

Completed acquisition by Sports Direct International plc of a number of stores from JJB Sports plc

CR/41/09

The OFT's decision on reference under section 22(1) given on 7 August 2009. Full text of decision published 14 August 2009.

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.

INTRODUCTION

1. This decision should be read together with the OFT's decision of 1 May 2009, published on 21 May 2009 (the Decision), which concluded that the test for reference was met in relation to the completed acquisition by Sports Direct International plc of a number of stores from JJB Sports plc.

PARTIES

2. **Sports Direct International plc (SDI)** is the UK's leading sports retailer by revenue and operating profit, and the owner of a significant number of internationally recognised sports and leisure brands, operating approximately 375 retail outlets in Great Britain. The majority of retail outlets trade under the Sports Direct or Sports World fascias. SDI has acquired a number of retail businesses over the last few years, and some retail outlets still trade under their previous names, such as Lillywhites, McGurk, Exsports, Gilesports, Sports Soccer, Field and Trek, and Hargreaves.
3. In addition, SDI currently holds a 29.4 per cent stake in Blacks and a 25 per cent holding in each of Sweatshop and SheRunsHeRuns. The OFT considers that, in accordance with the OFT's guidance¹ and the established practice of the OFT and the Competition Commission (CC) in relation to determining material influence for the purposes of section 26 of the

¹ Paragraph 2.10 of the OFT's *Mergers – substantive assessment guidance* (OFT516).

Enterprise Act 2002 (the Act), absent any evidence to the contrary, it is or may be the case that SDI has material influence in relation to all three retailers (Blacks,² Sweatshop and SheRunsHeRuns), as the level of SDI's shareholding in each would be very likely to provide it with the ability to block special resolutions at shareholder meetings.³

4. **JJB Sports plc (JJB)** is one of the UK's leading high street sports retailers. As at 27 January 2008, JJB operated approximately 400 retail outlets in the UK⁴ – although the OFT is conscious that this reduced through 2008/09.⁵ JJB reported a pre-tax loss of £9.7 million for the first half of 2008.⁶

TRANSACTION, PROCESS AND TIMING

5. The transaction concerns the completed acquisition by SDI of 31 retail outlets from JJB which took place between 5 November 2007 and 1 December 2008 (collectively the 'Acquired Stores' or, individually, an 'Acquired Store').⁷
6. The OFT became aware of the transaction through an own-initiative investigation by the Mergers Intelligence Unit in December 2008. The original extended statutory deadline under section 24 of the Act was Monday 4 May 2009.

JURISDICTION

7. The OFT considers that the acquisition by SDI of 31 retail outlets from JJB constitutes enterprises ceasing to be distinct for the purposes of section 23 of the Act.
8. Section 27(5) of the Act provides that the OFT may treat successive events as having occurred simultaneously on the date in which the latest of them occurred. Section 27(6)(a) of the Act adds that a 'successive event' can occur within a two year period under or in consequence of the same

² Blacks includes a number of retailer brands including Millets and the Outdoor Group.

³ SDI did not contest this. Indeed, the OFT understands that SDI has already used its voting rights to block the sale by Blacks of its winter sports subsidiary, Free Spirit: <http://www.financeweek.co.uk/item/5265>.

⁴ JJB's 2008 Annual Report.

⁵ See <http://www.jjbcorporate.co.uk/pdf/26%20March%202009.pdf>.

⁶ Since then, JJB has disposed of its chain of combined fitness clubs with attached retail store space to Dave Whelan Sports Limited.

⁷ The retail outlets are located in the following locations: Barnsley, Basildon, Bedford, Bradford, Bristol, Cardiff, Ealing, Eltham, Farnborough, Harrogate, Huddersfield, Ilford, Isleworth, Inverness, Lancaster, Llanelli, Newcastle-under-Lyme, Newcastle-upon-Tyne, Newport, Orpington, Poole, Truro, Salisbury, Sutton, Uxbridge, Walthamstow, Washington, Wolverhampton, Wood Green, Worthing and York.

arrangement or transaction, or successive arrangements or transactions between the same parties. In this case, the date of the latest retail outlet acquisition was 1 December 2008.

9. SDI submitted that the retail outlet transactions were entirely separate and should not be aggregated on the basis of section 27(5) of the Act.
10. However, in this case, the OFT considers it appropriate to exercise its margin of appreciation under section 27(5) to treat as taken together all of the 31 Acquired Stores, notwithstanding that there have been other circumstances in which the factual context was such that the OFT considered that it would not be appropriate to do so.⁸ Although there was no evidence to suggest that the acquisition of the Acquired Stores was structured so as to avoid scrutiny under the merger control provisions of the Act, the OFT believes that it should take into account in choosing whether to exercise its ability under section 27(5) that such a large number of retail outlet acquisitions may, on a cumulative basis, have a significant effect even if each one might not do so individually. Accordingly, the OFT considers that these transactions fall squarely within the scope of section 27(5) of the Act and are therefore appropriate to be subject to merger review scrutiny under the Act.
11. Given that the Acquired Stores had UK turnover in the last financial year of approximately £[], the turnover test in section 23(1)(b) of the Act is not met.
12. However, the OFT believes that it is or may be the case that the share of supply test in section 23(2)(b) of the Act is met and, therefore, that a relevant merger situation has been created. This is because SDI's share of supply of goods by national sports retailers (Sports Multiples, ie SDI, JJB and JD Sports) in the UK, by number of outlets, in 2007 was 33 per cent.^{9,10} In this case, the acquisition of 31 retail outlets from JJB represents an increment of approximately 2.5 per cent.
13. In addition, the OFT believes that the share of supply test may also be met through the combination of SDI and the Acquired Stores' share of supply in the UK of sports clothing retail, which is also estimated to be greater than 25 per cent. SDI alone has a share of supply of all sports clothing retail in

⁸ Completed acquisition by Tesco plc of the Co-operatives Group's stores in Uxbridge Road, Slough as well as Stapleford Lane, Toton, Nottingham and Towers Place, South Shields (*Tesco/Slough*), 2 February 2004.

⁹ Verdict, UK Sports Retail 2008, pages 103, 117, and 133. SDI had 414 outlets out of a total of 1242 from the national generalist sports retailers (SDI, JJB and JD Sports – the Sports Multiples) in 2007. In 2008, SDI's share of outlets was 30.7 per cent.

¹⁰ The Act is clear that the OFT, in determining whether the share of supply test is met, may apply such criterion (whether value, cost, price, quantity, capacity, number of workers employed or some other criterion, of whatever nature), or such combination of criteria, as it considers appropriate (section 23(5) of the Act).

the UK¹¹ of 24.9 per cent measured by sales¹² and the OFT estimates that the increment arising from this transaction is approximately one per cent on the same basis.^{13,14}

14. For all of these reasons, the OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

BACKGROUND

The Decision of 1 May 2009

15. In the Decision, the OFT found that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
16. The OFT did not identify competition concerns at the national level given that the acquisition did not result in a reduction in the number of national sports retailers, or Sports Multiples, and because of the minimal increment to SDI's turnover (approximately four per cent) or the number of its retail outlets resulting from the acquisition.
17. However, for the reasons given in full in the Decision, the OFT found that the test for reference was met in relation to the supply of one or more categories of sports retailing¹⁵ in five local areas: Basildon, Llanelli, Newport, Harrogate and Isleworth.
18. The OFT therefore concluded that it was under a duty to refer the merger to the CC for further investigation.

¹¹ The OFT considers that it is reasonable for it to assert jurisdiction on the basis of the SDI and the Acquired Stores' share of supply of sports clothing retailing in the UK. As this segmentation has been used in specialist market reports (such as Verdict) such a description of goods or services supplied in the UK appears to the OFT to be reasonable, and an appropriate basis on which to apply its jurisdictional test.

¹² Verdict: UK Sports Retailing 2008, page 68.

¹³ JJB operates 409 retail outlets and has a share of supply of 13.8 per cent on the basis of total sales. Apportioning this share equally across these retail outlets gives an average retail outlet level share of 0.03 per cent. Multiplying this by the number of retail outlets purchased (31) gives a total increment of the order of 1 per cent.

¹⁴ Moreover, the OFT notes that if the share of supply attributable to those retailers over which SDI has material influence over (Blacks, Sweatshop and SheRunsHeRuns) were included in SDI's share of supply, then this figure would be well over 25 per cent. For example, the OFT understands from the Verdict report that the Blacks chain (in which SDI has over a 29.4 per cent stake) has a share of supply in the region of three to four per cent for sports clothing retail.

¹⁵ The three categories examined by the OFT were: (1) sports clothing (including both sports specific clothing and sports fashion wear), (2) sports equipment, and (3) sports footwear.

SDI's offer of undertakings in lieu of reference

19. During the course of the OFT's investigation, SDI indicated that in order to remedy any competition concerns identified by the OFT, and to avoid a reference to the CC, it would be prepared to offer undertakings in lieu.
20. SDI offered a divestment package covering each of the retail outlets where the OFT found that the merger gave rise to competition concerns.
21. The OFT considered that the divestment of a store in each of the areas in which the OFT had found a realistic prospect of a substantial lessening of competition would be capable of addressing the competition concerns in a clear cut manner in accordance with the scheme of the Act as well as the OFT's guidance¹⁶ and decisional practice.

Need for an upfront buyer

22. The OFT considered that it was appropriate in the circumstances of this case to require that the relevant divestments be made in whole or in part to an upfront buyer or buyers.
23. An upfront buyer requirement means that the proposed divestment purchasers will have committed contractually, subject to formal approval of the undertaking in lieu, to acquire the relevant divestment retail outlet(s) before the OFT accepts the undertakings in lieu and loses its duty to refer. This means that the OFT will consult publicly on the suitability of the proposed divestment purchasers, as well as any other aspects of the draft undertakings, during the public consultation period.
24. The OFT stated in the Decision that it will seek an upfront buyer 'where the risk profile of the remedy requires it, for example where the OFT has reasonable doubts with regard to the ongoing viability of the divestment package and/or there exists only a small number of candidate purchasers' (paragraph 107).¹⁷
25. It was not clear to the OFT in this case that there would be a significant number of purchasers interested in acquiring the divestment retail outlets, in particular given the limited number of Sports Multiples. Furthermore, even if there were purchasers that might be interested in acquiring some or all of the divestment retail outlets, it was not clear that they would be able to do so without giving rise to potential competition concerns (such that they would not be regarded as suitable purchasers).

¹⁶ See in particular paragraph 8.3 of the OFT's *Mergers – substantive assessment guidance*.

¹⁷ This is in accordance with the OFT's current guidance. See paragraph 8.32 of the OFT's *Mergers – jurisdictional and procedural guidance* (OFT527).

26. Therefore, the OFT decided that any decision to seek undertakings in lieu from SDI should be on the basis of an upfront buyer provision for the retail outlets to be divested.

OFT's suspension of the duty to refer

27. The OFT therefore stated in the Decision that it was suspending its duty to refer in order to consider whether to accept undertakings in lieu of reference from SDI pursuant to section 73 of the Act but that this should be on the basis of an upfront buyer requirement.

28. The OFT stated in the Decision that:

'... it should be noted that, particularly given the current economic climate, the OFT has some reservations regarding the ability of SDI to divest these retail outlets to an upfront buyer. Should SDI be unable to swiftly find a suitable purchaser, and therefore divest the retail outlets in an expeditious and timely manner, then the OFT would reactivate its duty to refer to the CC' (paragraph 109).

29. The Decision therefore made clear that the suspension of the duty to refer gave SDI an opportunity to identify a suitable buyer in an expeditious and timely manner, absent which a reference would follow.

30. Pursuant to section 25(4) of the Act, the OFT extended the four month statutory timetable by notice to SDI on 1 May 2009 because it was seeking undertakings from SDI under section 73 of the Act.

Timetable to identify an upfront buyer

31. At the time of the Decision, the OFT's established practice and procedure for the acceptance of undertakings in lieu in upfront buyer cases was reflected in the Mergers – jurisdictional and procedural guidance: draft guidance consultation document that had been published for consultation in March 2008. This stated that:

'Where the OFT considers that an upfront buyer is required, the parties will be given a relatively short, individually-determined period following the announcement of the decision suspending the duty to refer in which to identify the upfront buyer, obtain confirmation from the OFT that the buyer is likely to be acceptable, and enter into the sale agreement' (paragraph 8.32).

32. Since publication of the Decision, the OFT has finalised this guidance. In the finalised guidance, the OFT provided additional detail on the procedure for the acceptance of undertakings in lieu in upfront buyer cases, reflecting its decisional practice since publication of the consultation document in

March 2008. The OFT's Mergers – Jurisdictional and procedural guidance¹⁸ states that:

'Where the OFT considers that an upfront buyer is required, the parties will be given a relatively short, individually-determined period following the announcement of the decision suspending the duty to refer in which to identify the upfront buyer, obtain provisional confirmation from the OFT that the buyer is likely to be acceptable, and enter into the sale agreement on the terms described above. This time period is likely to be a matter of weeks, rather than months, but will depend on the circumstances.

In each upfront buyer case, the OFT will, following the announcement of the suspension of the duty to refer, agree with the parties a timetable of milestones for this period in order to ensure that the parties are making timely progress towards the ultimate signing of an agreement with a suitable purchaser. This timetable will be communicated to the parties confidentially and will not be made public. However, failure by the parties to progress a sale as envisaged under the timetable will prompt the OFT to consider whether undertakings in lieu are in fact unworkable such that it should refer the merger to the CC' (paragraphs 8.33 and 8.34).

33. As is evident from the above, there is no statutory or generally publicised timetable in which a buyer must be identified and an agreement reached. It is for the OFT to decide how long it gives the merging parties (in this case SDI) to find a divestment purchaser (or purchasers) and to agree a sale, failing which a reference will be made. In setting a reasonable period, the OFT will take account of all the relevant circumstances of the case.
34. The OFT announced the Decision on 1 May 2009. On 7 May 2009, the OFT wrote to SDI proposing that SDI be required to have agreed sales for the five stores with suitable purchasers by 12 June 2009. However, SDI expressed concerns regarding the achievability of sales by this deadline and requested that it be extended to allow SDI more time.
35. On 8 May 2009, the OFT therefore agreed to give SDI a longer timetable, providing for a deadline of 31 July 2009, by which time sales should be agreed. This extended timetable was determined on the understanding between the OFT and SDI that this period provided a realistic opportunity for SDI to agree a sale, failing which a reference to the CC would follow. In confirming this timetable with SDI, the OFT stated to SDI that 'the OFT will not agree to any extensions beyond this timetable', reflecting the fact that SDI had been granted a significantly longer period than the OFT initially considered reasonable in this case in which to agree a sale with suitable purchasers.

¹⁸ OFT527, June 2009.

36. In accordance with established practice, the divestment timetable was not made public to preserve SDI's negotiating position with potential purchasers.
37. In accordance with the OFT's practice at the time of the Decision, and as now set out in paragraph 8.34 of the OFT's Mergers – Jurisdictional and procedural guidance (quoted in paragraph 32 above), the OFT required from SDI a weekly update on the progress of divestment.

DEVELOPMENTS AFTER SUSPENSION OF THE DUTY TO REFER

38. Following formal communication of the divestment timetable on 8 May 2009, the onus was on SDI to market the stores to a suitable purchaser, or suitable purchasers, in order to agree a sale.
39. SDI informed the OFT on 28 May 2009 that it was concentrating its efforts on achieving a sale of the five stores back to the original owner (JJB). On 29 May 2009, the OFT raised concerns with SDI as to whether JJB could be expected to satisfy the standard purchaser approval criteria¹⁹ given that it had previously chosen to dispose of the stores. However SDI informed the OFT that it believed it would be possible to persuade the OFT that JJB was a suitable purchaser.²⁰
40. At the beginning of July, the OFT became increasingly concerned with the lack of apparent progress on the divestment, particularly given SDI's failure to provide regularly a weekly update, as required. The OFT therefore wrote to SDI on 6 July 2009 reminding them of the need for weekly updates and the approaching deadline of 31 July 2009, and requesting information about the divestment progress. SDI responded on 8 July 2009 that its hopes for a sale to JJB might not come to fruition and that it would be exploring other options.
41. Notwithstanding the OFT's letter to SDI of 6 July, SDI continued to fail to comply regularly with its weekly update obligation in July. On 28 July 2009 SDI informed the OFT that it would be unable to meet the 31 July deadline and that it therefore requested a further extension of time to achieve a sale. In discussions with the OFT on 29 July 2009, SDI accepted that it had – in good faith – taken a risk in pursuing a strategy to divest to JJB. Once it had realised that, for reasons not initially foreseeable,²¹ this would not materialise, it had considered alternative options with other

¹⁹ In particular the requirement that the proposed purchaser has the incentive and intention to maintain and operate the relevant business as part of a viable and active business in competition with the merged party and other competitors in the relevant market.

²⁰ The OFT notes that it has on occasion approved a previous vendor as a suitable purchaser in other divestment contexts.

²¹ In particular that the relationship between SDI and JJB had broken down for reasons unrelated to the potential acquisition of the five stores.

potential purchasers, including other large national chains and smaller sports retailers.

42. On 3 August 2009, after the expiration of the 31 July 2009 deadline, SDI submitted a formal request for an extension to the deadline until the end of September 2009. SDI put forward the following reasons to justify its request for an extension of the divestment timetable.
- SDI acted reasonably in seeking initially to achieve a sale to JJB because of the advantages such a sale would bring, namely that: JJB was the former owner; that it would have avoided a package deal to different purchasers; that it had the means and incentive to proceed; and that it would have restored pre-merger competition. SDI could not reasonably have foreseen that, for extraneous reasons, the SDI / JJB relationship would deteriorate such that JJB was no longer a purchaser.
 - SDI is currently pursuing a number of prospective purchasers, ranging from large national chains down to smaller independents. Despite difficult market conditions, SDI believes that there is a 'realistic prospect' of securing the divestments.
 - A CC reference would not be justified. The five Acquired Stores have been part of SDI for a considerable time period. Any remedy by the CC (if it shared the OFT's concerns) would simply comprise equivalent divestment remedies that would be implemented after the CC's investigation. Further, a reference would not be a useful employment of the CC's resources.
 - SDI submitted in its formal request that it 'would strongly submit that a CC reference should be the last resort, to be applied only where the OFT is satisfied either that there are no realistic purchase prospects on the table or that the merged company is not applying itself to the task. Neither of these conditions is met in the present case.'
43. The OFT has considered carefully the arguments that SDI has made for an extension of time. Its conclusions are set out below.

ASSESSMENT

44. The Decision found that the reference test was met in relation to the supply of one or more categories of sports retailing in five local areas: Basildon, Llanelli, Newport, Harrogate and Isleworth.
45. The OFT suspended its duty to refer in order to seek undertakings in lieu from SDI because it considered that sale of stores in these five areas would constitute a clear-cut remedy to the competition concerns identified. The

OFT had some reservations regarding the ability of SDI to divest these retail outlets to a suitable buyer. It therefore required that sale be achieved to an upfront buyer. In doing so, the OFT clearly stated that, should SDI be unable to find a suitable purchaser swiftly, and therefore be unable to divest the retail outlets in an expeditious and timely manner, then the OFT would reactivate its duty to refer to the CC.

46. From the Decision on 1 May 2009, SDI was given until the end of the (extended) divestment timetable on 31 July 2009 in which to locate a suitable purchaser (or suitable purchasers) and agree a sale.
47. SDI chose to pursue a sale to a single purchaser, JJB, because it recognised the difficulty of achieving a sale to multiple different purchasers. This was notwithstanding the OFT's initial concerns about whether JJB would in fact be a suitable purchaser. Ultimately, the proposed acquisition by JJB collapsed for unrelated reasons.
48. The OFT now considers that it is not appropriate to extend the suspension of its duty to refer in order to give SDI additional time to agree a sale for the following reasons:
 - SDI has mischaracterised the respective roles of the OFT and CC in describing a reference as a 'last resort'. Once the OFT decides that the duty to refer is met, then a reference should follow. The only basis for the OFT not to refer in this situation is if it is seeking undertakings in lieu from merging parties (and therefore believes that there are good reasons to consider that they will be forthcoming within a reasonable timeframe²²).
 - In this case, the OFT does not believe that there are good reasons to consider that undertakings in lieu will be forthcoming within a reasonable timeframe given the upfront buyer requirement. SDI has provided the OFT with insufficient evidence indicating that a sale would be achieved in relation to all five stores if it were granted an extension of two months, as requested. The reasons for the OFT's view in this respect are as follows.
 - One of the reasons SDI sought to sell to JJB was because of difficulties involved in achieving sales of the five stores to multiple bidders. These difficulties remain.
 - In relation to the other Sports Multiples, SDI itself raised with the OFT in their discussions on 29 July 2009 the prospect that the Sports Multiples might be consciously refusing to engage with SDI

²² The OFT is under a duty of expedition in relation to references under section 103(1) of the Act.

given their knowledge of its need to divest the five stores if it were to avoid a reference.

- As regards smaller independent operators, the OFT considers that it is far from clear that these would be regarded as suitable purchasers for one or more of these stores (for the reasons given in paragraphs 24 to 27 of the Decision).
- The general economic conditions may result in fewer potential buyers amongst both larger and smaller operators. Indeed, SDI noted in its letter of 3 August 2009 the 'current, hugely challenging, high street conditions. Bank finance remains extremely tight'.
- SDI has not demonstrated genuine commitment to the divestment process. It has engaged only sporadically with the OFT since announcement of the Decision and has provided very little information about its divestment plans or progress. This is in contrast with certain other upfront buyer cases, where the OFT has been willing to extend the divestment timetable because the parties in question have demonstrated to the OFT a genuine commitment to realising a sale and provided evidence to the OFT to demonstrate that there were good reasons to consider that a sale would be achieved.

49. In light of all these circumstances, the OFT considers that it is not appropriate to provide SDI with additional time in which to seek to secure divestments. This is primarily because the OFT does not believe that a divestment would be achieved within the period requested by SDI. However, the OFT's decision to refer at this point in time is strengthened by SDI's lack of commitment to the divestment process, which further reduces the OFT's confidence in a successful divestment being achieved within a reasonable time period. In these circumstances, it is right and proper that the OFT should refer in accordance with the duty on it under the Act.

DECISION

50. The OFT's duty to refer is no longer suspended and the acquisition of the 31 retail outlets from JJB which took place between 5 November 2007 and 1 December 2008 will therefore be referred to the CC under section 22(1) of the Act in accordance with the Decision. Pursuant to section 25(5)(c) of the Act, upon reference to the CC, the ongoing extension to the duration of the statutory time limit in section 24(1) of the Act will be cancelled.