

***Case No COMP/M.4139 -
SONY / NEC / JV***

Only the English text is available and authentic.

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

Article 6(1)(b) NON-OPPOSITION
Date: 31/03/2006

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 31.03.2006

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In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 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 Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sir/Madam,

**Subject: Case No COMP/M.4139 –Sony/NEC/JV
Notification of 24/02/06 pursuant to Article 4 of Council Regulation
No 139/2004¹**

1. On 24 February 2006, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 by which the undertakings Sony Corporation (“Sony”, Japan) and NEC (“NEC”, Japan) acquire within the meaning of Article 3(1)(b) of the Council Regulation joint control by way of purchase of shares in a newly created company constituting a joint venture (“JV”, Japan).

I. THE PARTIES

2. **Sony** is a global entertainment and electronics company and is active in the manufacturing and commercialization at a worldwide level of electronic consumer products (e.g., televisions, audio and video players, personal computers, and car navigation systems) as well as electronic components for those products (e.g., LSIs (large scale integrated circuits), optical pick-ups, audio/video/data recording media, data recording systems and batteries).
3. **NEC** is a global electronics operator active in two main sectors: IT products and services. (e.g. software, PC servers, personal computers) and network communications (e.g. broadband technology, mobile telephones and handsets).

¹ OJL 24, 29.1.2004 p. 1.

4. The **JV** will be active in the business of a number of optical datastorage disk drive (“ODD”) products. The ODD products in question will be (i) on the one hand all ODD drives currently existing in the market (CD-ROMs, CD-RWs, DVD-ROMs, Combo (CD-RW/DVD-ROM), DVD+/-RW, PDD, and MO drives); and (ii) on the other hand ODDs using the new blue laser technology.

II. CONCENTRATION

5. On November 17, 2005 Sony and NEC signed a Memorandum of Understanding recording their intention to create a joint venture in the ODD sector. The JV will pool together the ODD activities of Sony and NEC.

Joint Control

6. The Parties submit that the JV will be jointly controlled by both Sony and NEC. After the completion of the proposed transaction, Sony will own 55% of the shares in the JV and NEC will own the remaining 45% of the share capital. Accordingly, Sony will appoint the majority of the Board of Directors (4 out of 7). However, according to the Parties, NEC will have a veto right in the decisions relating to [...]². The Parties submit that these matters require resolution at the board of directors meeting with affirmative vote by at least one director appointed by NEC, which shall not be withheld unless there is a reasonable ground for objection such as damage to the value of the JV business.
7. The later condition put on NEC’s veto right, does not undermine joint control. The Parties submit in that case NEC’s approval is not obtained, at Sony’s request, a remedial procedure takes place. [...]³
8. This provision might lead to the conclusion that Sony could have a casting vote. Apart from the fact that paragraph 37 of the Commission Notice on the Concept of Concentration indicates that there can be joint control when a casting vote by the majority shareholder can be exercised only after a series of stages of arbitration, the “casting vote” in this case would be connected to a termination of the JV. Consequently, if the Parties intend to continue the JV, they need to find an agreement on the issues mentioned above.

Full-functionality

9. The Parties submit that the JV will perform on a lasting basis all the functions of an autonomous economic entity. The JV will combine both parents’ business divisions which perform all ODD activities of the Parties. It will, thus, be active in the development, designing, manufacturing (by subcontracting to third parties), marketing, sales and other related business of the existing and new-generation ODDs. The JV will be constituted for an indefinite duration. Neither Sony nor NEC will remain active themselves in the ODD business.

2 Description of matters that require consent by both parties, including matters identified in paragraphs 21-29 of the Commission’s Notice on the concept of concentration.

3 Description of the different procedural steps.

10. The transfer of employees and assets will ensure that the JV can operate as an independent company on a lasting basis. The employees will in a first step be seconded to the JV, but the Parties intend to transfer them completely within a one year period. However, the management personnel, which will also be responsible of the day-to-day business, will be contractually linked to the JV upon its establishment and not to the parents. Besides material resources, the assets mainly consist of licenses from the parents which will be granted for an indefinite period and will be irrevocable. All inventions made by the JV will be owned by the JV.
11. The fact that manufacturing will be subcontracted to third parties does not affect the full function character of the JV, since the outsourcing of manufacturing is generally a trend in the high-tech industries as it was already found in earlier decisions in this sector⁴. Only Magneto-Optical (“MO”) ODDs which constitute [0-10%] of the JV’s total estimated sales will be manufactured by the parent company Sony. According to the JV Agreement, the JV is free to continue or terminate the manufacturing contracts transferred by the parents.
12. The JV will not be dependent on its parents for either inputs or sales. The parent companies will only supply the JV with a small proportion of its requirements of key components (Sony: optical pick-ups and NEC: LSIs). During the first year of activity, the Parties estimate that only about [20-30%] of the LSIs used by the Joint Venture will be sourced from NEC and less than [10-20%] of the optical pick-ups supplies required by the JV will be sourced from Sony. In total, the parents’ inputs will constitute [0-10%] of the total value of the JV’s products.
13. Approximately [0-10%] of the JV’s production will be sold directly to customers from the outset (to Japanese OEMs and distributors) and approximately [5-10%] of the JV’s sales will be made to the parent companies who will use the ODDs within their finished products. Regarding the remaining [80-100%], the JV is expected to market those products vis-à-vis OEM customers or distributors under its own name and on its own account, at arms length through the sales subsidiaries of both Sony and NEC acting as agents for the JV. According to the Joint Venture Agreement, the Joint Venture will be able to terminate its relationship with these sales subsidiaries subject to prior notice and consent from the relevant parent company for the first [...] months and with no limitation thereafter. The Parties envisage that the JV establishes its own distribution system no later than [...] months after the JV’s creation.

III. COMMUNITY DIMENSION

14. The undertakings concerned have a combined aggregate world-wide turnover of more than EUR 5 billion⁵ (EUR 55.5 billion for Sony, EUR 35.9 billion for NEC in 2004). Both Sony and NEC have a Community-wide turnover in excess of EUR 250 million (Sony: EUR [...], NEC: EUR [...] in 2004), but they do not achieve more than two-thirds

⁴ Case COMP/M.2260 Hitachi/LG Electronics/JV, case COMP/M.3349 Toshiba/Samsung/JV.

⁵ 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, p 25).

of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV. COMPETITIVE ASSESSMENT

A. Relevant markets

Relevant Product Market

15. The sector concerned is that of ODD products comprising different versions of CD as well as DVD and Combo drives (combined CD-Rom / DVD drives). These drives can have read or write functions or can carry out both on CD or DVD players, personal computers, notebook computers, game consoles, and other hardware devices.
16. According to the parties and in line with previous Commission decisions, separate product markets can be defined, due to different requirements and functionalities, for ODDs for computers on the one hand and ODDs for living room equipment on the other hand. In any event, the Joint Venture has no plans to sell existing formats of ODDs for living-room equipment use, *inter alia* because manufacturers of such equipment produce themselves their own ODD units.
17. The Parties submit that, on the basis of limited demand side substitutability, the computer ODD market could be further segmented into half-height ODDs, which are used in desktop computers, and slim ODDs for laptops. They, however, consider that a further segmentation based on each individual CD or DVD version would not be appropriate due to a high degree of supply-side substitutability. As in earlier decisions⁶, the exact market definition can be left open in this respect since in any alternative no competition concerns arise.

Relevant Geographic Market

18. The parties submit that the market is world-wide in scope due to low transportation cost, no trade barriers, important trade flows, global product standards and globally active suppliers and customers. In previous cases⁷, the Commission left open whether the market was EU-or worldwide. Also in this case, the market definition can be left open as the competitive assessment does not change under either market definition.

B. Competition analysis

Existing ODDs

19. While there are no vertically affected markets, Sony and NEC have a combined market share of [10-20]% in the market for DVD-RW. At EU-wide level, the combined market share is [20-30]% (Sony [0-10]%; NEC [10-20]%), while on a worldwide basis it is [20-30]% (Sony [0-10]%; NEC [10-20]%). The main competitors in both geographic markets are Hitachi/LG ([15-25]%), Pioneer ([10-20]%) and Panasonic ([10-20]%). These market shares would be slightly higher on the basis of a further segmentation into

⁶ Case COMP/M.2260 Hitachi/LG Electronics/JV, case COMP/M.3349 Toshiba/Samsung/JV.

⁷ Case COMP/M.2260 Hitachi/LG Electronics/JV, case COMP/M.3349 Toshiba/Samsung/JV.

half-height DVD-RW where the Parties reach a combined market share of [20-30]% (Sony [0-10]%, NEC [20-30]%) in an EU-wide and in a worldwide market, with Hitachi/LG again being the strongest competitor with [20-30]%, followed by Pioneer with [10-20]%. In the potential market for slim DVD-RW, the Parties' combined market share ranges between [10-20]% and [10-20]%. Under all other possible market definitions, the parties have combined market shares between [0-10]% and [10-20]% and thus are subject to ample competitive constraints.

20. Against this background, competition concerns in the existing ODD markets are unlikely. In the DVD-RW market, the combined entity will face strong competitors such as Hitachi/LG, Pioneer and Panasonic. It can moreover be assumed that producers with a stronger focus on one of the other ODD products, such as Lite-On, TEAC, Philips-BenQ, Toshiba-Samsung, would be able to expand their activity on the DVD-RW market without major difficulties in case of a price increase.
21. The parent companies of the JV outsource the manufacturing of their ODD drives to third parties: Sony outsources production mainly to Lite-On (around [80-100]% of Sony ODDs in 2004 were produced by Lite-On), while NEC outsources production of its ODDs to two firms, Sanshin (Malaysia) and Tenshin Mitsumi (China). The merger will not have short-term effects on the parent companies' relationships with their current ODD manufacturers and the JV will continue to subcontract the manufacturing of ODDs to the parents' current subcontractors at least for the entire 2006. Therefore, it would not appear that the position of ODD manufacturers, such as Lite-On would change to any significant extent because of the merger. In any event, even assuming that Lite-On will become supplier of ODDs also for NEC (i.e. it will produce ODDs for the entire JV, thereby absorbing the portion of NEC's current outsourcers), the market position of Lite-On at manufacturing level will not be such as to create any significant adverse effect on competition for the production of ODDs, as its market share will be around [10-20]% while several other manufacturers exist, such as HDLS (with around [25-35]%), Toshiba-Samsung (with around [15-25]%), Panasonic (with around [5-15]%), etc.

Next generation ODDs

22. The JV will be also active in the development of the next generation ODDs which are based on blue (instead of red) laser. There are currently two main technologies which are being developed: "Blu-Ray" and "High-Density" DVD ("HD-DVD"). Both technologies will offer greater data storage capacity and better picture quality with equal or lower production costs. According to the Parties, all major competitors are actively developing products in the blue laser field and are expected to gain similar market shares as in the existing ODD markets.
23. The parent companies of the JV are at present active in both technologies. Sony is one of the founders of the Blu-Ray Disc Association (BDA), which develops the Blu-Ray standard, while NEC is one of the main pillars of the DVD Forum, which develops the High-Density standard (HD DVD). Next-generation products are currently being developed by Sony and NEC and will be transferred to the JV following the implementation of the transaction. Based on the parties' stated intention, the JV will be active in the development, production (through subcontractors) and marketing of next

generation products as requested by customers. [...] it will ship HD DVD drives [...], while Blu-ray drives are expected to be marketed [...] ⁸.

24. The investigation carried out by the Commission showed that, for the time being, given that the market for future ODDs is in its infancy, the merger will not change to any significant extent the incentives of the parent companies or of the JV to clearly favour one standard over the other. Moreover, internal documents of the parties show that they intend to continue supplying HD DVD drives, as well as of Blu-ray drives to customers with which supply agreement existed prior to the merger.
25. In addition, the merger does not foreclose access to necessary IP rights as regards the developments of existing or future generation ODDs. The essential patents for the blue laser DVD formats are available through patent pooling both from Blu-ray and HD-DVD patent holders and the DVD Forum offers access to patents relating to the current DVD format. Moreover, patent holders grant licences on a non-discriminatory basis. Therefore no competition concerns arise with respect to these nascent markets due to the merger.

V. CONCLUSION

26. 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,
Markos Kyprianou
Member of the Commission

⁸ Timing of the expected introduction of next-generation products.