Merger Remedies Evaluation

A report for the Competition and Markets Authority

by

Aldwych Partners and NOCON

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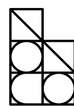

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1. Executive Summary

1.1 The Competition and Markets Authority (CMA) investigates mergers that have the potential to lead to a substantial lessening of competition (SLC) in one or more markets in the UK. Where the CMA identifies competition concerns, it will, in almost every case, adopt remedies to address these concerns. Nearly 270 merger remedies have been put in place by the CMA and its predecessor agencies under the Enterprise Act 2002.

1.2 Merger remedies include the prohibition of a merger, divestment of all or part of a merging business or behavioural requirements that regulate the conduct of a merged business. The CMA, through its merger remedies evaluation programme, identifies learning points from past merger remedies that can inform its merger remedies policy and practice. This report is the product of the eighth phase of its evaluation programme.

1.3 This report's focus is on the CMA's recent experience with "carve-out" remedies. These remedies involve the divestment of a combination of assets, contracts and staff, which were not previously a self-standing business or business unit. Like other divestment remedies, the aim is to create a new competitor that replaces the competitive constraint that has been lost through a merger, while at the same time allowing a merged business to retain those activities that do not give rise to competition concerns.

1.4 The report is based on case studies of five CMA merger inquiries carried out between 2017 and 2020. In four of the five inquiries, the CMA adopted a carve-out remedy, while in the fifth (Ecolab / Holchem), a carve-out remedy was proposed by the merger parties although, ultimately, the CMA required the divestment of an entire business unit. The five case studies, in chronological order, are:

- Electro Rent Corporation / Microlease Inc and Test Equipment Asset Management Limited (May 2018);
- Rentokil Initial plc / Cannon Hygiene Limited (January 2019);
- Rentokil Initial plc / MPCL Limited (April 2019);
- Ecolab Inc / The Holchem Group Limited (October 2019); and
- Stryker Corporation / Wright Medical Group NV (June 2020).

1.5 Carve-out remedies' greater complexity, relative to other divestment remedies, means that a greater level of risk to their effectiveness can be expected, and this is reflected in the approach to the case studies in this review. Each case study includes an assessment of whether the remedy was effective in addressing the CMA's competition concerns, a discussion of the risks associated with the remedy, observations on whether these risks crystallised, and consideration of the CMA's efforts to mitigate these risks through its remedy design and implementation.

1.6 The remedies adopted in the five case studies varied in the extent to which they succeeded in addressing the CMA's competition concerns. Two remedies (Ecolab / Holchem and Electro Rent / Microlease) were broadly successful in addressing the CMA's competition concerns albeit with some caveats around the remedy in Electro Rent / Microlease. By contrast, the merger remedies in Rentokil / Cannon and Rentokil / MPCL were less successful. The success of the final merger remedy (in Stryker / Wright) is, for the reasons discussed in the report, more equivocal.

1.7 Overall, the case studies show that carve-out remedies carry significant risks to their effectiveness and that risk mitigations, such as fallback remedies, may only be of limited use. Key learning points from the case studies are summarised below.

(a) Carve-out remedies that unwind or undermine economies of scale, density or scope can be expected to significantly increase the risk to the remedy's effectiveness.

(b) Carve-out remedies can provide merger parties with greater opportunities to influence the content of a divestment package and, through this, limit future competition.

(c) Carve-out remedies that transfer customers to a new supplier will depend on customer consent and this can pose a substantial risk to these remedies' effectiveness.

(d) Carve-out remedies pose additional challenges for purchasers' ability to carry out effective due diligence as the divestment package is not based on a pre-existing business unit.

(e) Merger parties may be able to weaken future competition through their influence over the choice of purchaser for a divestment package. This is a greater risk in carve-out remedies, where fewer prospective purchasers have the ability to become effective competitors.

(f) Fallback remedies may not significantly mitigate the risks associated with carve-out remedies given the low probability of their use and their limited assistance to prospective purchasers in negotiating divestment packages.

1.8 Where the CMA concludes that a carve-out remedy is likely to be effective in addressing competition concerns, the case studies indicate that additional safeguards may be warranted to address their risks. This could include, for example:

- setting additional and/or more specific requirements for prospective purchasers to be regarded as suitable purchasers;
- providing less discretion for negotiations between merger parties and prospective purchasers over the content of divestment packages;
- requiring increased safety margins when specifying asset or contract values for inclusion in divestment packages; and
- making increased use of monitoring and divestiture trustees in overseeing and managing divestment processes.

2. Introduction

2.1 The CMA, when investigating a merger, assesses whether it could lead to an SLC in one or more markets in the UK. Where competition concerns are identified, remedies will, in almost every case, be adopted so as to address these concerns. Remedies put in place by the CMA can include the prohibition of a merger, divestment of all or part of a merging business or, in a small minority of cases, behavioural requirements that regulate a merged business's conduct.

2.2 Nearly 270 merger remedies have been adopted by the CMA and its predecessors under the Enterprise Act 2002 and, as of April 2023, around 190 merger remedies remained in force.[1] The CMA, and previously the Competition Commission (CC), identifies learning points from past merger remedies and feeds these into merger remedies policy and practice through an evaluation programme that was first established in 2004. This report is the product of the eighth phase of this evaluation programme.

2.3 This report's focus is on the CMA's recent experience with "carve-out" remedies. These remedies involve the divestment of a combination of assets, contracts and staff, which were not previously a self-standing business or business unit. Like other divestment remedies, the aim is to create a new competitor that replaces the competitive constraint lost through a merger, while at the same time allowing a merged business to retain those activities that do not give rise to competition concerns.

2.4 The report is based on case studies of five CMA merger inquiries that were carried out between 2017 and 2020. In four of the five inquiries, the CMA adopted a carve-out remedy, while in the fifth a carve-out remedy was proposed by the merger parties although, ultimately, the CMA decided on the divestment of an entire business unit. The five case studies, in chronological order by CMA decision date, are:

- Electro Rent Corporation / Microlease Inc and Test Equipment Asset Management Limited (May 2018);
- Rentokil Initial plc / Cannon Hygiene Limited (January 2019);
- Rentokil Initial plc / MPCL Limited (April 2019);
- Ecolab Inc / The Holchem Group Limited (October 2019); and
- Stryker Corporation / Wright Medical Group NV (June 2020).

2.5 This evaluation report is the first to have been commissioned externally by the CMA, bringing an independent perspective to the case studies. Aldwych Partners and NOCON are pleased to have conducted this review for the CMA. Our acknowledgement and thanks for participating in this review go to interviewees at the merging businesses, purchasers of the divestment packages, competitor businesses, customers and monitoring trustees. Our work has also benefited from discussions with the CMA staff involved in the merger inquiries as well as with the project team and steering committee responsible for commissioning this review. Our thanks go to them as well. Aldwych Partners and NOCON as the report's authors, however, have independently reached the findings set out in this report.

2.6 The report is set out as follows:

- Section 3 sets out the review's aims and methodology and introduces the case studies;
- Section 4 provides our observations on the effectiveness and risk profile of the merger remedies that are the subject of the case studies; and
- Section 5 identifies key learning points from this review.

2.7 The case studies are contained in Appendices A to E.

[1] Details of Enterprise Act 2002 merger remedies are contained in the mergers orders and undertakings register available at https://www.gov.uk/government/publications/mergers-orders-and-undertakings.

3. Aims, methodology and introduction to the merger remedy case studies

3.1 The focus of this report is, as set out above, the CMA's recent experience with carve-out remedies. This section sets out the framework for the evaluation, describing the project's research aims (Section 3.1) and the methodology used for the case studies (Section 3.2). The mergers and their remedies, which are the subject of the case studies, are introduced in Section 3.3.

3.1 Research aims

3.2 The research aims for this evaluation can be best understood in terms of its contribution to the CMA's overall merger remedies evaluation programme. The CMA, and previously the CC, has been carrying out merger remedy evaluations since 2004. The programme's aim is to develop the CMA's expertise, policy and practice on merger remedies. Each evaluation report helps inform wider policy and practice discussions, and helps the CMA in developing and implementing remedies that are effective and timely in addressing competition concerns arising in its merger inquiries, and through this, safeguard the interests of UK consumers.

3.3 Most merger remedies involve either a straightforward prohibition, or a divestment of a standalone business or business unit. Carve-out remedies, however, involve the divestment of a more limited combination of assets, contracts and staff, which were not previously a self-standing business or business unit. Like other divestment remedies, the aim is to create a new competitor that replaces the competitive constraint lost through a merger, while at the same time allowing a merged business to retain those activities that do not give rise to competition concerns.

3.4 Carve-out remedies, as a result of being based on a combination of assets, contracts and staff that are not a pre-existing business or business unit, entail greater complexity than other divestment remedies. This, in turn, increases the level of risk that the CMA must manage. The CMA's merger remedies guidance describes the risks and challenges of carve-out remedies as follows:

> "Where a proposed divestiture comprises part of a business … the capabilities and resources of prospective buyers are likely to be more critical to a successful outcome than for a standalone business. A package of assets proposed for divestiture may, for example, lack an established infrastructure and its viability may therefore be more dependent on an appropriate match with the capabilities of the purchaser. A package of assets may also be far more difficult to define or 'carve-out' from an underlying business, and the CMA may have less assurance that the purchaser will be supplied with all it requires to operate competitively."[2]

3.5 The greater complexity of carve-out remedies, relative to other divestment remedies, and the greater level of risk to their effectiveness, is reflected in the approach to the case studies in this review. Each case study includes an assessment of whether the remedy was effective in addressing the CMA's competition concerns, the risks associated with the remedy, whether these risks crystallised, and the effectiveness of any mitigations designed into the remedy. A number of learning points are identified in this report that can contribute to the CMA's merger remedies policy and practice. These are, however, necessarily qualitative in nature given the limited number of case studies and the variety and complexity of individual cases.

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[2] Competition and Markets Authority, *Merger remedies*, CMA87, December 2018, paras 5.13-5.14.

3.2 Methodology

3.6 The methodology for this review is a case study based evaluation. The five merger remedies which have been evaluated were selected by the CMA. In four cases a carve-out remedy was adopted, while in the fifth a carve-out remedy was proposed by the merger parties, but the CMA ultimately decided on another remedy.

3.7 The five merger inquiries on which the remedy case studies are based took place between 2017 and 2020. This is sufficiently far in the past to allow a meaningful assessment of the remedies' effectiveness, but also sufficiently recent to be relevant and have access to key individuals involved in each remedy process. The case studies include both Phase 1 and 2 merger inquiries (see Table 3.1).

Table 3.1: Merger remedies case studies

Merger Parties	CMA inquiry	Decision date
Electro Rent Corporation Microlease Inc and Test Equipment Asset Management Limited	Phase 2	May 2018
Rentokil Initial plc Cannon Hygiene Limited	Phase 2	January 2019
Rentokil Initial plc MPCL Limited	Phase 1	April 2019
Ecolab Inc The Holchem Group Limited	Phase 2	October 2019
Stryker Corporation Wright Medical Group NV	Phase 1	June 2020

3.8 Each case study commenced with background research, including a review of the CMA's report and other inquiry papers as well as discussions with CMA staff who participated in the inquiry. Following this, interviews were conducted with key stakeholders. This included representatives from the merger parties, purchasers of the divestment packages, competitors to the merging businesses, customers and monitoring trustees.

3.9 Interview questions were tailored for each stakeholder to reflect their role in the remedy. Broadly, questions were asked about the CMA's remedies process; the choice of remedy; its implementation; events since the remedy was put in place; and whether the remedy had worked as expected. Notes of each interview were drafted and shared with interviewees for confirmation and correction. The information supplied by interviewees was supplemented with further desk-based research, including public information on market developments since the divestment.

3.10 On completing the interviews and research for each case study, a summary of the initial findings was prepared by the Aldwych/NOCON project team to facilitate an internal team discussion and to assist in identifying learning points. A further discussion then took place with the CMA staff who participated in the remedy's design and implementation to test the review team's understanding and to explore issues that had arisen during the interviews. Case studies were then drafted to reflect the evidence gathered during these interviews and the related research.

3.11 The main body of this report draws together the findings from the five case studies and explores common themes from across the case studies. These themes then form the basis for the report's learning points.

3.3 Introduction to the merger remedy case studies

3.12 This section introduces the five merger inquiries and the remedies that form the basis for the case studies set out in this report. A brief description of each merger and merger remedy is set out which provides background for the discussion of the remedies' effectiveness and risk profiles in Section 4.

3.3.1 Electro Rent Corporation / Microlease Inc

3.13 The first merger remedy case study concerns the acquisition of Microlease Inc and Test Equipment Asset Management Limited (Microlease) by Electro Rent Corporation (Electro Rent) in January 2017. Both businesses supplied testing and measurement equipment (TME), which is used by businesses to validate the performance of their electronic devices. TME customers come from a broad range of industries, including telecommunications, aerospace and defence. Electro Rent and Microlease were active in multiple countries, including the UK.

3.14 In the UK, Electro Rent and Microlease primarily overlapped in the supply of TME for rent. Electro Rent served the European market, including the UK, from its main depot in Belgium. TME was stored and distributed to rental customers from this location with only a smaller supporting depot and staff in the UK. Microlease was the UK's largest supplier of TME for rent, and while Electro Rent was significantly smaller, it was Microlease's closest competitor as a result of its large European, and global, stock inventory. As a result, the CMA concluded that the merger would give rise to an SLC in supply of TME for rent in the UK.

3.15 To remedy the SLC, the CMA decided that it would require the divestment of Electro Rent UK, and, if no suitable purchaser could be found, the divestment of the entire European operations of either Electro Rent or Microlease. As Electro Rent's UK TME rental business was primarily serviced from its main depot in Belgium, a divestment of Electro Rent UK required a carve-out of TME rental assets from its wider pool of TME rental assets in Europe.

3.16 The divestment package, that is the Electro Rent UK business, was acquired by MCS Limited (MCS) in early 2019. MCS was already active in TME rental in the UK, and after acquiring the divestment package it performed well financially. In late 2022, MCS was acquired by Test Equity, a US-based business that has now expanded into Europe.

3.3.2 Rentokil Initial plc / Cannon Hygiene Limited

3.17 The second merger remedy case study concerns the acquisition of Cannon Hygiene Limited (Cannon) by Rentokil Initial plc (Rentokil) in January 2018. Rentokil is a global supplier of hygiene and pest control services, while Cannon was part of OCS Group Limited (OCS), which included Cannon in the UK and several other countries in Europe and Asia.

3.18 In the UK, Rentokil and Cannon overlapped in the supply of washroom, healthcare waste collection and mats services.[3] The CMA's primary concern in relation to the merger was in relation to washroom services. Washroom services involve the supply of services and consumables for washrooms in public, office and industrial buildings. Typically, a supplier will carry out regular, scheduled visits to customers' washrooms so as to replenish products (e.g. toilet paper) and collect waste (e.g. feminine hygiene units and nappy bins).

3.19 Customers for washroom services include local, regional and national businesses, with the CMA finding that a limited group of suppliers were capable of servicing of customers that were present either nationally or in multiple regions. This included Rentokil, Cannon, PHS,

[3] Mats services involve the supply of indoor and outdoor mats which help prevent slips and trips.

Cathedral and Mayflower, although the competitive constraint offered by Cathedral and Mayflower to the other three suppliers was more limited. The CMA concluded that the merger would give rise to an SLC in the supply of washroom waste disposal services to: (i) multi-regional and national customers that purchased washroom services directly from a supplier; and (ii) public and private framework customers with multi-regional or national coverage.

3.20 To remedy the SLC, the CMA decided that it would require the divestment of all of Cannon's contracts with the customer groups set out above along with the staff and assets (e.g. vehicles, depots and licenses) necessary for servicing these customers. If no suitable purchaser could be found, the CMA would require a divestment of Cannon in its entirety.

3.21 Implementation of the preferred remedy meant that the relevant contracts, staff and assets had to be carved out from the wider Cannon business in the UK. Citron Hygiene UK (Citron) purchased the divestment package, which ultimately included contracts with some local and regional customers in addition to those customer contracts specified by the CMA, in October 2019. Citron was a recent entrant to the UK market, having been formed following a management buyout of Cannon Hygiene in Canada. It has acquired several more washroom services businesses in the UK since its purchase of the divestment package.

3.3.3 Rentokil Initial plc / MPCL Limited

3.22 The third merger remedy case study concerns the acquisition of MPCL Limited (MPCL) by Rentokil in September 2018. MPCL was part of Mitie Group plc (Mitie), a UK facilities management business, and as part of the transaction Rentokil entered a Preferred Supplier Agreement (PSA) with Mitie under which Rentokil would provide pest control services to some of Mitie's facilities management customers.

3.23 In the UK, Rentokil and MPCL overlapped in the supply of pest control services. Customers included local, regional and national businesses and other organisations with pest control needs. The CMA found that only four suppliers could compete for national customers, namely Rentokil, MPCL, Ecolab and Pestokil. Rentokil was the UK's largest supplier and MPCL the third largest. The CMA concluded that the merger would give rise to an SLC in the supply of pest control services to national customers in the UK.

3.24 To remedy the SLC, the CMA decided that it would require the divestment of all of MPCL's pest control contracts with national customers, other than those receiving services under the PSA with Mitie, along with the staff and assets (e.g. vehicles, depots) necessary for servicing these customers. The CMA also required that the PSA be amended to reduce its duration and to remove Rentokil's status as the exclusive supplier of pest control services to Mitie's facilities management customers.

3.25 Implementation of the remedy meant that the relevant contracts, staff and assets had to be carved out from the wider MPCL business. The ServiceMaster Company LLC (ServiceMaster), the owner of a leading US pest control business, Terminix, purchased the divestment package in October 2019. It combined the divestment package with another pest control business in the UK that it had recently acquired and has since continued to build its business through the acquisition of several smaller pest control businesses in the UK.

3.26 In the second half of 2022, Rentokil acquired Terminix globally, but consistent with its undertakings to the CMA, Terminix's UK business was excluded from the acquisition. Ownership of Terminix UK passed to Norvestor, a private equity firm, which has since rebranded the business as Vergo Pest Management.

3.3.4 Ecolab Inc / The Holchem Group Limited

3.27 The fourth merger remedy case study concerns the acquisition of The Holchem Group Limited (Holchem) by Ecolab Inc (Ecolab) in November 2018. Ecolab is a US incorporated supplier of water, hygiene, and energy technologies and services, while Holchem was a privately owned UK-based business. Ecolab and Holchem overlapped in the supply of formulated cleaning chemicals and ancillary services to customers in the foodservice, hospitality, accommodation, healthcare, government, education and retail sectors in the UK.

3.28 The CMA found that the merged business would be around twice as large as its next largest competitor, with only two other suppliers of scale, namely Diversey Limited and Christeyns Food Hygiene Limited. Moreover, Holchem and Ecolab were close competitors for each other's customers and for new customer opportunities. The CMA concluded that the merger would give rise to an SLC in the supply of formulated cleaning chemicals and ancillary services to food and beverage customers in the UK.

3.29 To remedy the SLC, Ecolab proposed a carve-out remedy based on the divestment of a portfolio of customer contracts and the staff and assets necessary to deliver services to these customers, including manufacturing and warehousing facilities, and a proposal for encouraging customers to transfer to the purchaser of the divestment package. The CMA, however, rejected this proposal and instead required the divestment of the entirety of Holchem Laboratories, which comprised the vast majority of Holchem. Ecolab applied to the Competition Appeal Tribunal for a review of the CMA's decision, but was not successful.

3.30 Kersia Group (Kersia) purchased Holchem, in its entirety, in May 2020. Kersia was an existing multinational supplier of cleaning products and services to businesses in the food supply chain with a relatively small presence in the UK. Since its acquisition by Kersia, Holchem has continued as a supplier of formulated cleaning chemicals and ancillary services in the UK and has taken on the management of Kersia's pre-existing UK business.

3.3.5 Stryker Corporation / Wright Medical Group NV

3.31 The final merger remedy case study concerns the acquisition of Wright Medical Group NV (Wright) by Stryker Corporation (Stryker) in November 2019. Stryker is a US incorporated, global supplier of medical devices and products, while Wright was a Netherlands incorporated global supplier of medical devices.

3.32 In the UK, Stryker and Wright both supplied orthopaedic medical devices, and more specifically, overlapped in the supply of total ankle replacement prostheses, finger joint arthroplasty products, foot plating products and synthetic bone graft substitutes. The CMA estimated that Stryker and Wright had a combined market share of 90-100% in ankle replacement products, with other suppliers having market shares of less than 5%. The CMA concluded that the merger gave rise to an SLC in the supply of total ankle replacement prostheses products in the UK.

3.33 The CMA's review was carried out in parallel to a review by the US Federal Trade Commission (FTC). The FTC concluded that, in the US, the merger gave rise to concerns in finger joint arthroplasty products as well as ankle replacement products. The CMA decided that it would require the divestment of Stryker's ankle replacement product and its supporting staff and assets, which complemented the divestment that was required to address FTC concerns, namely Stryker's ankle replacement and finger joint arthroplasty products.

3.34 Implementation of the remedy meant that Stryker's ankle replacement product, known as STAR, had to be carved out from the wider Stryker business (as did its finger joint arthroplasty

product). The divestment package included the STAR product and related assets, including pipeline products, intellectual property, supplier contracts and a small number of staff.

3.35 Colfax Corporation (Colfax) purchased the divestment package in November 2020. Colfax was an existing global supplier of orthopaedic medical devices for shoulders, knees and hips, and has since been renamed Enovis. Enovis continues to supply STAR in the UK.

4. Observations on the effectiveness and risk profile of the merger remedies

4.1 This section draws together the findings from the five merger remedy case studies. It discusses the remedies' effectiveness in addressing the competition concerns identified by the CMA, and common themes that emerge from the case studies concerning risks to the remedies' effectiveness and approaches to mitigating these risks.

4.2 Different approaches to the design of carve-out remedies and their effect on the remedies' risk profiles are also explored in this section. These different approaches can be summarised as follows:

- *Geographic carve-outs:* as adopted in Electro Rent / Microlease where Electro Rent's UK business was separated from its wider European business and placed in the divestment package.
- *Customer carve-outs:* as adopted in Rentokil / Cannon and Rentokil / MPCL where contracts with national customers and supporting assets at the acquired firms were separated from other customer contracts and placed in the divestment package.
- *Product carve outs:* as adopted in Stryker / Wright where Stryker's ankle replacement product was separated from Stryker's wider product portfolio and placed in the divestment package.[4]

4.3 Risks to the remedies' effectiveness are discussed in terms of the three broad risk categories set out in the CMA's merger remedies guidance, namely:

(a) Composition risks: risks that the scope of the divestment package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the market.

(b) Purchaser risks: risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser.

(c) Asset risks: risks that the competitive capability of a divestment package will deteriorate before completion of the divestment, for example, through the loss of customers or key members of staff.[5]

4.4 The section is set out as follows: the effectiveness of the merger remedies is reviewed in Section 4.1; common themes arising from the merger remedy case studies in relation to composition risks are discussed in Section 4.2; purchaser risks are discussed in Section 4.3; and asset risks are discussed in Section 4.4.

4.1 Effectiveness of the merger remedies

4.5 The remedies reviewed in the case studies achieved varying degrees of success in addressing the competition concerns identified by the CMA in each merger inquiry. Two of the remedies (Ecolab / Holchem and Electro Rent / Microlease) were broadly successful albeit with some caveats around the Electro Rent / Microlease remedy, while the remedies in Rentokil / Cannon and Rentokil / MPCL were less successful. The final remedy (in Stryker / Wright) delivered an outcome that is, for the reasons discussed below, somewhat equivocal.

4.6 In Ecolab / Holchem, the CMA required the divestment of nearly the entirety of Holchem, and Ecolab chose to also include those small parts of the business that it had been allowed to

[4] The divestment package also included Stryker's finger joint arthroplasty products as a result of FTC intervention.
[5] CMA, *Merger Remedies*, CMA87, December 2018, para 5.3.

retain. This was the only remedy in the five case studies that did not involve carving-out a package of assets from a wider business. The remedy restored the pre-merger market structure, and has been effective in addressing the CMA's competition concerns. The divestment business, Holchem, has continued to serve customers as it did prior to being acquired by Ecolab.

4.7 In Electro Rent / Microlease, the CMA required the divestment of Electro Rent UK, which was carved out from Electro Rent's wider European business. The purchaser of the divestment package has been an effective competitor in the market for the supply of TME for rent in the UK, and from this perspective the remedy has been a success. The competitive constraint offered by the purchaser has, however, been at risk of dissipating as a result of it not having sufficient scale to invest profitably in new TME rental assets (see Section 4.2.1). This concern seems to have been mitigated by the recent acquisition of the purchaser by an international TME supplier, although this has been a fortuitous rather than planned outcome.

4.8 In Rentokil / Cannon and Rentokil / MPCL, the CMA required the divestment of a package of customer contracts (and supporting assets), and in both cases the divestment packages were loss-making on a standalone basis. The purchasers' ability to act as effective competitors has been constrained by the need to devote substantial management time and resources to turning these acquisitions into financially sustainable businesses. In at least one of the two cases, the financial losses stemming from the divestment package has had a direct effect on customers' willingness to retain the purchaser's services. For these reasons, neither of these remedies can be regarded as more than partially successful. The significant composition and purchaser risks carried by these two remedies are explored further in Sections 4.2 and 4.3.

4.9 In Stryker / Wright, the CMA required the merged business to divest an orthopaedic product that it supplied in the market where competition concerns arose. The divestment product has, under its new ownership, lost market share which may indicate that it is a weaker competitive constraint than before the merger. However, to some extent at least, this competitive weakness relates to events that were in train prior to the merger rather than the crystallisation of risks linked to the remedy's design. Nevertheless these issues were not identified during the remedies process (see Section 4.2.4). Further, other challenges have emerged since the remedy's implementation, which stem from the post-divestment relationship between the merged business and the purchaser (see Section 4.3.3).

4.10 The varying success of these remedies supports the view set out in the CMA's merger remedies guidance that carve-out remedies generally have greater risks to their effectiveness. The guidance says:

> "The CMA will generally prefer the divestiture of an existing business, which can compete effectively on a stand-alone basis, independently of the merger parties, to the divestiture of part of a business or collection of assets. This is because divestiture of a complete business is less likely to be subject to purchaser and composition risk and can generally be achieved with greater speed.[6]

4.2 Composition risks

4.11 The case studies give rise to four common themes that relate to composition risks in carve-out remedies. These themes, discussed below, are:

- the risks associated with divestment packages which contain "dual use" assets where only some of the services produced by these assets are included in the package (Section 4.2.1);

[6] CMA, *Merger Remedies*, CMA87, December 2018, paras 5.12 to 5.14.

- the risks arising from merger parties' ability to influence the content of divestment packages (Section 4.2.2);
- the role of customer consent (Section 4.2.3); and
- risks arising from limits to the effectiveness of purchasers' due diligence on divestment packages (Section 4.2.4).

4.2.1 Dual use assets in divestment packages

4.12 In three of the case studies (Electro Rent / Microlease, Rentokil / Cannon and Rentokil / MPCL) the divestment package included assets that, before the divestment, were used to produce services that were excluded from the divestment package. The case studies show how, in this situation, economies of scale, density (or scope) can be lost when creating a divestment package, which increases the cost of producing divestment services and constrains the purchaser's ability to compete. In contrast, however, the merged business can benefit by adding those assets of the acquired business that it retains to its existing operations and extending any economies of scale, density (or scope) that are present.

4.13 In Electro Rent / Microlease, Electro Rent had, before the merger, served its customers in Europe, including the UK, from its main depot in Brussels using a single pool of TME rental assets. The remedy, in carving out Electro Rent UK, took a subset of Electro Rent's TME rental assets in Europe and allocated them to the divestment package. These assets were selected based on their use by UK customers in the previous two years, but they would also have been used by customers elsewhere in Europe during this time.

4.14 Creating a separate pool of TME rental assets for the divestment package meant unwinding the economies of scale that Electro Rent achieved by serving a larger geographic area from a single location with a single asset pool. Electro Rent was not disadvantaged by this loss of economies of scale as it was able to combine its retained business with the Microlease business that it acquired. The purchaser was also, in the short-term at least, not affected by the loss of these economies of scale. This is because it acquired the divestment package at a significant discount to the assets' replacement value, and this allowed it to price its TME rental services competitively.

4.15 However, the purchaser told us that had it acquired the divestment assets from new (i.e. not at a discounted price), then its TME rental prices would have been uncompetitive. If the purchaser had remained a UK-focused business in the longer term, then it seems likely that it would have continued to lack the scale needed to invest profitably in new TME rental assets, and the competitive constraint it offered in the TME rental market is likely to have dissipated. The purchaser has, however, been recently acquired by a much larger international TME business, and this seems likely to have given this business the scale needed to continue being an effective competitor.

4.16 In both Rentokil / Cannon and Rentokil / MPCL, contracts with national customers were carved out from the acquired businesses together with the staff, vehicles and other assets needed to service these customers. However, these same staff, vehicles and other assets had been used before the merger to serve the regional and local customers that were being retained by Rentokil as well as national customers in the divestment package. Creating a divestment package that included national customers and the necessary supporting assets without the regional and local customers meant unwinding the economies of density in Cannon's pre-merger local service networks.

4.17 The loss of these economies of density meant that the purchaser incurred higher costs in servicing the national customers in the divestment package. Moreover, national customers tended to have greater servicing requirements, which meant that they had higher servicing

costs relative to other customer types, and further were better able to negotiate lower prices. All of this meant the national customers in the divestment packages were less profitable than other customers even before the removal of economies of density in local service networks. The combined effect was that the divestment packages in both cases were unprofitable on a standalone basis. Even when a substantial number of local and regional customer contracts were added to the divestment package in Rentokil / Cannon, this was not sufficient to make the divestment package profitable.

4.18 The purchasers, in both cases, have experienced significant challenges in turning the loss-making divestment packages into profitable businesses. Both purchasers have acquired additional businesses in an effort to restore the economies of density that were lost in creating the divestment packages, but the process of achieving profitability has been slow. This lack of profitability has, in turn, constrained the purchasers' ability to act as effective competitors.

4.19 The risk to a remedy's effectiveness from the loss of economies of scale, density (or scope) has the potential to be mitigated by selecting a purchaser with a complementary asset base that can restore lost economies. Fewer such purchasers, however, are likely to exist compared to the number of purchasers that might be available for a standalone business that does not need to be combined with the purchaser's own assets to achieve profitability. Closer monitoring and oversight of the sales process by the CMA or a monitoring trustee may help mitigate this risk. The experience of purchaser selection in the case studies is discussed in Section 4.3.

4.2.2 Merger parties' influence over the content of divestment packages

4.20 Carve-out remedies can provide merged businesses with greater opportunities to influence a divestment package's content. The boundaries of such a package will inevitably be less well defined at the start of a remedies process compared to the divestment of a standalone business or business unit. Prospective purchasers may also have the opportunity to influence the content of divestment packages in a carve-out remedy, but are likely to be at a disadvantage given the information asymmetries between them and a merged business. The CMA will similarly be at an informational disadvantage when it comes to deciding on the composition of the package.

4.21 Merged businesses have an incentive to use this advantage to influence the divestment package's content so as to limit the future competitive constraint offered by a purchaser. The case studies illustrate how the CMA has used different approaches to decide on the content of divestment packages and the effect this has had on merged business's ability to exert influence.

4.22 In Electro Rent / Microlease, the CMA, first, provided a framework for negotiations between the merged business and prospective purchasers on the content of the divestment package. The CMA decided that the package should contain those TME assets on rent to UK customers as well as additional TME assets up to a certain value. Rather than specifying the exact additional TME assets to be included in the package, the CMA allowed the purchaser to select these assets from the Electro Rent inventory with Electro Rent giving the purchaser enough detail about its inventory to facilitate this selection, without having to provide complete visibility of its asset portfolio.

4.23 The CMA additionally decided that Electro Rent should be required to offer certain other assets and services to prospective purchasers (namely, one of the brand names acquired with Microlease and access to Electro Rent's global inventory of TME rental assets), but it did not mandate their inclusion in the divestment package. The CMA left it to the parties to negotiate

terms for these optional elements and when no agreement was reached these elements were omitted from the final package.

4.24 In Rentokil / Cannon, the CMA specified a minimum set of customer contracts for inclusion in the divestment package (i.e. those within the scope of the SLC decision). It did not require the package to include any other customer contracts, nor did it require Rentokil to make any offer of additional contracts. Nevertheless, the purchaser and Rentokil agreed to include a significant number of additional customer contracts in the package. In contrast to Electro Rent / Microlease, however, Rentokil controlled the selection of these contracts, and the purchaser did not have any sight of the wider pool of contracts from which the selection was made.

4.25 In Rentokil / MPCL, the CMA took a similar approach to Rentokil / Cannon and did not require the package to include any other customer contracts beyond those within the scope of the SLC decision, nor did it require Rentokil to make any offer of additional contracts. In contrast to Rentokil / Cannon, however, the purchaser and Rentokil did not reach any agreement to include additional contracts in the divestment package, and it is not clear that the purchaser made any such request of Rentokil.

4.26 These case studies illustrate three different approaches by the CMA to specifying the content of a divestment package in a carve-out remedy, namely:

- *Specifying a framework and allowing the parties to negotiate the details*: as in Electro Rent / Microlease in relation to the value and selection of additional TME assets to be included in the divestment package.
- *Specifying a minimum package and leaving negotiation of any additional elements to the parties*: as in Rentokil / Cannon and Rentokil / MPCL in relation to the inclusion of additional customer contracts in the divestment package.
- *Mandating an offer to prospective purchasers*: as in Electro Rent / Microlease in relation to purchasing a brand name and retaining access to Electro Rent's global inventory of TME rental assets.

4.27 Each of these approaches has advantages and disadvantages albeit to different degrees. The first approach, by specifying an outcome and allowing the parties to negotiate the details, minimises the risk to the CMA of mis-specifying a package by being overly prescriptive. However, there is also a risk that this approach may allow a merged business to have too much influence over the divestment package's content, given its informational advantage. Moreover, potential purchasers will be interested in acquiring those assets that will maximise profits, and this may not always align with acquiring those assets best suited to remedying an SLC.

4.28 The second approach of specifying a minimum package and leaving negotiation of any additional elements to the parties is likely to be appropriate when the CMA is comfortable that the specified package is sufficient to address its competition concerns. However, to the extent that there is any material uncertainty on this point it is unlikely that unguided negotiations between the parties will result in a larger package that addresses this risk. As was seen in Rentokil / Cannon, even when the purchaser secured additional customer contracts it was not enough to ensure the package's profitability and the remedy's success. For many carve-out remedies, where there may be uncertainty over whether the package is sufficient to address competition concerns, an alternative approach may be more effective at reducing composition risk.

4.29 The third approach of requiring a merged business to offer certain assets to prospective purchasers, and leaving it to the parties to negotiate the terms for their acquisition, may be the least satisfactory of the three approaches. If the CMA is uncertain about the importance of certain assets to a remedy's success, then mandating an offer to prospective purchasers is

unlikely to result in any assets that are important for its success being included in the divestment package. The merged business will have an incentive to ensure that these assets are excluded, and it can pursue this by, for example, making it difficult to agree commercial terms with prospective purchasers and/or by exploiting its informational advantage to mask these assets' importance.

4.2.3 Requirement for customer consent

4.30 Where a divestment package in a carve-out remedy includes customer contracts, but not the legal entity that holds these contracts (as a result of it being retained by the merged business), then customers' consent to the transfer of their contracts to a new service provider will usually be required. This situation is particularly likely to be encountered with customer carve-outs. The viability of such a remedy will depend on customers' willingness to provide their consent, and three of the case studies (Ecolab / Holchem, Rentokil / Cannon and Rentokil / MPCL) show how this can vary between cases.

4.31 In Ecolab / Holchem, Ecolab proposed a customer carve-out, but this was rejected by the CMA as a result of, amongst other factors, concerns that customers would be unwilling to transfer to a new service provider. The CMA found that food and beverage manufacturers, who were key customers for the merged business, attached a great deal of importance to their supplier of cleaning chemicals and ancillary services as this was a critical input to their operations. As a result, the CMA considered that there was a significant risk that customers would refuse to transfer or would soon return to the merged business, thus rendering the remedy ineffective.

4.32 In Rentokil / Cannon, the customer contracts in the divestment package included contracts entered into directly with customers and those entered into via framework agreements. In contrast to Ecolab / Holchem, most customers were not particularly concerned about their supplier of washroom services (as shown by the difficulties the CMA encountered in gaining customer engagement during the merger inquiry). There were, however, concerns that the framework agreements presented an obstacle to customers transferring to a new supplier. This was because the purchaser of the divestment package had not previously been admitted to these framework agreements. Ultimately, however, a novation to the master contracts was agreed and almost all affected customers (around 8,000 – 10,000 customers in total) agreed to this approach without difficulty. The ease with which this novation was agreed most likely reflected the low priority that most customers attached to the identity of their washroom services supplier.

4.33 The Ecolab / Holchem and Rentokil / Cannon cases show that the ease of securing customer consent to being transferred to a new supplier can vary markedly, and is likely to be linked to the importance placed on the supplier's service by its customers.

4.34 In Rentokil / MPCL, a different approach was employed to address the risk of not securing customers' consent to being transferred to a new supplier. In this case, the MPCL legal entity was included in the divestment package, which allowed the customer contracts that were part of the divestment package to be acquired by the purchaser without any need for explicit customer consent. As a result, to the extent that customer consent was required it was for those customers being retained by the merged business and where it was not forthcoming, then the default outcome was that the customer would be acquired by the purchaser of the divestment package.

4.35 The approach used in Rentokil / MPCL, referred to as a "reverse carve-out", has some potential to overcome customer consent risks more generally. However, there are likely to be limits to this approach. In Rentokil / MPCL, some former MPCL customers, whose contract had transferred to Rentokil, presumably with their consent, switched their business to the

purchaser shortly after the remedy's implementation. These customers, as we understand it, were loyal to MPCL and regarded the purchaser's business as the successor to MPCL. These customer transfers did not affect the remedy's success, but other scenarios can be envisaged, such as the one that concerned the CMA in Ecolab / Holchem, where customers move towards, instead of away from, the merged business and undermine a remedy's effectiveness.

4.2.4 Purchasers' due diligence on divestment packages

4.36 Purchasers' due diligence on divestment packages has the potential to mitigate composition risks at least to some degree as it allows purchasers to assess whether the package is sufficient to allow them to compete in a market.

4.37 The difficulty, however, is that due diligence processes can have significant limitations, and carve-out remedies are likely to be at greater risk of due diligence flaws. Carve-out packages frequently lack historic financial accounts, business records for assets in the package may not be readily separable from wider business records, and the content of the package may still be under negotiation. Three of the case studies (Stryker / Wright, Rentokil / MPCL and Rentokil / Cannon) illustrate the due diligence challenges that purchasers can encounter.

4.38 In Stryker / Wright, the purchaser's due diligence did not fully reveal the significant regulatory challenges that were emerging in relation to Stryker's ankle replacement product.[7] A safety notice for the divestment product was issued by the US Food and Drug Administration (FDA) only a few months after the package was purchased. Further challenges also emerged with securing FDA approval for one of the pipeline products in the package. These issues have contributed to the divestment product's loss of competitiveness since the remedy's implementation.

4.39 In Rentokil / MPCL, difficulties in extracting information from MPCL's business management software led the purchaser to estimate the cost of serving those customers in the package using an average for all MPCL customers. However, as the package only included national customers, which incur higher servicing costs, customer service costs were underestimated, and the package's profitability was overestimated. In Rentokil / Cannon, the purchaser had difficulties obtaining details about some of the assets in the package. For example, individual histories of vehicles in the package were not available (which we were told was a function of Cannon's global insurance policy), and this lack of information had the effect of subsequently inflating the purchaser's insurance costs.

4.3 Purchaser risks

4.40 Purchaser risks are the risk that a suitable purchaser for a divestment package is not available or the package is sold to a weak or otherwise inappropriate purchaser. CMA approval of prospective purchasers provides important protection against this risk, with the CMA seeking to ensure "that a prospective purchaser is independent of the merger parties; has the necessary capability to compete; is committed to competing in the relevant market; and divestiture to the purchaser will not create further competition concerns".[8]

4.41 Several common themes emerge from the case studies in relation to purchaser risks. These are:

- the reliance on purchasers' resources, expertise and assets in carve-out remedies (Section 4.3.1);

[7] These challenges did not come to light in the merger inquiry either.
[8] CMA, *Merger Remedies*, CMA87, December 2018, paras 5.21.

- the risks arising from merger parties' influence over the choice of purchaser for a divestment package (Section 4.3.2);
- the risks arising from post-divestment relationships between merger parties and purchasers of divestment packages (Section 4.3.3); and
- the use of fallback remedies as a form of risk mitigation (Section 4.3.4).

4.3.1 Reliance on purchasers' resources, expertise and assets

4.42 Purchasers of divestment packages must have access to the financial resources, expertise and assets that will let them operate a divestment package as an effective competitor.[9] In the case of carve-out remedies, this reliance is even more important than for other divestment remedies. This is because divestment packages in carve-out remedies are not self-standing businesses and must, by definition, be combined with the purchaser's resources, expertise and/or assets for the remedy to be a success.[10]

4.43 This reliance on purchasers' resources, expertise and assets for a remedy's success stands out most prominently in those case studies where the creation of the divestment package resulted in the loss of economies of scale or density (i.e. Rentokil / Cannon, Rentokil / MPCL and Electro Rent / Microlease) – see Section 4.2.1. In neither Rentokil / Cannon nor Rentokil / MPCL did the purchaser have significant existing local service delivery networks capable of restoring the economies of density lost when creating the divestment package. The purchasers' expertise in non-UK markets, their ability to finance the losses incurred by the divestment packages, and their ability to acquire additional businesses that could eventually restore the lost economies of density was, in these cases, not enough to make the remedy a success (see Section 4.1).

4.44 In Electro Rent / Microlease, the CMA was concerned to ensure that the purchaser was committed to the UK TME rental market given the risk of divestment assets being sold or deployed outside the UK. The divestment package's profitability meant that, unlike in Rentokil / Cannon and Rentokil / MPCL, there was little reliance, in the short-term, on the purchaser's financial resources. However, the remedy's long-term effectiveness relied on the purchaser achieving sufficient scale so that it could profitably invest in new TME rental assets (see Sections 4.1 and 4.2.1). The recent acquisition of the purchaser by a larger, international TME business means that the business is now likely to have this scale, but this was not a planned outcome for the remedy.

4.45 In Stryker / Wight, the remaining carve-out remedy in the case studies, there was no material loss of economies of scale, density (or scope) that the purchaser had to replicate for the remedy to be successful. Rather, the remedy relied on the purchaser's capabilities as an existing supplier of orthopaedic medical devices to provide the specialist support that was needed for the ongoing success of the divestment product. This included, for example, the purchaser's in-house R&D, regulatory and compliance functions. This expertise has not, however, been sufficient to avoid a deterioration in the divestment product's competitiveness since the remedy's implementation. However, for the reasons discussed in Section 4.2.4, this deterioration is more likely to be attributable to factors that were in place prior to the divestment.

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[9] "The purchaser must have access to appropriate financial resources, expertise (including managerial, operational and technical capability) and assets to enable the divested business to be an effective competitor in the market. This access should be sufficient to enable the divestment package to continue to develop as an effective competitor" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.21).

[10] "Where a proposed divestiture comprises part of a business or specified assets … the capabilities and resources of prospective buyers are likely to be more critical to a successful outcome than for a standalone business. A package of assets proposed for divestiture may, for example, lack an established infrastructure and its viability may therefore be more dependent on an appropriate match with the capabilities of the purchaser" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.13).

4.46 In Ecolab / Holchem, where a standalone business (i.e. Holchem) was divested, the more limited dependence on the purchaser's capabilities, resources or assets for the remedy's effectiveness is clearly demonstrated. Holchem has, since its divestment, been able to continue serving and competing for customers with limited support or intervention from its new owner.

4.3.2 Merger parties' influence over the choice of purchaser

4.47 Responsibility for identifying prospective purchasers for a divestment package resides with the merged business (except where a divestiture trustee has been appointed).[11] The CMA will then evaluate the suitability of the prospective purchasers that are presented to it. The merged business's ability to select prospective purchasers for CMA approval may allow it to promote prospective purchasers that it believes will be weaker competitors while excluding other potentially stronger competitors.[12]

4.48 In carve-out remedies, where there are likely to be fewer prospective purchasers with the resource, expertise or assets needed to turn the divestment package into an effective competitor (see Section 4.3.1), a merged business's influence over the choice of purchaser may present even greater risks. Further, where there is negotiation over the divestment package's content (see Section 4.2.2), there may be opportunities to favour prospective purchasers that are willing to concede on optional elements that might otherwise strengthen their ability to compete.

4.49 While the CMA's purchaser approval process will mitigate this risk by ruling out prospective purchasers that are weak or otherwise inappropriate, merged businesses and prospective purchasers have a shared interest in ensuring that prospective purchasers are presented in a way that maximises the likelihood of them being judged as meeting the necessary standard. Further, merged businesses will have an interest in promoting prospective purchasers that meet this standard by the barest minimum rather than those that significantly exceed it.

4.50 The case studies provide examples of potentially weaker competitors advancing through the sales processes for divestment packages, but potentially stronger competitors, who might have been expected to be interested in acquiring a divestment package, not participating to any significant extent. None of the examples set out below is definitive, and there may be multiple explanations for the selection of the purchaser in each case. However, as a whole, the cases appear to support a view that merged businesses do act upon the incentive to secure weaker competitors as purchasers of divestment packages.

4.51 In Electro Rent / Microlease, four prospective purchasers were put forward for evaluation by the CMA. Two of the prospective purchasers were rejected by the CMA (in one case based on concerns about its independence from the merger parties). Of the two remaining prospective purchasers, Electro Rent selected a UK-focused business ahead of a competitor that was seeking to build pan-European scale. Electro Rent said that it chose its preferred purchaser for the divestment package based on its perception of the ease of securing a completed sale with the two prospective purchasers. However, as discussed earlier, this UK-focused purchaser was likely to have lacked the scale necessary to provide a long-term competitive constraint on

[11] "Except in circumstances where a divestiture trustee is in place, the merger parties are responsible for securing a prospective buyer and demonstrating that it satisfies the CMA's criteria for a suitable purchaser. However, the CMA will keep the progress of the divestiture under close scrutiny. Where the merger parties receive interest in the divestiture package from multiple prospective buyers, they may ask the CMA to evaluate the suitability of a small set of short-listed purchasers. This is to avoid the merger parties progressing one prospective purchaser, possibly through lengthy due diligence, but this purchaser then being found not to satisfy the CMA's purchaser suitability criteria" (CMA, *Merger Remedies*, CMA87, December 2018, paras 5.22-5.23).

[12] The merger parties can also be expected to be influenced by the amount of money offered for the divestment package by potential purchasers, and to balance this against considerations about future competition.

the merged business (see Section 4.2.1), and this may have also influenced Electro Rent's choice of purchaser.

4.52 In Rentokil / Cannon, Rentokil initially put forward a financial investor, with no experience in washroom services, as the proposed purchaser of the divestment package. The CMA rejected the purchaser based on concerns about its capability and commitment to competing in the market, and then rejected the same purchaser a second time after renewed representations. (Consistent with this, in another case study, the purchaser of the divestment package told us that it was likely that it had been put forward by the merger parties as a result of it being perceived as a weaker competitor than other prospective purchasers.)

4.53 The CMA initially thought it likely that one of the smaller national washroom service providers would have found the Rentokil / Cannon divestment package attractive, given their ability to combine the package with existing customer routes. This would have allowed one of these firms to restore at least some of the economies of density that were lost in creating the divestment package (see Section 4.2.1) and to earn a return on its investment more quickly than other prospective purchasers. However, to the extent that these firms had any interest in the divestment package, they did not participate in the sales process, and Rentokil had little incentive to encourage them to do so.

4.54 In Rentokil / MPCL, two prospective purchasers attended presentations on the divestment package, after which one dropped out, leaving a single purchaser for CMA approval. The purchaser, as was the case in Rentokil / Cannon, had considerable experience in the sector in overseas markets but only a limited UK presence. This lack of a UK presence in pest control services meant that it did not have service delivery routes that it could combine with the divestment package, which as set out earlier constrained its profitability and ability to compete with the merged business (see Sections 4.2.1 and 4.3.1).

4.3.3 Post-divestment relationships between merger parties and purchasers

4.55 A merged business may be able to weaken the competitive constraint offered by the purchaser of a divestment package if there are ongoing links between the two businesses. The CMA seeks to guard against this risk by ensuring that prospective purchasers do not have any significant connection to the merged business other than interim access to services that may be required for the purchaser to be able to operate effectively.[13]

4.56 In three of the case studies (Stryker / Wright, Ecolab / Holchem and Rentokil / Cannon) there were post-divestment links between the merged business and the purchaser of the divestment package.

4.57 In Stryker / Wright, Stryker has continued manufacturing the divestment product on an interim basis while the purchaser secures authorised manufacturer status from EU regulatory authorities.[14] This interim arrangement has, however, created challenges for the purchaser as the merged business has continued to have interactions with regulators in relation to the divestment product while it remains the manufacturer.

[13]. The CMA's merger remedies guidance notes that the "purchaser should have no significant connection to the merger parties that may compromise the purchaser's incentives to compete with the merged entity (e.g. an equity interest, common significant shareholders, shared directors, reciprocal trading relationships or continuing financial assistance)" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.21). However, "Purchasers may require access to key inputs or services at appropriate terms from the merger parties, on an interim basis, in order to enable the divestiture to operate effectively. Such arrangements may be permitted by the CMA for a limited period" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.25).

[14] CMA merger remedies guidance states that proposed purchasers "will be expected to obtain in advance all necessary approvals, licences and consents from any regulatory or other authority" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.21). However, the EU's regulatory regime for the supply of medical devices meant that it was not possible for the purchaser to achieve regulatory approval in advance of acquiring the divestment package.

4.58 No material difficulties have emerged as a result of post-divestment links between the merged businesses and the purchasers of the divestment packages in Ecolab / Holchem and Rentokil / Cannon. In Ecolab / Holchem, the CMA allowed Ecolab to advance a loan to the purchaser to assist in financing its purchase of the divestment package. This was unusual but a result of the transaction taking place during the first Covid lockdown when access to finance was curtailed. The loan was repaid by the purchaser within 12 months, ending the link between Ecolab and the purchaser.

4.59 In Rentokil / Cannon, the customer contracts in the divestment package transferred to the purchaser in stages over a three year period. However, in one location – the Isle of Wight – Rentokil continues to deliver services on behalf of the purchaser. We were told that this type of arrangement is quite common in washroom services, and given the small service area it seems unlikely to have any material influence on the purchaser's ability to compete.

4.3.4 Fallback remedies

4.60 The final theme to emerge from the case studies in relation to purchaser risk concerns the use of fallback remedies (or "alternative divestiture packages").[15] Fallback remedies provide an alternative if a suitable purchaser cannot be found for the initial divestment package.[16] In the case of carve-out remedies, a fallback remedy might encourage the merged business to make concessions on a divestment package's content (where this is subject to negotiation) to ensure that a suitable purchaser is found. In these situations, a fallback remedy may strengthen a prospective purchaser's bargaining position even though the fallback remedy's existence will be unknown to prospective purchasers (as this part of the remedy is confidential).

4.61 Fallback remedies were employed in two case studies (Electro Rent / Microlease and Rentokil / Cannon). [✂].

4.62 In Rentokil / Cannon, the purchaser was able to negotiate the inclusion of additional customer contracts in the divestment package over and above the minimum specified by the CMA. Such an outcome may not have eventuated without the fallback remedy.[17] In Electro Rent / Microlease, however, there is little evidence for the fallback remedy strengthening the purchaser's negotiating position. The purchaser did not, for example, negotiate acceptable terms for acquiring either a brand name or access to Electro Rent's global inventory of TME rental assets (see Section 4.2.2).

4.63 The option of including a fallback in a remedy may give the CMA an unwarranted degree of comfort when it adopts carve-out remedies. This is because the probability of adopting a fallback remedy is likely to be quite low. This is for several reasons: most divestment packages are likely to attract buyers at some price; potential purchasers are interested in acquiring divestment packages at discounted prices; the CMA may find it difficult to identify precisely the characteristics needed by purchasers over and above general suitability criteria; and adopting

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[15] The CMA's merger remedies guidance says that "In some circumstances, it may be appropriate to define a more extensive and/or marketable divestiture package (an "alternative divestiture package") which the CMA would require the merger parties to sell if the initially proposed package were not sold within a specified period" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.17).

[16] "Alternative divestiture packages may be appropriate if there is doubt as to the marketability of the initially proposed divestiture package or where a business is subject to major asset risks and the speed of divestiture is likely to be a critical requirement. In such circumstances, the prior identification of an alternative, more extensive and more marketable package may be the most effective means of facilitating rapid disposal if the initial package cannot be sold to a suitable purchaser within a specified period" (CMA, CMA would require the merger parties to sell if the initially proposed package were not sold within a specified period" (CMA, *Merger Remedies*, CMA87, December 2018, para 5.18).

[17] As noted elsewhere, the volume of additional contracts included in the divestment package was not, however, sufficient to secure its profitability.

the fallback remedy during a sales process may create other risks (e.g. asset risks for the divestment package).

4.64 If the probability of using a fallback remedy is low, and the presence of a fallback remedy only provides limited assistance for prospective purchasers in negotiating improved divestment packages (as seen in the case studies), then it seems reasonable to conclude that fallback remedies may not, in practice, provide the CMA with any significant risk mitigation.

4.4 Asset risks

4.65 The third broad category of risk identified in the CMA mergers remedies guidance is asset risks. These are risks that the competitive capability of a divestment package will deteriorate before completion of the divestment, for example, through the loss of customers or key members of staff. The CMA guards against these risks, in the case of completed mergers, through its use of interim measures, such as initial enforcement orders (IEOs) and the appointment of monitoring trustees.[18]

4.66 All five mergers in the case studies were completed mergers, and the CMA issued IEOs in each case. The CMA followed this up with the appointment of monitoring trustees in four of the five mergers, with the only exception being Stryker / Wright where a monitoring trustee was appointed by the FTC.

4.67 Interviewees in each of the case studies commented on their experience of interim measures, and the role of the monitoring trustees. Many, although not all, comments were positive, and the case studies offered fewer insights in terms of common themes regarding asset risks, particularly compared to composition risks and purchaser risks. There was no suggestion from the case studies that the use of carve-out remedies had any specific implications in relation to the management of asset risks.

4.68 In two case studies (Rentokil / Cannon and Rentokil / MPCL), the management teams that operated the acquired businesses under hold separate arrangements found the experience quite difficult in the period before a monitoring trustee was appointed. These teams said they received limited support from the acquirer, or the acquirer's advisers, and found the process of understanding and complying with their obligations under the IEO both challenging and stressful. In both cases there were concerns about extreme consequences arising from breaching the IEO even if this was unintentional. To some extent these pressures may have been the result of a lack of management capacity in the aftermath of the merger. In any event, the appointment of a monitoring trustee in both cases appeared to alleviate the issues being experienced.

4.69 In Ecolab / Holchem, feedback from the purchaser was that they had taken comfort from the hold separate arrangements while considering a purchase of the divestment package. Another merger party suggested that the CMA could potentially make greater use of internal corporate governance systems to help smooth the CMA inquiry process and its management of asset risks.

4.5 Effects of the Covid pandemic and supply chain pressures

4.70 All of the merger remedy case studies involved transactions that took place at, or around, the time of the Covid pandemic. The years since the pandemic have seen significant pressures emerge in UK firms' supply chains. In some cases, these pressures arose as a result of the

[18] CMA, *Merger Remedies*, CMA87, December 2018, para 4.80.

pandemic but there have also been other contributing factors, such as Brexit and the war in Ukraine.

4.71 In Electro Rent / Microlease, interviewees told us that international supply chain pressures delayed the availability of new TME for sale, and this increased customer demand for TME to rent. We were also told that the Covid lockdowns increased the priority for 5G network roll-outs so as to provide the connectivity to support working from home and this, in turn, increased demand at least for a period from a significant portion of the customer base for TME rentals.

4.72 In Ecolab / Holchem, interviewees told us that the Covid lockdowns created significant disruption in the demand for cleaning chemicals given the shutdown of hospitality venues and brewing operations, although this was partly offset by a short-lived increase in demand for hand sanitiser. As described above, the purchaser's acquisition of the divestment business was also made more challenging by the difficulties in accessing finance during the Covid lockdown, which necessitated CMA approval of vendor finance for the acquisition of the business. We were also told that there have been significant challenges in managing supplier cost increases, due to increased energy costs, given the more limited ability to increase prices for customers.

4.73 In Stryker / Wright, demand for orthopaedic medical devices dipped significantly during the pandemic and its immediate aftermath as a result of disruption to the UK healthcare system, and the understandable prioritisation of emergency care over elective care. Of potentially more significance to the competitive landscape is that recent tightening of the EU's regulatory arrangements for medical devices appears to have resulted in suppliers withdrawing some orthopaedic products from the market.

4.74 As might be expected, these macro-level events had different effects on the industries in which the case studies took place. However, the combination of the Covid pandemic, Brexit and other geopolitical events has meant that all of the businesses that we interviewed have experienced more than usual disruption to their operations. All of the divestments have experienced slower growth and progress against business plans than anticipated at the time remedies were designed and implemented.

4.75 This disruption points towards the importance of designing remedies with adequate margins such that purchasers can reasonably withstand unanticipated events. To the extent that there were specific impacts on the design or implementation of merger remedies, such as the CMA's approval of the vendor finance extended by Ecolab to Holchem's purchaser, this appears to have been limited.

5. Learning points

5.1 Carve-out remedies, due to their greater complexity compared to other divestment remedies, can be expected to carry greater risks to their effectiveness. The case studies bear out this expectation and show the ways in which these risks are manifested, and a number of learning points from the case studies are set out below. Some of these learning points support the existing understanding of the risks associated with carve-out remedies, while others may represent new insights.

(a) *Carve-out remedies that unwind or undermine economies of scale, density or scope can be expected to significantly increase the risk to these remedies' effectiveness.* The pool of potential purchasers with complementary assets that can promptly restore lost economies and compete effectively with the merged business will be much smaller than for other divestment packages, and in some cases, there may not be any such purchaser available.

(b) *Carve-out remedies can provide merger parties with opportunities to influence the content of a divestment package and, through this, limit future competition*. Divestment packages in carve-outs are less well-defined than is the case with a standalone business or business unit and, as a result, are subject to greater negotiation over their content. The case studies show that the CMA has used several approaches to deciding on the composition of these packages. Those approaches that afford the merger parties' more influence appear to result in higher composition risks.

(c) *Carve-out remedies that transfer customers to a new supplier will depend on customer consent and this can pose a substantial risk to these remedies' effectiveness.* The ease of securing customer consent can vary markedly according to the importance placed on the supplier's service by its customers. Alternatively remedy designs, such as reverse carve-outs, may assist where customer consent challenges are administrative or process-related in nature, but are unlikely to be effective where customer concerns about a transfer are more fundamental.

(d) *Carve-out remedies pose additional challenges for purchasers' ability to carry out effective due diligence as the divestment package is not based on a pre-existing business unit.* The financial profile of the package will generally be less transparent and prospective purchasers are likely to have less insight into how the package operates. Limits to the effectiveness of purchasers' due diligence in carve-out remedies means that the CMA cannot rely on this as an effective means of mitigating composition risks for these remedies.

(e) *Merger parties may be able to weaken future competition through their influence over the choice of purchaser for a divestment package. This risk is greater in carve-out remedies, where fewer prospective purchasers have the ability to become effective competitors.* The CMA's purchaser approval process mitigates this risk by screening out prospective purchasers that are inappropriate as a result of not meeting minimum requirements. However, it may be more difficult in carve-out remedies for the CMA to set minimum requirements that are sufficiently specific and comprehensive. As a result, merger parties may have scope to promote weaker, rather than stronger, prospective purchasers.

(f) *Fallback remedies may not significantly mitigate the risks associated with carve-out remedies given the low probability of their use and their limited assistance to prospective purchasers in negotiating divestment packages.* The option of including a fallback remedy may, as a result, be providing the CMA with an unwarranted degree of comfort when adopting a carve-out remedy as the initial divestment package.

5.2 Overall, the case studies show that carve-out remedies carry significant risks to their effectiveness and that risk mitigations, such as fallback remedies, may only be of limited use. This may be relevant to future merger inquiries when identifying those remedy options that are capable of addressing competition concerns.

5.3 Where the CMA concludes that a carve-out remedy is likely to be effective in addressing competition concerns, the case studies indicate that additional safeguards may be warranted to address the risks associated with these remedies. These could include, for example:

- setting additional and/or more specific requirements for prospective purchasers to be regarded as suitable (e.g. purchasers that can immediately, or almost immediately, earn profits from a divestment package);
- providing less discretion for negotiations between merger parties and prospective purchasers over the content of divestment packages;
- requiring increased safety margins when specifying asset or contract values for inclusion in divestment packages; and
- making increased use of monitoring and divestiture trustees in overseeing and managing divestment processes.

5.4 These interventions are not, however, costless, and the CMA may wish to take this into account when choosing between those remedies that it has identified as being effective in addressing an SLC.

Case study A: Electro Rent Corporation / Microlease Inc

A.1 This case study examines the merger remedy implemented by the CMA following the acquisition of Microlease Inc and Test Equipment Asset Management Limited (Microlease) by Electro Rent Corporation (Electro Rent). The case study is based on desk-based research and interviews with stakeholders, including the CMA, Electro Rent, a former director of MCS Rentals Limited (MCS), TestEquity LLC (TestEquity), a competitor and the monitoring trustees.

A.1 The parties and the merger

A.2 Microlease, prior to its acquisition by Electro Rent, was a global supplier of Testing and Measuring Equipment (TME), headquartered in the UK. Electro Rent is a US headquartered TME business. TME is used to validate the performance of electronic devices used in a variety of industries including telecommunications, aerospace and defence, industrial and information technology. Electro Rent and Microlease (together, the Parties) supplied TME for purchase, leasing and rent. In the UK, the Parties primarily overlapped in the supply of TME for rent and, to a lesser extent, for sale.

A.3 Prior to acquiring Microlease, Electro Rent's European operations were centred in Brussels, which was the location for its headquarters, its major depot for TME rental assets and most of its staff. Electro Rent also had a small depot and a small number of supporting staff in the UK, but customers in the UK and the rest of Europe were, for the most part, served from the Brussels depot, using a single pool of TME rental assets. Microlease's global business was primarily focused on the UK and Europe, and the telecommunications sector accounted for almost a third of its UK revenue in 2016.

A.4 On 31 January 2017, Electro Rent completed the acquisition of Microlease and on 1 February 2017 the CMA issued an Initial Enforcement Order (IEO), which required Electro Rent to keep the operations of Electro Rent and Microlease separate for the duration of the CMA merger inquiry. The CMA's Phase 1 inquiry commenced on 13 April 2017, and the transaction was referred for a Phase 2 investigation on 19 October 2017. Directions to appoint a monitoring trustee were made on 7 November 2017.

A.5 In defining the relevant market, the CMA found that the market for the supply of TME for rent was separate from the market(s) for the supply of TME for sale or lease. It further concluded, notwithstanding customers' limited ability to switch between different types of TME, the TME rental market should not be segmented by industry or equipment type. Instead, the CMA took account of suppliers' ability to satisfy different customer requirements in its competitive assessment. The geographic market was identified as UK-wide, and included rental sales to UK customers from suppliers whose stock of TME was based outside the UK.

A.6 Microlease was the largest supplier in the UK market for the supply of TME for rent. While Electro Rent was significantly smaller, the CMA found that it was Microlease's closest competitor as a result of its ability to serve UK customers from its large European, and global, TME stock. The Parties were the UK's only two rental partners for some of the largest original equipment manufacturers, which allowed them to purchase equipment at discounts not available to other rental suppliers. Other TME rental suppliers for UK customers either did not supply the same product/customer groups or focused on narrow product segments. As a result, the CMA considered that the merger would leave many UK customers with only one credible supplier of TME for rent.

A.7 The CMA concluded, in its final report published on 17 May 2018, that the Merger had resulted, or could be expected to result, in an SLC in the market for the rental supply of TME in the UK.

A.2 The remedy and its implementation

A.8 On 27 July 2018, the CMA accepted undertakings from Electro Rent to divest Electro Rent UK to a suitable purchaser. Electro Rent UK was not, however, a standalone business unit, and the divestment package of assets and customers had to be carved out from Electro Rent's wider European business.

A.9 Identifying the assets to be included in the divestment package was complicated by:

- the short-term nature of TME rental contracts, which meant that those UK customers currently renting TME might not reflect the long-term customer base for the UK business; and
- the practice of deploying TME rental assets to customers across Europe, which meant that those assets in the UK at a point-in-time might not reflect the full set of assets needed by a purchaser to become an effective competitor.

A.10 The CMA addressed these challenges by including all of Electro Rent's current contracts with UK customers in the divestment package and, in addition, allowing the purchaser to select additional TME rental assets up to a value of £3.5 million from a list of Electro Rent's TME inventory that had been used to serve UK customers over the past two years. The value of these additional assets was based on the replacement value of equipment rented to UK customers in the previous two years, with an additional margin to provide comfort that the package was, overall, a sufficient size to allow the purchaser to compete effectively.

A.11 The CMA decided that prospective purchasers should also be given the option of acquiring either the Microlease or Livingston brand (which were both part of the Microlease business) together with transitional support arrangements from Electro Rent, including access to Electro Rent's global inventory. A confidential fallback option was included in the remedy, which would have required [✂] if no suitable purchaser for the initial divestment package could be identified.

A.12 Electro Rent and its advisers identified prospective purchasers for the divestment package and presented four candidates to the CMA for approval. The CMA was concerned to ensure that prospective purchasers were committed to the UK market given the mobility of TME rental assets and the ease with which these assets could be deployed to customers outside the UK. The CMA was also concerned that the sale price for the divestment package, which was at a significant discount to the assets' replacement value, might increase the risk of an onward sale of the package's assets in the second-hand TME market, or result in insufficient incentives to ensure the fullest possible utilisation of these assets in the rental market. As a result, the CMA focused on reviewing the commitment that bidders showed to the UK market as evidenced through business plans and UK warehousing facilities (or otherwise identifying the extent of transitional support that would be required from Electro Rent).

A.13 Two of the prospective purchasers presented to the CMA were approved: one was a UK focused TME rental supplier; while the other was a European operator that did not have a UK presence but was interested in entering the UK market. The remaining two prospective purchasers were not considered suitable by the CMA. The CMA found that many executives in the sector often had shared work histories as a result of working in the industry for a long period, and this had the potential compromise the independence of competing suppliers. Of

the two prospective purchasers approved by the CMA, Electro Rent selected MCS, the UK-focused TME rental supplier, as its preferred purchaser.

A.14 To facilitate the process of choosing assets to be included in the divestment package MCS was supplied with a partial, rather than complete, list of Electro Rent inventory. This allowed Electro Rent to maintain the confidentiality of its market strategy, which may have been revealed had it had to supply a full inventory list. The CMA provided some oversight of the spread of assets selected by MCS but, consistent with not segmenting the relevant product market by industry or equipment type, this oversight was high level. In negotiating the divestment package with Electro Rent, MCS did not purchase the Microlease or Livingston brand nor secure access to Electro Rent's international inventory.

A.15 Electro Rent told us that it found the clarity of the CMA's requirements helpful in achieving rapid implementation of the remedy. It appreciated being allowed to lead on the details of the divestment as this also contributed to the speed of its implementation. Electro Rent expressed disappointment over the fines it received for breaching the IEO and suggested that it may be possible, in situations where the CMA sought improved engagement, for large multinational listed corporations like Electro Rent to offer its most senior international executives as alternative primary contacts for the CMA inquiry team. However, these global escalation systems often require a formal request before they can be engaged. Electro Rent suggested that the CMA could, in instances where compliance is becoming a concern, gain improved compliance outcomes by escalating its concerns in this way.

A.16 MCS completed the acquisition on 4 February 2019.

A.3 Post-remedy developments

A.17 As a result of acquiring the divestment package, MCS's customer base, revenues and profits increased. Customers that transferred with the divestment package were largely retained, and a review of MCS's publicly available financial accounts indicates that there was organic growth in its customer base after the acquisition.

A.18 MCS's new TME rental assets allowed it to supply customers involved in the construction of the UK's 5G telecommunications network. MCS's former director told us that acquiring these TME assets from new would have been uneconomic, and had it attempted to enter this market segment with new assets it would not have been price competitive when seeking to rent them out to customers.

A.19 MCS remained focused on the UK market after acquiring the divestment package and did not expand more widely in Europe. Soon after acquiring the divestment package the sector suffered from the disruption created by the Covid pandemic and, in particular, the effect this had on international supply chains. This disruption increased demand for TME rental assets from some customers as they sought to fill the gap created by delays in the supply of new equipment. Brexit also affected those TME rental businesses with pan-European operations as the transit of goods across the UK border required additional paperwork and experienced increased delays.

A.20 MCS's financial success following its acquisition of the divestment package is likely to have increased its attractiveness as an acquisition target. In late 2022, MCS was purchased by TestEquity, a US business active in the sale, servicing, and rent of TME that was expanding into Europe. At around the same time as acquiring MCS, TestEquity also purchased a business in Germany that specialises in the sale of second-hand TME.

A.4 Observations on the remedy's effectiveness and risk profile

A.21 This section sets out our observations on the remedy's effectiveness and its risk profile.

A.4.1 Effectiveness of the remedy

A.22 As set out above, the remedy adopted by the CMA was a divestment of Electro Rent UK, a carve-out from Electro Rent's wider European business. Divestment remedies are intended to remedy an SLC by re-establishing the market structure that could be expected in the merger's absence.[19] In this case, the remedy re-established a separate competitor for TME rentals in the UK.

A.23 There were, however, potential risks to the remedy's effectiveness including the possibility that: (i) the divestment package may not meet the needs of all of the Electro Rent UK's customers (which would have allowed the Merger Parties to monopolise segments that could not be served by MCS, as the purchaser of Electro Rent UK); and (ii) MCS did not achieve a scale sufficient to let it offer a competitive constraint to the merged business beyond the short term.

A.24 In terms of industry coverage, before the merger, Electro Rent UK was primarily focused on the telecommunications sector. Electro Rent told us that around 70% of its activity was in telecommunications and 30% in other sectors.[20] This weighting of Electro Rent's activity was reflected in the divestment package assets, and this complemented MCS's existing focus on the sector.[21] The concentration of telecommunications sector equipment in the divestment package and Electro Rent's pre-merger focus on the sector indicates that MCS was likely to have been successful in acquiring a set of assets that met the broad requirements of the Electro Rent UK customer base. This is also consistent with the lack of concerns raised by customers when feedback was sought during this review.

A.25 In terms of scale, to the extent that there were significant economies of scale in Electro Rent's European business prior to the merger (i.e. from using a single asset pool to serve customers across Europe), then the CMA's remedy, by carving out Electro Rent UK, had the effect of unwinding these economies, from the perspective of the purchaser of the divestment package. This risk was identified by the CMA in its final report, and while the CMA concluded that it would be mitigated by selecting a suitable purchaser, there was no specific requirement in the purchaser suitability criteria for prospective purchasers to have assets capable of restoring the lost economies of scale.[22]

A.26 The structure of Electro Rent's pre-merger business suggests that these economies were significant. Further support for the presence of significant economies of scale was provided by MCS's former director who told us that MCS, with its UK focused business, would not have been able to competitively rent out the assets acquired through the divestment package, at a discount, if it had purchased them new at full price. MCS's prices would have been uncompetitive if the assets had been purchased from new, with the implication that its lack of scale caused it to have a higher cost base.

[19] CMA, *Merger Remedies*, CMA87, December 2018, para 3.5.
[20] The CMA described Electro Rent's business revenue at paragraph 2.24 of the final report as predominantly telecommunications [60-70%], followed by Infotech and Aerospace & Defence at [20-30%] and [10-20%] respectively.
[21] MCS told us that it only had a small presence in other TME sectors, such as defence and aviation, while Electro Rent told us that MCS's selection of assets from the Electro Rent inventory was weighted 60% telecommunications and 40% generic RF equipment.
[22] The effect of the divestment package on economies of scale are described at paragraphs 9.88 to 9.96 in the Final Report, while purchaser suitability criteria are set out in paragraphs 9.186 to 9.188.

A.27 In the short-term, the unwinding of economies of scale by carving-out Electro Rent UK from the wider European business was likely to have had minimal consequences. Even if MCS had a lower utilisation rate for the divestment package assets as a result of only having a UK customer base, the financial consequences of lower utilisation would have been offset by the package's discounted purchase price. This is supported by MCS's published accounts, which indicate that it was financially successful after acquiring the divestment package.[23]

A.28 There is a question, however, as to whether in the longer-term MCS, if it remained a UK-focused business, would have had sufficient scale to invest profitably in new TME rental assets. Indeed, MCS itself appeared to suggest this likelihood to the CMA, as referenced in the final report.[24] However, if MCS did not invest in new TME rental assets then the competitive constraint that it offered in the UK TME rental market could be expected to progressively dissipate. Fortuitously, MCS's recent acquisition by TestEquity, with its much larger global business, may have mitigated this concern.

A.29 Overall, the remedy appears to have been effective in the short-term in remedying the SLC that was identified by the CMA. Longer-term risks to the effectiveness of the remedy may have been mitigated by MCS's recent acquisition by TestEquity, a TME supplier that is substantially larger in scale.

A.4.2 Composition risks

A.30 Composition risks occur when a divestment package does not attract a suitable purchaser, either as a result of the scope of the package being too constrained or not appropriately configured, or alternatively as a result of the divestment package not allowing a purchaser to operate as an effective competitor. In this case, the divestment package's spread of TME rental assets appears to have met the needs of Electro Rent UK's customers. MCS's acquisition of the package, as a result, restored the competitive constraint that was lost through the merger (in the short-term at least).

A.31 There does, however, appear to have been an element of risk concerning the content of the divestment package, which arose from the CMA's approach to defining the product market. The CMA concluded that the relevant product market was the supply of TME for rent, with no segmentation by industry or equipment type, notwithstanding the limits to demand-side and supply-side substitution that it had identified.[25] This approach to product market definition, while pragmatic given the facts of the case, may also have contributed to composition risks, given MCS's subsequent freedom over the selection of assets from Electro Rent's inventory for inclusion in the divestment package. If MCS had selected a very different mix of TME rental supply assets (e.g. not telecommunications focused), it is possible that the remedy would not have been effective in restoring competition.

A.32 The CMA, however, told us that this risk had been mitigated both by including current customers in the divestment package and by ensuring that the value of the assets in the divestment package was greater than that used by Electro Rent UK in recent years.

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[23] The outcome may, however, have been quite different if MCS had paid a price for the divestment package that more closely reflected their replacement value. If MCS had been unable to secure sufficiently high utilisation rates, the divestment package would have been loss making and this may have affected MCS's ability to compete effectively with the merged business. (That said, at a higher sale price, MCS may have dropped out of the sales process for the divestment package, and it may have been acquired by the other prospective purchaser, which appears to have had a larger-scale business, and this may have allowed it to achieve the higher utilisation rates that would have justified a higher purchase price.)

[24] See paragraph 9.83 of the CMA's final report.

[25] See paragraph 5.130 of the Final Report, May 2018. In paragraphs 5.109 to 5.114 the CMA considers whether the product market should be further segmented and decides that it would not assist in its competitive assessment of the merger. However, the CMA notes at paragraph 5.114 that rental suppliers are not necessarily capable of supply-side substitution across the market (the need for specialist stock and knowledge being significant barriers across sub-sectors).

However, if MCS had sought a different combination of assets it is not clear that the CMA would have had an opportunity to intervene given that MCS had already been approved as a purchaser.

A.33 Electro Rent's ability to influence the assets chosen by MCS, so as to potentially weaken it as a competitor, was constrained by the CMA's requirement that MCS be provided with a list of Electro Rent's TME rental assets from which it could choose. While Electro Rent was able to constrain, to some degree, the content of this list so as to protect its commercial strategy, the transparency provided by this list is likely to have been helpful.

A.34 A further requirement for the divestment package was that prospective purchasers should be offered the Microlease or Livingston brand and access to Electro Rent's international inventory. Following negotiations between Electro Rent and MCS, these elements were not included in the divestment package.[26] To the extent that Electro Rent was able to influence the negotiation process so that these elements were excluded, this may have contributed to the remedy's composition risk.

A.4.3 Purchaser risks

A.35 Purchaser risks occur if a suitable purchaser is not available or if the merger parties sell to a weak or otherwise inappropriate purchaser.

A.36 Electro Rent, as also set out above, put forward four prospective purchasers for the divestment package, and two were approved by the CMA. The confidential fallback remedy, [✄], seems likely to have contributed to Electro Rent's efforts to ensure that the initial divestment package attracted a buyer.

A.37 Electro Rent may, however, sought to choose the prospective purchaser, out of the two that were approved, which represented the weakest competitive threat (subject to any trade-off between the sale price for the divestment package and the likely effect of stronger, or weaker, competition on future profits).[27]

A.38 While MCS achieved considerable commercial success following its acquisition of the divestment package, there is also some evidence that the other prospective purchaser, which was building a pan-European TME rental business, may have represented a greater competitive threat to Electro Rent over the long term. On the other hand, Electro Rent's choice of MCS, a UK focused business, may have minimised the risk of divestment package assets being used outside the UK, rather than in the market where the SLC had been identified.

A.4.4 Asset risks

A.39 Asset risks occur when the competitive capability of a divestment package deteriorates before completion of the divestment, for example, through the loss of customers or key members of staff. The CMA's merger inquiry was assisted by two monitoring trustees, one which acted for the duration of the Initial Enforcement Order (IEO) (as replaced by an

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[26] The remedy permitted Electro Rent and MSC to negotiate the value and need for the optional elements. In this circumstance the CMA relies upon its assessment of the purchaser's business case and the purchaser's due diligence and incentive to achieve its business case objectives. That is, if the purchaser decides it is not necessary to acquire the elective elements of a remedy package, then the CMA accepts that this is appropriately within the purchaser's discretion.

[27] Electro Rent's willingness to accept a purchase price for the divestment package that was significantly below the book value of these assets is likely to have been motivated by several factors including: (i) its interest in securing a speedy implementation of the remedy in the UK to remove an impediment to the global transaction; (ii) the relatively small size of the Electro Rent UK business that it had to divest relative to the Microlease business in the UK that it had acquired; and (iii) the CMA's fallback remedy.

Interim Order), and a second that was appointed under the Final Undertakings and acted for the duration of the divestment process.

A.40 This case suggested a degree of asset risk arising from Electro Rent's actions during the CMA's inquiry, which included exercising the break clause on its UK head office and appointing a director to Microlease's board without the CMA's consent. However, the CMA appears to have effectively managed these issues following reports from the monitoring trustees throughout the merger inquiry process.

Case study B: Rentokil Initial plc / Cannon Hygiene Limited

B.1 This case study examines the merger remedy implemented by the CMA following the acquisition of Cannon Hygiene Limited (Cannon), a provider of washroom, healthcare waste collection and mats services in the UK, by Rentokil Initial UK Limited, a subsidiary of Rentokil Initial plc (Rentokil). The case study is based on desk-based research and interviews with stakeholders, including the CMA, Rentokil, Citron Hygiene UK (Citron), competing suppliers of washroom services and the monitoring trustee.

B.1 The parties and the merger

B.2 Rentokil is a UK-headquartered supplier of hygiene and pest control services with a global presence, while Cannon, before its acquisition by Rentokil, was owned by OCS Group Limited (OCS), a global facilities management provider. Rentokil and Cannon (together, the Parties) overlapped in the UK in the supply of washroom, healthcare waste collection, and mats services.[28]

B.3 On 21 December 2017, Rentokil and OCS entered into a sale and purchase agreement for the acquisition of the OCS hygiene services business, which included Cannon in the UK and several other countries in Europe and Asia. The acquisition also included Cannon Hygiene International Limited in the UK, which develops, markets and procures dispensers and certain key consumables. The UK element of the transaction completed on 1 January 2018.

B.4 On 31 January 2018, the CMA served an Initial Enforcement Order (IEO) on Rentokil which required Rentokil to keep the operations of Rentokil and Cannon separate for the duration of the CMA merger inquiry. The CMA's Phase 1 inquiry commenced on 19 April 2018 and its decision that the merger gave rise to a realistic prospect of an SLC in washroom services, but not healthcare waste collection nor mats services, was announced on 18 June 2018. The CMA referred the merger for a Phase 2 investigation on 28 June 2018 and a monitoring trustee was appointed on 10 July 2018.

B.5 By way of background, washroom services involve the supply of services and consumables for washrooms in public, office and industrial buildings. This includes the supply and fitting of various dispensers, replenishing products (e.g. toilet paper) and waste collection (from feminine hygiene units and nappy bins). Typically, service visits occur regularly according to a schedule with suppliers' staff travelling a route that allows them to visit multiple customer sites each day. Suppliers will service a particular region from a central depot, storage facility, or warehouse, where vans can be restocked with consumables and products.

B.6 The CMA found in its Phase 2 investigation that the complexity of servicing customers increases with the number of regions in which a customer requires washroom services. As a result, competition for local and regional customers was distinct from competition for multi-regional and national customers.[29] Five main suppliers were found to be capable of serving multi-regional and national customers, namely the Parties, PHS, Cathedral and Mayflower. However, the competitive constraint that Cathedral and Mayflower offered to the Parties and PHS was found to be limited.

B.7 The CMA considered that the supply of waste disposal services was a distinct segment of the washroom services market, and the competitive effects of the merger should be

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[28] Mats services involve the supply of indoor and outdoor mats which help prevent trips and slips.

[29] Multi-regional and national customers were defined as those with premises in at least eight out of twelve UK regions, and included businesses such as major grocery retailers and coffee shop chains. These customers tend to seek a washroom supplier that can service all of their locations under a single contract.

considered separately in relation to this segment. The CMA also assessed the competitive effects of the Merger with respect to three different customer segments, namely: (i) end-customers procuring directly; (ii) public and private framework agreements; and (iii) facilities management customers.

B.8 The CMA concluded, in its final report published on 25 January 2019, that the Merger had resulted, or could be expected to result, in an SLC in relation to the supply of washroom waste disposal services to multi-regional and national customers where customers are: (i) located in eight or more regions of the UK and purchase directly from a washroom services supplier; or (ii) purchasing through public and private framework arrangements.

B.2 The remedy and its implementation

B.9 On 16 April 2019, the CMA accepted undertakings from Rentokil to divest all of Cannon's contracts with customers where an SLC was identified along with the employees primarily engaged in providing or supporting these contracts, and the assets, permits, licenses, and relevant customer and operational information relating to these contracts. The remedy also included a commitment from Rentokil to offer transitional services to the purchaser of the divestment package.

B.10 The divestment package was not profitable on a standalone basis. Contracts with multi-regional and national customers tend to have much smaller profit margins than those with local and regional customers. Further, separating the servicing of multi-regional and national customers from local and regional customers undermined the route density that interviewees told us is an important factor in the profitability of washroom services. Higher route densities allow staff members to perform more customer visits each day and thus generate more revenue.

B.11 Recognising that the divestment package might not be sufficiently attractive to potential buyers, the CMA included a fallback remedy that would be implemented if a suitable purchaser for the divestment package could not be found. [✂].

B.12 Rentokil initially proposed a financial investor as the purchaser of the divestment package. Rentokil had shared a confidential information memorandum with seven parties at the outset of the divestment process, but only two were interested in participating in the sales process. (We were told that this limited interest was likely to have been a result of the divestment package's lack of profitability.) The CMA found that the financial investor would not be a suitable purchaser given its lack of experience in washroom services and its inability to demonstrate to the CMA's satisfaction a credible commitment to this market.

B.13 The CMA subsequently decided that the next purchaser proposed by Rentokil, namely Citron, was a suitable purchaser. Citron had been formed through a management buyout of Cannon Hygiene in Canada and, at the time of acquiring the divestment package, was owned by a private equity fund, Birch Hill Equity Partners. Citron supplied washroom services across Canada and in US regions near the Canadian border. Citron had recently entered the UK market when it participated in the divestment process. Its UK presence included ownership of a small washroom services business in Leicestershire and 1st Class Hygiene in the Midlands.

B.14 Negotiations between Rentokil and Citron resulted in a significant number of additional contracts with local and regional customers being added to the divestment package so as to increase the density of service routes and the package's profitability. Rentokil was responsible for selecting the additional contracts that were put forward for inclusion in the

divestment package. Citron did not have sight of the full range of contracts that might potentially be included. These additional contracts substantially increased the size of the divestment package's revenues. Citron acquired the divestment package in October 2019.

B.15 Regarding the divestment package's supporting assets, Citron found that the depots included in the package were generally larger than required and two out of ten depots were not needed at all. (One of these properties was returned to Rentokil and the other to its landlord.) Citron had to negotiate revised arrangements with the landlord for each depot and, in one case, this was against the backdrop of an impending lease expiry. Citron encountered some difficulties in obtaining information on some of the divestment package assets. In particular, the insurance and maintenance history of the vehicle fleet included in the divestment package was unavailable. This had the effect of increasing Citron's subsequent insurance costs significantly beyond the level it had anticipated.

B.16 The handover of contracts from Rentokil to Citron was planned to take place in three stages over three years. Contracts in central England transferred in the first year, followed by contracts in the Southwest in the second year, and contracts in Scotland in the final year. Rentokil delivered services to customers under licence to Citron in the period prior to the transfer of these contracts. The final handover of contracts was ultimately extended due to the impact of Covid. Citron told us that the staged transfer allowed it to complete an additional acquisition and agree joint ventures to build capacity and improve route profitability before taking on each tranche of contracts.

B.17 Several thousand framework customers had their contracts transferred to Citron as part of the divestment process and we were told that, on the whole, once customers understood the wider context, they were content to agree an amendment to the master contracts in favour of Citron, with only one customer requiring a formal letter of novation.

B.3 Post-remedy developments

B.18 Since acquiring the divestment package, Citron has continued to serve a portfolio of national, regional and local customers across the UK. Citron remains considerably smaller than Cannon was prior to its acquisition. Citron operates from eight depots, compared to the 25 depots operated by Cannon before its acquisition. (That said, Citron also uses a different operational delivery model which requires less depot space.)

B.19 Citron's ability to develop its business after acquiring the divestment package, was constrained by Covid's arrival in early 2020. During this time, two major national customer contracts were lost, at least in part as a result of the effect of Covid restrictions and their impact on customer relationships when customers' premises were closed. We were also told that the two national customers that were lost at this time were, ultimately, not critical to Citron's business plan.

B.20 Citron has also won new contracts with other national customers since purchasing the divestment package, and it has purchased several regional washroom services businesses, which have improved its route densities and profitability. In addition, it has restructured its business operations, ensuring that its depots are the right size for its service delivery model, and selling non-core operations (i.e. non washroom services).

B.21 Notwithstanding this progress, Citron has made substantial losses since purchasing the divestment package and is not yet profitable. This is in contrast to the profitability of the Cannon business prior to its acquisition by Rentokil.

B.22 Elsewhere in the market, Elis, the laundry services group headquartered in France, launched a UK-wide washroom services business in late 2019 and is reported to have won at least one major national customer contract. PHS, the UK's second largest supplier of washroom services acquired Mayflower, one of the smaller national operators, in May 2022.

B.4 Observations on the remedy's effectiveness and risk profile

B.23 This section sets out our observations on the remedy's effectiveness and its risk profile.

B.4.1 Effectiveness of the remedy

B.24 Divestment remedies are intended to remedy an SLC by re-establishing the market structure that could be expected in a merger's absence.[30] The remedy adopted by the CMA in this case achieved this outcome with respect to those customer segments where the CMA identified an SLC. At the same time, however, the adoption of a loss-making divestment package raised questions about risks to the remedy's sustainability. The remedy would only be effective if Citron was willing to finance its losses until it acquired sufficient customers (either organically or through acquisition) to achieve profitability. To date, Citron has been willing to make the investment necessary to convert the divestment package into a viable business.

B.25 Further, while the loss making divestment package may have increased Citron's incentive to compete for new customers, it also inhibited its ability to do so given the need for management attention to business restructuring and aligning costs with revenues. That is, Citron is likely to have been a materially weaker competitor than Cannon had been before its acquisition by Rentokil. At the point at which achieves, or has achieved, profitability, there will still have been an extended period in which management attention has had to focus on business restructuring rather than on customers, the market, or its competition.

B.26 Overall, the remedy is best described as only having been partially effective given the ongoing challenge that Citron has experienced in combining the divestment package with its other services in the UK and transforming this into a profitable business.

B.4.2 Composition risks

B.27 Composition risks occur when a divestment package does not attract a suitable purchaser, either as a result of the scope of the package being too constrained or not appropriately configured, or alternatively as a result of the divestment package not allowing a purchaser to operate as an effective competitor.

B.28 In this case, the divestment package had considerable composition risks. As the carve-out package was a different form and shape to the business from which it had been extracted, there was a significant likelihood that the premises, staff and assets would not match the operational needs of the purchaser's business. This is an inherent risk of carve-out remedies. That is, that elements of the divestment package do not fit with the purchaser's existing operations and require significant restructuring.

B.29 Additionally, the divestment package lacked the economies of density present in Cannon's service delivery routes prior to the remedy. Citron and Rentokil agreed that Rentokil would add a significant volume of local and regional contracts to the divestment package (in addition to the national customer contracts that the CMA required to be divested) but this

[30] CMA, *Merger Remedies*, CMA87, December 2018, para 3.5.

was not sufficient for the package to achieve profitability. Interviewees for the case study emphasised the importance of achieving profitability through route density.

B.30 The risks of a carve-out remedy increase significantly if: (i) existing efficiencies (or synergies) are lost in creating the divestment package (e.g. a loss of economies of density in service delivery networks or efficiencies from shared overhead costs); (ii) new inefficiencies are created (e.g. oversized premises); and (iii) the divestment package's viability depends on it being combined with the purchaser's existing operations or with significant new business development by the purchaser. All of these factors were present in this case.

B.31 A further source of composition risk arose from Rentokil and Citron negotiating the exact content of the divestment package. It may often be appropriate for a merged business and prospective purchasers to negotiate over a divestment package's content given that different purchasers may have different objectives. However, as the remedy only required the inclusion of national customer contracts in the package, Rentokil had considerable discretion in deciding which additional contracts, if any, would be offered to Citron. Rentokil would have had an incentive to retain those customer contracts that increased the density of its existing routes, and were thus most profitable, while offering other contracts to Citron. Further, in these situations, there is a risk that a purchaser will, in negotiating with the merged business, prioritise securing a deal at the expense of obtaining all of the assets needed to become an effective competitor.

B.32 Finally, the divestment package's composition may have limited the number of parties interested in participating in the sales process for the divestment package. An unprofitable divestment package in a carve-out can be expected to be less attractive than a profitable stand-alone business.

B.33 In managing composition risks, the CMA also relied, in part, on Citron's due diligence on the divestment package. However, as noted above, Citron encountered some difficulties in obtaining information on some of the divestment package assets. In particular, the insurance and maintenance history of the vehicle fleet included in the divestment package was unavailable. This has had the effect of increasing Citron's subsequent insurance costs significantly beyond the level it anticipated.

B.4.3 Purchaser risks

B.34 Purchaser risks occur when a suitable purchaser is not available or if the merger parties sell to a weak or otherwise inappropriate purchaser.

B.35 The CMA told us that, given the importance of route density, it anticipated that one of the smaller existing national providers of washroom services might emerge as a purchaser of the divestment package, although we understand that interest from these parties dissipated early in the divestment process. The CMA did not, however, require prospective purchasers to have an existing service delivery network in the UK capable of quickly restoring the economies of density that were lost in creating the divestment package. However, in reviewing prospective purchasers, the CMA rejected a financial investor that was initially proposed as the purchaser of the divestment package.

B.36 The CMA reviewed Citron's acquisition and growth plans for the UK when assessing its suitability as a purchaser. Despite being new to the UK market, Citron had knowledge and experience of the industry, and additionally, Citron's investors had an ongoing programme of acquiring other washroom service businesses in the UK, which demonstrated its commitment to the market.

B.4.4 Asset risks

B.37 Asset risks, occur when the competitive capability of a divestment package deteriorates before completion of the divestment, for example, through the loss of customers or key members of staff. Hold separate arrangements, as implemented through the IEO and the appointment of a monitoring trustee, are the primary tools used by the CMA to manage asset risks during a merger inquiry. The intention is to conserve the target business and ensure that all remedies remain available to the CMA in the event of an SLC finding.

B.38 As set out above, in this case an IEO was issued on 31 January 2018, which was around a month after Rentokil's acquisition of Cannon. A monitoring trustee was appointed on 10 July 2018, shortly after the start of the Phase 2 review.

B.39 We were told that staff at Cannon experienced a difficult time while working under the hold separate arrangements, with a view that they only received limited support. Although sufficient resource was made available by Rentokil for the Cannon business as it was held separate there was considerable uncertainty for staff and customers.

Case study C: Rentokil Initial plc / MPCL Limited

C.1 This case study examines the merger remedy implemented by the CMA following the acquisition of MPCL Limited (MPCL), the pest control business owned by Mitie Group plc (Mitie), by Rentokil Initial plc (Rentokil). It is based on desk-based research and interviews with stakeholders, including the CMA, Rentokil, Vergo Pest Management (Vergo) and the monitoring trustee.

C.1 The parties and the merger

C.2 MPCL, before its acquisition by Rentokil, was part of Mitie, a provider of facilities management and professional services in the UK. Rentokil was (and is) a UK-headquartered supplier of pest control and hygiene services with a global presence. Rentokil and MPCL (the Parties) overlapped in the supply of pest control services in the UK, with Rentokil being the UK's largest pest control business and MPCL the third largest.

C.3 In September 2018, Rentokil acquired 100% of MPCL's issued share capital from Mitie. Rentokil and Mitie also entered a Preferred Supplier Agreement (PSA) under which Rentokil would provide pest control services to some of Mitie's facilities management customers. The CMA considered both the acquisition of MPCL and the PSA to form part of the same transaction (the Merger). On 9 October 2018, the CMA issued an Initial Enforcement Order (IEO) to keep the Rentokil and MPCL operations separate, and on 18 December 2018 the CMA issued directions for the appointment of a monitoring trustee.

C.4 The CMA's Phase 1 inquiry commenced on 15 February 2019. During its review the CMA found that the complexity of supplying pest control services to customers with multiple premises increased with the number and geographic spread of these premises. Fewer suppliers could meet the needs of customers with multiple premises and, in particular, the merged Rentokil/MPCL would have only two competitors for national customers, namely Ecolab and Pestokil. As a result, the CMA's decision, published on 12 April 2019, found that the Merger gave rise to a realistic prospect of an SLC in the supply of pest control services to national customers in the UK.

C.2 The remedy and its implementation

C.5 On 22 August 2019, the CMA accepted undertakings from Rentokil for the divestment of MPCL's pest control contracts with national customers (defined as those customers present in eight or more UK regions). Rentokil also agreed to amend the PSA to make it non-exclusive and to reduce its duration.

C.6 The divestment package, in addition to including these customer contracts, also included the assets (e.g. vehicles, employees, facilities, equipment) and transitional services necessary for the purchaser to become an effective competitor. Rentokil was responsible for identifying the customer contracts (in line with the CMA's definition of a national customer) and supporting assets that would be offered to prospective purchasers.

C.7 The CMA recognised that the remedy did not fully restore the pre-Merger situation as the pre-Merger relationship between MPCL and Mitie was not re-established through the divestment. While MPCL had been the default supplier of pest control services to Mitie's facilities management customers, this default supplier arrangement was retained by Rentokil under the PSA, rather than being including in the divestment package.

C.8 The CMA also recognised that a business based solely on the divestment package, which only included national customer contracts, would not be profitable on a standalone basis. Nevertheless, it was expected that the package could form part of viable business when combined with a purchaser's other existing or new contracts.

C.9 The profitability of the divestment package was impacted by the carve-out process in two main ways.

- First, contracts with national customers were less profitable than contracts with local and regional customers. National customers are generally able to negotiate a lower price per visit and usually require more visits than other customers.
- Second, by separating out national customers, the divestment package lost the local route density that MPCL had built up over a considerable period and which allowed it to maximise the number of customer visits its technicians could carry out each day. (The local routes served by MPCL prior to the Merger included a mix of national, regional and local customers.)

C.10 The CMA sought to ensure the remedy's effectiveness by requiring an upfront buyer and by satisfying itself of the sufficiency of the proposed purchaser's business plan. This approach was intended to address the remedy's dependence on a purchaser combining the divestment package with an existing portfolio of customers and/or its acquisition of new customers. There was not, however, any requirement for prospective purchasers to have a business in the UK, including a service delivery network, that was capable of quickly restoring the economies of density that were lost when creating the divestment package.

C.11 [✄]. [✄].

C.12 Rentokil initiated the sales process for the divestment package by contacting strategic and financial investors that might be interested. Rentokil told us that it had expected significant interest given that customer contracts in the industry are usually highly contested. However, only two potential acquirers attended presentations on the divestment package and of these only one, The ServiceMaster Company LLC (ServiceMaster), further pursued its interest. ServiceMaster was a US-headquartered company providing a range of household and business services. This included ownership of a leading US pest control business, Terminix. ServiceMaster had, just prior to participating in the divestment process, acquired a small pest control business with operations in the UK and Ireland, namely Pest Pulse.

C.13 ServiceMaster was aware that the divestment package was not profitable on a standalone basis. It expected to make losses for the first few years while it won new customers and improved the density of its service routes. Underlining the scale of this financial challenge, Rentokil allocated approximately 80% of MPCL's employees to the divestment package, reflecting the time allocated to national customers by MPCL staff, but the national customer contracts in the package only accounted for 50-55% of MPCL revenues.

C.14 The CMA's approval of ServiceMaster as purchaser of the divestment package took into account various factors, including its financial resources, its experience in operating route-based businesses and, in particular, delivering pest control services over a wide geographic area (in the US), and in addition, its experience of acquiring and integrating other businesses. The CMA also took account of ServiceMaster's plans to supplement its more limited experience in the UK market with expertise from Pest Pulse and from key staff, including technical and operational employees, that were transferring with the divestment package. ServiceMaster provided the CMA with a business plan for its operation of the divestment package, setting out its long-term strategy and objective for its pest control operations in the UK.

C.15 The CMA concluded that ServiceMaster had the incentive and intention to maintain and operate the divestment package as part of a viable and active business in competition with Rentokil and other suppliers of pest control services.

C.16 To address potential concerns about obtaining customers' consent for transferring their contracts to ServiceMaster, ServiceMaster a "reverse" carve-out was used, whereby ServiceMaster acquired the MPCL legal entity obviating the need to obtain each customer's consent to the transfer of its contract. This risk was transferred to Rentokil. We were told that the reverse carve-out simplified the process.

C.17 The acquisition of MPCL by ServiceMaster was announced in October 2019.

C.3 Post-remedy developments

C.18 Following its acquisition of MPCL, ServiceMaster operated both the divestment package and Pest Pulse, under the Terminix brand. The contracts included in the divestment package lost money, as expected, but the scale of these losses was greater than expected. One reason for this was that ServiceMaster's financial model and business plan for the contracts that it was acquiring in the divestment package estimated future customer service costs using average customer service cost for all of MPCL's customers, not just national customers. We were told that Mitie's data systems did not contain sufficiently granular data to allow more detailed modelling, and this led to an underestimate of the cost of servicing those customers that were included in the divestment package.

C.19 ServiceMaster also found it more challenging than it had anticipated to grow its UK customer base after acquiring the divestment package. Terminix, as a loss-making business, was disadvantaged in competing for new contracts with larger customers. This was because these customers often include an assessment of a potential supplier's financial viability based on its credit score, and this, in turn, was influenced by a supplier's profitability. Notwithstanding these challenges, Terminix continued to compete for large contracts, and retained the majority of the customers that transferred to it with the divestment package, even after the expiration of the non-solicitation agreement with Rentokil that was included in the remedy.

C.20 Even so, Terminix found that it had to cut costs to make progress towards profitability, and this included reducing the number of sales staff, which, in turn, affected its ability to compete for customers. To demonstrate the scale of Terminix's financial challenge, we were told that an immediate return to profitability would have required a 30% reduction in headcount but doing so would have rendered it incapable of servicing customers.

C.21 Terminix acquired several smaller pest control businesses in the UK after its acquisition of the divestment package to help build route density and profitability, and continues to pursue this strategy. Helpfully, some customers that transferred to Rentokil as part of the 'reverse' carve out returned to Terminix following its acquisition of the divestment package. Published accounts for the business show increased revenues and reduced losses, although it has not yet returned to profitability. We were told that improving route density, and achieving profitability, is a slow process.

C.22 In the second half of 2022, Rentokil acquired the Terminix business globally but, consistent with its undertakings to the CMA, it did not acquire Terminix's UK operations. Instead, ownership of the UK business passed to Norvestor, a Norwegian private equity firm (which also acquired Terminix's Norwegian business). The UK and Norwegian businesses have since been rebranded as Vergo Pest Management.

C.23 In terms of developments elsewhere in the market since implementation of the remedy, we were told that the CMA's requirement for non-exclusivity in the PSA (between Rentokil and Mitie's facilities management customers) has not led to any material customer switching from Rentokil. This has been attributed to the relationship-based nature of the industry and strong customer loyalties. Rentokil also told us that it had observed some national customers, since the CMA merger inquiry, splitting their national contracts into smaller regional contracts that can be serviced by regional suppliers.

C.24 In terms of new competitors, Anticimex, a major international pest control business, acquired the UK's Pestokil in 2022, and Rollins Inc (Rollins), a US pest control business has recently acquired several regional suppliers in the UK. We were told that the Rollins acquisitions could, in time, form the basis for a new competitor for national customers. We were told that the industry generally has undertaken a period of consolidation resulting from the owners of many owner-operated businesses retiring or deciding to exit rather than take on the risk of expansion to improve business profitability.

C.4 Observations on the remedy's effectiveness and risk profile

C.25 This section sets out our observations on the effectiveness of the remedy adopted by the CMA and its risk profile. By way of wider context, this remedy was implemented at the end of a Phase 1 inquiry as undertakings in lieu of a reference to Phase 2. There is a requirement for "undertakings in lieu" to be 'clear cut' as there is limited time for the CMA to carry out research and develop its understanding of the entirety of any risks and ways to mitigate these risks in comparison to a Phase 2 inquiry.

C.4.1 Effectiveness of the remedy

C.26 Divestment remedies are intended to remedy an SLC, and its resulting adverse effects, by re-establishing the market structure that could be expected in the absence of the merger.[31] Terminix (now Vergo) has continued supplying national customers since acquiring the divestment package and, in this sense, the CMA's remedy has maintained choice for customers. However, as set out above, the remedy did not fully restore the pre-Merger situation for national customers as the PSA made Rentokil, rather than the purchaser of the divestment package, the default supplier to Mitie's facilities management customers.

C.27 As with the remedy in the Rentokil / Cannon merger, the divestment of a loss-making package raised questions about risks to the remedy's sustainability. The remedy would only be effective if the purchaser, in this case Terminix, was willing to finance its losses until it acquired sufficient customers (either organically or through acquisition of additional businesses) to achieve profitability. Following the remedy, Terminix, and now Norvestor, have been willing to make the investment necessary for the business based on the divestment package to become viable.

C.28 Terminix's ability to compete for customers has, however, been constrained by the loss-making nature of the business, which has affected at least some customers' willingness to contract with it, and the need for Terminix's management to engage in cost-cutting and restructuring so as to minimise losses.

C.29 Given this, Terminix appears to have been a less effective competitor for national customers than MPCL before the Merger. While it remains early days for Vergo, it has inherited the same challenges that were facing Terminix. Overall, the remedy is best described as only

[31] CMA, *Merger Remedies*, CMA87, December 2018, para 3.5.

having been partially effective, given the ongoing challenge that has been experienced in combing the divestment package with other assets and transforming this into a profitable business that can compete strongly for customers.

C.4.2 Composition risks

C.30 Composition risks occur when a divestment package does not attract a suitable purchaser, either as a result of the scope of the package being too constrained or not appropriately configured, or alternatively as a result of the divestment package not allowing a purchaser to operate as an effective competitor.

C.31 The loss-making nature of the divestment package in this case gave rise to significant composition risks in terms of the likelihood of it being unable to attract a suitable purchaser, or the purchaser being unable to operate as an effective competitor. The CMA's requirement for an upfront buyer, to a degree, mitigated this risk. However, as with Rentokil / Cannon, the divestment package, by separating out national customers, lacked the economies of density that were previously present in MPCL's service delivery routes. As a result, the remedy relied on the purchaser being able to restore these economies so as to become an effective competitor.

C.32 Further, as discussed above, ServiceMaster encountered challenges with the due diligence process, perhaps in part due to the tight timescales available for due diligence and in part due to the limitations arising from the carve-out itself. This resulted in overly optimistic planning assumptions. We were told that CMA tested the profitability assumptions of the business case at the time of its purchaser review but ultimately the CMA relied upon the purchaser's own due diligence when considering whether it had the ability to advance its own business plan.

C.4.3 Purchaser risks

C.33 Purchaser risks occur when a suitable purchaser is not available or where the merger parties sell to a weak or otherwise inappropriate purchaser.

C.34 ServiceMaster had significant industry experience, albeit internationally rather than in the UK. It also had sufficient resources to carry out the investment needed to transform the loss-making divestment package into a viable business – although as noted above, the financial model used to prepare the business plan for the divestment package led to overly optimistic financial projections. We were told that ServiceMaster's long-term outlook was an important contributor to its acceptance as a suitable purchaser.

C.35 The CMA did not, however, require prospective purchasers to have an existing service delivery network in the UK capable of quickly restoring the economies of density that were lost in creating the divestment package.

C.4.4 Asset risks

C.36 Asset risks occur when the competitive capability of a divestment package deteriorates before completion of the divestment, for example, through the loss of customers or key members of staff. Hold separate arrangements and the appointment of a monitoring trustee are often used by the CMA to manage asset risks during a merger inquiry (through the imposition of an IEO). The CMA's intention when imposing these restrictions is to conserve the target business and ensure that all remedies remain available to the CMA in the event of an SLC finding.

C.37 As set out above, in this case, hold separate requirements and a monitoring trustee were put in place shortly after the merger, which was around two months before the start of the CMA's Phase 1 inquiry.

C.38 MPCL's management team, which was tasked with holding the business separate from Rentokil, told us that working under the hold separate arrangements had been challenging and stressful in the period before the monitoring trustee was appointed.

C.39 While the management team received some advice from Rentokil's legal advisers, they felt that they lacked expert support on how to comply with the CMA's requirements, and were highly concerned about the consequences of inadvertently breaching the IEO given the emphasis that had been place on the severity of the consequences of doing so.

C.40 The management team felt that they also lacked support or advice on how to obtain the draft derogations from the IEO necessary to support day-to-day business. For example, in pest control an ISO accreditation is a common part of marketing the service to new customers, but use of Rentokil's accreditation was perceived by the CMA to be pre-emptive action, and the managed team was only able to explain the position in a way acceptable to the CMA once the monitoring trustee was appointed and could facilitate the discussion. Overall, the management team felt that strict implementation of the IEO made day-to-day business difficult, but this improved significantly with the appointment of the monitoring trustee.

Case study D: Ecolab Inc / The Holchem Group Limited

D.1 This case study examines the merger remedy implemented by the CMA following the acquisition of The Holchem Group Limited (Holchem) by Ecolab Inc (Ecolab). It is based on desk-based research and interviews with stakeholders, including the CMA, Holchem, Kersia Group (the acquirer of Holchem), and the monitoring trustee.

D.1 The parties and the merger

D.2 Holchem supplies cleaning chemicals and ancillary services to food and beverage (F&B) manufacturers and other customers in the UK and Ireland. Ecolab is a US headquartered supplier of water, hygiene and energy technologies that also supplied cleaning chemicals and ancillary services to F&B customers and other customers in the UK. Cleaning chemicals are used by F&B customers to ensure that places where food and beverages are manufactured, processed and packaged are clean and hygienic and free from contamination.

D.3 In November 2018, Ecolab acquired the entire issued share capital of Holchem. On 24 December 2018, the CMA issued an Initial Enforcement Order (IEO) to keep the Ecolab and Holchem operations separate. The CMA's Phase 1 inquiry commenced on 14 February 2019 and concluded on 10 April 2019. The CMA decided at this stage that the Merger gave rise to an SLC in the supply of formulated cleaning chemicals and ancillary services to F&B customers. The CMA referred the Merger for a Phase 2 inquiry on 24 April 2019 and a monitoring trustee was appointed on 14 May 2019.

D.4 The CMA found in its Phase 2 inquiry that the merged business would have a market share of 30-40% in the supply of formulated cleaning chemicals and ancillary services to F&B customers in the UK. This was around twice the size of the next largest competitor, and there were only two other large suppliers in the market, Diversey Limited (Diversey) and Christeyns Food Hygiene Limited (Christeyns). The CMA considered that Holchem and Ecolab were close competitors. Evidence reviewed by the CMA indicated that Holchem was Ecolab's closest competitor for lost customers and for new customers targeted by Ecolab, a conclusion that was also supported by tender data. Similarly, Ecolab was a close competitor for Holchem's customers, although Diversey and Christeyns appeared to be closer competitors.

D.5 The CMA concluded, in its final report published on 7 October 2019, that the Merger had resulted, or may be expected to result, in an SLC in the supply of formulated cleaning chemicals and ancillary services to F&B customers in the UK.

D.2 The remedy and its implementation

D.6 The CMA decided that Ecolab should be required to sell Holchem Laboratories Limited (Holchem Laboratories), a Holchem subsidiary that accounted for almost all of Holchem's activity. In adopting this remedy, the CMA rejected an alternative proposal for a carve-out remedy that was put forward by Ecolab.

D.7 Ecolab's proposed divestment package included:

- a portfolio of [✄] customer contracts, customer records, supporting staff, and supplier-owned equipment at customer sites;
- supporting manufacturing and warehousing facilities;

- transitional support, including the supply of F&B cleaning products, training, and technical expertise until the purchaser could transfer customers to its own range of F&B cleaning chemicals; and
- a proposal for encouraging customers and staff to switch to the purchaser of the divestment package.

D.8 The CMA was not persuaded that Ecolab's proposal for a carve-out remedy would be an effective remedy to the SLC. In particular, the CMA found that there was evidence that customers would not welcome being transferred to a new supplier (i.e. the purchaser of the divestment package). Further, that while some customers might agree to change their supplier the CMA had no certainty that these customers would remain with their new supplier and no powers to intervene if they chose not to do so. For those customers unwilling to transfer, the supply of cleaning chemicals was considered business critical given the potential food safety risks that could arise from an adverse event in the supply of these chemicals.

D.9 In response, Ecolab applied to the Competition Appeal Tribunal (CAT) on 1 November 2019 for a review of the CMA's decision on the SLC and the remedy. Consistent with its merger remedies guidance, the CMA progressed the remedy's implementation while the CAT process was underway and on 23 December 2019 it accepted undertakings from Ecolab for the divestment of Holchem Laboratories.[32] Following a hearing on 18-19 February 2020, Ecolab's application was dismissed by the CAT in a decision handed down on 21 April 2020. A sale to Kersia Group (Kersia) was concluded in May 2020, before the divestment period had officially begun (and so a wider call for purchaser interest was not initiated by Ecolab).

D.10 Kersia is a multinational company focused on food safety that provides products and services across the food supply chain. Kersia told us that it found the CMA's purchaser approval process, where it explained its goals for the UK business, to be reasonable. Kersia was not interested in Ecolab's proposed carve-out, but saw the acquisition of Holchem in its entirety as an opportunity to fulfil its ambition to grow in the UK beyond its existing agricultural chemicals business.

D.11 The acquisition of Holchem included not only Holchem Laboratories but also those other, smaller, parts of Holchem that were outside Holchem Laboratories, namely Merlin and Imperial Laboratories. That is, Ecolab chose to sell the entirety of its investment in Holchem rather than retain those parts that were permitted under the remedy.

D.12 The negotiation of Holchem's sale to Kersia took place during the first Covid lockdown which made the process somewhat more difficult than usual. With access to finance being curtailed as a result of the lockdown the CMA exceptionally permitted a vendor loan to Kersia to facilitate the transaction.

D.3 Post-remedy developments

D.13 Since being acquired by Kersia, Holchem has continued to supply cleaning chemicals and ancillary services in the UK as it had prior to being acquired by Ecolab. Holchem considers that the wider competitive landscape has not changed significantly since the remedy was

[32] This approach was consistent with the CMA's merger remedies guidance which states that "Merger parties have the right to apply to the CAT for a review of a decision by the CMA … The effect of the statutory deadline for acceptance of Final Undertakings or the making of a Final Order is that, notwithstanding any such application, the CMA is required to accept Final Undertakings or make a Final Order whilst appeal proceedings are pending … The CMA will work with the merger parties to progress as far as practicable the prompt implementation of remedies, while paying appropriate respect to merger parties' legitimate rights of defence and the role of the CAT and other courts" (CMA, *Merger Remedies*, CMA87, December 2018, paras 4.76-4.78).

put in place. There has, however, been some suggestion that tighter regulatory requirements in relation to cleaning chemicals may be resulting in smaller competitors exiting the market.

D.14 In contrast to a carve-out remedy where a purchaser of the divestment package may need to contribute significant capabilities and resources following an acquisition, this has not been the case with this remedy. Holchem is a stand-alone business that has not required any significant management support or other resources from Kersia. To the extent that Kersia has made changes to Holchem, these are largely a function of its integration into a larger multinational group. Holchem staff have received opportunities to work in the wider business and Holchem has been able to position itself to win multinational customers. Holchem has also taken over the management of Kersia's smaller pre-existing UK business.

D.15 The first Covid lockdown, which started in March 2020, caused significant disruption for the supply of cleaning chemicals. The closure of hospitality and brewing operations during the pandemic had a significant effect on demand for Holchem's products, although this was partially offset by a short-lived increase in demand for hand sanitiser (to which Holchem was able to respond). Supply chain difficulties were also created by Covid-related shutdowns in China, the temporary blockage of the Suez Canal in March 2021, Brexit-related border delays, and more recently the significant increase in energy prices (which is a significant cost component when producing cleaning chemicals). This has meant that Holchem's progress against its business plan has been slower than was expected.

D.16 The vendor loan that the CMA approved as part of Kersia's acquisition of Holchem, due to the extenuating circumstances created by Covid, was repaid to Ecolab in advance of its initial 12-month term.

D.4 Observations on the remedy's effectiveness and risk profile

D.17 This section sets out our observations on the effectiveness of the remedy adopted by the CMA and its risk profile.

D.4.1 Effectiveness of the remedy

D.18 Divestment remedies are intended to remedy an SLC, and its resulting adverse effects, by re-establishing the market structure that could be expected in a merger's absence.[33] The remedy adopted by the CMA in response to the SLC that it identified in this merger has been effective in restoring the competitive constraint that would have been lost if Ecolab had retained ownership of Holchem. Holchem has continued to supply cleaning chemicals and ancillary services in the UK in the same way it had prior to being acquired by Ecolab.

D.4.2 Composition risks

D.19 Composition risks occur when a divestment package does not attract a suitable purchaser, either as a result of the scope of the package being too constrained or not appropriately configured, or alternatively as a result of the divestment package not allowing a purchaser to operate as an effective competitor.

D.20 The CMA sought to minimise composition risks in this remedy by requiring Ecolab to divest the entirety of Holchem Laboratories. Holchem's two smaller subsidiaries, Merlin and Imperial, were excluded from the package given that they were not relevant to the SLC that had been identified, and their exclusion seems unlikely to have given rise to any material

[33] CMA, *Merger Remedies*, CMA87, December 2018, para 3.5.

composition risk. In any event, Ecolab chose to include Merlin and Imperial in the divestment package.

D.21 The CMA's choice of remedy contrasts with Ecolab's proposed divestment package, which included a portfolio of customers and supporting assets. The CMA, as discussed above, concluded that Ecolab's proposal encompassed too great a risk of rendering the remedy ineffective in addressing the SLC. This conclusion was principally based on evidence that customers were resistant to being asked to transfer to a new supplier.

D.4.3 Purchaser risks

D.22 Purchaser risks occur if a suitable purchaser is not available or if the merger parties sell to a weak or otherwise inappropriate purchaser. The case study does not reveal any unanticipated purchaser risks or the crystallisation of purchaser risks which the CMA had knowingly taken on. The CMA's merger guidelines state that the "CMA will wish to satisfy itself that a prospective purchaser is independent of the merger parties; has the necessary capability to compete; is committed to competing in the relevant market; and divestment to the purchaser will not create further competition concerns".[34]

D.23 As Holchem was a self-standing business unit that could compete on a stand-alone basis, the CMA was less reliant on the purchaser's capabilities to ensure the effectiveness of its planned remedy. The CMA was able to take comfort from Kersia being active in the same industry as Holchem, albeit outside the UK, and its commitment to supporting Holchem's business plan (which was mid-development at the time of the CMA's purchaser appraisal). This meant that the CMA could rely on a high-level purchaser appraisal that did not require a detailed assessment of Kersia's plans for Holchem.

D.24 As noted above, the CMA exceptionally permitted a loan from Ecolab to Kersia to facilitate the sale of Holchem as a result of the transaction taking place during the first Covid lockdown when access to finance was curtailed. Vendor finance has the potential to create purchaser risk in that it can undermine a purchaser's independence from the merger parties. However, in this case, there do not appear to have been any adverse consequences arising from the loan, which was repaid by Kersia within its initial 12-month term.

D.4.4 Asset risks

D.25 Asset risks occur when the competitive capability of a divestment package deteriorates before completion of the divestiture, for example, through the loss of customers or key members of staff. Hold separate arrangements and the appointment of a monitoring trustee are used by the CMA to manage asset risks during a merger inquiry.

D.26 In this case, a monitoring trustee was appointed at the outset of the CMA's Phase 2 investigation. Holchem told us that the hold separate arrangement worked well from their perspective and minimal management effort was needed to keep the monitoring trustee briefed and to update Ecolab with monthly accounts in CMA approved form. The monitoring trustee told us that it had a 'light-touch' involvement throughout the Phase 2 investigation and remedy process, which it thought appropriate given the stand-alone nature of the business. Holchem told us that responding to the CMA's information requests was demanding and these interactions felt at times overbearing in the absence of legal or other support.

[34] CMA, *Merger Remedies*, CMA87, December 2018, para 5.21.

D.27 Kersia Group told us that it took comfort from the circumscribed oversight that Ecolab was permitted during the CMA inquiry. Limited access to financial performance data and exclusion from business systems meant that Kersia Group found it easier to integrate Holchem and have confidence that Holchem did not need significant support to undertake a process of leaving its acquirer’s systems.

Case study E: Stryker Corporation / Wright Medical Group NV

E.1 This case study examines the merger remedy implemented by the CMA in its review of the acquisition of Wright Medical Group NV (Wright) by Stryker Corporation (Stryker) (together, the Parties). The case study is based on desk-based research and interviews with stakeholders, including the CMA, Stryker, Enovis (the acquirer of the divestment package, formerly known as Colfax Corporation), competing suppliers of orthopaedic medical devices, and NHS Supply Chain and NHS Scotland, which operate NHS framework agreements for purchasing orthopaedic medical devices in the UK.

E.1 The parties and the merger

E.2 Stryker is a US-headquartered company that supplies medical devices and products, including orthopaedic medical devices. Wright Medical Group NV (Wright), before its acquisition by Stryker, was a Netherlands-headquartered medical device company. Stryker and Wright overlapped in the supply of several orthopaedic medical products in the UK, namely: (i) total ankle replacement prostheses products; (ii) finger joint arthroplasty products; (iii) foot plating products; (iv) hammertoe arthrodesis products; and (v) synthetic bone graft substitutes.

E.3 In November 2019, Stryker acquired all of the outstanding ordinary shares of Wright (the Merger). On 19 May 2020, the CMA commenced a Phase 1 merger inquiry and on 28 May 2020 it issued an Initial Enforcement Order (IEO) to keep the Stryker and Wright operations separate. The Merger was also investigated by the US Federal Trade Commission (FTC) in parallel with the CMA's review. Following submissions from the Parties that the test for reference had been met, and a request that its findings be accelerated, the CMA concluded on 30 June 2020 that the Merger gave rise to a realistic prospect of an SLC in the supply of total ankle replacement prostheses products in the UK.

E.4 By way of background, the number of ankle replacements in the UK has been growing in recent years, but remains relatively small at around 1,000 per year. This compares to around 100,000 hip replacements and around 100,000 knee replacements each year.[35] Ankle replacement products, such as those supplied by the Parties, are sold to both NHS and private sector hospitals with around two thirds of ankle replacement surgery taking place in NHS hospitals. NHS purchases of ankle replacement products are either direct from the supplier or via national framework agreements that are managed by NHS Supply Chain in England and Wales, and by NHS Scotland in Scotland.

E.5 The CMA estimated that the Parties' combined market share in the supply of ankle replacement products in the UK was 90-100%, with Stryker holding a pre-acquisition market share of 10-20% and Wright 70-80%. Most other suppliers had market shares of less than 5%.

C5.2 The remedy and its implementation

E.6 To remedy the SLC, the CMA accepted undertakings from Stryker to divest its ankle replacement product (known as Scandinavian Total Ankle Replacement, STAR) and its related assets to a suitable purchaser. The CMA's remedy sat alongside a similar remedy

[35] Data on hip, knee and ankle replacement procedures in England, Wales and Northern Ireland is available from the National Joint Registry at https://reports.njrcentre.org.uk/.

adopted by the FTC, which also required the divestment of STAR as well as Stryker's finger joint implant product.

E.7 The divestment package, as it related to STAR, included:

- the STAR product and two pipeline products, at least one of which was in the midst of securing regulatory approval from the US Food and Drug Administration (FDA);
- intellectual property (IP) specific to STAR, design history files, clinical research data, and an inventory of finished goods, work in process and raw materials;
- five US-based staff dedicated to STAR;
- customer and supplier lists and contracts, account histories and pricing information, and commercial data;
- non-solicitation undertakings for certain customers and staff; and
- government approvals (to the extent these were transferrable).

E.8 The divestment package also included transitional arrangements for Stryker to continue manufacturing STAR until the purchaser could secure regulatory authorisation from the EU authorities as STAR's new manufacturer. In the US, regulatory authorisation for the supply of a medical device, like STAR, transfers with product ownership. However, in the EU authorisation resides with the legal entity that owns the product. As a result, when ownership of a product changes, the new owner (unless it has purchased the relevant legal entity) must secure its own authorisation from the EU authorities. As a result, the divestment package also included:

- a manufacturing agreement and related regulatory quality agreement, pending transfer of legal manufacturer status; and
- licensing of certain IP related to the manufacture of STAR.

E.9 Stryker proposed Colfax Corporation (Colfax) as the buyer of the divestment package. We were told that Colfax had, during the merger inquiry, initiated contact with Stryker to express interest in acquiring any divestment package based on an expectation that a divestment would be required. Colfax was already a supplier of shoulder, knee, and hip orthopaedic products and was interested in expanding into foot and ankle products. We were told that the CMA's purchaser approval process was straightforward and proceeded smoothly.

E.10 Stryker and Colfax signed a sale and purchase agreement for the divestment package on 15 October 2020, conditional upon the CMA's acceptance of the undertakings. The CMA accepted these undertakings on 4 November 2020.

E.3 Post-remedy developments

E.11 Since acquiring the divestment package, Colfax has been renamed Enovis and has continued to sell STAR globally, including to UK customers. Enovis told us that STAR's market share has declined since the acquisition, which it attributes to two main causes.

- First, there were unexpected delays in the launch of a cutting guide to accompany STAR. (These guides assist surgeons when planning and carrying out an ankle replacement.) The cutting guide was one of the pipeline products sold with the divestment package and was in the process of securing FDA approval when it was purchased. However, flaws in the design of the cutting guide emerged after its purchase which caused significant delays to its availability.

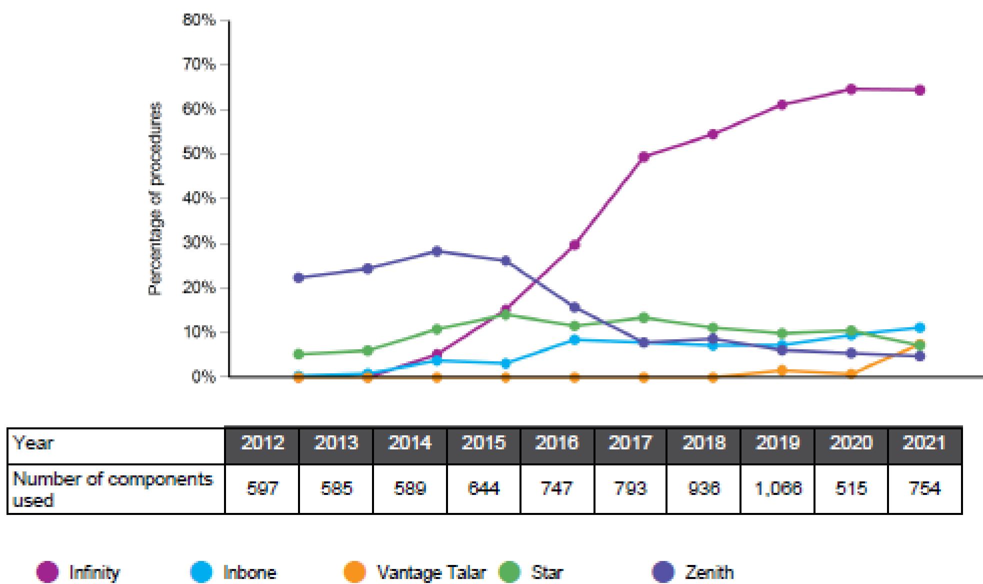
- Second, in March 2021, a few months after the divestment package was sold, the FDA issued a safety alert for STAR. This related to an issue that first emerged in 2016, namely, the risk of the product's plastic component breaking, particularly when

patients had more active lifestyles. Enovis told us that it had worked with the FDA to address its concerns and that a new plastic component will soon be available.

E.12 Enovis told us that, notwithstanding these challenges, neither of which fully came to light during its due diligence on the divestment package, it believed STAR has a positive future. Its long product history means that there is a substantial amount of data available for clinicians on its performance and this helps support its market position.

E.13 While Enovis's comments about the decline in STAR's market share were not specific to the UK, publicly available data shows a decline in STAR's UK market share in 2021, the first full year after Enovis acquired the divestment package and the most recent year for which data is available (see Figure 1). Enovis told us that the factors which it believed had caused STAR's declining market share were also likely to be relevant to the decline in its UK market share. This loss in UK market share appears consistent with a weakening of STAR's position as a competing ankle replacement product in the UK since the divestment.

Figure 1: Most commonly used ankle replacement products in the UK, 2010 to 2021



Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Number of components used	597	585	589	644	747	793	936	1,066	515	754

Source: National Joint Registry.
Note:
(i) The UK's National Joint Registry collects data on joint replacement surgery and monitors the performance of joint replacement implants in England, Wales and Northern Ireland.
(ii) Suppliers of the five products in this figure are Enovis (STAR), Stryker (Infinity and Inbone), Exactech (Vantage) and Corin (Zenith).

E.14 In addition to the regulatory issues that had come to light following its acquisition of the divestment package, Enovis told us that the transitional arrangements whereby Stryker had continued as STAR's manufacturer had created challenges in managing interactions with regulatory authorities and the extent to which Stryker's incentives to minimise regulatory risk for STAR were aligned with Enovis. These risks had not, however, as yet crystallised into any adverse outcomes.

E.15 In terms of wider market developments, the NHS Supply Chain framework agreement was being re-procured at the time of writing this case study and the products admitted to the new agreement will have a major bearing on competition in the supply of ankle replacement products in the UK. There has been some suggestion that not all suppliers will seek readmission of products that are currently on the framework but that other new products

may become available. In particular, we were told that Corin, the supplier of Zenith, had exited the UK market (although we were unable to confirm this directly with Corin).

E.4 Observations on the remedy's effectiveness and risk profile

E.16 This section sets out our observations on the effectiveness of the remedy adopted by the CMA and its risk profile.

E.4.1 Effectiveness of the remedy

E.17 Divestment remedies are intended to remedy an SLC, and its resulting adverse effects, by re-establishing the market structure that could be expected in a merger's absence.[36] The remedy adopted by the CMA in this case achieved this outcome, re-establishing an independent competitor in the supply of ankle replacement products, where the CMA had identified an SLC.

E.18 STAR's loss of market share since its acquisition by Enovis suggests a weakening of the competitive constraint that it offers to other suppliers of ankle replacement products in the UK. But, to the extent that this loss of market share is attributable to factors that were in train prior to the Merger (namely, delays to the availability of the cutting guide and the FDA safety notice), then it is not clear that this loss of competitive strength can be attributed to risks associated with the remedy. That is, in the absence of the Merger, STAR's strength as a competitor product is likely to have weakened in any event.

E.19 Overall, the remedy's effectiveness is somewhat equivocal. On the one hand, it re-established an independent competitor and while it has since exerted a weaker competitive constraint, this appears to be due to factors that were present prior to the transaction. On the other hand, the remedy process was not successful in identifying or addressing those factors that have since contributed to STAR's loss of strength as a competing product.

E.4.2 Composition risks

E.20 Composition risks occur when a divestment package does not attract a suitable purchaser, either as a result of the scope of the package being too constrained or not appropriately configured, or alternatively as a result of the divestment package not allowing a purchaser to operate as an effective competitor.

E.21 In this case, the main composition risk appears to have been that Enovis was reliant on Stryker manufacturing the product on its behalf until EU authorisation could be secured for it as the legal manufacturer of STAR. That is, the scope of the package, by providing Stryker with transitional manufacturing responsibilities had the potential to constrain the purchaser's ability to operate as an effective competitor. The CMA recognised this risk. However, it is not clear that it was fully addressed in the remedy.

E.22 A second point related to the composition risks of this remedy is that Enovis appears to have been unable to fully identify all of the relevant information about the product that it was acquiring during its due diligence on the divestment package. In particular, as set out above, a product safety notice for STAR was issued less than six months after its acquisition by Enovis and the cutting guide that was in the midst of securing FDA approval had to undergo significant design modifications to secure that approval. The emergence of these issues appears to have weakened STAR as a competing product following the merger in a way that

[36] CMA, *Merger Remedies*, CMA87, December 2018, para 3.5.

was not anticipated (even if, as pointed out above, this competitive weakness may have taken place in the absence of the merger as well).

E.4.3 Purchaser risks

E.23 Purchaser risks occur when a suitable purchaser is not available or if the merger parties sell to a weak or otherwise inappropriate purchaser. In this case, purchaser risk was enhanced by the fact that the divestment package comprised individual products (i.e. ankle replacement products and finger joint implant products) rather than a standalone business or business unit. However, these risks appear to have been minimised given Enovis's experience as an existing supplier of orthopaedic products.

E.4.4 Asset risks

E.24 Asset risks occur when the competitive capability of a divestment package deteriorates before completion of the divestment. It is possible that Stryker may have had some incentive to allow relations with the FDA, with respect to STAR, to deteriorate during the Merger and divestment process. As far as we can tell, if this did happen, it was not an issue that was picked up by the monitoring trustee during the transaction. This may be because there was nothing substantive for the monitoring trustee to report upon or because it was outside the scope of the monitoring trustee's responsibilities.

E.25 The multi-jurisdictional nature of this transaction, and the fact that more than one competition authority was involved in its review, seems likely to be a complicating factor for the CMA when seeking to minimise asset risks during a merger inquiry.