COMPLETED ACQUISITION BY JLA NEW EQUITYCO GROUP LTD THROUGH ITS SUBSIDIARY VANILLA GROUP LTD OF WASHSTATION LTD

Issues statement

9 May 2018

The reference

1. On 16 April 2018, the Competition and Markets Authority (**CMA**), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the **Act**), referred the completed acquisition by JLA New Equityco Ltd (**JLA**) via its subsidiary Vanilla Group Ltd of Washstation Ltd (**Washstation**) for investigation and report by a group of CMA panel members (the **inquiry group**).

2. In accordance with section 35(1) of the Act, the inquiry group must decide:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (**SLC**) within any market or markets in the UK for goods or services.

3. If a relevant merger situation has resulted, or may be expected to result in an SLC, then the inquiry group must also decide:

   (a) whether action should be taken by the CMA for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which has resulted from, or may be expected to result from, the SLC;

   (b) whether to recommend the taking of action by others for such a purpose; and

   (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

4. In deciding the matters set out in paragraph 3, the inquiry group:

   (a) shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any adverse effects resulting from it; and

(b) may, in particular, have regard to the effect of any action on any relevant customer benefits (**RCB**s) in relation to the creation of the relevant merger situation concerned.

5. In this statement, we set out the main issues we are likely to consider in reaching our decisions, having had regard to the evidence gathered to date including evidence set out in the phase 1 decision to refer the acquisition of Washstation by JLA for further investigation (the **Phase 1 decision**[1]). This does not preclude the consideration of any other issues which may be identified during the course of our inquiry, which will include the gathering of further evidence.

6. Throughout this document, where appropriate, we refer to JLA and Washstation collectively as 'the **Parties**'.

Background

7. On 18 May 2017, Vanilla Group Ltd, a subsidiary of JLA, acquired the whole of the issued share capital of Washstation (the **Merger**).

8. 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.

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

10. The Parties overlap in the supply of managed laundry services to higher education customers, such as universities, colleges and student accommodation providers, and hospitality and leisure customers, such as hostels and holiday parks. 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**).

11. Other customers of managed laundry services include (i) hospitals, care homes, schools etc, who use machines for their housekeeping operations

[1] Completed acquisition by Vanilla Group Ltd of Washstation Ltd, CMA decision of 3 April 2018 (CMA/6792/17).

(**healthcare and school customers**); and (ii) hospitality and leisure customers (eg holiday parks, hostels etc), who provide machines to their end-users (**leisure customers**).

12. There are four types of agreement offered by managed laundry services providers:

    (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).

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

Market definition

14. 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 CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing whether a merger may give rise to an SLC, the CMA may take into account factors such as constraints outside the relevant market, segmentation within the relevant market, and other ways in which some constraints are more important than others.[2]

15. In general, market definition and the analysis of competitive effects are both driven by considerations relating to the 'closeness' of substitution between the Parties' offers and those of alternatives.

[2] See Merger Assessment Guidelines (CC2/OFT 1254), September 2010 (Merger Assessment Guidelines), paragraph 5.2.2.

16. The Parties overlap in the supply of:

(a) managed laundry services through variable rental agreements to higher education customers in the UK;

(b) managed laundry services through variable rental agreements to leisure customers in the UK.

17. The CMA, in the phase 1 decision, assessed the effects of the Merger by reference to the supply of managed laundry services to higher education customers under variable rental agreements in the UK. As set out in paragraphs 35, 38 and 47-49 of the CMA phase 1 decision,[3] the Parties submitted that the appropriate product frame of reference in this case should be the supply of managed laundry services to customers (irrespective of the type of agreement and type of customer). They also submitted that a UK market for managed laundry services is the narrowest appropriate geographic frame of reference.

18. We will investigate the extent to which other types of agreement are alternatives to managed laundry service variable rental agreements for higher education customers in the UK.

19. In particular, we will conduct customer research to investigate, higher education customers' preferences and requirements, including their:

(a) willingness to consider fixed rental or sales contracts instead of variable rental contracts;

(b) willingness to consider suppliers without experience of higher education sector.

20. We will also investigate whether the product frame of reference should be widened on the basis of supply-side substitution to include: (i) suppliers not currently offering variable rental agreements; and/or (ii) suppliers offering managed laundry services to customers outside the higher education sector.

21. We plan to use the geographic scope as defined in the phase 1 decision (national geographic market of the whole of the UK) as the starting point for our analysis, but we will assess whether it is appropriate to define a narrower geographic scope than UK-wide or to consider any differences in the nature of competition at regional level in the competition assessment.

[3] Completed acquisition by Vanilla Group Ltd of Washstation Ltd, CMA decision of 3 April 2018 (CMA/6792/17).

Assessment of the competitive effects of the merger

Counterfactual

22. We will assess the possible effects of the merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation in the absence of the merger). We will therefore consider what would have been likely to have happened if the merger had not taken place and what would have been the likely conditions of competition in the foreseeable future.

23. At Phase 2 the CMA has to make an overall judgement on whether or not an SLC has occurred or is likely to occur. To help make this judgment on the likely future situation in the absence of the merger, the CMA may examine several possible scenarios, one of which, for completed mergers, may be the continuance of the pre-merger situation, but only the most likely scenario will be selected as the counterfactual.[4]

24. As set out in paragraphs 24 and 25 of the CMA phase 1 decision,[5] we have seen no evidence supporting a different counterfactual to the pre-merger conditions. JLA submitted that it has no reason to believe that the market would look materially different absent the Merger.

25. Therefore, we currently believe the pre-merger conditions of competition to be the relevant counterfactual.

Assessment of the impact of the merger on competition

26. Theories of harm describe the possible ways in which an SLC could arise as a result of the merger and provide the framework for our analysis of the competitive effects of the merger. We have set out below the theory of harm which we intend to investigate. The identification of a theory of harm does not preclude an SLC being identified on another basis following further work by us, or the receipt of additional evidence.[6] We welcome views on the theory of harm set out below.

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[4] Merger Assessment Guidelines, paragraph 4.3.6.
[5] Completed acquisition by Vanilla Group Ltd of Washstation Ltd, CMA decision of 3 April 2018 (CMA/6792/17).
[6] Merger Assessment Guidelines, paragraph 4.2.1

Horizontal unilateral effects through the loss of actual competition

27. The Merger, by removing a competitor of JLA could provide JLA the incentive to deteriorate the elements of its competitive offering.

28. In general, for this theory of harm to hold, two conditions need to be met:

(a) the merger parties are close competitors (ie they are considered to be good alternatives by customers); and

(b) other suppliers cannot replicate the competitive constraint that the merger parties exert on one another.

29. In the managed laundry sector contracts are negotiated through bilateral negotiations or tenders and, therefore, closeness of competition can be measured in terms of which suppliers represent close "outside options" for any particular customer, i.e. the customers' next best alternatives to their preferred supplier. The strength of an outside option will depend on:

(a) degree of product homogeneity or differentiation;

(b) capacity constraints of alternative suppliers and likelihood of entry/expansion.

30. The Merger could give rise to unilateral effects if Washstation was a viable, and close outside option to JLA. If removing this outside option reduces customers' bargaining strength in negotiations and tenders, the Merger could result in customers accepting a worse deal than pre-merger (eg higher prices, lower commissions or worsening of other non-price competitive parameters, such as quality or service levels).

31. The CMA will assess the effects of the Merger in relation to the supply of managed laundry services in which the Parties overlap (see paragraph 16). However, given Washstation's minimal revenues generated from the supply of managed laundry services to customers outside the higher education customers, our current intention is to focus on the Parties' overlap in managed laundry services to higher education customers.

32. The CMA found in the Phase 1 decision that, on the basis of tender data, third party evidence and internal documents, the Parties were each other's closest competitor, faced weak competitive constraints from other competitors and had a share of supply of more than 90% in the supply of managed laundry services to higher education customers.

33. JLA stated that other suppliers offer managed laundry services on a variable rental basis to higher education customers in the UK (Hughes/Armstrong,

Brewer & Bunney, Goodman Sparks and Wolf Laundry). It also submitted that any supplier currently active in the commercial laundry market, be it through fixed or variable rental, machine sales or servicing of machines, regardless of the customer segment, is an existing or potential competitor.

34. In order to understand the nature and extent of competition between different suppliers of managed laundry services, we will examine the following factors:

(a) Closeness of competition between JLA and Washstation:

We will consider whether the Parties were close alternative suppliers for each other's customers, and whether competition between the Parties influenced how they set prices or other aspects of their service. We will also investigate whether, as submitted by JLA, Washstation had or would likely have financial difficulties absent the Merger and whether and to what extent those difficulties would have had an impact on the competitive constraint Washstation would have imposed on JLA absent the Merger.

(b) Competitive constraints from other managed laundry suppliers and other types of managed laundry service contracts:

35. We will consider the degree of differentiation between suppliers and the extent to which other suppliers and/or other types of agreement are alternatives for the Parties' customers. We will also consider whether students (as end users of the service) would switch to other alternatives to the managed laundry services offered by the universities, such as high-street laundrettes, in response to a deterioration of service or increase in price.

36. To assess these factors, we will seek additional evidence, including on:

(a) customers' approaches to contract negotiations or tender processes, and the responses received from different suppliers in past tenders or negotiations;

(b) customers' requirements and preferences that may have an impact on their choice of suppliers, including

(i) customers' propensity to switch between types of agreements (variable rental, fixed rental and sales agreements);

(ii) customers' propensity to use providers with limited or no previous experience; and

(iii) customers' views on the importance of certain non-price factors, such as overall quality of service, the offering of online services (ie online portals through which students can monitor machine availability) and/or other ancillary services (eg refurbishment of the laundry rooms).

Countervailing factors

37. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find.

Entry and expansion

38. The Phase 1 decision concluded that entry or expansion would not be timely, likely or sufficient to offset the effects of the Merger, as there was little evidence on historic entry/expansion (apart from Washstation who had already close ties to the higher education sector). The Phase 1 decision also identified some possible barriers to entry and expansion, including the financial risk associated with variable rental agreements, the tender requirements of HE customers and certain upfront costs. A number of competitors indicated their willingness to expand/enter in this sector, but the CMA received insufficient evidence to conclude that this entry would offset the Merger effect.

39. JLA submitted that barriers to entry and expansion are low in the supply of managed laundry services and that regardless of the type of contract, other suppliers of commercial laundry services who do not currently supply higher education customers could easily expand into the higher education sector at little cost. JLA also stated that there are clear and identifiable opportunities in the supply of managed laundry services on a variable rental basis to HE customers and that a new entrant can easily replicate the competitive constraint that was imposed by Washstation within a short period of time.

40. We plan to investigate the ease and likelihood of entry and expansion, and whether entry or expansion by effective competitors could be expected to be timely, likely and sufficient to prevent any SLC that might otherwise arise.

41. To investigate this issue, we intend to seek additional evidence, including on:

    (a) the history of entry, expansion and exit, in particular the opening of Washstation in 2013 and subsequent development of its UK business;

    (b) any changes to the way in which higher education customers procure laundry services, for example through buyer groups, that might affect the likelihood of entry or expansion in the foreseeable future;

(c) the steps involved in new entry or expansion into the supply of new customers or new geographies, and costs of doing so;

(d) the likelihood of future entry/expansion;

(e) the barriers to entry and expansion, including:

(i) the financial risks associated with variable rental agreements;

(ii) the duration of managed laundry services contracts and likelihood of a contract being rolled over instead of being retendered or renegotiated at the end of its term;

(iii) working capital/investment costs;

(iv) costs associated with tenders;

(v) logistics and service engineer network, including access to and availability of a sufficient number of suitable engineers;

(vi) what additional services may be required to accompany the service; and

(vii) customers' preferences to switch supplier (eg cost of switching, length of existing contracts, and importance of an established relationship).

Buyer power

42. Contracts are bilaterally negotiated between suppliers and customers. Therefore, the extent of any countervailing buyer power that customers of managed laundry services may have depends on what alternative suppliers each individual customer can use to negotiate prices and services with the Parties. In addition, we note that that no customer appears to account for a high proportion of JLA or Washstation's revenues generated from the supply of managed laundry services.

43. We will examine how negotiations are carried out between the Parties and customers, and the strength of outside options the customer has both in terms of existing suppliers of managed laundry services in the higher education sector and potential new suppliers (as set out in paragraph 34), This will determine if there are sufficient outside options for customers to switch to post-merger and therefore exercise countervailing buyer power of a scale to be sufficient to offset an SLC.

Efficiencies

44. We will examine any evidence available to us in relation to efficiencies arising from the Merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset any loss of competition.

Possible remedies and relevant customer benefits

45. Should we provisionally conclude that the Merger may be expected to result in an SLC in one or more markets, we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.

46. In any consideration of possible remedies, we will take into account whether any relevant customer benefits might be expected to arise as a result of the Merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

47. Any party wishing to respond to this issues statement should do so in writing, by no later than **5pm on Wednesday 23 May 2018**.

Please email JLAWashstation@cma.gsi.gov.uk or write to:

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