

**PARTIES' RESPONSE TO THE CMA ISSUES STATEMENT DATED
15 MAY 2019**

("RESPONSE")

ME/6793/18

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The terms used in this Response have the same meaning as that given in the Parties' responses to the CMA's "Market Questionnaires" to the Parties of 1 May 2019.

A. INTRODUCTION

1. The Parties have already made extensive submissions during Phase 1, in their Initial Submissions and in their responses to the Requests for Information already provided to the CMA during Phase 2 as to why no SLC is likely to arise as a consequence of the Transaction. In brief summary, the Parties have explained previously why the following key dynamics of competition in the supply of cleaning chemicals to UK F&B customers mean that the Transaction should be cleared unconditionally:

1.1 Significant competitive constraints over the Merged Entity remain:

- 1.1.1 **Intense rivalry from other manufacturers of formulated products:** there will still be at least 3 significant competitors other than the Parties. "Specialists" in particular areas of the market also provide an additional competitive constraint. Furthermore, a myriad of smaller local competitors and foreign suppliers with smaller activity in the UK exist, who can easily expand production due to the low barriers to entry and expansion.
- 1.1.2 **High degree of product substitutability:** Formulated products developed for F&B typically show little differentiation from Supplier to Supplier and are substitutable for unformulated products and alternative solutions¹ with respect to many applications.
- 1.1.3 **Low switching barriers for customers:** A low proportion of customers go out to tender and/or enter into long-term exclusive agreements, meaning that most customers can replace their suppliers without warning. F&B suppliers are, therefore, under a continuous competitive threat.
- 1.1.4 **Industry standards ensure quality:** The introduction of food safety management systems such as HACCP, as well as quality "labels" such as the Marks & Spencer approved list of suppliers facilitate market access for smaller, less widely-recognised suppliers and drives service competition from non-hygiene chemical Suppliers.

1.2 The Parties are not close competitors, in particular:

- 1.2.1 **Ecolab's UK business is heavily focussed on customers for whom Holchem cannot bid,** i.e. International Customers who procure on a multi-country basis, typically negotiated outside the UK, serving a majority of sites outside the UK, and generating a majority of revenues outside the UK; and
- 1.2.2 **The Parties' sales to UK-only customers have different focusses,** with Holchem being focussed on Food while Ecolab is focussed on Beverage and Dairy.

- 1.3 **Ecolab's motivations for the Transaction are pro-competitive and favourable to consumers,** i.e. to reduce procurement costs for raw materials, enhance customer value through selling innovative Ecolab products to Holchem customers and improving commercial execution.

2. The Parties welcome the confirmation in the CMA's Issues Statement dated 15 May 2019 ("**Issues Statement**") that no competitive concerns arise in respect of the supply of cleaning products for institutional customers.

¹ Such as electrolyzed or ozonated water

B. THE MARKET REMAINS COMPETITIVE AFTER A MERGER OF THE PARTIES

Intense rivalry from other suppliers of formulated products

2. In any event, there would still be at least 3 significant competitors other than the Parties who are already operating in the UK to exert a competitive restraint. Each of Diversey, Christeys/Klenzan and Kersia/Hypred/Kilco have complete product ranges, personnel, technical expertise and manufacturing capability available to immediately serve any of the Parties' customers in the UK in Beverage, Dairy and Food, including Ecolab's International Customers with business in other EEA Member States that Holchem itself cannot serve.
3. The Decision also notes the presence of "specialists" concentrated in the Beverage² and Dairy³ Micro-Segments, who provide an additional competitive constraint. The Parties have submitted evidence that these specialists also offer products to the Food Micro-Segment and note that, given some additional complexity of Beverage and Dairy cleaning processes⁴ compared to those in Food, these specialists are more capable of expanding their range into Food than a notional Food specialist would be of expanding into Beverage or Dairy. Having said that, industry expertise is really not a barrier, given that Holchem, which is heavily concentrated in Food, has been able to expand into Dairy, building on the knowledge, expertise and services already provided to Food and Beverage customers.
4. Foreign competitors active in sales to F&B customers elsewhere in the EEA are also able to expand into the UK. Like other suppliers, Ecolab offers a single range of products and services across geographic borders. All European Ecolab F&B customers have access to the same "core range" of products and services: due to efficiency reasons and to ensure a consistent offering for multi-jurisdiction customers. Also, innovations are intended to be rolled out across the entire geographic area that is covered (not in the least to maximize return on investment). There can be some geographic variation in product and service availability from country to country, but typically this is driven by the relevant (EEA-wide) regulatory landscape.
5. Entry and expansion barriers are low for the large number of (i) competitors with small market shares already operating in the UK⁵; and (ii) potential competitors already selling identical products and providing identical services in other EEA Member States. Production capacity is not a constraint due to the wide availability of toll-manufacturing options and supply side substitutability, and costs from additional personnel being required for servicing are minimal.

Product substitutability

6. Formulated products developed for F&B are substitutable, with both unformulated products (such as nitric acid and caustic soda), as well as alternative solutions such as ozonated water. With regard to the small number of applications for which unformulated products are unsuitable (e.g. hand care), for many of these applications identical products are manufactured and sold by the myriad of Institutional manufacturers.
7. The Parties have been able to provide numerous concrete examples of the threat from unformulated products, and suspect there are many more out there. Many suppliers of these unformulated products will have a pre-existing relationship with F&B customers, as a result of the latter's requirements for chemicals that are used in other F&B applications than cleaning

² E.g. Sopura

³ E.g. Evans Vanodine

⁴ Related to CIP and Membrane applications

⁵ Both smaller local suppliers and local operations of large suppliers headquartered outside the UK

(for example in flavouring, colouring or other preparation processes).

8. While unformulated products and alternative solutions are not suitable for all applications, they are suitable for a significant proportion of applications, both in terms of volume of product supplied and associated revenues. Further, in light of the fact that unformulated products are based on the same chemistry as their formulated counterparts, it is easy for customers to alternate without complicated switching procedures or storage requirements, and in fact many customers store and use a combination of formulated and unformulated products for particular applications or circumstances. As shown in the examples provided in response to the Parties' Market Questionnaires, the loss of revenue from customers to solutions based on unformulated products can have a significant impact on the Parties' business with those customers. The mere threat of losing volumes of sales to a customer, would therefore be a significant constraint on any formulated supplier.

Low switching barriers for customers

9. As shown in the pricing and tender analysis previously provided to the CMA
 - 9.1 The vast majority of purchases made by F&B customers are made on bespoke prices⁶;
 - 9.2 Very few F&B customers are "locked in" to contracts with their suppliers;
 - 9.3 Customers have their own obligations to comply with health & safety regulations, and resulting hygiene requirements, with publically available guidelines and training, and they will therefore have their own in-house expertise.
 - 9.4 Customers can and do switch quickly between different suppliers; and
 - 9.5 When customers do switch, this switch is not, as a rule, tendered⁷ and comes as a result of an alternate F&B supplier making a better offer on a prospective approach.
10. As a result of this, F&B suppliers experience significant competitive uncertainty in the marketplace and must continue to offer their customers the best prices in order to head off any attempt by competitors to poach customers.
11. The majority of the Parties' UK-Only Customers do not procure under a contract, meaning that they are able to switch suppliers quickly in the event of a price increase. A testament to the competitiveness of the market is the fact that UK-Only Customers are often able to secure discounts to list prices even where they have not made any commitments to their suppliers in the form of a purchasing agreement. This is partly because there is a large number of smaller competitors, both domestic suppliers and international suppliers with a foothold in the UK capable of servicing UK-Only Customers.
12. With regard to Very Small Customers, these customers make up the majority of both Parties' UK F&B customers by number but do not receive significant levels of support or interaction with supplier representatives⁸, while Smaller Customers receive much less support than Large

⁶ Meaning that margins vary significantly product by product and from customer-to-customer, and (combined with the fact that UK F&B sunk costs benefit other Segments in the UK as well as products sold on foreign markets) make a margin analysis impractical.

⁷ While the evidence suggests that International Customers *do* typically tender for their suppliers, (i) they are the exception; and (ii) the Parties do not compete for these customers. A tender analysis is therefore highly unlikely to capture the extent to which the Parties and other competitors exercise a competitive constraint in the market. Notably, the CMA was only able to identify tenders for ✕ customers in a six-month period in which the Parties competed with each other.

⁸ It is important to note that, while the support provided to F&B customers (in particular by Holchem) is regarded as a key differentiator in the marketplace, it is not essential to an F&B customers' operations. Best practice guidance for legally required HACCP-compliant processes (e.g. https://www.food.gov.uk/sites/default/files/media/document/chapter9-haccp-principles-final_version-2.pdf) suggest that even the smallest F&B customers must have more than one member of staff dedicated to product safety procedures (which include cleaning). The need for daily monitoring and corrective action means that F&B customers cannot rely on the external suppliers' expertise alone and must have expertise in-house.

National Customers. Their business is, therefore, particularly vulnerable to challenge from smaller competitors.

C. CLOSENESS OF COMPETITION

13. Although the Parties do not suggest segmenting the market beyond F&B as a whole, further segmentation by customer Micro-Segment demonstrates that the Parties are not close competitors. A breakdown of the Parties' sales in 2018 to all customers across these Micro-Segments (which was previously provided in Annex 6.1 to Ecolab's response to the Market Questionnaire) is repeated below:

	Food		Beverage		Dairy		Total	
	£'000	%	£'000	%	£'000	%	£'000	%
Ecolab	✗	✗	✗	✗	✗	✗	✗	✗
Holchem	✗	✗	✗	✗	✗	✗	✗	✗
Combined	✗	✗	✗	✗	✗	✗	✗	✗
Market Size	✗	100%	✗	100%	✗	100%	✗	100%

Source: RBB analysis of Ecolab Model, Ecolab, Holchem.

14. As shown in the above, the Parties have different areas of focus, with Holchem being primarily concentrated in the much larger Food Micro-Segment, and Ecolab's turnover being fairly evenly split across Beverage, Dairy and Food. The result of this is that Holchem enjoys low and very low shares of supply in Beverage and Dairy respectively, while Ecolab has a low share of supply in Food.
15. Using the market sizing model created by Ecolab and reviewed by RBB, there is **no increment of 10% or more in any Micro-Segment**⁹.
16. The CMA has also made inquiries into further segmentation by size of customer. As the Parties' previous submissions have demonstrated, it is reasonable and appropriate to consider the demand side in four bands:
- 16.1 International Customers, who have a centralised procurement model and look for suppliers that can provide cleaning chemicals on a multi-country basis; and
- 16.2 UK-Only Customers, made up of:
- 16.2.1 Large National Customers, who make orders on a UK only basis of over

⁹ The Parties' market size model is based on output figures for the F&B industry in a variety of sub-categories, cross-referenced with the notional average spend on cleaning chemicals per unit of output. The CMA may wish to test and further refine this model by seeking spending and output data from UK F&B customers. Publicly available data on individual customer output volumes is extremely limited (consisting largely of marketing-driven claims of capabilities, rather than actual output figures) and not tracked as a matter of course by F&B suppliers.

£50,000 per year;

16.2.2 Smaller Customers, who make orders of between £8,000 and £50,000 per year;
and

16.2.3 Very Small Customers, who make orders of under £8,000 per year.

17. As previously submitted and shown in its customer data, Ecolab's UK F&B business is heavily concentrated on International Customers. Holchem *cannot supply International Customers*, as it would need to enter several new geographic markets simultaneously¹⁰. The turnover for Holchem's business meanwhile is concentrated on Large National Customers, which Ecolab has had considerably less success in winning.
18. Although the Parties are not in a position to determine the proportion of the F&B market (or the individual Micro-Segments) covered by demand from UK-Only Customers, Ecolab's share of supply within these notional markets would be even lower than its shares of supply to all customers outlined in the table above.

D. MARKET SEGMENTATION

19. The Issues Statement considers whether the market for F&B customers in the UK should be further segmented.
20. While the CMA has not explicitly said so, the questions asked so far during the Phase 2 process do not indicate that the CMA is considering segmenting the UK market on a regional basis. The Parties would concur with such a conclusion because there does not appear to be any plausible argument in favour of doing so.
21. Segmentation by different regions within the UK does not provide a meaningful distinction. The products can be distributed by the supplier, or via a third party logistics company from a single plant or warehouse, and site visits are infrequent. A Supplier can employ Sales/ Service staff or experts otherwise in one part of the UK, who can travel to customers in other parts of the UK. It is not necessary to base staff in different parts of the country, or even in the UK itself.
22. Even country borders do not provide a strict boundary for segmentation. The CMA has been presented with evidence that certain suppliers on the UK F&B market are able to provide customer support through experts flown in from other countries¹¹. While customer servicing visits *are* a part of the package of goods and services provided to F&B customers, these visits are infrequent, with only the largest customers receiving monthly visits from their suppliers.
23. With regard to further segmentation of the *product* market, the CMA's previous questions to the Parties in Phase 2 suggest that it may be considering segmentation of the market into the Beverage, Dairy and Food Micro-Segments. As has previously been submitted to the CMA, there is extensive supply-side substitution across F&B because:
- 23.1 The manufacturing processes and assets for producing cleaning chemicals are identical: with F&B cleaning products for Beverage, Dairy and Food (and indeed, the vast majority of cleaning chemicals used for any hygiene solution - including Agricultural

¹⁰ While an International Customer may technically be able to change its procurement model with respect to its UK business in order to transform into a Large National Customer, the Parties are unaware of any instance where this has *actually happened*. The current trend is for procurement to be centralised (i.e. for Large National Customers with foreign manufacturing facilities to become International Customers). Given that a centralised internal procurement team will procure inputs other than cleaning chemicals as well, a SSNIP in UK F&B cleaning chemicals is highly unlikely to trigger a change in procurement model. Even if an International Customer were to fragment its procurement process, it would be able to discipline the Merged Entity in other jurisdictions in response to a UK-only increase in prices.

¹¹ Ecolab occasionally does this in the UK

and Institutional) being manufactured on the same production lines;

- 23.2 The majority of products are used in more than one Micro-Segment, given that there is a large overlap between the types of applications used in each of them (e.g. CIP, COP, environmental cleaning etc).
24. Although in the F&B hygiene industry a general distinction is made between Beverage, Dairy and Food Micro-Segments, in practice no strict borders can be drawn between the different Micro-Segments.
- 24.1 The general distinction between Micro-Segments is based on what customers produce. Every type of F&B (output) product requires certain (specific) hygiene standards, and creates distinct demand for hygiene applications (CIP, COP, Bottle washing, etc.). Therefore, typically, open surface cleaning has more relative importance in Food than in Beverage or Dairy where CIP applications typically have more relative importance. In practice, however, there can be Food producers where CIP has more relative importance than selected producers in Dairy where open surface cleaning has more relative importance. This means that despite the fact that F&B (output) products differ between Micro-Segments, from a hygiene application perspective there is significant overlap.
- 24.2 Because of this overlap, there is a considerable overlap between the personnel and know-how required in order to operate in each Micro-Segment, and it is not unusual for experts to support multiple Micro-Segments, move from one to another, or move from customer to supply side or vice versa¹².

There are not, therefore, good grounds for defining the product and customer market in a more granular fashion than F&B as a whole.

¹² For example, Ecolab's Field Operatives are F&B generalists while Holchem's Food Field Operatives also support its Dairy customers.