Completed acquisition by American Greetings Corporation of Clinton Card Group

ME/5575/12

The OFT's decision on reference under section 22(1) given on 12 October 2012. Full text of decision published 30 October 2012.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. American Greetings Corporation (**American Greetings**) is active in the design, manufacture and sale of greetings cards and other associated products, such as gift packaging and party goods. American Greetings are active in the United States, Canada, Australia and New Zealand, as well as the UK where it trades under the name UK Greetings Limited (**UK Greetings**). American Greetings is based in Ohio, USA and is publicly listed on the New York Stock Exchange. American Greetings' global turnover in the financial year ended 29 February 2012 was around £1 billion, of which £267 million was attributable to the UK.[1]

2. Lakeshore Lending Limited (**Lakeshore**) is a wholly-owned subsidiary of American Greetings and a special purpose vehicle established for the purposes of the acquisition.[2]

3. The Clinton Cards Group (**Clinton Cards**) was a retailer of greetings cards, operating under the brand names Clinton Cards and Birthdays. Prior to being placed into administration on 9 May 2012, Clinton Cards had around

[1] Global turnover of US$1.695 billion taken from American Greetings 2012 Annual Report, converted to sterling at US$1.5977/£. Source: End-month spot exchange rate for February 2012, Bank of England. UK turnover sourced from UK Greetings Fully Consolidated Contribution Statement for the Year to February 2012.

[2] Lakeshore and UK Greetings are hereafter collectively referred to as American Greetings, the parent company.

784 UK stores. Clinton Card's UK turnover in financial year 2011 was around £364 million.

TRANSACTION

4. On 8 May 2012, American Greetings acquired all of the outstanding senior secured debt claims owed by Clinton Cards from two banks for around €56 million (£35m).[3] Clinton Cards entered administration on 9 May 2012.

5. American Greetings succeeded in the competitive bidding process run by the Administrators for the purchase of businesses and assets previously part of Clinton Cards. On 6 June 2012, the Administrators transferred certain assets as a going concern to Lakeshore through a business and asset sale and purchase agreement for a consideration of £23 million (the **Transaction**). This transfer included around 382 Clinton Card's branded retail stores,[4] staff, and the Clinton Card's trademarks.

6. American Greetings also acquired 20 leasehold stores (previously operated under the brand name Birthdays) and the Birthday's trademark (the business and assets transferred as a result of the Transaction, including the Clinton Card's branded stores and Birthdays leasehold stores, are hereafter referred to as **Clinton**).

JURISDICTION

7. The OFT considers the Transaction has resulted in two enterprises ceasing to be distinct as set out in section 23(1)(a) of the Enterprise Act 2002 (the **Act**).

8. The annual UK turnover of Clinton Cards in its last financial year (2011) was around £364 million. This was prior to Clinton Cards entering into

[3] Separate from the acquired senior secured debt, American Greetings had approximately US$25 million (around £16 million) of unsecured exposure to Clinton Cards, a majority of which was in default.

[4] American Greetings submitted that the exact number varies between 380 and 400 stores, dependent on the outcome of negotiations with landlords of the relevant stores. The Sale and Purchase Agreement details 380 acquired Clinton stores, plus 20 Birthdays leaseholds.

administration. The turnover of those businesses and assets transferred to American Greetings is estimated to be above £70million.[5,6]

9. As a result, the OFT believes that the Transaction has resulted in the creation of a relevant merger situation for the purposes of section 23 of the Act.

10. The Transaction completed on 6 June 2012, and the OFT accepted the parties' submission on 20 July 2012. The administrative deadline in this case is 15 October 2012, and the statutory deadline is 2 November 2012.

MARKET DEFINITION

Product scope

11. The OFT considers that market definition provides a framework for assessing the competitive effects of the merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[7]

12. The OFT's approach is to first consider whether narrow candidate product markets may be widened through demand-side substitution. In non-horizontal mergers, the OFT first considers the products or services of one of the merging firms in the narrowest candidate market in applying the hypothetical monopolist test. The OFT will assess whether the hypothetical monopolist could profitably raise the price of at least one of the products in the candidate market by at least a small but significant amount.[8]

13. American Greetings is active in publishing greetings cards (wholesale supply) and Clinton is active in the retail supply of greetings cards (plus

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[5] See American Greetings [Internal Business Document]. In any event, the OFT considers the turnover test, as set out in section 23(1)(b) of the Act, is met.

[6] Hereafter all dollar figures in this decision refer to US dollars.

[7] See *Merger Assessment Guidelines*, Joint Publication of the Competition Commission and the Office of Fair Trading, OFT1254, September 2010, paragraph 5.2.2.

[8] See *Merger Assessment Guidelines*, paragraphs 5.2.6 to 5.2.19.

associated goods). In a past OFT decision, the retail supply of greetings cards has been considered separately from the wholesale supply of greetings cards.[9]

14. In this case, American Greetings submitted the wholesale supply and retail supply represent two separate relevant product markets. Although some sales of wholesale greetings cards manufacturers are direct to end customers through online distribution, these are limited (as is discussed in detail below). The OFT therefore considers the wholesale and retail supply of greetings cards separately.

Wholesale supply of greetings cards

15. American Greetings submitted there is a single relevant market for the wholesale supply of greetings cards by publishers.

16. The direct supply of greetings cards to end customers through the online distribution channel does not represent a direct constraint in the wholesale supply of greetings cards to retailers (as they do not supply to retailers), and so this channel is excluded from the relevant market.[10]

17. One of the large greetings cards suppliers, Card Factory, is vertically integrated, active at both the wholesale and retail level. At the retail level, Card Factory self-supplies the majority of their own greetings cards but do stock some greetings cards from other publishers. At the wholesale level, Card Factory has no sales to other retailers of cards it has produced.

18. American Greetings submitted that Card Factory must be included as part of the market for the wholesale supply of greetings cards and shares of supply of wholesalers must be calculated with reference to their retail

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[9] See *Completed acquisition by Clinton Cards Limited of Birthdays Limited (and its subsidiaries), Birthdays Direct Limited and Thorpalm Greeting Cards Limited*, OFT, 8 March 2005 (*Clinton/Birthdays*), paragraph 11.

[10] The OFT notes that the scope of the relevant wholesale market is also dependent on the extent to which the wholesale supply of greetings cards is constrained by competition at the downstream retail level by cards sold direct to customers through online distribution. However, the OFT considers this potential indirect constraint downstream unlikely to be sufficient to warrant widening the upstream product market as third parties generally did not support the proposition that customers switch between traditional retailers supplied by wholesale publishers and online greetings cards suppliers.

sales, despite Card Factory not currently having any sales of greetings cards to third parties at the wholesale level.

19. When considering whether production of an input used for self-supply by a firm should be included in the relevant market for assessing any effects on input prices, the OFT generally follows the principle that captive production by a firm will be included in the relevant market only if it can be demonstrated that it would be profitable for the supplier to forgo its use and sell into the merchant market in response to a small but substantial non-transitory increase in price (SSNIP), considered here to be five per cent.[11]

20. Card Factory submitted that it would be unlikely to supply third party retailers in the event of a SSNIP. [ ] The rationale for this is the significant benefits for a retailer of offering product that cannot be obtained elsewhere.

21. The OFT therefore does not consider, based on the evidence available to it, that this self-supply is part of the relevant market for the wholesale supply of greetings cards.

Retail supply of greetings cards

Specialist and non-specialist stores

22. Greetings cards are retailed across different store types: specialist greetings cards stores and non-specialist stores, including, for example, supermarkets, convenience stores, garden centres, department stores and cash and carry outlets. Internal business documents submitted by American Greetings indicate that in 2011, 'card shops' represented 40-50 per cent of retail supply, while 'grocery stores' represented 25-35 per cent.[12]

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[11] See *Merger Assessment Guidelines*, paragraph 5.2.20, for an outline of the OFT's approach to self-supply. For application in previous OFT decisions see, for example, *Anticipated acquisition by AB Agri Limited of the business and assets of the Uffculme Feed Mill*, OFT, 15 September 2011, paragraph 12 *et seq*. and *Anticipated acquisition by Nynas UK AB of the business activities of UK Bitumen Limited (and access to Teesside Bitumen storage terminal)*, OFT, 26 November 2009, paragraph 43.

[12] Clintons [Internal Business Document], submitted as Annex O to the response to OFT questions dated 17 July 2012.

23. In *Clinton/Birthdays*, the OFT considered the retail supply of greetings cards to include sales by both specialist and non-specialist retailers.[13]

24. Clinton is a specialist greetings cards store. In this case, American Greetings submitted there is a single relevant market for the resale of greetings cards by all retailers. To support this, American Greetings submitted recent independent market reports, produced by the market research firms Mintel and Key Note, as well as referencing a further independent report titled [ ]. These reports point to a wide range of retailers that have started to sell greetings cards, which has negatively affected sales for specialist stores and highlight that the share of supply of supermarkets and online retailers have increased over time and the share of specialist retailers has decreased over the same period proportionally, while the overall size of the market has remained constant. American Greetings also pointed to industry experts commenting on Clinton Card's demise – stating this was because it could not keep up with competition from other specialist (Card Factory in particular) and non-specialist (supermarkets in particular) retailers.

25. The OFT's market investigation did not support widening the product market beyond specialist greetings cards retailers to include supermarkets and other non-specialist retail outlets. The vast majority of third parties stated that final consumers would not switch away from specialist retailers in response to a SSNIP, pointing to narrower ranges stocked in non-specialist retailers and the materially different purchasing behaviour of customers of specialist retailers: customers of non-specialist retailers tend to purchase out of convenience, whereas customers are more likely to actively seek out specialist retailers with the intention of purchasing a card. While some third parties indicated that switching may occur, the price changes would need to be significantly greater than a SSNIP of five per cent.

26. Despite this, a small number of non-specialist retailers indicated that they had seen an increase in sales since the closure of Clinton Card's stores (as a result of the administration process). Only one third party, stated that

[13] See *Completed acquisition by Clinton Cards Limited of Birthdays Limited (and its subsidiaries), Birthdays Direct Limited and Thorpalm Greeting Cards Limited.*, OFT, 11 February 2005, paragraph 11.

customers do switch between different retailers, although this view was an exception.

27. The OFT notes American Greetings' submissions but emphasises that an increase in sales or share of total greetings cards sales by one supplier or group of suppliers and a simultaneous decrease in sales or share by another supplier or group of suppliers is not necessarily probative of the scope of the relevant market. The OFT's market investigation points to sufficiently strong competition among specialist retailers to define these as a relevant market in this case. The OFT notes this is consistent with the observation that specialist retailers may have been losing sales to supermarkets and other non-specialist retailers. A relevant market consists of products or services that could be profitably monopolised. Some degree of competition across market boundaries is the norm especially in light of a closure of a large industry participant (instead of a small price rise).

28. The OFT therefore considers sales of greetings cards by specialist greetings cards retailers separately for the purposes of the competitive assessment.

Online retail sales

29. American Greetings submitted that online retailers (or online publishers that retail direct to consumers) are part of the same relevant market as 'bricks and mortar' retailers. To support this, American Greetings pointed to independent Mintel and Key Note reports, which state that specialist online card retailers have taken away business from the traditional outlets and highlight the popularity of online sites having affected sales of traditional greetings cards retailers. American Greetings also pointed to [ ] which state that the number of customers sending electronic greetings cards and buying cards online has risen significantly in recent years.

30. Third parties in this case indicated that online retail, which is estimated to represent between three and five per cent of greetings cards sales, is not a feasible alternative for end customers pointing to a range of factors limiting substitution, including appealing to different customer types and need, different frequency of purchases, materially different product (more personalisation, bespoke, wider range, higher prices). Online suppliers of greetings cards are considered by third parties to be, for the most part, incremental to sales of greetings cards through bricks and mortar retailers.

Associated goods

31. The OFT notes that specialist greetings cards stores (and also non-specialist stores but to a much lesser extent) also supply associated goods, such as gift packaging and gifts. Third parties in this case generally indicated that these are complementary to the purchase of greetings cards and it is the sale of greetings cards that brings the customer into the store and motivates the purchase. Internal business documents submitted [ ] also suggest that customers who purchase these associated goods are likely to represent a subset of the customers that purchase greetings cards, [ ].[14]

32. The OFT considers that the retail supply of associated goods may therefore be a complimentary and secondary product to greetings cards and therefore may be aggregated into a single product market along with the supply of greetings cards on the demand-side.[15] However, as considering associated goods separately or together alongside greetings cards makes no material difference to the competitive assessment, the OFT has not found it necessary to conclude on this point in this case.

GEOGRAPHIC SCOPE

33. American Greetings submitted the relevant geographic market for both the wholesale and retail supply of greetings cards is national.

34. In *Clinton/Birthdays*, the OFT considered that retail competition takes place at a local level, with a one-mile radius around the relevant stores taken as a starting point for the assessment.[16]

35. In this case, third parties stated that publishers can engage with national retailers at a centralised level or will have local sales representatives or agents that visit smaller retailers on their behalf to try to persuade the

[14] Clinton Cards [Internal Business Document], submitted as Annex B2 to the response to OFT questions dated 19 July 2012.

[15] This may be the case where customers predominantly purchase both products from the same retailer and retailers compete in supplying the bundle (including both products). For details of the OFT's approach to secondary products and services see *Merger Assessment Guidelines*, paragraph 5.2.20.

[16] See *Completed acquisition by Clinton Cards Limited of Birthdays Limited (and its subsidiaries), Birthdays Direct Limited and Thorpalm Greeting Cards Limited.,* OFT, 11 February 2005, paragraph 9.

retailer to stock their product. Despite this localised interaction with retail customers, all third parties generally considered the relevant geographic market for the wholesale supply of greetings cards to retailers to be national.

36. At the retail level, third parties considered demand for greetings cards to be local and were generally supportive of a one-mile radius around a specialist greetings cards store as a realistic starting point.

37. The OFT notes there may also be an element of national competition between large chains and the extent to which national chains face each other in local areas may be a factor in determining the extent to which they can influence each other's decision making at the national level. The OFT is not aware of the parameters of competition that are set at a national level and those at a local level by Clinton. However, as outlined in detail below, the OFT considers any foreclosure strategy most likely to apply at a local level, and so this is the principal geographic scope focused on for the purposes of the competitive assessment.

Conclusion on frame of reference

38. The OFT considers the wholesale and retail supply of greetings cards separately. In terms of the wholesale supply of greetings cards, the OFT considers this on a national level. At the retail level, the OFT considers specialist greetings cards retailers separately from non-specialist greetings cards retailers, both principally at a local level, using a one-mile radius around a Clinton store as a starting point. The OFT also takes a cautious approach and considers all retailers together for the purposes of its competitive assessment, where appropriate.

COUNTERFACTUAL

Exiting Firm

39. The OFT assesses the competitive effects of a merger by comparing the prospects for competition with the merger against the competitive situation absent the merger. The description of the latter, the counterfactual, is affected by the extent to which events or circumstances are foreseeable. In practice the OFT generally adopts the pre-merger situation as the counterfactual against which to assess the impact of the merger. However,

the OFT will assess the merger against an alternative counterfactual where, based on the evidence available, it considers that the prospect of pre-merger conditions continuing is not realistic (for example, because the OFT believes that one of the merging firms would inevitably have exited from the market).[17]

40. Clinton Cards went into administration on 9 May 2012 and a package of Clinton Card's business and assets was subsequently sold by the Administrators to American Greetings on 6 June 2012 through a competitive bidding process.[18]

41. American Greetings did not suggest that an exiting firm scenario applies in this case. Nevertheless, given the circumstances of administration, the OFT has examined the extent to which such a scenario may apply.

42. In forming a view on the exiting firm scenario, the OFT considers:

i) whether the firm would have exited (through failure or otherwise) and

ii) whether there would have been an alternative purchaser for the firm or its assets to the acquirer.[19]

Exit from the Market

43. For the OFT to be satisfied that the firm would have exited absent the Transaction, it would need, on the basis of compelling evidence, to believe that it was inevitable that the firm would exit the market with no serious prospect of reorganisation.

44. The OFT recognises that Clinton Cards was in financial difficulty and was unable to meet its financial obligations, hence it entering administration. However, the OFT notes that even where a business has been in

[17] This approach is outlined in the *Merger Assessment Guidelines*, section 4.3.

[18] American Greetings described the reasons for Clinton's financial difficulties as, amongst other things, [ ]. See Clinton's [Internal Business Document], submitted as Annex A2 to the response to OFT questions dated 19 July 2012.

[19] The OFT may also consider what would have happened to the sales of the firm in the event of exit. However, the OFT does not consider an assessment of this aspect of the exiting firm criteria necessary in this case.

administration, this is not automatically considered, by itself, sufficient to satisfy the criteria that exit would have been inevitable.[20]

45. American Greetings submitted that the purchase by American Greetings of Clinton was a '[ ] sale' that preserved the Clinton business. Without this Transaction, American Greetings submitted that Clinton would have ceased trading entirely within six months.

46. The OFT notes that Clinton Cards attempted to restructure and reorganise its business prior to the administration process. [ ][21,22] Clinton Cards had the intention of proposing a Company Voluntary Arrangement (**CVA**) to its suppliers and other creditors in June 2012.[23]

47. The CVA was never undertaken. At this stage, American Greetings [ ] engaged the insolvency practitioners, Zolfo Cooper, in order to assess the options available to it in relation to protecting its current exposure to Clinton Cards. [ ], American Greetings purchased the secured debt of Clinton Cards and placed the company into administration.

48. Internal American Greetings' business documents discussing its intentions at this time indicate that it considered Clinton Card's management plans to be inadequate to save the Clinton Card's business with no funding beyond the current year and generally perceived Clinton Cards to be in a parlous financial condition. For example: [ ].[24,25]

49. The OFT considers the extent to which Clinton Card's financial trajectory prior to being placed in administration was towards exit from the market or simply a less attractive course to American Greetings – in particular restructuring through a CVA – is unclear as other American Greetings' internal business documents suggested.

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[20] See, for example, *Anticipated acquisition by HMV of 15 Zavvi stores*, OFT, 14 May 2009, paragraph 33 *et seq.*

[21] [ ].

[22] [ ].

[23] Joint Administrators' Report and Statement of Proposals, Clinton Cards Plc and other groups companies – in Administration, 29 June 2012, paragraphs 2.9 to 2.10.

[24] [ ].

[25] [ ].

50. The extent to which Clinton Cards would have been able to reorganise, absent American Greetings placing them into administration, is unclear from these American Greetings' documents alone as a number point to the underlying strength of Clinton Cards as a going concern. One internal document, for example, stated that a restructured Clinton with half its existing store count would be [ ]. Another document noted that trading profit during bankruptcy would be around [ ], with a cost of bankruptcy of [ ].

51. Indeed, American Greetings' analysis of the options available to them appears to suggest that the acquisition may have been [ ].[26]

52. The OFT investigated with the Administrator, Zolfo Cooper, and with Clinton Card's advisers prior to administration, KPMG, whether there was any prospect that Clinton could have continued independently, either through a CVA or through reorganising in administration. [ ]. Zolfo Cooper believes that a CVA was not a viable option due to the level of secured debt, the cash requirement to fund the business through the CVA process and the significant operational turnaround required. For similar reasons, Zolfo Cooper does not believe there was any option in administration other than an accelerated sale process.[27]

53. [ ].[28]

54. The OFT has not received corroboration on the likely course of events, absent American Greetings' purchase of the secured debt, from the previous secured debt holders in order to ascertain their analysis or diagnosis of Clinton Card's failing financial circumstances. As a result, there is uncertainty over the extent to which the secured creditors considered a CVA to be a feasible option; the extent to which they would have been willing, or were planning, to provide additional funding to Clinton Cards; and, more generally, the course of action the secured creditors

[26] Options examined by American Greetings included [ ]. See American Greetings [Internal Business Document], submitted as Annex A2 to the response to the OFT dated 19 July and American Greetings [Internal Business Document], submitted as Annex P to the response to OFT questions dated 17 July 2012.

[27] Zolfo Cooper believes that the previous owners of the secured debt, RBS and Barclays, also would have been very likely to put Clinton Cards into administration, although the OFT has been unable to confirm this with RBS or Barclays.

[28] [ ].

would have followed, had American Greetings not purchased the secured debt.

55. The OFT recognises that, in the absence of evidence from the existing secured creditors on their propensity to provide additional funding and their general sense of the feasibility of a CVA, it is difficult to conclusively determine what would have likely occurred, absent acquisition of the debt by American Greetings. Accordingly, based on the evidence available, the OFT is unable to reach a sufficient level of confidence that exit would have been inevitable. However, the OFT notes that, in any event, as outlined below, the exiting firm criteria as a whole are not met and so has not reached a definitive conclusion on this particular aspect of it.

An Alternative Purchaser

56. Even if the OFT believes that a firm would have exited, there may be other buyers whose acquisition of the firm as a going concern, or of its assets involved in the Transaction, would produce a better outcome for competition than the merger under consideration.

57. The OFT investigated carefully with the Administrator the extent of alternative offers for Clinton as part of the administration process.

58. Immediately following appointment, the Administrators marketed the business and assets of Clinton Cards.[29] As a result of this, 43 expressions of interest were received and 29 confidentiality agreements were subsequently signed by interested parties, all of whom received a sales memorandum containing further information. The deadline for best and final offers was 21 May 2012. The Administrators did not receive any offers in respect of the business as a whole but received 11 offers for different compositions of the business. The Administrators stated to the OFT that these bids were filtered to three or four serious bids that could demonstrate sufficient financing to be credible. Two of the bids that were dismissed were of a value above that offered by American Greetings but could not demonstrate sufficient financial support.

[29] Details of the sales process are provided in the Joint Administrators' Report and Statement of Proposals, Clinton Cards Plc and other groups companies – in Administration, 29 June 2012, paragraph 3.14 *et seq*.

59. The Administrator stated to the OFT that, among the three to four credible bids, was a bid given by a private equity company. Originally, this private equity company made a formal bid of around £15 to 20 million for all stores and brands. This offer was subsequently increased through a verbal offer of over £30 million but the bidder withdrew from the process during the due diligence phase. The Administrator believes this bidder would have taken the business at some price (although it is not clear what the price would have been). This bidder also bid for the brands and was intending to operate the stores as Clinton Cards stores. The number of the stores they would have operated going forward is unclear as the successful bidder would have acquired only the option to purchase all the stores, which then would have been subject to negotiations with the landlords. However, the Administrator believes it was likely that the bidder would have continued to operate around 300-350 stores.[30] Some of the other bids assessed by the Administrator were from competing retailers.

60. American Greetings submitted that none of the alternative bids were credible and would have involved operation of fewer stores than American Greetings. Some internal business documents submitted by American Greetings confirmed its perception of the [ ], including: a private equity bidder seeking to operate most of the chain but with a bid that was [ ].[31]

61. The Administrator understandably favoured American Greetings' higher bid over the alternative bidders. However, the OFT notes that consideration of alternative offers is not limited to those bids equivalent to that of American Greetings. The fact that American Greetings' offer may have been commercially preferable to other offers is not sufficient for the OFT to disregard the alternative bids as realistic alternative purchasers. The question for the OFT is whether – in the absence of American Greetings' offer – the assets would have been transferred to another purchaser that was acceptable both to the Administrator and would be substantially less anti-competitive than American Greetings.

62. Given the evidence of the Administrator, the OFT considers that if American Greetings' bid to the Administrators had not been successful,

[30] Though the bidder intended to remain in-market (in the sense the Clinton Cards stores would have remained as greetings cards stores.

[31] American Greetings [Internal Business Document], submitted as Annex P to the response to the OFT dated 17 July 2012.

another bidder would have taken on operations of the Clinton stores (or some composition of the Clinton Card's stores), and that this would likely have been significantly less anti-competitive. The OFT therefore does not consider the evidence supports an exiting firm scenario in this case.

63. The OFT therefore considers the relevant counterfactual to be a hypothetical alternative purchaser that raises no competition issues but would have operated a similar number of stores to that of American Greetings.

COMPETITIVE ASSESSMENT

64. American Greetings is a wholesale supplier of greetings cards to Clinton, a retailer of greetings cards. There is no horizontal overlap between the parties, and so the OFT has considered only vertical issues arising from the Transaction and, in particular, has focused on the extent to which input foreclosure and/or customer foreclosure may result from the Transaction.

65. This is followed by an assessment of possible supply-side responses and countervailing buyer power.

Commercial Behaviour of American Greetings since the Acquisition

66. American Greetings submitted that since the acquisition it has sought to secure supply of greetings cards from third party upstream publishers, and also secure its own supply of greetings cards to third party retailers. This is supported by internal documents submitted by American Greetings, which discuss the potential for [ ] and indicate that American Greetings should [ ].[32] American Greetings argued that this behaviour points to the absence of any competitive harm arising from the Transaction in the future.

67. The OFT considers it important to emphasise that it believes that considerable caution is required in placing weight on events since an acquisition has occurred as evidence of what may be expected to occur going forward.[33] Specifically, the OFT considers that, even if there was no

[32] See American Greetings [Internal Business Document], submitted as Annex A2 to the response to OFT questions dated 19 July 2012.

[33] See, for example, *Completed acquisition by Ryanair Holdings plc of a minority interest in Aer Lingus Group plc*, OFT, 5 July 2012, paragraph 137 *et seq*.

evidence that pointed toward a substantial lessening of competition since the acquisition, this should not be regarded as conclusive, as American Greetings has been able to adapt its behaviour since the acquisition. This would be the analytical approach taken by the OFT in all completed cases.

68. The OFT notes that statutory test in respect of competed mergers is whether it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition. To this extent, it is not necessary for the OFT to show that a substantial lessening of competition (or the adverse effects of it) has already resulted, provided that there are reasonable grounds to believe that a substantial lessening of competition may be expected to result from the merger going forward.

69. In this decision the OFT considers, as it would in any completed merger, whether the acquisition may be expected to result in a substantial lessening of competition prospectively.

Corporate Structure

70. American Greetings submitted that Clinton is run independently by an external firm, Schurman Retail Group [see endnote [i]], which reports through a subsidiary, Lakeshore, to American Greetings, whereas UK Greetings, reports to American Greetings through another subsidiary, AG (UK) Limited. American Greetings submitted that there are no reporting lines between the retail division and wholesale division. As a result, American Greetings argued strongly that the fact that the merging parties will remain separate legal entities with different management has an impact on the ability and incentive to engage in input foreclosure.

71. As a first phase authority, the OFT can give no weight to the fact that merging parties are currently being run by different subsidiaries of the same parent company in assessing the likelihood of competition concerns to arise from a transaction, in these circumstances. No evidence has been submitted, which compellingly demonstrates that American Greetings has no current influence or control over either or both of its subsidiaries or could not do so in future. For example, should Schurman Retail Group underperform [see endnote [ii]], American Greetings' course of action could be to take day to day control of the operation of Clinton itself. Similarly, should it be profitable in the future for American Greetings to take account

of the joint profitability of Clinton and UK Greetings, it is difficult for the OFT to consider why American Greetings would not take such action.

72. Moreover, the OFT notes that coordination or communication between Clinton and UK Greetings is not necessary for a foreclosure strategy to be pursued. To foreclose an input, for example, American Greetings need only have UK Greetings restrict supply to competing retailers. The incentive, should it exist, remains, regardless of corporate structure, as American Greetings gains the benefits of diverted sales and increased profits at Clinton, independent of any communication between American Greetings and Clinton or UK Greetings and Clinton.

INPUT FORECLOSURE

73. Input foreclosure relates to the denial or restriction of access to a source of supply or input to competing firms. In this case, the relevant input is greetings cards, which American Greetings currently supplies to Clinton and other downstream retailers.

74. Input foreclosure may arise where, post-merger, the vertically integrated merged firm (American Greetings/Clinton) has the ability and incentive to restrict access to greetings cards to downstream retail rivals that it would otherwise have supplied absent the Transaction. Restriction of access to supply can be a complete refusal to supply (total foreclosure) or continuing to supply the input but only at a higher price or on less attractive terms (partial foreclosure).

75. The effect of both strategies is to raise the price of the upstream product, greetings cards, and potentially increase downstream retail rivals' costs, making them less competitive (and the merged firm relatively more competitive) in the downstream retail market. This change in the competitiveness of retailers downstream may ease the competitive constraint on the merged firm, enabling it to diminish its competitive offering downstream (for example, through increasing the retail price).

76. However, given that the merged entity would only benefit from such a foreclosure strategy (whether total or partial) if consumers would then switch away from the retailers being subjected to the strategy to Clinton,

the OFT has focused its analysis in those local areas in which a Clinton outlet is located (see below for further details).

77. In examining the prospect to this type of harm to competition, the OFT will assess the merged firm's ability to engage in foreclosure, its incentive to do so and the overall effect on competition.[34]

Ability to foreclose

Importance of the Input

78. Such a foreclosure strategy is possible only if the input concerned – greetings cards – is important for the overall downstream product (the retail supply of greetings cards).[35]

79. American Greetings argued that the purchase of greetings cards is only a small part of the total costs incurred by Clinton. Of total costs of sales of £[ ] million, American Greetings submitted that only [ ] per cent of this is the purchase of goods, with only [ ] per cent of this (that is, [ ] per cent of total costs of sales) attributable to the purchase of greetings cards. The remaining costs of sales ([ ] per cent) are made up of shop-related costs, including rent and staff.

80. The OFT notes that at a general level, greetings cards are critical to the re-sale of greetings cards, by the nature of the retailers selling these goods. For a specialist greetings cards store the sale of greetings cards is their primary function. Third party specialist retailers stated that even where additional sales are made of other products, it would be difficult for a specialist retailer to alter the product mix to be less reliant on greetings cards, as it is greetings cards that attract customers.[36]

81. Specifically addressing American Greetings' submission, the OFT also notes, that the cost of greetings cards as an input to Clinton relative to Clinton's total costs – as opposed to that of Clinton's rivals – is not the

[34] See *Merger Assessment Guidelines*, paragraph 5.6.6.

[35] See *Merger Assessment Guidelines*, paragraph 5.6.10(a).

[36] Internal business documents submitted by American Greetings indicate that [ ]. See American Greetings [Internal Business Document], submitted as Annex B2 to the response to OFT questions dated 19 July 2012.

principal focus of the analysis, albeit the OFT acknowledges that the data on any retailer, including Clinton, may be illustrative and probative of the proportion more widely.

82. Further, the OFT notes that the analytical framework relating to the importance of the costs of the input, relative to the price of the downstream product, is driven by the ability of downstream rivals to make use of alternatives or absorb increased costs whilst retaining their ability to compete. If the price of the input is low relative to the price of the downstream product, after the merger the merged entity may not be able to increase prices on the downstream market by raising the price of the input (that is, the rival retailers are no substantially worse off).

Availability of substitutes

83. The merged firm would also only have the ability to foreclose downstream competitors if, by restricting access to its upstream products, it is able to negatively affect the overall availability of inputs for the downstream retail market. This may be the case, principally, where there are limited alternatives to obtain the input upstream. Otherwise, rival retailers can obtain wholesale greetings cards from other suppliers.[37]

84. American Greetings argued the upstream market is intensely competitive, and numerous and diverse smaller producers exert competitive pressure on larger publishers. American Greetings' estimates of shares of supply are shown in table 1. American Greetings' estimated share of supply of greetings cards to retailers is around 25-35 per cent with Hallmark on 25-35 per cent.[38] No other publisher would have a share of supply greater than four per cent.

[37] See *Merger Assessment Guidelines*, paragraph 5.6.10(b).

[38] In line with its product frame of reference, this figure excludes Card Factory and Moonpig.

Table 1: Greetings cards wholesale share of supply in the UK, 2011[39]

Wholesaler	Share (per cent)
American Greetings	25-35
Hallmark	25-35
International Greetings	0-5
Carte Blanche	0-5
Simon Elvin	0-5
Paper House	0-5
Other	20-30

85. American Greetings submitted that upstream competitors are strong, credible publishers with direct relationships with all the major retailers and that retailers could quickly switch to these alternative publishers.

86. The OFT also notes the growth of American Greetings' share of supply in recent years. Internal business documents indicate that American Greetings has increased its share of supply from around 15-25 per cent in the space of around two years.[40]

87. The OFT's market investigation highlighted mixed views from third parties in relation to the availability of alternative suppliers and the extent of competition upstream. Several third parties stated that there are a limited number of suppliers to large retailers, including American Greetings and Hallmark, but were generally unconcerned by the availability of alternatives. For large retailers, the limited number of suppliers was due to their requirement for a broker and/or category manager, rather than just a publisher. They use a single supplier to broker a wide range from numerous publishers. American Greetings pointed to at least two other wholesalers supplying to large retailers and also operating as brokers (in some cases on an exclusive basis with a large retailer). Further, a number of smaller

[39] Source: OFT analysis based on data submitted by American Greetings.

[40] This appears to be as a result of the acquisition of Watermark. See comparison of card share of supply estimates in American Greetings [Internal Business Document] and UK Greetings [Internal Business Document], both submitted as Annex C2 to the response to OFT questions dated 19 July 2012.

publishers indicated that they supply retailers through the larger brokers.[41]

88. A small number of smaller specialist retailers indicated that there are limited alternative suppliers. Specifically, some specialist retailers stated that American Greetings represents a significant proportion of their sales and they need to stock a significant proportion of American Greetings' cards. According to these third parties, the ability to supply the stock that provides for a sufficient range and product mix in store, and which enables them to compete effectively as specialist retailers, is limited to two suppliers: Hallmark and, in particular, American Greetings. Without American Greetings, obtaining a sufficient range in store would be very difficult, significantly more costly, and limited to Hallmark. A specialist retailer would never be able to fully switch away from both American Greetings and Hallmark, and so, should a specialist retailer not stock American Greetings' cards, then they would be reliant on Hallmark to make up the bulk of their range.

89. This was also supported by a competitor, Card Factory, who indicated that it would be difficult for an independent retailer with a number of stores to switch away from American Greetings completely. Indeed, Card Factory highlighted that one of the reasons for integrating upstream was to reduce its reliance on the main UK publishers [ ].

90. The OFT notes, at a general level, that the assessment of the ability to foreclose is not simply based on the number of alternative upstream suppliers, but the extent to which there are other equivalent input sources, taking into account the competitive offers of alternative suppliers (including the range offered); the preferences of customers for suppliers (where remaining upstream suppliers may be more or less efficient or more or less preferable); and the best response of alternative upstream suppliers following any foreclosure by American Greetings.

91. The OFT recognises that it is clear that Hallmark would continue to compete with American Greetings post-merger, potentially limiting American Greetings' ability to foreclose its competitors. Hallmark is generally, in terms of range and scale, considered to represent a strong

[41] The majority of third parties also stated that, contrary to American Greetings' submission, smaller publishers do not have relationships with the larger retailers. Instead, larger retailers tend to have a relationship only with one of a small number of wholesalers, including American Greetings, Hallmark, Woodmansterne, and one or two others, who then act as a broker.

alternative to American Greetings by third parties. However, the OFT notes that one equivalent input source may not be sufficient to prevent foreclosure.[42]

92. Nevertheless, and most importantly, the OFT also notes that other specialist retailers highlighted a number of other alternative publishers from which they could source, pointing to, for example, Carte Blanche and the Great British Card Company, among others. A number of these specialist retailers were able to point to as many as five or six alternative upstream publishers that currently comprise, or could comprise, a significant proportion of their stock. These retailers did not point to a reliance on American Greetings and/or Hallmark, despite requiring a large range of stock as specialist retailers. Instead, they suggested that they were able to multi-source from numerous publishers, so as to obtain the required range. These third parties were unconcerned by the Transaction. Linked to this, is the fact that, according to American Greetings, specialist retailers have regular access to the offerings of many publishers at various trade fairs held across the UK throughout the year.

93. Indeed, the OFT notes that many retailers currently source a significant proportion of their sales from alternative suppliers, with American Greetings representing a maximum of around 40 to 50 per cent of the stock of the specialist retailers spoken to by the OFT and, in many cases, significantly less.[43] Specialist retailers are clearly currently multi-sourcing to a significant degree and are able to bear any costs of doing so while still remaining competitive. A number of publishers also stated that there were no significant cost disadvantages for a retailer to multi-source, as commonly it is the publisher who will have a sales representative or agent that calls at the retailer, so that search and sourcing costs are not necessarily borne by the retailers.

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[42] Hallmark's best response to a price increase by American Greetings would likely be to also increase its prices (albeit by less than the price rise of American Greetings). The OFT notes therefore that competition with Hallmark does not completely eliminate American Greetings' ability to increase prices or otherwise deteriorate the competitive offering.

[43] Only where an 'independent' retailer was a designated 'From the Heart' store did this proportion increase to above [ ] per cent. In 'From the Heart' stores, American Greetings provides [ ] in return for a long-term commitments (varying from between four and 10 years) from the retailer to predominantly stock UKG greetings cards (around [ ] per cent or above). Such arrangements means the retailer becomes a designated 'From the Heart' store.

94. American Greetings provided examples where specialist retailers had switched away completely from American Greetings to another greetings cards supplier other than Hallmark, including [ ] and [ ] (although American Greetings did not note the extent to which these retailers continued to source from, or were reliant on, [ ]).

95. American Greetings also pointed to the presence of distributors who build a portfolio of greetings cards from various publishers and then re-sell them. These distributors, according to American Greetings, use their own warehousing facilities and network of sales agents across the UK, and they take responsibility for the sales, marketing and distribution of card ranges, leaving the publisher to concentrate on developing and producing its ranges. These distributors, American Greetings argued, are able to provide retailers with a full range of cards without the need of going to American Greetings.[44]

96. Two specialist retailers also raised concerns relating to certain American Greetings' lines that are in particular demand by customers, and if customers could not obtain those product lines at a store, then the customer would look elsewhere. There is some support for this view in internal business documents submitted by American Greetings, which indicate the rationale for retailers seeking exclusive deals is, in part, [ ]. Customers' purchasing behaviour must therefore, by inference, reflect an awareness of specific product lines when purchasing.

97. In this regard, American Greetings argued that none of their greetings cards are a 'must stock' good, stating that there are numerous specialist retailers that do not stock American Greetings' cards, including, in particular, those retailers that are linked to Hallmark and source principally from Hallmark.[45] American Greetings also suggested that there are many independent specialist retailers that source from neither Hallmark nor American Greetings, although no evidence was provided of these retailers.

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[44] See GCA Alternative Route to Market available at www.greetingcardassociation.org.uk/info-resource/distributors/an-alternative-route-to-market. A list of the greetings cards distributors is available on request from the GCA. Hallmark has its own distributor business, called Hambledon.

[45] Hallmark Gold Crown Stores are similar to American Greetings' 'From the Heart' stores [ ]. There are currently 400 Hallmark Gold Crown stores and Hallmark plans to double this number in the near future: www.hallmark.co.uk/InStore/Own-a-Store .

98. On this point, the majority of third parties did not consider specific product lines or brands to be especially strong in driving sales, indicating that consumers generally do not shop for any specific greetings card line.

99. The OFT notes that other factors may also point to the ability of American Greetings to foreclose, including where:

(a) The cost of switching upstream supplier is high and remaining suppliers cannot expand output (say, due to capacity constraints).

(b) There are other factors limiting downstream rivals access to inputs (for example, exclusive contracts between Clinton and other upstream suppliers).

(c) Confidential information of rivals is transferred alongside the assets, which could potentially be used to put rivals at a competitive disadvantage.

Switching supplier and capacity

100. American Greetings submitted that switching supplier is relatively easy and it provided examples of supermarkets that have switched supply between American Greetings and Hallmark, including specialist retailers who stopped sourcing from American Greetings altogether.[46]

101. American Greetings also argued that capacity and costs are different across upstream suppliers. The OFT is generally more concerned if alternative suppliers are restricted in the extent to which they can expand output, as this would limit their ability to supply competing retailers. However, despite American Greetings' own arguments, other competing publishers were generally of the view that it would be straightforward to increase supply and that expanding capacity further was not an issue. Only one publisher argued that increasing production takes significant planning and could not be undertaken immediately.

[46] Four examples are given with [ ] of the retailers switching to [ ] and [ ] to [ ].

Exclusive contracts

102. The OFT's market investigation indicated that exclusive contracts are relatively common between wholesalers and retailers. Third parties pointed to numerous agreements between publishers and some of the larger retailers. American Greetings confirmed that it had [ ]. Internal business documents submitted by American Greetings indicate that such [ ].[47]

103. The OFT considers that the presence of exclusive contracts between the merged firm and independent greetings cards wholesale suppliers may limit the ability of downstream retail rivals to have adequate access to inputs through two means. First, where relevant capacity is allocated and fixed to a particular retailer, this capacity cannot be used to supply those customers looking to switch away from American Greetings. However, suppliers, aside from American Greetings and one other supplier, stated that greater usage of existing capacity through expanding output or increasing capacity further is not an issue, and it seems this would have no affect on the availability of supply [see endnote [iii]].

104. Moreover, some third party specialist retailers point to the Transaction potentially limiting their access to alternative publishers as American Greetings can offer business through Clinton to other upstream publishers under exclusive contract, removing these publishers as choices for other retailers downstream. The retailers that raised this suggested it may even have an effect on overall wholesale prices. However, the OFT found no evidence of complete exclusivity between a publisher and a retailer (as opposed to certain lines of stock). The OFT notes further that Clinton has a significantly reduced presence since exiting administration, operating half the number of stores that it did prior to administration. All of the previous exclusive deals that Clinton Cards had in place have now opened up to other retailers, and it is not clear whether Clinton would offer sufficient sales to warrant exclusivity from a publisher (given that exclusivity is commonly associated with minimum volumes).

Confidential information

105. A small number of retailers also raised the concern that American Greetings may have access to confidential information. Relationships between

[47] American Greetings [Internal Business Document].

retailers and upstream suppliers, according to third parties, commonly involve working in partnership to increase sales and develop the most appropriate range and product mix, which inevitably involves the passing of information between retailer and supplier. The retailers that raised this issue stated that American Greetings will likely have information on the volumes and ranges sourced from other suppliers, as well as American Greetings themselves [see endnote[iv]].

106. American Greetings submitted that its current corporate structure prevents the passing of such confidential information between the integrated wholesaler and retailer, but it does not suggest that it would not possess such information.

107. Corporate structure aside, it is not clear to the OFT the extent to which knowledge of confidential information may allow American Greetings to more effectively foreclose retail rivals or, more generally, put them at a competitive disadvantage.[48]

Conclusion on ability to foreclose

108. On the basis of the evidence presented above, the OFT considers that it is unlikely that the merged firm may have the ability to foreclose downstream rivals, as there are alternative suppliers from which retailers can source. Nevertheless, the OFT considers the merged firm's incentives to foreclose in order to determine the full extent to which American Greetings could potentially raise rivals' costs, as well as the possible benefits to American Greetings, if any, of pursuing such a strategy.

Incentive to foreclose

109. The incentive to foreclose depends on the extent to which it would be profitable to pursue such a strategy, taking account of the costs and benefits of doing so.

110. The cost of such a strategy involves the lost margin received upstream due to the reduction in sales that the merged company forecloses to

[48] The OFT recognises that vertical mergers may allow the merged firm to gain access to commercially sensitive information about the activities of non-integrated rivals. See *Merger Assessment Guidelines*, paragraph 5.6.13.

downstream retail rivals. The lower the margins upstream, the lower the loss from restricting input sales.

111. The benefit of such a strategy involves the margin gained on sales diverted downstream. The higher the downstream margins, the higher the profit gain from diverted sales downstream at the expense of foreclosed rivals.

112. The benefits of raising rivals' costs will also depend on the extent to which downstream demand is diverted away from foreclosed rivals and the share of that diverted demand captured by the merged firm.

113. The incentives to foreclose differ for, and determine, the specific strategy that may be pursued by the merged firm. In this case the OFT considers the potential incentive that the merged firm will have to refuse to supply or to supply the input on less attractive terms (for example, an increased wholesale price to rival retailers, supplying greetings cards to rival retailers with a material delay compared to supply internally, or supplying a reduced range to rival retailers).

Potential Losses Upstream

114. American Greetings submitted financial information which indicates its variable profit margin varies between [ ] per cent and [ ] per cent.[49] These estimates are based on sales (net of returns and discounts) less logistical costs and sales, distribution and marketing costs (**SDM**). The range reflects the extent to which certain cost items vary with output. Logistical costs and a proportion of SDM costs are considered variable, as these represent costs that vary with the quantity of output sold. The exact proportion of SDM that should be considered variable is unclear, but it is considered reasonable that a proportion of marketing costs may be a sunk cost that is independent of the quantity of output. To take this into account, the OFT has also considered a profit margin based on only three-quarters of SDM being variable costs.

115. Other information submitted by American Greetings suggests the scale of the losses upstream associated with any foreclosure strategy may be limited. Internal documents indicate that Clinton Cards was American

[49] UKG [Internal Business Document], submitted to the OFT as Annex A2 to the response to OFT questions dated 22 August 2012.

Greetings' largest UK account by some margin, representing [ ] per cent of its UK earnings, although sales of cards through Clinton Cards represented only [ ] per cent of total sales.[50] The OFT is not aware of the reason for the greater [ ]. However, the OFT considers this evidence suggests that if American Greetings were to foreclose other retailers the sales lost may be relatively limited in terms of impact on margin.

116. The losses upstream will be greater if the strategy involves a complete refusal to supply.[51] Indeed, even a complete refusal to supply specialist retail stores (see below) may, at its greatest (excluding the downstream dynamics and expansion of demand through Clinton), result in a limited loss to American Greetings, given that a [ ] of American Greetings' earnings is through Clinton in any event.[52] A partial foreclosure strategy may involve less risk as the merged firm would not force downstream rivals to switch entirely to other suppliers (although some losses may occur from those that do). Gains may also be made upstream from the increased margin on retained retail customers.

Potential Gains Downstream

117. In assessing the gains downstream, the OFT considers the demand that may be diverted to Clinton following an increase in the upstream price to rival retailers by American Greetings, including: the extent of the price rise downstream following the price rise upstream; the extent to which customers switch away from rival retailers; and the extent to which diverted customers are captured by the merged firm. Finally, the OFT considers the value of those diverted customers to the merged firm (relative to the value of those lost customers upstream).

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[50] [ ], taken from American Greetings [Internal Business Document], submitted as Annex P of the response to OFT questions dated 17 July 2012 and American Greetings [Internal Business Document], submitted as Annex A2 of the response to OFT questions dated 19 July 2012.

[51] Such a strategy may also have increased risks as foreclosed retailers attempt to obtain replacement product from alternative suppliers.

[52] Around [ ] per cent of total UK Greetings' sales are [ ], although this has been declining in recent years. See UK Greetings, [Internal Business Document] and UK Greetings [Internal Business Document].

118. In relation to the price rise downstream,[53] the OFT recognises that, in relation to partial foreclosure, any price rise downstream will likely be less than the price rise upstream as greetings cards represent only a proportion of the downstream cost, and some of the price rise may be absorbed by the retailer.

119. The OFT estimates that an upstream price increase of 20 per cent, for example, would result in a downstream price increase of seven per cent, while an upstream price increase of 30 per cent would result in a downstream price increase of 11 per cent.[54] This would, however, also be limited by the extent to which the retailer's stock was represented by American Greetings,[55] meaning that any partial foreclosure strategy would need to involve a significant increase in price to have any material effect on retail rivals' competitiveness. Therefore, the OFT notes that for American Greetings to raise rivals' costs materially, prices upstream would have to increase by a significant amount (or involve a refusal to supply) in order to make rival retailers relatively less competitive and induce switching downstream. Despite the fact that a number of retailers pointed to a lack of alternatives upstream, given that other retailers were able to point to various alternative suppliers, and all independent retailers (that is, not a 'From the Heart' or Hallmark Gold Crown store) are currently sourcing a significant proportion from alternative suppliers, the OFT considers that the availability of substitutes means a significant degree of foreclosure is unlikely, and the extent to which gains downstream would arise is highly uncertain.

120. In relation to the extent of switching away from rival retailers downstream, third party retailers indicated that the retail supply of greetings cards is

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[53] The OFT notes that third party retailers that raised concerns state that foreclosure may occur through increased prices but may also occur through American Greetings giving exclusive access to new releases for a period of time (say, six months) before these are sold to independent retailers. According to these retailers, new releases are a significant driver of sales and a delay in the supply of these, following sale of them through Clinton, would result in a significant loss in sales.

[54] The OFT has made a conservative assumption of 90 per cent pass-through and the cost of greetings cards representing 40 per cent of the final price (American Greetings submitted that the downstream margin is estimated to be around [ ] per cent).

[55] If, for example, the retail price of greetings cards sourced from American Greetings increases by 10 per cent, but represents only 50 per cent of the retailer's greetings cards stock, the average increase in price of all of the retailer's stock, other things remaining constant, will be only five per cent.

highly price sensitive and customers switch between card retailers in response to small price changes. Many third party specialist retailers stated that the effect of increasing the price of their stock by five to 10 per cent would result, over time, in a significant proportion of their customers diverting to competing retailers, albeit price increases on specific greetings cards may be more likely to lead to switching to different greetings cards in the same retailer. Indeed, a number of third party retailers stated that they price below Clinton (for example, by around 20 pence per card) and if prices were to equalise, customers would switch. The OFT notes that the average price of a card is around £2.40 (of which 20 pence represents only 8 per cent).[56] These third party retailers also estimated that, in the event that they do not stock American Greetings' cards at all, even more customers would switch away.

121. In relation to the diverting customers captured by the merging firm, the OFT considers that this is limited to those locations in which Clinton are present (otherwise no diverting customers would switch to Clinton). On this basis, any national foreclosure strategy is unlikely, as there will be numerous retailers that American Greetings is foreclosing with no diverting customers downstream. As a result, the OFT considers any incentive on American Greetings to foreclose exists only in those local areas in which a Clinton is present and located within the near vicinity of the foreclosed rival. In these local areas, where there is a specialist retailer, and few other alternatives, American Greetings may have an incentive to foreclose those rival retailers. American Greetings did not provide any evidence indicating the number of local areas that might be affected, nor of the diversion to Clinton or to other retailers that might be likely to occur in those local areas, in the event of a price rise by American Greetings [see endnote [v]]. While a small number of third party specialist retailers stated that, in the event customers switch away from them, most would switch to Clinton, a number of other retailers stated that sales would divert to a number of alternatives.

122. In relation to the value of those diverting customers, American Greetings submitted estimates of Clinton's variable profit margin, which is in a range

[56] See, for example, American Greetings [Internal Business Document], submitted as Annex P of the response to OFT questions dated 17 July 2012.

greater than, or equal to [ ] per cent.[57,58] These profit margins relate to Clinton Card's entire store portfolio. The OFT notes that the retained stores are more likely to represent the most profitable units of the Clinton Card's portfolio on entering administration, and so the profit margin of these stores may be even higher, although the OFT recognises that much of the variation in profitability at stores may have been driven by fixed costs (and, in particular, rent) at those stores. In addition, the OFT notes that where the incentive to foreclose may be greatest – where a Clinton store faces limited competition downstream – the profit margin may be significantly higher.[59]

Conclusion on incentive to foreclose

123. On balance, based on the evidence available to it the OFT does not consider American Greetings has the ability and incentive to foreclose downstream rivals.

Effect of foreclosure

124. In the absence of an ability and incentive to foreclose the OFT does not consider it necessary to determine the extent of any effect of foreclosure on consumers as a result of reduced downstream retail competition. Nevertheless, the OFT notes that if there remains sufficient downstream competitors whose costs are unaffected by any foreclosure strategy – including where a competitor is vertically integrated and is able to self-supply – there may remain a sufficient constraint on the merged firm post-merger, preventing retail prices from rising.

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[57] Clinton Cards [Internal Business Document], submitted as Annex M to the response to OFT questions dated 17 July 2012.

American Greetings [Internal Business Document], submitted as AnnexA2 to the response to OFT questions dated 19 July 2012.

[58] Clinton Cards [Internal Business Document], submitted as Annex B2 to the response to OFT questions dated 19 July 2012, which details a profit margin of 65 per cent.
Clinton Cards [Internal Business Document], submitted as Annex B2 to the response to OFT questions dated 19 July 2012.

[Internal Business Document], submitted as Annex E2 to the response to OFT questions dated 19 July 2012.

[59] The OFT also notes that the merged firm may gain additional benefits from those customers whose decision to divert is driven by greetings cards but that purchase associated goods in addition to the card(s), adding to the downstream gain.

125. The OFT considers that the presence of Card Factory in any local area in which a Clinton's store is present, may reduce the proportion of diverted customers that switch from a foreclosed retailer to Clinton, thereby further reducing the likelihood of foreclosure arising.

Conclusion on Input Foreclosure

126. As outlined above, the OFT does not believe American Greetings has the ability and incentive to foreclose, due to the availability of substitutes, the extent of the price rise required to have any effect on rivals' costs, and the uncertainties surrounding the downstream gains realised as a result of the foreclosure strategy. As a result, the OFT does not consider there to be a realistic prospect of a substantial lessening of competition in relation to input foreclosure.

CUSTOMER FORECLOSURE

127. Customer foreclosure relates to the denial of access to actual or potential customers to competing firms. In this case, the customer base is the retail outlets of Clinton, which American Greetings uses to sell its products to end customers. This strategy could involve, for example, the merged firm sourcing all or more of its greetings cards for retail stock from its vertically integrated upstream supplier, American Greetings thereby the merged firm may have the ability and incentive to foreclose access to a sufficient customer base to upstream rivals (such as Hallmark and Card Factory), reducing their competitiveness. Alternatively, it may purchase from rival upstream suppliers on less favourable terms than it would have, absent the Transaction.

128. For such a strategy to be feasible, the merged firm would need to have sufficient market power downstream in the retail market (that is, they would have to represent a sufficiently important route to market for upstream rivals, such as Hallmark). If there is a wide range of other retailers that upstream rivals can continue to supply cards to, the merged firm would not be able to effectively restrict access through foreclosure.

129. However, the OFT notes that third party suppliers that responded to the OFT did not support Clinton being so material to their business that not being able to supply to end customers through Clinton at all (the extreme case of total foreclosure) would materially affect their efficient scale or

ability to remain as effective competitors. Many upstream suppliers did not point to an efficient scale being relevant, whilst the other large suppliers, such as [ ], which raised customer foreclosure as an issue, currently supply significant volumes to other retailers that make up the vast bulk of their sales. Further, the OFT notes that [ ]. A number of upstream suppliers also pointed to the diminished importance of Clinton following administration, given the significantly reduced store portfolio.

130. As a result, the OFT does not consider the evidence points to American Greetings having the ability to foreclose other upstream suppliers through restricting access to Clinton.

BARRIERS TO ENTRY AND EXPANSION

131. Entry or expansion may potentially prevent or mitigate competition concerns arising through the theories of harm outlined above: the incentive of the merging parties (for example) to raise prices is diminished if such action would lead to entry or expansion by rivals. Similarly, the external stability of a coordinated outcome depends on the absence of a response from outside the coordinating group.[60]

132. The OFT recognises that any attempt at foreclosing downstream retailers creates an additional incentive on retailers to turn to available suppliers upstream and/or attempt to accelerate their expansion or to encourage additional entry. However, it is not clear the extent to which entry on a sufficient scale is feasible at the publisher level and if independent retailers could facilitate this.

133. Similarly, the OFT recognises that Card Factory has grown significantly in recent years and the opening of a Card Factory store in a local area may reduce the effect of any foreclosure strategy, as Card Factory would remain as a downstream competitor and would not be subject to foreclosure.

134. In the absence of competition concerns, the OFT has not found it necessary to conclude on the extent to which entry or expansion post-merger is likely to offset any anti-competitive effects from the merger.

[60] See *Merger Assessment Guidelines*, Section 5.8.

BUYER POWER

135. Customers may be able to use their negotiating strength to limit the ability of a merged firm to raise prices. Such countervailing buyer power may make competition concerns less likely to arise.[61]

136. American Greetings submitted that the retail rivals of Clinton include powerful specialist retailers and supermarkets that have strong countervailing buyer power. Examples have been provided where retailers have switched – or threatened to switch – volumes, in part or in total, to or from American Greetings, including: [ ].

137. American Greetings also provided examples of four independent specialist retailers that have switched from American Greetings to [ ] and [ ], and which no longer source from American Greetings at all. The extent to which these retailers remain reliant on Hallmark is unclear.

138. In the absence of competition concerns, the OFT has not found it necessary to conclude on the extent of countervailing buyer power in this case.

THIRD PARTY VIEWS

139. The OFT has received complaints about the Transaction from third parties contacted by the OFT, including customers and competitors. Third party comments have been taken into account where appropriate in the competitive assessment above. One third party expressed concern about the provision of own label cards and whether design and brand development could be used by the merged entity in its retail operations. However, the OFT considers this to be a contractual matter and not a competition concern.

ASSESSMENT

140. American Greetings is active in the wholesale supply of greetings cards in the UK, and Clinton is active in the retailing of greetings cards. American Greetings acquired 382 Clinton stores, which is around half that of the 784 stores that Clinton Card's operated before going into administration.

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[61] See *Merger Assessment Guidelines*, Section 5.9.

141. The OFT has assessed the Transaction on the basis of the wholesale of greetings cards at the national level and the retailing of greetings cards at the local level (in a one-mile radius). Moreover, the OFT has taken a cautious approach and examined the affect of the Transaction on specialist retailers of greetings cards.

142. In this case the OFT carefully considered whether, absent the Transaction, Clinton Cards would have failed, thereby not offering a competitive constraint on other retailers or providing a route to market for various wholesalers. In doing so, the OFT investigated: (i) whether Clinton Cards would have exited; (ii) whether there would have been an alternative purchaser for the Clinton stores (or some composition of the Clinton Card's stores); and (iii) what would have happened to the sales of Clinton's in the event of exit. Based on the evidence available, the OFT is unable to reach a sufficient level of confidence that exit would have been inevitable. Furthermore, in relation to the second criteria, the evidence does suggest that another bidder would have taken on operations of the Clinton stores (or some composition of the Clinton Card's stores), and that this would likely have been significantly less anti-competitive. It was not considered necessary to examine the third criteria in this case. Accordingly, the OFT does not consider the evidence supports an exiting firm scenario in this case.

143. There is no horizontal overlap between the merging parties. However, the OFT has investigated whether vertical foreclosure may arise as a result of the Transaction. In particular, the OFT examined the prospect of input foreclosure (that is, American Greetings raising prices of, or refusing to supply, greetings cards to rival downstream retailers) and customer foreclosure (Clinton no longer buying greetings cards from rival wholesalers).

144. For input foreclosure, some retailers raised concerns that they would not be able to source their required range of greeting cards from alternative wholesalers. However, other specialist retailers were able to point to a number of other alternative suppliers from which they could and do source greeting cards at no cost disadvantage. The OFT considers that, despite the merged firm's relative presence in the upstream supply of greetings cards and its importance to retailers in providing a range of stock, the presence of sufficient credible suppliers means that the merged firm will

not have the ability to harm rival retailers downstream. Further, competing wholesalers are not significantly capacity constrained.

145. In terms of the firm's incentive, the OFT notes that for American Greetings to raise rivals' costs materially, prices upstream would have to increase by a significant amount, such that foreclosure would need to be of a significant degree (or a complete refusal to supply), in order to make rival retailers relatively less competitive and induce switching downstream. Some retailers were able to point to various alternative suppliers and all independent retailers were already sourcing a significant proportion of their greetings cards from alternative suppliers. Moreover, the OFT notes that any potential gains downstream will be limited by the extent to which customers can switch to other publishers' cards in the same retailer.

146. As a result, on balance, the OFT does not consider American Greetings has the ability and incentive to foreclose downstream rivals via input foreclosure.

147. For customer foreclosure, the OFT's investigation found that third party wholesalers were not dependent on Clinton and Hallmark, the largest of American Greetings' competitors, does not currently supply Clinton at all.

148. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

149. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.

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[i] American Greetings subsequently clarified that Schurman Retail Group is a group of individuals from an independent company.

[ii] As with endnote ii above, American Greetings have clarified that this should be seen in the context of the Clinton business underperforming under the management of independents from the Schurman Retail Group.

[iii] American Greetings clarified that the merged firm does not have exclusive contracts with independent greetings cards wholesale suppliers.

[iv] American Greetings clarified that it does not have access to such information. In any event, it is common practice to have confidentiality agreements in place to protect the bilateral exchange of confidential information between each retailer and upstream supplier.

[v] American Greetings provided some local specific evidence showing overlapping independent specialist retailers for some of the areas in which Clinton is present.