

RENTOKIL INITIAL PLC / CANNON HYGIENE LIMITED**PARTIES' RESPONSE TO THE CMA ISSUES STATEMENT DATED 16
JULY 2018****1. Introduction**

- 1.1 The Parties welcome the confirmation in the Issues Statement that no competition concerns arise in relation to waste collection services and mats services.¹
- 1.2 In relation to washroom services, the Parties agree with the broad description of washroom services in the Issues Statement². However, they note that the CMA intends to use the frame of reference from the Reference Decision as a starting point for its Phase 2 analysis,³ notwithstanding the contradiction between this and the approach of the European Commission in Case M.8299 – *CWS-boco / Rentokil Initial Target Businesses* in 2017 in relation to markets that were in all material respects the same as the UK.
- 1.3 The Parties have already made detailed submissions, in their response dated 12 July 2018 to the Phase I Decision (the **Response**), in relation to this contradiction and in reaction to a number of other points now contained in the Issues Statement. They do not intend to repeat these submissions in depth now, but rather to summarise a number of them briefly below, and then to address in more detail some of the new questions raised for the first time in the Issues Statement principally in connection with local competition. References here to defined terms are the same as to those in the Response.

2. Summary of key issues already addressed by the Parties

- 2.1 By way of brief summary of the key issues with which the Parties have already set out their disagreement in the Response:
- (a) The Parties disagree with the Issues Statement's adherence to the notion "*that customers tend to procure multiple washroom products or services from a single supplier*".⁴ As set out in the Response, the Parties have concerns about the artificial focus on the supply of all washroom services by full-service washroom specialists. The evidence demonstrates that it is not the case that each customer looks for a "*full service offering*" let alone from a "*washroom services specialist*". On the contrary, the Parties have presented evidence that not only do customers use a range of suppliers to meet their washroom service requirements across different sites, but they also use a mix of suppliers at the same site.

¹ Paragraphs 20 - 21 and 22 - 40 of the Issues Statement.

² Paragraph 13 of the Issues Statement.

³ Paragraph 19 of the Issues Statement.

⁴ Paragraph 15 of the Issues Statement.

- (b) Similarly, the Parties disagree that the array of alternative supply options available to customers for each service mentioned in paragraph 16 of the Issues Statement provide “limited” competitive constraints. As set out in the Response, the significance of facilities management companies (*FMs*) as aggressive competitors as well as powerful customers and, in addition to cleaning companies, waste disposal companies and product suppliers and wholesalers, should not be underestimated. The Parties face serious competition nationally and on a regional or local basis not only for all seven individual services but also for permutations of bundles of services. This includes from product manufacturers (e.g. SCA Tork, Kimberly Clark), distributors / wholesalers (e.g. Bunzl) and from other washroom service providers - either directly or via FMs and cleaning companies.
- (c) The Issues Statement raises the question of whether the requirements and conditions of competition differ for large national (or multi-regional) customers with many sites (i.e. hundreds or thousands) and regional or local customers with a limited number of sites in one or only a few adjacent areas.⁵ The Parties submitted in the Response that such a distinction is artificial and contradicts the evidence available, including that cited in the Reference Decision. ‘National’ customers is an arbitrary and undefined concept not uniformly recognised by the Parties or by the market in general.⁶

As a result of its focus on so-called national customers, the Reference Decision failed to address the supply of services to the overwhelming majority of customers at all, and failed to understand the bottom-up nature of the dynamics in this industry whereby national competition is the sum of local competition. While it acknowledged the key point that some national customers might procure on a local basis, the Reference Decision did not go on to reach the appropriate conclusion that because multi-sourcing across regions is neither costly nor difficult, it is local and regional competition that is key to understanding the market dynamics in this industry.

- 2.2 In light of this, the Parties welcome the fact that their concern regarding the lack of assessment undertaken on local competition at Phase 1 appears to be subject to more prominent assessment at Phase 2. They think that the focus in the Issues Statement on the Phase 1 finding that some ‘national’ customers procure on a local basis is entirely appropriate to developing a proper understanding of the competitive constraints to which the merged entity will be subject. “Local” competition is the focus of the remainder of this submission.

3. Local and Regional competition

- 3.1 The Parties welcome the CMA’s intention to consider local and regional competition. In the Parties’ view, local and regional competition covers the vast majority (99.5% according to ONS data) of washroom services customers

⁵ Paragraph 17 of the Issues Statement.

⁶ See paragraphs 4.8 et seq. of the Response.

and it was a serious omission at Phase 1 not to consider this issue in any detail,⁷ or arguably, at all.

- 3.2 In order to help the CMA, the Parties have undertaken empirical analysis to shed light on the local and regional aspects of competition. This assessment will also inform the CMA's stated desire to consider (i) the closeness of competition between the Parties; and (ii) the extent of the competitive constraint imposed by PHS and other washroom services suppliers post-Merger.⁸
- 3.3 Although the focus is naturally on the second theory of harm set out in the Issues Statement (i.e. unilateral effects in the supply of washroom services by washroom specialists to regional and local customers), it is also responsive to the first theory of harm which focuses on unilateral effects at the national level, given the ease of multi-sourcing across regions to achieve national coverage. Specifically: (i) national customers already multi-source at the site level, with the average site taking fewer than [1-3] out of the seven washroom service lines from either Rentokil or Cannon; (ii) national customers, and notably FMs, can be expected to be large sophisticated organisations that deal with numerous different suppliers already; and (iii) there is unlikely to be a significant incremental cost associated with dealing with an additional supplier, with this figure estimated to be less than [0-5]% of the value of the contract.⁹ Indeed, the CMA itself found during Phase I that national customers would consider switching to regional suppliers in the case of a 5% price increase by national suppliers.¹⁰
- 3.4 The Parties together with their economic advisors, RBB Economics, have been able to produce the following two analyses:
- (a) *An analysis of local competition in washroom services:* this paper considers the local competition faced by the Parties in relation to the supply of washroom services, using data submitted to the CMA in response to the Market Questionnaire. Through use of a 'fascia analysis', the paper considers a number of aspects of local competition including those mentioned in paragraph 31 of the Issues Statement, such as the definition of regions and local areas, the variation of competition regionally and the service of regional or local customers by so-called 'national' suppliers.
 - (b) *An analysis of Rentokil Initial customer losses:* this paper considers a detailed breakdown of Rentokil's customer losses on a branch-by-branch basis. This provides insight into a number of considerations set out in paragraphs 29 and 31 of the Issues Statement, including the closeness of competition between the Parties and the competitive constraint provided by PHS, other parties (including FMs) and self-delivery.

⁷ Paragraph 1.7 of the Response and Paragraph 4.1 et seq. of the Response that refers to the Reference Decision's explicit statement as to the lack of analysis .

⁸ Paragraphs 29(d) and (e) and 30 of the Issues Statement.

⁹ Paragraph 5.13 of the Response.

¹⁰ Paragraph 30 of the CMA's Phase 1 Issue Paper.

- 3.5 These analyses show that there can be no reasonable basis on which the merger will result in a substantial lessening in competition (**SLC**) in the supply of washroom services at the local / regional level. In turn, the lack of competitive harm at the local level is a significant consideration to be taken into account when assessing competition at a ‘national’ level (if the CMA continues to seek artificially to bifurcate the market in this way). The analyses are described in full in the **Annexes** to this submission, and are summarised in the following sections.

4. An analysis of local competition in washroom services

- 4.1 This analysis is attached at **Annex 1** and considers the local competition faced by the Parties in relation to the supply of washroom services, using data submitted to the CMA in response to the Market Questionnaire.
- 4.2 The paper presents a fascia analysis using the Parties’ catchment areas based on 80% (which the Parties consider to be unduly conservative) and 95% thresholds and concludes that post-merger there is likely to continue to be effective competition around each branch. The 70% catchment area the CMA considered in the Market Questionnaire has also been analysed, but this results in no “5 to 4” or worse scenarios and is therefore not presented in this paper.
- 4.3 RBB has conducted this analysis on a highly conservative basis. In addition to sensitivity checking its results based on excessively narrow catchment areas, the effective competitor set excludes: (i) those competitors for which the exact location is not known; (ii) non-specialist competitors (e.g. FMs and cleaning companies); and (iii) self-delivery. The analysis then considers how the results may change if an even more conservative approach is taken, where it is assumed that the Parties only compete with those competitors providing all seven washroom service lines.
- 4.4 It can be seen from this paper that when the broadest (but still conservative) 95% threshold is considered, the Transaction represents a move from at least “5 to 4” – in some cases, very materially more - indicating there would not be local competition concerns. Even based on an excessively conservative 80% threshold there is in only one case on the data a concentration from 4 players to 3. Even in that case there is competition from [X], [X] and several other rivals that are located in, or understood to cover, the area.
- 4.5 In each case where even the most conservative approach is applied, there is minimal to no evidence of local or regional competition concerns. This analysis therefore constitutes compelling evidence that the Transaction will not result in an SLC in relation to the supply of washroom services at the local / regional level.

5. An analysis of Rentokil Initial customer losses

- 5.1 As submitted by the Parties in the Response, the Parties are not each other’s closest competitors and, by misinterpreting the win-loss data, the Reference Decision overstated the degree to which the Parties compete and understated the number of alternative suppliers. The Parties are now able to further substantiate their arguments in this regard through a more robust analysis and interpretation

of Rentokil's loss data, which shows as well that the Transaction will not result in material upward pricing pressure.

5.2 This analysis is set out in full at **Annex 2**. It is based on data gathered by Rentokil which asked each of its branch managers to identify the competitors to whom Rentokil lost (i) entire contracts ("terminations") or (ii) reductions on existing contracts ("reductions") during January 2017 to June 2018. Rentokil branches were asked to identify for any termination exceeding £500 at that branch the service lines affected and the value lost for each service line as well as the type of competitor (and name if available) to which Rentokil lost the business.

5.3 What emerges from the database is that:

- (a) PHS rather than the other Party is by far the most important competitor to each of Rentokil and Cannon;
- (b) in every region, Rentokil loses business to FMs, cleaning companies and self-supply. Consistent with these alternatives to the Parties being effective constraints, the share of lost value can be high. For example, in certain areas, FMs/cleaning companies accounted for over [10-20%] of the lost value while self-supply accounted for nearly [20-30%], which is entirely consistent with the Parties' previous submissions;
- (c) losses to [X] are broadly comparable to losses to [X], underlining the importance of also including [X] (which has national coverage) in any assessment of the effective competitive constraints that will continue to be imposed on the merged entity post-Transaction;
- (d) at every branch outside of [X], Rentokil loses business to washroom specialists other than PHS, Cannon, Cathedral and Healthcare Environmental, and this represents up to a quarter of lost value in [X], and 10% or more at the [X] branches in the base case;
- (e) the diversion ratio in respect of Cannon is low – typically below [10-20%] and at worst [10-20%] on the base case, the latter being a size that would be expected of a "6 to 5" merger among symmetric firms in the event customers have no option to stop purchasing washroom services entirely i.e. is inconsistent with any theory of harm; and
- (f) the conservative and robust branch-by-branch GUPPI analysis conducted by RBB shows that in no case does the relevant GUPPI exceed [5-10]% and that in all but three cases it is below [0-5]% (ranges that the CMA has found in recent cases to be unlikely to be indicative of competition concerns).¹¹ In other words, any loss of competition from Cannon is unlikely to put material upwards pressure on Rentokil's price (or downwards pressure on its levels of service).
- (g) While the GUPPI analysis is most informative about the constraint that Cannon places on Rentokil (and RBB finds this to be small), it can also

¹¹ At Phase II, the CMA has indicated that a GUPPI below 10%, in the absence of pass-through estimates, would not indicate a cause for concern. We note further that even where the GUPPI exceeds 10% it must be seen in the light of other evidence on competitive effects.

be inferred that Rentokil is not likely to be a major constraint on Cannon. This follows from viewing the two papers together. The local fascia analysis is conservative in that it considers only washroom specialists and so excludes the possibility that the Parties' branches face competition from FMs, cleaning companies or self-supply. However, evidence from Rentokil losses demonstrates that these are credible alternatives for Rentokil's customers and there is no reason to believe that this would not also be the case for Cannon customers. In other words, not only do Cannon branches face sufficient post-merger competition from nearby washroom specialists, but, on top of this, they are subject to competition from FMs, cleaning companies and self-delivery. Viewing these facts together indicates that any loss of competition from Rentokil is unlikely to put material upwards pressure on Cannon's price (or downwards pressure on its levels of service).

5.4 In summary, the analyses described above and set out in greater detail in **Annexes 1 and 2** demonstrate that any concerns about an SLC are misplaced. These analyses are conservative and robust and show that:

- (a) material competition remains in each area in which the Parties are active;
- (b) the Parties are not each other's closest competitor – that is PHS, to whom the Parties lose most business (and against whom they hope to be better able to compete as a result of the Transaction);
- (c) FMs, cleaning companies and other washroom service providers actively compete and win business from the Parties, and the threat of self-supply by customers is a genuine competitive constraint;
- (d) the Transaction will not result in material upward pricing pressure at the local or regional level; and
- (e) as such, credible options remain post-Transaction for national customers to obtain national coverage on competitive terms by procuring on a regional basis.

6. Countervailing factors

6.1 The Parties welcome the CMA's consideration of countervailing factors, and have already made representations on these in prior submissions. The Parties look forward to being able to continue to engage meaningfully on these issues to develop their existing representations, which can be summarised as follows:

- (a) *Entry and Expansion*: There are no material barriers to entry or expansion and any such barriers continue to be reduced due to recent market developments and innovation – in particular due to the increasing adoption of on-site servicing (*OSS*).¹²

¹² See Rentokil's response to Annex 1 of the Market Questionnaire Q's 25 – 28.

- (b) *Efficiencies*: Rentokil considers that a range of efficiencies are to be gained as a result of the Transaction, including [REDACTED].¹³
- (c) *Buyer power*: The Parties face considerable buyer power particularly from FMs, who are procurement specialists very adept at handling a number of suppliers. Similarly, those ‘national’ customers which source on a national / multiple site basis, are typically large and sophisticated buyers with highly experienced procurement teams.¹⁴ Smaller customers can and do also form strong buying groups, negotiating sophisticated framework agreements. In any event, even if they lack the countervailing buyer power of larger customers and FMs, the local competition analyses described above demonstrate that customers have a wide choice of alternatives to the Parties and that there is no meaningful prospect that they will be harmed post-Transaction.

7. Conclusion

- 7.1 The Parties welcome the recognition in the Issues Statement that additional analysis of regional and local competition will be necessary at Phase 2. The Parties analysis contains powerful arguments as to why the Transaction is not likely to result in an SLC. The Parties would be pleased to discuss these issues in greater detail in the coming weeks given their centrality to competitive dynamics in this market and the fact that this analysis was not developed by the CMA during the Phase 1 process.

¹³ See Rentokil’s response to Annex 2 of the Market Questionnaire Q’s 30 and 31.

¹⁴ See paragraphs 5.40 et seq. of the Response.

Annex 1
Analysis of local competition in washroom services

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Annex 2
Analysis of Rentokil Initial customer losses

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