Neutral citation [2007] CAT 24

IN THE COMPETITION APPEAL TRIBUNAL
Victoria House
Bloomsbury Place
London
WC1A 2EB

Case No: 1081/4/1/07

27 July 2007

Before:

Marion Simmons QC (Chairman)
Michael Davey
Richard Prosser OBE

Sitting as a Tribunal in England and Wales

BETWEEN:

CO-OPERATIVE GROUP (CWS) LIMITED

Applicant

-v-

OFFICE OF FAIR TRADING

Respondent

Mr Thomas Sharpe QC and Mr Matthew Cook (instructed by Clifford Chance) appeared for the Applicant

Mr Rupert Anderson QC and Mr Julian Gregory (instructed by the Solicitor to the Office of Fair Trading) appeared for the Respondent

Heard at Victoria House on 20 June 2007

JUDGMENT

I INTRODUCTION

1. On 29 November 2006 the OFT accepted from Co-operative Group (CWS) Limited ("CGL") undertakings in lieu of a reference ("the Undertakings") to the Competition Commission ("the CC") of the completed acquisition by CGL of Fairways Group UK Limited ("Fairways"). The Undertakings provided for the Office of Fair Trading (the OFT)'s approval of any proposed purchaser of the businesses which CGL had agreed to divest ("Funeral Divestment Businesses").

2. On 3 April 2007 the OFT refused CGL's request for approval of Southern Co-operatives Limited ("Southern") as a proposed purchaser ("the Decision").

3. By a notice of application dated 1 May 2007 the applicant, CGL, applied, pursuant to section 120 of the Enterprise Act 2002 ("the Act"), for judicial review of the Decision of the respondent, the OFT, made on 3 April 2007.

4. For the reasons set out below, we dismiss CGL's application.

II THE APPLICATION AND FORMS OF ORDER SOUGHT

5. In paragraph 2 of its notice of application, CGL's grounds of review are set out as follows:

   (a) Ground 1: The OFT has acted outside its powers by refusing approval of Southern as a purchaser.

   (b) Ground 2: The OFT acted unreasonably in finding that the divestment to Southern would not remedy, mitigate or prevent the substantial lessening of competition ("SLC") identified in the decision of 29 November 2006.

   (c) Ground 3: The OFT was wrong to reject the more proportionate remedy by CGL of "firewalling" information from the Chief Executive of Southern.

6. The notice of application annexed a witness statement by Alan Philip Hardman, Head of Legal Services of CGL, and other supporting materials including CGL's pre-decision submissions to the OFT.

7. A case management conference was held on 11 May 2007.

8. In accordance with the Tribunal's Order of 11 May 2007, the OFT filed its defence on 25 May 2007 and attached to it the witness statement of Mr Simon Pritchard, Director of the Mergers Branch at the OFT. Attached to Mr Pritchard's witness statement are a number of exhibits.

9. On 6 June 2007 CGL filed its skeleton argument and on 13 June 2007 the OFT filed its skeleton argument in reply.

10. The oral hearing took place before the Tribunal on 20 June 2007.

11. CGL requests the Tribunal to:

- set aside the Decision;
- refer the matter to the OFT with a direction to reconsider and make a new decision in accordance with the Tribunal's ruling;
- order the OFT to pay CGL's costs.

12. The OFT requests the Tribunal to:

- dismiss CGL's application.

III THE LEGAL FRAMEWORK

The Act

13. Section 22 of the Act provides in material part as follows:

> "(1) The OFT shall, subject to subsections (2) and (3), make a reference to the Commission if the OFT believes that it is or may be the case that:
>
> (a) a relevant merger situation has been created; and

(b) the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services

…

(3) No reference shall be made under this section if- …

(b) the OFT is considering whether to accept undertakings under section 73 instead of making such a reference

…"

14. Once the OFT decides it is under a duty to make a reference to the CC, as arose in this case, section 73 of the Act gives it the power to accept undertakings in lieu of making a reference to the CC. That section provides:

"(1) Subsection (2) applies if the OFT considers that it is under a duty to make a reference under section 22 or 33 …

(2) The OFT may, instead of making such a reference and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned as it considers appropriate undertakings to take such action as it considers appropriate.

(3) In proceeding under subsection (2), the OFT shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it.

(4) In proceeding under subsection (2), the OFT may, in particular, have regard to the effect of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned.

(5) An undertaking under this section-

(a) shall come into force when accepted;

(b) may be varied or superseded by another undertaking; and

(c) may be released by the OFT.

(6) An undertaking under this section which is in force in relation to a relevant merger situation shall cease to be in force if an order comes into force under section 75 or 76 in relation to that undertaking.

(7) The OFT shall, as soon as reasonably practicable, consider any representations received by it in relation to varying or releasing an undertaking under this section."

15. Section 74 of the Act sets out the effect of undertakings under section 73:

"(1) The relevant authority shall not make a reference under section 22, 33 or 45 in relation to the creation of a relevant merger situation if-

(a) the OFT has accepted an undertaking or group of undertakings under section 73; and

(b) the relevant merger situation is the situation by reference to which the undertaking or group of undertakings was accepted.

(2) Subsection (1) does not prevent the making of a reference if material facts about relevant arrangements or transactions, or relevant proposed arrangements or transactions, were not notified (whether in writing or otherwise) to the OFT or made public before any undertaking concerned was accepted.

(3) For the purposes of subsection (2) arrangements or transactions, or proposed arrangements or transactions, are relevant if they are the ones in consequence of which the enterprises concerned ceased or may have ceased, or may cease, to be distinct enterprises.

(4) In subsection (2) "made public" means so publicised as to be generally known or readily ascertainable.

(5) In this section "relevant authority" means-

(a) in relation to a possible reference under section 22 or 33, the OFT; and

(b) in relation to a possible reference under section 45, the Secretary of State."

16. Section 75 sets out the powers of the OFT where undertakings under section 73 are not fulfilled. Section 75 provides as follows:

"(1) Subsection (2) applies where the OFT considers that-

(a) an undertaking accepted by it under section 73 has not been, is not being or will not be fulfilled; or

(b) in relation to an undertaking accepted by it under that section, information which was false or misleading in a material respect was given to the OFT by the person giving the undertaking before the OFT decided to accept the undertaking.

(2) The OFT may, for any of the purposes mentioned in section 73(2), make an order under this section.

(3) Subsections (3) and (4) of section 73 shall apply for the purposes of subsection (2) above as they apply for the purposes of subsection (2) of that section.

(4) An order under this section may contain-

(a) anything permitted by Schedule 8; and

(b) such supplementary, consequential or incidental provision as the OFT considers appropriate.

(5) An order under this section-

(a) shall come into force at such time as is determined by or under the order;

(b) may contain provision which is different from the provision contained in the undertaking concerned; and

(c) may be varied or revoked by another order.

(6) The OFT shall, as soon as reasonably practicable, consider any representations received by it in relation to varying or revoking an order under this section"

17. Schedule 8 contains a list of remedies that can be included in an order under section 75 for any of the purposes mentioned in section 73(2). Schedule 8 provides in so far as material as follows:

"*Acquisitions and divisions*

12 (1) An order may prohibit or restrict-

(a) the acquisition by any person of the whole or part of the undertaking or assets of another person's business;

(b) the doing of anything which will or may result in two or more bodies corporate becoming interconnected bodies corporate.

(2) An order may require that if-

(a) an acquisition of the kind mentioned in sub-paragraph (1)(a) is made; or

(b) anything is done which results in two or more bodies corporate becoming interconnected bodies corporate;

the persons concerned or any of them shall observe any prohibitions or restrictions imposed by or under the order.

(3) This paragraph shall also apply to any result consisting in two or more enterprises ceasing to be distinct enterprises (other than any result consisting in two or more bodies corporate becoming interconnected bodies corporate).

13 (1) An order may provide for-

(a) the division of any business (whether by the sale of any part of the undertaking or assets or otherwise);

(b) the division of any group of interconnected bodies corporate.

(2) For the purposes of sub-paragraph (1)(a) all the activities carried on by way of business by any one person or by any two or more interconnected bodies corporate may be treated as a single business.

(3) An order made by virtue of this paragraph may contain such provision as the relevant authority considers appropriate to effect or take account of the division …

14 The references in paragraph 13 to the division of a business as mentioned in sub-paragraph (1)(a) of that paragraph shall, in the case of an order under section 75, 83, 84, 160 or 161, or an order under paragraph 5, 10 or 11 of Schedule 7, be construed as including references to the separation, by the sale of any part of any undertaking or assets concerned or other means, of enterprises which are under common control (within the meaning of section 26) otherwise than by reason of their being enterprises of interconnected bodies corporate.

…"

18. Section 90 provides that Schedule 10 of the Act has effect in setting out the procedure for accepting, amongst other things, undertakings in lieu of a reference. Schedule 10 provides in so far as material as follows:

"*Requirements for accepting undertakings and making orders*

1 Paragraph 2 applies in relation to-

(a) any undertaking under section 73 … (other than an undertaking under the enactment concerned which varies an undertaking under that enactment but not in any material respect); and

(b) any order under section 75 … (other than an order under the enactment concerned which is a revoking order of the kind dealt with by paragraphs 6 to 8 below).

2 (1) Before accepting an undertaking to which this paragraph applies or making an order to which this paragraph applies, the OFT, the Commission or (as the case may be) the Secretary of State (in this Schedule "the relevant authority") shall-

(a) give notice of the proposed undertaking or (as the case may be) order; and

(b) consider any representations made in accordance with the notice and not withdrawn.

(2) A notice under sub-paragraph (1) shall state-

(a) that the relevant authority proposes to accept the undertaking or (as the case may be) make the order;

(b) the purpose and effect of the undertaking or (as the case may be) order;

(c) the situation that the undertaking or (as the case may be) order is seeking to deal with;

(d) any other facts which the relevant authority considers justify the acceptance of the undertaking or (as the case may be) the making of the order;

(e) a means of gaining access to an accurate version of the proposed undertaking or (as the case may be) order at all reasonable times; and

(f) the period (not less than 15 days starting with the date of publication of the notice in the case of an undertaking and not less than 30 days starting with that date in the case of an order) within which representations may be made in relation to the proposed undertaking or (as the case may be) order.

(3) A notice under sub-paragraph (1) shall be given by-

(a) in the case of a proposed order, serving on any person identified in the order as a person on whom a copy of the order should be served a copy of the notice and a copy of the proposed order; and

(b) in every case, publishing the notice.

4 As soon as practicable after accepting an undertaking to which paragraph 2 applies or (as the case may be) making an order to which that paragraph applies, the relevant authority shall (except in the case of an order which is a statutory instrument)-

(a) serve a copy of the undertaking on any person by whom it is given or (as the case may be) serve a copy of the order on any person identified in the order as a person on whom a copy of the order should be served; and

(b) publish the undertaking or (as the case may be) the order.

5 (1) The requirements of paragraph 2(4) (and those of paragraph 2(1)) shall not apply if the relevant authority-

(a) has already given notice under paragraph 2(1) but not paragraph 2(4) in relation to the proposed undertaking or order; and

(b) considers that the modifications which are now being proposed are not material in any respect.

(2) The requirements of paragraph 2(4) (and those of paragraph 2(1)) shall not apply if the relevant authority-

(a) has already given notice under paragraphs 2(1) and (4) in relation to the matter concerned; and

(b) considers that the further modifications which are now being proposed do not differ in any material respect from the modifications in relation to which notice was last given under paragraph 2(4).

…"

19. Section 94 sets out the rights to enforce, amongst other things, undertakings accepted by the OFT under section 73. That section provides:

"(1) This section applies to any enforcement undertaking or enforcement order.

(2) Any person to whom such an undertaking or order relates shall have a duty to comply with it.

(3) The duty shall be owed to any person who may be affected by a contravention of the undertaking or (as the case may be) order.

(4) Any breach of the duty which causes such a person to sustain loss or damage shall be actionable by him.

(5) In any proceedings brought under subsection (4) against a person to whom an enforcement undertaking or an enforcement order relates it shall be a defence for that person to show that he took all reasonable steps and exercised all due diligence to avoid contravening the undertaking or (as the case may be) order.

(6) Compliance with an enforcement undertaking or an enforcement order shall also be enforceable by civil proceedings brought by the OFT for an injunction or for interdict or for any other appropriate relief or remedy.

(7) Compliance with an undertaking under section 80 or 82, an order made by the Commission under section 76 or an order under section 81, 83 or 84, shall also be enforceable by civil proceedings brought by the Commission for an injunction or for interdict or for any other appropriate relief or remedy.

(8) Compliance with an undertaking under paragraph 1, 3 or 9 of Schedule 7, an order made by the Secretary of State under paragraph 2 of that Schedule or an order under paragraph 5, 6, 10 or 11 of that Schedule, shall also be enforceable by civil proceedings brought by the Secretary of State for an injunction or for interdict or for any other appropriate relief or remedy.

(9) Subsections (6) to (8) shall not prejudice any right that a person may have by virtue of subsection (4) to bring civil

proceedings for contravention or apprehended contravention of an enforcement undertaking or an enforcement order."

The OFT Guidance

20. Pursuant to section 106(1) of the Act, the OFT is under a duty to publish guidance about the making of references by it under sections 22 or 33. Such "advice and information" may include guidance as to the circumstances in which it may be appropriate to accept undertakings in lieu of a reference to the CC: see section 106(6).

21. The OFT has issued guidance on its approach to undertakings in lieu of a reference to the CC – see section 8 of *Mergers – substantive assessment guidance* (OFT 516, May 2003) (as amended). The relevant extracts are set out below (omitting footnotes):

> "8.1 The Act allows the OFT (or the Secretary of State in public interest cases) to accept binding undertakings from the merging parties as an alternative to making a reference to the CC.
>
> 8.2 The OFT can only accept undertakings in lieu of reference in cases where it has concluded that the merger should be referred to the CC. Such a conclusion must be published and the reasons for reference identified. Any undertakings must be aimed at remedying or preventing the adverse competition effects identified. In considering any such undertakings, the OFT will seek to achieve undertakings in lieu that are sufficient to address clearly the identified adverse competition effects and are proportionate to them. The OFT will also seek to agree undertakings that preserve any merger-specific customer benefits. However, the OFT will not accept undertakings in lieu of reference that do not address the identified competition effects but which are designed instead to 'lock in' sufficient customer benefits to outweigh the risks of a substantial lessening of competition arising.
>
> 8.3 In order to accept undertakings in lieu of reference, the OFT must be confident that the competition concerns identified can be resolved by means of undertakings without the need for further investigation. Undertakings in lieu of reference are therefore appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation. It is for this reason that undertakings in lieu have typically been used in merger cases in the past where a

substantial lessening of competition arises from an overlap that is relatively small in the context of the merger (e.g. a few local markets affected by a national merger).

8.4 In cases in which there is doubt over the precise identification of the substantial lessening of competition or in which the effectiveness or proportionality of the proposed undertakings in lieu may be questioned, the OFT considers it unlikely that the 'clear cut' criteria mentioned above would be met. In these circumstances, acceptance of undertakings in lieu would not be appropriate.

8.5 An acquiring company can always take the initiative to propose suitable undertakings if it thinks that they may be appropriate to meet any competition concerns that it foresees. In such cases the company may be willing to resolve the problem by divesting itself of part of its business (a structural undertaking); alternatively, in order to remove the concerns that have been raised, it may give a formal commitment about its future conduct (behavioural undertakings). Alternatively, the OFT may invite companies to consider whether they want to offer undertakings where it believes that it is or may be the case that a merger may raise competition issues potentially warranting reference and which seem amenable to remedy by undertakings in lieu.

8.6 A merger involves a structural change to a market. A structural solution will therefore often be the most appropriate remedy if the OFT believes that it is or may be the case that a merger may (or may be expected to) result in a substantial lessening of competition. The OFT considers that structural undertakings are more likely to be accepted as undertakings in lieu than behavioural undertakings because they clearly address the market structure issues that give rise to the competition problems.

8.7 Typically, structural undertakings require the sale of one of the overlapping businesses that have led to the concern about competition. Ideally, this should be a self-standing business, capable of being fully separated from the merging parties, and in most cases will be part of the acquired enterprise. The sale should be completed within a stated period (usually a maximum of six months). After that an independent trustee may be appointed, at the owner's expense, to monitor the operation of the business pending disposal and/or to handle the sale if the owner has not completed the divestiture within the specified period.

8.8 Before approving the sale of any business as a remedy, the OFT will approve the buyer. This is to ensure that the proposed buyer has the necessary expertise, resources and incentives to operate the divested business as an effective competitor in the market place. If that is not the case, it is

> unlikely that the proposed divestiture would be an effective remedy for the anti-competitive effects identified.
>
> 8.9 In appropriate cases, the OFT will consider other structural or quasi-structural undertakings in lieu of reference. For example, divestment of the buyer's existing business (or part of it) might be appropriate, although in such cases the OFT will also need to consider the competition implications of the asset swap. Alternatively, a remedy such as an amendment to intellectual property licences might in some circumstances be appropriate.
>
> …"

IV PROCEDURE BEFORE THE OFT

22. On 24 March 2006 CGL acquired 86 per cent of the issued share capital of Fairways, thereby acquiring *de jure* control of Fairways (the remaining shares are held by individual managers).

23. On 5 May 2006 the merging parties lodged an informal merger notification with the OFT.

24. On 16 June 2006, for the purpose of preventing pre-emptive action, CGL gave initial undertakings in respect of the acquisition of Fairways (see section 71 of the Act).

25. On 27 June 2006 CGL submitted a paper to the OFT which proposed undertakings to divest a number of funeral homes in order to resolve the competition problems which had been identified by the OFT in the course of its preliminary investigation.

The Decision of 19 July 2006 ("the Original Decision")

26. On 19 July 2006 the OFT took its Original Decision. In the section headed "Assessment" the OFT set out its substantive analysis. The OFT concluded its assessment in the following terms:

> "57. The parties overlap in the supply of funeral directing services to individuals …

> 58. Competition for provision of funeral directing services to individuals is considered to occur at the local level in this case. We therefore identified those local areas where the parties' share of funerals was greater than 25 per cent post-merger for further, more detailed analysis. In respect of each of these areas we considered a number of measures of competition including share of funerals; share of deaths; geographic closeness of competition and the relative size and strength of the remaining competitors in the local area.
>
> 59. On this basis the OFT identified five local areas where it believes it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition: Southampton, New Forest, Eastleigh, Woking and Wychavon. In respect of these areas, the OFT considers this loss of competition will not be offset by constraints from current competitors. It is also not expected that new entry or expansion would be sufficiently timely to deter or defeat any attempts by the merged entity to capitalise on the loss of rivalry brought about by the merger by reducing service quality or increasing price.
>
> 60. Consequently, the OFT believes 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."

27. The OFT then explained that where it is under a duty to make a reference under section 22(1) of the Act, it may instead accept undertakings in lieu (Original Decision, paragraph 61). CGL had indicated that it was prepared to consider divesting funeral businesses where the OFT found there to be a substantial lessening of competition (Original Decision, paragraph 63).

28. In the Original Decision the OFT considered whether the undertakings proposed by CGL would address all of the adverse effects arising from the merger and, if so, whether the OFT should exercise its discretion under section 73(2) of the Act to negotiate undertakings in lieu of reference. The relevant paragraphs are set out below:

> "61. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from such of the parties concerned undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the

SLC concerned or any adverse effect which has or may result from it.

62. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's guidance on undertakings in lieu of reference state that, "undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation."

63. In lieu of reference to the Competition Commission, CGL has indicated a willingness to divest a range of funeral businesses sufficient to address any competition concerns identified by the OFT. As noted above, the OFT has identified five local areas where the merger has resulted or may be expected to result in a substantial lessening of competition. In respect of all five, the OFT considers that the parties proposed divestments appear to be sufficiently clear cut to remedy the substantial lessening of competition identified in these areas.

64. Furthermore, the OFT considers that any divestment should seek to ensure that the local conditions of competition are returned to that which existed prior to the merger, especially given the importance of reputation and location. Therefore, the OFT considers that the divestment, as a going concern, of the Fairways funeral businesses in these five local areas is sufficiently clear cut to remedy or mitigate the substantial lessening of competition identified (and thus capable of restoring competition to its pre-merger level).

65. In accordance with section 73 of the Act, the OFT has therefore decided to exercise its discretion to seek undertakings in lieu of reference to the Competition Commission in relation to five local areas in respect of which it has a belief that it is or may be the case that a substantial lessening of competition has resulted or may be expected to result from the merger."

29. Under the heading "Decision", the OFT concluded as follows:

"66. The OFT's duty to refer the completed acquisition by CGL of Fairways to the Competition Commission pursuant to section 22 of the Act is suspended, because on the information currently available, the OFT is considering whether to accept undertakings in lieu of reference from CGL pursuant to section 73 of the Act."

30. A non-confidential version of the Original Decision was published on the OFT's website on 5 December 2006.

The proposed undertakings

31. On 27 July 2006 the OFT sent CGL a draft set of undertakings in lieu for consideration. The draft undertakings contained a provision which is identical to paragraph 3.1(a) of the Undertakings ultimately accepted by the OFT (set out in paragraph 41 below), which provided as follows:

> " **DRAFT: 27 July 2006**
>
> **Purchaser Approval**
>
> 3.1 For the purposes of the OFT approving a proposed purchaser for any of the Divestment Funeral Businesses in accordance with these undertakings, CGL and/or any proposed purchaser shall satisfy the OFT that:
>
> (a) the proposed purchaser is independent of and unconnected to CGL and the Group of Interconnected Bodies Corporate to which CGL belongs and any Associated Person or Affiliate of CGL or such Group of Interconnected Bodies Corporate
>
> …"

32. From 27 July 2006 to 25 October 2006 the OFT discussed a number of CGL's comments and proposed amendments to the draft undertakings, some of which were accepted and some rejected by the OFT. The OFT rejected certain of CGL's proposed changes to the draft undertakings, including the following suggestions:

(a) That additional wording be inserted into paragraph 3.1(a) to enable existing employees of Fairways to purchase one or more of the Divestment Funeral Businesses;

(b) That additional wording be inserted into paragraph 3.1(b) to widen the scope of potential purchasers beyond those already active in the local area; and

(c) That paragraph 3.1(d) be deleted as it "risked confusing approval under the undertakings with a decision not to refer under the Enterprise Act" (see Mr Pritchard's witness statement, paragraph 55).

33. At no point, however, did CGL raise any query or objection to the requirement in paragraph 3.1(a) that the purchaser must be "independent of and unconnected" to CGL (see Mr Pritchard's witness statement, paragraph 56).

34. On 24 August 2006 CGL wrote to the OFT concerning the requirement imposed by the Original Decision that the funeral businesses to be divested should be only those formerly owned by Fairways.

35. On 25 October 2006 the OFT gave notice, pursuant to paragraph 2(1) of Schedule 10 to the Act, of proposed undertakings offered by CGL pursuant to section 73 of the Act. The notice and proposed undertakings were published on the OFT's website.

36. The OFT considered that the proposed undertakings were appropriate to remedy, mitigate or prevent the competition concerns identified in the Original Decision, and was therefore minded to accept them.

37. In the notice of 25 October 2006, the OFT invited interested parties to make their views known by no later than 15 November 2006. The OFT did not receive any responses to this consultation.

V THE UNDERTAKINGS

38. On 29 November 2006, the OFT accepted the Undertakings. The signed undertakings came into effect from this date and were entered into the Register of Orders and Undertakings: see section 91 of the Act.

39. The Undertakings are available on the OFT's website[1]. In summary they required CGL to divest 13 funeral businesses[2] as a going concern to a purchaser

[1] http://www.oft.gov.uk/shared_oft/mergers_ea02/undertakings/coopundertakings.
[2] Specified in Annex 1 of the Undertakings.

or purchasers approved by the OFT in accordance with the provisions of the Undertakings.

40. Paragraph 2.1 of the Undertakings provides that:

> "**Divestment of the Divestment Funeral Businesses**
>
> 2.1 CGL shall, using its best endeavours and acting in good faith, as soon as reasonably practicable, effect to the satisfaction of the OFT the divestment of each of the Divestment Funeral Businesses as a going concern by the end of the Divestment Period to a purchaser approved by the OFT in accordance with the provisions of these undertakings. …"

41. The purchaser or purchasers of the funeral businesses were to be approved by the OFT and to meet the conditions set out in paragraph 3 of the Undertakings. The conditions relevant to the present case are as follows:

> "**Purchaser Approval**
>
> 3.1 For the purposes of the OFT approving a proposed purchaser for any of the Divestment Funeral Businesses in accordance with these undertakings, CGL and/or any proposed purchaser shall satisfy the OFT that:
>
> (a) the proposed purchaser is independent of and unconnected to CGL and the Group of Interconnected Bodies Corporate to which CGL belongs and any Associated Person or Affiliate of CGL or such Group of Interconnected Bodies Corporate;
>
> (b) the proposed purchaser has the financial resources, expertise and incentive to maintain and operate each of the Divestment Funeral Businesses it is proposing to purchase as a viable and active business in competition with CGL and other competitors;
>
> (c) the proposed purchaser is reasonably to be expected to obtain all necessary approvals, licences and consents from any regulatory or other authority including landlord's consent to the transfer of any leasehold interest; and
>
> (d) the acquisition by the proposed purchaser of any of the Divestment Funeral Businesses is not expected to result in a substantial lessening of competition in the relevant local area such that it would fail to restore the local conditions of

competition as required pursuant to paragraph 64 of the Decision.

3.2 The OFT may require CGL and/or a proposed purchaser to provide it with such information and documentation as it may reasonably require to satisfy the OFT that the proposed purchaser will fulfil the requirements in paragraph 3.1 above."

42. Paragraph 13 of the Undertakings provides as follows:

"**Extension of time limits**

The OFT may, where appropriate, in response to a written request from CGL showing good cause, or otherwise at its own discretion, grant an extension to any time period referred to in these undertakings."

VI BACKGROUND TO THE DECISION

43. In order to implement the Undertakings, CGL was initially given until 28 February 2007 to identify a suitable purchaser or set of purchasers. This period was extended by the OFT and is presently extended until no later than "[…][**C**]"[3].

44. On 11 January 2007 CGL informed the OFT that it had received two offers in respect of the funeral businesses to be divested: one by Southern and another by a different company.

45. CGL's request for approval of Southern as a purchaser of the Funeral Divestment Businesses is contained in a letter of 19 January 2007 from CGL's legal advisers to the OFT. In an appendix to that letter, CGL gave the following information as to why Southern satisfies all of the "Purchaser Approval" requirements contained in the Undertakings:

"CGL considers that Southern satisfies all the Purchaser Approval criteria listed in section 3.1 of the Undertakings. More specifically:

3.1(a) The proposed purchaser is independent of and unconnected to CGL and the Group of Interconnected Bodies Corporate to which CGL belongs and any Associated Person

[3] This excision relates to commercially confidential information: Schedule 4, paragraph 1 to the Enterprise Act 2002.

or affiliate of CGL or such Group of Interconnected Bodies Corporate;

Southern and CGL are separate and distinct entities, each separately registered under the Industrial & Provident Societies Act and each separately owned and managed. The two societies are not Interconnected Bodies Corporate, Associated Persons or Affiliates (as such terms are defined in the Undertakings) and there are no other formal links between their respective funeral businesses.

Southern is a member of CGL and although the Chief Executive of Southern has been elected as a director of CGL, he is only one of 28 directors (all non-executive) and is subject to conflict of interest rules. This reflects the origins and the development of the Co-operative movement and is not reciprocal."

46. On 30 January 2007 the OFT emailed CGL to request further details on the relationship between CGL and Southern and in particular an explanation as to why it considered Southern was "independent of and unconnected to CGL and the Group of Interconnected Bodies Corporate to which CGL belongs and any Associated Person or Affiliate CGL or such Group of Interconnected Bodies Corporate" for the purposes of paragraph 3.1(a) of the Undertakings.

47. On 12 February 2007 additional information on the relationship between CGL and Southern was provided by CGL to the OFT. CGL's letter stated:

> "Southern and CGL are separate entities, operationally and financially independent of each other. They have in common the fact that both are industrial and provident societies and developed as part of the wider co-operative movement that started in the 19th century. As a result, although there are a limited number of links between the two organisations (detailed below), these do not compromise their independence. Specifically, they do not affect the restoration of competitive conditions and the remedying of the SLC identified within the relevant local markets as required under the Undertakings. In particular:
>
> - Both CGL and Southern are independently owned (by their respective customer-members) and managed. Their respective funeral businesses are completely separate and actively compete in localities where both are present, such as Bognor Regis and Chichester as well as competing for the acquisition of new businesses. There is no sharing of operational resources in those areas where Southern and CGL compete or elsewhere.

- In terms of branding - as noted below, the brand image of Southern and CGL is quite distinct. The Decision (paragraph 28) appears to indicate that reputation (one of the two key parameters on which firms in this sector compete) resides at branch level, notably in the original family names under which individual branches (or groups of branches) trade. Given that the branches to be acquired each carry their own trading names and reputations (RC Payne, FC Hughes etc.), there is clearly unlikely to be any confusion between the acquired branches on the one hand and existing CGL and/or Southern branches on the other. Similarly, there can be no confusion in ownership between Southern's funeral business operating company (Mutual Services (Portsmouth) Limited) and that of CGL (Co-operative Group (CWS) Limited).
- There is no material connection between CGL and Southern and consequently there could have been no objection to Southern purchasing the Divestment Fairways branches contemporaneously with CGL acquiring the remaining Fairways branches. It would be irrational if an assessment under the Undertakings were to produce the contrary result as transaction structure should not affect the competition outcome.

In short, CGL believes that approval of Southern as a buyer would remedy the SLC identified in the relevant local areas identified in the Decision and would restore effective competition in those areas."

48. On 16 February 2007 CGL and the OFT further discussed, by telephone, the application of paragraph 3.1(a) of the Undertakings. CGL confirmed, by email, the matters discussed with the OFT as follows (the accuracy of which was confirmed by the OFT):

"Just to confirm our recent conversation regarding CGL's request for Southern Co-operatives Limited (Southern) to be approved as a purchaser under the undertakings in lieu of reference (UIL) in the above case:

You have received our initial letter of 19 January and our response of 12 February to your questions, discussed the request with the Decision Maker and reached the conclusion that the fact that the CEO of Southern is a director of CGL means that CGL and Southern are not unconnected for the purposes of paragraph 3.1(a) of the UIL.

However, as this directorship is the only connection between CGL and Southern which would prevent Southern satisfying the requirements of paragraph 3.1 of the UIL, if Southern's

> CEO were to resign his position as a director of CGL, then the Decision Maker would formally approve Southern as a purchaser (or grant approval conditional on such resignation).

49. On 26 February 2007 CGL's legal advisers sent an email to the OFT containing further background information on Mr Bennett, the Chief Executive of Southern, and requesting an opportunity to discuss the situation with the OFT. In that email they wrote:

> "Thank you for confirming your initial position in relation to CGL's request for the approval of Southern as a suitable purchaser under the UIL.
>
> I am copying in Simon Pritchard on the basis of a discussion of the wider implications of this issue which arose during his call on Wednesday with Alex. This call was in connection with the proposed merger between CGL and United Co-operatives Ltd. To summarise for Simon's benefit - my letter of 12 February set out a number of links between CGL and Southern, comprising Southern's membership of CGL, the presence of Southern's CEO on the board of CGL, common membership of the Co-operative Retail Trading Group and participation in arrangements regarding the "co-op" logo and an arm's length supply-relationship for coffins. In addition to these, Southern also has a business insurance policy and a bank account/visa card with CGL's affiliates Co-operative Insurance Society and The Co-operative Bank respectively. Your initial view on the basis of that letter was that Southern is capable of remedying, mitigating or preventing the SLC in each of the relevant local areas but for the presence of Southern's CEO as a director of CGL.
>
> By way of further background, the individual concerned is Graham Bennett (56) and he has been Chief Executive of Southern since 1983. He is one of 28 directors (all non-executive) on the board of CGL and he also holds non-executive directorships in three of CGL's subsidiaries - Co-operative Financial Services, Co-operative Insurance Society Limited and The Co-operative Bank plc (where he is also the Chairman).
>
> From CGL's perspective, the question of Southern's status under the UIL is not an isolated point - a further eight of CGL's current complement of directors are CEOs of independent co-operatives. The background to and reasons for this state of affairs have been discussed on a number of occasions with the OFT in the past, most recently with Vincent Smith last August. If it is the OFT's contention that Mr Bennett's roles within Southern and CGL are such as to raise a possibility of collusive behaviour sufficient to frustrate what would otherwise be a

remedying of the SLCs identified, then you must understand that this would cast a shadow over the strategic divestment options of CGL across a number of sectors (funeral homes, convenience stores, travel agents, pharmacies), where both it and independent societies are active and might have an immediate impact on one transaction currently under consideration. Any commercial party is entitled to obtain regulatory certainty at the earliest practicable moment in terms of the range of buyers to whom it may or may not sell in circumstances where the OFT would insist on divestment. If individual societies presenting the same or similar facts to Southern are incapable of numbering amongst that range then this needs debating now.

In reaching your initial view that Mr Bennett's respective roles compromise Southern's status as a potential buyer, then as noted CGL assumes that this must be on the basis that, by virtue of his position, he is in some way able to co-ordinate or influence the behaviour of both CGL's and Southern's funeral businesses within the relevant local areas. The relationship between CGL and Southern and the membership and management structure of CGL were set out in my letter of 12 February and are summarised above. These are both independently owned and managed businesses and in CGL's view, the fact that Mr Bennett holds the posts that he does, does not alter that conclusion. In particular CGL does not believe that this gives rise to any material degree of influence between the two societies, nor that it carries any risk of co-ordination between the relevant businesses.

CGL would be happy to elaborate in more detail on any aspect of its relationship with Southern or receive from you proposals for any additional safeguards you may consider necessary to ensure that Southern fully and properly addresses the SLC identified in the decision.

As a more general point, given that the regime established under the Enterprise Act is intended to address issues of substance rather than form and given that the UIL have been given pursuant to s73 of that Act, it would surprising if the analysis of Southern's suitability as a purchaser under the UIL came to a different outcome to an analysis of Southern as a pre-agreed buyer of the divestment funeral businesses.

Our own view (as advisers to CGL) is that had CGL entered into an agreement with Southern to acquire the divestment funeral businesses at the time it agreed to purchase Fairways, then there could have been no objection to the acquisition of these funeral branches by Southern. The issue of whether there was any connection between CGL and Southern would only have been relevant in the context of determining which enterprises come under common control pursuant to sections

26(2) and (3) of the Enterprise Act 2002. We do not believe that CGL and Southern would be enterprises under common control as neither has material influence over the other and they are not subject to the material influence of any other person. Even if it were possible in these circumstances to characterise CGL and Southern as associated persons, there still could have been no objection.

Consequently, had CGL either purchased the 35 non-offending branches, with Southern separately purchasing the remaining 13 or if CGL had purchased all 48 with an immediate and unconditional on-sale to Southern of the 13 divestment funeral businesses, in neither case would we have expected any objections. The conclusion that Southern would be an acceptable pre-agreed buyer, but an unacceptable onward-purchaser therefore seems perverse. Moreover, it would make the option of agreeing UIL a less attractive option to would be acquirers, thereby undermining the utility of UILs as a practical and proportionate method of avoiding needless references to the Competition Commission.

I appreciate that co-operative structures are unusual within the UK and that they differ in many crucial respects from "traditional" corporate entities, registered under the Companies Act. CGL would be happy to meet and discuss this structure, its relationship with Southern and the implications on both the UIL purchaser approval process and on future transactions involving CGL and other co-operative societies.

…"

50. A further telephone conversation took place on 2 March 2007. The OFT's case team outlined its concerns about Mr Bennett's dual role as Chief Executive of Southern and director of CGL.

(a) A note of that meeting made by the OFT states:

"1. PB said that the OFT would be interested to know what the position was in relation to the following issues: what the scope was of CGL's conflict of interest rules and the possibility of Mr Bennett standing down from the Board of GCL. The OFT would also provide its initial views in respect to the various links between CGL and Southern described in RB's letter to AW of 12 February 2007.

Southern seat on the CGL Board

2. PH responded that other cooperatives also had a seat on CGL's board. PH understood that there was a degree of judgement involved in assessing whether there was a "connection" pursuant to the Undertakings between CGL and

Southern as a result of this board seat. However, that Southern's seat on CGL's Board was Southern's entitlement as a member of CGL.

3. PB asked PH whether the possibility of Mr Bennett standing down from the CGL Board had been put to Southern. PH replied that CGL had not put the issue of standing down from the CGL Board to Mr Bennett – and would be slow to do so. However, Mr Bennett was aware of the OFT's concerns as to the link between CGL and Southern flowing from his membership of the CGL Board.

CGL conflict of interest rules

4. PH said that CGL could carry out an audit regarding how CGL'S conflict of interest rules impacted on Mr Bennett. PH added that the question was how instructive this audit would be, as Mr Bennett sat at the supervisory Board level of CGL. The influence that Mr Bennett had over CGL was commensurate with him being one out of 28 directors – and would not confer the ability to exercise material influence over CGL's policy, but was impossible to quantify. PH did acknowledge, however, that this board seat conferred some level of influence over CGL.

5. AW said that the OFT's concerns relating to Southern's seat on CGL's Board were not limited to any influence Southern might have over CGL, but also the likelihood that there would be less intensive competition resulting from information flowing between CGL and Southern. PH agreed that "most competitors would relish" this kind of information flowing from CGL to Southern, but that there would be no access by CGL to Southern information. PH added that the information would be high level information in relation to a range of governance issues.

6. PH said that he could send a copy of CGL's conflicts of interest rules to OFT, and noted that the rules in question were brief.

OFT comments on links between CGL and Southern

7. PB said that the link which the OFT was concerned about was the fact that Southern's CEO, Mr Bennett sat on the CGL Board. Given this directorship, the OFT's initial view was that it was reasonable to conclude that Southern was not "independent of and unconnected to CGL" pursuant to paragraph 3.1(a) of the Undertakings. An unsolicited complaint from a third party had already raised concerns regarding approval of Southern as a proposed purchaser. The receipt of this complaint suggested that it was not unreasonable to consider that Southern was not "independent of and unconnected to CGL".

8. PB said that whilst 1 of 28 directors was [*sic*] probably would not confer on Southern the ability to exercise material influence over CGL's policy, the OFT's initial view was that CGL was not "independent of and unconnected to CGL" pursuant to the Undertakings.

9. However, PB said that the OFT's initial view was that Southern's membership of CGL was an historical legacy from the cooperative movement's creation and was in any event *de minimis*. The vertical supply relationship in respect of coffins was an arms length commercial agreement.

10. PH said that it was unclear where the threshold was for links which resulted in Southern being considered not to be "independent of and unconnected to CGL", as it was unclear why Southern's board seat posed problems, but the other links did not. PH also said that were CGL to come forward with a fix-it-first remedy in another hypothetical case, such a board seat would not raise problems. PB replied that each case had to be considered on its merits. However, on the facts of this case, concerns arose as a result on Southern's seat on CGL's Board.

11. PH raised the issue of the putting into place of firewall arrangements between CGL and Southern. AW replied that the OFT would give due consideration to any offer to put firewall arrangements in place as between CGL and Southern. PB added that CGL should give thought to the monitoring and enforceability of any such arrangements put to the OFT for its consideration."

(b) A telephone note was also prepared by CGL's legal advisers. It is in materially the same terms as the OFT note, except it also states that:

"AW appreciated the point that it may seem surprising that in an analysis under the Enterprise Act (for a fix it first remedy) and an analysis under the undertakings in lieu might arrive at a different conclusion, but PB stressed that the undertakings should be read at face value. These stated that there should be no connection between CGL and the purchaser and that this should be interpreted on the basis of what the reasonable man on the street would mean constituted a connection. In his view, the directorship was a clear connection. He accepted that there were other links between CGL and Southern - the minority membership and the arm's length trading arrangements and he felt that these would not constitute connections for the purpose of the undertakings but that the same could not be said for the directorship."

51. On 26 March 2007 CGL's legal advisers made further representations by letter to the OFT, which stated that:

> "We are writing on behalf of CGL, to follow-up on our recent telecon with you and your colleagues Philip Brentford and Laura Phaff on 2 March 2007, regarding the relationship between Southern Co-operatives Limited ("Southern") and CGL and, more specifically, that which arises from the presence of Mr Graham Bennett, the Chief Executive of Southern, on the board of CGL. We said we would come back to you on the possible firewalling of information relating to CGL's funerals business from Mr Bennett in his capacity as a CGL Director and also on the possible resignation of Mr Bennett as a CGL Director.
>
> Before addressing these issues we would like to recap on our understanding of the OFT's position regarding Mr Bennett's directorship of CGL and comment on the compatibility of that position with Section 73(2) of the Enterprise Act 2002.
>
> In your email of 16 February you confirmed that, on the basis of our letter of 19 January and response of 12 February to your questions, the OFT's conclusion was that because of Mr Bennett's CGL directorship, CGL and Southern are not unconnected for the purposes of paragraph 3.1(a) of the Undertakings. However, as this directorship is the only connection between CGL and Southern which could prevent Southern satisfying the requirement of paragraph 3.1(a) of the Undertakings, if Mr Bennett were to resign from his position as a CGL Director, the OFT would be able to approve Southern as a purchaser (or grant approval conditional upon such resignation).
>
> As will be clear from our previous correspondence, including our email of 26 February, and from our discussion on 2 March, in our view the fact that an analysis of a now hypothetical fix-it-first remedy, involving Southern under the Enterprise Act, would result in the OFT coming to a different conclusion from an analysis of a divestment to Southern under the Undertakings is illogical, and indeed you acknowledged as much during our call on 2 March. Nevertheless, the OFT's position, on that call, appeared to be that "connection", for the purposes of the Undertakings, should be interpreted in accordance with "what a reasonable man on the street would think constituted a connection". Based on such interpretation, the OFT's position is that Mr Bennett's directorship of CGL is a clear connection but other links between CGL and Southern are not.
>
> Having consulted with leading competition counsel, our firm view remains, that Article 3.1(a) of the Undertakings cannot be interpreted by the OFT in a manner which is inconsistent with the purpose and meaning of Section 73(2) of the Enterprise

Act. It therefore follows from this that the OFT cannot withhold its consent to a disposal to Southern pursuant to the Undertakings unless it can show that an SLC would perpetuate. For the reasons we have already outlined in previous correspondence, we believe that an SLC would not perpetuate following a disposal to Southern, notwithstanding Mr Bennett's directorship of CGL.

Consequently, it would be inconsistent with the purpose and meaning of Section 73(2) of the Enterprise Act for the OFT to make its consent to a disposal to Southern pursuant to the Undertakings conditional upon the resignation of Mr Bennett from his directorship of CGL or even to insist on the firewalling from Mr Bennett of CGL board information and discussion concerning CGL's funerals business.

Even if it were within the OFT's power to insist on the resignation of Mr Bennett's directorship of CGL as a condition to its consent to a disposal to Southern pursuant to the Undertakings, this would not be countenanced either by CGL or by Mr Bennett as it would compromise the democratic principles of CGL and the co-operative sector and would be disproportionate in view of the fact that funeral services is only one of a number of business areas in which CGL is active. Firewalling of Mr Bennett from CGL board information and discussion relative to the CGL funerals' operation goes some way (but very clearly far from all the way) to ameliorating these concerns but, in the context of the arm's length divestment terms negotiated between CGL and Southern, both CGL and Mr Bennett would be prepared to respect a firewall of this nature.

In practice, this would mean that any CGL board papers received by Mr Bennett, including agenda, minutes and supporting documentation, would be excised of all information relating to CGL's funerals business and Mr Bennett would recuse himself from any discussions at CGL board meetings relating to CGL's funerals business and his recusal would be clearly minuted. CGL would propose that its auditors, KPMG (who will be approached the moment the OFT indicates acceptance of the firewall principles), would monitor compliance with such firewalling arrangements and provide the OFT with written certification of such compliance on an annual basis.

We trust, on the basis of the proposed firewalling arrangements and given also all the other circumstances, that the OFT will be able to consent to a disposal to Southern pursuant to the Undertakings.

We look forward to hearing from you on the above and if you would find it helpful we would be happy to discuss further with

you and your colleagues CGL's proposed firewalling arrangements or any other matter arising from this letter."

VII THE DECISION

52. On 3 April 2007, in a letter to CGL, the OFT concluded that Southern did not meet the conditions set out in paragraph 3.1(a) of the Undertakings for obtaining the required approval since Southern is not "independent of and unconnected to CGL". The letter is in the following terms:

> "I refer to your letter of 26 March 2007 and to your request for approval of Southern Cooperatives Limited (Southern) as a proposed purchaser of the Divestment Funeral Businesses pursuant to the undertakings in lieu of reference accepted on 29 November 2006 (the Undertakings).
>
> The OFT remains of the view that, as Mr Bennett is both the Chief Executive of Southern and a CGL Director, Southern is not "independent of and unconnected to CGL" pursuant to paragraph 3.1(a) of the Undertakings.
>
> We note your reference to "a now hypothetical fix-it-first remedy" and to our telephone conference of 2 March 2007. The OFT does not engage in discussions regarding hypothetical remedy scenarios. However, where such comments refer to the proposed merger between CGL and United Cooperatives, the OFT will only engage in discussions regarding fix-it-first remedies where the proposals in question have been sufficiently particularised. As was made clear during our discussion, the OFT will consider any future case on its facts and merits – to do otherwise would mean fettering its discretion. However, on the facts of this case, we consider Southern to be connected to CGL as a result of its seat on the Board of CGL.
>
> The purpose of paragraph 3.1 of the Undertakings is to ensure that, pursuant to section 73(2) of the Enterprise Act 2002, the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, as identified in the OFT's decision published on 26 July 2006 (the Decision), are remedied, mitigated or prevented by divestment to a suitable purchaser.
>
> The concern which we referred to during our discussion of 2 March was that Southern's seat on CGL's Board would provide a conduit for the flow of information between CGL and Southern, such that CGL might be able to coordinate its conduct with that of the Divestment Funeral Businesses in relation to matters such as pricing and other strategic issues. Indeed, your client, Mr Philip Hardman of CGL acknowledged during our telephone conference that "most competitors would

> relish" the information Mr Bennett would have access to as a result of his seat on the Board of CGL. Moreover, an unsolicited complaint has already raised concerns regarding approval of Southern as a proposed purchaser given the connections at issue.
>
> You have indicated that resignation by Mr Bennett from the Board of CGL "would not be countenanced either by CGL or by Mr Bennett", which you consider to be disproportionate. We note your proposal in the alternative that fire-walling arrangements be established between Mr Bennett and CGL concerning CGL's funerals business, which are not of interim (or finite) duration. In these circumstances, the OFT does not consider that this proposal is clear-cut and capable of ready implementation because it raises long-term enforceability concerns associated with non-structural undertakings. On this basis, we are not able to accept this proposal.
>
> Consequently, the OFT does not consider that the competition concerns identified in the Decision will be adequately addressed in line with the Undertakings by divestment to Southern whilst Mr Bennett remains a member of the Board of CGL. Pursuant to the Undertakings Southern is clearly connected to CGL as a result of this directorship. The OFT is therefore unable to grant approval to Southern as a potential purchaser of the Divestment Funeral Businesses."

VIII CGL'S EVIDENCE

53. CGL's evidence is contained in a witness statement by Alan Philip Hardman, who is Head of Legal Services of CGL.

54. The OFT did not object to CGL adducing this evidence. We summarise this evidence below.

The co-operative movement

55. The co-operative movement dates back to the early nineteenth century and comprises a number of separate, independent co-operative societies which share the common goal of serving their members.

56. The purpose of the co-operative movement is to make profits from the participation and efforts of their members (i.e. industrial) and to apply the profits in making provision for their members' future (i.e. provident). Acting for

the mutual benefit of members was encouraged and facilitated by various Industrial and Provident Societies Acts, including in particular the Industrial and Provident Societies Act 1965 ("the 1965 Act").

Co-operatives in the UK

57. A consumer co-operative is a "business owned democratically by the people who acquire its products and services and who choose to become members of it". There are about 30 consumer co-operative societies in the UK.

58. Co-operative societies (including CGL and Southern) are registered as "bona fide co-operative societies" under the 1965 Act. They are not companies registered under the Companies Acts and, in significant respects, are different from a company.

Management of co-operatives

59. Each co-operative is an autonomous entity, responsible for determining its own policy. In general, co-operatives are subject to simpler procedures and less formal regulation than registered companies.

60. Co-operatives typically have a somewhat different management structure from companies and in the case of CGL in particular a clear distinction is drawn between:

(a) executive responsibility for the day-to-day management of a co-operative businesses; and

(b) non-executive supervision of a cooperative, which ensures that it is run in accordance with its rules and the best interests of its members.

CGL's trading activities

61. CGL was founded by co-operative retailers in 1863 in order to produce and manufacture goods exclusively for the consumer co-operative movement.

62. CGL today is engaged in both retailing and wholesaling and, in its capacity as a wholesaler, has a number of commercial relationships with other co-operatives, including Southern.

63. CGL has a broad portfolio of activities which generate annual revenues in excess of £7 billion. It is primarily active in a number of sectors including groceries, pharmacy, banking, travel agency, insurance and, through its "Funeralcare" business, funeral service provision.

64. In 2006 Funeralcare operated 629 funeral businesses across the UK and conducted 74,463 funerals.

CGL's Membership Structure

65. Ownership of CGL is in the hands of its membership. CGL has approximately 3.9 million individual members and 140 corporate members: each of whom has agreed to become members and to buy goods or services from CGL.

66. Both individual and corporate members are entitled to cast one vote at general meetings. In the event of a ballot, votes are weighted in proportion to the value of purchases made by CGL members. Individual and corporate members are also entitled to elect directors to the Board.

CGL's Management Structure

67. As a result of their ownership structure, co-operatives often adopt a different management structure to that of a company. CGL is managed at several levels by a Board of Directors, an Executive Committee and a series of business-specific management boards.

68. The Board of Directors is responsible for ensuring that CGL's affairs are being conducted within its rules and in the best interests of its members. It also determines CGL's vision and strategy (in consultation with the Executive Committee) and oversees the Chief Executive and the Executive Committee. The Board is not involved in the day-to-day running of CGL's business,

although it approves some business plans formulated and presented by CGL's management. The CGL Board consists of 28 non-executive directors; 17 of whom are elected by individual members and 11 of whom are elected by corporate members. Directors sit on the Board for a term of three years, although they are entitled to seek re-election.

69. The Executive Committee has responsibility for the formulation of commercial strategy (such as CGL's plans for business expansion), executive approval of business plans and other related matters. According to CGL, the functions of the Executive Committee correspond closely to the Board of Directors of a public limited company. The members of the Executive Committee have responsibility for the day-to-day management of CGL's businesses; these executive officers liaise with the senior managers of each business in order to formulate business plans and strategies, which are then presented to the Executive Committee for approval. The Deputy Chief Executive is responsible for CGL's Funeralcare business.

70. The next level of the management structure comprises the business-specific management boards. The management boards are responsible, within their respective spheres of business, for making day-to-day management decisions. The Funeralcare management board is therefore responsible for CGL's Funeralcare business.

CGL's relationship with Southern

71. Like CGL, Southern is a "bona fide co-operative society" registered under the 1965 Act. According to Mr Hardman, Southern and CGL are separate and distinct entities, each independently owned and managed.

72. Southern's core businesses are convenience food stores and funeral services, with a property portfolio of both trade and investment properties. Southern currently conducts 2,800 funerals each years and that business generates an annual turnover of £6.6 million. There is a supply arrangement between

Southern and CGL, whereby Southern purchases coffins at arms-length from CGL.

73. The Chief Executive of Southern is Mr Graham Bennett who has held this post since 1983. As with CGL, Southern's Board is a supervisory body consisting of non-executive directors; Mr Bennett does not sit on Southern's Board.

74. Southern is a corporate member of CGL, but CGL is not a member of Southern. Southern has less than 2% of the total votes within CGL (based on its purchases from CGL). Southern is entitled to nominate and vote for an eligible individual to stand for election to CGL's Board of Directors.

75. Southern nominated Mr Bennett for election to CGL's Board; he has been elected as a non-executive Director of CGL since 1984. Mr Bennett also holds non-executive directorships in three of CGL's subsidiaries: Co-operative Financial Services Limited, Co-operative Insurance Society Limited and the Co-operative Bank plc, of which he is also the Chairman.

76. As a result of the commercial arrangements it has with some its members CGL has established certain rules to prevent conflicts of interest. Those conflict of interest rules prevent directors who have a material interest (direct or indirect) from voting on a matter which is under consideration by the Board.

IX OFT'S EVIDENCE

Admissibility

77. The OFT relied on the witness statement of Mr Pritchard in support of the OFT's Defence in the application for review by CGL against the Decision.

78. The Tribunal notes that CGL did not object to the admissibility of Mr Pritchard's witness statement. Instead, CGL put forward arguments in its skeleton which sought to reply to those advanced in the Defence and Mr Pritchard's witness statement. The OFT contests the admissibility of those arguments; we address this issue in paragraphs 95 to 98 below.

79. We have taken Mr Pritchard's witness statement into account for the purposes of elucidation of the Decision.

The evidence of Mr Pritchard

80. Mr Pritchard has been the Director of Mergers at the OFT since October 2005.

81. During the consideration of CGL's request for approval of Southern as a purchaser of 13 funeral businesses formerly owned by Fairways, Mr Pritchard was kept abreast of all key prior developments in the OFT's handling of the matter by the case team and was the final decision maker in respect of the Decision. Mr Pritchard had direct personal involvement at all decisive stages.

82. Mr Pritchard's witness statement first summarises the OFT's general approach in relation to first-phase remedies. Referring to the statutory provisions, the OFT's *Mergers – substantive assessment guidance* and the Explanatory Notes to the Act, Mr Pritchard states:

> "*The need for the OFT to be confident*
>
> 20. The Explanatory Notes to the EA02 and the Guidance make it clear that the OFT should accept undertakings in lieu only where it is "confident" that they resolve the competition concerns. This commentary reflects the fact that by this stage the OFT will have found a SLC in the UK that the UK competition authorities are under a duty to remedy as comprehensively as is reasonable and practicable. Before undertakings in lieu are accepted, there is the possibility of a reference to the CC which would be able to consider the competitive effects of the merger and any possible remedies in some detail. However, once undertakings in lieu are accepted, there is no going back, as section 74(1) EA02 precludes a reference after that point.
>
> 21. Undertakings in lieu therefore become the definitive solution to any SLC. Section 74(1) EA02 precludes a reference to the CC even where undertakings are breached. In that situation, the OFT must rely on its order-making power under section 75 EA02 and, if necessary, invoke civil proceedings under section 94 EA02 to enforce the undertakings and/or the order. Moreover, third parties have the right to bring an action for breach of statutory duty against a party to an undertaking who does not comply with it, where the third party has suffered loss or damage. It is in part for this reason that it is important

that the terms of undertakings in lieu are clear and straightforward to assist with their enforceability.

The need for the OFT to be confident without the need for further investigation

22. Not only does the Guidance make clear that the OFT must be confident that undertakings would be an effective remedy, but they also make clear that the OFT must be confident of their effectiveness "without the need for further investigation" (SRP1 tab 17 page 200). This important additional requirement reflects the two-phase merger process in the UK, which also exists in other jurisdictions.

23. For problematic cases under the UK merger regime, the OFT generally plays the role of a first screen, whereas the CC decides the matter (*OFT v IBA* [2004] EWCA Civ 142, 53). However, in an accepted undertakings in lieu case, it is the OFT that decides the matter. As the Explanatory Notes to the EA02 make clear, the point of undertakings in lieu is to enable the OFT to reach a decisive outcome, by remedying the adverse competitive effects of the merger, where it can be confident that can be done "without recourse to a potentially time-consuming and costly investigation" of the sort carried out by the CC (SRP1 tab 16 page 151). Were the OFT to have to carry out a very detailed investigation before it could be confident that proposed undertakings would be an effective remedy, that would undermine the purpose of undertakings in lieu and trespass onto territory of the CC as second-phase investigator."

83. Mr Pritchard's explanation for applying a "clear cut" standard also included the following:

"*Other reasons in favour of a clear cut standard*

27. The vulnerability of remedies to failure is recognised in a number of ex post studies into the effectiveness of remedies. Structural remedies, and in particular divestiture packages, are universally regarded by leading competition authorities as generally the least risky and problematic of the spectrum of possible merger remedies, and are therefore generally preferred by the OFT, the CC, DG Comp and the U.S. agencies. Yet all these studies highlight the risks associated even with divestiture remedies and, in the case of the FTC and DG Comp studies, present sobering failure rates where divestiture remedies ultimately proved ineffective in fully restoring competition.

28. Accordingly, the OFT seeks to ensure that undertakings in lieu do not feature loopholes allowing circumvention of the objective of the undertakings – namely, to restore competition."

84. Mr Pritchard further explains that, in assessing compliance with the Undertakings, the OFT has as its policy objective the restoration of competition lost by the merger:

> "*Remedying a merger by restoring lost competition*
>
> 29. In applying the clear cut standard, the OFT's starting point and preferred remedy is always to seek an outcome that restores competition to pre-merger levels, thereby comprehensively remedying the SLC. The objective is to ensure that competition following the remedy is as effective as pre-merger competition.
>
> 30. Accordingly, the Original Decision, the Undertakings and my 5 September 2006 letter (on 3 occasions) refer to the goal that merger remedies should restore competition lost by the merger. For example, in my 5 September letter I discussed the need to determine "whether the UIL package is suitable to restore competition lost by the merger"."

85. Mr Pritchard then sets out the rationale for requiring a purchaser to be independent of and unconnected to the seller as follows:

> "**Links between merging parties and purchasers of divested assets**
>
> 31. Divestment undertakings typically include a number of requirements to ensure that competition is restored. One of these requirements is that the purchaser must be independent of and unconnected to the seller, i.e. the merged company.
>
> 32. This provision is required to ensure that, as far as possible, the purchaser will actively compete against and thereby replace competitive pressure faced by the seller pre-merger. The concern is that links between the two companies might create a risk of them competing less intensely than they otherwise would, for example by providing them with the means and/or incentive to coordinate their behaviour. If links result in them competing less intensely, it is unlikely that the competition lost as a result of the merger would be effectively restored, i.e. it is unlikely that post-divestment competition would be as effective as pre-merger competition. Consequently, if there is a link between the seller and a proposed purchaser, the OFT will then consider the nature of the link and assess objectively whether that link might potentially risk the viability and effectiveness of the remedy.
>
> 33. The OFT regards the 'independent of and unconnected to' requirement as an inherent requirement in any satisfactory divestment undertaking and it is a standard requirement not only of the OFT at first-phase but also of the CC at second-phase and of other competition authorities."

86. Mr Pritchard refers to the competition concerns which may be posed by individuals holding senior management positions in competing companies:

> "**Competition concerns posed by individuals holding senior management positions in competing companies**
>
> 34. Competition policy has for a long time had concerns about individuals holding senior management positions in competing companies.
>
> 35. Such links are capable of creating the means and/or the incentive for companies to reach anti-competitive agreements or to co-ordinate their behaviour – a possibility which it is not appropriate for the OFT to investigate in detail at the first-phase stage when considering whether to accept undertakings in lieu. The existence of fiduciary duties owed by senior management to their companies does not eliminate this risk – in many instances it may be in the best financial interests of the companies concerned to act in this way.
>
> …
>
> 37. Even if deliberate agreements or co-ordination does not take place, it can be difficult for the managers concerned to make decisions in relation to one company without taking into account the interests of or commercially confidential information about the other company that they have learnt as a result of their dual role."

87. Mr Pritchard describes the OFT's policy towards behavioural remedies as follows:

> "**Behavioural remedies**
>
> 40. The OFT, like many other competition authorities, has an explicit policy preference in its guidelines in favour of structural remedies. See paragraphs 8.6 to 8.9 of the Guidance.
>
> 41. Behavioural remedies are capable of raising a number of different concerns. They often seek to replace pre-merger competition with post-merger regulation, and therefore do not restore competition itself – they treat the symptoms rather than the disease. Some behavioural remedies risk increasing transparency and make it easier for competitors to collude. They can distort investment decisions and ossify business processes.
>
> 42. Behavioural remedies are also capable of raising significant monitoring and enforcement concerns. It is difficult to design them so as to ensure that there are no loopholes, and, even if that is achieved, circumvention can go undetected. Monitoring the remedy can impose significant costs on the private parties as well as regulatory body concerned.

43. Nonetheless, notwithstanding its preference for structural remedies, consistent with the Guidance the OFT does not inevitably refuse behavioural remedy offers, particularly in non-horizontal cases, or in cases that are specific or unusual. Such unusual circumstances existed in the most recent OFT case suspending to the duty to refer in relation to behavioural undertakings, which was in the Virgin/Stagecoach bid for the Intercity East Coast passenger rail franchise in December 2004. In its decision the OFT noted in particular: (i) the short duration of the competitive harm, as overlapping franchises would soon be re-tendered, and therefore of the remedy; (ii) the regulated nature of the passenger rail market with respect to many rail fares and service quality aspects and (iii) the close scrutiny of a sectoral regulator, all of which substantially mitigated standard concerns about circumvention, monitoring and enforcement.

88. Mr Pritchard summarises the OFT's general approach in relation to firewall remedies as follows:

"**Firewall remedies**

44. Firewall arrangements can constitute an effective merger remedy in appropriate cases. However, they are capable of raising several of the concerns that apply to behavioural remedies more generally.

(a) There can be practical difficulties in devising a set of provisions that will ensure that all pertinent information will not be disseminated such that there will be an effective and enforceable remedy.

(b) The risk of undetected (inadvertent and deliberate) breach in practice is material, even with the best-crafted undertaking on paper.

(c) If the firewall is breached and competitively-sensitive information is disclosed, that information is then 'out of the bag' and there can be no means of restoring the position to what it was before the breach so the value of enforcement action is not remedial and restorative to competitive harm done but merely creates some future deterrent effect to disincentivise further breach.

(d) To mitigate the risk of undetected breach, firewall arrangements require rigorous and detailed ongoing monitoring and enforcement which require considerable time and effort (and cost) not only of the parties but also of the limited resources of the OFT.

45. The Guidance does not discuss specific behavioural remedies such as firewalls. The OFT's views are influenced by and, therefore, in line with comments included in the longer

and more detailed DoJ Guide to Merger Remedies 2004 which states as follows in relation to firewall remedies (pages 22-23):

> "The problems with firewalls are those of every regulatory [i.e. behavioural remedy] provision. The first concern is the considerable time and effort the Division and courts have to expend in monitoring and enforcing such provisions. The second problem is devising a provision that will ensure that pertinent information will not be disseminated in any event …
>
> For these reasons, the use of firewalls in Division decrees is the exception and not the rule. They are infrequently used in horizontal mergers because, no matter how carefully crafted, the risks that the merging firms will act collaboratively in spite of the firewall are great. However, they have occasionally been used in some defense industry mergers and in vertical and other non-horizontal mergers where both the loss of efficiencies from blocking the merger outright and the harm to competition from allowing the transaction to go unchallenged are high".

46. The OFT would not rule out accepting a firewall remedy, even in a horizontal case, but it would give careful consideration to the extent to which on the facts the general problems with firewalls or any other specific problems applied.

47. An important element in assessing the risks and costs posed by such remedies is the likely duration that the remedy would need to stay in force, because these risks and burdens are cumulative over time. Specifically, the longer the firewall is in place:

(a) the greater the risk that sooner or later it will inadvertently be breached or deliberately circumvented, and do so undetected by the OFT;

(b) the greater the aggregated monitoring and compliance costs in any event; and

(c) the greater the chance, assuming a detected breach, of the need to conduct costly enforcement action.

Accordingly, a remedy for which one could be confident that the period would be sufficiently short and finite might, in some circumstances, present tolerable risks and costs where one of long-term or even indefinite duration might not."

X THE TRIBUNAL'S JURISDICTION

89. The Tribunal's jurisdiction is contained in section 120 of the Act:

> "(1) Any person aggrieved by a decision of the OFT … under this Part in connection with a reference or possible reference in relation to a relevant merger situation or a special merger situation may apply to the Competition Appeal Tribunal for a review of that decision.
>
> …
>
> (4) In determining such an application the Competition Appeal Tribunal shall apply the same principles as would be applied by a court on an application for judicial review.
>
> (5) The Competition Appeal Tribunal may –
>
> > (a) dismiss the application or quash the whole or part of the decision to which it relates; and
> >
> > (b) where it quashes the whole or part of that decision, refer the matter back to the original decision maker with a direction to reconsider and make a new decision in accordance with the ruling of the Competition Appeal Tribunal."

90. It is common ground that CGL is a "person aggrieved" and that the Tribunal has jurisdiction for the purposes of section 120(1) of the Act.

91. In judicial review proceedings the Tribunal reviews an administrative decision: see section 120(4). It considers whether the OFT has directed itself properly in law; whether the OFT has called its attention to the matters it is bound to consider; whether the OFT has excluded from its consideration matters which are irrelevant to that which it has to consider and whether the decision to which it has come is one which is reasonable in this sense: that it is, or can be, supported with good reasons and is a decision which a reasonable authority might reasonably reach: see *Somerfield v Competition Commission* [2006] CAT 4, paragraphs 55-57 and the case-law there cited.

92. It also follows from section 120(4) of the Act that it is not for the Tribunal to substitute its own assessment for that of the competition authority: see, for example, *Unichem Limited v Office of Fair Trading* [2005] CAT 8, paragraph 177 and *Stericycle International LLC v Competition Commission* [2006] CAT 21, paragraph 149.

93. In exercising its power of review, as explained further in paragraph 139 *et seq* below, the Tribunal must take into account the specific purpose of accepting undertakings in lieu of a reference to the CC. This purpose is to resolve the competition concerns identified by the OFT without recourse to a full investigation by the CC.

XI PRELIMINARY ISSUES

94. The parties' submissions require us to consider three preliminary issues. First, the extent to which an applicant may depart from or enlarge upon the notice of application. Second, the statutory scheme for accepting undertakings in lieu of a reference to the CC. Third, the effect of undertakings accepted by the OFT and the ways in which they may be enforced. We address these issues before coming to our review of the Decision.

Should the Tribunal disallow those parts of CGL's submissions which depart from or enlarge upon the notice of application?

95. In its skeleton argument, the OFT submits that CGL attempts to develop for the first time a number of new arguments. The OFT submits that CGL appears to focus not on the application of the Undertakings to Southern but rather the legality of the OFT's acceptance of the Undertakings offered by CGL itself. According to the OFT, it appears from CGL's skeleton that CGL has abandoned, or at least significantly changed, its case on the unlawfulness of the Decision, with the consequence that CGL's arguments should be held inadmissible.

96. Pursuant to Rule 8(4) of the Competition Appeal Tribunal Rules 2003 S.I. 2003 No. 1372 ("the Tribunal's Rules"), read in conjunction with Rule 28(1), an applicant is expected to develop all the grounds of review relied on, together with any supporting documents, in the notice of application, and not to add wholly new grounds of review in the course of the proceedings (see, also, *Somerfield*, cited above, paragraph 132 and *Floe Telecom Ltd v Office Of Communications* [2004] CAT 7, paragraph 52). It is important that this approach is adhered to as regards the notice of application, not least so that the respondent authority may properly plead, in its defence, to the grounds contained in that document.

97. A new ground of review may not be added without the Tribunal's permission (in accordance with Rule 11 of the Tribunal's Rules), but no objection can be made, particularly in a case which has to be dealt with in a relatively short timescale, if an applicant seeks to develop its submissions in support of its existing grounds of review, particularly, as the OFT itself accepts, when done in reply to the OFT's defence and supporting evidence.

98. We do not consider that CGL's arguments are inadmissible. Its submissions permissibly elaborate and develop its arguments on ground 1.

99. Finally, we note that CGL is not seeking to challenge the lawfulness of the Original Decision, the OFT's decision to accept the Undertakings nor the terms of those Undertakings. Such a challenge would, in any event, now be out of time.

The scheme of section 73 of the Act

100. In the present case, the OFT believed that it is or may be the case that CGL's acquisition of the disputed funeral businesses has resulted, or may be expected to result in a SLC within the meaning of section 22(1)(b) of the Act. No reference shall be made, however, where the OFT is considering whether to accept undertakings under section 73 instead of making such a reference: see section 22(3)(b). CGL offered and, following a process of consultation, the OFT accepted undertakings which required CGL to divest specified funeral businesses as a going concern to a purchaser or purchasers approved by the OFT in accordance with the terms of the undertakings.

101. The heading to Section 73 under Chapter 4 of Part 3 of the Act is "ENFORCEMENT *Powers exercisable before references under section 22 or 33*".

102. The scheme of section 73 of the Act may be summarised in the following terms:

    i. Section 73 of the Act applies where the OFT considers that it is under a duty to make a reference to the CC in the circumstances set out in sections 22 and 33: section 73(1).

ii. Instead of making a reference, under section 73(2), the OFT may accept undertakings "for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned" or any adverse effects resulting from it. It follows that the OFT has a discretion, as opposed to a duty, to accept undertakings in lieu of a reference to the CC.

iii. In those circumstances, the OFT may accept "from such of the parties concerned as it considers appropriate undertakings to take such action as it considers appropriate": see section 73(2).

iv. The phrase "as it considers appropriate" in section 73(2) confers a broad margin of assessment on the part of the OFT in determining whether or not to accept undertakings and, if accepted, their implementation.

v. In deciding whether to accept undertakings, the OFT must take into account all of the material factual considerations and in particular:

   a. must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it: section 73(3).

   b. may, in particular, have regard to the effect of any action taken pursuant to the undertakings on any relevant customer benefits in relation to the creation of the relevant merger situation: section 73(4).

vi. If the OFT is proposing to accept undertakings in lieu under section 73, the OFT must consult the persons controlling the enterprises concerned, giving the OFT's reasons for the proposed decision, so far as practicable: see section 104.

vii. An undertaking under section 73 shall come into force when accepted by the OFT: section 73(5)(a).

The effect and enforcement of undertakings in lieu

103. Section 74(1) of the Act provides that the OFT shall not make a reference to the CC if it has accepted undertakings under section 73. Section 74(1) "does not

prevent the making of a reference if material facts about relevant arrangements or transactions ... were not notified (whether in writing or otherwise) to the OFT or made public before any undertaking concerned was accepted": see section 74(2). Save for that exception, it is common ground that the OFT cannot refer a relevant merger situation to the CC once it has accepted undertakings under section 73. In the event that an undertaking accepted by the OFT has not been, is not being or will not be fulfilled, the OFT does not have the power to refer the merger for a full investigation by the CC. Its powers in that event are contained in section 75 and section 94.

104. The OFT must, as soon as reasonably practicable, consider any representations received by it in relation to varying an undertaking accepted under section 73 (section 73(7)). If the OFT is asked to modify an undertaking under section 73 which is material in any respect then, under the combined provisions of section 90 and Schedule 10, paragraphs 1 and 2(1), it must give notice of the proposed modifications and consider any representations received thereon. An undertaking accepted under section 73 may be varied by another undertaking: see section 73(5)(b). The Tribunal notes that CGL did not request a variation of the undertaking in this case.

105. Where an undertaking accepted by the OFT under section 73 has not been, is not being or will not be fulfilled, section 75 confers an order-making power upon the OFT. An order may be made for the purpose of remedying, mitigating or preventing the SLC or any resulting adverse effect: see section 75(2). An order under section 75(2) may contain any of the remedies set out in Schedule 8 to the Act; such remedies include divestiture under paragraph 13(1) of Schedule 8. An undertaking under section 73 ceases to be in force if an order under section 75 comes into force: section 73(6) of the Act.

106. The Tribunal notes that section 92(1)(a) of the Act requires the OFT to keep under review the carrying out of any "enforcement undertaking", which includes undertakings under section 73. Section 92(2) provides that the OFT shall from time to time consider whether an enforcement undertaking is being complied with. In the event that it is not being complied with, the OFT shall take such

action as it considers appropriate in relation to the enforcement of that undertaking: section 92(3)(e). Section 94(6) provides that compliance with an undertaking shall be enforceable by civil proceedings brought by the OFT for an injunction or for any other appropriate relief or remedy.

107. The Tribunal also notes that section 94(2) of the Act imposes on the person who gave the undertaking a duty to comply with it. That duty is owed to any person who may be affected by a breach of the undertaking: see section 94(3). Any breach of the duty which causes such a person to sustain loss or damage is actionable in civil proceedings: see section 94(4).

XII GROUND 1: THE OFT HAS ACTED OUTSIDE ITS POWERS BY REFUSING APPROVAL OF SOUTHERN AS A PURCHASER

CGL's submissions

108. By ground 1, CGL submits that the OFT has acted outside its powers by refusing approval of Southern as a purchaser of the Funeral Divestment Businesses.

109. CGL submits that the OFT's construction of paragraph 3.1(a) of the Undertakings is substantially wider than is necessary to remedy, mitigate or prevent the SLC identified by the OFT in the Original Decision. According to CGL, the OFT wrongly construed paragraph 3.1(a) of the Undertakings so as to require a greater degree of independence than would be required for the proposed purchase to remedy, mitigate or prevent the SLC identified in the Original Decision.

110. CGL submits that the requirements for giving approval in paragraph 3.1 of the Undertakings must be construed in a way which is consistent with the purpose of undertakings under section 73(2) i.e. in order to remedy, mitigate or prevent the SLC identified by the OFT.

111. CGL submits that the construction the OFT purported to adopt in the course of a telephone conversation on 2 March 2007, namely what a reasonable man in the street would consider constituted a connection, was erroneous. Such a

construction demonstrates, in CGL's view, that the OFT did not exercise its powers in accordance with the purpose for which they are granted.

112. Even if the "reasonable man" test was not the approach adopted by the OFT, CGL submits that the OFT adopted a construction of the Undertakings which required a greater degree of independence/non-connection than would be required so that the proposed purchase was not expected to result in a SLC.

113. CGL also maintains, however, that the Decision is flawed because the OFT required a greater degree of independence than that which would prevent the SLC identified by the Original Decision. As a result, claims CGL, the interpretation adopted by the OFT was not consistent with the purpose of the Undertakings, as set out in section 73(2) of the Act.

114. In its skeleton argument CGL further submits, in response to the OFT's defence, that the OFT applied the wrong legal test. CGL submits that the OFT has misunderstood the proper purpose of the Undertakings when it states that they should ensure that post-divestment competition restores pre-merger competition. According to CGL, "this is seductive but it is not the law". Instead CGL submits that the role of undertakings is not to restore anything: according to section 73(2) of the Act, undertakings must remedy, mitigate or prevent the SLC found to exist; no more, no less. According to CGL, whilst restoration of the *status quo ante* may satisfy the requirements of section 73(2), there will be many situations where, on analysis, something other than, or even less than, the restoration of pre-merger competition would satisfy the legal test.

OFT's submissions

115. The OFT submits that CGL's arguments are unfounded and must be rejected.

116. In response to the claim that the OFT misconstrued paragraph 3.1(a) of the Undertakings on the basis of what a reasonable man in the street would consider constituted a connection, the OFT submits, first of all, that this phrase was simply a reference to the plain meaning of the Undertakings. In accordance with

accepted statutory interpretation, referring to Bennion, *Statutory Interpretation*, 5th [*sic*] edition, p382, the OFT took as its starting point the plain meaning of the Undertakings. Applying the plain meaning, the OFT considered Southern to be connected to CGL as a result of Mr Bennett's dual role i.e. acting as Chief Executive of Southern and as a Director on the Board of CGL.

117. In addition to the plain meaning, the OFT considered the competition concerns which might arise from the various connections between Southern and CGL. The OFT considered that certain connections between Southern and CGL – such as Southern being a corporate member of CGL and purchasing coffins from CGL – were unproblematic. However, the OFT considered Mr Bennett's dual role to be problematic. The OFT was concerned in particular that, post-divestment, Southern's seat on CGL's Board would provide a conduit for the flow of information between CGL and Southern. Accordingly, in the OFT's view, Mr Bennett's dual role gave rise to the likelihood that post-divestment competition would be less intense than it otherwise would have been.

118. The OFT submits that the publicity and consultation requirements contained in Schedule 10 to the Act are a further reason to be cautious before accepting an interpretation of undertakings in lieu of a reference which diverges to a significant extent from their plain meaning. Schedule 10 requires that, before the OFT accepts undertakings, it should publish the proposed undertakings and consider any representations made in relation to them. An additional period of consultation is required if material modifications to the undertakings are proposed. In the OFT's view, this statutory consultation process would be undermined if it were subsequently to adopt an interpretation of undertakings which significantly diverged from their plain meaning. It would open the way to outcomes which may not have been obvious to consultees, and on which they would not therefore have had a proper opportunity to comment. In this case, had the proposed undertakings expressly stated, for example, that the OFT could approve a purchaser even though one of more of its senior management sat on the Board of CGL, that is a matter which third parties may legitimately have wished to comment on. As it happens, the Undertakings did not include such an

express qualification and, therefore, the statutory consultation took place on the basis of the Undertakings' plain meaning.

119. In response to CGL's submission that the OFT has applied the wrong legal test – i.e. to ensure that the divestment restores pre-merger competition – the OFT submits that it is not open to CGL now to make such a challenge to the Undertakings. Such a challenge is both out of time and outside the scope of the notice of application.

120. In any event, the OFT rejects CGL's contention that by seeking to restore competition it has adopted a much stricter standard than it was permitted to adopt under section 73. The OFT submits that the purpose of restoring competition is not stricter than the wording of sections 73(2) and 73(3) of the Act; it is actually demanded by those provisions. According to the OFT, the primary purpose of undertakings in lieu is to remedy the SLC as comprehensively as is reasonable and practicable.

121. The OFT submits that, in order comprehensively to remedy a SLC, it is not always necessary to restore the pre-merger factual *status quo*. Even where seeking to restore competition, one is seeking to restore the pre-merger level of competition, not necessarily the factual position which produced the level of competition. The divestment of part of an acquired business back to the original seller – which would in many situations come close to restoring the pre-merger factual position – might be one way of comprehensively remedying a SLC, but it is not necessarily the only way.

The Tribunal's Analysis

122. CGL's case is put on two bases: first, CGL relies on the true construction of the Undertakings which they submit the OFT interpreted without regard to section 73 and to the proper purpose of the Undertakings, namely to remedy, mitigate or prevent the SLC identified in the Original Decision. Second, CGL submits that the OFT's objective of restoring competition to pre-merger levels is not the only way to remedy, mitigate or prevent the SLC. According to CGL, the OFT should

have considered whether something other than (or even less than) the restoration of pre-merger competition would satisfy section 73(2) of the Act.

123. The question for the Tribunal to decide is whether the OFT's approach to the implementation of the Undertakings and in particular its powers to approve a purchaser was one the OFT had no power to make and/or was vitiated by an error of law, having regard to the correct construction of the Undertakings and section 73 of the Act.

124. This issue concerns the lawful implementation of the Undertakings accepted by the OFT under section 73 of the Act: that is separate and distinct from the antecedent issue of the OFT's powers when deciding whether to accept undertakings under section 73 of the Act.

125. Section 73 of the Act does not expressly deal with the OFT's powers when implementing the Undertakings and in particular its powers to approve a purchaser of a business which a merging party has offered to divest.

126. Section 73(2) provides that the OFT can accept undertakings "for the purpose of remedying, mitigating or preventing" the SLC or any resulting adverse effect. Section 73(2) also provides that the OFT may "take such action as it considers appropriate" for that purpose. In this case, the OFT considered that the remedial action which was appropriate to remedy the SLC identified in the Original Decision was the restoration of competition lost by the merger as it stated in paragraph 64 of the Original Decision (see paragraph 28 above).

127. The context in which undertakings in lieu of a reference are proposed by the parties and, in the exercise of its judgment, accepted by the OFT is explained by Mr Pritchard as follows:

> "23. For problematic cases under the UK merger regime, the OFT generally plays the role of a first screen, whereas the CC decides the matter (*OFT v IBA* [2004] EWCA Civ 142, 53). However, in an accepted undertakings in lieu case, it is the OFT that decides the matter. As the Explanatory Notes to the EA02 make clear, the point of undertakings in lieu is to enable the OFT to reach a decisive outcome, by remedying the adverse competitive effects of the merger, where it can be confident

> that can be done "without recourse to a potentially time-consuming and costly investigation" of the sort carried out by the CC. Were the OFT to have to carry out a very detailed investigation before it could be confident that proposed undertakings would be an effective remedy, that would undermine the purpose of undertakings in lieu and trespass onto territory of the CC as second-phase investigator."

128. Undertakings under section 73 are proposed and considered after a preliminary investigation, and are accepted in lieu of a full investigation. The OFT's role is as a first screen (see *Office of Fair Trading & Ors v IBA Health Ltd* [2004] EWCA Civ 142, paragraph 47). Its knowledge of the affected market or markets inevitably cannot be as detailed as that of the CC. Neither that role nor the general scheme of the Act lends itself to carrying out a complex and detailed investigation at the stage of implementing the undertakings accepted under section 73. It follows that we do not consider the OFT is required, at the implementation stage, to conduct a detailed investigation as to whether a structural connection between a divesting party and a proposed purchaser would deliberately or inadvertently result in them being less effective competitors. That issue requires a full investigation which only the CC could have undertaken. Once an undertaking has been accepted under section 73, no such investigation is possible. If the merging parties wish to engage in a more elaborate and complex remedy process, they can refuse to sign the undertakings in lieu and opt for a reference to the CC.

129. When deciding whether or not to accept undertakings in lieu, section 73(3) requires the OFT to have regard, in particular, "to the need to achieve as comprehensive a solution as is reasonable and practicable to the [SLC] and any adverse effects resulting from it".

130. The OFT's *Guidance* does not deal with the criteria for approving a proposed purchaser. However, paragraph 8.4 of the Guidance states that:

> "In cases in which there is doubt over the precise identification of the substantial lessening of competition or in which the effectiveness or proportionality of the proposed undertakings in lieu may be questioned, the OFT considers it unlikely that the 'clear cut' criteria mentioned above would be met. In these circumstances, acceptance of undertakings in lieu would not be appropriate."

131. Reference has been made by the parties to the Explanatory Notes to the Act. Paragraph 226 states that section 73 of the Act:

> "… allows the OFT to seek and accept undertakings from one or more parties to a merger in place of a reference. The purpose of accepting undertakings is to allow the OFT (where it is confident about the problem that needs to be addressed and the appropriate solution) to correct the competition problem the merger presents without recourse to a potentially time-consuming and costly investigation. This provision mirrors the existing power in section 75G FTA 1973 for the Secretary of State to accept undertakings-in-lieu, but with responsibility transferred to the OFT."

132. The Explanatory Notes are a permissible aid to statutory construction insofar as they shed light on the mischief which the Act is intended to remedy. For present purposes, we note that the Explanatory Notes make it clear that the purpose of accepting undertakings is to allow the OFT to correct the competition problem the merger presents without recourse to a potentially time-consuming and costly investigation. However, the Explanatory Notes cannot be used to aid construction of the true meaning of the sections of the Act.

133. In construing the Undertakings, the starting point should be the ordinary meaning of the words used (see Bennion, *Statutory Interpretation*, Fourth edition, section 151(1)). The Tribunal accepts the explanation given by Mr Pritchard that this was what the case team had in mind when they referred to "what a reasonable man in the street would consider a connection" on 2 March 2007. Mr Pritchard's witness statement explains that:

> "63. During the telephone conference on 2 March 2007, members of the OFT referred to the need to read the Undertakings "at face value" and to interpret them "on the basis of [how] the reasonable man on the street" would read them. Although I was not involved in that call, I understand from my colleagues who were involved that this language was simply their way of referring to the natural meaning of the Undertakings."

134. This approach is also consistent with the consultation process required by section 90 and Schedule 10 to the Act (set out in paragraph 18 above). As the OFT points out in its Defence, it would otherwise be difficult for third parties to

comment on proposed undertakings if they were to be construed in a way that is materially different from their ordinary meaning.

135. Furthermore, as noted in paragraph 107 above, the duty to comply with an undertaking under section 94(2) of Act is owed to any person who may be affected by a breach of the undertaking: see section 94(3). If an undertaking is not construed according to its ordinary meaning, it would place any person who may be affected by a breach in difficulty since the meaning of the undertaking may not be obvious and may become an issue between such person and the person who gave the undertaking.

136. Turning to the wording of the Undertakings, paragraph 3.1(a) clearly states that:

> "3.1 For the purposes of the OFT approving a proposed purchaser for any of the Divestment Funeral Businesses in accordance with these undertakings, CGL and/or any proposed purchaser shall satisfy the OFT that:
>
> (a) the proposed purchaser is independent of and unconnected to CGL and the Group of Interconnected Bodies Corporate to which CGL belongs and any Associated Person or Affiliate of CGL or such Group of Interconnected Bodies Corporate;"

137. The Tribunal does not regard the present case as raising any question of ambiguity, or of choosing between two possible interpretations. The ordinary meaning of the Undertakings accepted by the OFT and signed by CGL is clear: CGL must satisfy the OFT that Southern is independent of and unconnected to CGL. It is the OFT's case that it is not satisfied that Southern, the third party identified by CGL as a proposed purchaser, is independent and unconnected. Accordingly, the OFT submits that the divestment to Southern would fail to comply with the Undertakings.

138. Although the ordinary meaning is a legitimate starting point when applying the Undertakings, both parties agree that this cannot be all that is of concern. In oral argument, counsel for CGL submitted that "since the undertakings were entered into in the context of section 73, the concept of connection should be construed against the background of the Act rather than being construed in isolation".

Counsel for the OFT also accepted that, when assessing compliance with the Undertakings, there must be a "relevant connection" between the proposed purchaser and CGL i.e. a connection that raises competition concerns and which is unlikely to solve the problem which undertakings in lieu are designed to remedy.

139. We consider that consideration of the purpose of undertakings accepted by the OFT under section 73 is a legitimate part of the process of construction. We also consider, as explained further in paragraph 181 *et seq* below, that it was not unreasonable for the OFT to consider the Chief Executive of Southern sitting on CGL's Board to be a relevant connection.

140. This approach is elucidated by Mr Pritchard's witness statement where he explains that a purchaser is required to be independent of and unconnected to the seller in order:

> "32 … to ensure that, as far as possible, the purchaser will actively compete against and thereby replace competitive pressure faced by the seller pre-merger. The concern is that links between the two companies might create a risk of them competing less intensely than they otherwise would, for example by providing them with the means and/or incentive to coordinate their behaviour. If links result in them competing less intensely, it is unlikely that the competition lost as a result of the merger would be effectively restored, i.e. it is unlikely that post-divestment competition would be as effective as pre-merger competition. Consequently, if there is a link between the seller and a proposed purchaser, the OFT will then consider the nature of the link and assess objectively whether that link might potentially risk the viability and effectiveness of the remedy."

141. Contrary to CGL's submissions, we are satisfied that the OFT did not act outside its powers by refusing to approve Southern, having regard to the correct construction of the Undertakings and section 73 of the Act.

142. The Undertakings unequivocally require the proposed purchaser or purchasers to be "independent of and unconnected to CGL". The Undertakings do not say, as CGL now submits they should have said, that a proposed purchaser must be

sufficiently independent of and unconnected to CGL for a sale to Southern to remedy, mitigate or prevent the SLC identified in the Original Decision.

143. The Decision and the elucidation of it provided by Mr Pritchard make it clear that, when assessing compliance with the Undertakings, there must be a connection between the proposed purchaser and CGL that raises competition concerns. In the present case, it was Mr Bennett's dual management role that the OFT considered might give rise to material competition concerns. The Decision states:

> "The concern which we referred to during our discussion of 2 March was that Southern's seat on CGL's Board would provide a conduit for the flow of information between CGL and Southern, such that CGL might be able to coordinate its conduct with that of the Divestment Funeral Businesses in relation to matters such as pricing and other strategic issues."

144. We consider that the qualification suggested by CGL would be inconsistent with the clear wording of paragraph 3.1(a) of the Undertakings. In that regard, we note that CGL was given an opportunity to comment on the Undertakings and in fact did so on several occasions. However, at no point before signing the Undertakings in their present form, did CGL raise any query or objection to the clear wording of paragraph 3.1(a) of the Undertakings. In any event we consider that even if CGL's submission with regard to the word "sufficiently" were correct, that the inclusion of this word would not render the Decision to be outside the OFT's powers and accordingly unlawful.

145. We consider that, on the evidence before the OFT, Mr Bennett's dual role in Southern and CGL clearly entailed competition risks of the sort described by Mr Pritchard in paragraphs 34-37 of his witness statement. It follows from this that we consider that the OFT's conclusion that it was not satisfied that divestment to Southern would restore pre-merger competition nor remedy, mitigate or prevent the SLC identified in the Original Decision was a reasonable conclusion. If the Funeral Divestment Businesses were sold to an independent and unconnected purchaser, in accordance with paragraph 3.1(a) of the Undertakings, the divestment would satisfy both the wording of section 73(2) and the OFT's policy objective of restoring competition lost by the merger.

146. Mr Pritchard notes that the OFT *Guidance*, cited at paragraph 21 above, is intended to apply primarily to when the OFT is considering whether or not to accept undertakings, rather than to when the OFT is applying agreed undertakings to a specific proposed purchaser. However, he states that the OFT:

> "66 … took the view that the policy considerations set out in the Guidance were relevant also at the purchaser approval stage, in addition to the natural meaning of the Undertakings. Applying those policy considerations, it was only Mr Bennett's position on CGL's Board that prevented us from being confident that divestment to Southern would restore pre-merger competition and therefore led us to conclude that such a remedy would not be clear cut – the other links we concluded were unproblematic from a merger remedy perspective. As a result it was ultimately only the common directorship that we decided caused Southern not to satisfy the paragraph 3.1(a) requirement."

147. Applying those general concerns to the present case, Mr Pritchard explains that:

> "88 … The OFT could not be confident without further investigation that divestment to Southern would restore competition to its pre-merger level, and concluded that CGL's proposal of Southern as a purchaser did not provide a clear cut remedy."

148. In its skeleton and at the oral hearing, CGL contended that, by seeking to restore pre-merger levels of competition, the OFT applied the wrong legal test when implementing the Undertakings. In CGL's view, in accordance with the purpose and wording of section 73(2), the role of the Undertakings is to remedy, mitigate or prevent the SLC. CGL submits that the OFT should have looked at the state of competition on the market post-divestment to see if there would still be an SLC.

149. The objective of restoring competition to pre-merger levels was only the OFT's starting point in this case (see paragraph 29 of Mr Pritchard's witness statement). That is an important qualification in our view since it left open the possibility for a merging party to satisfy the OFT (without requiring the OFT to conduct a detailed investigation) that its proposed remedy clearly and comprehensively removes the SLC without restoring competition to pre-merger levels, thereby satisfying the requirements of section 73(2) of the Act. However, CGL did not so satisfy the OFT.

150. We consider that the remarks of the Tribunal at paragraph 99 of *Somerfield* apply equally to the approach of the OFT in the particular circumstances of this case and in particular that:

> "in our view, it is not unreasonable for the CC to consider, as a starting point, that "restoring the status quo ante" would normally involve reversing the completed acquisition unless the contrary were shown. After all, it is the acquisition that has given rise to the SLC, so to reverse the acquisition would seem to us to be a simple, direct and easily understandable approach to remedying the SLC in question."

151. Accordingly, we do not consider that it is unreasonable for the OFT, in the particular circumstances of the present case, to seek to ensure that competition is restored to pre-merger levels. We consider that to be a permissible approach by the OFT in the particular circumstances of the present case, given the broad margin of assessment bestowed upon it by sections 73(2) and 72(3) of the Act. Such an approach, depending on the circumstances, is a straightforward one to remedying the SLC in question, especially in cases which have only involved a preliminary investigation by the OFT.

152. For the reasons set out above we reject CGL's claim that the OFT erred in law.

Conclusion on Ground 1

153. We consider that, in implementing the Undertakings, the OFT's construction of the Undertakings was not erroneous in law and was one which was open to a reasonable decision maker to come to.

154. It was submitted by CGL that a "fix-it-first" remedy – i.e. a divestiture remedy in which completion of divestiture takes place before the merger in question – might have avoided the OFT's concerns in this case. However a fix-it-first remedy was not adopted by CGL. We do not consider that it can now be prayed in aid as a justification for setting aside the Decision which the OFT was reasonably entitled to take on the facts as they existed at the time of the Decision.

155. For all of the reasons set out above, ground 1 of the application is dismissed.

XIII GROUND 2: THE OFT ACTED UNREASONABLY IN FINDING THAT THE DIVESTMENT TO SOUTHERN WOULD NOT REMEDY, MITIGATE OR PREVENT THE SLC IDENTIFIED IN THE ORIGINAL DECISION

CGL's submissions

156. By ground 2, CGL submits that there is no evidential basis or analysis produced by the OFT which would reasonably have allowed it to come to the conclusion that a sale to Southern would not remedy, mitigate or prevent the SLC identified in the Original Decision.

157. According to CGL, the OFT failed to produce any evidence or perform any analysis which would allow it to conclude that Mr Bennett's position on the Board of CGL might allow CGL to coordinate its conduct with that of the Funeral Divestment Branches in the local markets when this would not otherwise be the case.

158. CGL submits that the Decision incorrectly refers to Mr Bennett's position on CGL's Board as being "Southern's seat". Although Mr Bennett was elected to CGL's Board by its corporate members, he was not elected as a representative of Southern to serve Southern's interests. CGL submits that there is no evidence to suggest that Mr Bennett has failed to discharge his duties scrupulously or in any way exploited his position of trust to advance Southern's interests by passing CGL's confidential information to Southern. This was accepted by counsel for the OFT at the oral hearing.

159. CGL criticises the OFT for failing to identify what specific information Mr Bennett might receive as a result of his position on CGL's board which would materially improve Southern's knowledge of CGL's behaviour in the relevant local markets and so allow it to coordinate with CGL.

160. CGL submits that there is no evidential basis to support the OFT's concern that information would pass from Southern to CGL. Equally, Mr Bennett is not acting as a representative of CGL in his capacity as Chief Executive of Southern so there

is no basis upon which he could pass information on Southern's behaviour in the relevant local market to CGL.

161. CGL submits that even if Mr Bennett could make use of information acquired by him in his capacity as Chief Executive of Southern in exercising his powers as director of CGL, this could not result in coordination in the relevant local markets. In so submitting CGL relies on the fact that Mr Bennett is not involved in the day-to-day management of the funeral businesses and is, in any event, bound by CGL's conflict of interest rules. Southern does not have any control or material influence over CGL.

162. CGL submits that there is no indication that the OFT carried out any analysis of whether tacit coordination would or could take place in the relevant local markets. CGL submits that had the OFT carried out such an analysis, it would have found that the characteristics which must be exhibited by a relevant market in order for tacit coordination to exist are not present; receipt of information by Mr Bennett could never result in tacit coordination that would otherwise not exist.

163. CGL submits that the OFT produced no evidence that there was a real possibility of deliberate collusive behaviour, contrary to the Chapter I prohibition contained in section 2 of the Competition Act 1998.

164. In its skeleton argument, CGL submits a typology of levels of merger analysis, comprising: "comprehensive analysis", "detailed analysis" and "overview". Comprehensive analysis refers to the type of analysis carried out by the CC and is not relevant in this case. Detailed analysis is the kind of detailed but not comprehensive analysis conducted by the OFT pursuant to section 22. It is also the kind of analysis which CGL considers the OFT is required and entitled to carry out at the stage of considering whether the Undertakings have been met. Overview, by contrast, is CGL's attempt to describe what the OFT regards itself as entitled to do when assessing compliance with the Undertakings i.e. a review of the general position but stops short of any actual investigation.

165. CGL submits that the Decision relies on a theory of harm – namely the prospect of some form of coordinated behaviour – without having taken any steps to determine if the minimum evidentiary support for the theory exists or to conduct an even minimal analysis of that theory in order to determine if it is viable or not.

OFT's submissions

166. The OFT submits that ground 2 is based on a misunderstanding that the OFT could decline to approve Southern as a purchaser only if it can show that divestment to Southern would result in a SLC.

167. When assessing whether Undertakings have been complied with, the OFT submits that CGL is wrong to argue that the OFT is required to carry out a detailed factual analysis as to whether a specific anti-competitive outcome would occur.

168. The OFT submits that the same policy considerations which apply to the acceptance of undertakings in lieu, as set out in the Explanatory Note and its Guidance, apply to their interpretation and application. Hence, the OFT will approve a purchaser where it can be confident that the remedy will address the competition concerns without the need for further investigation. The OFT could not be confident that this was true in this case.

169. The OFT submits that it is reasonable for the OFT generally to take the view that the involvement of the same person in senior management roles in competing companies creates a risk of the two companies competing less intensely than they otherwise would. It is impossible for a person to guarantee that information learnt in one capacity will not, even if only subconsciously, influence his or her views and actions when acting in a different capacity. In this regard, the OFT refers to paragraphs 139, 150 and 154 of the Tribunal's judgment in *Stericycle v Competition Commission* [2006] CAT 21. The OFT also notes that overlaps in senior management of competitors present a separate risk to competition by facilitating communications or exchange of information that could lead to tacit coordination or the entering into of an anti-competitive agreement. The existence of fiduciary duties does not reduce that risk.

170. The OFT submits that there was no reason to suppose that the present case was exceptional, such that those general concerns relating to dual senior management roles in competing companies did not apply: Mr Bennett was Southern's Chief Executive and a director on CGL's Board.

171. The OFT submits that two pieces of evidence support the conclusion it reached in the Decision. First, the OFT notes that a third party, Mr Chris Huhne MP, wrote to the Chief Executive of the OFT, expressing concern about the links between CGL and Southern. Second, the OFT relies on the fact that, during a telephone conference on 2 March 2007, one of CGL's representatives acknowledged that most competitors would relish the kind of information flowing from CGL to Southern.

172. The OFT submits that CGL's tripartite hierarchy between different levels of analysis is artificial and overly-rigid. The OFT is prepared to carry out a proportionate amount of analysis and investigation at the section 73 stage, as it did in this case, but considers CGL's suggested approach – that the OFT carry out a detailed analysis at the first phase remedies stage – is contrary to the statutory scheme, the Explanatory Notes and the OFT's policy as set out in its Guidance. To the extent that CGL is seeking to challenge the legality of the OFT's Guidance, the OFT invites the Tribunal to reject them without any detailed consideration.

173. The OFT submits that the structural link between CGL and Southern was a *de novo* issue that had not been relevant to the section 22 assessment, and analysing it would have required the OFT to carry out a further in-depth investigation. Even if the OFT had carried out this further detailed investigation, it is far from clear that the OFT would have been able to make itself confident that the *prima facie* concerns would not remain on the facts.

The Tribunal's Analysis

174. We consider that, in its submissions, CGL have conflated the powers of the OFT to accept undertakings (and the proper approach to be adopted in that regard) with

the question of whether the OFT are satisfied that the proposed undertakings which they have accepted have been or will be fulfilled. It seems to us that these are two separate questions and must not be confused. This application is only concerned with the second question i.e. whether the OFT were wrong in law when they determined that they were not satisfied that a divestment to Southern fulfilled the Undertakings, without fully investigating the evidence in relation to the relationship between CGL and Southern in particular having regard to Mr Bennett's role in both these organisations.

175. Section 73 does not specify the nature or extent of any investigation or evaluative process which must be carried out by the OFT either before it accepts undertakings or, as in this case, when assessing whether undertakings are being fulfilled.

176. Paragraph 2.1 of the Undertakings provides that:

> "2.1 CGL shall, using its best endeavours and acting in good faith, as soon as reasonably practicable, effect to the satisfaction of the OFT the divestment of each of the Divestment Funeral Businesses as a going concern by the end of the Divestment Period to a purchaser approved by the OFT in accordance with the provisions of these undertakings. …"

177. Furthermore, the opening words of paragraph 3.1 of the Undertakings provide:

> "3.1 For the purposes of the OFT approving a proposed purchaser for any of the Divestment Funeral Businesses in accordance with these undertakings, CGL and/or any proposed purchaser shall satisfy the OFT that: …"

178. Those words, in the Undertakings which CGL gave to the OFT, put the onus on CGL to satisfy the OFT that Southern is a suitable purchaser. Counsel for CGL correctly accepted at the hearing that "the burden is on us to do that" (Transcript, 20 June 2007, p 34, line 8). Of course, the OFT, for its part, must adequately examine the information provided to it, that is to say, it must consider whether it demonstrates that the Undertakings have been complied with or not. Indeed, in its submissions, the OFT accepted that it should carry out a proportionate amount of analysis and investigation at the section 73 stage. The OFT explained at the hearing that it did not simply say that "connection means any connection of any

kind and we are putting our fingers in our ears now" (Transcript, 20 June 2007, p 53, lines 9-11).

179. We consider that section 73 bestows an important power on the OFT (see *IBA Health Ltd v Office of Fair Trading* [2003] CAT 27, paragraph 205) with the consequence that the OFT should examine carefully and impartially the information provided to it. However, that is very different from carrying out a detailed investigation.

180. When the OFT is considering whether, in accordance with paragraph 3.1(a) of the Undertakings, it is satisfied that Southern is "independent of and unconnected to CGL", the OFT must exercise its powers reasonably and proportionately. We accept, however, that the OFT has a broad margin of assessment under section 73: see paragraph 102 iv above.

181. The question for us to decide is whether the Decision was erroneous in law or was one which it was reasonably open to a reasonable decision maker in the position of the OFT to have arrived at.

182. The fact that the OFT could have adopted a different decision does not, in itself, show that the alternative it did adopt was unreasonable.

183. Following CGL's request, on 19 January 2007, that the OFT should approve Southern as a purchaser, the OFT requested information and documents from CGL on 30 January 2007. There followed a telephone conference, held on 2 March 2007, which put forward the OFT's initial view, based on the evidence then available to it, "that it was reasonable to conclude that Southern was not independent of and unconnected to CGL pursuant to paragraph 3.1(a) of the undertakings" (see paragraph 50 above). CGL wrote to the OFT with a further proposal on 26 March 2007. That seems to us to be an eminently sensible approach for both parties to have taken.

184. In considering whether CGL's challenge is justified the starting point is the Decision itself, which states that:

> "The concern which we referred to during our discussion of 2 March was that Southern's seat on CGL's Board would provide a conduit for the flow of information between CGL and Southern, such that CGL might be able to coordinate its conduct with that of the Divestment Funeral Businesses in relation to matters such as pricing and other strategic issues. Indeed, your client, Mr Philip Hardman of CGL acknowledged during our telephone conference that "most competitors would relish" the information Mr Bennett would have access to as a result of his seat on the Board of CGL. Moreover, an unsolicited complaint has already raised concerns regarding approval of Southern as a proposed purchaser given the connections at issue."

185. The concern expressed in the Decision is elucidated by Mr Pritchard at paragraph 35 of his witness statement which makes clear that, in the OFT's view, CGL had adduced no evidence to suggest that the general concerns relating to an individual holding senior management roles in competing companies do not apply in this case.

186. The competition concern in the present case is that when an individual holds two or more senior management roles in competing firms, that role may compromise the purchaser's incentive to compete with the merging parties after divestiture. As Mr Pritchard points out in his witness statement, at paragraph 79, it may create the means and/or the incentive for companies to enter into anti-competitive arrangements and/or coordinate their behaviour, thereby creating a risk that competition would be less intense than it otherwise would have been. When firms have greater knowledge and more or less justified expectations about competitors than they normally would have, if totally independent of each other, there is always a risk in particular that competition will be less effective than it otherwise would have been.

187. Turning to the question whether the normal competition concerns arising from dual senior management roles apply in this case, the Decision states:

> "The concern which we referred to during our discussion of 2 March was that Southern's seat on CGL's Board would provide a conduit for the flow of information between CGL and Southern, such that CGL might be able to coordinate its conduct with that of the Divestment Funeral Businesses in relation to matters such as pricing and other strategic issues."

188. It is clear from CGL's submissions before the OFT and Mr Hardman's witness statement (see paragraph 71 of this judgment) that, but for the dual role of Mr Bennett, Southern and CGL are separate and distinct entities and would therefore be capable of effectively competing with one another. Indeed, at the oral hearing, counsel for CGL said:

> "…it is uncontested and it is obvious from the documentation – that even before the acquisition of the branches which were divested, Southern and CGL were in competition, albeit to a limited extent." (Transcript, 20 June 2007, p.4)

189. The ability and incentive of Southern and CGL to compete with one another may also be deduced from the OFT's view that the proposed divestment to Southern would satisfy the terms of paragraph 3.1(d) of the Undertakings.

190. We consider that such ability and incentive may be compromised by a structural connection between the parties, Mr Bennett's dual role being one example, which, paragraph 3.1(a) of the Undertakings was intended to prevent. Paragraph 10.1(b) of the Undertakings similarly addresses this concern post-divestment[4].

191. At paragraph 79 of his witness statement, Mr Pritchard explains that the OFT's general concerns about approving a divestiture remedy where the seller and proposed purchaser are competing companies and where an individual holds a senior management role with both applied in this case:

> "Specifically, the OFT was concerned that the connection at board level between CGL and Southern provided a conduit for the flow of information between CGL and Southern, and consequently for coordination between CGL and Southern."

192. One of the OFT's principal concerns, as expressed in the Decision, concerned the exchange of confidential information. In our view it is clear from the face of the Decision that this concern was wider than merely the disclosure of pricing information, as submitted by CGL. Indeed, the notice of application accepts that Mr Bennett would have access to information about matters such as business expansion, which would normally be regarded as confidential as between competitors.

[4] See: http://www.oft.gov.uk/shared_oft/mergers_ea02/undertakings/coopundertakings.

193. We note also that, at the oral hearing, counsel for CGL accepted that there is some force in the concern that a board at a supervisory level considering strategic issues will receive salient information. Given the well-known risks which exchanges of confidential information may pose for competition, we consider that these matters were properly taken into account by the OFT in coming to its decision.

194. In addition, we note paragraph 37 of Mr Pritchard which states that:

> "Even if deliberate agreements or co-ordination does not take place, it can be difficult for the managers concerned to make decisions in relation to one company without taking into account the interests of or commercially confidential information about the other company that they have learnt as a result of their dual role."

195. We consider that it was well within the OFT's margin of assessment for it to refuse to approve Southern as a purchaser of the Funeral Divestment Businesses. The OFT considered the evidence adduced by CGL and, for the reasons set out in the Decision, was not satisfied that Southern was independent of and unconnected to CGL. In the final paragraph of the Decision, the OFT observed that, as of 3 April 2007, Southern was "clearly connected to CGL as a result of [Mr Bennett's] directorship and drew the conclusion that "the competition concerns identified in the Decision" will not be adequately addressed "by divestment to Southern whilst Mr Bennett remains a member of the Board of CGL".

196. In an attempt to counter the OFT's concerns, CGL, in its submissions, claims that the OFT misapprehended both the nature of the consumer co-operative movement and Mr Bennett's dual role. CGL claims that there is no simplistic "read across" from the role of the board of directors in a body corporate and the role of a board within a co-operative. CGL submits, moreover, that Mr Bennett is not and would not be involved in the day-to-day management of Funeralcare, CGL's funeral business. A related point is that Mr Bennett does not and would not receive any information, in particular pricing information, which could give rise to competition concerns at the local level. Above all, CGL submits that Mr Bennett is one of twenty-eight non-executive directors sitting on a supervisory board.

197. We consider that the matters referred to in the preceding paragraph are ones which require a careful and detailed investigation. By giving the Undertakings, CGL accepted that no such investigation by the CC would take place; otherwise a reference would have meant that the CC could investigate these matters. In its skeleton argument, CGL accepted that, if the OFT is not obliged to carry out such detailed analysis for the purposes of enforcing the Undertakings, then the Decision was correct in this respect.

198. We accept CGL's submission that the Decision wrongly refers to Mr Bennett's position on CGL's Board as being "Southern's seat". On this issue we accept the evidence of Mr Hardman who stated in his witness statement that:

> "41. As a corporate member of CGL, Southern is entitled to nominate any qualifying individual to stand for election to CGL's Board. In such an election Southern will be entitled to vote as will the remainder of CGL's corporate members. Previously Southern nominated Mr Bennett, who was elected and sits on CGL's Board."

199. However we do not consider that this error by the OFT was material to the Decision. The Decision was founded upon the OFT's concerns about the dual senior management role held by Mr Bennett in both Southern and CGL.

Conclusion on Ground 2

200. In light of the foregoing, CGL's second ground of review also fails.

XIV GROUND 3: THE OFT WAS WRONG TO REJECT THE MORE PROPORTIONATE REMEDY BY CGL OF "FIREWALLING" INFORMATION FROM THE CHIEF EXECUTIVE OF SOUTHERN

CGL's submissions

201. By ground 3, CGL claims that the OFT was wrong to reject CGL's proposed remedy which was to excise all information relating to CGL's funerals business from the CGL board papers sent to Mr Bennett and for Mr Bennett to recuse himself from any discussions at CGL board meetings relating to CGL's funerals

business ("the firewall proposal"). CGL submits that the OFT's refusal to consider the firewall proposal is unreasonable and disproportionate.

202. CGL claims that the OFT did not properly consider the firewall proposal. CGL claims that it was not discussed with CGL. Instead CGL submit that its proposal was summarily dismissed on the basis that it was not clear-cut and capable of ready implementation because the arrangements were not of interim or finite duration.

203. Whilst CGL acknowledges that the OFT has a discretion in deciding which solutions would satisfy the Undertakings, it submits that the OFT appears to have approached the firewall proposal on the basis of assumptions about behavioural remedies rather than considering the particular circumstances of the matter.

204. With respect to compliance with the firewall proposal, CGL submits that, had the OFT considered the matter and informed itself of what was involved, having KPMG, a major firm of auditors, responsible for the monitoring and reporting of CGL's compliance would constitute ample reassurance to the OFT. CGL also submits that the OFT did not take into account the fact that Mr Bennett's term as a director expires in 2009. Whilst there is no guarantee that Mr Bennett may not stand for and be re-elected, CGL claims that the firewall remedy may in fact be of quite limited duration.

205. According to CGL, the firewall proposal is a practical, comprehensive and proportionate solution because, in the absence of any power vested in CGL to insist, in these circumstances, upon Mr Bennett's resignation from either the CGL board or from his position as Chief Executive of Southern, the alternative would be to sell such of the Funeral Divestment Businesses to another purchaser or purchasers approved by the OFT.

206. CGL also submits that the OFT is entitled and required, in considering the effectiveness of CGL's firewall proposal, to carry out the same kind of analysis

in the context of the Undertakings that the OFT does in order to determine whether it is under a duty to refer a merger to the CC.

OFT's submissions

207. The OFT submits that ground 3 must fail because the OFT did give proper and careful consideration to CGL's firewall proposal and the Decision was one that a reasonable decision maker could have reached.

208. The OFT refutes the suggestion that it simply dismissed the firewall proposal on the basis of assumptions relating to behavioural remedies. According to the OFT the Decision was based on a consideration of the nature of the firewall proposal. The OFT's consideration of that remedy took into account the OFT's policy in respect of behavioural remedies but was not limited only to that policy. The OFT also took into account the difficulties caused by firewall remedies generally (referring to paragraph 44 of Pritchard) and the extent to which they applied to the firewall proposal in this particular case.

209. The OFT was concerned in particular that the firewall proposal would have to continue for as long as Mr Bennett remained as Chief Executive of Southern and on CGL's Board. The proposal would not be of interim or finite duration and therefore raised long-term enforceability concerns. These concerns were material in the present case because the OFT regarded it as reasonable to assume that Mr Bennett's dual role, and therefore, the firewall proposal, would be of long-term duration.

210. In reaching its conclusions as to longevity, the OFT took into account the fact that Mr Bennett had been a director on CGL's board since 1984. He also holds important positions with three of CGL's subsidiaries and as Chairman of the Co-operative Bank plc. Neither Mr Bennett nor CGL gave a guarantee that he would not stand for re-election again. In the light of these considerations, it was reasonable for the OFT to conclude that there was a real risk that Mr Bennett would stand for re-election, potentially more than once, thereby prolonging the

duration of the firewall proposal and accentuating the OFT's concerns about its long-term enforceability.

211. The OFT submits that the proposed involvement of KPMG was insufficient in itself to confidently dismiss the foregoing concerns without the need for further investigation.

The Tribunal's Analysis

212. By letter of 26 March 2007 CGL made the firewall proposal.

213. The question before us is whether the Decision, in relation to the firewall proposal, was one which is reasonable in this sense: that it is, or can be, supported with good reasons or at any rate is a decision which a reasonable authority might reasonably reach.

214. We consider, in respect of evaluating the firewall proposal, that the OFT has a considerable margin of assessment under section 73; see paragraph 102 iv above. In its submissions, CGL did not suggest otherwise.

215. In the Decision the OFT set out the reasons why it considered the firewall proposal to be unacceptable:

> "We note your proposal in the alternative that fire-walling arrangements be established between Mr Bennett and CGL concerning CGL's funerals business, which are not of interim (or finite) duration. In these circumstances, the OFT does not consider that this proposal is clear-cut and capable of ready implementation because it raises long-term enforceability concerns associated with non-structural undertakings. On this basis, we are not able to accept this proposal."

216. We consider that the OFT did have regard to relevant considerations, and did evaluate the merits of the firewall proposal, giving reasons for its decision. The Decision clearly states that, in the OFT's view, the firewall proposal raised concerns typical of those relevant to behavioural commitments. Although the OFT's guidance does not specifically discuss firewall remedies, paragraph 44 of Mr Pritchard's witness statement elucidates the Decision and in particular the

concerns associated with the enforcement of firewall remedies. Those concerns include that:

> "(a) There can be practical difficulties in devising a set of provisions that will ensure that all pertinent information will not be disseminated such that there will be an effective and enforceable remedy.
>
> (b) The risk of undetected (inadvertent and deliberate) breach in practice is material, even with the best-crafted undertaking on paper.
>
> (c) If the firewall is breached and competitively-sensitive information is disclosed, that information is then 'out of the bag' and there can be no means of restoring the position to what it was before the breach so the value of enforcement action is not remedial and restorative to competitive harm done but merely creates some future deterrent effect to disincentivise further breach.
>
> (d) To mitigate the risk of undetected breach, firewall arrangements require rigorous and detailed ongoing monitoring and enforcement which require considerable time and effort (and cost) not only of the parties but also of the limited resources of the OFT."

217. Contrary to CGL's suggestion, we do not consider that the firewall proposal was rejected only for reasons of principle. We consider that the OFT having regard to the information before it considered it would be difficult to effectively monitor compliance with that remedy in this case, notwithstanding the proposed role of KPMG. Mr Pritchard makes clear that the OFT took into account its policy in respect of behavioural remedies, the difficulties caused by firewall remedies generally and the extent to which they applied to the firewall proposal in the present case. Most importantly as regards the latter consideration, Mr Pritchard explains that:

> "94. Although Mr Bennett's current term as a director expires in 2009, the OFT was aware that no guarantee would be given by CGL or Mr Bennett that Mr Bennett (or another senior officer of Southern) would not stand for re-election. The OFT also noted that Mr Bennett had been a director of CGL since 1984. In the light of these considerations, the OFT could not be confident that any firewall arrangements would be of a fixed or finite nature – indeed, it was possible that they could go on well past 2010."

218. It was because the firewall proposal would continue for as long as Mr Bennett remained as Chief Executive of Southern and CGL's Board that the remedy gave rise to the long-term enforceability concerns referred to in the Decision. Mr Hardman's evidence was that Mr Bennett has been a director on the CGL Board since 1984 and that he holds a number of important positions in the Co-operative organisation (see paragraph 75 above). Mr Hardman also stated that CGL directors must seek re-election every three years. That being so, Mr Bennett is due to either stand down from the CGL Board or seek re-election in 2009. As is elucidated in Pritchard:

> "95. … the OFT was concerned that adopting a firewall remedy in this case could raise significant long-term enforceability concerns. As noted above, the risks and burdens associated with firewall remedies tend to increase over time as a result of a cumulative effect: the longer the remedy goes on for, the greater the risk that it will be circumvented, and the greater the monitoring and enforcement costs. The OFT therefore considered that there was reason to question the clear cut nature of the firewall remedy. Consequently, and although the OFT had regard to the fact that the firewall arrangements were more acceptable to CGL, Southern and Mr Bennett than the OFT did not believe that it was appropriate to accept the firewall remedy in the light of the Guidance and its statutory duties."

219. CGL submits that the OFT should have evaluated the qualities and role of KPMG. We accept the OFT's submission that, in the absence of further investigation, the proposed involvement of KPMG was not sufficient for it to conclude that the firewall proposal would provide as comprehensive a solution as is reasonable and practicable to the SLC identified in the Original Decision. We do not consider that the OFT's conclusion casts any doubt on the qualities of KPMG. Rather the OFT, acting reasonably, was not prepared to run the risks described by Mr Pritchard which a firewall remedy of uncertain duration would entail.

220. CGL also submits that the OFT should have had regard to Mr Bennett's fiduciary duties. On this issue, we consider that the existence of fiduciary duties owed by directors and senior management does not eliminate the risks to competition posed by the involvement of the same person in senior management roles in

competing companies. For the same reason CGL's conflict of interest rules do not eliminate those risks.

221. For the reasons already indicated, in paragraphs 175 *et seq* above, we do not consider that the OFT was required to carry out a detailed investigation or analysis of the firewall proposal.

222. In these circumstances, we consider that it was well within the OFT's margin of assessment to reject the firewall proposal. It may well be that CGL disagrees with the Decision and its treatment of the firewall proposal, but that is not a sufficient basis for saying that the OFT acted so unreasonably that a reasonable authority could not have made the Decision. It is not the role of the Tribunal, in carrying out its judicial review function under section 120 of the Act, to second-guess the OFT's assessment of whether the firewall proposal is an appropriate solution that would satisfy the Undertakings.

Conclusion on Ground 3

223. In the light of the foregoing we can see no basis for suggesting that the OFT's conclusion as regards the firewall proposal was unreasonable on the evidence before it.

224. It follows that ground 3 also fails.

XV CONCLUSION

225. For the reasons set out in this judgment, the Tribunal dismisses the application.

Marion Simmons Michael Davey Richard Prosser OBE

Registrar 27 July 2007