

***Case No COMP/M.4271 -
DAIKIN / OYL***

Only the English text is available and authentic.

**REGULATION (EC) No 139/2004
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 02/10/2006

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 02/10/2006

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PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party :

Dear Sir/Madam,

**Subject: Case No COMP/M.4271 - Daikin / OYL
Notification of 28/08/2006 pursuant to Article 4 of Council Regulation
No 139/2004¹**

I. INTRODUCTION

1. On August 28, 2006, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 by which the Japanese company Daikin (hereinafter referred to as “Daikin”) acquires sole control of the Malaysian company O.Y.L. (hereinafter referred to as “OYL”).

II. THE PARTIES

2. Daikin is a company active in the manufacturing and marketing of air conditioning systems. It also sells chemical, defence, electronics, transportation and refrigeration systems, oil hydraulics, and semiconductor divisions.
3. OYL manufactures and markets heating, ventilating, and air-conditioning systems.

III. THE CONCENTRATION

4. The operation consists of the acquisition of sole control by Daikin of the whole of OYL, by way of purchase of all shares. It would therefore constitute a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

¹ OJ L 24, 29.1.2004 p. 1.

IV. COMMUNITY DIMENSION

5. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion² (Daikin EUR 5 326 million, OYL EUR 1 382 million). Each of Daikin and OYL has a Community-wide turnover in excess of EUR 250 million (Daikin [...], OYL [...]). Neither Daikin nor OYL achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension within the meaning of Article 1(2) of the EC Merger Regulation.

V. COMPETITIVE ASSESSMENT

1. Market definition

6. Only the activities of the parties in the production and marketing of air conditioners overlap. Daikin is marginally active in a vertically related market (supply of compressors to assemblers of air-conditioning systems).

Relevant product markets

Air conditioning systems

7. The parties submit that the range of air-conditioning (AC) systems can be divided into three different product markets, according to their cooling capacity (measured in kilowatts): the market for residential and small commercial AC systems (0-25 kilowatts); the market for medium commercial AC systems (25-250 kilowatts); the market for industrial and large commercial AC systems (>250 kilowatts).
8. Residential and small commercial AC systems are used in homes and small commercial businesses and are described by the parties as commoditized products (see below for the product descriptions). Medium commercial systems are used in smaller offices, hotels, shopping centers, etc., whereas large commercial/industrial systems are employed in large offices and hotels, shopping-centers, public buildings and industry. For these last two segments, products are custom-made solutions, and service and after-sale maintenance are key. In terms of prices, a residential and small commercial systems costs up to EUR 5000, while medium commercial systems can reach EUR 20 000. The price range of large commercial/industrial systems would be, according to the parties, EUR 30 000 to EUR 100 000 for systems with a capacity between 300 kw and 1 500 kw³.
9. In a previous decision⁴, the Commission already examined the market for air-conditioners. The Commission found that it was relevant to make indeed a distinction according to cooling capacities and singled out the market for air residential and small commercial AC systems⁵ from other systems. However, in this decision, the

² Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25).

³ EUR 1 000 000 would correspond to a system with a capacity of around 10 000 kw.

⁴ M.1433—Carrier Corporation/Toshiba, decision of March 25, 1999.

⁵ Although at that time (1999), the power range of these systems was 0-10 kilowatts instead of 0-25 kilowatts.

Commission examined systems with cooling capacities ranging from up to 10kw on the one hand and above 250kw on the other hand. No consensus has emerged from the market investigation as to where the border between light commercial/residential and medium commercial systems lies, even if the parties' view was partially confirmed. In any case, as the market shares of the parties and of their competitors are very similar on the up to 10-12kw⁶ range to those on the 0 to 25 kw range⁷, it is not necessary, for the competitive assessment of this case, to decide on where this border should be set⁸.

10. In this previous case, the Commission also raised the question, while leaving it open, of making a further distinction according to the type of air-conditioners. Indeed, the possible market for residential and small commercial AC systems encompasses a broad range of products such as window systems⁹ (cooling capacity up to 10-12 kw) , portables¹⁰ (up to 10-12 kw), mini-chillers¹¹ (up to 25kw), and room air conditioners¹² (up to 25 kw). However, the sales of window systems, portables, and mini-chillers are minimal compared to those of room air conditioners¹³. In any case, as the parties make no sales of window systems and portables, and marginal sales of mini-chillers, the relevant product market for the present case would be the market for room air conditioners.
11. Similarly, the possible market for medium commercial AC systems is made up of products using different technologies: small chillers¹⁴ (25-250 kw), variable refrigerant flow (VRF)¹⁵ (25-150 kw)¹⁶, and ducted systems¹⁷ (25-150 kw). OYL makes no sales of VRF systems so that the relevant product markets would be the market for small chillers and the market for ducted systems.

⁶ Basic systems (portables and window systems) can now reach a cooling capacity of 12kw..

⁷ Estimates of the parties.

⁸ However, for systems in restaurants, small offices, and shops in Southern Europe, systems (room air conditioners) can reach 25kw so that a 25kw boarder seems to be more relevant than a 10kw one.

⁹ Window systems are air conditioners installed in a window and require a hot-air flue outlet.

¹⁰ Portables are mono-block systems that can be moved from a room to another.

¹¹ Mini-chillers are systems based on chilled water technology and are used to cool a space such as an apartment. It requires professional installation as they involve pipes to transport the water.

¹² Room air conditioners (or split systems) have split up indoor and outdoor parts. They are usually used to cool a room but several indoor units can be connected together so as to cool several rooms, while using only one outdoor unit. These systems require professional installation and after-sales service. The average price for such systems is between EUR 600 and EUR 5000.

¹³ For example, the Italian market for Residential/light commercial segment was worth EUR 762 million in 2005 thereof EUR 718 million is room air conditioner systems. The size of the markets for window systems, portables, and minichillers together is therefore around EUR 45 million.

¹⁴ Based on chilled water technology

¹⁵ Consists of air inlet units connected to external condensing units.

¹⁶ In the last two years, Daikin and some of its competitors have started marketing VRF systems with a cooling capacity starting as low as 14kw. [...].

¹⁷ Ducted systems are essentially larger room air conditioners (or split systems).

12. The distinction according to the type of air conditioners has no effect on the market for industrial/large commercial AC systems as these systems all use the same technology (large chillers)¹⁸.
13. The market investigation has revealed that competitors and their clients (installers, service providers, and distributors) view the cooling capacity as the key to implement segmentation. In any case, even for smaller systems, the competitive assessment does not hinge on whether a segmentation according to types of AC systems rather than cooling capacity should be made so that the question can remain open.

Compressors

14. Compressors are used in air-conditioning systems. The parties submit that, based on previous decisions of the Commission¹⁹, relevant product markets should be defined according to the compressor end application so that the market for compressors for air-conditioners would be a relevant product market. However, given that the activities of Daikin on this market are marginal, the exact market definition has no impact on the competitive assessment.

Relevant geographic markets

15. In M.4133—Carrier Corporation/Toshiba, the Commission gave strong indications that the markets for air-conditioning systems were at least EEA-wide—based both on the parties' arguments (such as the uniformity of products sold) as well as the results of the market investigation—although ultimately leaving the question open.
16. In this case, however, the parties submit that at least the markets for residential and light commercial AC systems (or room air conditioners) and the markets for medium commercial AC systems (or small chillers and ducted systems) have a national span mainly due to significant competition condition variations across countries. For example, in Southern Europe, markets are considered mature, demand is high and substantial competition leads to lower prices than in North-Western Europe. In Central Europe, prices are lower than in Western countries as markets are less mature and buyers have lower income.
17. The market investigation has revealed that, while products are generally homogeneous across Europe, some features of the markets point to differences among EEA countries. It was generally recognized by competitors that markets from South Europe tend to be more competitive (and demand is also much larger) and prices lower. This is particularly true for residential/light commercial systems. For larger systems, prices are more homogeneous but distribution, installation and after-sale servicing are seminal. While manufacturers often entrust specialized installers and distributors with these tasks, the systems are very specific so that distributors and installers deal with only one brand. As a result, entering the market of an EEA country requires time. It is however not necessary to take a stand on the geographic span of these markets as it does not alter the conclusion of the competitive assessment.

¹⁸ Although it is possible to combine several VRF units to reach cooling capacities greater than 250kw, this solution entails possible loss of comfort, problems of feasibility, and cost issues. As such VRF is not considered as a viable solution for cooling capacity above 250 kw.

¹⁹ M.1175—Ingersoll - Rand / Dresser - Rand / Ingersoll - Dresser Pump, M.1493—United Technologies / Sundstrand, M.479—Ingersoll-Rand / MAN

18. As for the markets for compressors for air-conditioning systems, the parties submit that they are at least EEA-wide. This is in line with the Commission's previous decisions dealing with compressors. The question whether the market for compressors for air-conditioning systems is EEA-wide or worldwide can be left open since it does not change the competitive assessment.

2. Competitive assessment

Horizontal overlaps

On the basis of cooling capacity²⁰

19. On the basis of the product market definition submitted by the parties and confirmed by the market investigation, the possible European markets for residential/light commercial, and for medium commercial, and large commercial/industrial air conditioners would be marginally affected so that any anti-competitive impact resulting from the transaction is unlikely²¹:

EEA-wide (2005)	Daikin	OYL	Daikin + OYL	Market size (million EUR)
Residential/light commercial	[15-25%]	[0-5%]	[20-30%]	3172
Medium commercial	[15-25%]	[0-5%]	[20-30%]	1421

20. As can be seen from the figures, OYL's presence in Europe is very limited. Furthermore, the two companies' relative strengths reside, at least in Europe, in different product markets: while Daikin is an important manufacturer for residential/light commercial and medium commercial systems, OYL is stronger in the market for large commercial/industrial systems (which is not affected by the transaction). In addition, as regards the markets for residential/light commercial and medium commercial systems, the market investigation has shown that OYL's products are not regarded as close substitutes to Daikin's products, as Daikin's products are usually deemed of greater quality. Close competitors to Daikin are, among others, Carrier Toshiba and Mitsubishi²².
21. If product markets were to be considered national in scope, a number of national markets for residential/light commercial, for medium commercial, and for large commercial/industrial air conditioners would be technically affected²³. However, in

²⁰ These market shares are estimate of the parties based on the segmentation [0-25], [25-250]. However if the limit between light commercial/residential and medium commercial systems was 10-12kw (instead of 25), the competition would not be changed as the market shares of the parties are very similar.

²¹ On the market for large commercial/industrial air conditioners, the market share of the parties are the following: Daikin: [0-5%]; OYL: [0-10%]

²² It should be however be noted that the ease to switch manufacturers is not obvious from the results of the market investigation, in particular for larger systems., given that they require distributors and installers to develop a brand specific know-how.

²³ For residential/light commercial systems: Belgium, Denmark, Germany, Italy, Lithuania, Malta, Poland, Portugal and the United Kingdom. (total: 9 markets)

For medium commercial systems: Belgium, Cyprus, Czech Republic, Greece, Hungary, Italy, Lithuania, Netherlands, Poland, Portugal, Spain, and the United Kingdom. (total: 12 markets)

most of these markets, the transaction does not bring about major changes as the market position of the parties would remain very limited or the overlap very modest. Furthermore, the elements mentioned above for the EEA-wide assessment remain valid at the national level. In fact, as can be seen from the table below, there exist few markets (6) where the combined market share of the parties would be above 25% and the overlap greater than 1%:

2005	Daikin	OYL	Daikin + OYL	Market size (million EUR)
Residential/light commercial				
Belgium	[35-45%]	[0-5%]	[40-50%]	42
Denmark	[15-25%]	[5-15%]	[25-35%]	6
Italy	[20-30%]	[0-5%]	[25-35%]	762
Poland	[10-20%]	[5-15%]	[25-35%]	26
Medium commercial				
Hungary	[20-30%]	[0-10%]	[25-35%]	7
Lithuania	[15-25%]	[5-15%]	[25-35%]	2

22. In Belgium, the combined market share on the market for residential/light commercial is the highest ([40-50%]). However the market share of OYL is very small and stable ([0-5%] over the last three years), hence the transaction does not remove a sizeable constraint on the market. Moreover, numerous competitors, are active (Airwell ([5-15%]), Carrier Toshiba ([5-15%]), Melco ([0-10%]), Hitachi ([0-10%]), etc.) and have all established network of dedicated local distributors. Hence, anti-competitive effects are unlikely on this market. On the other markets, the new entity would hold approximately [25-35%] of the market which, in light of the presence of these same competitors, is not indicative of probable anti-competitive effects. In particular for the affected markets in Hungary, and in Lithuania, the market shares do not seem to be indicative of market power as, given the size of these markets, they can change substantially following project specific demands.

On the basis of type of air-conditioners

23. Even on the basis of the likely less relevant product market definition (by type of air conditioners), the operation does not raise competition concerns. At the European level, the operation will likely have no impact as only the market for room air conditioners would be (technically) affected since Daikin and OYL hold respectively [20-30%] and [0-5%] of the market. The markets belonging to the medium commercial segment (that is, the markets for small chillers, for large ducted and for VRV systems) are indeed not affected as Daikin predominantly sells VRV systems, whereas OYL does not market such systems.

24. At the national level, the national markets with a combined market share of more than 25% and an overlap greater than 1% would be the following:

For large commercial/industrial systems: Belgium, Cyprus, Greece, Slovenia, and Spain (total: 5 markets)

	Daikin	OYL	Daikin + OYL	Market size (million EUR)
Room air conditioners				
Belgium	[40-50%]	[0-5%]	[40-50%]	42
Denmark	[15-25%]	[5-15%]	[25-35%]	5
Italy	[25-35%]	[0-5%]	[25-35%]	718
Poland	[15-25%]	[5-15%]	[25-35%]	24
Small chillers				
Belgium	[25-35%]	[0-5%]	[25-35%]	4
Hungary	[15-25%]	[20-30%]	[40-50%]	2
Lithuania	[0-10%]	[35-45%]	[40-50%]	0.4

25. As explained above, the vast majority of sales of light commercial/residential systems are sales of room air conditioners so that the affected national markets for room air conditioners are identical to the affected national markets for residential/light commercial systems, and market shares are very similar. Consequently, the very same analysis as in paragraph 22 applies and, thus, no competition concerns can be identified.
26. Regarding small chillers, the largest overlap occurs in Hungary ([15-25%]) with a combined market share of [40-50%]. However, as explained above for medium commercial systems in paragraph 22, this market share can vary substantially from a year to another given the hitherto lack of market maturity. This argument is also valid for the Lithuanian market for small chillers. As for the Belgian market for small chillers, in view of the overlap ([0-5%]) and the market share of the new entity ([25-35%]), no competition concerns can neither be identified, all the more as the new entity will continue to face the competition of Carrier Toshiba ([15-25%]), Trane ([10-20%]), York ([10-20%]), and Clivet ([5-15%]).
27. Accordingly no clients have raised any issue concerning the merger. A competitor has expressed the fear that prices might go down as a result of fierce competition at the expense of environmental standards. However, environmental standards are framed by European directives²⁴ and, as made clear by the market investigation, Daikin's products are considered to be high-quality and environment-friendly products. Consequently, the risk of a race to the bottom in terms of the products' environmental friendliness seems, at least as a result of the transaction, very limited or even non-existent.

²⁴ Air conditioning manufacturers selling products in the European Union must comply with the following regulations and directives: (a) Regulation No. 842/2006/EC on certain fluorinated greenhouse gasses; (b) Regulation No. 2037/2000/EC on substance that deplete the ozone layer; (c) Directive 2002/95/EC on waste of electrical and electronic equipment; (d) Directive 2002/95/EC on restriction of hazardous substances; (e) Directive 2005/32/EC establishing a framework for the setting of eco-design requirements for energy using products; (f) Directive 2002/31/EC for energy labelling of household air conditioners; (g) Directive 94/62/EC on packaging materials and packaging waste, amended by Directive 2005/20/EC; (h) Directive 91/157/EEC on batteries and accumulators containing dangerous substances; (i) Directive 2004/35/EC on environment liability with regard to the prevention and remedying of environment damage and (j) Directive 2005/91/EC on the energy performance of buildings.

Vertical issues

28. Daikin devotes the overwhelming majority of its production of compressors to internal use: it made limited sales in 2005 to various European competitors producing air-conditioning systems (EUR [2,5-3,5] million in 2005—that is [500-1000] compressors). The market share of Daikin on the upstream market for the supply of compressors to air-conditioner assemblers is therefore far below 25%²⁵. Since the combined market share of the parties on the downstream EEA markets is also below 25% (except for the possible market for VRF where OYL makes no sales), there is no downstream affected markets. It is only if downstream markets are considered national in scope, that markets are technically vertically affected (for example, on the Belgian market for room air conditioners, the parties would have $[40-50\%]+[0-5\%]=[40-50\%]$ market share). However, any foreclosing demeanour of the new entity is likely to have no effect on the market given the very limited sales of compressors from Daikin and the existence of market players specialized in the supply of compressors such as Tecumseh Europe, Danfoss Commercial, Copeland Europe, Bitzer, and Frascal.

VI. CONCLUSION

29. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EC) No 139/2004.

For the Commission
signed
Andris Piebalgs
Member of the Commission

²⁵ This is minimal compared to the yearly production of compressors. For example, the parties believe that 173 474 compressors were produced in Europe in 2004.