon for distribution (the bourbon market).

73. The Commission considers that the relevant counterfactual is that Pernod has been granted clearance to acquire the brands that are subject to this determination from Allied and that those brands will remain with Pernod at least in the short term.

74. The Commission considers that in the factual scenario Fortune will acquire all legal and equitable rights to the assets and brands that are the subject of this Application and that Fortune and Pernod are deemed to be associated for a period of six months following the transaction.

75. The Commission is of the view that the degree of existing competition in the factual scenario compared to the counterfactual, given the minimal aggregation that results from the acquisition, is sufficient to prevent a substantial lessening of competition in the bourbon market post-acquisition.

DETERMINATION ON NOTICE SEEKING CLEARANCE

76. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Fortune Brands, Inc. of the brands and assets described in paragraph 49 from Pernod Ricard S.A.

Dated this 8th day of July 2005

Paula Rebstock
Chair
Commerce Commission

APPENDIX 1

ASSETS AND SHARES TO BE ACQUIRED

The acquisition relates to:

1. The assets associated with the following brands (which are to be acquired either by direct acquisition of the assets themselves or of shares in the companies owning the assets):

Spirits:	***Wines:***
Whisk(e)y Teachers (Scotch whisky) Laphroaig (Scotch whisky) DYC (Spanish whisky) Canadian Club (Canadian Whisky) Maker's Mark (US whiskey) Tequila Sauza Brandy Courvoisier (Cognac) Centenario Fundador Jacobi Aniseed Castellana Bitters Kuemmerling	Fortified wines Harvey's (sherry) Cockburn's (port) Still wines (US) Buena Vista (US still wine) Clos du Bois (US still wine) Atlas Peak (US still wine) Callaway (US still wine) William Hill (US still wine) Jerry Garcia (US still wine) Gary Farrell (US still wine) Haywood Estate (US still wine) Jakes Fault (US still wine)

2. The distribution assets of Allied Domecq plc, as acquired by Pernod Ricard S.A., in:

   - the United Kingdom
   - Spain (except wine distribution)
   - Germany; and
   - for United States wine

   (which are to are to be acquired either by direct acquisition of the assets themselves or of shares in the companies owning the assets); and

3. [

]