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Day 1

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Session I – Remedies: The Use of Upfront Buyers in Divestiture Remedies

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Overview (1)

- What do we mean by upfront buyer?
- Fix it first remedies
- CMA guidance for up-front buyers at Phase 1
- CMA guidance for up-front buyers at Phase 2
- Why we use up-front buyers?
- Why we do not use up-front buyers
- Phase 1 vs Phase 2
- Disadvantages of using upfront buyers
- Case Study 1 – *Hain/Orchard* (Phase 1)
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What do we mean by upfront buyer?

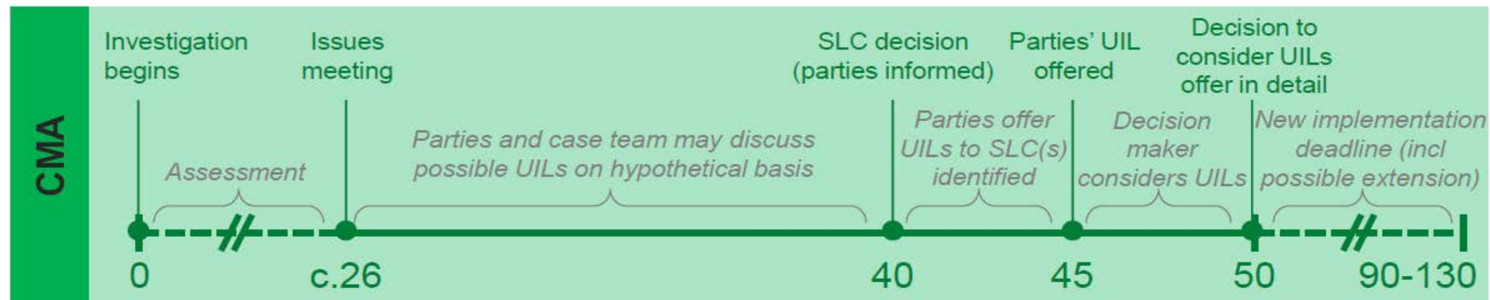
- Used in divestment remedies when an SLC is found.
- An upfront buyer requirement means that the proposed buyer will be required to have committed contractually, subject to formal CMA approval of the undertakings, to acquiring the relevant divestment businesses before the CMA accepts the undertakings. **This means that the CMA will accept undertakings only where a sale to an upfront buyer has been agreed subject only to the condition that the CMA approves the sale, thereby demonstrating that a sale to a suitable buyer is achievable.**
- Upfront buyers may be a requirement when considering divestment remedies at phase 1 or at phase 2.
- The CMA will consult publicly on the suitability of the proposed buyer, as well as any other aspects of the draft undertakings, during the public consultation period (whether at phase 1 or phase 2).

Differences between the UK and EU

- In **form**:
  - In the UK, **no prohibition on closing** so we review a mix of anticipated and competed acquisitions. The procedure is the same – the parties must have a legally binding agreement with an approved purchaser before the CMA will clear the transaction. If the transaction has completed, the parties will be subject to a hold-separate Order until clearance (conditional or otherwise) is given.
  - In the EU the parties **cannot close the main transaction** so if concerns identified and commitments proposed, parties cannot close before they have found a buyer and the Commission has approved it.
- In **substance** – the same approach.
- Up-front buyers vs *fix-it-first*.

CMA's guidance for up-front buyers at Phase 1 (1)

- Timings at phase 1:



- Extensions are allowed in some cases, including when an upfront buyer is involved.
- **Upfront buyers are often used to manage the risks arising from the fact that, once it has accepted UILs, the CMA loses its duty (and ability) to refer the merger to Phase 2.**

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CMA's guidance for up-front buyers at Phase 1 (2)

- The CMA will normally seek an upfront buyer where the divestiture package is not an existing standalone business and/or where the risk profile of the remedy requires it. For example where the **CMA has reasonable doubts with regard to the ongoing viability of the divestment package and/or there is only a small number of suitable candidate purchasers.**
- If parties consider that an upfront buyer is not required in their case, they should include reasons for this when making their UIL offer.
- In their UIL offer parties may identify a proposed buyer for any divestiture package or may make their UIL offer on the basis that any divestiture would be to an upfront buyer.
- The time period given to parties is likely to be a matter of weeks, rather than months, given the statutory deadline by which UILs must be finally accepted. Consequently, parties are advised to give early consideration to the possible need for, and identity of, an upfront buyer.

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CMA's guidance for up-front buyers at Phase 1 (3)

"Where the CC [CMA] **is in doubt as to the viability or attractiveness to purchasers of a proposed divestiture package (ie composition risk) or believes there may be only a limited pool of suitable purchasers (ie purchaser risk),** it may require the merger parties to obtain a suitable purchaser that is contractually committed to the transaction before permitting a proposed merger to proceed or a completed merger to progress with integration."

Mergers Guidance on the CMAs Jurisdictions and Procedures (CMA2)

"Where the [CMA] considers that the competitive capability of the divestiture package may deteriorate pending the divestiture (ie asset risk) or completion of the divestiture may be prolonged, it may also require that the up-front buyer completes the acquisition before the merger may proceed or, in the case of a completed merger, before the merger parties may progress with integration."

Merger Remedies: Competition Commission Guidelines (CC8)

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Why we use up-front buyers? (1)

- Whether at phase 1 or phase 2 the general principle for the use of upfront buyers is the same; to mitigate risk.
- This may be due to:
  - **Composition risk**
  - **Purchaser risk**
  - **Asset risk and timing incentives**
- The first two are about how confident we are that a suitable buyer will be found for the package as proposed
- The last is about whether an upfront buyer will sharpen or dampen the incentives to achieve a prompt disposal.

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Why we use up-front buyers? (2)

- Merging parties will have incentives to offer a weak divestment package so that the buyer is a weak competitor. This could make it more difficult to find a buyer in the first place, or that a buyer is a weak competitive constraint.
- The upfront buyer condition ensures that the CMA can ensure and approve the purchaser.
- The nature of the assets being divested (particularly if it is not a stand-alone business), irregularity of these assets being traded, scale required or complexity of the transaction, could all result in it being difficult to find a purchaser.

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Why we use up-front buyers? (3)

- The upfront buyer condition places the risk on the merging parties to incentivise them to find a suitable buyer.
- This is particularly useful when consent of a third party is required at phase 1, as we cannot compel the third party to do anything.
- Critically, we may be concerned about the difficulty in finding a buyer that we deem an effective competitor.

When we do not use up-front buyers

- If the assets proposed for divestment are **not regularly traded** then there might not be a readily identifiable market.
- However, some assets/businesses are traded often and we may be confident there is a waiting pool of potential buyers.
- For example if a petrol station needs to be divested, we know that these are regularly traded and therefore we can be confident that there will be a buyer if the price is right.

Phase 1 vs Phase 2

- In general upfront buyers are more commonly used in phase 1 than in phase 2.
  - In phase 1, UILs are given voluntarily by the parties and accepting UILs we lose our ability to refer to phase 2.
  - In phase 2, we are sometimes compelling parties to make a disposal against their will and we have the ability to compel the sale through a divestiture trustee.

Phase 1 vs Phase 2

- Requiring an up-front buyer at phase 1 helps create strong incentives on parties to progress quickly and proactively – ie we don't accept the UILs until they have shown that they have found a purchaser.
- Lastly, with a completed merger and a full divestiture, requiring an 'up front buyer' doesn't increase the impact on the parties.

Disadvantages of using upfront buyers (1)

- Extra burden on the merging parties
- Requires the parties to contact many potential buyers and in a short time frame (usually they need to (at least start) to identify potential purchasers before they know that there is even an SLC finding).
- At phase 1, risk that time runs out before a buyer is found, forcing a referral to phase 2.

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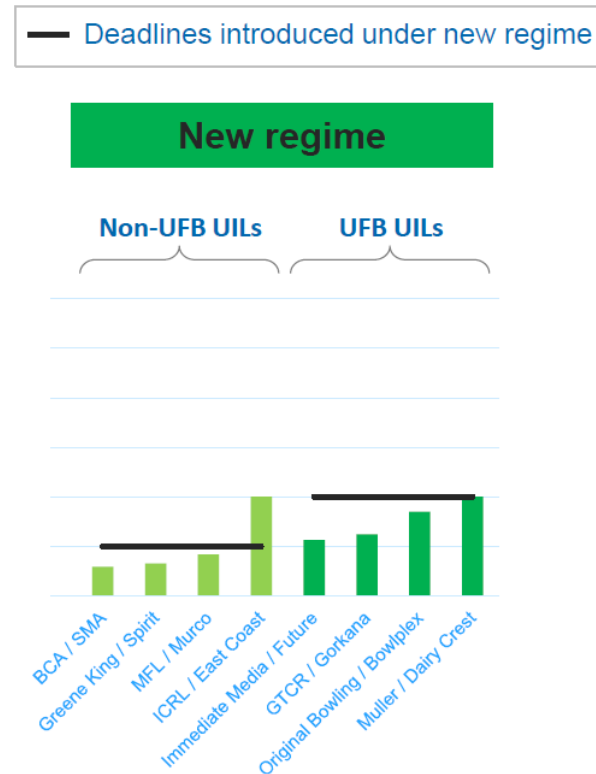
Disadvantages of using upfront buyers (2)

- An order under section 75 of the Act could be used instead if Parties fail to find a suitable buyer without an upfront buyer requirement but this is an additional administrative burden on the CMA.
- Timings – cases requiring upfront buyers have taken slightly longer on average (although difficult to say if this is due to the upfront buyer requirement)

Disadvantages of using upfront buyers (3)



Case Study 1 – *Hain/Orchard* (Fruit juice)

- Hain and Orchard both produced & supplied prepared fruit and fruit juice. There were very limited competitors in the supply of freshly squeezed fruit juice.
- Competition concerns were found in the supply of own label freshly squeezed juice to retail customers (a merger to monopoly) and food service customers (where there was only one other competitor).
- There was also a concern that other companies supplying similar products were not interested in entering the freshly squeezed market. Furthermore any suitable buyer needed credibility/ good customer relationships with retail customers.

Why an up-front buyer?

- The CMA decided that the divestment business being sold should be a **complete business**, and that an upfront buyer was necessary because there were only a **small number of suitable candidate purchasers**.
- The Parties' proposed divestment was the sale of the acquirers business at their manufacturing plant including manufacturing assets, key staff, know-how and customer contracts, as a going concern.
- In this case the upfront buyer requirement was sensible given that only one buyer was eventually put forward. The CMA accepted the UILs.

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Case Study 2 – *Acadia/Priory* (Mental health hospitals)

- Acadia Healthcare Company and Priory Group overlapped in the supply of a number of inpatient and outpatient mental healthcare services to the UK's national health service.
- The CMA identified over 20 local areas across 5 mental healthcare services where there could be a competition problem as a result of those responsible for commissioning the service in each area having a reduced choice of providers.
- The services were acute services, children's and adolescent mental health services, psychiatric intensive care units, rehabilitation services and secure mental health services.
- Acadia initially offered undertakings to address the CMA's concerns by offering to sell a total of 19 hospitals in the affected areas to an up-front buyer, to be approved by the CMA.

Why an up-front buyer?

- Complex market.
- Complex customer relationships – the NHS.
- Inter-dependencies between hospitals – the need for a national referral network.
- A need to ensure that all competition concerns were remedied – not just the profitable areas.

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Case Study 3 – *Immediate Media/Future* (Magazines)

- Merger between two print magazine publishers. The publishers overlapped in a number of different magazines. Competition concerns were identified in relation to Needlecraft where there was no effective competition (market shares of 90-100%) and in Genealogy (combined market share 55 – 65%) where there was only one other competitor title and no constrain from the internet.
- During the UILs process at phase 1, the Parties proposed divestment resulted in Immediate Media selling all magazine titles and associated websites in the needlecraft and genealogy markets that it purchased from Future.
- In addition to these magazine titles, Immediate Media's offer included employees and additional assets, such as intellectual property rights and subscriber and advertiser databases that Immediate Media believed should be included to ensure that the business / businesses being sold were viable.

Why an up-front buyer?

- Typically magazines are easy to sell and regularly traded, so would not normally involve an upfront buyer. However, the CMA's guidance states that '*the CMA will normally seek an upfront buyer where the divestiture package is not an existing standalone business*'.
- Immediate Media's proposed divestment packages were not standalone businesses with the ability to produce and distribute print magazines. The CMA anticipated that the buyer would likely need to be an existing publisher, which reduced the number of possible buyers for the divestment business / businesses.
- The Parties found an upfront buyer (Dennis) and the CMA accepted the UILs.

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Case Study 4 – *Ladbrokes/Coral* (Betting shops)

- A merger between two of the three biggest bookmakers in the UK. This merger was fast-tracked to phase 2 for an in-depth investigation and involved the analysis of over 1000 local overlaps between the Parties' betting offices.
- The phase 2 team found 642 problematic overlaps/SLCs.
- The CMA found that a divestiture remedy was the most effective way of dealing with these SLCs.

Why an up-front buyer?

- There were two main concerns with the effectiveness of a divestiture option.
  - The risk of failure – the complexity of finding a purchaser or purchasers which can be effective at remedying an SLC in all of the 642 local areas could be difficult.
  - The need for scale (the nature of the LBO market is such that sufficient scale would be required to represent an effective competitor to the Parties).
- These risks were such that the transaction should not be cleared until both Parties had identified suitable purchasers and entered into a binding sale. If an upfront buyer was not found in time, then the merger would be prohibited.

Trends towards using up-front buyers

- The CMA has increasingly relied upon up-front buyers in phase 1 and phase 2.
- This in part reflects the CMA's willingness to accept increasingly complex UILs at phase 1.
- It also reflects the scale of some of the divestitures and the need to ensure that the up-front buyer can compete both on a local basis and a national basis (where relevant).
- However, **non up-front buyer** cases do still happen!

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Case Study 5 – European Commission example

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Questions?

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