Completed acquisition by Vanilla Group Limited (JLA) of Washstation Limited

Decision on relevant merger situation and substantial lessening of competition

ME/6792/17

The CMA's decision on reference under section 22(1) of the Enterprise Act 2002 given on 3 April 2018. Full text of the decision published on 27 April 2018.

Please note that [✂] indicates figures or text which have been deleted or replaced in ranges at the request of the merging parties and third parties for reasons of commercial confidentiality.

SUMMARY

1. On 18 May 2017, Vanilla Group Ltd (**Vanilla**) acquired Washstation Limited (**Washstation**) (the **Merger**).

2. Vanilla is a subsidiary of JLA New Equityco Limited (**JLA**), the holding company of the JLA group. JLA and Washstation are together referred to as the **Parties** or the **merged entity**.

3. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that the Parties' enterprises have ceased to be distinct and that the share of supply test is met. The four-month period for a decision, as extended, has not yet expired. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

4. The Parties overlap in the supply of managed laundry services to higher education customers, such as universities, colleges and student accommodation providers. Managed laundry services are services in which non-domestic washing machines and tumble dryers (**machines**) are either rented or sold to customers and the provider is responsible for the maintenance of those machines (**managed laundry services**).

5. The CMA found that the conditions of competition in the supply of managed laundry services differ between the higher education sector and other sectors, with a more limited set of competitors offering the service to higher education customers. Higher education customers have different needs as they predominantly use variable rental agreements[1] and require bespoke ancillary services, such as the refurbishment of laundry rooms and online services.

6. The CMA found that, for higher education customers, there is limited demand side substitution between variable rental agreements and other sorts of managed laundry service arrangements, such as fixed rental and sales agreements. There is also limited supply-side substitution between variable rental agreements and these other arrangements mainly because of the greater financial risk associated with variable rental agreements.

7. The CMA found that competition in the supply of managed laundry services to higher education customers under variable rental agreements is national, with some regional variation.

8. The CMA therefore assessed the impact of the Merger in the supply of managed laundry services to higher education customers under variable rental agreements in the UK. The CMA investigated whether the Merger might give rise to horizontal unilateral effects in this frame of reference.

9. The CMA found that the Parties have a combined share of supply of [90-100]% with an increment of [5-10]% in the relevant frame of reference. The CMA found consistent evidence that the Parties are each other's closest competitor. The CMA also found that other competitors do not exert a strong competitive constraint on the Parties in the relevant frame of reference.

10. The CMA believes that it cannot rely on entry and/or expansion being sufficiently timely, likely or sufficient to offset the effects of the Merger on competition. Although some competitors indicated an intention to grow their UK presence, the CMA has not received evidence to show that such expansion will replace the competitive constraint that would be lost by the Merger.

11. The CMA therefore believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects.

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[1] Under a variable rental agreement, the provider rents a machine to the customer (eg a university), the provider receives all end-user usage fees but, out of this, the provider pays the customer a commission based on a percentage of the revenues generated.

12. The CMA considered whether it was appropriate in this case to exercise its discretion to apply the *de minimis* exception.[2] However, given the market size and the Parties' expectations that the market will grow, as well as the significant harm which could be expected to arise from the Merger as a result of the principal constraint on JLA being removed, the CMA decided not to apply the exception in this case.

13. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). JLA has until 10 April 2018 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, the CMA will refer the Merger pursuant to sections 22(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

14. JLA is the holding company of the JLA group. The JLA group is active across several sectors offering managed laundry services and catering services to a variety of customers such as care homes, schools, hotels, universities and hospitals. JLA offers managed laundry services through Circuit Launderette Services Ltd. The turnover of JLA in the financial year ending October 2016 was approximately £105 million, all generated in the UK.

15. Washstation is a managed laundry service provider, predominantly serving customers in the higher education sector and, to a very limited extent, the hospitality and leisure sector. The turnover of Washstation in 2016 was approximately £[✂], all generated in the UK.

Transaction

16. On 18 May 2017, JLA, through Vanilla, acquired all the shares of Washstation through a share purchase agreement (**SPA**) for a purchase price of around £[✂].

[2] *Mergers: Exception to the duty to refer in markets of insufficient importance* (CMA64), 16 June 2017.

Procedure

17. The CMA's mergers intelligence function identified this transaction as warranting an investigation.[3]

18. The Merger was considered at a Case Review Meeting.[4]

Jurisdiction

19. As a result of the Merger, the enterprises of JLA and Washstation have ceased to be distinct.

20. The Parties overlap in the supply of managed laundry services to higher education customers under variable rental agreements, with an estimated combined share of supply of [90-100]% (increment of [5-10%]). The CMA therefore believes that the share of supply test in section 23 of the Act is met.

21. The Merger completed on 18 May 2017 but was not made public. The CMA was first informed about the Merger on 30 October 2017. The four-month deadline for a decision under section 24 of the Act is 4 April 2018, following extension under section 25(2) of the Act.

22. The CMA therefore believes that it is the case that a relevant merger situation has been created.

23. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 5 February 2018. The statutory 40 working day deadline for a decision is therefore 3 April 2018.

Counterfactual

24. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For completed mergers the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger.

25. The Parties submitted that Washstation was facing financial difficulties, [✂]. However, the Parties did not submit that, absent the Merger, Washstation would have inevitably exited the supply of managed laundry services and, moreover, the CMA found evidence that other companies would have been

[3] See *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, paragraphs 6.9-6.19 and 6.59-60.
[4] See *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, from paragraph 7.34.

interested in acquiring Washstation had it not been acquired by JLA, which would have maintained similar competitive conditions.

26. Therefore, the CMA believes the pre-Merger conditions of competition to be the relevant counterfactual.

Background

27. The Parties overlap in the supply of managed laundry services mainly to universities, colleges and student accommodation providers[5] (**higher education customers**).

28. Other customers of managed laundry services include (i) hospitals, care homes, schools etc, who use machines for their housekeeping operations (**healthcare and school customers**); and (ii) hospitality and leisure customers (eg holiday parks, hostels etc), who provide machines to their end-users (**leisure customers**).

29. There are four types of agreement offered by managed laundry services providers:[6]

   (a) Fixed rental agreements: the provider rents the machine to a customer and carries out repairs and maintenance works. The customer pays a fixed monthly fee and retains any payments made by end-users for use of the machine.

   (b) Variable rental agreements: the provider rents the machine to a customer and carries out repairs and maintenance works. The customer receives a commission from the provider based on a percentage of the revenues generated from end-users using the machine.

   (c) Sales agreements: the customer purchases the machine.

   (d) Maintenance and repair services agreements: the provider carries out all repairs and maintenance of the machine (these agreements are often signed alongside a sales agreement).

30. JLA offers all of the above agreements; Washstation only offers variable rental agreements.

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[5] These are private entities that provide student housing and related services to students either directly or on behalf of a university/college via an outsourcing arrangement.
[6] Providers may also sell consumables and spare parts to customers. However, this only represents a very small part of JLA's business ([5-10]%).

Frame of reference

31. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on the merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.

Product scope

32. The Parties overlap in the supply of managed laundry services under variable rental agreements mainly to higher education customers. The CMA considered whether to widen this product frame of reference to include the supply of managed laundry services to other customers or the supply of managed laundry services under other types of agreement.

Different types of customer

33. The CMA first considered whether it was appropriate to widen the product frame of reference to include other customers, in particular healthcare and school customers and leisure customers.

Demand side

34. The CMA considered whether customer requirements and options may differ between higher education customers and (i) healthcare and school customers; and (ii) leisure customers.

- *Parties' submissions*

35. JLA submitted that commercial laundry machines are provided by the same suppliers to all customer types. It said that sales, renting and marketing activities, as well as repairs and maintenance services, do not vary based on the type of customer. In addition, there is no variation in price or service quality by customer type. JLA submitted that leisure customers, in particular, have similar requirements to higher education customers, offering laundry rooms to their guests/end-users with small machines which are cash- or cashless-operated.

- *CMA analysis*

36. The CMA compared the requirements for managed laundry services of higher education customers with those of leisure customers and healthcare and school customers. Third party laundry service providers told the CMA that higher education and leisure customers have broadly the same requirements in terms of speed of repairs and other services (eg machine installations). However, the evidence provided to the CMA showed the following differences:

    (a) While most higher education customers prefer variable rental agreements:

    (i) healthcare and school customers tend not to use this type of agreement; and

    (ii) a significant proportion of leisure customers do not use variable rental agreements (for example, while [90-100]% of JLA's revenues in the higher education sector are from variable rental agreements, only [40-50]% of JLA' revenues in the leisure sector are from this type of agreement).

    (b) Third parties indicated that higher education customers often request an online portal service through which students can monitor machine availability and the customer can monitor usage (**online services**). Healthcare and school customers do not require these services as machines are for internal use, and they are rarely requested by leisure customers.

    (c) Third parties also said that higher education customers require machines where the end-user pays. By contrast, healthcare and school customers do not need any payment method as machines are only for internal use.

    (d) Third parties also said that, while the higher education sector has moved towards cashless-operated machines (eg with campus cards), the majority of leisure customers still tend to prefer cash-machines as other payment options are expensive to purchase and install.

    (e) While higher education customers consider the comfort and appearance of their laundry rooms as important, and normally require refurbishment works within their contracts for managed laundry services, these are not required by healthcare and school customers and are only rarely required by leisure customers.

Supply-side

37. The boundaries of the relevant product market are generally determined by reference to demand-side substitution. However, the CMA may aggregate several markets on the basis of supplier responses when firms have the ability and incentive quickly to shift capacity between different products, when the same firms compete to supply the different products and the conditions of competition are the same for each product.[7]

- *Parties' submissions*

38. The Parties submitted that supply-side substitution is easy in managed laundry services as the machines, installation/servicing and customer administration requirements are identical across the commercial laundry sector. The Parties said that cashless payment and online service solutions could be acquired with no significant investment and refurbishment services could be easily outsourced.

- *CMA analysis*

39. The CMA found that the competitor set offering managed laundry services to higher education customers is different from the competitor set offering managed laundry services to healthcare and school customers and/or leisure customers.

40. From the 12 managed laundry service suppliers that responded to the CMA's questionnaire, five said that they serve both higher education customers and healthcare and school customers. However, the CMA found that one of these five providers had no current sales to the higher education sector and each of the remaining four generated less than [10-20]% of their managed laundry services revenue from this sector (more detail on shares of supply in the higher education sector is set out in the competitive assessment below). The CMA notes that two of the five suppliers said that they only offer sales agreements and that they did not offer variable rental agreements, which, given the strong preference by almost all higher education customers for variable rental agreements (see paragraph 36(a)), indicates that this sector is not a focus for them.

41. From the 12 managed laundry service suppliers that responded to the CMA's questionnaire, six said that they serve both higher education customers and leisure customers. Of those six, three stated that they focus almost entirely on

[7] Merger Assessment Guidelines, paragraph 5.2.17.

leisure customers, with higher education customers accounting for less than [0-5]% of their total customer base. One of these three providers said that it only offers sales agreements to its customers, supporting the view that higher education is not its focus.

42. The CMA found that Washstation and JLA generate approximately [90-100]% and [30-40]% respectively of their total managed laundry revenue from higher education customers and that they each have a much higher share of supply in higher education than in any other sector. The CMA found that all the other managed laundry service suppliers that supply both higher education and other customers generate a much lower proportion of their revenue (less than [0-5]%) from higher education customers and have a much lower share of supply in managed laundry services to higher education customers (less than [0-5]%) than in the supply of these services to other customers.

43. Managed laundry service providers told the CMA that they were unable to grow in the higher education sector because of the lack of opportunities to gain customers in this sector, caused by long existing contracts (with JLA and Washstation), the strong position of these two incumbents, and/or the preference of universities to deal with a known supplier. Alternative providers also said that the variable rental agreements used in this sector are unattractive as margins are low and there is uncertainty about how much income will be generated. They said that, in addition, the need to offer refurbishment of the laundry room, different payment methods and online services added to the initial investment required and could be substantial for large tenders covering several student buildings (these barriers are discussed further in the entry and expansion section below). The CMA believes that this evidence indicates that existing managed laundry service suppliers may not be able to switch quickly capacity from healthcare and school or leisure customers to higher education customers.

44. The CMA also notes that the SPA between JLA and Washstation [✄]. The CMA believes that this is a further indication of the different conditions of competition in the supply of managed laundry services to higher education customers compared with other customers.

45. On the basis of this evidence, the CMA believes that the conditions of competition are different for higher education customers compared with healthcare and school and leisure customers and that opportunities for supply-side substitution are limited.

Conclusion on different types of customer

46. For the reasons set out above, the CMA believes it is appropriate to consider higher education customers as a distinct product frame of reference.

Different types of agreement

Parties' submissions

47. JLA said that customers (including higher education customers) do not exclusively choose one type of agreement, but rather have a mix of machines under fixed and variable rental agreements and may also purchase some machines.

48. JLA submitted that there can be substitution between rental and sales agreements as customers can, and do, threaten to use owned machines.

49. JLA acknowledged that higher education customers do not often switch from variable rental agreements to other types of agreement but said this was because these customers are satisfied with the offering available.

Demand-side

50. For each of the Parties, and for their competitors, the CMA found that the vast majority of revenues in the higher education sector are generated from variable rental agreements (see paragraph 36(a)(ii)).

51. Switching information provided by JLA indicated that only a very limited number of higher education customers switched from variable rental agreements to fixed rental agreements in the past three years, representing less than [0-5]% of JLA's total revenues.

52. The CMA asked customers who have a variable rental agreement with the Parties what they would do if their existing managed laundry service provider reduced its commission payment by 5%. Very few customers indicated that they would switch to a fixed rental agreement and even fewer said that they would purchase their laundry machines. The majority of respondents told the CMA that they would accept the lower commission or that they would retender.

53. This evidence indicates that other rental agreements may not be seen as alternatives to variable rental agreements by most higher education customers. [✂].[i]

Supply-side

54. The CMA found little evidence of any type of agreement other than a variable rental agreement in the higher education sector.

55. The CMA also notes that the former owner of Washstation used separate legal entities for his variable rental business and his fixed rental business, indicating that they serve different markets.

Conclusion on different types of agreement

56. For the reasons set out above, the CMA believes it is appropriate to consider the supply of managed laundry services to higher education customers under variable rental agreements as a distinct product frame of reference. However, the CMA did not have to conclude on whether it is appropriate to broaden the product frame of reference to include other types of supply agreement as, given almost all supply in the higher education sector is under variable rental agreements, including other agreements in this sector within the frame of reference would not alter materially the CMA's findings.

Conclusion on product scope

57. For the reasons set out above, the CMA assessed the Merger by reference to the supply of managed laundry services to higher education customers under variable rental agreements.

58. The CMA took account of the constraint from the supply of managed laundry services to higher education customers under other types of agreement in its competitive assessment.

Geographic scope

59. The Parties submitted that, prior to the Merger, both JLA and Washstation promoted their businesses and bid for contracts across the UK.

60. The CMA found that the Parties' higher education customers are located across the UK, and that both JLA and Washstation are able to provide repair and maintenance services through their engineer network across the UK.

61. Third parties also confirmed that the Parties and their main competitors in the supply of managed laundry services to higher education customers compete for contracts at a national level, with only a few smaller competitors operating at a regional level.

62. For these reasons, the CMA assessed the Merger by reference to the UK. The CMA considered whether the nature of competition is different in any local area (ie regional or sub-regional) in its competitive assessment.

Conclusion on frame of reference

63. For the reasons set out above, the CMA assessed the impact of the Merger in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

Competitive assessment

Horizontal unilateral effects

64. The removal of one party as a competitor might allow the Parties to increase prices, lower quality, reduce the range of their services and/or reduce innovation.

65. In order to assess the likelihood of the Merger resulting in horizontal unilateral effects, the CMA has considered:

(a) Shares of supply;

(b) The closeness of competition between the Parties; and

(c) Constraints from other competitors.

Shares of supply

66. The Parties submitted data on shares of supply for the higher education sector based on numbers of customers. The Parties' estimated that their combined share of supply was [30-40]% (increment of [5-10]%), with Miele and Electrolux (and their distributors) accounting for [40-50]% (around [20-30]% each), and Armstrong and other providers accounting for [5-10]% and [20-30]%, respectively.

67. On the basis of the CMA's market testing, the CMA found share of supply estimates that were very different to those of the Parties. The CMA asked the Parties to identify their competitors in the supply of managed laundry services to higher education customers under variable rental agreements. The CMA formed its share of supply estimates on the basis of revenue data for 2017

submitted by the Parties and by almost all the competitors identified by the Parties.[8]

68. The CMA recognises that the resulting estimates may overstate the Parties' shares since they may not capture the entire market. However, as the CMA has obtained revenue data from all of the main competitors identified by the Parties,[9] any omission will have a limited impact.

69. The CMA found that the Parties have a combined share of supply of [90-100]%, with an increment of [5-10]% in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

70. The third largest provider, Armstrong, has a share of supply of [0-5]%. The shares of supply of other competitors, eg Brewer and Bunney, Goodman Sparks and Wolf Laundry, are significantly lower than Armstrong's share. The CMA found that, even when considering shares of supply which include both variable and fixed rental agreements to higher education customers, the share of supply estimates do not change significantly.

71. The CMA believes that the Parties' very high combined share of supply raises prima facie competition concerns.

Closeness of competition

72. The CMA assessed the closeness of competition between the Parties by considering the following evidence:

    (a) The Parties' submission

    (b) Customer switching;

    (c) Information on the Parties' offerings

    (d) Internal documents; and

    (e) Third party views.

[8] The Parties submitted contact details of 14 competitors, of which 12 provided their turnover figures relating to the supply of managed laundry services to higher education customers under variable rental agreements in the UK. In several cases, third parties indicated that they did not generate any turnover from these services and/or that they were not offering these services.

The Parties' submission

73. JLA submitted that the Parties offer similar products and services: both JLA and Washstation offer managed laundry services to higher education customers under variable rental agreements in the UK. However, JLA said that Washstation was a smaller business than JLA, with only 10 employees, and it had a stronger focus on higher education customers.

74. JLA also submitted that, at the time of the Merger, Washstation was financially stretched, and was late in paying commissions to its higher education customers, indicating that it was not imposing a strong competitive constraint on JLA.

Customer switching

75. Higher education customers choose their managed laundry supplier either by tender or through bilateral negotiation. The CMA examined tender evidence focussing on whether, pre-Merger, the Parties were direct competitors and whether, during these tenders, they were ranked as close bidders by customers.

76. JLA provided data on contracts for which it tendered between 2016 and 2017, including, where possible, information on the winning competitor where it was unsuccessful. The CMA found that, of the five tenders in which JLA was unsuccessful (out of 18 tenders), four were won by Washstation, indicating that the Parties were close competitors for at least some customers.

77. The CMA also requested data from customers who chose their managed laundry service supplier (either by tender or negotiation) within the last three years. The average contract length used by managed laundry services providers is around eight years. The CMA received responses from customers in relation to 21 tenders and 11 negotiations. This evidence showed:

   (a) Of the 21 tenders, JLA won 15, Washstation won five and another competitor won one.[10]

   (b) The Parties competed in 10 tenders with values ranging from £[✂] to £[✂][11] indicating that competition between the Parties is strongest in larger tenders.

[10] These 20 contracts represent approximately [10-20]% of the total turnover from the Parties in the higher education sector. JLA participated in 19 tenders and Washstation participated in 12 tenders. In six of the 21 tenders JLA was the only bidder.

[11] These 10 tenders represent approximately [5-10]% of the total turnover from the Parties in the higher education sector.

(c) Of the 10 tenders where the Parties competed, 7 were won by JLA and in almost all instances Washstation was ranked second, with only one instance where it was ranked third; and 3 were won by Washstation where in each case JLA was ranked second.

(d) Of the 11 customers who had negotiated directly with laundry providers, all of them said that they had negotiated with JLA, and JLA had won 10 out of the 11 contracts. Washstation was mentioned five times, and won the only other contract.

78. This evidence indicates that, prior to the Merger, the Parties were regularly bidding against each other and winning customers from each other, suggesting that the Parties were a significant competitive constraint on each other. This evidence, together with the share of supply data above, indicates that the Parties were each other's closest competitor in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

Information on the Parties' offerings

79. The information submitted by the Parties detailing their respective service propositions showed that they offer very similar managed laundry services to higher education customers. The only difference identified by the Parties is that, whilst JLA has recently invested[12] in a new mobile app through which students can operate their machines and pay for their laundry, Washstation currently has no such service.

80. This evidence was confirmed by tender proposal documents and other documents submitted by the Parties, and by third parties, which indicated that JLA and Washstation offer very similar packages to higher education customers. In particular, both offer:

(a) small size machines with similar features;[13]

(b) refurbishment of laundry rooms, with themed laundry rooms, sofas and TV screens if requested;

(c) same-day repair services;

[12] JLA launched the app in 2015 with an upfront investment of £[✂].
[13] See, for example, a document in which JLA compares the technical features of its washing and dryer machines only against the machines used by Washstation, showing that both machines have very similar features. Word document retrieved from [✂] named 'COMPARISON TABLE with BREEAM', date 5 October 2016 (document number URN004).

(d) online services for students to check the availability of machines.

81. On the basis of this evidence, the CMA believes that, prior to the Merger, the Parties' offerings to higher education customers were very similar.

Internal documents

82. The CMA found that many of the documents submitted by the Parties that were relevant for the CMA's assessment indicated that the Parties compete closely for higher education customers. In particular, these documents showed that:

(a) JLA monitored Washstation's machine purchases;[14]

(b) JLA monitored Washstation's higher education customers;[15]

(c) JLA had found that a number of higher education customers mentioned Washstation as an alternative to JLA when negotiating with JLA;[16]

(d) JLA tracked which providers won pipeline customers, finding that Washstation was a competitor winning customers from JLA frequently;[17]

(e) JLA had discussed offering a price match to a possible higher education customer which it identified to be a customer of Washstation;[18]

(f) JLA bid against Washstation for a contract with the [✂] saying: "*Basically, we are up against Washstation in a test the market situation, so need to provide the wow factor in proposals*."[19]

(g) JLA identified a list of universities as prospective customers, almost all of which were Washstation customers.[20]

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[14] See e-mail of 18 June 2016, 9:26 from [✂] to [✂] (document URN006).
[15] See e-mail of 19 December 2016, 12:34 from [✂] to [✂] (document URN049).
[16] Email from the University of [✂] and [✂] and from [✂]
See e-mail of 11 October 2016, 10:44 from [✂] to [✂] (document URN036),
e-mail of 27 January 2017, 11:39 from [✂] to [✂] (document URN053), and e-mail of
9 November 2016,9:06, from [✂] to [✂] (document URN044).
[17] Excel table from [✂]named '2017 PIPELINE - USE THIS ONE!!.xlsx', dated 11 April 2017, showing customers won and lost. (document URN066).
[18] See e-mail of 28 September 2016, 8:18 from [✂]to [✂] (document URN033).
[19] See e-mail of 9 March 2017, 8:39 from [✂] to [✂] (document URN080).
[20] See e-mail of 26 October 2016, 8:18 from [✂] to [✂] and other [✂] in cc (document URN039).

(h) When JLA lost a tender to supply the University of [✂] to Washstation, the university told JLA that it was the only other bidder and that the Parties had scored comparable grades in various criteria:[21]

(i) A document in which Washstation assessed how its main customers will react to the Merger, stated: *"Difference in commission levels between Circuit and Washstation ([60-70] vs [50-60]%). Large customer who may not like not having a large-scale alternative to play off to with procurement being cash generative/savings driven."*[22]

83. This evidence, together with the similarity in the Parties' offerings, supports the view that, prior to the Merger, the Parties were each other's closest competitor in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

Third party views

84. Customers told the CMA that, prior to the Merger, Washstation was offering better commission terms than JLA, while JLA was a strong competitor on quality of service, online services and end-users payment methods.

85. Notwithstanding the slight differentiation in the Parties' offering, almost all customers and competitors said that the Parties offer a very similar proposition. For example, one customer told the CMA that, during their last tender in [✂], Washstation offered a very similar package to JLA, both including online services for students.

86. Almost all customers indicated that JLA and Washstation were close competitors.

87. On the basis of customer responses, no alternative competitor was identified as a closer competitor to JLA for higher education customers than Washstation (or vice versa).

Assessment of closeness of competition

88. For the above reasons, the CMA believes that, prior to the Merger, the Parties were each other's closest competitor in the supply of managed laundry

[21] See document named 'Circuit RBS Laundry U 120517.docx' retrieved from [✂], dated 15 May 2017 (document URN087).
[22] See excel table named 'template for top customer slides.xlsx' found at [✂], document date 11 May 2017 (document URN083)

services to higher education customers under variable rental agreements in the UK.

Competitive constraints

89. Unilateral effects are more likely where customers have little choice of alternative supplier. The CMA considered whether there are alternative suppliers which would provide a competitive constraint on the merged entity. The CMA considered:

(a) The Parties' submission

(b) Customer switching;

(c) Internal documents;

(d) Third party views; and

(e) Changes in the commissions offered by the Parties.

Parties' submission

90. The Parties said that the supply of managed laundry services to higher education customers is very competitive and fragmented, with a large number of competitors across the UK. The Parties named the following significant competitors: Armstrong, Goodman Sparks, Miele and its distributors, Electrolux and its distributors, Girbau and Laundry 365.[23] The Parties said that Hughes had recently bought Armstrong, which would strengthen Armstrong financially, making it an even stronger competitor. According to the Parties, [✂].

Customer switching

91. Out of the five tenders which JLA lost to a competitor (out of 18 tenders) in 2016/17, four were won by Washstation and only one was lost to another competitor (Thain Commercial, a Miele distributor, for a contract in Scotland).

92. The tender data shows that, on some occasions, other competitors participated in tenders. However, out of the 21 tenders for which the CMA received information:

[23] Other competitors mentioned were Hughes Trade, OPL Group, MAG, MARRS, Lavamac.

(a) Armstrong was named in less than a [✂] of tenders, typically ranked [✂] after JLA and Washstation.

(b) Goodman Sparks was mentioned only once, ranking [✂] after JLA and Washstation.

(c) Electrolux and Miele were also mentioned only once, both by the same customer for a sales agreement contract rather than a variable rental agreement.

(d) Wilson (now part of JLA) and PHS Laundryservices[ii] (also now part of JLA) were each mentioned only once.

(e) Four of the 21 tenders included other unnamed providers, in two of which, the unnamed provider was ranked second after JLA (Washstation did not participate in these tenders); while in the other two, the unnamed provider was ranked lowly, behind three other providers which included JLA and Washstation.

93. In the 11 contract negotiations mentioned above in paragraph 77(d), in two instances JLA only competed with Washstation; in three instances JLA competed with Washstation and other providers; and in two other instances JLA competed with other providers but not Washstation. In the remaining four instances, JLA was the only provider invited to negotiate. This evidence showed that the only other providers participating in these negotiations were Armstrong, Miele, Laundry 365, and LPD (all mentioned only once), and several unnamed providers who were never successful.

94. This evidence indicates that, prior to the Merger, the Parties faced limited competitive constraints from other providers of managed laundry services to higher education customers in the UK. The CMA notes that this is consistent with the Parties' very high combined share of supply (see paragraph 69).

Internal documents

95. Some of the internal documents submitted by the Parties also indicated that, prior to the Merger, the Parties faced limited competition from other competitors. For example:

(a) A letter from the University of [✂] suggests that 15 companies expressed interest in its tender but only Washstation and JLA submitted bids;[24]

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[24] See paragraph 82(h) above, document named 'Circuit RBS Laundry U 120517.docx' retrieved from [✂], dated 15 May 2017. (document URN087)

(b) A thread from a forum for UK Education and Research communities (forwarded from an employee of Laundry 365 to JLA) asked: "*We would like to know if there are other alternatives to commercial launderettes (Circuit or Washstation) that other Universities are pursuing or how other Universities are addressing issues with laundry provision*."[25]

(c) Two JLA internal emails, where JLA discusses a tender proposal to [✄] (a student accommodation provider in [✄]), mention Armstrong, but no other competitors are identified.

96. This evidence supports the view that, prior to the Merger, the Parties faced limited competitive constraints from other providers of managed laundry services to higher education customers.

Third party views

97. The CMA contacted 14 third parties who JLA considered as competitors to the Parties, of which 12 responded (see paragraph 67). Six of these 12 third parties said that they did not offer managed laundry services and/or did not serve higher education customers.[26] The CMA found that only Armstrong, Brewer and Bunney, Goodman Sparks and Wolf Laundry offer managed laundry services under variable rental agreements to higher education customers.[27]

98. Out of the six competitors offering managed laundry services to higher education customers (ie including two competitors that use other types of agreement than variable agreements), four[28] had concerns about the Merger.

99. Out of the 54 customers who responded to the CMA, 35 said that they had concerns about the Merger. The principal concern expressed by customers was that the Parties are the only credible alternative to each other in the market.

100. Customers said that Miele and Electrolux were not offering variable rental agreements to higher education customers and therefore were not good alternatives to the Parties.

[25] See e-mail from [✄] to [✄] of 18 May 2017, 13:59 (document URN099)
[26] [✄].
[27] The CMA notes that both Brewer and Bunney and Girbau also only operate in part of the UK.
[28] [✄].

101. On the basis of third party evidence, the CMA found that Armstrong and Goodman Sparks were the most credible alternatives to the Parties for higher education customers.

102. [✄] Customers told the CMA that Armstrong typically scored lower than the Parties in tender processes, particularly due to its limited online services, payment methods, and its less attractive commission terms.

103. [✄] told the CMA: [✄] It added: [✄].

104. The CMA believes that the evidence from third parties supports the view that, prior to the Merger, the Parties faced limited competitive constraints from other providers of managed laundry services to higher education customers in the UK. This is consistent with the limited combined share of supply (0-10%) of these alternative providers.

Changes in the commissions offered by the Parties

105. The Parties submitted data that compared commission levels on JLA's renewal contracts with higher education customers between January 2016 and December 2017. The Parties submitted that the evidence did not suggest that higher education customers had suffered lower commissions as a result of the Merger.[29]

106. The CMA acknowledged that this evidence did not indicate commission reductions post-Merger. However, the CMA noted a number of limitations with the analysis, including (i) it did not cover Washstation's customers, who may be most likely to be adversely affected by the Merger given that Washstation typically paid higher commissions than JLA (see paragraph 82); and (ii) it did not cover pre-Merger customers lost by JLA to Washstation, who again may be more likely to be adversely affected by the Merger.[30] Additionally, the CMA notes that adverse effects on customers from a loss of competition may arise in many ways, including through customers obtaining a worse quality of service (which was mentioned by several customers). For these reasons, the CMA did not put much weight on the evidence of changes in commission rates.

[29] A fairly high proportion (over [40-50]%) of customers who renewed contracts with JLA did so at the same commission rate; and, of the remainder, some obtained increases and others reductions in commissions.
[30] The level of commission depends on a variety of factors, such as the price paid by end-users (ie the students), the machine to student ratio, the number of sites, maintenance levels and frequency of maintenance, which may change when the contract is renewed.

Assessment of competitive constraints

107. For the reasons set out above, the CMA believes that, prior to the Merger, the Parties faced limited competitive constraints from other providers of managed laundry services to higher education customers in the UK.

Conclusion on horizontal unilateral effects

108. The CMA believes that the Parties have a very high combined share of supply of managed laundry services to higher education customers under variable rental agreements in the UK; the Parties are each other's closest competitor in this supply; and they face limited competitive constraints from other providers.

109. Therefore, the CMA believes that it is or may be the case that there is a realistic prospect that the Merger will result in an SLC in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

Countervailing Constraints

Entry and expansion

110. Entry, or the expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases, may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.[31]

Parties' submission

111. JLA said that barriers to expand, in particular from one customer group to another, are low as there are no sunk costs. It said that replicating any competitive constraints imposed by Washstation would be simple, inexpensive and achievable in a very short period of time. JLA also submitted that upfront costs were negligible, enabling new providers to enter. JLA noted that Washstation had only six engineers and yet was able to operate a service network across the UK.

[31] Merger Assessment Guidelines, paragraph 5.8.3

112. JLA said that [20-30]% of its contracts with higher education customers were due to be retendered in the next two years, offering competitors sufficient opportunities to gain market share.

113. The Parties submitted that, following the acquisition of Armstrong by Hughes, the combined Hughes/Armstrong was now a strong competitor with strong financial backing. The Parties said that Hughes/Armstrong had recently won a new managed supply contract with a higher education customer.

Barriers to entry and expansion

114. The evidence received by the CMA from third parties indicates that there are several possible barriers to entry or expansion in the supply of managed laundry services to higher education customers:

   (a) Several third parties noted the financial risks associated with the uncertain income flows from variable rental agreements.

   (b) Some third parties noted cash flow concerns associated with the higher education sector given students do not use these services during holiday periods.

   (c) Several third parties mentioned the difficulty of building a business based on sufficient higher education customers due to the presence of long term contracts (typically 8 years). In this context, some third parties noted the difficulty of building a national presence given the timescale required to gain sufficient national contracts.

   (d) Another third party said that the costs of expanding from another sector can be significant, with a capital investment of around £200,000 needed to be able to service a full campus with multiple laundry rooms, ie refurbishment costs, machines, payment solutions, online and ancillary services and a network of engineers.

   (e) Another third party noted that a managed laundry service provider needs to build a reputation with higher education customers, and that there are learning costs involved in how to submit a competitive tender proposal.

115. The CMA found that the only significant entry/expansion in the higher education sector in recent years was by Washstation. The CMA notes that this business was established by someone with significant experience and contacts in the sector.

116. The CMA considers that most of the points in paragraph 114 above, individually, may not constitute significant barriers to entry or expansion.

However, the CMA notes that there has been very little entry or expansion in this sector in recent years. The CMA believes that the barriers identified by third parties, in particular the long duration of existing contracts and limited growth opportunities, the financial risks associated with variable rental agreements, the need to build a reputation and certain upfront costs, together with the limited entry/expansion seen in recent years, indicate that there is significant uncertainty as to whether future entry and/or expansion will be likely, timely and sufficient to offset the adverse effects of the Merger.

Competitors who could enter or expand

117. The CMA assessed whether specific competitors have plans to enter or expand in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

118. The CMA received submissions from a few third parties indicating that they might have plans to enter or expand in this sector: [✂]. None provided internal documents showing how they would enter, over what period, and how successful they would be.

119. [✂] estimated that the costs of expanding were around £200,000. It noted the risks associated with variable rental contracts and low margins. [✂] said that the main barriers to its expansion were the lack of tender opportunities and the high investment necessary for small expected returns.

120. [✂]. [✂] told the CMA that it was actively looking into tender opportunities with higher education customers [✂]. It said that the estimated cost of entry was not substantial as [✂]. [✂] estimated that an upfront investment of £50,000 was necessary to enter this sector, and it would take 1 to 2 years to set up the necessary contract agreements and marketing activities. [✂] said that the main barriers to its expansion in the higher education sector were long-term contracts, tender learning costs and building a reputation.

121. [✂] told the CMA [✂]. [✂] estimated that to gain a meaningful share in the supply of managed laundry services to higher education customers would take around five years.

Conclusion on entry and expansion

122. Although some competitors have indicated an intention to enter or grow their presence in the supply of managed laundry services to higher education customers in the UK, the CMA does not believe that it can rely on such entry or expansion to be likely, timely and sufficient to mitigate the adverse effects of the Merger. The CMA believes that the barriers identified by third parties, in

particular the long duration of existing contracts and limited growth opportunities, the financial risks associated with variable rental agreements, the need to build a reputation and certain upfront costs, and the absence of any meaningful entry and expansion in the past years except for by Washstation, indicate that successful future entry/expansion in this sector is uncertain. The CMA notes that, while the acquisition of Armstrong by Hughes might increase the financial strength of Armstrong, it is uncertain whether it will result in Armstrong imposing a stronger competitive constraint on the merged entity.

123. For these reasons, the CMA believes that it cannot rely on entry or expansion being timely, likely and sufficient to prevent a realistic prospect of the Merger resulting in an SLC.

Buyer power

124. The Parties submitted that certain higher education customers are well-informed about their alternatives, face low switching costs, and exert significant buyer power through their tenders.

125. Buyer power can be generated by different factors. An individual customer's negotiating position will be stronger if it can easily switch its demand away from the supplier, or where it can otherwise constrain the behaviour of the supplier. Typically, the ability to switch away from a supplier will be stronger if there are several alternative suppliers to which the customer can credibly switch, or the customer has the ability to sponsor new entry or enter the supplier's market itself.[32] However, even where a market is characterised by customers who are larger than the suppliers, it does not necessarily follow that there will be countervailing buyer power.[33]

126. As set out above, the CMA has found that there are very limited alternative suppliers to which higher education customers can credibly switch, and the CMA has found no evidence to suggest that customers are willing to sponsor entry or enter the supply of managed laundry services themselves.

127. For this reason, the CMA does not believe that buyer power will be sufficient to offset any SLC arising from the Merger.

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[32] Merger Assessment Guidelines, paragraph 5.9.2 and 5.9.3.
[33] Merger Assessment Guidelines, paragraph 5.9.4

Third party views

128. The CMA used an online questionnaire to gather evidence from the Parties' customers. The questionnaire was sent to 378 managing companies and 246 universities/colleges, and the CMA received 83 distinct responses (a response rate of 13.3%). Out of the 54 customers who expressed a view on the Merger in response to the CMA's questions, 35 said that they had concerns, while 19 were of the view that it would have no adverse impact.

129. The CMA also sent questionnaires to 14 competitors and received 12 responses. Out of the six competitors offering managed laundry services to higher education customers who responded to the CMA's questions, four had concerns about the Merger.

130. Third party comments have been taken into account where appropriate in the competitive assessment above.

Conclusion on substantial lessening of competition

131. Based on the evidence set out above, the CMA believes that it is or may be the case that the Merger has resulted, or may be expected to result in a realistic prospect of an SLC as a result of horizontal unilateral effects in the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

Exceptions to the duty to refer

132. Where the CMA's duty to refer is engaged, the CMA may, pursuant to section 22(2)(a) of the Act, decide not to refer the merger under investigation for a Phase 2 investigation on the basis that the market(s) concerned is/are not of sufficient importance to justify the making of a reference (the ***de minimis* exception**).

133. The CMA has considered whether it is appropriate to apply the *de minimis* exception in this case.

134. The Parties submitted that, were the CMA to find that the duty to refer is engaged, it would be appropriate for it to apply the *de minimis* exception as no undertakings in lieu of a reference (**UiLs**) are in principle available which are not tantamount to prohibition, the market is small (about £15 million), and the magnitude of harm is limited due to the presence of outside constraints (ie ease of entry/supply-side substitution).

Markets of insufficient importance

135. In considering whether to apply the *de minimis* exception, the CMA will consider, in broad terms, whether the costs involved in a reference would be disproportionate to the size of the market(s) concerned, taking into account also the likelihood that harm will arise, the magnitude of competition potentially lost and the duration of such effects.[34]

'In principle' availability of UiLs

136. The CMA's general policy, regardless of the size of the affected market, is not to apply the *de minimis* exception where clear-cut UiLs could, in principle, be offered by the parties to resolve the concerns identified.[35]

137. In most cases, a clear-cut UiL will involve a structural divestment. The CMA considered whether the Parties could divest Washstation to restore competition to the level that would have prevailed absent the Merger. However, this divestment would be tantamount to prohibiting the Merger, which indicates that UiLs are not available 'in principle'.[36]

138. Accordingly, the CMA does not believe that an 'in principle' clear-cut UiL is available in this case.

Assessment of the expected customer harm

139. Where the CMA concludes that clear-cut UiLs are not in principle available, it then considers whether the merger impact is expected materially to outweigh the public costs of a reference. In assessing the customer harm, the CMA will take into account four key factors: the size of the market, the likelihood that the SLC will actually occur, the magnitude of competition lost by the merger, and the duration of the SLC.[37] The CMA will also consider the wider implications of a *de minimis* decision.[38] Each of these factors is discussed in turn below.

[34] *Mergers: Exception to the duty to refer in markets of insufficient importance* (CMA64), 16 June 2017.
[35] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 21.
[36] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 25.
[37] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 28.
[38] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraphs 40-44.

Market size

140. The CMA considers that the market concerned will generally be of sufficient importance to justify a reference (such that the exception will not be applied), where its annual value in the UK is more than £15 million.[39]

141. In the present case, the relevant market is the supply of managed laundry services to higher education customers under variable rental agreements in the UK.

142. Originally, the Parties submitted that their turnover generated by the supply of managed laundry services to higher education customers under variable rental agreements in the UK amounted to £[25-30] million in 2017. On the basis of this evidence and third party submissions, the CMA estimated that the total market size was around £[28-29] million in 2017.

143. However, the Parties subsequently submitted that the market size calculation should exclude commissions paid to higher education customers and only include the net revenues retained by providers. On this basis, the Parties estimated the market size to be approximately £[10-15] million in 2017 (using an assumption that the remaining competitors have a market share of around [0-10]%). JLA submitted that customer commissions are collected by JLA on behalf of customers and therefore should not be included in the turnover calculation. JLA said that this is in line with the European Commission's approach to turnover in its Consolidated Jurisdictional Notice.[40]

144. JLA also submitted that, in the next two years, the value of contracts that will be re-tendered is only around £[✂] million, and that this amount should be considered as the size of the affected market.

145. On this latter point, the CMA believes that there is a realistic prospect of an SLC in the market for the supply managed laundry services to higher education customers under variable rental agreements in the UK. Therefore, in this case, the CMA believes that the size of the relevant market is the sum of all suppliers' annual turnover in the UK in that market[41], rather than the value of the contracts that will be re-tendered in a short-term future period.

146. The CMA also noted a submission from the Parties which included an independent market study by Knight Frank, indicating that the market for managed laundry services to higher education customers is growing, with

[39] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 3.
[40] See paragraph 159 of the Consolidated Jurisdictional Notice.
[41] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 30.

14,000 new student bedrooms to be built in 2018/2019.[42] The CMA estimated that, if this growth is taken into account, the size of the relevant market is likely to be around £17 million in two years (excluding commissions).

147. In this case, the CMA did not have to decide whether commissions paid to higher education customers should be excluded from the calculation of the market size as, even excluding these commissions, the size of the market concerned is currently very close to £15 million and growing.

148. Accordingly, the CMA believes that the affected market is of a size which suggests that it would generally be of sufficient importance to justify a reference.

The likelihood of the SLC and the magnitude of competition lost

149. The CMA takes into account the strength of its belief on anticompetitive effects of the merger and the magnitude of the loss of competition when deciding whether to exercise the *de minimis* exception.[43]

150. In the present case, the Merger has led to one firm having more than 90% share of supply. The Parties were each other's closest competitor pre-Merger, with little competitive constraint remaining from alternative suppliers. The CMA believes that the effects of this loss of competition are likely to be increases in price (ie reductions in commissions to customers), decreases in quality and less innovation. Some of these adverse effects will be passed through and felt by end-users (ie students).[44]

151. These factors point against the application of the *de minimis* exception.

Durability

152. The CMA notes that there is some evidence of entry/expansion, which might limit the period of detriment resulting from the Merger. However, as set out above, the CMA believes that entry/expansion will not be likely, timely and sufficient to offset the effects of the Merger.

153. In the context of the above factors indicating the high likelihood and significant magnitude of harm which can be expected to arise from the Merger, the CMA does not believe it can rely on entry/expansion to limit the duration of the

[42] When considering market size, the CMA will not view the market statically, but will take into account factors which indicate that the market size may be significantly expanding or contracting in the foreseeable future (*Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 30, fifth bullet point).
[43] *Mergers: Exception to the duty to refer in markets of insufficient importance*, (CMA 64), 16 June 2017, paragraphs 31-33.
[44] *Mergers: Exception to the duty to refer in markets of insufficient importance*, paragraph 36.

adverse effects to a sufficient extent to warrant the application of the *de minimis* exception.

Conclusion on the application of the de minimis exception

154. Taking all the above factors into consideration, the CMA believes that the market concerned in this case is of sufficient importance to justify the making of a reference. Therefore, the CMA believes that it is not appropriate for it to exercise its discretion to apply the *de minimis* exception.

Decision

155. Consequently, the CMA believes that it is or may be the case that (i) a relevant merger situation has been created; and (ii) the creation of that situation has resulted, or may be expected to result, in an SLC within a market or markets in the UK.

156. The CMA therefore believes that it is under a duty to refer under section 22(1) of the Act. However, the duty to refer is not exercised[45] whilst the CMA is considering whether to accept undertakings[46] instead of making such a reference. JLA has until 10 April 2018[47] to offer an undertaking to the CMA.[48] The CMA will refer the Merger for a phase 2 investigation[49] if JLA does not offer an undertaking by this date; if JLA indicates before this date that it does not wish to offer an undertaking; or if the CMA decides[50] by 17 April 2018 that there are no reasonable grounds for believing that it might accept the undertaking offered by JLA, or a modified version of it.

157. The statutory four-month period mentioned in section 24 of the Act in which the CMA must reach a decision on reference in this case expires on 4 April. For the avoidance of doubt, the CMA hereby gives JLA notice pursuant to section 25(4) of the Act that it is extending the four-month period mentioned in section 24 of the Act. This extension comes into force on the date of receipt of this notice by JLA and will end with the earliest of the following events: the giving of the undertakings concerned; the expiry of a period of 10 working days beginning with the first day after the receipt by the CMA of a notice from JLA stating that it does not intend to give undertakings; or the cancellation by the CMA of the extension.

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[45] Section 22(3)(b) of the Act.
[46] Section 73 of the Act.
[47] Section 73A(1) of the Act.
[48] Section 73(2) of the Act.
[49] Sections 22(1) and 34ZA(2) of the Act.
[50] Section 73A(2) of the Act.

Rachel Merelie
Senior Director, Delivery and Sector Regulation
Competition and Markets Authority
03 April 2018

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[i] The second sentence of paragraph 53 should read as follows: [✄].

[ii] The term PHS Laundryservices in paragraph 92(d) should read PHS LaundryServ