

Case No ME/70010/22

COMPLETED ACQUISITION BY COPART UK LIMITED

OF

HILLS SALVAGE AND RECYCLING LIMITED

RESPONSE TO CMA'S NOTICE OF POSSIBLE REMEDIES

19 May 2023



1. EXECUTIVE SUMMARY

1. The remedies proposal in this response is without prejudice to Copart's strong belief that the Transaction raises no substantial lessening of competition ("**SLC**") and should be cleared unconditionally. Please see the Parties' forthcoming response to the CMA's Provisional Findings dated 5 May 2023 ("**Provisional Findings**").
2. Copart believes, contrary to the provisional views expressed in the Notice of Possible Remedies dated 5 May 2023 ("**Remedies Notice**"), that the divestiture of Hills Motors' salvaging operations excluding its recycled parts capabilities would be a comprehensive remedy that would effectively address the provisional SLC and its adverse effects.
3. In particular:
 - a) Hills Motors' recycled parts capabilities, namely the Skelmersdale site, the Green Parts Specialists brand and associated staff involved with parts recycling, can be separated without difficulty from the rest of Hills Motors' business. Parts recycling takes place at their Skelmersdale site¹, while salvaging operations take place, except for *de minimis* activity, outside the Skelmersdale site. The parts recycling business can therefore be retained by Copart without jeopardising the remainder of Hills Motors' business. Furthermore, by divesting Hills Motors as a whole to the purchaser, subject to the carve-out of the recycled parts business, asset risk is minimised: any risk associated with the carve-out is borne by Copart, not the purchaser. Any assets or staff retained by Copart, and thereby excluded from the divestment, would have to be specifically agreed and described in the contract with the purchaser, and approved by the CMA.
 - b) In the Provisional Findings, the CMA provisionally concludes that an in-house recycled parts capability is not necessary for the continued success of Copart's own business.² For the same reason, a purchaser would be able to impose a strong competitive constraint on Copart post-merger without the need for its own recycled parts business. However, parts recycling is fast becoming commonplace in the salvaging business, and there are a large number of competing salvagers which already have their own recycled parts business. The proposed remedy would thus eliminate any perceived composition risk by ensuring that the divestment is made to a purchaser which already has a parts recycling business.
 - c) The purchaser would benefit, *inter alia*, from:
 - i. Salvaging storage capacity;
 - ii. Hills Motors' auction platform technology in development (to which the CMA attaches such importance in provisionally concluding that the competitive constraint from Hills Motors would have increased further in the absence of the transaction);
 - iii. Its claims management portal; and
 - iv. The existing Ageas contract together with the network of third-party contracts required to fulfil it.

¹ Only a very limited amount of dismantling takes place on the Dumfries site.

² Provisional Findings, paragraph 8.30 and ff.

- d) Combined with the purchaser's existing salvaging and parts recycling capability, the purchaser would be able at least to replicate, and likely exceed, the competitive constraint currently provided by Hills Motors.
 - e) To further minimise any risk, at the option of the purchaser, Copart would be willing to provide a transitional agreement for the supply of parts recycling services to the purchaser to enable the purchaser to fulfil the green parts commitments, under the existing Hills Motors salvaging contracts transferred as part of the divested business, until the purchaser is able to adapt its own vertically integrated operations to meet those commitments.
 - f) While the Remedies Notice recognises that it would likely be necessary for a suitable purchaser to be a pre-existing parts recycler, any purchaser risk would be limited given the large number of potential purchasers which already have this capability, including Charles Trent, Recycling Lives, Redcorn, Silverlake and ASM, to name a few. Indeed, Copart has reason to believe that there is likely to be substantial interest from this group in any divestment. Given the relatively fragmented nature of the parts recycling market, competition issues are unlikely to arise.
4. Copart's proposal would also allow Copart to offer a combined salvaging and parts recycling business to its customers in response to customer demand and in competition with other vertically integrated salvager-dismantlers such as IAA/SYNETIQ and e2e. The benefit to customers is clear from customers' consistent support for the merger and the absence of any customer concerns. This benefit to customers would not accrue if a complete divestiture of Hills Motors were to be implemented.

2. DIVESTMENT OF ENTIRETY OF HILLS MOTORS IS DISPROPORTIONATE

5. As explained in the CMA's Merger Remedies Guidance, *"in order to be reasonable and proportionate, the CMA will seek to select the least costly remedy, or package of remedies, of those remedy options that it considers will be effective."* Since the partial divestment proposed by Copart would be effective in addressing the SLC and resulting adverse effects, it would be disproportionate to require the divestment of the entirety of Hills Motors.
6. This is supported by the CMA's Provisional Findings which found:
- a) Salvaging and parts recycling to be separate markets;³ and
 - b) Copart could credibly compete without its own in-house parts recycling capability.⁴
7. Hills Motors' parts recycling operation is no longer (if it ever was) a uniquely competitive proposition for winning salvaging work:
- a) Parts recycling is now mainstream across the industry. As described below, there are now a large number of salvaging companies which have their own parts recycling capability; and
 - b) This is supported by Hills Motors' internal documents [REDACTED]⁵ [REDACTED].

³ Provisional Findings, paragraph 7.91.

⁴ Provisional Findings, paragraph 8.30(d).

⁵ Hills Motors' response to the CMA's s.109 notice dated 12 September, [REDACTED].

8. Hills Motors' parts recycling activity accounts for just under [X]% of Hills Motors' revenues. The purchaser would therefore be receiving a business that amounts to over [X]% of Hills Motors' existing revenues. In these circumstances, where it operates in a separate market not part of the competitive overlap, the businesses are easily severable and the vertical integration enjoyed by Hills Motors can be replicated at any one of a number of potential purchasers, it is disproportionate to require that the remaining [X]% is also divested.

3. COPART'S ALTERNATIVE PROPOSED REMEDY

9. Contrary to the CMA's provisional view, Copart believes that a total divestment of Hills Motors is unnecessary and disproportionate as the alleged SLC and its adverse effects can demonstrably be addressed by means of a divestment of the entirety of Hills Motors, with a carve-out of the assets devoted to its parts recycling business (the "**Alternative Remedy**").
10. The Alternative Remedy would consist of the divestment of Green Parts Specialist Holdings Ltd and all the Hills Motors legal entities. In accordance with the divestiture package elements identified by the CMA in its Remedies Notice,⁶ it would include:
- a) Physical sites for storing salvage vehicles;
 - b) Warehousing on these physical sites;
 - c) Trucks equivalent in number to those currently used by Hills Motors for salvaging;
 - d) IT systems, notably Hills Motors' nearly developed auction platform and its claims management portal;
 - e) Salvaging staff;
 - f) Customer contracts, including those with a parts recycling element, notably the Ageas contract;
 - g) Salvaging customer data;
 - h) Supplier contracts;
 - i) IP rights and branding;
 - j) Existing stock and inventory;
 - k) The right to receive services and utilities;
 - l) Transitional parts recycling services, at the option of the purchaser, to enable it to meet contractual commitments prior to full integration with the purchasers' own parts recycling business; and
 - m) A customary non-solicit regarding staff and customers to ensure the transfer of the Hills Motors' expertise and goodwill.
11. Copart would merely carve-out the assets devoted to parts recycling, namely the storage area of vehicles stacked up for dismantling, the dismantling warehouses with their dismantling machinery, the storage area for parts, dismantling staff, trucks used for collecting vehicles for dismantling, parts delivery vans and the 'Green Parts Specialists' brand. Since the fixed physical assets in this list are comprised in the Skelmersdale site, and the trucks identified at point (c) are clearly severable, this means there is a clear line of demarcation around the carved-out assets.
12. Since the Alternative Remedy would involve the divestment of Hills Motors' salvaging business, it would completely remove the overlap in salvaging between Hills Motors and Copart, and therefore address in a clear-cut, structural manner the CMA's SLC which solely concerns salvaging.

⁶ At paragraph 28.

13. In the next sections we demonstrate why the Alternative Remedy clearly addresses the CMA's three types of risks when it comes to assessing a remedy, namely 'asset risk', 'composition risk' and 'purchaser risk'.

4. NO ASSET RISK ARISES

14. According to the CMA, "*asset risk arises if the competitive capability of the divestiture business deteriorates before completion of the divestiture*"⁷. The Alternative Remedy does not pose this risk.
15. Since the Alternative Remedy would be structured as a sale of the whole Hills Motors business, subject to a carve-out of parts recycling assets, preparation of the sale would be scarcely different to a sale of the whole Hills Motors business. The assets devoted to parts recycling are clearly demarcated from the rest of the Hills Motors business, as noted above. No complex physical or legal separation or re-engineering of the divestment business is therefore required. Any Hills Motors assets or staff retained by Copart, and thereby excluded from the divestment, would have to be specifically agreed and described in the contract with the purchaser, and approved by the CMA. This also means that, with a limited refresh, the due diligence materials from Copart's acquisition of Hills Motors can be repurposed, allowing for a swift and straightforward sale to the purchaser.
16. The Hills Motors business has been continuing to operate throughout the CMA's merger investigation and there is no reason to presume it would deteriorate during the shorter period before completion. Indeed, with the onset of winter and the diminishing effects of the pandemic, the volume of salvage vehicles flowing to Hills Motors' salvaging business is, all else being equal, likely to increase in the coming months. Moreover, because Copart's acquisition of Hills Motors was a completed merger, the performance and viability of the Hills Motors' business has been subject to ongoing scrutiny by a monitoring trustee throughout the CMA's phase 2 review. In addition, there remain generous incentive structures in place, such as bonus schemes, to motivate staff and therefore ensure the success of the Alternative Remedy.

5. NO COMPOSITION RISK ARISES

17. According to the CMA, "*composition risk arises if the scope of the divestiture business is too narrowly constrained or not appropriately configured to attract a suitable purchaser, or does not allow a purchaser to operate as an effective competitor*"⁸. The Alternative Remedy does not raise any such composition risk.
18. The Alternative Remedy comprises all of the Hills Motors salvaging business. As well as being a standalone salvaging business, it would significantly enhance an existing salvager's footprint across the UK. This would clearly be attractive to many potential purchasers.
19. The CMA has provisionally found that "*Hills Motors' recycled parts capability is part of its competitive proposition in the supply of salvaging services*"⁹. However, even if it were a requirement for the divested business to be vertically integrated with a parts recycling business, the Hills Motors' salvaging business can easily be sold to and integrated with a purchaser's own parts recycling business. In particular, a large proportion of the Hills

⁷ Remedies Notice, paragraph 16(c).

⁸ Remedies Notice, paragraph 16(a).

⁹ Remedies Notice, paragraph 25.

Motors business is already outsourced to third party salvagers/parts recyclers,¹⁰ which means that the sale would merely amount to an extension of the status quo for customers rather than a complete departure. This is also analogous to the creation of the leading competitor, IAA/SYNETIQ, which was created out of the merger of, *inter alia*, salvaging and parts recycling businesses.

20. Copart would also offer any potential purchaser an optional transitional parts recycling services agreement to enable the purchaser to fulfil the recycled parts commitments, under the existing Hills Motors salvaging contracts transferred as part of the divested business, until the Purchaser is able to adapt its own vertically integrated operations to meet those commitments.
21. The purchaser would therefore benefit, *inter alia*, from Hills Motors' salvaging storage capacity, its auction platform technology in development (to which the CMA attaches such importance in provisionally concluding that the competitive constraint from Hills Motors would have increased further in the absence of the transaction), its claims management portal and the existing Ageas contract together with the network of third-party contracts required to fulfil it. Combined with the purchaser's existing salvaging and parts recycling capability, the purchaser would be able at least to replicate, and likely exceed, the competitive constraint currently provided by Hills Motors.
22. In short, the Alternative Remedy would restore the competitive constraint provided by Hills Motors as a vertically integrated salvager and parts recycler.

6. NO PURCHASER RISK ARISES

23. According to the CMA, "*purchaser risk arises if a divestiture is made to a weak or otherwise inappropriate purchaser or if a suitable purchaser is not available*"¹¹. Again, this is not an applicable risk to the Alternative Remedy.
24. There are plenty of suitable purchasers who, in accordance with the CMA's criteria, are (a) independent of the Parties and (b) already have a strong track record in salvaging and whose business would be enhanced by the Hills Motors' salvaging footprint. Even if purchasers were limited to those with pre-existing parts recycling operations, there would be plenty of suitable candidates with a strong track record in both salvaging and dismantling, such as Charles Trent, Recycling Lives, Redcorn, Silverlake and ASM.
25. Various parties were interested in acquiring Hills Motors at the time of its sale to Copart. Given it remains an attractive business, there is every reason to predict significant interest in its sale under the Alternative Remedy.
26. Competition issues are unlikely to arise in salvaging, given the modest combined share of potential purchasers (which would naturally exclude IAA/SYNETIQ) with Hills Motors' share.¹² Competition issues are also unlikely to arise in parts recycling, given that there would be no overlap following retention by Copart of the Hills Motors parts recycling business and given the relatively fragmented nature of the parts recycling market.¹³

7. ALTERNATIVE REMEDY WOULD MAINTAIN RELEVANT CUSTOMER BENEFITS

¹⁰ Over [X]% of Hills Motors' vehicles are outsourced to other salvagers/parts recyclers (Final Merger Notice, paragraph 52) and over [X]% of vehicles under the Ageas contract (Final Merger Notice, paragraph 123).

¹¹ Remedies Notice, paragraph 16(b).

¹² See, for instance, Provisional Findings, Tables 8.1 and 8.2.

¹³ See, for instance, Provisional Findings, Table 11.2 and paragraph 11.22.

27. Unlike the entire divestment of Hills Motors, the Alternative Remedy would generate significant relevant customer benefits (“RCBs”) which would not have arisen but for the merger.
28. According to Enterprise Act 2002, the requirements of an RCB are that:
- a) the benefit may be expected to accrue within a reasonable period as a result of the creation of the relevant merger situation concerned; and
 - b) the benefit is unlikely to accrue without the creation of that situation or a similar lessening of competition.¹⁴
29. An RCB takes the form of “*lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom*” or “*greater innovation in relation to such goods or services*”.
30. By acquiring an in-house parts recycling operation Copart would be able to offer actual and potential customers a combined salvaging and parts recycling service. This would result in an increase in competition, as there would now be another vertically integrated competitor to the likes of IAA/SYNETIQ and e2e and indeed Hills Motors – assuming Hills Motors were acquired, under the Alternative Remedy, by a pre-existing parts recycler. At least the following benefits would therefore flow to customers:
- a) An in-house parts recycling operation would offer customers sufficient provenance guarantees and quality control for the resulting green parts, given that Copart is already its customers’ trusted counterparty for salvaging and related services. In short, risk averse insurers would prefer to deal with one trusted supplier. This in turn would increase customers’ standing in terms of proving compliance with their ESG targets;
 - b) Salvaging and the supply of recycled parts are highly complementary (indeed when recycled parts are supplied to the insurer repair network, the insurer is the customer both of a combined salvage and parts recycling offer and, ultimately, of the recycled parts). An in-house parts recycling operation would eliminate the double marginalisation cost to customers. All else being equal, Copart combined with Hills Motors’ parts recycling would be able to set a lower price for green parts than if it were to outsource the parts recycling operation to third parties (assuming this were to provide sufficient provenance guarantees, which is not the case). The CMA’s conclusions in the Provisional Findings – in particular, Copart’s apparently strong market position and concentration levels upstream and Hills Motors’ apparently strong market position in the supply of recycled parts – point to very significant double marginalisation and thus the benefits to customers from integration being considerable; and
 - c) For the increasing number of customers for whom a combined salvaging and parts recycling provider is considered essential,¹⁵ Copart will simply not be a credible competitor, in the absence of an in-house parts recycling operation. Tenders to other vertically integrated operators such as IAA/SYNETIQ and e2e would not therefore be constrained by Copart and, all else being equal, would result in higher prices or worse terms being received by those customers. Even for those customers where a combined salvaging and recycled parts operation is not essential, but

¹⁴ Enterprise Act 2002, s.30(3).

¹⁵ See, *inter alia*, the Parties’ Initial Submission on the CMA’s Phase 1 Decision, section 2.4.

where they have a preference or strong preference for a combined offer, the competitive constraint provided by Copart will be weakened relative to that under the merger or Alternative Remedy.¹⁶ Given this preference cannot be met by Copart, some existing Copart customers with a particularly strong preference for a combined offer, will be forced to choose their second preference. In doing so, the customer incurs losses, potentially significant losses.¹⁷

31. The key evidence that there would be these significant RCBs for customers comes from customers themselves, as they have actively been demanding an in-house parts recycling operation of Copart or, as in the case for LV, taking their business elsewhere in the absence of Copart having such an offering.¹⁸ This is corroborated by Copart's Seller Survey:

- a) Approximately 90% of respondents believed that Copart's acquisition of Hills Motors would impact Copart's salvage service capabilities as *"very positive"* or *"mostly positive"*;¹⁹
- b) Approximately 59% of respondents believed Copart's acquisition of Hills Motors would be *"very positive"* or *"mostly positive"* for competition for salvaging services, with over a third being neutral;²⁰
- c) The extensive benefits identified by respondents included the following, in their own words:
 - *"Hills acquisition will compliment [sic] Copart's offering as green parts become more accepted in the future."*
 - *"Bringing these two businesses together to share best practice and provide the industry with a better offering is what's needed."*
 - *"provides copart with a more rounded offering"*
 - *"As long as therer is choice of suppliers in the market whocan work nationwide there will always be competition to supply services, so Copart would have to continue to deliver value to its customers."*
 - *"Meets requirements and adds additional element to total loss cycle. Support ESG strategy and drive to reduce carbon"*
 - *"We consider that the merger allows Copart to improve its service offering by being able to offer green parts (which it does not do at present) and that, post-merger, Copart will be better placed to deliver and improve the Hills green parts service offering due to Copart's national scale"*

¹⁶ The Provisional Findings note that eight out of 17 customers indicated that it was important for a salvager to offer a recycled parts service: Provisional Findings, paragraph 8.30(a).

¹⁷ A prohibition or full divestment of Hills Motors would therefore lead to customers facing higher prices. For example, assume Copart were selected as the customer's first choice based solely on price (i.e., Copart offered them a better return). If the customer is then compelled to choose its second preference in order to obtain an integrated offer, it will unequivocally be subject to a price rise and suffer harm. If Copart was the customer's strong first preference aside from the recycled parts provision, these losses could potentially be significant and occur across multiple customers. The Provisional Findings raise concerns about the levels of concentration in the sector and Copart's high market share. One implication of this is that the difference in price between first and second preference is, other things equal, likely to be particularly high thus the losses to these customers are likely to be high. To the extent the CMA believes Copart can develop an alternative recycled parts offer in the counterfactual, customers are still subject to a significant price increase for the period until Copart can 'enter' this market.

¹⁸ See, *inter alia*, Response to Issues Letter dated 1 November, section 2.2; Parties' response to the CMA's RFI dated 16 December 2022 (Phase 2 RFI 1), question 1; Parties' response to the AIS and working papers, paragraph 27.

¹⁹ Seller Survey, response to Q23.

²⁰ Seller Survey, response to Q24.

- *“In comparison the Synetiq, Copart have been weak in green part provision. Embedding Hills will make life easier for us as a customer.”*
- *“Will allow a greater amount of vehicle to be processed in the green parts area”*
- *“Similar in the IAA/synetiq acquisition in that it allows Copart to provide a one stop shop so to speak”*
- *“We see the acquisition as a strengthening of COPARTS overall service offering.”*
- *“Syntiq were becoming a dominant supplier of a UK wide green parts solution, so Copart's acquisition will bring healthy competition to the green parts supply market, allows esure and other Copart customers to benefit from the supply of green parts form their own salvaged vehicles.”*
- *“Happy that competitors have similar set ups”.*

32. Copart recognises the CMA has raised some methodological concerns with the Seller Survey.²¹ However, even if the CMA were to downplay the statistical results of the survey for technical reasons, the CMA should still recognise the direction of customer views and, in particular, the pertinence of their free-form comments from what are sophisticated, FCA-regulated customers, many of them publicly listed, whose views ought to carry considerable weight. This is especially so given the Seller Survey is consistent with the CMA’s own provisional finding that *“some customers, including large insurance customers, told us that there may be benefits from the Merger due to the complementary natures of Copart’s position in salvage services and Hills Motors’ position in dismantling and recycled parts provision”*²². It is also consistent with the CMA’s provisional finding that *“Copart’s internal documents ... highlight customer demand for a recycled parts solution and that a key driver for the Merger was to respond to competitive threat from IAA”*²³. Moreover, the CMA is also able to engage further with customers in order to satisfy itself of the customer benefits which customers themselves have been expressing.
33. As regards the Enterprise Act criterion that an RCB accrue within a reasonable period, the RCB in question would accrue immediately. Indeed, as previously noted, Copart’s customers have already been clamouring for Copart to be able to offer a parts recycling service.
34. As regards the Enterprise Act’s second criterion – that Copart could not otherwise replicate the RCBs – it is clear that the RCBs are specific to the merger or at least the Alternative Remedy. Copart has explained in detail why Copart could not develop a greenfield parts recycling operation in a reasonable timeframe to meet customer demand.²⁴ The CMA’s own market investigation also confirmed this, as *“[d]ismantlers ... cited the costs of developing a green parts operation as prohibitive for new entrants.”*²⁵
35. As regards other means of achieving the RCBs, the CMA has not established that alternatives were realistically considered by Copart and that such alternatives are as a matter of fact practicable. The CMA cites in its Provisional Findings merely one email exchange between senior Copart executives in October 2021 and a single internal presentation dated February 2022 in which options other than an acquisition of a dismantler were considered. However, these relate to Copart’s initial high-level thinking as regards how to respond to customer demand for a parts recycling service. When faced

²¹ Provisional Findings, paragraph 8.98.

²² Provisional Findings, paragraph 8.96.

²³ Provisional Findings, paragraph 2.16.

²⁴ See, *inter alia*, Parties response to the CMA’s notice under section 109 of the Act dated 3 November 2022, paragraph 6; Parties’ response to CMA request for information of 15 August 2022.

²⁵ CMA’s Decision on relevant merger situation and substantial lessening of competition dated 28 November 2022, paragraph 87.

with a new customer demand, Copart will customarily put various options on the table as an initial step for discussion, but this does not mean these various options are viable. These emails predate any exploration by Copart of what options were genuinely viable.

36. As noted above, Copart has also provided evidence why alternatives to an in-house parts recycling operation would not be acceptable to Copart's customers for reasons of lack of sufficient provenance guarantees.²⁶ The CMA has responded to this in a footnote to its Provisional Findings with the assertion that "*the Parties did not explain why if a list of approved ATF buyers could be used to guarantee a vehicle was destroyed a list of approved ATFs could not be used to guarantee the provenance of parts with appropriate checks in place*"²⁷. Here the CMA is referring to Copart's QAB approved ATF network for destroying vehicles. However, this was set up at the behest of two particular customers with particular needs for proof of destruction. There is no analogy to be drawn with Copart's customers' separate demand for provenance guarantees in relation to recycled parts to be used for repairing their customers' vehicles: this represents a greater degree of sensitivity and Copart believes its customers are best placed to understand and communicate their provenance needs to Copart. We also note that, unlike the Alternative Remedy, the use of a third-party network would (as indicated above) result in double marginalisation and likely higher prices to customers.
37. In summary, Copart has provided extensive evidence that the acquisition of a pre-existing parts recycler, namely Hills Motors, was not merely the preferred option but the only viable option for responding to customer demand. The vertical integration of salvaging and parts recycling that the merger would achieve should thus be considered an important relevant customer benefit, which only the Copart's Alternative Remedy would preserve.

8. CONCLUSION

38. In conclusion, Copart continues to believe the Transaction should be cleared unconditionally. However, insofar as the CMA maintains its provisional finding of an SLC in salvaging, it would be disproportionate for it to call for the entire divestiture of Hills Motors, including its parts recycling business. For all the reasons set out above, a sufficient and proportionate remedy would be the divestiture of the entirety of Hills Motors, subject to a readily circumscribed carve-out of its parts recycling business. Copart looks forward to engaging constructively with the CMA on the question of remedies.

²⁶ See, *inter alia*, Copart's response to Notice 2 to Copart, question 11.

²⁷ Provisional Findings, footnote 431.