SLAUGHTER AND MAY

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CMA prohibits JD Sports/Footasylum merger

On 6 May 2020 the UK Competition and Markets Authority (CMA) announced its decision to block the completed acquisition of Footasylum plc by JD Sports Fashion plc following an in-depth Phase 2 investigation. In a **press release** the CMA said the transaction would lead to a substantial lessening of competition in the UK which would *"leave shoppers with fewer discounts or receiving lower quality customer service"*. The regulator noted that while COVID-19 has created uncertainty for retailers, it found no evidence that the impact of the pandemic would remove competition concerns. JD Sports will therefore be required to sell the Footasylum business in its entirety to a suitable buyer.

The parties

JD Sports is an international retailer of sports, fashion and outdoor wear, selling a range of branded sports-inspired footwear and apparel, and some own-brand apparel. It operates 375 stores in the UK and online. Footasylum is a UK-based retailer of sports and fashion wear which operates 70 stores in the UK and online.

Timeline of the deal

On 12 April 2019 JD Sports acquired Footasylum for £90.1m. The CMA imposed an initial enforcement order on 17 May 2019, and launched a Phase 1 investigation on 24 July 2019. In October 2019 the CMA **referred** the merger to a Phase 2 investigation after the parties decided not to offer undertakings in lieu, and published an issues **statement** setting out the key issues it would consider (including an analysis of how closely the parties compete with one another and the constraint they face from other competitors, such as Nike and Adidas).

Following the publication of the CMA's Provisional Findings on 11 February 2020, which provisionally found that the transaction raised competition concerns at a national level, JD Sports did not take up the option to offer a remedy or to engage in remedy discussions. The CMA announced its decision to prohibit the merger on 6 May 2020. It will allow JD Sports a "*reasonable timeframe*" to sell Footasylum to a suitable buyer (to be approved by the CMA) who will maintain and invest in the business and ensure that the parties continue to compete against each other as independent businesses.

For further information on any competition related matter, please contact the **Competition Group** or your usual Slaughter and May contact.

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Summary of the CMA's findings

In its **final report** the CMA concluded that the parties are close competitors in the markets for the supply of sports casual fashion (including apparel and footwear) in-store and online, and that the loss of competition between them could mean consumers would see fewer discounts, a lower quality of customer service and less choice online and in-store. This decision was based on a wide range of evidence, including:

- more than 2,500 internal strategy and decision-making documents showing that the parties closely monitor each other's activity;
- two surveys of over 10,000 customers showing that a high proportion of one party's customers regard the other party as the next best alternative;
- an impact assessment showing that Footasylum store openings have negatively impacted footwear and apparel revenues of nearby JD Sports stores; and
- the similarities in branded sports-inspired casual footwear and apparel sold by both parties, and their similar target demographic (16-24 year olds with a focus on males).

Notably, although market share figures suggested that the share increments in the relevant markets were relatively low (in the region of 0-10 per cent in addition to JD Sports' 20-40 per cent), the CMA considered that market shares did not help it understand how closely the retailers competed given the wide range of products and unclear delineation of market boundaries. The CMA also considered whether the parties face constraints from suppliers of branded products, in particular Nike and Adidas, but ultimately concluded that while these suppliers are influential, this would not prevent competition issues from arising.

In its press release the CMA stated that, *"although JD Sports is a larger retailer than Footasylum, they have millions of customers in a fast-growing sector. Therefore, the loss of competition between them is important"*. Kip Meek, Chair of the CMA Inquiry Group, said that the merger *"would mean the removal of a direct competitor from the market, leaving customers worse off"*.

Impact of COVID-19 on the competitive assessment

In a corporate **statement** JD Sports said that it "*fundamentally disagrees*" with the CMA's conclusions as it "*fails to take proper account of the dynamic and rapidly evolving competitive landscape in which we operate*". The statement also referred to the "*long-lasting – and likely permanent*" impact which the COVID-19 pandemic is expected to have on the retail industry, insisting that the pandemic should have been given more attention.

In its final report, the CMA acknowledged the challenges arising from COVID-19 and that much of the evidence-gathering took place before the pandemic affected the market. However, it does not expect the impact of the pandemic to remove competition concerns, stating: *"it is not clear that either of the Parties is being hit harder relative to other retailers, such that either would be in a much weaker competitive position in comparison to each other and other retailers, or that other competitors would become significantly stronger"*. Moreover, the CMA noted that as neither JD Sports nor Footasylum argued that they would go out of business absent the deal, the failing firm defence was not met. However, the regulator has allowed JD Sports some flexibility around timing the sale of Footasylum given the uncertainty caused by the pandemic.

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The parties have four weeks (from the date of the Phase 2 decision) should they wish to lodge an appeal with the Competition Appeal Tribunal.

Other developments

Merger control

SAMR's evolving VIE policy

An ongoing merger review into the **Mingcha /Huansheng JV** by China's State Administration for Market Regulation (SAMR) has sparked speculation that there has been a change in the approach taken by SAMR in relation to merger filings made by companies with a variable interest equity (VIE) structure.

The VIE structure is widely used as a way to enable foreign ownership and financing in various restricted sectors. It is widely adopted by Chinese tech companies. SAMR's practice has been to not accept merger filings involving a VIE structure, to avoid tacitly endorsing the legality of the structure.

Chinese competition authorities have previously reviewed transactions involving a VIE structure only in exceptional circumstances. For example, in the 2012 Walmart/Newheight case, MOFCOM imposed a remedy in granting **conditional clearance** that required Walmart not to use a VIE structure to engage in certain value-added telecommunications services (which was a restricted sector at the time). SAMR is also reported to be investigating the Didi/Uber transaction (and Didi operates via a VIE structure).

The recent SAMR announcement states that Mingcha is ultimately controlled by the Cayman-incorporated Leading Smart Holdings via "a series of contractual arrangements", indicating that a VIE structure is indeed in place. Some speculate that this does not represent a wholesale change in SAMR's approach because this transaction simply concerns the formation of a JV by a company with a VIE structure, and cannot be held to show that an acquisition of a target company with a VIE structure would be accepted by SAMR for review in the same way. Nonetheless, this development is a positive step towards ensuring that transactions do not escape SAMR review simply by virtue of involving a party with VIE structure, which had previously been the case, even if it remains to be seen whether all VIE-related transactions will be accepted by SAMR.

State aid

European Commission adopts second amendment to extend the scope of the State aid Temporary Framework for COVID-19 aid

On 8 May 2020 the Commission adopted a **second amendment** to its COVID-19 State aid Temporary Framework. The Temporary Framework was adopted on 19 March 2020 (see our **Client Briefing** for more details) and the Commission announced a first amendment to the framework on 4 April 2020 to cover further measures. These included both the provision of further support for coronavirus related research and the construction and upgrading of testing facilities for products relevant to tackling the coronavirus outbreak. This second amendment extends the scope of the Temporary Framework to cover recapitalisations and the provision of subordinated debt to companies in need, whilst protecting the level

playing field in the EU with certain conditions. The Commission justifies this State aid expansion, arguing that well-targeted public interventions could help out the *"otherwise viable non-financial undertakings"* facing a *"temporary liquidity crisis due to the COVID-19 outbreak"* which may experience long-term solvency issues if equity is not available.

Subordinated Debt: The amendment makes it possible for Member States to provide subordinated debt on favourable terms to companies which are in financial difficulty as a result of the crisis. This is subject to certain conditions under the Temporary Framework for public loans, such as: a maximum value for a loan that can be provided to each beneficiary and a minimum level of interest rates and credit risk margins. As the amendment increases the ability of companies to take on senior debt in a way similar to capital support, both a credit-risk mark-up and a limit on amount compared to senior debt will apply (a third for large enterprises and half for SMEs). In addition, subordinated debt will have to be assessed in line with conditions for recapitalisation measures in cases where certain ceilings are exceeded in relation to wage bills and total turnover.

Recapitalisation: The amendment sets out the criteria for Member States to support undertakings facing financial difficulties due to COVID-19, either through equity or hybrid instruments. This is subject to certain safeguards:

- Necessity, appropriateness and size of intervention: recapitalisation aid should only be granted if: (i) no other appropriate solution is available; (ii) it is in the 'common interest' to intervene; (iii) the intervention is limited to enabling the viability of the company; and (iv) the intervention does not therefore go beyond the restoration of the beneficiary's capital structure to the pre-crisis position.
- Remuneration: the State should receive appropriate remuneration for the investment and this remuneration must be as close to market terms as possible, so as to lower the potential for competition distortion. The framework explains the methodologies for the remuneration of equity instruments and hybrid capital instruments.
- Exit of the State from the capital: beneficiaries and Members States must develop a plan for the exit of the State. If exit is in doubt after six years (for public companies) or seven years (for private companies), then the amendment provides for a restructuring plan to be notified to the European Commission.
- Governance: until the State exits in full there is a ban on payment of dividends and share buybacks. Remuneration, including bonuses, to management is also strictly controlled until at least 75 per cent of the recapitalisation is redeemed.
- Cross-subsidisation and acquisition ban: recapitalisation aid cannot be used by beneficiaries to support the economic activities of integrated companies that were in difficulty prior to 31 December 2019. Until at least 75 per cent of the recapitalisation is redeemed, beneficiaries (excluding SMEs) are in principle prevented from acquiring stakes higher than 10 per cent in competitors (including upstream and downstream operations).
- Transparency: Member States must, within three months of the recapitalisation, publish details on both the amount of aid and the identity of State aided companies. Beneficiaries, other than SMEs, must also publish information on the use of the aid received.

While the Temporary Framework is in place until the end of December 2020, for recapitalisation measures only the period is extended until the end of June 2021.

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CMA issues statement on consumer protection law in relation to cancellations and refunds complaints during the health crisis

The CMA launched a **programme of work** to investigate reports of businesses failing to respect cancellation rights during the Coronavirus pandemic. The CMA COVID-19 Taskforce was launched on 20 March 2020 to identify harmful sales and pricing practices and to take enforcement action if evidence arose that firms may have breached competition or consumer protection law. The Taskforce noted that four out of five complaints received were those related to cancellations and refunds. In parallel to this, on 30 April 2020 the CMA published **guidance** in relation to consumer contracts, cancellations and refunds in light of the COVID-19 pandemic. It clarifies the CMA's view of how the law should operate in this area.

The CMA identified the following three areas of concern: (i) holiday accommodation entities pressuring people to accept vouchers which could only be used during a more expensive period; (ii) wedding venues refusing to refund any money and telling people to claim on their insurance; and (iii) nurseries asking people to pay high sums in order to keep a place open for their child. The CMA is particularly concerned that businesses should not be allowed to profit through 'double recovery' of their money from the Government and from customers.

According to its guidance, the CMA would expect a consumer to be offered a full refund where:

- a business has cancelled a contract without providing any of the promised goods/services;
- the provision of a service has been prevented due to restrictions from Government public health measures; and
- the consumer cancels because Government public health measures prevent them from using the services.

The CMA states that businesses should not charge an administration fee for processing refunds but recognises that timeframes for refunds may be extended, provided this is made clear to consumers. Andrea Coscelli, CEO of the CMA, commented that *"the current situation is throwing up challenges for everyone, including businesses, but that does not mean that consumers should be deprived of their rights at this difficult time. If we find evidence that businesses are failing to comply with consumer protection law then we will take tough enforcement action to protect those rights"*.

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