MONCKTON CHAMBERS

Completing Notifiable Mergers without Notifying the OFT: a Risky Business?

By Ronit Kreisberger [1]

Stericycle International LLC, Stericycle International Limited and Sterile Technologies Group Limited v Competition Commission [2006] CAT 21; judgment of 19 September 2006

On 22 September 2006, the Competition Appeal Tribunal ("the CAT") handed down judgment in a challenge, brought under section 120 of the Enterprise Act 2002, by the parties to a completed merger, Stericycle International LLC, Stericycle International Limited (collectively "Stericycle") and Sterile Technologies Group Limited ("STG") against an order and subsequent directions of the Competition Commission ("the CC") in respect of the integration of the merged businesses pending the outcome of a CC investigation into the merger.

The CAT dismissed the applicants' challenge, finding that the CC's order and directions, which provided, inter alia, for the appointment of a Hold Separate Manager, was both reasonable and within its margin of appreciation.

Factual Background

Stericycle and STG are each engaged in the supply of clinical waste services. Post-merger, the parties have a 65 per cent share of the UK market for high temperature treatment of healthcare risk waste and a 55 per cent share of the UK market for alternative technologies treatment of healthcare risk waste.

Following an auction of STG, Stericycle acquired 100% of the issued share capital of STG. The merger completed on 27 February 2006, seven days after Stericycle secured exclusivity in respect of the acquisition.

Although the transaction triggered the thresholds for notifying mergers to the OFT[2], the parties chose not to notify the acquisition prior to completion.

Monckton Chambers
1 & 2 Raymond Buildings
Gray's Inn
London WC1R 5NR

Tel 020 7405 7211
Fax 020 7405 2084
DX LDE 257

chambers@monckton.com
www.monckton.com

---

[1] The views expressed are those of the author only.

[2] Section 23 of the Enterprise Act 2002 provides that a "relevant merger situation" has been created where two or more enterprises have ceased to be distinct and either:-

i) the UK turnover of the enterprise being acquired exceeds £70 million; or

Investigation by the OFT

The OFT wrote to Stericycle on 28 February 2006, the day after completion, with a request for information concerning the transaction and subsequently made a number of further information requests. It was not until 24 May 2006 that the OFT sent a set of draft undertakings to the parties which, in essence, precluded further integration. The parties initially objected to giving the undertakings on the basis that the degree of integration which had already taken place was so significant as to denude the proposed undertakings of any practical effect. In response, the OFT noted that, given that the undertakings only applied to *further* integration, in the event of complete integration "the undertakings will have no effect and no court will enforce them." The parties therefore agreed to give the undertakings but stated that they made no representations as to their substance given the level of integration which had already taken place.

Referral to the Competition Commission

The OFT accepted the signed undertakings on 19 June 2006 and subsequently, on 28 June 2006, decided to refer the merger to the CC on the basis that the merger had resulted, or may be expected to result, in a substantial lessening of competition in the UK.[3]

The CC adopted the OFT undertakings but then sought the parties' agreement to a further set of undertakings, the aim of which was to prevent "pre-emptive action" on the part of the merged businesses pending final determination of the reference. Agreement on the undertakings having proved impossible, the CC issued an order on 18 July 2006 setting out a number of general and specific obligations on the merged entities precluding further integration. This included an obligation (at paragraph 2(j) of the Order) in respect of the commercial and marketing, finance and accounting and environment, health and safety functions, either to preserve existing separate teams carrying on those functions or to liaise with the CC with a view to ensuring suitable arrangements were introduced to achieve separation. The CC also issued directions, on the same date, requiring the parties to appoint a Monitoring Trustee ("the MT"), to assess the degree of integration which had occurred and to monitor and ensure compliance with the Order.

On 19 July 2006, Stericycle and STG brought an action in the CAT for interim relief from the 18 July Order, in particular in respect of the paragraph 2(j) obligations, which the CC had indicated that it could not rule out implementing before any appeal was determined. This application was, however, stayed pending provision of the MT's report on the basis that the CC would, in the meantime, refrain from enforcing paragraph 2(j) of the Order until it was in a position to specify the precise steps it considered were necessary to create separate teams in the light of the MT's report.

Having considered the MT's report (by Grant Thornton), the CC issued directions on 25 August 2006 which provided, *inter alia*, for the appointment of a Hold Separate Manager ("HSM"). The HSM was to be appointed as CEO of STG, his primary function being the day to day management and control of the business and to ensure that it is held separate from the Stericycle business. The directions also precluded the flow of confidential information between Stericycle and STG unless "strictly necessary in the ordinary course of business."

The Appeal

On 31 August 2006, Stericycle and STG filed a supplementary notice of application challenging the appointment of the HSM and the restrictions on the flow of confidential information contained in the 25 August directions. On the same day, the CAT ordered the lifting of the stay previously imposed on the proceedings.

---

ii) at least one quarter of all the goods or services of any description are supplied by or to the same person.

[3] Section 22(1) of the Enterprise Act 2002 sets out the OFT's duty to make references in relation to completed mergers which arises where a relevant merger situation has been created which has or may be expected to result in a substantial lessening of competition within any market in the UK.

The application was brought under section 120 of the Enterprise Act 2002 which provides for the review by the CAT, on the basis of judicial review principles, of CC decisions made in connection with a reference or possible reference in relation to a relevant merger situation. STG and Stericycle argued that, if the imposition of the HSM was, as they contended, unlawful, the CC's directions should be quashed and the matter remitted to the CC.

CAT Judgment

Appointment of the HSM

In brief, the applicants argued that the appointment of a HSM was an unnecessary, unreasonable and disruptive step to take and that the CC had failed to provide sufficient reasons for its decision.

The test which the Tribunal applied in reviewing the CC's decision to appoint a HSM was whether that decision was within the range of decisions open to it as a reasonable decision maker. The Tribunal noted that the mere fact that the CC could have adopted a different decision would not, in itself, establish that the approach adopted was unreasonable. As to the duty to give reasons, the Tribunal rejected the notion that the CC was required to give detailed reasons for *not* adopting each of a range of possible alternatives put to it by the applicants. The issue was whether the decision which it actually decided to adopt was sufficiently reasoned.

The applicants argued that the decision to appoint a HSM was motivated by the CC's concerns relating to the areas of sales and marketing and operations and finance which did not justify the imposition of a HSM given that: (a) the same manager would, in any event, remain responsible for sales and marketing in both STG and Stericycle and there was an agreed protocol for the allocation of new business between the merged businesses during the inquiry; (b) there was limited scope for integrating operations functions over the period of the inquiry and any concerns could be addressed by commitments as to separate decision making regarding spending decisions; and (c) the finance functions remained separate in any event.

The CAT disagreed, finding, as a matter of fact, that the CC decided to impose the HSM in order to address its overall concern that the merged businesses were subject to one 'directing mind'. The CAT found that this was a legitimate concern and that the CC's view, that the longer the businesses were subject to a single directing mind, the harder would be their separation or ultimate divestiture, was a reasonable one, and a sufficient basis for its decision. The CAT also held that the imposition of a HSM was not disproportionate given the considerable steps which had already been taken to integrate the businesses. On that basis, the CAT found that the CC did have regard to relevant considerations and did weigh the options available to it, giving reasons for its decision. As to the applicants' arguments that a HSM would have no role to play, the CAT held that, in the absence of a HSM, STG would be without a "demonstrably independent CEO operating at arm's length from Stericycle". The CAT also took the view that it could not be assumed that matters, in respect of sales and marketing and operations and finance, which required a decision by the CEO to be taken in the interests of STG, would not arise during the course of the CC investigation. The CAT therefore concluded that the imposition of the HSM was indeed within the margin of discretion open to the CC.

Confidential Information

The applicants brought an alternative challenge to the restrictions in the CC's directions on the flow of confidential information. The CAT found that the CC's aim of minimising the future extent of the flow of confidential information between the two businesses was entirely legitimate, notwithstanding the extent to which certain confidential information had already passed. The CAT also took the view that the continued flow of such information might impede subsequent action to be taken by the CC, such as, divestiture. Finally, the CAT rejected the argument that the exception for the passing on of information where "strictly necessary in the ordinary course of business" rendered the provision unreasonable or unworkable.

Context of the Judgment

The CAT drew attention to the fact that over two months had elapsed since completion before the OFT raised the need for undertakings from the parties, which it regarded as "part of the problem" given that the applicants had, by that stage, embarked on a programme of integration.

The CAT was also clearly influenced by what it described as a lack of clarity in the undertakings given to the OFT resulting from the express exception for integration which had already occurred and which led to the applicants' effective disregard for them. In those circumstances, the CAT "well understood" the CC's concerns in respect of the degree of integration which had already taken place and the wide interpretation which the parties gave to the undertakings. The CAT was of the view that it should have been apparent to the applicants that a reference was "on the cards" given both the number of information requests made by the OFT and the parties' high combined market shares. The applicants therefore took a substantial risk by initiating a programme of integration post-completion.

The CAT endorsed the CC's Guidance in this regard which mentions a number of risk factors which may justify the imposition of an HSM including substantial integration of the merged businesses and the likelihood of further integration. The Tribunal therefore described the action taken by the applicants post-completion as amounting to "classic circumstances in which it is likely to be legitimate for the CC to appoint to a HSM."

Comments

The judgment highlights the risks which businesses take in respect of notifiable acquisitions which are not notified to the OFT prior to (or at the time of) completion.

Although the UK does not have a mandatory notification system for mergers which meet the relevant thresholds, the CAT has clearly taken the view that parties who both complete and proceed with integration, in the knowledge that there is a possibility of referral to the OFT, must bear the risks of their actions. In those circumstances, there appears to be little scope for arguing that action taken by the CC to ensure that the merged businesses operate separately, is unfairly disruptive to the merged entity. Additionally, it is notable that the CAT accepted the CC's view that the risks associated with the merged businesses being subject to a single directing mind were sufficient to justify the imposition of a HSM. The judgment thus signals the wide discretion enjoyed by the CC in imposing measures to guard against integration by the merged businesses post-completion.

However, the CAT was clearly influenced by the degree of integration which had taken place in this case between STG and Stericycle and the parties' approach to the OFT undertakings. Thus, it seems that the greater the degree of integration between the businesses, the more sympathetic the CAT will be to the need for intrusive interim measures on the part of the CC.

The costs of separating combined entities can of course be considerable. In the words of the early Tom Cruise film "there's a time for playing it safe, and a time for risky business." In the light of the enhanced powers of the CC under the Enterprise Act and their interpretation by the CAT, advisers may take the view that completing notifiable mergers in the UK without notifying the OFT, falls firmly into the latter category. This may well be one of those times for playing it safe.

Paul Lasok QC, George Peretz and Jorren Knibbe acted for Stericycle and STG and John Swift QC and Ben Rayment acted for the Competition Commission.

For more information on Ronit Kreisberger, please contact the Clerks on 020 7405 7211 or consult the 'Find a Barrister' Section on www.monckton.com.