

NZWSI PRELIMINARY OBSERVATIONS ON CWH PROPOSED DIVESTMENT UNDERTAKING

More time is needed to make considered submissions on this issue

- 1 WSI received CWH's proposed divestment undertaking on 3 May 2011, the day before the public conference was due to commence. It would not be fair, or consistent with the principles of natural justice, to expect parties to provide a response to the undertaking and address the commercial and legal issues that it raises a few days after it is received. The need for a reasonable time to assess the implications of a proposed undertaking is recognised in the Commerce Commission's *Merger and Acquisitions Guidelines* (2003), which emphasise the need for proposed undertakings to be provided at an early stage in the process.¹
- 2 WSI seeks an opportunity to make more detailed submissions on the proposed divestment undertaking, after having had an opportunity to consider it more closely and to obtain appropriate advice. In this note WSI provides some preliminary comments on the proposed undertaking, in order to assist the Commission during the conference process.

Section 69A does not contemplate this sort of undertaking

- 3 First, s 69A of the Commerce Act 1986 is not intended to deal with the situation where an entire acquisition is problematic in competition terms and where the whole of the assets acquired must be divested in order to avoid harm to competition. This undertaking does not appear to be within the intended scope of s 69A.

The undertaking does not prevent harm to competition

- 4 Second, it seems that if the acquisition proceeds but the conditions in the undertaking are not met, and CWH divests all the shares it holds in WSI (and any assets acquired from WSI), the following results would occur:
 - 4.1 there would be some harm to competition in the short-term, as a result of common ownership and control of CWH and WSI;
 - 4.2 there would be a substantial risk of significant harm to competition in the medium to long-term (see the discussion of asset risk and purchaser risk below); and
 - 4.3 the claimed benefits of CWH's acquisition would not occur.

¹ See also the ACCC *Formal Merger Review Process Guidelines* (2008) at [3.102].

- 5 So if the undertaking is triggered, the acquisition will have harmed competition and there will be no offsetting benefits – which means the acquisition should not have been authorised in the first place. The real risk of this scenario means the Commission cannot be satisfied, even with the undertaking in place, that the benefits from the acquisition outweigh the detriments.

The undertaking does not satisfy the usual criteria under the *Guidelines*

- 6 Third, CWH's divestment undertaking does not meet the usual criteria for acceptance of divestment undertakings under the Commission's *Mergers and Acquisitions: Divestment Remedies Guidelines* (2010). There is both significant asset risk and purchaser risk in this case.
- 7 The asset risk is significant because of the likelihood that if the acquisition proceeds WSI will lose customers and market share. WSI would also be likely to lose key personnel and associated capability. WSI would be permanently weakened as a competitor as a result of an acquisition by CWH followed by a divestment some three months after the acquisition becomes unconditional (and potentially a longer period from conditional contract to divestment, depending on the form of the contract and the conditions it contains).
- 8 There is also significant purchaser risk associated with the proposed divestment. There is no assurance that CWH will find an appropriate buyer for the shares within three months, especially as the acquisition would trigger an obligation under the Takeovers Code to make a full offer for the remaining shares.
- 9 The Commission usually requires divestments to occur before any merger proceeds, to ensure that asset risk and purchaser risk do not materialise, and that competition is not harmed in the very manner that the undertaking is designed to prevent. In this case, where the undertaking relates to the whole of the assets to be acquired, that is not feasible. Rather, the approach suggested by WSI remains that any authorisation should be conditional on CWH obtaining, before it proceeds with any acquisition, either 90% of the WSI shares or the necessary approvals for its proposed rationalisation.

Essential elements of any undertaking

- 10 If however the Commission were to consider proceeding on the basis of a divestment undertaking, the Commission should require the terms of the undertaking to ensure, so far as possible, that the status quo is maintained and the effectiveness of WSI as a competitor is not compromised. The terms of any undertaking should also ensure that sale of the CWH shares occurs promptly if the conditions of authorisation were not met. This would require as a minimum:

- 10.1 transfer of the shares to an independent trustee, not to CWH, pending satisfaction of the conditions. CWH would not be entitled to give any directions to the trustee in respect of the exercise of any voting or other rights attached to the shares;
 - 10.2 the trustee would be required to maintain the status quo, and not to exercise any voting rights or other powers attached to the shares, including but not limited to the power to appoint or remove directors;
 - 10.3 no assets of WSI would be acquired by CWH, pending satisfaction of the conditions;
 - 10.4 no commercially sensitive information about the business of WSI would be provided to CWH, pending satisfaction of the conditions;
 - 10.5 the terms of the trust on which the shares are held would authorise and require the trustee to sell the shares if the conditions are not met, without any involvement in the sale process on the part of CWH. If the conditions are not met within three months the trustees would be authorised to commence a sale process immediately, and to sell the shares for the best price obtainable within one month after that date.
- 11 A revised undertaking which ensures so far as possible that the status quo is maintained and the effectiveness of WSI as a competitor is not compromised, in the event that the conditions of authorisation are not met, should be submitted by CWH and provided to all interested parties for comment.