Anticipated acquisition by Kingfisher plc of 30 stores from Focus (in administration)

ME/5043/11

The OFT's decision on reference under section 33(1) given on 7 July 2011. Full text of decision published 24 August 2011.

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

PARTIES

1. **Kingfisher plc (Kingfisher)** is the parent company of B&Q plc (B&Q), the largest national DIY retailer in the UK with 321 stores. It also operates other trade-focused specialist retail businesses: Screwfix, which supplies tools, accessory and hardware and TradePoint supplying building, hardware, tools and other repair and maintenance equipment to tradesmen through trade counters located at some 120 B&Q stores. For the financial year ending 29 January 2011, B&Q's retail sales were £3.9 billion.

2. **The Target Stores** are 30[1] stores owned by Focus (DIY) Limited (in administration) and its sister company, Do It All Limited (in administration), all trading as **Focus**.[2] Focus is ultimately controlled by Cerberus, a US-

[1] Kingfisher originally notified the OFT of its intention to acquire 31 Focus stores. However, after the OFT's preliminary review, the company chose to withdraw from the purchase of the Focus store in Dorchester. Evidence available to the OFT during its preliminary investigation showed that there was a realistic prospect of a substantially less anti-competitive purchaser for that store than Kingfisher. The store has now been released back to the Administrator who can market it to other potentially interested buyers and therefore, this decision does not conclude on the competitive impact (if any) of this merger in that local area. The evidence indicated that the merger would have reduced the number of DIY national sheds within 10 miles –and within 20 minutes drive time- of the Dorchester Focus store from two to one. In addition two third parties raised this as the most problematic area since there are no other competitors in the sub-region of south Dorset.

[2] For ease of reference, this decision refers to Focus to include both companies Focus (DIY) Limited and Do It All Limited (unless otherwise stated). The Target Stores are located in

based private equity firm. Prior to being placed in administration, they retailed nationally in DIY products. The Target Stores' turnover in 2010 was some £83 million.

BACKGROUND

3. The Target Stores formed part of Focus's portfolio of 177 DIY stores across the UK until Focus went into administration on 5 May 2011.

The events leading up to the Focus business entering into administration

4. Focus has its origins in the 1980s. It then grew organically and by a series of acquisition in the 1990s (Do It All and Wickes) and 2000 (Great Mills) after having been acquired by two private equity firms, Duke Street Capital and Apax Partners in the late 1990s. At its peak, it had up to 400 stores and an estimated turnover of over £1.5 billion. These firms sold 172 DIY stores retailing under the 'Wickes' brand to Travis Perkins plc in 2005 for over £900 million. In 2007, the remaining stores trading as 'Focus' were sold to its current owners, Cerberus, another private equity firm for £1. The transfer included substantial liabilities which required an immediate cash investment from the new owners of over £170million. Kingfisher submits that the consideration paid at that time reflected the poor financial performance and its inability to service its debt.

5. The OFT's investigation confirmed that following the sale of the Focus business to Cerberus there were various attempts to improve the performance, restructure or rescue all or a substantial part of Focus business, or to wind it up. This included the entry into a creditors' voluntary arrangement (CVA) in August 2009, which according to Focus senior management avoided insolvent administration. In October 2010, the merchant bank, Lazard & Co. Limited (Lazard) was appointed to either sell or recapitalise the Focus business in whole or in part. Pursuant to this instruction, Lazard undertook a wide-ranging marketing campaign of the Focus business including the Target Stores. This sales and recapitalisation effort was unsuccessful. The poor financial position of Focus was underlined by the Administrator which stated '[a]t the time of the credit crunch and weakened housing market, sales were materially impacted and

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Ashington, Buxton, Cardigan, Chard, Consett, Devizes, Ebbw Yale, Fakenham, Gainsborough, Goole, Harrogate, Haverhill, Huntingdon, Kendal, Launceston, Leominster, Leven, Louth, Malvern, Melton Mowbray, Newark, Pembroke Dock, Shepton Mallet, Skegness, Spalding, Stroud, Sudbury, Thetford, Uttoxeter and Witney.

poor trading results were experienced throughout 2008 and 2009. The difficult trading conditions were further impacted by underperforming stores within the Group's portfolio.'[3]

6. Focus's senior management, Cerberus and the Administrator told the OFT that these attempts to restructure, sell or refinance the business ended with Focus's entry into insolvent administration on 5 May 2011 and the appointment of Ernst & Young (E&Y) as administrator (the Administrator). On 1 May 2011 Cerberus informed Focus's management that it was no longer viable for it to continue to financially support Focus and would not support management's proposal to enter into a new CVA. The OFT understands that the high level of debt already underpinning the business, including cash injections in the past financial year, and the fact that interest payments were being accrued and covenants waived underpinned Cerberus' decision. In addition, a second CVA required an extension to existing lending facilities and a likely further funding requirement which appeared unlikely given the difficult retail environment which threatened seriously Focus's forecast profitability. The situation was aggravated by the fact that no additional funding was available. Focus's management duly placed the business into Administration on 5 May 2011.

The actions taken by the administrator following entry into administration on 5 May 2011

7. The process of administration is governed by the Insolvency Act 1986 which sets out three objectives of administration: (a) to rescue the business as a going concern; (b) to achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or (c) to realise property in order to make a distribution to one or more secured or preferential creditors.[4]

[3] Administrators' statement of proposals of 24 June 2011 pursuant to paragraph 49 of schedule B1 to the Insolvency Act 1986 (Administrator's Proposal), pages 4-5 (at www.focusadministration.co.uk).

[4] Objective (a) should be pursued unless it is not reasonably practicable to do so or if objective (b) would achieve a better result for the company's creditors as a whole. Objective (c) may only be pursued if it is not reasonably practicable to achieve either objective (a) or (b) and can be pursued without unnecessarily harming the interests of the creditors of the company as a whole.

8. In this regard, the Administrator told the OFT that ' [i]t was unlikely that objective (a) could practically be achieved'.[5] This led the Administrator to pursue objective (b) by continuing trade at the stores over the short term to allow stock to be realised through ongoing sales at the stores whilst pursuing disposal of the business and assets including the Group's lease portfolio.[6]

THE TRANSACTION AND RATIONALE

9. On 6 May 2011, Kingfisher entered into an option agreement with Focus and the Administrator to acquire, subject to certain conditions including the consent of many different landlords, the Target Stores (the Option Agreement).[7]

10. Kingfisher submits that this acquisition fits into its plan to expand B&Q into carefully-targeted UK locations where it has no store representation. It has taken the opportunity arising as a result of Focus's entering into Administration after having found it difficult in the recent past to identify suitable sites in its chosen UK locations.

11. The OFT received a satisfactory informal submission from Kingfisher on Friday 10 June 2011 and launched its formal investigation on Monday 13 June 2011. Pursuant to its published administrative procedures[8], the OFT's 40-day administrative timetable expires on 5 August 2011.

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[5] See also Administrator's Proposal, page 6. The reasons given were (i) the significant level of debt; (ii) the fact that Focus and its advisors had already pursued a sale strategy prior to the Administration which attracted no interest in the business as a going concern; (iii) the significant restructuring costs which would be necessary to incur in if an equity sale was sought; (iv) Focus had been loss making for a prolonged period of time prior to Administration and was unlikely to return to profitability in the short to medium term given the significant cash outflow required to trade the business following its peak trading period in the Spring/Summer months and to meet the high fixed costs of the business; and (v) the poor credit terms Focus was trading on given its suppliers' concerns about its viability.

[6] Administrator's Proposal, pages 6 and 7. The reasons given were '[a]s part of the efforts to secure a sale prior to the Administration, it was apparent that interest existed from several parties for certain parts of the [Focus] Group's retail portfolio. In addition, management and ot her parties indicated that they were interested in purchasing a large proportion of the [Focus] Group's property portfolio were therefore likely to be enhanced if they were disposed of whilst trading continued during the Administration'.

[7] Agreement containing the Option for sale of certain properties between Focus (DIY) (in administration), Do It All Limited (in administration), the Administrators and Kingfisher Group Limited dated 6 May 2011.

[8] See OFT Mergers- Jurisdictional and procedural guidance, June 2009 (OFT Guidance), paragraphs 4.51 and 4.65.

JURISDICTION

12. Each Target Store constitutes an enterprise for the purposes of section 26 of the Enterprise Act 2002 (the Act). A relevant merger situation arises when two or more enterprises cease to be distinct and either the UK turnover test or the share of supply test set out in section 23 of the Act is met.

13. In anticipated mergers, the requisite test for the OFT to have jurisdiction is that it has to reach a belief that it is or may be the case that arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation (section 33(1) of the Act). The OFT believes that Kingfisher (the Option Holder) is intending to exercise the Option Agreement, either in its entirety or with regard to some of the Target Stores. On this basis, the OFT believes there are arrangements in progress or contemplation.

14. The OFT has considered carefully in this case whether it is or may be the case that enterprises would cease to be distinct under the arrangements in question, such that these arrangements would give rise to a relevant merger situation. Specifically, the OFT considered whether the Target Stores taken over by Kingfisher should be considered to be 'enterprises' for the purposes of the Act.

Enterprises ceasing to be distinct

15. The Option Agreement is limited to the properties and the fixtures and fitting and the parties do not intend that the business or any part of the business or the contracts of employment of any employees shall be transferred by the Option Agreement.[9]

16. As stated in the *Merger Assessment Guidelines*[10] 'the transfer of physical assets alone may be sufficient to constitute an enterprise, for example where the facilities or site enable a particular business activity to be continued.' According to the Administrator, the most valuable assets of the Target Stores are the leases of its properties. In retail cases, the OFT is

[9] Clause 7.1 of the Option for sale of certain properties dated 6 May 2011 between Focus (DIY) Limited (in administration), Do It All Limited (in administration), the Administrators and Kingfisher Group Limited

[10] Merger Assessment Guidelines, a joint publication of the Competition Commission and the Office of Fair Trading, September 2010, (OFT1254) (Merger Assessment Guidelines), paragraph 3.2.4.

particularly conscious of the importance of the location of the site and the goodwill inherent in the public identification of a site with a particular trade.

17. As a result, the OFT believes that it is or may be the case that each of the Target Stores constitutes an enterprise for the purposes of consideration under the Act.

18. Lastly, the turnover test pursuant to section 23 of the Act is met since the UK turnover of the Target Stores is above £70 million.

19. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

COMPETITIVE ASSESSMENT

20. The OFT has considered in this case whether the appropriate counterfactual against which to assess this merger is the prevailing conditions of competition, that is, the continuing presence of the Focus stores as a competitor to other DIY retailers. This is, in large part, because Focus entered into administration on 5 May 2011 and the majority of its stores were closed by the last weekend of June.

21. The Merger Assessment Guidelines set out that the OFT will as a general policy adopt the prevailing conditions of competition as the counterfactual against which to assess the impact of a merger.[11] The OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, the OFT considers that the prospect of prevailing conditions continuing is not realistic because, for example, one of the firms would have exited from the market or whether there is a realistic prospect of a counterfactual that is more competitive than prevailing conditions. It is important to note that as a phase 1 body, the OFT will adopt an 'is or may be the case' standard to its assessment of the counterfactual, in contrast to the Competition Commission which has more time to determine the more likely outcome.

22. In this case, the OFT considered closely whether the acquisition by Kingfisher of 30 Focus stores raised prima facie competition concerns. On

[11] Merger Assessment Guidelines, paragraph 4.3.5.

a cautious basis, and in line with previous precedents, the OFT considered an appropriate frame of reference to be the supply of DIY products by the three national DIY shed retailers only. In line with previous retail merger cases, the OFT considers that the ambit of retailing is local. The OFT therefore considered whether on this cautious frame of reference the merger raised national and/or local concerns. On a national basis, no issues arise since the turnover of the Target Stores represents only about 1 per cent of national DIY shed turnover. This is a small increment to Kingfisher's existing share of 56 per cent nationally.

23. As regard the local ambit, the OFT, on a cautious basis, applied the three filters previously used in Homebase/Focus[12] to narrow down the areas of potential competition concern. These filters assessed whether the merger would lead to any fascia reduction within radii of five and ten miles, or within a 20-minute drive-time isochrone, all centred on the Target Store, on the basis of a narrow candidate product market of only the national DIY sheds (i.e. B&Q, Homebase, and Wickes)[13]. Kingfisher argued that DIY sheds do not compete with each other over distances greater than six miles. They provided economic analysis based on Kingfisher's store portfolio that attempted to demonstrate that stores did not lose sales to competitors more than six miles away and did not react to any competition (such that margins fell) that arose from stores more than six miles away. However, although this analysis appeared to hold on average across the store portfolio, other evidence (including the diversion ratios in this case) undermined the application of these findings to the particular areas affected by this case, which may be more rural and thus have DIY sheds that are more geographically dispersed.

24. At a local level, there were 20 areas where no fascia reduction occurred: Ashington, Cardigan, Chard, Fakenham, Gainsborough, Goole, Harrogate, Haverhill, Kendal, Lauceston, Louth, Malvern, Melton Mowbray, Newark, Pembroke Dock, Skegness, Spalding, Sudbury, Thetford, Witney. No third parties raised concerns about competition being harmed between particular stores in any of these areas. Thus, no competition issues appear to arise in

[12] OFT decision of 15 April 2008 on the completed acquisition by Home Retail Group plc of 27 Focus stores (Homebase / Focus), paragraphs 66 and *ff.*

[13] There were no regional DIY sheds in any of the overlap markets and Focus stores that were not being acquired by Kingfisher were ignored unless there was evidence that they were being kept in the market by an alternative DIY shed competitor.

these areas as Kingfisher does not operate stores within the candidate local geographic markets.

25. There were local overlaps leading to a reduction in fascia in the remaining 10 areas: Buxton, Consett, Devizes, Ebbw Vale, Huntingdon, Leominster, Leven, Shepton Mallet, Stroud and Uttoxeter (collectively the Overlap Stores).

26. In respect of the Overlap Stores, Kingfisher supplied evidence on diversion ratios between each Overlap Store and the other DIY national sheds present in the area, estimated from a customer survey. When combined with evidence on stores' variable profit margins, the diversion ratios between Focus and Kingfisher's B&Q in two of these areas (Huntingdon and Stroud) were not high enough to give the OFT cause for concern over unilateral effects. The OFT therefore excluded these two areas from any further analysis, leaving eight areas where the merger may give rise to potential competition concerns.

27. In line with its approach in HMV/Zavvi and the particular circumstances of this case, the OFT decided that it would not be appropriate to conduct an in-depth analysis in relation to competition in each of the remaining eight Overlap Stores[14] if there was compelling evidence showing that an individual store would have exited the market in any event. That is, if an alternative counterfactual applied[15]. In this case, on the basis of extensive evidence supplied by the Administrator, Focus's management, the firm's parent company and other national DIY retailers and other relevant third parties, the OFT has been able to reach a requisite level of belief to enable it to decide which of the eight remaining Overlap Stores would have exited the market absent the merger. The OFT notes that this will not be possible in relation to each case where firms enter into administration or where exiting firm scenarios are alleged.

28. As is set out below, the OFT considers that it is appropriate to adopt an alternative counterfactual in relation to each of those eight remaining Overlap Stores.

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[14] Those are: Buxton, Consett, Devizes, Ebbw Vale, Leominster, Leven, Shepton Mallet and Uttoxeter.
[15] HMV/ Zavvi, paragraph 28.

THE COUNTERFACTUAL

29. The OFT considers, for the reasons set out below, that all of the Target Stores (including the Overlap Stores and for sake of completeness, the entire Focus business) would have failed for financial reasons and/or commercial strategic reasons. The OFT considers that realistically there was no substantially less anti-competitive purchaser for these remaining eight Overlap Stores despite the fact that the Administrator sold the stores to Kingfisher soon after the entry into administration.[16]

30. Kingfisher argued that the correct counterfactual for the assessment of the acquisition was the Focus business having entered into administration and, absent the merger, the Target Stores ceasing to operate. Kingfisher submitted that there was no less anti-competitive purchaser available given the extensive marketing efforts of Focus's management, through Lazard, to sell the business in whole or in part pre-administration and given the efforts of the Administrator to sell the business prior to the quick sale to Kingfisher.

31. In order for the OFT to accept that the prospect of Focus remaining in the market was not realistic, it would need to believe on the basis of compelling evidence that:[17]

    - the exit of the Target Stores was uninfluenced by the prospect of the merger; and
    - the Target Stores would have exited (through financial failure or otherwise);
    - there would have been no substantially less anticompetitive alternative purchaser for the remaining eight Overlap Store to Kingfisher; and
    - the exit of the remaining eight Overlap Stores and the dispersal of their sales across firms remaining in the market would not have been substantially less anticompetitive than their purchase by Kingfisher.

    Taking each of these in turn.

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[16] As indicated above, Kingfisher's original submission also included Focus' former store at Dorchester which was eventually withdrawn (see footnote 1 above).
[17] See Merger Assessment Guidelines, paragraphs 4.3.8 to 4.3.18, and Stena/DFDS, Dorf Kettal/Johnson Matthey and Ratcliff Palfinger/Ross & Bonnyman.

Whether the exit of the Target Stores was influenced by the prospect of the merger

32. Consistent with its approach in Stena/DFDS[18] and Ratcliff Palfinger/Ross & Bonnyman[19] the OFT has assessed whether the exit of the Target (including the Overlap) Stores was influenced by the prospect of the merger. The OFT considered the impact of the Kingfisher deal in the period pre-administration and the period post-administration.

Assessment of impact of Kingfisher deal pre-administration

33. Kingfisher told the OFT of its earlier interest in acquiring several Focus' stores. Given that Focus's financial difficulties were widely known pre-merger and that Lazard had been instructed to sell the business, Kingfisher expressed an interest in acquiring certain stores directly (and through third parties) in 2010 and early 2011.

34. The OFT therefore considered carefully whether the fact that Kingfisher had expressed an interest or made indicative offers for the Target Stores (or at least for some of them) had any bearing on the various events that led to the Focus business entering into administration. The OFT's investigation has not found any evidence that this was the case for the following reasons.

35. As described at paragraphs 4 and ff above, the events leading up to the administration revolved around certain proposals to restructure or recapitalise the business which were put to Focus's parent company, Cerberus, by Focus's management. The preferred option of Focus's management was a second CVA. For various reasons unconnected to Kingfisher's expressions of interest or to the acquisition of the Target Stores, Cerberus considered that the proposed second CVA was not a commercially viable solution to the concerns over Focus's financial performance. Cerberus therefore did not support the proposals of Focus's management. This led to other significant lenders also withdrawing their support for any new restructuring exercise. Focus's management then filed

[18] See OFT decision of 8 February 2011 on the completed acquisition by Stena AB of DFDS Seaways Irish Sea Ferries Limited and related assets, paragraphs 36 and 37.
[19] See OFT decision of 18 February 2011 on the anticipated acquisition by Ratcliff Palfinger Limited of the commercial vehicle tail lifts spare parts business of Ross & Bonnyman Limited, paragraph 48.

for administration when it became clear that it will not get the necessary support (and any necessary funding) for a new restructuring plan.

36. In assessing whether or not Cerberus's decision was influenced by the Kingfisher deal, the OFT notes that:

- the Kingfisher deal ultimately agreed with the Administrator is different in terms of the number of stores and value (both are lower) than that offered by Kingfisher pre-administration. As such, it cannot be said that Cerberus would have gained as a secured creditor of the Focus business from it going into administration;
- Cerberus is not one of the primary secured creditors and neither the pre-administration or the post-administration offers made by Kingfisher were sufficient to repay the debts owed to Cerberus; and
- Focus's management independently filed for administration and not the Cerberus board, although it is likely to have been clear to Cerberus that its refusal to support Focus's management's plans would likely result in that course of action.

37. On the basis of the above, the OFT does not consider that the prospect of this merger influenced Focus's decision to enter into administration to any material extent.

Assessment of impact of Kingfisher deal post-administration

38. The OFT has also considered whether the prospect of a Kingfisher deal had any influence on the likely exit of the Target Stores or the Focus business post-administration. In this regard, the OFT notes that the Administrator is under legal and fiduciary duties pursuant to the Insolvency Act 1986. Having regard to the considerable prior efforts at restructuring and recapitalising the stores by Focus and Lazard from October 2010 to April 2011, and to the financial position of the Focus' business, the Administrator told the OFT that it could not seek to restructure the business (see paragraph 5 above). The Administrator then sought to sell the business to realise value for the creditors, in accordance with its duty under the Insolvency Act. This led to a series of transactions—including this one with Kingfisher—and to the closure of stores which could not quickly be sold, to avoid incurring further debts.

39. On this basis, the OFT does not consider, based on the evidence available to it, that the exit of the Focus stores once they went into administration was influenced by the Kingfisher transaction.

Whether the Target Stores would have exited for reasons of financial failure or for other commercial strategic reasons

40. Focus entered into administration on 5 May 2011. However, the fact that a firm has entered into administration does not conclusively demonstrate that the exiting firm criteria are met. This is, in part, because the firm (or a part of it, such as the Target Stores) may have been able to emerge from administration in a reorganised form and to continue to compete in the market.

41. In this regard, the OFT assessed two issues in connection with whether the Target Stores would inevitably or imminently have exited through financial failure or otherwise:

    - whether Focus was unable to meet its financial obligations in the near future; and

    - whether Focus was unable to restructure itself successfully, taking into account the profile of assets and liabilities and the action the management has taken to address the firm's position.

    Each is considered below.

    Assessment of Focus's financial position

    The OFT's investigation has indicated that the Focus' business had been experiencing significant losses for a number of years and that failure was a real possibility. The key events were as follows:

    - Following the sale of Wickes in February 2005 to Travis Perkins, the OFT understands that financing arrangements included a £185m senior bank facility and £100m mezzanine note issue.

- Financial performance remained poor under the ownership of Duke Street Capital and Apax Partners and in July 2007 Focus was acquired by Cerberus. Arguably, that acquisition prevented Focus from entering into administration at that time. The new owners, Ceberus, embarked on a restructure and rationalisation programme including:

- 2008—major restructuring including around 20 per cent reduction in staff and reducing overheads by closing 76 stores (52 loss-making). Pre-pack insolvency was considered (Project Rome), but did not proceed;

- 2009—Ernst & Young was appointed to carry out an independent business review (Project Tulip). Focus agreed with bank lenders to extend its revolving credit facility until 2011, although this represented an overall reduction in the credit facility's size from £75 in 2008 to £ 50 million. Focus also commenced a creditors' voluntary arrangement (CVA) (Project Phoenix/Paint), reducing annual outgoings on 38 closed stores in return for an upfront payment of some of the charges. Two distribution centres were consolidated into one. Rent payments on open stores were agreed payable monthly in advance instead of quarterly; and

- 2010—Focus engaged Rothschild (Project Sharp) to refinance the revolving credit facility but no agreement was reached because the banks were unable to provide a facility of adequate size. Later in that year Focus instructed Lazard (Project Dome) to assist in the development of possible disposal strategies. This led to an agreement to sell six branches to ASDA. In November 2010 Ernst and Young were appointed to carry out a second business review.

42. The OFT notes therefore that Focus's management, with the support of Cerberus, had continued to avoid administration or insolvency for a number of years in spite of poor financial performance. However, the OFT notes that its analysis indicates that, in spite of these efforts to restructure the business, the financial performance of the Focus Group deteriorated between the financial years 2007 and 2011. This indicates that the store profit before central and unallocated costs declined from £42.7m in 2007 to £13.4m in 2011. If central/unallocated costs are removed, there were losses in 2008, 2009 and 2011. The sale of some stores in 2007/2008

might have been one of the reasons for this drop in profits. As a proportion of sales after central costs, profits deteriorated from 2.8 per cent in 2007 to a loss of 3.3 per cent in 2011.

43. Focus was also burdened with significant debts and high annual interest payments. The OFT notes that the published accounts for the FLP2 Ltd, the parent company of the Focus group for financial year ended February 2010 also showed a £63m charge for impairment of goodwill in 2009, contributing significantly to a shareholders' deficit of £153.5m in February 2010. At this date, the company was highly geared with £188.5m of bank loans and overdrafts due over one year: £110m repayable in 2013 and £60m in 2014 both with accrued interest payable on maturity and a £50m revolving credit facility. The firm paid interest on this debt of £15.4m in 2010.

44. On the basis of the above evidence, Focus's business was struggling financially but significant efforts to restructure the business had kept the business trading in the past. The OFT was also aware of Focus's management's new plans to a further restructuring attempt. Thus, the OFT could not be sufficiently confident that exit was inevitable solely for financial reasons pre-administration. It therefore considered whether exit was inevitable for commercial reasons and whether the business could have been restructured pre-administration.

Whether the Focus business could have been restructured

45. In April 2011 a joint management and Cerberus executive restructuring plan was presented to the board of FLP2 – the Cerberus parent company for the Group. The plan considered a range of restructuring options and recommended a new CVA, in preference to a substantial store disposal (a potential sale of 27 branches to Kingfisher was considered to result in an unattractive core business) or a pre-pack administration that would have resulted in a greater short term working capital requirement. However, Cerberus, the major secured creditor and owner, and the lenders of the revolving credit facility, did not support the plan and Focus's management put the Focus companies into administration on 5 May 2011.

46. The OFT discussed with Focus's management and Cerberus the reasons for the rejection of the proposed package. Focus's management explained that it had expected that the proposal would be agreed, not least because a

Cerberus executive had been a member of the team that had developed the plan. Although it would have generated the most cash in short-term, the sale of branches to Kingfisher was felt to take away too much of the profitable business and would leave an unattractive core business.[20] Management believed that the best prospect was to keep the business going, with a significant improvement when the economy and trade recovered, given the high fixed cost element of the business. However they recognised that an upturn was not likely until 2013.

47. Cerberus rejected the plan because it did not consider that Project Paris could be achieved without requiring a further cash injection from Cerberus. Cerberus noted that a previous injection had been made in 2010. There were a number of aspects of the plan where Cerberus considered the risks to be too high; notably that they would not obtain the necessary agreement from creditors and they were concerned about successfully achieving the scaling down and move of the company's head office. In addition the plan identified the risk of a further need for a seasonal advance of £5m (which could perhaps be achieved with the disposal of some stores). Project Paris also envisaged to re-negotiate the existing revolving credit facility (albeit reduced to £40m). All parties involved accepted that this credit facility would have provided no room for unscheduled financial needs and further funding requirements might not be totally excluded. They also pointed out that they had previously seen a number of proposals and plans that had been over-optimistic and had not met the expected targets.

48. Cerberus emphasised that it bought distressed companies with the aim of turning them around and did not withdraw support lightly. However having provided support for over three years and considering a wide range of alternative restructuring or divestment options, Cerberus felt that it could not provide further support for a plan that it considered to have 'significant execution risk'.

Conclusion on Focus's financial position and whether it could have been restructured

49. The OFT considers that the exit of the overall Focus business (and the Target Stores) was inevitable on the basis of the evidence available to it.

[20] Many of the stores now being sold are the more profitable branches, 18 out of the 50 most profitable branches in FY 2011 and 27 out of the top 90.

Although as noted above, taken alone, the financial issues faced by Focus do not indicate that failure might not have been imminent.

50. It is clear that the company's survival was dependent on further support of its major creditors – notably Cerberus and the banks providing the revolving credit facility. As long as that support was in place, further restructuring might be considered, as Project Paris showed. However, once that support was withdrawn, the company was no longer viable. In effect, the exit or entry into administration was triggered by a strategic commercial decision by the major creditor and owner of the firm which prevented restructuring of the business.

51. On the basis of the above, the OFT is confident that there is sufficient compelling evidence that the first limb of the failing firm criteria is met; that is, that the exit of the overall Focus business and consequently the Target (including the Overlap) Stores absent the merger was inevitable and that there was no realistic prospect of their re-organization.

Whether there realistically was a substantially less anti-competitive purchaser for the Overlap Stores

52. The OFT has assessed whether any alternative effective competitors (other national DIY sheds) had shown an active interest in acquiring the eight Overlap Stores (those raising possible competition issues) and, if so, whether they represented a substantially less anti-competitive alternative to Kingfisher as a purchaser of the store concerned.

53. Kingfisher submitted that it is clear from the representations made by the Administrator and by Lazard[21] that only Kingfisher and one food retailer had expressed a realistic interest in acquiring any of the Focus stores pre-administration. In Kingfisher's view, the OFT should attach greater evidentiary weight to this than to any interest subsequently shown (or even any actual acquisition) by any national DIY competitor **following** the appointment of the Administrator.

54. In this regard, the OFT spoke to all those involved in any attempt prior to this merger to find alternative purchasers or a further re-organisation of the business. This confirmed that Kingfisher was the only national DIY shed

[21] As per Letter of Engagement of 17 December 2010 between Lazard, on the one side; and Cerberus and Focus's management, on the other.

which had expressed a realistic interest pre-administration in acquiring any of those eight Overlap Stores (or, indeed, any of the Target Stores).

55. However, the OFT considers that the pre-administration marketing exercise undertaken by Lazard, whilst sufficient for the Administrator to proceed quickly to a deal with Kingfisher, does not provide sufficient evidence that there were no less anti-competitive purchasers for the Overlap Stores for the purposes of this assessment. This is because the entry into administration of a business can change the incentives of other firms to acquire it. The OFT notes that this is consistent with Kingfisher's views in its internal documents[22] in which it expected that other companies would become interested in some of the stores when they entered administration. The subsequent purchase of stores from the Administrator by parties other than Kingfisher is also consistent with this.

56. Further, third parties confirmed that they had maintained an active interest in the Focus business although their position pre-administration was that they had no interest in making offers for the Focus' business while it continued trading as that could have led to Focus's demise further, which in turn, would strengthen Kingfisher's position in the DIY retail market and/or they had no interest in the terms that would be available to purchase these stores pre-administration. In other words, they were interested in acquiring stores only following Focus's fall.

57. In the light of these responses, the OFT considered whether these purchasers were realistic alternatives; that is, whether they were genuinely interested in purchasing each or any of the Overlap Stores and if so, whether a purchase by them would lead to a significantly less anti-competitive outcome than the proposed merger.

58. In this regard, Travis Perkins (owner of Wickes) and Home Retail Group (owner of Homebase) provided evidence identifying several Target Stores in which they were interested. One of these, Buxton, was also one of the remaining eight Overlap Stores. This evidence did not support the existence of a less anti-competitive alternative purchaser to Kingfisher, however, for seven Overlap Stores (Consett, Devizes, Ebbw Vale, Leominster, Leven,

[22] See, for example, Kingfisher's presentation of 17 November 2010 titled Project Phelps, slides 21 and 22.

Shepton Mallet and Uttoxeter) because no realistic alternative suitable purchaser had been identified.

59. The OFT understands that Travis Perkins had announced pre-administration that it was not interested in paying a lease premium in relation to any of the leaseholds for any Focus stores. In other words, it was not, at that stage, in the market to purchase the Focus stores on the basis they were likely to be marketed by Lazard. Post-administration, Travis Perkins sought to contact the administrator on 6 May to enquire about certain stores. Travis Perkins was told that it could acquire any store other than the 31[23] stores Kingfisher had agreed to acquire under the Option Agreement.

60. The information supplied by Travis Perkins however did not indicate that it was interested in all of the Target Stores or the Overlap Stores. Travis Perkins supplied to the OFT a copy of the areas for which it requested further information from the Administrator. The list included 52 areas, ten of which related to stores already included in the Option Agreement. Out of the remaining 42 available stores, Travis Perkins eventually only purchased 13. In first instance, Travis Perkins told the OFT of its preliminary interest to acquire one of the Overlap Stores, Buxton. Travis Perkins later submitted that some contacts with the landlord had casted some doubts about the feasibility of a transaction in the given terms. The OFT assessed that while Focus's interest to enter into that local area remained, it was not sufficiently confident that if the Buxton store had been were available, Travis Perkins would have made an offer for the store. The above developments were not suggestive of Travis Perkins having much interest in any of the remaining eight Overlap Stores.

61. Notwithstanding this, the OFT assessed whether a purchase by Travis Perkins of the Buxton store would be significantly less anti-competitive than by Kingfisher. In this regard, Travis Perkins's Wickes store was located at the same distance from the Focus store as Kingfisher's B&Q store. Acquisition by Travis Perkins would therefore have given rise to the same reduction in the number of competitors in the local geographic market as the acquisition by Kingfisher. On this basis, it was not clear to the OFT that a purchase by Travis Perkins would be any less anti-competitive.

[23] At that stage, B&Q was also intending to purchase the Focus' store located at Dorchester.

62. The information supplied by Home Retail Group, the parent company of Homebase confirmed that it was interested in only two stores. These were Dorchester and Melton Mowbray. Melton Mowbray is not an Overlap Store. As stated above,[24] Kingfisher withdrew its notification to acquire the Dorchester which has now reverted to the market.

63. In summary, therefore, on the basis of the revised transaction none of the Overlap Stores that Kingfisher wishes to acquire raises the realistic prospect of an SLC given that the OFT considers that all the Target Stores would have exited the market absent the merger and would not have been acquired by a significantly less anti-competitive purchaser.

What would have happened to the sales of the Overlap Stores in the event of their exit?

64. Lastly, conditional to the previous two limbs being met, the OFT has considered whether the exit of the Overlap Stores and the dispersal of their sales across firms remaining in the market would have been substantially less anticompetitive than their purchase by Kingfisher.

65. The OFT considers that it is most likely that, given its status as the leading brand in the DIY retail market, many of the sales at the Overlap Stores would have in any event switched to B&Q. There is some evidence for this in relation to the diversion ratio information provided by the parties, which over all Overlap Stores show that the majority of the diversion going to B&Q. This is consistent with the exit of the Overlap Stores leading to a significant proportion of sales being captured by Kingfisher in any event, meaning that the merger may have a limited effect on competition. Furthermore, no specific evidence has been presented to the OFT to indicate that the exit of the Focus store in any of the individual Overlap Store areas would result in a substantially less anti-competitive outcome to the acquisition by B&Q in that particular area.

Conclusion

66. Based on the above, the OFT believes that the exit of the Target (including the Overlap) Stores was not influenced by the prospect of this merger. Based on the evidence available to it, the OFT also believes that all the

[24] See footnote 1 above.

Overlap Stores would have imminently and inevitably exited the market absent the merger and that there would have been no substantially less anticompetitive alternative purchaser for the Overlap Stores to Kingfisher. In addition and conditional to the previous two limbs being met, the OFT has concluded that the exit of the Overlap Stores and the dispersal of their sales across the three national DIY national sheds remaining in the market would have not been substantially less anticompetitive than their purchase by Kingfisher. It is not therefore necessary to undertake any further detailed competitive assessment at local level in this case. The merger will therefore not lead to the realistic prospect of a substantial lessening of competition in any UK market.

ASSESSMENT

67. The OFT believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation in relation to the Target Stores by Kingfisher and that these should be treated together under section 27 of the Act.

68. On a cautious basis and in line with OFT precedents, the OFT has considered an appropriate frame of reference to be the supply of DIY products by the four national DIY shed retailers only (those are B&Q, Homebase, Wickes and the failed Focus). Also, as in previous retail merger cases, the OFT considers that the ambit of retailing is national and local.

69. On a national basis, no competition issues arise. The turnover of the Target Stores represents only about 1 per cent of the share of the national DIY national sheds. This is a small increment to Kingfisher's existing national share of 56 per cent.

70. At local level, the OFT has assessed whether the merger would lead to any fascia reduction within radii of five and ten miles or within a 20-minute drive-time isochrone, all centred on the Focus's Target Store. On this basis, this merger does not raise any competition concerns in relation to 20 Target Stores.

71. The remaining 10 Target Stores give rise to horizontal overlaps (Overlap Stores). In relation to two of these Overlap Stores (Huntingdon and Stroud), the evidence presented to the OFT, in particular diversion ratios related to these local areas were not in the levels usually raising concerns and were therefore excluded of any further assessment.

72. On the remaining eight Overlap Stores, the OFT found that the exit of the Overlap Stores was not influenced by the prospect of this merger. Based on the evidence available to it, the OFT also believes that all the Overlap Stores would have imminently and inevitably exited the market absent the merger and that there would have been no substantially less anticompetitive alternative purchaser for the Overlap Stores to Kingfisher. In addition and conditional to the previous two limbs being met, the OFT has concluded that the exit of the Overlap Stores and the dispersal of their sales across the three national DIY national sheds remaining in the market would have not been substantially less anticompetitive than their purchase by Kingfisher. It is not therefore necessary to undertake a detailed competitive assessment at local level in this case. Accordingly, the merger itself cannot be regarded as the cause of any lessening of competition in those areas.

73. Consequently, the OFT does not believe that it is or may be the case that the acquisition of the Target Stores by Kingfisher may be expected to result in a substantial lessening of competition within a market or markets in the UK.

DECISION

74. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.

7 July 2011