Completed acquisition by JLA New Equityco Limited of Washstation Limited

Summary of Final Report

1. The Competition and Markets Authority (CMA) has found that the completed acquisition by JLA New Equityco Limited (JLA) of Washstation Limited (Washstation) (the Merger) has resulted, or may be expected to result, in a substantial lessening of competition (SLC) in the market for the supply of managed laundry services to higher education customers under vend share agreements in the UK.

Background: the Parties and the industry in which they operate

2. JLA and Washstation (together, the Parties) overlap primarily in the supply of managed laundry services to higher education customers, such as universities, colleges and student accommodation providers, through so-called vend share agreements in the UK.

3. Vend share agreements are one of three types of commercial laundry services agreements. Under a vend share agreement, the provider supplies and installs the machines and carries out repair and maintenance works. The customer does not pay rent to the provider, but instead receives an agreed percentage of the revenues generated from end-users of the machines in the form of commission from the provider.

4. The other two types of commercial laundry services agreements are (i) fixed rental agreements; and (ii) maintenance and repair services agreements. Together, fixed rental agreements and vend share agreements are commonly referred to as managed laundry services.

5. JLA, through its various subsidiaries, offers commercial laundry services (including managed laundry services), catering, heating and fire safety services to a variety of customers, such as care homes, schools, hotels, universities and hospitals. JLA offers managed laundry services to higher education customers through its subsidiary Circuit Launderette Services Limited.

6. Washstation is active in the provision of managed laundry services under vend share agreements, which it supplies to two types of commercial customers: higher education customers and hospitality and leisure customers.

7. Other than the Parties, the next two largest providers of managed laundry services under vend share agreements to higher education customers in the UK are James Armstrong and Company Ltd (Armstrong), which was acquired by Hughes Electrical Ltd (Hughes) in January 2018, and Goodman Sparks Ltd.

The investigation

8. As part of our investigation, we received several submissions and responses to information requests from the Parties, held in depth-hearings with both higher education customers and providers of managed laundry services and commercial laundry services, and carried out an extensive review of internal documents held by the Parties. We also considered the results of customer research commissioned by the CMA.

Relevant merger situation

9. On 18 May 2017, JLA acquired all of the issued share capital of Washstation. We are satisfied that the Merger has resulted in the creation of a relevant merger situation because this transaction has resulted in the Parties ceasing to be distinct, and the statutory share of supply test is satisfied. In the present case, as a result of the Merger, the Parties have a combined share of supply of more than 90% in the provision of managed laundry services to higher education customers under vend share agreements in the UK.

Counterfactual

10. To assess the effects of the Merger on competition we considered what the competitive situation would have been absent the Merger (the counterfactual). In order to determine the counterfactual, we have considered, based on the evidence, what the most likely scenario would have been had Washstation not been acquired by JLA.

11. We considered two possible counterfactual scenarios: (i) whether Washstation would continue to operate in the market as it did prior to the Merger (ie pre-Merger conditions), or (ii) whether it would continue to operate in the market but impose a lesser competitive constraint on JLA, as submitted by JLA.

12. We have found that Washstation would have continued to compete in the supply of managed laundry services to higher education customers as it had

done prior to the Merger. This finding is based on the following evidence and analysis:

(a) due diligence commissioned by JLA on Washstation's business shows that the business was forecast to grow (revenues, profitability and cash flow) and our analysis of contract data shows that Washstation had been on a growth path since 2010;

(b) while some additional finance may have been required to continue to develop the business and support its continued expansion, Mr A. Copley, the former owner of Washstation (Mr Copley), told us that, prior to the Merger, he was considering raising additional finance to develop the business;

(c) Washstation's commission rates (ie the percentage of vend revenues paid to higher education customers) were not significantly different from those of JLA and while Washstation appears to have some uneconomic contracts, these are limited in number and do not cast material doubts on the ability of the Washstation business to continue to compete as it did pre-Merger; and

(d) while there have been some instances of customer dissatisfaction with other aspects of Washstation's performance, this has resulted in the loss of a limited number of Washstation contracts and has not significantly weakened Washstation's ability to compete as it did pre-Merger.

13. We also assessed whether Hughes' acquisition of Armstrong was sufficiently likely at the time of the Merger to be incorporated in the counterfactual. We found that Hughes' expansion plans for the Armstrong business were, to some extent, linked to the Merger. Accordingly, the most likely counterfactual is the counterfactual in which Armstrong would continue to operate under the pre-Merger conditions of competition.

14. Therefore, we have found that the most likely counterfactual is the pre-Merger conditions of competition.

Market definition

15. The purpose of market definition in a merger investigation is to provide a framework for the analysis of the competitive effects of the merger.

16. The primary overlap between the Parties is in the provision of managed laundry services to higher education customers under vend share agreements in the UK.

17. In establishing whether the relevant product market should be broader than the activities in which the Parties overlap, we assessed:

(a) the extent to which other means of procuring laundry services are demand-side substitutes for vend share agreements, and so represent credible outside options to customers; and

(b) the extent to which providers of managed laundry services to other sectors and through other contractual models are the same as the providers of managed laundry services to higher education customers and have the ability and incentive to quickly supply higher education customers.

18. Our investigation revealed that the majority of customers do not consider that alternative types of procurement, such as fixed rental agreements or outright purchase, are alternatives to vend share agreements. In particular, almost all higher education customers used (and continue to use) vend share agreements for the supply of managed laundry services and very few customers have previously switched from vend share to fixed rental agreements. Some higher education customers expressed their preference for vend share agreements, mainly because they: avoid the need for capital outlays by the customer (and the associated financial risks), do not require customers to assume operational responsibility for the laundry service, and provide a source of income (with the vend revenues generated by students being shared between service providers and the higher education customers).

19. We also found that higher education customers have some different requirements from customers in other sectors, due to their end-user profile, which may be expected to limit the ability of providers active in other sectors to quickly supply them (eg in terms of laundry room refurbishment, more stringent services requirements, the risk associated with the requirement of vend share agreements, and experience in supply to higher education customers). The evidence also indicated that overall, the set of firms active in serving the higher education sector is broadly different from the set of firms serving customers in other segments.

20. With regard to the geographic scope of the market, the competitive constraint on firms bidding for higher education contracts will stem from the willingness of customers to award contracts to rival firms. We therefore find it appropriate to adopt a national geographic market to assess the aggregate constraint that each managed laundry service provider within the higher education sector may impose on each other.

21. In summary, we have concluded that the relevant market should be defined as managed laundry services to higher education customers under vend share agreements in the UK (the higher education market).

Competitive assessment

22. We assessed the competitive effects of the Merger, including evidence on the strength of the constraints the Parties imposed on each other and the constraint imposed by other providers. To do this, we considered: (i) market shares over time and in respect of new contracts; (ii) contract sizes and commission rates; (iii) who JLA lost contracts to (‘switching ratio analysis’); and (iv) evidence from internal documents, third party hearings and customer research on providers’ strengths and weaknesses and the closeness of competition between them when contracts were awarded.

23. Taken together, our analysis of data on market shares, new contracts wins and commission rates show that, prior to the Merger: (i) the Parties accounted for more than 90% of that market (with an increment as a result of the Merger of [5-10%]); (ii) Washstation was the strongest competitor to JLA and that it was growing; (iii) Armstrong represented a much weaker constraint, with a market share of [0-5]%, declining in the last three years.

24. Evidence from past tenders and contract negotiations shows that JLA and Washstation were each other’s closest competitor, with Washstation accounting for the large majority of contracts lost by JLA. While Armstrong was the other most credible competitor, the evidence shows that Armstrong represented a weak constraint on JLA. Other competitors and self-supply represented very weak constraints.

25. Overall, during third party hearings, all third parties identified JLA and Washstation as close competitors. Customers only identified JLA, Washstation, Armstrong and Goodman Sparks as competitors in the supply of managed laundry services under vend share agreements (while some customers had, in some cases, received expressions of interest from other providers, none of these providers had ultimately been awarded a contract).

26. We concluded from the submissions from competitors and other providers of laundry services that, with the exception of Armstrong, other providers exert a very weak constraint on JLA. This is because alternative providers of laundry services: (i) currently only serve a very small number of higher education customers and/or are relatively small companies, with limited financial resources and/or a limited geographic presence, or (ii) are not actively competing for these customers and, in some cases, do not offer vend share agreements.

27. Internal documents also show that JLA perceived Washstation as its closest competitor and took into account the risk of losing higher education customers to Washstation when formulating its offer. These documents also show that higher education customers used Washstation's presence as a bargaining tool when negotiating with JLA. JLA also considered Armstrong to be a competitor for some customers, however, there was little evidence of JLA monitoring other providers.

28. The results of the CMA's customer research indicate that: (i) JLA holds an influential position in the higher education market and that JLA and Washstation have the technology to offer a range of payment methods and online services, which respondents said other providers appeared not to have at the time of the customer research; (ii) JLA and Washstation are the two main providers of managed laundry services, with the other most credible alternative being Armstrong.

29. Taken together, the evidence shows that prior to the Merger, Washstation competed strongly against JLA, with Armstrong representing a much weaker constraint.

30. We found that the Merger may be expected to have a negative effect in JLA's offering in new contracts. As the remaining competitors post-Merger will not sufficiently constrain JLA, JLA may be expected to have the ability and incentive, when it negotiates new contracts, to degrade its competitive offer, including in relation to price and/or service levels.

31. In addition, we cannot exclude that the Merger may be expected to negatively affect existing contracts, as the remaining competitors post-Merger will not sufficiently constrain JLA and JLA could degrade some of the parameters of its service offering which are not constrained by contractual commitments.

32. On the basis of the evidence, we conclude that, unless there are countervailing factors, the Merger has resulted or may be expected to result in an SLC in the higher education market and that the SLC may be expected to result in adverse effects in the form of the degradation of the competitive offer, including price and service levels.

Countervailing factors

33. We considered whether entry and/or expansion or buyer power might prevent an SLC from arising in this case.

34. As regards entry and/or expansion, there have been no recent instances of meaningful entry or expansion, apart from Washstation itself, which entered

the higher education market in 2010 and benefited from Mr Copley's experience and knowledge of the higher education market. If barriers to entry or expansion were low, we would expect to see more instances of recent entry and/or expansion.

35. We found that the financial cost of entry and expansion is not significant in absolute terms. However, third party evidence indicates that these costs are likely to deter some potential providers, when considered together with the time required to recoup the initial capital outlay compared with other opportunities in the commercial laundry sector. We also found that there were some risks associated with the offer of vend share agreements (eg the risk of not recouping the initial investment in the relevant machines), which may be expected to further deter some potential entrants. In addition, we noted that JLA, being a distributor of an original equipment manufacturer (OEM), has a cost advantage when acquiring machines, compared with providers who are not authorised dealers, which allows JLA to offer more attractive prices that new entrants are likely to find difficult to match.

36. Furthermore, we found that the following non-financial barriers to entry and expansion are likely to make entry or expansion in the higher education market difficult for some providers.

(a) experience and reputation in the higher education market is an important factor for customers when they choose their suppliers of managed laundry services;

(b) the merged entity has a number of advantages resulting from its relationship with existing customers, including knowledge of the termination date of the large majority of the contracts in the higher education market. This means, for example, that potential providers who do not have such knowledge face a competitive disadvantage and are likely to compete for a more limited number of contracts;

(c) in any given year there is a limited number of contracts open for competition and a lack of transparency on when some of these contracts are available to competitors looking to enter into or expand in the higher education market.

37. Given our findings above, we would require sufficient countervailing evidence of future entry and expansion to conclude that post-Merger entry is likely, timely and sufficient to constrain the merged entity. Having considered various potential providers that could enter or expand into the higher education market, our view is that Hughes Armstrong was the only credible candidate

with the potential to expand in this market in a timely and sufficient manner to constrain the merged entity.

38. Hughes Armstrong has the intention and incentive to expand into the higher education market. However, the evidence on Hughes Armstrong's proposed changes to its offering and its performance in recent tenders, shows that Hughes Armstrong's expansion is not likely to be timely and sufficient to constrain the merged entity in the foreseeable future.

39. More specifically, although Hughes Armstrong expressed the intention to improve its offer, the associated changes in Armstrong's strategy and capabilities have not yet been implemented, it is uncertain when its offer will become a compelling proposition, and Hughes told us that the financial commitment to expansion in the higher education market is dependent on whether Armstrong would be successful in winning business.

40. Evidence on Hughes Armstrong's performance in recent tenders and customer feedback also shows that it remains, and is likely to remain, a weak constraint on the merged entity in the foreseeable future. In this regard, we note that Hughes Armstrong did not submit offers in respect of a number of opportunities that have arisen in recent months (in particular private accommodation providers), it has lost its largest customer, all the contracts it has won were small contracts, and it scored significantly lower than JLA in some large tenders.

41. Taking the evidence in the round, we found that even if Hughes Armstrong may expand in the future, it is not likely that Hughes Armstrong would achieve a sufficient scale in a timely manner such as to prevent an SLC arising.

42. In addition, we found that entry or expansion by other potential providers did not meet one or more of the requirements that entry or expansion should be likely, timely and sufficient to prevent an SLC arising.

43. We received no evidence that buyer power would offset our competition concerns such as to prevent an SLC arising.

44. Moreover, we have not been provided with relevant and specific evidence that the Merger would create rivalry enhancing efficiencies such as to prevent an SLC arising.

Conclusion

45. In view of the foregoing, having assessed the evidence in the round, we have concluded that the Merger has resulted, or may be expected to result, in an

SLC in the market for the supply of managed laundry services to higher education customers under vend share agreements in the UK.

Remedies

46. Having concluded that the Merger has resulted, or may be expected to result, in an SLC, we considered what action should be taken to remedy, mitigate or prevent the SLC or any of the resulting adverse effects we have found.

47. We concluded that a structural remedy in the form of a divestiture of the Washstation business would be the only effective remedy and would be a proportionate remedy.

48. Subject to the requirements of the purchaser and negotiations between JLA and the purchaser, we consider that the divestiture package should include, but is not limited to, the following:

(a) Washstation contracts with higher education customers held by the Washstation business at the time of the divestiture.

(b) Washstation machines installed at customer sites.

(c) Washstation machines that have been removed from customer sites (following contract losses) and are currently held in storage by JLA or are due to be returned to JLA to be held in storage.

(d) Where the purchaser requires additional machines to fulfil the obligations of Washstation under agreed contracts at the time of divestiture or where the purchaser requires machines to be installed during any transitional period following divestiture, JLA must sell these machines to the purchaser on a basis which is consistent with that upon which machines were previously supplied to Washstation. This should be included in any transitional services agreement and should only apply in respect of obligations that are due to be fulfilled before the end of the any transitional services agreement.

(e) All remaining assets associated with the Washstation business (subject to confirmation by the monitoring trustee and hold separate manager currently overseeing and operating Washstation on a hold separate basis).

(f) Technology and supporting contracts to facilitate machine availability monitoring and payment solutions as provided by Washstation prior to the Merger.

(g) Washstation bank accounts.

(h) Washstation brand, trademark and domain name.

(i) Washstation dedicated telephone helpline number.

(j) All available data relating to the Washstation business, including customer records, installations plans (including details of all sub-contractors used in the installation process), sales pipeline data, and financial records. This includes all data held on the Washstation IT server and JLA systems and any data held in physical form by JLA.

49. In addition, subject to the needs of the purchaser, JLA must provide key support and back office functions (eg engineering support, sales support, account managers, customer support, IT and Finance) to the purchaser under a transitional services agreement. The precise terms of the arrangement for the provision of these services to be provided on a transitional basis (as well as any potential complements to the agreement) are to be determined through negotiations between JLA and the purchaser and will be reviewed by the CMA as part of the approval of the terms of the divestiture.

50. Once any potential purchaser has been identified, we will consider in more detail the divestiture package as well as the viability of any purchaser. We will consider the suitability of each potential purchaser on its own merits and on a case-by-case basis.