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The logo for Ashurst, consisting of the word "ashurst" in a lowercase, bold, sans-serif font.

Dear Sir

**Consultation on divestiture remedies**

Further to Paul Geroski's letter to Nigel Parr of 21 June, we are writing to set out our comments on the Competition Commission's consultation on the "Application of Divestiture Remedies in Merger Inquiries".

We have no objection to these comments being made public in whole or in part.

**General comments**

As a general comment, the description of the process of arriving at a divestment remedy (particularly where it takes the form of an undertaking) does not acknowledge that the process essentially involves a negotiation between the CC and the parties. In many places the paper reads as if it is invariably for the CC to take the initiative in deciding the scope and terms of a divestment. Experience suggests that this is not invariably the case: indeed the CC's General Advice (see paragraph 6.25) and Guidelines on Merger References (see paragraph 4.46) both expressly refer to the process of negotiation with the parties. For example, it will seldom be the case that there is a single divestment package that would meet the competition concerns – there will typically be a range of packages which would be proportionate and acceptable to the CC. It is usually for the parties to propose a package to the CC from within this range which is commercially acceptable to them and it is then for the CC to decide whether the proposal is acceptable from the perspective of remedying the competition concerns.

As a further general observation, the paper is not very clear in identifying precisely which issues (and what level of detail) will be decided at each stage of the process. The CC's General Advice states that "*The report will contain sufficient detail on remedies to provide a firm basis for implementation by the Commission through negotiating undertakings and/or imposing orders*" (see paragraph 6.25). We consider that it is in the interests of all concerned to retain a flexible approach so that the detail of any required divestment is negotiated subsequent to the announcement of the CC's headline decision. We do not, for example, consider that it would be appropriate or necessary in the majority of cases for the CC to identify the precise terms of the divestment package or reach a conclusion on the appropriate time frame for the divestment in its report. Generally there would seem to be no need for the mechanics of the divestment to be decided at the pre-report stage. The EC Merger Regulation process is not comparable in this respect as it is necessary under EC procedural rules for the detailed undertakings to have been

finalised and signed before the European Commission can take its decision. We would urge the CC to take full advantage of the opportunity which UK procedure offers to negotiate the detail of undertakings outside the often time-pressured timeframe for the headline decision as to whether to clear or prohibit the merger (as was the case under the Fair Trading Act 1973).

Finally as regards general points, it would be useful to include guidance on the extent to which, and the points at which, the CC will invite third party consultation – "market testing" – of the various elements of proposed divestment requirements.

### **Specific comments in relation to various paragraphs**

**Para 2.1** – Query whether it is correct to say that a divestiture remedy seeks to create a new source of competition. This suggests that competition post merger might be greater than it was pre-merger. Perhaps it would be more accurate to say that divestiture remedies seek to *preserve* competition by ensuring that the competing businesses which have merged or which are intended to be merged, remain independent. This may be achieved by divestment of one (or part of one) of the merging businesses to a purchaser not previously present in the market, or to an existing competitor.

**Para 2.7** – the extent to which divestiture remedies in completed mergers are more difficult than their equivalents in relation to anticipated mergers is controllable to some degree by the CC through its powers to impose interim undertakings or orders. These powers are of course intended precisely to prevent "pre-emptive action" which might prejudice the outcome of the inquiry. It would seem appropriate therefore to mention the CC's policy in relation to interim undertakings and orders at this point (it may be that the oblique reference to "protective measures" is aimed at this point).

**Para 3.2** – in assessing the scope of a divestiture package, the CC will need to be particularly vigilant to take a balanced view. The comments of the parties in this regard and the comments of third parties (particularly those with an interest in purchasing the proposed package) may be pulling in different directions.

**Para 3.6** – We have a number of reservations in relation to this part of the paper:

- (a) First, it is not clear that the parties require any "incentivisation" to complete divestment obligations:
  - (i) if the parties have structured the package to be divested in such a way that there is difficulty in identifying a purchaser, then typically this would prevent maximum value being obtained for the sale, which is clearly undesirable;
  - (ii) the parties already face the prospect of the sale being conducted by the divestiture trustee if it is cannot be agreed sufficiently quickly;
  - (iii) the time pressure which divestiture requirements impose in itself risks creating a "fire sale" where the purchaser knows that the vendor is obliged to reach an agreement within a limited time frame and will not be able to walk away from an unattractive deal. Purchasers in these circumstances can – and do – use this factor to negotiate aggressively;
  - (iv) the fact that the "crown jewels" alternative exists will presumably be included in the published version of the undertakings, so a potential purchaser will know that if it drags its feet over negotiations for the initial divestment package there may be a much better prize in prospect. Any "incentive" which the parties may have to expedite the sale of the initial divestment package may be countered by the corresponding incentive which the prospect of obtaining the "crown jewels" gives the purchaser to proceed slowly; and

- (v) finally, in our experience, the parties to a merger are usually concerned to finish the regulatory clearance process as quickly as possible because of the uncertainty and disruption which it creates in the day-to-day running of a business at both management and employee levels.

Taking all of these factors into account, it is not at all clear that any incentive of the type suggested in this part of the consultation paper is required or that it would be effective. On the other hand, there is a significant risk that the obligation to give a "crown jewels" alternative would materially distort the commercial sale process. A divestment remedy is not required to have any element of punishment or deterrent to it, so it would arguably raise questions of proportionality and fairness to structure a divestment package in such a way that it created material prejudice to the parties seeking to achieve the required divestment.

- (b) Secondly, the single paragraph describing the "crown jewels" package does not reflect the extent to which the CC's powers in relation to remedies are strictly circumscribed by the Enterprise Act 2002. We consider that there is a similar critical linkage between, on the one hand, the CC's findings of fact as regards the substantial lessening of competition and any adverse effects arising out of it and, on the other hand, the power to impose remedies, as existed under the Fair Trading Act 1973 and was highlighted in **R v Secretary of State for Trade and Industry, ex parte Thomson Holidays** [2000] UKCLR 189. We consider that it therefore remains essential that the CC should tailor remedies precisely to correspond to the findings of fact which lead to the finding of an anti-competitive outcome. There is, moreover, the requirement that remedies should be proportional, as the CC itself emphasises in its Guidelines on Merger References, at paragraph 4.9. Neither of these points are reflected in the paragraph concerning "crown jewels" divestiture packages.

Consider, for example, a merger where the purchaser is a manufacturing business active in market A, in which it has one old factory. The target is also active in market A, where it has one new factory and also in market B, where it also has a new factory. The CC decides that the merger will have an anti-competitive outcome in market A and requires the purchaser to sell one of the factories. The purchaser decides to keep the factories which it has acquired from the target, and undertakes to sell its own old factory. The CC requires, as a "crown jewels" alternative, that it will have to sell the target's new market A factory if it is unable to sell the old factory in sufficient time. Clearly, in this case, the "crown jewels" alternative still addresses the substantial lessening of competition which the CC identified. However, if the CC were to require that the "crown jewels" alternative should comprise the target's new market B factory, this would clearly be ultra vires and disproportionate since the finding of an anti-competitive outcome has nothing to do with market B at all.

This example may appear extreme, but there is nothing in the consultation paper to confirm that it is not what is envisaged, and given that the purpose of any guidelines is to clarify and enlighten, this would appear to be a material omission.

- (c) Thirdly, the wording of the final sentence of paragraph 3.6 indicates that the CC appears to envisage that the "crown jewels" assets would be supplemental and not alternative to the initial divestment package. This would seem to raise serious questions of proportionality. If the initial bundle of assets is not sufficient to attract a purchaser then arguably that package is inadequate in itself. If, on the other hand, the "crown jewels" are not strictly needed because the initial divestment package comprises a full and complete remedy to the substantial lessening of competition then it is not clear that the CC has the power to require the supplemental "crown jewels" assets to be sold in any case. It is suggested that it is not for the CC to decide what must be sold: the CC is not in a comparable position to a vendor negotiating the scope of assets to be sold in order to attract a purchaser and secure a good price.
- (d) Fourthly, the limited scope of the CC's powers in relation to remedies in light of the case law referred to above would tend to suggest that the possibility of a "crown jewels" alternative being required will, in practice be fairly limited. Again, the paper gives no indication

whether the CC is likely to seek to identify a "crown jewels" package in all cases, some cases or only very rarely. We anticipate that any client faced with the possibility of being asked to commit to sell a "crown jewels" package will resist it strongly, for the reasons described above. As such, it would seem appropriate that the CC should give some sort of guidance as to the types of transactions where this may be necessary and the likelihood that such a demand will be made.

In conclusion there would appear to be serious commercial difficulties and questions of legality surrounding the "crown jewels" proposals which the paper does not currently either acknowledge or seek to address. In the event that this proposal is retained, we suggest that it would require much fuller explanation if the guidance is to be of practical value to business and its advisers – at the moment, the primary impact of paragraph 3.6 is to cause alarm and uncertainty.

**Paras 4.3 and 5.7** – these paragraphs state that the CC will seek to review the divestiture agreement. In the vast majority of cases, where there is likely to be a straightforward sale with no on-going links between the parties, the contents of the sale and purchase agreement will be, for the most part, wholly irrelevant to the assessment of competition issues. However, the sale and purchase agreement is seldom the only relevant document. In many cases the sale of a business will generate a raft of related and ancillary contracts supporting the sale and purchase agreement, and covering issues such as tax, property, site sharing, provision of ancillary and/or essential services, licences of intellectual property rights, due diligence, etc. In many private equity transactions where venture capital funds are involved, the financial arrangements may be very sophisticated with various layers of finance, even if the legal mechanisms of the sale itself are relatively uncomplicated. In such cases, the sale and purchase agreement would be only one element in the structure of the divestment.

It is not currently the practice of either the OFT or the European Commission to review the contractual documents which implement a divestment obligation and we would suggest that a return to an RTPA-style obligation to copy and submit large volumes of documents for the regulators to wade through would be unnecessarily burdensome for all concerned. Moreover, it would lead to inevitable delays. Even where the contractual documentation is not complex, it would seem much more pragmatic and efficient to require the parties to describe in outline the terms of the sale and any financing arrangements or other on-going links with the purchaser. Any such description of the contractual arrangements would of course be subject to the criminal penalties in section 117 of the Enterprise Act 2002 for providing false or misleading information. In any case, the wording of the divestment commitments may well mean that if there were any on-going links between the parties, this would raise questions as to whether the undertakings were being complied with. In our experience, in such circumstances the parties would typically raise the issue with the authorities to obtain confirmation that the proposed plans were acceptable and not considered to breach the undertakings.

**Para 5.2** – we would suggest that this paragraph fails to acknowledge the fact that where a party is obliged to sell a business or bundle of assets, it will want to achieve the best sale price possible. Clearly, this will balance the risk which the paper identifies that there will be "significant incentives" to run down the business to be sold.

**Para 5.5** – in line with the general comments at the start of this letter, we strongly question whether it would be necessary or appropriate to disclose in the CC's report the timescales for divestment, which is an issue for negotiation with the parties once the CC's decision has been announced. As regards confidentiality of the required timeframe, for the reasons explained above in relation to paragraph 3.6, the process of divesting a business following a CC report is often described as a fire sale – the only protection which the parties have in this respect is that the purchaser of the divestment package may not know the deadline by which the sale must be completed. The OFT and European Commission currently acknowledge this point and in our experience do not disclose the required divestment timeframe.

**Para 5.7** – see comments on paragraph 4.3 above.

We trust that these comments are useful. Please do not hesitate to contact Nigel Parr or Catherine Chibnall if you would like to discuss any of them further.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Ashurst', written in a cursive style.

**Ashurst**

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