

Non-confidential version

Thermo / GVI

Thermo's further response to the CC, 16 May 2007

CC note: This response was made as a result of new evidence since the Provisional Findings which is reflected in the Final Report published on 30 May.

1. Introduction and Summary

1.1 This paper considers the material recently put to Thermo by the CC, in light of: (i) the expert evidence of Grant Thornton in relation to the insolvency procedure that forms the backdrop to the CC's counterfactual analysis; and (ii) the new evidence that came to light on 3 April 2007 concerning the actual entry by Nu Instruments into the Gas IRMS market.

1.2 In short, with regard to the counterfactual and the Grant Thornton report:

- The CC considers that a pre-packaged sale of GVI out of administration following an accelerated M&A process, or a rapid sale of GVI out of a funded administration, would be the most likely outcome of any counterfactual.
- But there is no evidence to support the view that funding would be available for the purpose. The source of funding identified by Grant Thornton for the purpose, namely cash flow, would not be available on the facts.
- Given the lengthy failed sale process conducted by the GVI directors, funding for such a strategy would be available from the Bank only if it had a very high level of certainty that an accelerated disposal would succeed.
- The failed process conducted by the GVI directors would also lead the Bank to look for independent evidence as to prospects of success.
- The Bank could not have considered that there were many possible purchasers. Even with the benefit of the present lengthy investigation, the CC has only identified a total of three potentially interested parties.
- The risk-averse nature of [X] and the relative obscurity of [X] mean that the Bank would be unlikely to view two of the three buyers of the business identified by the CC as credible participants in a pre-packaged or funded administration sale process.
- It is doubtful that a process reduced to just [X] would be likely to produce the value necessary to justify a funding decision on the part of the Bank.
- The evidence put to the CC by [X], and Grant Thornton's comments on the state of GVI's business, suggest that even if a process had been launched it is in any event

highly unlikely that [REDACTED] would have become sufficiently comfortable, within the aggressive timetable, to proceed with a purchase, notwithstanding the possibility of a “fire sale” price.

- If a pre-packaged sale or a funded administration were to fail to produce a purchaser [REDACTED].

1.3 With regard to the CC’s assessment of the impact of Nu’s entry into Gas IRMS:

- The acquisition of GVI by Thermo has not led to a reduction in the number of actual competitors on the market.
- New entry by Nu Instruments is a direct result of Thermo’s acquisition in the absence of which Nu would not have undertaken *de novo* entry.
- In all cases of horizontal mergers of which we are aware, identification of a substantial lessening of competition arises from a reduction in the number of independent competitors. That source of an SLC does not and cannot arise here and the CC’s case is consequently without precedent.
- In formulating a novel theory of harm, the CC faces a particularly high burden and standard of proof.
- The CC has failed to show why the actual new entry by Nu Instruments results in a substantial lessening of competition as compared to the counterfactual of entry by Nu Instruments with GVI assets (the IsoPrime). Rather, there is evidence to suggest that the merger may actually have increased competition.
- The evidence of Nu Instruments does not support a finding of a substantial lessening of competition. Nu have stated that they expect to achieve a share of [REDACTED] in Gas IRMS, i.e. higher than GVI’s highest historical share ([REDACTED]).
- The CC has ignored or misunderstood the impact on competition as Nu Instruments grows towards its target market share.
- The CC has further failed to provide any substantive evidence or robust analysis to support its conclusion that entry by Nu with the IsoPrime would be substantially quicker.
- The CC has not considered the ability of Nu Instruments to impose a greater and more timely constraint in the UK, given its existing UK manufacturing and distribution network. This is inconsistent with the CC’s statutory duty to consider the effect on any market or markets in the UK.

2. Commentary on the Grant Thornton Report

- 2.1 The CC, on the basis of the Grant Thornton report (the “GT Report”), concludes that through an accelerated disposal process referred to as distressed merger and acquisition (“distressed M & A”) the business would find a buyer, but only subject to the company first going into administration before the transaction completed.

- 2.2 Thermo agrees with Grant Thornton that the investigating accountants could have raised with the Bank the possibility of pursuing a pre-packaged administration or funded administration sale strategy. Thermo also agrees that this strategy “*would be dependent on the short term cash forecast of the business*” (GT Report, paragraph 3.8). Furthermore, Thermo believes that the conclusions reached by Grant Thornton, namely that the Bank would have “*no appetite to significantly increase its exposure*” and that the directors “*would be unwilling or unable to provide additional funding*” (GT Report, paragraphs 3.3 and 3.4), are the only conclusions available on the evidence.
- 2.3 Thermo cannot, however, agree that there would be “*sufficient cash flow to fund wages, salaries and some other essential payments in the short term*” (GT Report, paragraph 3.9) for the following reasons¹:
- (i) Grant Thornton correctly states that suppliers during a pre-packaged administration sale process would “*effectively be paid on a cash basis*”. The cash demands on the business would therefore be extremely high. If a funded administration had been used to market the business, cash demands would also have been extremely high as the administrators sought to keep the business together for sale.
 - (ii) Alongside increased cash demands, both the pre-packaged administration process and marketing out of a funded administration could be expected to lead to materially lower cash returns. In such circumstances, customer concern in continuing to deal with the business tends to manifest itself in a reluctance to pay outstanding debts (in particular for instruments or services that have yet to be delivered).
 - (iii) Cash receipts by GVI could not have funded payments falling due – in the month of July, including the two weeks following Thermo’s acquisition, GVI collected a total of just over [£] from its debtors in the context of minimum payments² in July of [£] (employee payroll, pension contributions and tax, national insurance and regular direct debits). The position is only likely to have worsened during a pre-packaged or funded administration.
- 2.4 In this respect, the fact that Thermo has made a relatively modest provision against recovery is neither here nor there (GT Report, paragraph 3.9). No comparison can be made between (a) the level of recovery that has been achieved by Thermo as a result of a process conducted over many months actively working with customers to resolve issues in the field and following the injection of further funds into the business and (b) the level that could be expected to be recovered in an accelerated disposal process.
- 2.5 It follows that Thermo does not think that funding would have been available for a pre-packaged administration or funded administration sale process. However, even if funding were available, it is unlikely that a buyer would have been identified to whom the business could be sold using the pre-packaged or funded administration sale route. For its part, particularly in light of the lengthy failed sales process already conducted by the directors, the

¹ Thermo notes with interest that Grant Thornton merely states that it is “*possible*” that such cash flow would be available (GT Report, paragraph 3.9),

² In other words, GVI’s business critical payments.

Bank would make such funding available only if it had a very high level of certainty that the strategy would lead to a successful sale.

- 2.6 In deciding whether or not a buyer was likely to emerge from a pre-packaged or funded administration process, given the time constraints, the Bank would undoubtedly be heavily influenced by the views expressed by the directors of GVI. The available evidence does not suggest that the views of the GVI directors would have encouraged the Bank in this respect³:
- (i) Whatever views the CC may have formed of the adequacy of the sale process in relation to GVI, the directors of GVI considered that they had made good faith efforts to identify realistic or credible potential purchasers of GVI and had failed to conclude a sale notwithstanding an eighteen month process. They would have certainly conveyed that to the Bank;
 - (ii) There is no evidence to believe that the GVI directors would have encouraged the Bank to pursue further discussions with Glenrose. The directors' view was that Glenrose [X] "*was most unlikely ever to follow through with a real offer, and certainly not within a short time frame*".
 - (iii) Nor is there evidence to suggest that the GVI directors would have given the Bank any reason to believe that [X] would participate in a pre-packaged or funded administration sale. The GVI directors had formed the view (rightly or wrongly) that [X] was simply not interested in GVI [X]. [X] had not in any way dissuaded the GVI directors from this view by expressions of interest in acquiring GVI [X].
 - (iv) As for [X], they were simply not on the radar of the GVI directors as a potential acquirer, evidenced by the fact that they would appear to have had no recollection of the approach made by [X], which in any event was not taken any further by [X].
- 2.7 On this basis, it would appear that a decision by the Bank to engage in a pre-packaged or funded administration sale process would have to be supported by compelling independent evidence that a buyer would be forthcoming. In this context it is important to note that a pre-packaged or funded administration sale is not a random process, but is typically targeted at a number of the most readily identifiable and credible buyers of the business to be sold⁴. Thermo notes that even after the lengthy trawl conducted in the present investigation, the CC has identified only three potential purchasers of the business: [X].
- 2.8 It is unlikely that either [X] or [X] would have been independently identified by the Bank as credible purchasers of the business in a pre-packaged process or out of a funded administration.
- 2.9 Both a pre-packaged and funded administration sale process would be conducted on the basis of no or minimal due diligence. The CC has previously noted Glenrose's "*stated*

³ Other than perhaps to explore a sale to Thermo. However, as the discussion is concerned with the counterfactual to a Thermo acquisition, this has been excluded from consideration in the analysis of the likelihood of a pre-packaged or funded administration sale.

⁴ Of which Thermo was by far and away the most credible (see footnote 2 above).

*preference to acquire robust businesses which can be improved rather than failing businesses which need turning around*⁵. [X]. The very nature of the pre-packaged or funded administration process would therefore appear to exclude Glenrose as a credible buyer, even taking into account the ability to negotiate on price.

- 2.10 [X] is not a company that would have been independently identified by the Bank as a potential acquirer from a pre-packaged or funded administration sale process. [X]. In this respect, it is also significant that [X] does not appear to have formed part of the list of 42 companies the CC identified as potentially interested in acquiring GVI in the counterfactual⁶. [X] simply would not have appeared on the Bank's shortlist for the purposes of the process.
- 2.11 We recognise that [X] would have been identified by the Bank as a potential acquirer of the business in a pre-packaged or funded administration sale process. But [X] seems highly unlikely to have been able to conclude a sale of GVI within the very limited period of time available under these processes. [X] The evidence does not point to a buyer with the ability to execute a deal in a short space of time on the basis of very limited due diligence.
- 2.12 Moreover, the GT Report relies on a degree of competitive tension in the process when concluding a pre-packaged or funded administration sale process to be the most likely outcome. For the reasons outlined above, the Bank would be likely to conclude that (other than Thermo) only one possible purchaser existed, namely [X]. [X] has explicitly told the CC that they *"would not have been prepared to offer any large sum, ... since a large investment was needed in the business to ensure that it overcame its problems"*⁷. The Bank would have been mindful that [X] would only become more concerned about the state of GVI's business in any limited due diligence exercise and that, absent Thermo, [X] would realise that it was the only prospective purchaser, such that it is likely that its offer would decrease yet further. This would bring the prospective purchase price closer to the hurdle value which the Bank would need to overcome even to consider pursuing this strategy.
- 2.13 For these reasons, Thermo does not consider that the Bank would have adopted either the pre-packaged administration sale process or the funded administration sale strategy outlined in the GT Report. If, however, the Bank did decide to provide limited funding for a short period of time in one final attempt to secure a buyer for the business, the evidence suggests that such a strategy would most likely have failed to succeed in the very limited period available.
- 2.14 The only potentially credible alternative to Thermo would be [X]. However, The CC has acknowledged that the *"risks associated with GVI's failure to meet orders, poor supplier relationships and problematic products would have seriously threatened the viability of [X] own business. [X] is successfully managed by scientists, not business turnaround specialists, and they are likely to have concluded that an acquisition of the business was too risky"*⁸. In either a pre-packaged sale process or a purchase out of a funded administration, [X] would have had very limited or no opportunity to conduct due diligence and would have received no warranty or indemnity protection. The evidence suggests that [X] would simply

⁵ Provisional Findings, Appendix F, paragraph 30.

⁶ Provisional Findings, paragraph 6.12.

⁷ Ibid, paragraph 41.

⁸ Ibid, paragraph 43.

not have got comfortable in the time available, and given the information that would have been available, that it could adequately deal with the significant risks which the acquisition of GVI posed to its business through negotiations on price alone.

- 2.15 In conclusion, neither the pre-packaged administration or funded administration sale strategy is credible on the facts. If the pre-packaged or funded administration routes were not available or had failed, liquidation or administration on a break-up basis would follow. [X] The conclusions to the contrary on this issue are unsupported by the evidence and wrong.

3. Commentary on the Competition Commission's Assessment of New Entry

- 3.1 The paragraphs below summarise the four key issues which arise on the CC's assessment of Nu's entry into the Gas IRMS market, and the conclusions which must be drawn from the CC's latest assessment.

(i) The merger does not reduce the number of competitors

- 3.2 The CC told Thermo that Nu Instruments' latest evidence (provided to the CC subsequent to the publication of the provisional findings) would not have entered the market if either (i) Thermo had not acquired GVI; or (ii) a third party had acquired GVI or GVI's Gas IRMS assets:

"Nu confirmed that, had Thermo not acquired GVI, and if GVI had subsequently failed, it would have sought to acquire the assets of GVI, so as to facilitate its entry into this market, rather than enter with its own product. If Nu had not been the successful acquirer of GVI and if the actual acquirer of GVI's business or its assets had successfully replicated GVI's business there is no reason to believe that Nu would still have entered the Gas IRMS market on its own"

- 3.3 When considering the questions which the CC must decide under section 35 of the Enterprise Act 2002, it is incumbent on the CC to compare the situation that has occurred with the merger (i.e. the present situation where Thermo has acquired GVI) with the counterfactual (i.e. the most likely situation to have occurred had Thermo not acquired GVI):

- (i) In light of the announcement by Nu Instruments of its entry into the Gas IRMS market, it is clear that the situation with the merger has resulted in Thermo competing with Nu Instruments offering its new product, the Nu Horizon and a competitive fringe of smaller players;
- (ii) Equally, it is clear from the evidence that the CC has collected, that the counterfactual would have resulted in Thermo competing with Nu Instruments (or another competitor less effective than Nu) offering the GVI IsoPrime and the same competitive fringe of smaller players.

- 3.4 It follows that the CC's analysis involves comparing the two scenarios identified above, both of which involve competition between Thermo and Nu Instruments. The only difference between (i) and (ii) is that the parties will hold different product portfolios. Consequently both economically, and for the purposes of fulfilling its statutory duty under the Enterprise Act, the CC is considering a merger which will not lead to a reduction in the number of independent competitors in the marketplace.

- 3.5 The present case is consequently without precedent - in all cases of horizontal merger of which we are aware, the main factor to cause a substantial lessening of competition (“SLC”) is the reduction in the number of independent competitors that typically occurs. That source of an SLC does not and cannot arise here.
- 3.6 It follows from the above that if the CC confirms its conclusions, it will be deploying a novel theory of harm in a horizontal merger. Any such conclusion demands a particularly high standard of proof, including powerful economic analysis and empirical evidence to support its case, given its inability to rely on presumptions about the effects of a reduction in the number of competitors.

(ii) There is evidence to suggest that the merger might have increased competition

- 3.7 On the basis of the evidence presented to Thermo, there is a distinct possibility that the merger has led to an increase, rather than a lessening, of competition when compared with the counterfactual.
- 3.8 The counterfactual involves the resurrection of old GVI technology (in the form of the IsoPrime), whereas the actual merger situation has resulted in the launch of a new product with innovative features by a highly reputed company in the IRMS industry (Nu Instruments) which, but for the merger, would not have been introduced.
- 3.9 Furthermore, Nu Instruments expects that its product will ultimately have a significant competitive impact, [X]. This is substantially more than the historic market share (of less than [X] in any year) of GVI. This is all the more significant given that the CC has now dropped its previous claim that the acquirer of GVI’s assets would be able to achieve 50-100% of GVI’s market share.
- 3.10 Given the real possibility that the merger will lead to a substantial increase in competition, the burden on the CC to show that, on the balance of probabilities, the merger has resulted in an SLC, is even stronger. The CC has adduced no evidence in support of its conclusion and has not discharged the burden of showing that the merger results in an SLC.

(iii) The CC has not discharged the burden of proof in finding an SLC

- 3.11 As set out above, it is incumbent on the CC to show that any reduction in competition arising as a result of the merger is substantial. It cannot do so by reference to a reduction in the number of competitors (the most obvious manner in which competition is reduced). It must also take into account evidence suggesting that the actual merger scenario might be more competitive than the counterfactual scenario. Finally, the CC must show that on the balance of probabilities, the difference between those two scenarios, each with the same two competitors, is sufficient to amount to a substantial lessening of competition.
- 3.12 Given the evidence that the Nu Horizon product [X], and that Nu may ultimately capture a larger market share than any acquirer of GVI’s assets in the counterfactual, the CC may seek to assess the difference in terms of the difference in scale of entry and timing of entry between the two scenarios.

- 3.13 The CC's analysis of the evidence on the timing of competition is flawed. The CC has taken Nu's statement that "[redacted]" and sought to conclude that this is several years longer than it would take through acquisition of the IsoPrime.
- 3.14 Thermo submits that the CC's reasoning here is entirely deficient, as it is based on a total failure to consider, or even to apply, elementary principles to the transition to effective competition.
- 3.15 First, the CC has failed to analyse, investigate or estimate the ramp-up of market share towards the [redacted] target, but reaches conclusions as though Nu will 'suddenly' acquire the significant share after a lengthy period of time. In reality, there would be some transition towards the final market position of the Nu Horizon. It is incumbent on the CC to show that any reduction in competition in that period of transition is substantial, both in magnitude and in duration.
- 3.16 Second, the CC has totally failed to recognise that there is a fundamental difference between Nu achieving its full long-term scale and Nu becoming an effective competitor. In the transition period between launch and a market position of [redacted], Nu will be competing fiercely with Thermo.
- 3.17 More specifically, to the extent that Nu suffers from an initial reputational disadvantage (which Thermo submits the CC has adduced no evidence to support to any acceptable standard of proof), [redacted]. The CC appears to have ignored this point totally. In this regard, it is instructive that the CC continues to argue that GVI competed disproportionately to its market share, and that the same would have been true for an acquirer of GVI's assets under the counterfactual. Such a *volte face* with regard to the same evidence is puzzling and requires explanation by the CC.
- 3.18 Furthermore, there is evidence from previous entry episodes to suggest that Nu Instruments is able to expand very quickly when effecting *de novo* market entry. At around the end of 2002 or the beginning of 2003, Nu entered the Noble Gas market with a new and innovative product, the 'Noblesse'. Before Nu's entry, Micromass was the monopoly supplier in that IRMS segment. Nu established itself as a strong competitor almost immediately, capturing a large share of new orders and capturing 50% of products shipped in 2004 and 2005. This shows that a lack of product reputation is no impediment for Nu to expand quickly in a new market.
- 3.19 Accordingly, and in conclusion on the timing of entry, the CC has failed even to show that there is any difference on timing as between the actual merger situation and the counterfactual, let alone analyse how any such difference is substantial such as to support a finding of an SLC.

(iv) Harm to UK customers is particularly unlikely

- 3.20 As a UK-based company, Nu is especially well connected among the UK scientific community and possesses sales infrastructure in the UK. As a consequence, even if Nu's expansion at the global level was delayed by a lack of reputation or lack of access to sales infrastructure (which in Thermo's view the CC has failed to establish), this would be unlikely to affect customers in the UK. It is axiomatic that the CC's duty is to consider whether the acquisition

“has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom”⁹ (emphasis added).

Slaughter and May (MSR/SPS)
16 May 2007

Placed on the CC website 30 May 2007

⁹ Section 35(1)(b), Enterprise Act 2002.