

JD SPORTS / FOOTASYLUM

COMPANY A'S COMMENTS ON THE CMA'S REMEDIES PAPER

I. Introduction

- (1) Company A welcomes the CMA's Remedies Paper and the provisional conclusion that only a full divestiture of Footasylum Limited ("**Footasylum**") (including the Footasylum brand) by JD Sports Fashion plc ("**JD Sports**") would represent an effective remedy to the substantial lessening of competition ("**SLC**") at the national level that was identified in the CMA's Provisional Report on the case remitted to the CMA by the Competition Appeal Tribunal ("**PR**"). Company A urges the CMA to confirm this view in its final decision in relation to the completed acquisition of Footasylum by JD Sports (the "**Merger**").
- (2) To address the SLC identified in the PR, post-divestment, Footasylum must be able to operate as an effective national multi-channel retailer competing vigorously with JD Sports and other players on the market. This note seeks to emphasise, first of all, how the CMA can achieve an effective and timely divestiture process and, second, specific requirements to which the CMA should pay attention when selecting a suitable purchaser. Specifically:
 - (a) The circumstances of the Merger necessitate the appointment of a divestiture trustee at the outset of the divestment process. Allowing JD Sports an initial period of time to run the divestment process is likely to result in delay and consequent erosion of the competitive capability of the Footasylum business. This is because JD Sports has no commercial incentive to procure divestiture of Footasylum to a suitable purchaser [X]. The upfront appointment of a divestiture trustee, under the supervision of the CMA, will ensure that a suitable purchaser is secured and the SLC is eliminated in a timely manner. [X]
 - (b) Post-divestment, Footasylum must be able to compete vigorously as an effective national multi-channel retailer in the UK. To achieve this, the purchaser must meet at least the following suitability criteria: (i) be fully independent from JD Sports and its parent entity, Pentland; (ii) have the capability to operate Footasylum as an effective competitor, including by being able to obtain supplies of 'must-have' branded products; (iii) have adequate financial resources to make *inter alia* the appropriate levels of capital expenditure; and (iv) preferably, have deep expertise and a strong track record in owning and operating retail businesses in the UK, preferably in the sporting and/or lifestyle goods sectors.

II. Running a timely and efficient divestiture process

The circumstances of the Merger necessitate the appointment of a divestiture trustee from the outset of the divestment process

- (3) While it is the CMA's usual approach to allow the merger parties an initial period of time to secure the sale of a divestiture package to a suitable purchaser, Company A has significant concerns about leaving it to JD Sports to secure a suitable buyer that will satisfy the CMA's criteria in a timely manner. Company A believes that, considering the circumstances of the Merger and the characteristics of the sector, the sale of Footasylum should be conducted from the outset by a divestiture trustee, who would operate under the direction of the CMA, monitor the sale process and ensure that all offers are properly considered.
- (4) JD Sports has the incentive to secure an acquisition of Footasylum by a purchaser that would result in a lesser competitive constraint on it (depending on the relative value of the bids and the expected loss of trade to Footasylum post-divestment). In addition, JD Sports has a very close relationship with Nike and adidas.¹ Given the opportunity to lead the divestment, JD Sports will have the power to act on this incentive and limit the effectiveness of the remedy by delaying and influencing the sale process to secure its preferred outcome *i.e.*, the creation of a weak new competitor that would pose no real constraint. JD Sports has every incentive to seek to protract the sale process in order to keep one of its closest rivals off the market and ultimately secure a divestment to a purchaser that would result in a lesser competitive constraint on it. Allowing JD Sports to take charge of the divestment process would allow JD Sports to abuse the sale process, including by:
- (a) filtering the prospective purchasers and only considering ones who do not adequately meet the suitability criteria (in particular, criteria related to the capability to operate Footasylum as an effective competitor in the retail supply of sports-inspired casual (i) footwear (in-store and online) and (ii) apparel (in-store and online) in the UK (the "**Relevant Markets**"));² and
- (b) [REDACTED].³
- (5) Company A's concerns in this case echo those of the Competition Commission ("CC") in *Tesco/CWS*⁴ in 2007 where the CC imposed the appointment of a divestiture trustee

¹ "A factor in the company's success has been its relations with key suppliers like Nike, Adidas, Under Armour and Puma, who are very particular about how their wares are presented and priced. "We preserve brand equity and deliver it in an appealing environment. There's a lot of working together," said Mr Cowgill, noting that JD is regularly name-checked by Nike executives in its earnings calls." Financial Times, [How JD Sports won the UK 'athleisure' race](#) (21 April 2018).

² Reference to Relevant Markets is made in accordance with the relevant markets identified by the CMA in the PR (paragraph 5.5). [REDACTED]

³ [REDACTED]

⁴ Completed acquisition by Tesco plc of the Co-operative Group (CWS) Ltd store at Uxbridge Road, Slough, No. ME/1344/03 ("*Tesco/CWS*").

at the start of the sale process due to concerns that "*Tesco [had] an incentive to secure the implementation of the option that would result in a lesser competitive constraint on it*" and would have the ability "*to act on this incentive and it would be likely to seek to influence the sale process to secure its preferred outcome*" by, for instance deterring bidders or influencing the level of the bids such that the CC might consider them wholly unreasonable.⁵ The CMA followed the same approach in *Ryanair / Aer Lingus* (2015) where a divestment trustee was appointed at the outset of the divestment process.⁶

- (6) It is Company A's view that appointing a divestiture trustee at the start would be a proportionate option to improve the probability that the most suitable available purchaser for Footasylum is identified. Absent a divestiture trustee, there is also a substantial risk of delay in the sale caused by JD Sports trying to manipulate the process to its own advantage.
- (7) Moreover, the additional time that has already elapsed through the appeal and remittance process, further increases the need for a prompt divestment of Footasylum to a suitable purchaser to allow Footasylum to exit its current transitional period and continue operating as a viable and effective competitor on the market. The need for prompt divestment further justifies the need for a divestiture trustee to be appointed at the outset to ensure an expedited process.

- (8) [✂].

To mitigate the risk of deterioration of Footasylum's competitive capability a trustee must ensure that the Footasylum business is appropriately supported through the divestment process

- (9) The length of the divestment process poses a real risk of erosion of the competitive capability of the Footasylum business. Footasylum operates in an industry where consumer goodwill is not only fundamental but can often also be transient. Sporting goods and lifestyle retailers seek to create 'top-of-mind' awareness with consumers and maintain commercial momentum through marketing, advertising, as well as influencer and celebrity endorsements and collaborations. Maintaining consumer goodwill therefore requires active management and significant expenditure.
- (10) Under the CMA's current Interim Order, JD Sports and Pentland are under the obligation to *inter alia* "*at all times procure that, [...] (b) the Footasylum business and the Pentland business are maintained as going concerns and **sufficient resources are made available for the development of the Footasylum business and the Pentland business, on the basis of their respective pre-merger business plans***" and that "(e) *except in the ordinary course of business for the separate operation of the Footasylum*

⁵ Tesco / CWS, paragraph 8.107.

⁶ Completed acquisition by Ryanair Holdings plc of a minority interest in Aer Lingus Group plc, ME/4694/10 ("*Ryanair/Aer Lingus*")

*business or the Pentland business: (i) all of the assets of the Footasylum business and the Pentland business are **maintained and preserved, including facilities and goodwill**.*"⁷ This provision should be extended to capture the duration of the divestment process. Given Footasylum's weak financial position, it is important to stress that this provision places JD Sports and Pentland under an obligation to provide the required funding to allow Footasylum adequately to develop and preserve its business (including goodwill), should Footasylum not be in a position to make the necessary expenditure itself.

- (11) Compliance of JD Sports and Pentland with this obligation should be guaranteed by a divestiture trustee appointed at the outset of the divestiture process.

III. Choosing a suitable purchaser

- (12) To eliminate the SLC, the purchaser of Footasylum will need to demonstrate its ability to operate Footasylum as an effective national multi-channel retailer competing vigorously with JD Sports and other players on the market.
- (13) Under the CMA's *Merger Remedies* guidelines, a suitable purchaser of Footasylum must meet the following criteria:
- (a) **independence** from JD Sports and Footasylum;
 - (b) **capability** to operate Footasylum as an effective and viable competitor in the Relevant Markets, including *inter alia* financial capability and expertise in UK retail operations;
 - (c) **commitment** to competing in the Relevant Markets; and
 - (d) divestment to it **must not create further competition concerns**.⁸
- (14) The CMA's assessment of whether prospective purchasers meet these criteria must factor in the particular commercial characteristics of the sector and the Merger parties.

Independence

- (15) A suitable purchaser must be fully independent from JD Sports and in particular from the Pentland group, a global group of retail and wholesale footwear and apparel businesses with an extensive network of affiliates.

Capability to compete

⁷ Interim Order made by the Competition and Markets Authority pursuant to section 81 of the Enterprise Act 2002, dated 4 December 2019, paragraph 5 (b) and (e) (emphasis added).

⁸ *Merger Remedies*, CMA87, 13 December 2018, paragraphs 5.20 *et seq.*

- (16) Footasylum must be able to compete vigorously on the market on par with JD Sports, Footlocker and others, much as Footasylum was doing pre-Merger. The purchaser's capability to exert this level of competitive constraint will depend upon a variety of factors the most fundamental of which are addressed below.
- a) Adequate supplies of 'must-have' branded products
- (17) The CMA has acknowledged in the PR that "[...] *supply arrangements impact on competition between retailers, particularly in relation to the products that might be the most popular, the most fashionable or in some sense a premium product. Higher tier products that are more attractive to customers are likely to have more impact on the competitive position of a retailer.*"⁹ [REDACTED]
- (18) As a result, a critical factor in assessing a purchaser's capability to operate Footasylum as an effective national multi-channel retailer and a true competitive force in the Relevant Markets is its ability to ensure that Footasylum continues to have adequate access to supplies of Nike and adidas 'must-have' footwear and apparel products. By divesting Footasylum to a purchaser who does not have the ability to secure access to 'must-have' products for Footasylum, JD Sports would achieve the same outcome that it sought to achieve through its acquisition of Footasylum – eliminate one of its closest competitors (if not the closest competitor) in both footwear and apparel. It is therefore fundamental that the selected purchaser has some existing contacts with Nike and adidas and, preferably, a trading history with the major brands (either in the lifestyle or the sporting goods sector or both).
- (19) For the reasons explained above (section II), it is imperative for a divestiture trustee to oversee the sale process from the outset. The divestiture trustee should also seek to guarantee that, post-divestment, Footasylum will have adequate access to the appropriate volume and range of 'must-have' Nike and adidas products. Given the significance of these 'must-have' products for competition, the divestiture trustee should seek to ensure that, as part of the divestiture process, Footasylum procures contractual assurances from Nike and adidas that the two brands will supply it with the appropriate volume and range of 'must-have' products in the long term. Failing that, JD Sports should be obliged to procure, [REDACTED] that Footasylum obtains appropriate supplies of 'must-have' products. [REDACTED].¹⁰
- (20) [REDACTED].
- b) Financial resources
- (21) A suitable purchaser of Footasylum must have the appropriate financial resources not only to purchase the Footasylum business without over-leveraging itself, but also to be

⁹ PR, paragraph 6.31.

¹⁰ [REDACTED].

able to make the levels of capital expenditure required to maintain and operate Footasylum's network of over 65 stores throughout the UK, to make the significant advertising and marketing expenditure that is a pre-requisite to success in this industry [§].

c) Expertise

- (22) Footasylum's purchaser must have deep expertise in the industry and a strong track record in owning and operating retail businesses in the UK, ideally in the sporting and/or lifestyle goods sectors (including managerial and operational capability as well as marketing know-how) or have a concrete plan to quickly acquire such expertise (e.g., through hiring). This means that strategic players in the industry are more likely to be suitable purchasers compared to purely financial investors.

Commitment to competing in the Relevant Markets

- (23) In addition to capability, the purchaser must demonstrate to the CMA that it has a concrete business plan for the Footasylum business and objectives for competing in the Relevant Markets in the UK on a lasting basis.

Divestment to the suitable purchaser must not create further competition concerns

- (24) Divestiture to a suitable purchaser must not give rise to a realistic prospect of further competition concerns. Given the limited presence of strong competitors in the Relevant Markets (as noted by the CMA in the PR) ¹¹ this likely means [§]

IV. Concluding remarks

- (25) Company A welcomes the CMA's conclusion that a full divestment of Footasylum is the only possible remedy that could eliminate the SLC arising from the Merger. As explained in this note, there are several risks associated with allowing JD Sports to run the process of seeking a suitable purchaser for Footasylum. Company A strongly urges the CMA to appoint a divestiture trustee to oversee the divestment process from the outset. The presence of a divestiture trustee will not only contribute towards the timeliness of the process (therefore lowering the risk of deterioration of the competitive capability of Footasylum), but will also create a critical layer of protection, preventing JD Sports from manipulating the sale process to its advantage, given that its commercial incentives are in conflict with the aim that the full divestment remedy is seeking to achieve.
- (26) Company A will be following up with its thoughts on the CMA's PR and remains at the disposal of the CMA to provide additional evidence to assist in this Merger inquiry.

¹¹ PR, paragraph 11.71 and 11.156.