

Completed acquisition by the CdMG group of companies of
Ferryways NV and Searoad Stevedores NV

ME/3145/07

The OFT's decision on reference under section 22(1) given on 24 January 2008.
Full text of decision published on 8 February 2008.

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

PARTIES

1. **The CdMG group of companies** (CdMG) is controlled by [] the **Cobelfret group of companies** (Cobelfret Group). Cobelfret Group is active in the supply of short-sea unitised freight shipping, including new car transportation, on Anglo-Continental routes. It is also owns or has interests in a number of port facilities both in the UK and on the Continent.
2. Given the connection between CdMG and the Cobelfret Group, the OFT will treat the companies as associated persons for the purposes of considering this transaction.¹ For the purposes of assessing the relevant market and for the competitive assessment, the term 'Cobelfret' has been used to collectively describe both CdMG and the Cobelfret Group.
3. **Ferryways NV** (Ferryways) was active in the supply of short-sea unitised freight shipping. Ferryways' turnover in the UK was approximately £6 million in the last financial year. **Searoad Stevedores NV** (Searoad) provided stevedore services in Ostend. Searoad had no turnover in the UK. Prior to the transaction, both parties were part of the same group of companies.

TRANSACTION

4. On 1 June 2007, two special purposes companies, LineCo NV and TerminalCo NV (the Acquiring Companies) purchased Ferryways and Searoad respectively (the Target Business). The Acquiring Companies are both wholly owned subsidiaries of CdMG.²

¹ Section 127, Enterprise Act 2002.

² As part of a separate transaction, RoRoCo NV, part of the CdMG group of companies, purchased certain ships chartered by Ferryways.

5. The parties notified the transaction to the OFT on 28 June 2007 in response to an OFT enquiry letter. The extended statutory deadline is 24 January 2008.

JURISDICTION

6. As a result of this transaction CdMG and the Target Business have ceased to be distinct. Prior to the transaction the parties overlapped in the supply of short sea unitised freight shipping between ports in the Humber and continental Europe, with a combined share of approximately 30 per cent, meaning the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

THE COUNTERFACTUAL

7. Applying the substantial lessening of competition test involves comparing prospects for competition with and without the merger. The OFT's default proxy for assessing prospects for competition in the absence of the merger – the 'counterfactual' – is given by conditions prevailing pre-merger. A detailed explanation of the OFT's policy and approach on counterfactual issues – including the subset of 'failing firm defence' issues – is set out in its recent decision in *Tesco/Kwik Save*³ and that framework applies to the present case.
8. For reasons set out in detail below, the present case, like *Tesco/Kwik Save*, is a rare example of the high evidentiary burden of the failing firm defence being met. While the transaction has combined two competitors in the short-sea freight sector routes between UK and Continental ports, ultimately nothing turns on the degree of competition lost relative to pre-merger conditions in circumstances where the OFT is satisfied that the merger is not the cause of the deterioration of competition. It is therefore convenient for present purposes to focus on this lack of causation by way of the application of the failing firm defence.

Background: events following the transaction

9. Cobelfret claims that, immediately following the acquisition, two whistleblowers within the Target Business disclosed cases of financial irregularities, including fraudulent practices, in connection with the Target Business's banks. Disclosure of these matters to the banks led to the withdrawal of the Target Business's credit facilities and subsequent defaulting of payments. On 13 June 2007 the Target Business went into default of payment and stopped supplying services, and on 15 June 2007

³ Anticipated acquisition by Tesco Stores Limited of five former Kwik Save Stores, decision of 11 December 2007, paras. 8ff.

the Belgian Court appointed administrators in respect of the Target Business. The Target Business subsequently went into liquidation on 27 June. As a result of these events, the Target Business's charter agreements in respect of all of the vessels which it used to operate its shipping line were terminated.

10. On 21 June 2007 Cobelfret commenced legal proceedings in Belgium against the sellers to recover the price paid [end note 1] for the Target Business, on the grounds that they fraudulently provided false information as to the financial circumstances of the Target Business prior to the transaction. This case has not yet been resolved. Cobelfret claims that the liquidation of the Target Business is a direct result of its financial position prior to the acquisition, and was not a consequence of any actions taken by Cobelfret following the acquisition.
11. The circumstances surrounding this transaction are particularly novel in that the financial collapse of the Target Business occurred following its acquisition by Cobelfret, even though Cobelfret alleges that the causes of the financial collapse existed prior to the transaction. Given these particularly novel, and highly unusual, circumstances, the OFT has considered whether a departure from its standard counterfactual of prevailing conditions of competition would be justified and to assess the transaction on the basis that the Target Business would have stopped trading irrespective of its acquisition by Cobelfret. This amounts to a failing firm defence claim in very unusual conditions even among cases involving distressed target firms. However, where, as under the failing firm defence, it is alleged that there is an absence of causation between the merger and any lessening of competition, the OFT will as a matter of policy seek a high level of supporting evidence and in a line of previous cases involving distressed firms the OFT has judged parties' claims against a 'sufficient compelling evidence' standard.⁴

Failing firm defence criteria

Inevitable market exit of the Target Business and no serious prospect of re-organisation

12. Cobelfret submitted that the Target Business was insolvent and had been trading on a fraudulent basis for some time prior to the acquisition. It submitted that, as a direct result of these circumstances, the concessions for Searoad to use the Ostend terminal in Belgium were withdrawn, and Ferryways' charter agreements in respect of the vessels used in its shipping line have been terminated. The Target Business ceased to operate, it no longer has any goodwill and the customers of the Target Business moved elsewhere.

⁴ See *Tesco/Kwik Save* at paragraph 31, *Thermo/GVI*, decision of 15 December 2006 and previous cases cited therein.

13. The alleged fraudulent practices of the sellers in connection with the Target Business are set out in the legal proceedings filed by Cobelfret in the Belgian High Court. They include:
 - In relation to a credit arrangement with ING Bank (the ING loan), the withdrawal of amounts which were substantially higher than the amounts authorised under the credit facility. The amount allowed under the ING loan was connected to various receivables in the Ferryways accounts, which Cobelfret alleges were unlawfully inflated.
 - That Ferryways entered into loan agreements in violation of the ING loan, one of which was included in the financial accounts of Ferryways. Additional financial irregularities are alleged in relation to the other loan agreements as set out in the legal proceedings.
 - Irregularities regarding the ships used by Ferryways, including the listing in the Ferryways' accounts of ships and spare parts not owned by Ferryways.
 - Irregularities relating to invoicing and overdue payments which inflated the value of the Target Business, and other irregularities in the financial accounts.
14. In Cobelfret's court petition, it claims that unless the new directors had continued the 'serious deceptions vis-à-vis the banks, [the Target Business] would have, on a very short term, headed towards a fatal liquidity and solvability crisis'. Indeed, following discussions between Cobelfret and the banks that had provided credit to the Target Business, all credit facilities were cancelled and the Target Business went into liquidation.
15. A number of third parties contacted by the OFT suggested that the Target Business was a weak competitor to the established short sea unitised freight shippers operating between the UK and European ports, and, even in the absence of knowledge of the financial circumstances set out above, a number of third parties suggested that Ferryways was in a perilous financial position prior to the acquisition. These views are at least consistent with Cobelfret's claims although, given the nature of the allegations made by Cobelfret (in particular the inherently covert nature of the alleged fraudulent activity of the sellers), independent third party evidence on the actual financial position of the Target Business prior to the acquisition is difficult to obtain. The OFT spoke to the various banks who had loan arrangements with the Target Business. However, these banks could not provide the OFT with an independent account of the activities leading to the administration and liquidation of the Target Business, as their decisions to withdraw their funding was largely based on information provided to them by Cobelfret.

16. The sale and purchase agreement did, however, provide for a post-purchase audit report to be undertaken by Ernst & Young. The OFT obtained a copy of this report [end note 2]. The report does not consider the events following 31 May 2007 (i.e. the bank demands, discontinuation of services and liquidation of the Target Business) but provides a reflection of the financial state of the company at 31 May 2007, the day immediately prior to the completion of the purchase of the Target Business. The report is limited to an analysis of the accounts of the Target Business, so does not consider the fraudulent nature (or otherwise) of the financial practices of the sellers (this matter is currently before the Belgian High Court). However, a number of aspects of the report are relevant to the OFT's analysis. These include:

- A number of receivables were incorrectly taken into account and customers' payments ignored, for the purposes of determining the borrowing base for the ING loan. The result of this was that the borrowing base was 'artificially' raised by €1,658,000.
- That not all of the 'agreements and ratios' in relation to the ING loan had been met integrally.
- The arms length character with regard to the financial bookings of the boat charters was described as 'doubtful', and the inaccurate accounting of the various aspects of the charter arrangements resulted in the accounts being 'positively influenced' by amounts of €1,184,000 in 2005 and €1,095,000 in subsequent years.
- The corrected financial accounts of the Target Business show net liabilities of €7,371,000⁵ as at 31 May 2007. The liabilities of the Target Business were collectively €2,386,000 more than the limit set out in the sale and purchase agreements.

17. The Ernst & Young report supports Cobelfret's claims that there were a number of material irregularities with the financial accounts of the Target Business as at 31 May 2007. These irregularities are consistent with Cobelfret's submissions regarding the financial state of the Target Business prior to the transaction and the court action it has pursued. It also follows from all of the above that there was no serious prospect of reorganisation of the Target Business absent the merger.

18. Based on this evidence, the OFT concludes that, in the short term, the Target Business would have ceased to trade and it and its assets would have exited the market regardless of its acquisition by Cobelfret.

⁵ €6,734,000 for Ferryways NV and Ferryways (UK) Limited and €637,000 for Searoad Stevedores NV.

No less anti-competitive alternative to the merger?

19. In assessing the appropriate counterfactual in this case, the OFT considered whether a different competitive outcome could have occurred in the absence of the transaction.
20. Based on the very specific (and highly novel) facts and circumstances of this case, the OFT does not believe that in the absence of the merger there would have been a materially different outcome from the present case. As outlined above, the discovery of the Target Business's financial irregularities set off a chain of events that led to it quickly ceasing to carry on business. Included in this chain of events were the withdrawal of the Target Business's loan arrangements, its concession to use the Ostend terminal in Belgium, the refusal of stevedoring suppliers to continue to service the Target Business at its UK ports (the Target Business did not require a concession to these ports) and the cancellation of all ship charters.
21. This loss of these key assets required to operate the Target Business quickly led to the loss of all of its customers. The collapse of the Target Business meant that, despite the transaction, Cobelfret did not purchase a viable business, and effectively did not acquire a going concern.
22. Based on the evidence obtained by the OFT, any third party acquiring the Target Business would on proper due diligence have discovered the financial irregularities which Cobelfret discovered, and so would have experienced the same immediate collapse of its business. Even had the Target Business not been acquired (either by Cobelfret or by another acquirer), given the available evidence the OFT considers that it would not have continued trading, such as to act as a competitive constraint beyond the very short term. Nor in these peculiar circumstances does the OFT entertain the argument that allowing the Target Business to have failed absent the merger would have produced a materially better outcome for competition than with the merger.
23. The OFT therefore considers it has sufficient compelling evidence to conclude that any effect on competition arising following the merger would have arisen in the absence of the merger itself, given the financial circumstances of the Target Business and the events subsequent to the merger. As such, the stringent criteria for the failing firm defence are met and it has not been necessary to conduct a detailed assessment on the pre- and post-merger state of competition to determine the competitive effects of this merger.

THIRD PARTY VIEWS

A number of third parties suggested that the Target Business was not financially secure prior to the merger, although few third parties could point to actual evidence to illustrate this. Until the OFT obtained an independent Ernst & Young report, completed in November 2007, it was difficult to obtain an independent picture of the financial position of the Target Business prior to the acquisition.

ASSESSMENT

24. This merger combines two companies active in the supply of short-sea unitised freight shipping between the UK and European ports. However, immediately upon acquiring the Target Business, Cobelfret discovered a number of financial irregularities in the accounts of the business. This set off a chain of events that led to the Target Business quickly ceasing to carry on business.
25. The OFT considered whether, given these events, it was appropriate to depart from the prevailing conditions of competition as the counterfactual for the competitive assessment, and assess the transaction on the basis that the Target Business would have stopped trading irrespective of its acquisition by Cobelfret. As a matter of policy, the OFT sought a high level of supporting evidence to support this departure from its presumptive counterfactual as it does in all cases involving claims that the merger is not the cause of any lessening of competition.
26. The OFT examined the allegations made by Cobelfret as to the irregularities in the accounts of the Target Business. While independent third party evidence was initially difficult to obtain, a post-merger independent due diligence report confirmed that there were a number of material financial irregularities within the Target Business. Based on this evidence, the OFT found that the Target Business would have ceased trading irrespective of its acquisition by Cobelfret.
27. Given sufficient compelling evidence on the chain of events following the transaction, and in particular the loss of loan facilities, port access arrangement, ship charters, and ultimately customers, the OFT also concluded that any effect on competition arising following the merger would have arisen under any reasonable scenario in the absence of the merger, given the financial circumstances of the Target Business and the events subsequent to the merger. As such, the failing firm defence is made out in this case.
28. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

