

Non-confidential version

THEATRE GROUP

**RESPONSE TO PROVISIONAL DECISION ON REMEDIES AND PROVISIONAL FINDINGS
RELATING TO THE PRIVATE HEALTHCARE MARKET INVESTIGATION**

6 February 2014

Simmons & Simmons

CONTENTS

Section	Page Number
Executive Summary	3
Introduction	5
The Financial Impact of the Remedies Requiring Freehold Disposals from the Theatre Group is Disproportionate	11
The CC's Market Investigation Lacks Due Process and Has Been Procedurally Unfair to the Theatre Group	16
The Structure of the Remedies	20
Annex 1 – The CC's AEC Findings	21
Annex 2.1 – ██████████ Annex 2.2 – List of Potential Leasehold and Freehold Divestments	23

Competition Commission (“CC”) Private Healthcare Market Investigation
Theatre Group Response to CC Provisional Remedies Decision

Executive Summary

- (A) The Theatre Group challenges both the lack of proportionality and the procedural unfairness inherent in the CC’s provisional remedies decision (the “**Decision**”) which is materially unfair to the Theatre Group.
- (B) The Theatre Group, as acknowledged by the CC, is economically separate and under separate control from BMI OpCo and will be seriously and adversely affected by the CC’s Decision. The CC has failed to take account of this fact in its processes and analysis.
- (C) The Theatre Group is a property owning group only. The CC has not found an AEC resulting from its property ownership.
- (D) The proposed remedies endanger the successful completion of the current debt restructuring being undertaken by Theatre Group and, at the very least, are likely to extend an already long and complex process, with the additional cost and uncertainties involved
- (E) In the context of the Theatre Group, proportionality and due process are particularly important, given: (1) the scale of the detriment to the Theatre Group; and (2) the remoteness of any AEC identified by the CC from the Theatre Group and from any market considered by the CC.

Lack of Proportionality

- (F) The CC’s proposed remedies, in so far as they impact the Theatre Group, are disproportionate in at least two ways:
- First, given the significant impact of the proposed divestments on the Theatre Group, **any** such proposal is likely to be disproportionate in respect of the Theatre Group. In particular, the mandatory sale of its freehold interests in up to four hospitals will have a material adverse impact on the Theatre Group and its lenders; potentially [REDACTED]. The CC has not taken account of this in its consideration of proportionality. Were it to be taken properly into account, the CC’s numerical analysis of proportionality would show that the proposed divestment by the Theatre Group of its freehold interests is disproportionate.

- Second, and in addition, the CC's consideration of the mandatory sale of freehold interests is fundamentally flawed; it has failed to consider whether there are any less onerous ways to achieve its objective.

Procedural Unfairness

- (G) The CC's process has been materially unfair in material ways. As a result the CC has not complied with its duty under s.169 Enterprise Act 2002.
- (H) Key elements of the logic by which the CC has provisionally concluded that it is necessary to require the divestment by the Theatre Group of its freehold interests are, so far as the Theatre Group can tell, absent from the CC's Decision.
- (I) The CC has failed to give any consideration to the impact of the proposed remedies on the Theatre Group. This includes the impact of both the requirement that the Theatre Group disposes of its freehold interests and the broader impact of the divestment remedy on the quality of BMI OpCo's covenant as the Theatre Group's largest tenant.
- (J) The CC has withheld potentially material facts from the Theatre Group and this failure has left the Theatre Group with insufficient information for the Theatre Group to be able to understand and comment on the key reasons for the CC's conclusion that freehold disposals are required. The CC has acted unfairly in overly redacting material from its published findings, so that the Theatre Group cannot see the 'gist' of what others have told the CC.
- (K) The CC has consulted others, whose commercial interests potentially conflict with those of the Theatre Group, but not the Theatre Group. In particular, the CC has acknowledged that the Theatre Group has the large majority of the economic value in the businesses to be disposed of.¹ [REDACTED]
[REDACTED]
[REDACTED].
- (L) The CC's remedies are aimed at AECs which are based on historic, not current facts. BMI OpCo's rents have been irrevocably externalised from the Mixer / BMI OpCo group. Furthermore, the CC's conclusions on BMI OpCo's capital employed appear based on a second best valuation approach, rather than industry best practice.

¹ Paragraph 2.138 of the Decision.

Competition Commission (“CC”) Private Healthcare Market Investigation
Theatre Group Response to CC Provisional Remedies Decision & Provisional Findings

1. **Introduction**

- 1.1 This is the response of the Theatre Group to the Competition Commission’s (“CC”) Provisional Remedies Decision (the “**Decision**”), as notified to the Theatre Group from 16 January 2014 onwards.²
- 1.2 This submission is as extensive as the Theatre Group can provide. However, it remains necessarily incomplete, given the paucity of information available to it in the heavily redacted Decision as regards the CC’s reasoning and the grounds for requiring the divestment of freehold properties by the Theatre Group. The Theatre Group notes that the CC has only recently attempted to mitigate this situation but that disclosure was inadequate and at the margin.³ As a result, a significant amount of information apparently relevant to the Theatre Group remains unavailable to the Theatre Group (whilst being made available to others, including BMI OpCo). The CC is duty bound to provide the Theatre Group with the ‘gist’ of the case against the Theatre Group, which the CC has failed to do. As a result, the Theatre Group has been unable to understand the ‘gist’ of the case being made by the CC.⁴
- 1.3 However, even on the limited information available, it is clear that:

² The Theatre Group notes that the CC’s summary document was dated 16 January 2014. However, the Theatre Group only received a heavily redacted, non-confidential version of the full document on 21 January 2014, when it was published on the CC’s website. The Theatre Group understands that the main parties received full, unredacted, confidential versions of the main documents on 15 January 2014 or earlier.

³ The the CC’s letter dated 27 January and its decision of 28 January provided to the Theatre Group limited information redacted from the published Decision. On 31 January 2014 the CC refused a request by the Theatre Group for further redacted information.

⁴ See in particular *Groupe Eurotunnel S.a. v Competition Commission* (SCOP and DFDS as interveners) (Cases 1216/4/8/13 and 1217/4/8/13), judgment dated 4 December 2013, at paragraph 230.

- (A) Given the significant impact of the proposed divestments on the Theatre Group, any such proposal is likely to be disproportionate in respect of the Theatre Group. The proposed remedy which would require the disposal by the Theatre Group of certain of its freehold interests would be disproportionate; and
- (B) There have been significant flaws and omissions in the process and fairness of the CC to the detriment of the Theatre Group in reaching this Decision, which are not now capable of rectification within the statutory timeframe of this inquiry.

1.4 Although this submission is primarily in response to the CC's Decision, the Theatre Group considers that it is essential that it is seen in the context of the Theatre Group's views on the CC's AEC findings. Those views are set out in Annex 1.

Financial & Ownership Structure

- 1.5 The Theatre Group consists of the companies listed in Annex 2.1 of this document and of GHG 38 (Property Holdings) Limited ("**GHG 38**") (together the "**Theatre Group**"⁵). Each member of the Theatre Group, other than GHG 38, owns freehold or superior leasehold interests in the property set out against its name in Annex 2.1, subject to a lease in favour of BMI Healthcare Limited ("**BMI OpCo**"). BMI OpCo is the only tenant of the companies in the Theatre Group and collectively the members of the Theatre Group own 35 of the hospital properties operated by BMI OpCo.⁶ The Theatre Group lets its properties to BMI OpCo pursuant to commercial leases.
- 1.6 The CC has proposed the divestment of up to seven hospitals operated by BMI OpCo; and the divestment of freehold interests in up to four of those hospitals by the Theatre Group. Annex 2.2 identifies the Theatre Group companies which are the subject of divestment remedies.
- 1.7 The equity in each of the Theatre Group companies is currently indirectly owned by General Healthcare Mixer Partnership LLP ("**Mixer**"), which is also the owner of BMI OpCo. However, the economic interest in the Theatre Group is now held by its creditors

⁵ Although this document refers to the Theatre Group, the (worthless) equity in each member of the Theatre Group is ultimately owned by General Healthcare Mixer Partnership LLP. The role of GHG 38 is to act as the agent of each member of the Theatre Group in relation to the lenders to the Theatre Group companies. The composition of the board of directors of each Theatre Group company is the same and references in this document to the Theatre Group are references to each member of the Theatre Group.

⁶ Mixer also owns the Magnolia Group of companies. The Magnolia companies also own hospitals and lease them to BMI OpCo. Theatre Group and Magnolia Group are operated and financed separately. The position of the Magnolia Group is not covered by this document.

rather than its shareholders. Accordingly, the directors of each Theatre Group company owe their duties in the discharge of the office of director to the creditors and not to the shareholders.⁷ As a result, the Theatre Group is now managed independently from BMI OpCo. [REDACTED]

[REDACTED].

- 1.8 References to the financial interests of the Theatre Group are also references to the financial interests of its lenders.
- 1.9 The CC has been on notice since at least [REDACTED] that the Theatre Group has been under separate de facto control from BMI OpCo. This has been acknowledged by the CC.⁸ However, it has made no attempt to address the consequences of that change. Indeed, in the redacted published version of its Decision, there is no mention of the Theatre Group at all.
- 1.10 In its provisional findings, the CC set out its views on the financial position of the Mixer / BMI OpCo group. In doing so, it disregarded the cost to BMI OpCo of its rental payments, on the grounds that these were intra-group costs.⁹ The CC has failed to move away from this decision to apply the “*principle of ‘substance over form,’*” under which it treated Mixer / BMI OpCo’s “*separated operating companies and property companies*” on a “*consolidated*” basis, notwithstanding its recognition of the separate control and economic ownership of the Theatre Group. The CC must instead look to the substance **and** the form by basing its analysis on the now separate interests of BMI OpCo and the Theatre Group. As it stands, the CC’s conclusions are built on historic data, which is no longer current or valid.

The Financial Position of the Theatre Group

- 1.11 The Theatre Group has borrowings directly with a lender group on a basis which is completely separate and distinct from BMI OpCo’s borrowings. The total liabilities of the Theatre Group (including its contingent and prospective liabilities) described below are approximately [REDACTED] as at [REDACTED], which is secured over the entire undertaking of the Theatre Group.

⁷ See Court of Appeal judgment in *West Mercia Safetyware v Dodd* [1988] BCLC 250.

⁸ [REDACTED]

⁹ See in particular paragraph 58, footnote 39, page A6(13)-20.

1.12 The Theatre Group entered into a [REDACTED] facility agreement (the “**Facility Agreement**”) relating to the acquisition of the Theatre Group portfolio of properties. The terms of the security arrangements generally require the Theatre Group to seek the consent of its lenders prior to effecting any disposal of its assets. The outstanding indebtedness of the Theatre Group under the Facility Agreement is currently in excess of [REDACTED], and was due for repayment in full on [REDACTED]. This was temporarily extended until a later date as the Theatre Group was not in a position to repay this indebtedness when it fell due.

1.13 The Theatre Group also entered into hedging arrangements with various banks in relation to the Facility Agreement (the “**Hedge Documents**”). The mark to market liability of the Theatre Group in respect of the swaps under the Hedge Documents is approximately [REDACTED]. This value is affected by a number of factors, including movements in the long term interest rate curves (which vary daily) and the amortisation profile of the notional swap amounts. In the absence of an event crystallising this contingent liability, it could reasonably be expected to reduce over time and as a result of the generally expected increase in interest rates over the next few years. [REDACTED]

[REDACTED]

[REDACTED] Not only would this immediately put the Theatre Group’s finances under significant additional pressure; it would impact on the economic interests of the lenders and hedge counterparties.

1.14 The aggregate market value of the properties owned by the Theatre Group (on an open market RICS basis) at [REDACTED].¹¹ This valuation does not reflect the adverse impact on the value that will result from any weakening of BMI OpCo’s covenant as tenant directly resulting from the remedies proposed by the CC.

1.15 [REDACTED]. The obligations of each member of the Theatre Group are cross-guaranteed, so that the obligations of each group company are obligations of the entire Theatre Group. [REDACTED]

[REDACTED]

10 [REDACTED]

11 Valuations by DTZ and Colliers International.

████████████████████ and the economic interest in the Theatre Group is now held by its creditors rather than its shareholders.

- 1.16 In response to its inability to meet the debt repayment obligations which fell due in ██████████ ██████████ the Theatre Group has been in discussions for more than ██████████ months with its lenders to restructure its debts. As has been made public, the current proposals for this restructuring are based on the willingness of certain lenders to contribute a significant sum of new money, on the condition that there will be no property sales.
- 1.17 The CC's Decision therefore represents a significant additional obstacle to a successful restructuring of the Theatre Group's debts.

Commercial Leases

- 1.18 The only assets of the Theatre Group are its reversionary interests (mostly freehold) in the hospital properties which are let to BMI OpCo and the present interests in the BMI OpCo leases. These leases are fully repairing and insuring leases, and the Theatre Group believes that they are substantially in a form acceptable to UK financial institutions and were at market rental levels at the outset. In summary, the key terms of the leases include the following:
- (A) fixed rent with an annual adjustment;
 - (B) a lease term of ██████████, with an ██████████
██████████;
 - (C) termination rights provided to the Theatre Group (including a charge over certain major equipment installed by BMI OpCo at various hospitals) in certain circumstances such as the insolvency of BMI OpCo or non-payment of rent; and
 - (D) the ability of the Theatre Group to prevent the transfer of the lease by the tenant in certain circumstances, including where it considers the new tenant's covenant to be weaker than the BMI OpCo's covenant was at the outset of the lease.■
- 1.19 As part of the commercial arrangements relating to the leases, the parties entered into a rent deferral agreement whereby the leases were varied so as to defer payment of principal rent in respect of the first period of rent from and including ██████████ up to and including ██████████ due under each lease; a total of some ██████████. The parties

agreed that the relevant deferred rent would be payable by BMI OpCo on demand by the relevant Theatre Group company on the earliest of the following events:

- (A) on or after [REDACTED] to the extent necessary to meet corporation tax liabilities of the relevant Theatre Group company;
- (B) the relevant Theatre Group company exercises its right of re-entry or the lease ends or is determined sooner;
- (C) upon default, sale, assignment, transfer or disposal of the lease; and
- (D) upon sale or transfer or change of control of the relevant Theatre Group company or its immediate holding company.

1.20 All of the assets of the Theatre Group are pledged to its lenders. In certain circumstances, the Theatre Group will need the unanimous consent of lenders before it is able to consent to any assignment of any leases by BMI OpCo. The Theatre Group itself can only withhold its consent to BMI OpCo in certain defined circumstances.

1.21 BMI OpCo and the Theatre Group entered into a Tax and Expenses Indemnity in [REDACTED] under which BMI OpCo agrees, in certain circumstances, to pay certain expenses of the Theatre Group and also to reimburse it for tax payments. In particular, these payables include administrative and other costs incurred in the ordinary course and liabilities for corporation tax and certain other tax liabilities. [REDACTED]

2. The Financial Impact of the Remedy Requiring Freehold Disposals from the Theatre Group is Disproportionate

2.1 The CC's proposed remedies will have a very significant financial impact on the Theatre Group. The Theatre Group is a property investment company only, and the AECs identified by the CC are exclusively in relation to BMI OpCo's operating business. The Decision is silent as regards any AECs involving lessors or freeholders. Any barriers to entry relate to BMI OpCo's operating business rather than the ownership of any land.

2.2 In this context, the Theatre Group further notes that the CC puts considerable emphasis on the guidance of the Competition Appeal Tribunal ("**CAT**") in its judgment in *Tesco v CC* (2009) where the CAT established the 'double proportionality' approach.¹³ Paragraph 139 provides that:

"In this regard it may well be sensible for the Commission to apply a "double proportionality" approach: for example, the more important a particular factor seems likely to be in the overall proportionality assessment, or the more intrusive, uncertain in its effect, or wide-reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be. Ultimately the Commission must do what is necessary to put itself into a position properly to decide the statutory questions. As the Commission itself accepts, this includes examining and taking account of relevant considerations, such as the effectiveness of the remedy, the time period within which it will achieve its aim, and the extent of any adverse effects that may flow from its implementation."

2.3 In accordance with Article 1 / Protocol 1 of the Human Rights Act 1998, the CC needs to exercise the highest degree of caution in depriving a property investor of its contractually obtained property rights. Furthermore, as an 'innocent party' in relation to any apparent adverse effects on competition, when the CC does take account of the impact of the remedies on the Theatre Group, it must also consider and weigh the intrusive and wide ranging nature of remedies imposed and make appropriate and significant adjustments accordingly. The CC has failed to do this.

2.4 The CC's Decision to require the Theatre Group to divest certain of its freehold interests is disproportionate for two main reasons:

¹³ *Tesco v CC* [2009] CAT 6, paragraph 139.

- (A) First, the detriment to the Theatre Group far outweighs any perceived benefit to the consumer; and
- (B) Second, the CC has not examined any remedy (other than divestment) that is less draconian but which serves the purpose of allowing a suitable purchaser to be found for the identified BMI OpCo businesses.

We consider each in turn.

The detriment to the Theatre Group far outweighs any perceived benefit to the consumer

2.5 The financial consequences for the Theatre Group of the disposal of its freehold interests in up to four hospitals are as follows:

- (A) The structure of the remedies package will inevitably lead to freehold disposals at an undervalue, with the Theatre Group's freeholds 'stapled' to the disposal by BMI OpCo of its operating businesses. A large number of private hospitals would all be offered on to the market at the same time with a sale timeline fixed by the CC. The most recent open market valuation of the Theatre Group's interests in the four properties proposed for freehold disposal (as part of the valuation described in paragraph 1.14 above) is [REDACTED]. A sale of those properties on the basis of remedies proposed by the CC would result in a significant discount to this value because:

- (1) It would be known to the market that it was a forced sale;
- (2) There would be an obligation to carry out the sale in a relatively short period;¹⁴ and
- (3) By 'stapling' the freehold interest to the operating interest, the CC will substantially reduce the number of potential purchasers of the freehold interest.

- (B) This financial loss to the Theatre Group will be further increased by the [REDACTED]
[REDACTED]
[REDACTED] Although the CC has recognised that the majority of the economic

¹⁴ The period which the CC proposes to allow the Theatre Group for disposal of its properties is redacted from paragraph 2.91 of the version of the Decision provided to the Theatre Group. The Theatre Group has twice requested that the CC provide it with this information, but the CC has declined to do so. However, it can be readily inferred from the assessment of the various respondents' positions on this point, set out in paragraph 2.90, that the period is intended to be short.

value in the hospitals which are subject to disposal remedies lies with the Theatre Group, [REDACTED]
[REDACTED]
[REDACTED];

(C) The typical transaction costs for the sale of the freeholds would be [REDACTED]. In addition, the sale of any property will require the consent of third parties, which will be time consuming and expensive to obtain. The Theatre Group and its lenders will inevitably incur significant additional costs in the course of obtaining those consents (if they can be obtained) and in order to remove properties from the complex financing structure of the Theatre Group; and

(D) [REDACTED]
[REDACTED]
[REDACTED]

2.6 In total the losses itemised in paragraph 2.5 are potentially [REDACTED] [REDACTED] which have not been taken into account by the CC in its assessment of the proportionality of its proposed divestment remedy.

2.7 There are two further direct and certain financial consequences of these disposals for the Theatre Group, which must be taken into account [REDACTED] [REDACTED]. They are as follows (the range of numbers reflecting the fewest and largest number of freehold disposals possible to execute the Decision):

(A) The sales will trigger a total net corporation tax liability for the Theatre Group which it estimates is likely to be between [REDACTED]. The Theatre Group considers that it is [REDACTED]
[REDACTED]
[REDACTED]

(B) [REDACTED]
[REDACTED]

2.8 To the extent that the Theatre Group is able to understand the CC's cost / benefit analysis of the proposed remedy, it appears that none of the costs to the Theatre Group (or to BMI OpCo) of the proposed disposals have been considered at all. There is certainly no mention of the Theatre Group in the analysis described in paragraph 2.160 *et seq* of the Decision. It is immediately apparent from the information above that the NPV of the loss to Theatre Group is significant and has not been taken into account in the CC's numerical

reckoning. Were the CC to do so, it would conclude that the NPV of the detriment to the Theatre Group exceeds its own best case assessment of the NPV of the entire consumer benefit from the combined BMI OpCo / Theatre Group disposal remedy.

- 2.9 The CC has not carried out any separate proportionality analysis of the proposed requirement that the Theatre Group should be required to sell its freehold properties; nor has it identified any consumer benefit arising from the forced sale by the Theatre Group of its freeholds. This is a clear failure of the CC's duty to attempt to quantify the impact of its proposed remedies.¹⁵

The CC has not examined any remedy (other than freehold divestment) that is less draconian but which serves the purpose of allowing a suitable purchaser to be found

- 2.10 The CC has concluded that the sale of the Theatre Group's freehold sales is necessary, not because the ownership of those freehold interests by the Theatre Group gives rise to an AEC, but because of concerns about the ability to achieve the sales of BMI OpCo's leasehold interest with the current leasehold arrangements in place. The CC's concerns are set out in the Decision without any detailed explanation or analysis of their validity and appear to be based on a threshold ratio of rent to EBITDA(R) of ■■■ which is not explained or justified.
- 2.11 The CC is under a statutory duty to arrive at the least onerous remedy. This is particularly the case given the remoteness of the Theatre Group from the identified AEC and the uncertainty about the need for sales of freeholds of either the hospitals identified or any hospitals. However, the CC has failed to consider whether there is a way to achieve the sale of BMI OpCo's hospitals, if that is required, which is less onerous to the Theatre Group, such as facilitating a renegotiation of the terms of the leases to the extent required to achieve a disposal of the BMI OpCo operating business. The CC has not complied with the principle of 'double proportionality' as regards the Theatre Group and the CC's conclusions are vitiated by its own omissions.
- 2.12 For the avoidance of doubt, it is not the Theatre Group's position that any adjustment to the terms of its leases would inevitably either (1) be proportionate in the context of any perceived benefit to the consumer; or (2) be less disproportionate than a freehold sale. However, the CC cannot reach a rational conclusion on proportionality without weighing up the consequences of all possible remedies; and it has not done so.

¹⁵ Tesco v CC [2009] CAT 6, paragraph 133.

- 2.13 In conclusion on proportionality, given the significant impact of the proposed divestments on the Theatre Group, **any** such proposal is likely to be disproportionate in respect of the Theatre Group, but in particular the CC's Decision to require the Theatre Group to dispose of its freehold properties is disproportionate in depriving the Theatre Group of its property rights.
- 2.14 Lastly, as a matter of public policy, the Theatre Group has significant concerns about the impact on the broader UK real estate investment sector (including sale and leaseback transactions outside of the private acute care market), in the event that the CC proceeds with its provisional remedies. International investors will be concerned about the prospects of government interference which may result in lower levels of overall investment into the UK real estate sector.

3. The CC's Market Investigation Lacks Due Process and Has Been Procedurally Unfair to the Theatre Group

- 3.1 The CC accepts, in its Decision, that the Theatre Group is de facto under separate control and separate ownership from BMI OpCo. Furthermore, it recognises, at paragraph 2.138 of the Decision, that the majority of the economic interest in the BMI OpCo business now resides in the Theatre Group. Thus, the Theatre Group has a great deal at stake in this investigation, notwithstanding the fact that it is not an operator in the private healthcare market, and the standard of fairness to be applied by the CC must be assessed in this context.
- 3.2 The Theatre Group contacted the CC for the first time in [REDACTED]. Yet there has been almost no dialogue between the Theatre Group and the CC; the Theatre Group has had no contact at all with the Group. In its letter of 29 January 2014 the CC says that there are no areas on which the CC members or staff wish to ask specific questions of the Theatre Group at the Theatre Group's only (half day) hearing.
- 3.3 The CC's process has been materially deficient so far as the Theatre Group is concerned in a number of respects:
- (A) key elements of the logic by which the CC has provisionally concluded that it is necessary to require the divestment by the Theatre Group of its freehold interests are, so far as the Theatre Group can tell, absent from the CC's Decision;
 - (B) the CC has not given any consideration of the impact of the proposed remedies on the Theatre Group; and
 - (C) The CC has failed to provide the Theatre Group with a sufficiently full version of its Decision to enable the Theatre Group to exercise its right properly to respond.

Key elements of the logic by which the CC has provisionally concluded that it is necessary to require the divestment by the Theatre Group of its freehold interests are, so far as the Theatre Group can tell, absent from the CC's Decision

- 3.4 A critical element of the CC's Decision, as it affects the Theatre Group, is the impact of rent cover on the underlying hospital business. The Decision does not explain the basis on which the CC appears to have concluded either that a [REDACTED] EBITDA(R) rent cover was an appropriate benchmark, or how this should be applied on a case by case basis.

- 3.5 The CC must be aware that the issue of freehold / leasehold disposals has an impact on the distribution of value between BMI OpCo and the Theatre Group. It is clear from paragraph 2.83 of the Decision, which was provided to the Theatre Group only when asked for, that the CC has given BMI OpCo an opportunity to make submissions on a separate paper setting out the CC's views "vis-à-viz rent covers". The Theatre Group has not seen that paper or been afforded an opportunity to comment on it before the CC reached the Decision. This is demonstrably unfair and to the disadvantage of the Theatre Group.
- 3.6 More generally, the Decision contains no commentary on how the CC has reached the view that it will be necessary to require the sale of the freeholds of hospitals with low rent cover; what valuation evidence has been relied on; why BMI OpCo or its successor operator cannot successfully operate a hospital with rent cover of below [REDACTED]; what evidence the CC has considered of other, comparable hospitals and their rent cover; or how the EBITDA(R) of those hospitals has been calculated and checked.
- 3.7 To the extent that the CC has, as it claims in paragraph 2.84, carried out a case by case analysis of the rent cover of each hospital, the details of that analysis have not been provided to the Theatre Group, despite repeated requests. As a result, the Theatre Group does not know the basis on which the CC has reached its conclusions and has been denied the opportunity to make any submissions in respect of it. This is in breach of s169 Enterprise Act 2002.

The CC appears not to have given any consideration to the impact of the proposed remedies on the Theatre Group

- 3.8 The published (redacted) version of the CC's Decision (which the CC originally considered sufficient to discharge its duty to consult the Theatre Group) makes no reference to the Theatre Group at all.
- 3.9 As discussed above, it appears that the CC has not taken account of the interests of the Theatre Group in assessing the proportionality of its proposed divestment remedy requiring the Theatre Group to sell its freehold interests. Without a clear description of how it has done so, the Theatre Group is denied its legitimate right to comment on and be consulted on the CC's considerations.
- 3.10 The impact of the divestment remedy on the Theatre Group includes, but is not limited to, the impact of the freehold disposals discussed above. If the divestment remedy is implemented, BMI OpCo will remain the Theatre Group's largest tenant. The CC has

failed to consider the economic consequences of sales of hospital businesses by BMI OpCo for the Theatre Group in its calculations of the consequences of its proposed divestment remedy. Any reduction in the quality of the covenant of BMI OpCo as a tenant will have a direct result on the value of the Theatre Group's interests.

3.11

[REDACTED]

3.12 The Theatre Group has seen nothing in the CC's Decision which gives it any comfort that these matters have been considered by the CC.

The CC has failed to provide the Theatre Group with a sufficiently full version of its Decision to enable the Theatre Group to exercise its right properly to respond

3.13 The CC has consistently run its procedure, [REDACTED], in a manner which has denied the Theatre Group access to sufficient information to be able to make properly informed submissions.

3.14 It is clear from the CC's own publications that the CC has had considerable discussions with BMI OpCo about the basis for and the features of the divestment remedy. It has had no such interaction with the Theatre Group, yet it has recognised that the Theatre Group holds most of the economic value in the assets to be sold.

3.15 The first time that the CC clearly told the Theatre Group that it was going to require freehold disposals was in a letter of 16 January 2014. The Theatre Group was able to see the public, redacted version of the Decision only when it was published, on 21 January 2014. The CC has therefore given the Theatre Group only 16 days to respond on remedies which represent a significant economic threat to the Theatre Group.

- 3.16 The Theatre Group wrote to the CC on 22 January asking for the release of the information redacted from the published version of the report by 5pm on 23 January 2014. In response, the CC released a small proportion of the information requested to the Theatre Group on the evening of 28 January, just six working days before the deadline for submissions. The CC has consistently refused¹⁶ to supply the Theatre Group with information directly relevant to a proper understanding of the reasons why it will require the Theatre Group to dispose of its freehold interests, including:
- (A) The period within which the CC proposes that the Theatre Group will be required to make the required disposals (paragraph 2.91); and
 - (B) The key components of the CC's 'case by case' analysis of which hospitals should be subject to freehold disposal (eg. Paragraph 109 of schedule 2.2).
- 3.17 The CC has discussed the appropriate period for the required disposals by the Theatre Group with a third party (BMI OpCo) and has made a provisional decision as to that period. However it does not consider it necessary to disclose this to the Theatre Group.
- 3.18 The provision of this information is clearly necessary for the proper discharge by the CC of its functions, including the requirement under section 169 Enterprise Act 2002 to consult. In suggesting that it is inhibited from providing this information by virtue of section 244 Enterprise Act 2002, it has failed to take into account the provisions of section 241 Enterprise Act 2002.
- 3.19 The above points all constitute serious shortfalls in the required standards of procedural fairness which necessarily vitiate the CC's findings.

¹⁶ Most recently in an email from Thomas Wood of the CC to Simmons & Simmons of 31 January 2014.

4. **The Structure of the Remedies**

4.1 In this section, the Theatre Group comments on the structure of the proposed remedies. However, the points made here are directly relevant to the comments on proportionality and due process made above.

4.2 [REDACTED]
[REDACTED].
Nevertheless, the CC has already had substantive discussions about the sale structure and process with BMI OpCo but has refused, despite several requests, even to disclose to the Theatre Group the period it considers appropriate for the disposals.

4.3 The proposed divestments will be value destructive. This will be exacerbated if the Theatre Group is not given sufficient time to execute them (see paragraph 2.5 above). Depending on the number of hospitals to be sold, it is the Theatre Group's view that it is both essential and proportionate to allow a period of some years rather than months for the completion of these disposals.

4.4 The version of the Decision seen by the Theatre Group is almost completely silent on the mechanics by which the sale of both leasehold and freehold interests is to be completed. These will be complex transactions to manage and to execute under any circumstances, not least because any sale will actually involve two different entities selling two separate interests. The CC should have considered the proposed mechanics carefully, including the interaction with the Theatre Group financing structure and the BMI OpCo lenders, before making any judgment on proportionality or appropriate periods for the sale.

4.5 [REDACTED]
[REDACTED]. To require a process by which BMI OpCo is able to manage the sale of Theatre Group assets would be a further breach of the rights of the Theatre Group and a threat to its finances.

4.6 In this context it is concerning that the CC has already discussed the disposal process with BMI OpCo and yet has refused to provide the Theatre Group with even the most basic information about its Decision on the issue.

The Theatre Group

6 February 2014

Annex 1 – The CC’s AEC Findings

1. The Theatre Group is a real estate group, not active in the operation of private healthcare market. Its views on the CC’s work and conclusions are therefore limited to those points which affect it directly. In particular, BMI OpCo is its only tenant and source of revenue.

The financial state of BMI OpCo

2. The CC’s conclusions are based on a finding that BMI OpCo has been earning returns “*substantially and persistently in excess of its cost of capital*”. The Theatre Group’s comments on two key components of that calculation are set out below.
3. The Theatre Group notes that BMI OpCo has made extensive and detailed submissions on this issue to which the CC has yet to respond. [REDACTED]

The valuation of BMI’s hospitals

4. A key part of the CC’s conclusions on BMI OpCo’s profitability is its work on the value of BMI OpCo’s hospitals. The Theatre Group notes that the CC chose at the outset of this process to substitute its own calculations of value in place of independent third party professional valuations of the properties. Under the Institution of Chartered Surveyors’ Red Book rules, those valuations necessarily take account of both passing rents and the amounts by which passing rents might exceed market rents.
5. As a property investment company, the Theatre Group is proficient in the valuation of property and the mechanics of doing so. Whilst the Theatre Group has not seen the Colliers International valuation of MEA commissioned by BMI OpCo, referred to in its submission to the CC dated 11 November 2013, the Theatre Group notes that this appears to be a comprehensive assessment of the MEA, undertaken by a professional firm with considerable experience of hospital property, and which has conducted site visits to all hospitals. It was undertaken, so far as possible, in accordance with RICS guidelines and methodologies. It appears that the CC’s valuation of BMI OpCo’s capital employed comprised a number of different inputs, including a limited desktop valuation of the land element only by a non-sector-specialist department of DTZ. As a property group, the Theatre Group is naturally inclined towards placing more reliance and credibility on a full professional valuation rather than

something conducted to a different, limited scope. The Theatre Group therefore urges the CC to compare and contrast the different values and methodologies and to review the robustness of its own assessment of BMI's capital employed.

Rental payments

6. An important element in the CC's analysis of Mixer / BMI OpCo's financial position is the treatment of rent payments. It is clear from footnote 39 to Appendix 6.13 of the CC's provisional findings of 28 August 2013 that the CC's conclusions are based on a 'consolidated' analysis which treats rents as an internal transfer rather than a real cost to the business. This analysis predates the Theatre Group's engagement with the CC. The CC has been aware of the Theatre Group since [REDACTED], and acknowledges in [REDACTED].
- [REDACTED] However, the CC appears to have given no thought to the consequences of this change for either its AECs or remedies. It is an inescapable fact that the rents payable by BMI OpCo are now external costs to the Mixer / BMI OpCo group and must be recognised as such. The historic financial analysis which was used by the CC is just that – historic. To use it as the basis on which to construct forward-looking remedies would be irrational and incorrect.
7. Indeed, the basis on which the CC has concluded that freehold sales are required itself exposes a flaw in the CC's logic. The CC has decided that, where a hospital to be sold has a rent to EBITDA(R) ratio of less than [REDACTED], it is necessary to require the sale of the freehold. The fact that these hospitals operate on a ratio of less than [REDACTED] is an indication not of excess profitability but of weak profitability. How can it be possible to reconcile the CC's logic which requires disposal with its subsequent finding of weak profitability in the very hospitals where freehold sales are required?

Conclusion

8. As a consequence of the above matters, the Theatre Group is very concerned that the CC's provisional findings and proposed remedies are based on a misconception of an above average ROCE being earned by BMI OpCo. BMI OpCo's own submissions will no doubt confirm this.

THEATRE GROUP	PROPERTIES
[REDACTED]	[REDACTED]

Annex 2.2 – List of Potential Leasehold and Freehold Divestments

Potential Leasehold Divestments

Company Name	Potential Leasehold Divestments
[REDACTED]	Bishops Wood
[REDACTED]	Clementine Churchill
[REDACTED]	Cavell
[REDACTED]	Kings Oak
[REDACTED]	Chiltern
[REDACTED]	Shelburne
[REDACTED]	Sloane
[REDACTED]	Three Shires

Potential Freehold Divestments

Company Name	Potential Freehold Divestments
[REDACTED]	Chelsfield Park
[REDACTED]	Shirley Oaks
[REDACTED]	Saxon Clinic
[REDACTED]	Highfield