

## COMPLETED ACQUISITION BY RENTOKIL INITIAL PLC OF CANNON HYGIENE LIMITED

### Issues statement

16 July 2018

#### The reference

1. On 28 June 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 Rentokil Initial plc (Rentokil) of Cannon Hygiene Limited (Cannon) (the Merger) for further investigation and report by a group of CMA panel members (the Group).
2. In exercise of its duty under section 35(1) of the Act, the CMA 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. In answering these two questions we will apply a ‘balance of probabilities’ threshold to our analysis. That is, we will decide whether it is more likely than not that the Merger has or may be expected to result in an SLC.<sup>1</sup>
4. In this statement, we set out the main issues we are likely to consider in reaching our decision on the SLC question (paragraph 2(b) above), having had regard to the evidence available to us, including the evidence referred to in the CMA’s phase 1 decision to refer the Merger for further investigation (the Reference Decision).<sup>2</sup> This does not preclude the consideration of any other issues which may be identified during the course of our inquiry.
5. We are publishing this issues statement in order to assist parties submitting evidence to our inquiry. The issues statement sets out the issues we currently

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<sup>1</sup> [Merger Assessment Guidelines](#) (CC2/OFT1254), paragraph 2.12. The *Merger Assessment Guidelines* have been adopted by the CMA board (see [Mergers: Guidance on the CMA’s jurisdiction and procedure](#) (CMA2), Annex D).

<sup>2</sup> See the full text of the Reference Decision on the [case page](#).

envisage being relevant to our inquiry and we invite parties to notify us if there are any additional relevant issues which they believe we should consider.

6. Throughout this document we refer to Rentokil and Cannon collectively as 'the Parties'.

## **Background**

7. On 21 December 2017, the Parties entered into a Sale and Purchase Agreement, which included various hygiene services in Austria, India, Ireland, Portugal, South Africa, Spain, Thailand, the UK and New Zealand. In the UK, the transaction completed on 1 January 2018.
8. Rentokil is a global hygiene service and commercial pest control provider. In the UK, Rentokil provides washroom services, healthcare waste collection services, mats services and pest control services. Rentokil is listed on the London Stock Exchange and is a constituent of the FTSE 100 Index. The turnover of Rentokil for the year ended 31 December 2017 was approximately £2.4 billion worldwide of which £[~~2.4~~] was generated in the UK.
9. Cannon, formerly a multinational subsidiary of OCS Group Limited, also provides washroom services, healthcare waste collection services and mats services in the UK. Its UK turnover for the year ended 31 March 2017 was £[~~2.4~~].
10. The Parties overlap in:
  - (a) the supply of washroom services;
  - (b) the supply of healthcare waste collection services; and
  - (c) the supply of mats services.

## **Market definition**

11. 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 a merger, as it is recognised that there can be constraints on merger 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.<sup>3</sup>

12. As set out above, the Parties overlap in: (a) the supply of washroom services; (b) the supply of healthcare waste collection services; and (c) the supply of mats services.

### ***Washroom services***

13. Washroom services include the installation of washroom equipment, the servicing of equipment and the supply of consumables (eg paper towels, soap and toilet paper). Washroom equipment is generally installed on a supplier's first visit to a customer's washroom, with servicing and refills being provided on subsequent visits. Product and service categories include waste disposal (eg feminine hygiene and nappy bins), odour remediation, hand washing, hand drying, toilet tissue, toilet cubicle hygiene and vending.
14. The Reference Decision considered whether it was appropriate to segment the market by: (a) types of washroom products and services; (b) types of supplier (eg washroom specialists, facilities management companies, cleaning companies, office materials suppliers and wholesalers); and (c) types of customer, namely national (or multi-regional) customers and regional or local customers.<sup>4</sup>
15. The Reference Decision found that customers tend to procure multiple washroom products or services from a single supplier. The Reference Decision also found that it may not be economically viable for suppliers to offer only one product or service. The Reference Decision therefore considered a frame of reference including all washroom products and services.
16. The Reference Decision also considered whether different types of supplier of washroom services, such as facilities management and cleaning companies, office materials suppliers and wholesalers and manufacturers of specific washroom items (such as paper towels or soap dispensers) should be included in the frame of reference alongside full-range, full-service 'washroom specialists'. The Reference Decision found that washroom specialists face limited constraints from other types of supplier and therefore assessed the

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<sup>3</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

<sup>4</sup> 'National customers' hereafter refers to customers with sites located across the whole of UK or in multiple regions within the UK.

effects of the Merger in the supply of washroom services by washroom specialists.

17. The Reference Decision also considered whether the requirements and conditions of competition differ for large national (or multi-regional) customers with many sites (eg hundreds or thousands) and regional or local customers with a limited number of sites in one or only a few adjacent areas. The Reference Decision found that although some national customers might procure on a local basis, many prefer to use a single national supplier for a high proportion of their sites.
18. The Reference Decision therefore assessed the Merger in the supply of washroom services by 'national washroom specialists' to: (a) national customers in the UK; and (b) regional and local customers in the UK (whilst taking account of constraints from other types of supplier).
19. In our assessment at phase 2, we will use this frame of reference from the Reference Decision as a starting point for our analysis but, where relevant, we will consider out-of-market constraints and/or any differences in the degree of competitive constraints from different suppliers. We expect to consider:
  - (a) Whether the market should be segmented by service lines.
  - (b) Whether the market should be segmented by supplier category (eg washroom specialists or any other non-washroom specialists).
  - (c) Any differences in the supply of washroom services to intermediaries (such as facilities management and cleaning companies) as compared to customers purchasing for their own use.
  - (d) Any differences between national and regional or local customers, or any other types of customer.
  - (e) An assessment of any regional markets (in particular, the relevant catchment area).

### ***Waste collection services***

20. The Reference Decision assessed the impact of the Merger separately in the supply of healthcare waste collection services to: (a) large quantity waste generators in the UK; and (b) small quantity waste generators in the UK, as their volume, collection and transportation requirements differed. The Reference Decision did not conclude on whether it was necessary to identify distinct frames of reference for national customers and regional or local customers as no competition concerns arose from the Merger on either basis.

## *Mats services*

21. The Reference Decision considered the impact of the Merger on the narrowest possible frame of reference, which was the outsourced supply of mats services in the UK. However, the Reference Decision did not conclude on the precise scope of the product frame of reference as the Merger did not give rise to competition concerns on any basis.

## **Assessment of the competitive effects of the Merger**

### ***Counterfactual***

22. The application of the SLC test (referred to in paragraph 2(b) above), involves a comparison of the prospects for competition with the Merger against the competitive situation without the Merger. The latter is called the 'counterfactual'. We will, therefore, assess the possible effects of the Merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the Merger).
23. For completed mergers, the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the competitive effects of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than those conditions.<sup>5</sup>
24. The Reference Decision found no evidence supporting a different counterfactual. In our assessment of the competitive effects of the Merger, we expect to adopt pre-Merger competitive conditions as the counterfactual.

### ***Theories of harm to be investigated by the CMA***

25. Theories of harm describe the possible ways in which an SLC could arise as a result of a merger and provide the framework for the analysis of the competitive effects of a merger. We have set out below the theories of harm that we are currently minded to investigate. However, we may revise our theories of harm or investigate other theories of harm as our inquiry progresses. The identification of a theory of harm does not preclude an SLC

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<sup>5</sup> [Merger Assessment Guidelines](#), paragraph 4.3.5.

being identified on another basis following further work by us, or the receipt of additional evidence.

26. We welcome views on the theories of harm described below. At this stage, we are working on the basis that there may be differences in the requirements of national customers and regional or local customers but, as set out in paragraph 19, we will examine this as part of our inquiry.

*Theory of harm 1: Horizontal unilateral effects in the supply of washroom services by washroom specialists to national customers*

27. Horizontal unilateral effects may arise where one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm to profitably raise prices, degrade quality, reduce the range of services on its own and without needing to coordinate with rivals and/or to prevent/reduce the introduction of additional services.<sup>6</sup> Horizontal unilateral effects are more likely where the merger parties are close competitors and / or where markets are concentrated. This theory of harm also applies to regional and / or local customers.
28. We will examine whether the Merger has resulted, or may be expected to result, in an SLC from unilateral horizontal effects in relation to the supply of washroom services by washroom specialists to national customers.
29. In our competitive assessment, we expect to examine:
- (a) How national customers procure washroom services, eg do they prefer one supplier for all or most of their service lines and / or one which can supply across their sites.
  - (b) The nature of competition in the market, including how suppliers compete for washroom customers and the criteria that customers consider important for a washroom services supplier to be credible.
  - (c) To what extent does the nature and strength of competition differ between service lines.
  - (d) The closeness of competition between the Parties.
  - (e) The extent of the competitive constraint imposed by PHS and other washroom services suppliers post-Merger.

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<sup>6</sup> [Merger Assessment Guidelines](#), paragraph 5.4.1.

- (f) The extent to which suppliers other than washroom specialists (such as facilities management and cleaning companies) compete with the Parties.
- (g) The extent to which regional suppliers compete with the Parties for national customers.
- (h) The market structure, including the market shares of suppliers and number of effective suppliers remaining in the market.

*Theory of harm 2: Horizontal effects in the supply of washroom services by washroom specialists to regional and local customers*

- 30. We will examine whether the Merger has resulted, or may be expected to result, in an SLC from unilateral horizontal effects in relation to the supply of washroom services by washroom specialists to local and regional customers. Many of the points covered in paragraph 29 are relevant here. We have not reproduced these points.
- 31. The additional questions that we propose to address include:
  - (a) How regions or local areas should be defined.
  - (b) Whether the nature of competition varies regionally / locally.
  - (c) Whether washroom specialists differentiate prices and / or service quality by location.
  - (d) Whether regional customers have similar requirements as national customers (other than the fact they operate fewer sites).
  - (e) The extent of the competitive constraint from regional or local suppliers.
  - (f) The extent to which national suppliers serve regional or local customers.

***Theories of harm the CMA is not currently minded to investigate***

*Horizontal effects in the supply of healthcare waste collection services in the UK*

- 32. The Reference Decision examined whether the Merger would result in an SLC in the supply of healthcare waste collection services to: (a) large quantity waste generators in the UK; and (b) small quantity waste generators in the UK.
- 33. In relation to waste collection services to large quantity waste generators, the Parties estimated at phase 1 that they have a combined share of [0-5]%. No

third party concerns were raised and this overlap was not investigated further at phase 1.

34. In relation to waste collection services to small quantity waste generators, the Reference Decision found that the Parties' combined market share was moderate and similar to the shares of supply of both SRCL and PHS. Evidence from Rentokil's internal documents indicated that SRCL, PHS, Cannon and HES were competitors. A number of smaller national suppliers together accounted for approximately 20% of the market. The Reference Decision therefore concluded that there are sufficient competitors, in particular SRCL and PHS, which will continue to impose sufficiently strong constraints on the Parties post-Merger.
35. The Reference Decision therefore concluded that there was no realistic prospect that the Merger would result in an SLC in the supply of healthcare waste collection services to either large quantity waste generators or small quantity waste generators in the UK.
36. Subject to any further evidence submitted in response to this issues statement or in the course of the inquiry, we are not currently minded to investigate this theory of harm further. We do, however, welcome reasoned submissions any parties may wish to make in this regard.

#### *Horizontal effects in the supply of mats services*

37. The Reference Decision noted that the increment to Rentokil's share of supply resulting from the Merger is small and that Cannon is a relatively small provider of outsourced mats services.
38. The Reference Decision also found that the Parties face three large national competitors in the supply of mats services, namely Berendsen, PHS and Johnsons Apparelmaster. All three firms are larger than either of the Parties, with Berendsen and PHS having a larger share of supply than the merged entity. All three firms confirmed that they are active in the outsourced supply of mats services on a national basis.
39. The Reference Decision therefore concluded that there are sufficient competitors which will continue to impose sufficiently strong constraints on the parties post-Merger even on the narrowest plausible frame of reference. For this reason, the Reference Decision concluded that there is no realistic prospect that the Merger will result in an SLC in the outsourced supply of mats services in the UK.
40. Subject to any further evidence submitted in response to this issues statement or in the course of the inquiry, we are not currently minded to investigate this



theory of harm further. We do, however, welcome reasoned submissions any parties may wish to make in this regard.

## **Countervailing factors**

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

### ***Entry and expansion***

42. We intend to consider how easy it is for washroom services or other suppliers to enter and expand the supply of washroom services to national customers and to regional and local customers. We will consider whether entry and/or expansion could be expected to be timely, likely and sufficient to prevent any SLC. To do this we will:
- (a) look at the history of actual entry, expansion and exit by the Parties and by their competitors and review any future plans for entry, expansion and exit;
  - (b) examine the factors which might inhibit entry or the expansion of existing competitors; and
  - (c) consider the cost (particularly the sunk cost) and time taken to enter and/or expand.

### ***Efficiencies***

43. We have not received any substantiated representations on efficiencies. Given the possible economies of servicing a dense network of customers along the same route, for example, we will investigate whether any efficiencies arise from the Merger. Part of this assessment will flow from our competitive effects analysis – for example, the possible reasons why certain firms are stronger competitors. However, the Parties are well placed to provide evidence on such efficiencies.

### ***Buyer power***

44. In some circumstances, the ability of customers to use their negotiating strength to prevent a merged firm from increasing prices may make an SLC less likely to occur.<sup>7</sup> If all customers have such countervailing buyer power, an

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<sup>7</sup> Typically, countervailing power will be stronger if there are several alternative suppliers to which the customer could credibly switch. The Merger, initially at least, reduces the number of suppliers available to customers.

SLC is unlikely to occur. If only some customers have countervailing buyer power, the CMA considers the extent to which the buyer power of these customers may be relied upon to protect all customers.<sup>8</sup> This is harder in markets where prices and service quality are differentiated across customers as a result of bilateral negotiations or tenders.

45. The Reference Decision did not consider that the Parties' national customers would have sufficient buyer power to prevent an SLC post-Merger. The Reference Decision found that:
- (a) customers will only have two effective national suppliers to choose between;
  - (b) no individual customer has a significant share of the Parties' total sales;
  - (c) direct national customers are unlikely to sponsor expansion of suppliers as washroom services are a relatively small cost to an individual customer; and
  - (d) even if some customers did have countervailing buyer power, this would not protect other customers from price increases as large customers negotiate prices individually.
46. Regional and local customers were considered even less able to exercise countervailing buyer power, since they will typically be significantly smaller in scale than national customers.
47. We are open to receiving evidence on the extent of any countervailing buyer power held by customers during our inquiry. We welcome reasoned submissions in relation to the extent of any countervailing buyer power held by customers.

### **Possible remedies and relevant customer benefits**

48. Should we decide that the Merger has resulted, or may be expected to result, in an SLC in any market(s), we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.
49. In any consideration of possible remedies, we may have regard to their effect on any relevant customer benefits in relation to the Merger and, if so, what these benefits are likely to be and which customers would benefit.

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<sup>8</sup> [Merger Assessment Guidelines](#), paragraph 5.9.1.

## Responses to the issues statement

50. Any party wishing to respond to this issues statement should do so in writing, by no later than **5pm on 30 July 2018**. Please email [rentokilcannon@cma.gov.uk](mailto:rentokilcannon@cma.gov.uk) or write to:

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