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Case No COMP/M.1597 - CASTROL / CARLESS / JV

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
Date: 14/10/1999

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COMMISSION OF THE EUROPEAN COMMUNITIES

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus […]. Where possible the information omitted has been replaced by ranges of figures or a general description.

Brussels, 14.10.1999 SG(99) D/8171

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sirs,

Subject: Case No IV/M. 1597-CASTROL/CARLESS/JV
Notification of 13.09.1999 pursuant to Article 4 of Council Regulation No 4064/89

1. On 13.091999 the Commission received a notification of a transaction whereby Castrol Ltd ("Castrol"), and Carless Refining and Marketing Ltd ("Carless") acquire within the meaning of Article 3(1)(b) of the Council Regulation joint control of a newly created company constituting a joint venture.

2. After examining the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EEC) No 4064/89[1] and does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

I. THE PARTIES AND THE OPERATION

3. Castrol is indirectly a wholly-owned subsidiary of, and acts as the day-to-day holding company of the lubricants businesses within the United Kingdom ("UK") of Burmah Castrol Plc, a publicly quoted company active in specialised lubricants, chemicals for use in the foundry, steel and construction industries, and printing inks.

4. Carless is mainly active in the refining, marketing and distributing of solvents, naphtha, light distillates and oils in the European Union ("EU"). It is indirectly a wholly owned subsidiary of Repsol SA, an integrated oil company.

[1] OJ L 395, 30.12.1989 p. 1; corrigendum OJ L 257 of 21.9.1990, p. 13; Regulation as last amended by Regulation (EC) No 1310/97 (OJ L 180, 9. 7. 1997, p. 1, corrigendum OJ L 40, 13.2.1998, p. 17).

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5. Following the signature of a Shareholders' Agreement, Castrol and Carless will create a joint venture, to be named Electrical Oil Services Limited ("EOS"). EOS will be transferred Castrol and Carless' existing operations in the supply and reclaiming of electrical oil, and the provision of related services within the EU.

II. CONCENTRATION

Joint control

6. The shares of the joint venture will be equally held by the parties, who will also have the right to appoint an identical number of Directors. Moreover, each parent company will have a veto right over all resolutions of the Board of Directors relating to any business, as such resolutions will require the approval of at least one director from each of Castrol and Carless. Finally, each parent company will have a veto right over the decisions relating to EOS' business plan, as such decisions will require the approval of at least 51% of the votes cast a at general meeting of EOS shareholders.

7. It is therefore concluded that Castrol and Carless will have joint control over EOS.

Full function joint venture operating on a lasting basis

8. EOS will be transferred Castrol and Carless' existing electrical oils businesses. As a result, it will perform and be responsible for all activities relative to the collection of used electrical oil, the reclaiming of used oil, the supply of virgin and reclaimed oil and the provision of related services (such as oil reconditioning), and the marketing and sales of such services and products. For that purpose, EOS will be transferred all of Castrol and Carless' assets relating to their current electrical oils businesses, and will have sufficient financial resources and personnel necessary to carry out its activities.

9. In the light of the above, it appears that EOS will perform on a lasting basis all the functions of an autonomous economic entity.

III. COMMUNITY DIMENSION

10. The undertakings concerned have a combined aggregate worldwide turnover of more than EUR 5 billion (Burmah Castrol, EUR 4,363m; and Repsol, EUR 18,573m). Both of them have a Community-wide turnover in excess of EUR 250 million (Burmah Castrol, EUR […]; and Repsol, EUR […]), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension. It does not constitute a cooperation case under the EEA Agreement.

IV. COMPATIBILITY WITH THE COMMON MARKET

A. Relevant product markets

11. Electrical oils come under three forms : virgin paraffinic oils, virgin napthenic oils and reclaimed naphtenic oils. They are used as insulators in high voltage electrical equipment, transformers and switchgears. Over time and usage, dissolved gases, moisture and sludge progressively accumulate within the electrical oil, thereby undermining the effectiveness of the oil as an insulator. Consequently, electrical oils are purchased by two main groups of customers : electrical equipment manufacturers

(OEMs), who “first fill” a new electrical equipment, and power generation and distribution companies, who replace the used oils within their existing equipment.

12. In addition to the supply of virgin and reclaimed electrical oil, EOS will offer additional support services, such as oil sample testing, oil reconditioning, and PCB removal.

13. The parties submit that all of these activities can be combined into a single product market for the supply of electrical oil and the provision of related reconditioning and reclaiming services. In particular, they consider that all types of electrical oil are substitutable from the demand side, as all forms of electrical oil are produced to the same performance criteria, and customers routinely do not specify any type of electrical oil, but rather compliance with existing technical standards, which indifferently cover all types of electrical oil.

Supply of electrical oil

14. Most of the competitors and customers who responded to the Commission enquiry indicated that they did not view all types of electrical oil as belonging to one single product market.

15. In particular, customers indicated that, despite lower prices for paraffinic oil, they did not purchase paraffinic oil because of lower performance and shorter life. This suggests that there might be a separate product market for paraffinic oils. This would be further indicated by the fact that paraffinic oil only accounts for 25% of EU sales, and 5% of UK sales of electrical oil, despite much lower prices (by more than 20% as far as the UK is concerned). This would also be confirmed by the fact that, in the UK, although prices for virgin paraffinic oil have not decreased as much as those for naphtenic oil over the last four years, paraffinic oils now account for a larger share of the UK electrical oil sector than they did in 1994.

16. Customers also indicated that there were a number of circumstances where they would buy virgin oils only, essentially because the use of reclaimed oil may shorten the life duration of some pieces of equipment (such as transformers), and because reclaimed oils usually contain PCB, a toxic product. In view of the volumes apparently concerned by such behaviour, this suggests that reclaimed oils cannot be considered substitutable with virgin oils for such usage, and that therefore there might be a separate product market for virgin naphtenic oil.

17. However, there does not appear to be a separate product market for reclaimed oil. It results from the Commission enquiry that, where reclaimed oil is purchased, virgin oil could also be considered, with the decision being essentially based on price. Given the low average price difference (less than 8% in the UK) for virgin and reclaimed naphtenic oil, the fact that such price difference has been reduced by more than 50% since 1994, and the superior performance (and absence of PCB) of virgin oil, it follows that, in the case of a hypothetical small but permanent relative price increase in reclaimed electrical oil, a substantial number of customers would turn to virgin naphtenic oil instead, which would make the hypothetical price rise unprofitable. This has also been broadly confirmed by the results of the Commission enquiry.

18. In the light of the above, it appears that the supply of reclaimed electrical oil does not form a specific product market, but instead belongs to a broader product market including, at least, the supply of virgin naphtenic oil.

19. However, for the purpose of this case, there is no need to further determine whether such product market could also comprise other products (such as virgin paraffinic oil, or even other types of electrical insulators) as, in all alternative segments considered, the operation will not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or a significant part of it.

Support services

20. The parties also consider that support services (e.g. oil reclaiming, sample testing, oil reconditioning, PCB removal, etc.) should be included in the same product market as that for the supply of oils, on the grounds that support services are integral to the process of reclaiming (and therefore to the supply of reclaimed oils), and that customers of reclaimed oils expect such services to be provided and see them as a part of the product they are buying.

21. However, for the purpose of this case, the exact definition of the product market for the supply of support services can be left open, as, in all alternative segments considered, the operation will not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or a significant part of it.

B. Relevant geographic markets

22. Castrol and Carless' electrical oils operations in the EU are exclusively concentrated in the UK and Eire. Nevertheless, the parties submit that the relevant geographic market for the supply of electrical oil and the provision of related support services is not less than EU-wide, on the basis that the incremental cost of transporting oil from one Member State to another is low, and that there is no commercial, technical, legal or practical reasons why electrical oil can only be supplied within a narrower area.

23. Although most of the competitors who responded to the Commission enquiry considered the market(s) for the supply of electrical oil to be EU-wide or even broader, with electrical oil being marketed in other countries than those where they are produced, and with differences in national standards apparently not creating barriers to trade, the replies from most customers point to narrower (i.e. national) geographic markets. In particular, it appears that the actual collection of used oils and delivery of new oils requires the operation of national logistics systems, without which transportation costs would be significantly increased and the suppliers' competitive position substantially undermined.

24. This suggests that there might be a UK market for the supply of electrical oil, and for the provision of support services as well. This would be further indicated by the fact that, for instance, the parties only operate in the UK and, for Carless, in Eire. This would finally be confirmed by the fact that the UK demand appears to show strong specificity, such as a definite preference for naphtenic oils (with paraffinic oils' share of sales being more than 5 times lower than the EU average) or the presence of specific support services such as PCB removal.

25. However, for the purpose of this case, the exact definition of the geographic markets can be left open, as, in all alternative definitions considered, the operation will not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or a significant part of it.

C. Competitive assessment

26. The parties' only overlaps concern the supply of virgin and reclaimed naphtenic oil and the provision of sample testing and oil reconditioning services in the UK. Repsol also supplies virgin naphtenic oil in Spain.

Single dominance

27. On the basis of the existence of a UK market, the parties' combined market shares (in terms of volumes) would reach [40-50]% for the supply of electrical oil as a whole, and 48% for the supply of virgin and reclaimed naphtenic oil.

28. However, they would remain submitted to the competition from other suppliers, and primarily Nynas, whose market share is [30-40]%. Furthermore, UK sales volumes of electrical oils have declined by 16% between 1994 and 1999, and it is not expected that this decline will stop in the foreseeable future. Such decline will lead to the creation of idle capacity, in particular at oil customers with in-house reclaiming capacity (such as National Grid, Midlands Electricity, Norweb, Scottish Hydro Electric etc.). These operators might therefore start competing for the supply of reclaimed oil to other consumers.

29. In the UK, the parties' combined shares for the provision of oil reconditioning services would be approximately [30-40]%. However, they would also remain submitted to the competitive pressure from other oil reconditioners, such as National Grid ([20-30]%), Lee Beasley ([5-15]%) or Eden ([5-15]%). And the parties' shares of oil analysis services would not exceed [5-15]%.

30. If, alternatively, the geographic markets were EU-wide, then the parties' and Repsol's combined market shares (in terms of volumes) would remain below [15-25]% for the supply of (virgin and reclaimed) naphtenic oil and the provision of oil reconditioning and sample testing services.

Collective dominance

31. In the UK, the parties and Nynas' combined shares of virgin and reclaimed naphtenic oil reach [80-90]% (in terms of volumes). It must therefore be determined whether the operation could create or strengthen a collective dominant position on that market.

32. However, the structure of the market does not appear to lend itself to the adoption of parallel competitive behaviour. This is because, i) as mentioned above, the UK market is in decline (-16% between 1994 and 1998), which leads to idle capacities and therefore creates incentives for price competition; and ii) prices are not transparent, as contracts are usually concluded on the basis of competitive bidding procedures.

33. In the case of Nynas and the parties, there appear to be even fewer incentives for the coordination of competitive behaviours, because Nynas only supplies virgin oil while Castrol and Carless primarily supply reclaimed oils (with virgin oil only representing 28% of their UK sales). Such difference in product range leads to different cost structures and therefore pricing policies. In case of a price rise for both virgin and reclaimed naphtenic oil, it would also lead to different demand variations for Nynas and the parties, as demand for virgin oil is also characterised by the fact that some customers will only choose virgin oil in certain circumstances (e.g. new and/or high value equipment).

34. Similarly, in the UK, the combined market share of the four largest suppliers oil reconditioning services would be approximately [75-85]%. However, there appears to be no grounds for these four companies to engage in parallel competitive behaviour. First, prices are not transparent in that market, as contracts are usually concluded on the basis of competitive bidding procedures. And second, the four main players appear to have different competitive incentives. This is because there are strong market shares asymmetries between the four main players (whose shares range between [30-40]% and [5-15]%), and therefore differences in cost structures and pricing policy; and also because these four companies are very different from one another, with EOS being primarily a supplier of electrical oil, National Grid a electrical transmission company, and Eden and Beasley being specialist reconditioners.

Conclusion

35. In the light of the above, it appears that the notified operation does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the EEA or any substantial part of that area

V. ANCILLARY RESTRICTIONS

36. The parties have agreed that Castrol and Carless would not compete with EOS in relation to the business of electrical oil supply, treatment and services within the EU, for the duration of the joint venture and […] afterwards.

37. This clause prevents a party from competing unfairly with EOS while seating at its Board of Directors (and therefore both exercising decisive influence on and receive competition sensitive information on the joint venture). It can therefore be considered to be directly related and necessary for the operation. However, its duration exceeds what it is necessary for the transaction, as it goes on for […] after the termination of the joint venture, when neither party will be in a position to seat at EOS' Board of Directors.

38. This clause is therefore covered by the present decision for the duration of the joint venture only.

VI. CONCLUSION

33. 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 (EEC) No 4064/89.

For the Commission,