Schneider/APC: a textbook first-phase case with creation of dominant position and structural remedies (1)

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On December 12, 2006, the French company Schneider notified its proposed acquisition of the US-based company American Power Conversion (APC) to the Commission. The main overlap in the parties’ activities concerned the sales of uninterruptible power supply (UPS) devices. The Commission considered that the proposed transaction was likely to lead to the creation of a dominant position and raised serious doubts as to its compatibility with the common market. The notifying party filed remedies that were accepted by the Commission.

This article discusses some of the interesting points raised by the case.

Short description of the products concerned

Both Schneider, through its affiliate MGE, and APC marketed UPS devices. UPS devices have two basic functions: first, they provide a back-up power in the event of power cuts, and second, they clean the power signal. They are used to protect electrical devices for which the interruption or disruption of power supply would have harmful consequences — such as desktop computers, or systems for larger structures such as hospitals, security systems, airports, etc. The larger the system to be supported, the larger the capacity (measured in kV A (3)) of the UPS device needed.

While the basic functions of all UPS devices remain the same regardless of the end-application, the wide array of prices and capacities meant that defining product markets required some sort of segmentation.

Product market definition

Schneider proposed to make a first segmentation of the market by considering a cut-off limit at 10kVA. Then, it expressed the view that, within the 0-10kVA capacity range, devices with a capacity of 3kVA or less could be distinguished from those with a capacity of more than 3kVA or above. No further distinction within the above 10kVA segment was proposed by Schneider.

The decision discusses in detail the relevance of these cut-off points and it is not the purpose of this article to repeat that discussion. However, one point of interest related to the possible difficulty of defining markets when a continuum of products is considered, especially when this continuum is characterized by power/capacity figures. On one hand, there was an obvious difference between a €100 UPS device destined for use with a desktop computer and a €50,000 UPS system capable of supporting hospital facilities. On the other hand, differentiating between a 9kVA UPS and an 11kVA may sound arbitrary (4).

In this case, however, the 9kVA and 11kVA UPS device were actually quite distinguishable. The reason for it is that the 10kVA corresponds to a technical cut-off point between “one-phase” devices (below 10kVA) and “three-phase” devices (above 10kVA). These technological differences correspond to a difference in terms of target customers. The 0-10kVA UPS devices are generally purchased by information technology (IT) wholesalers that typically resell these devices to retailers such as Fnac. The above 10kVA devices are bought by electrical technology (ET) wholesalers (5) or contractors that integrate UPS devices into electrical infrastructures of buildings.

On the other hand, the relevance of the 3kVA limit turned out to be slightly less obvious to specify and the question of whether there should be a segmentation of the above 10kVA segment proved difficult. Many possible cut-off points (e.g. 50kVA, 80kVA, 200kVA, etc.) were suggested, but neither the market investigation nor third party studies provided a clear picture either. However, in this specific case, these difficulties did not have any bearing on the competitive assessment.

(1) The content of this article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the author.
(2) The author wishes to thank Maria Rehbinder and Viktor Porubsky for their comments on the article.
(3) For kilo volt-ampere. Volt is the unit of electric tension, whereas ampere measures the electric current.
(4) For a recent illustration of the difficulty of defining product markets according to the power capacity, see e.g. M4271 Daikin/OYL. In this case, no clear-cut consensus emerged from the market investigation and an alternative segmentation—based on technology—was also examined.
(5) ET wholesalers sell electrical devices such as sockets, switches, plugs, etc. to professionals.
Geographic market definition

Schneider explained to the Commission that market for UPS devices had at least a European span on the grounds that Asia-based plants cater for the demand all over Europe, and that prices and standards were homogeneous across Europe.

However, the fact that production sites serving Europe are located in remote locations is in itself not a sufficient condition to define markets as wider than national in scope. In this case, it turned out that a national presence was essential to be an effective competitor in particular in larger Member States, while utilizing the services of a distributor seemed to be a second best solution mostly better suited to smaller Member States.

The Commission ultimately left the exact geographic scope of the markets open as competition concerns were raised on a European-wide basis and at the level of specific Member States.

 Competitive Assessment (6)

The deal commanded particular attention from the Commission in relation to the changes that would arise on the market for below 10kVA UPS devices: while APC led competition with [20-30]% of the EEA-wide market, Schneider’s MGE was the second most important market player with [10-20]%. The proposed merger would create a market player with nearly half of the market (7). In contrast to this high share, the next largest competitors (Riello, Eaton, Chloride, etc.) were rather weak as they had market shares of less than 10%. In addition, [20-30]% of the market was made up of a myriad of smaller players.

As these market shares are indicative of the creation of a dominant position, the Commission investigated the effects of the removal of APC’s largest competitor and the significance of the role played by smaller players.

It found that competition essentially rested on two criteria, price and quality, and that APC and Schneider were the best performing companies in these respects. In particular, the two companies had continuously introduced new products with a favourable price/quality rating from the customers’ perspective. In this context, the Commission found that brands play an important role and stand for the reputation for quality, and reliability of the products and services. MGE and, to an even greater extent, APC had built strong and recognized brands on the market.

Conversely, it appeared that competitors did not have the same advantages: a basic low capacity UPS device is relatively easy to produce and production of such devices is made on a significant scale in Asia. As a result, many smaller market players import “no-name” products to Europe, that are lower-priced but also less trusted, if not of poorer quality. Other larger market players such as Chloride, focus on the above 10kVA UPS segment.

The Commission’s investigation showed therefore that APC and Schneider’s MGE were close or even the closest competitors on the under 10kVA market and that they were perceived as head-to-head competitors by customers.

Furthermore, there appeared to be high barriers to entry and expansion which made it difficult for competitors to obtain a market position similar to Schneider’s MGE. For one thing, competitors need to be capable of matching the merged entity’s rhythm in introducing new products, and to develop a sufficiently efficient logistics and distribution in Europe for Asian-made products. Second, the entrant would have to establish a satisfactory track record to build a good reputation and a well-recognized brand. Third, it would have to obtain access to IT wholesalers, the distribution channel for UPS devices with a capacity below 10kVA. IT wholesalers and suppliers of UPS devices have close and long-term relationships and it is difficult to build such customer intimacy (8).

The Commission concluded therefore that the proposed transaction was raising serious competitive concerns on the market for 10kVA.

Structural Remedies

To remove the Commission’s serious competition concerns Schneider proposed structural remedies that consisted in the divestiture of its 0-10kVA UPS business. The discussion on the viability of the divested package focused on its access to distributors (that is, to IT wholesalers) and the optional transfer of the brand to ensure that the new business had solid foundations. In view of MGE’s particular history — it had previously been the subject of a successful leveraged buy out operation — the Commission had to ensure that the business would be attractive and able to effectively compete, irrespective of the nature of the

(6) For convenience of reading, only the assessment on the 0-10kVA market at the European level is given in this text. Defining the market for 0-3kVA and/or examining the situation at the national level did not change the conclusions.

(7) [40-50]%

(8) However, the Commission found that a market player does not need to sell other products to be an efficient supplier of below 10 kVA devices.
purchaser (industrial or financial). The divested package, in particular, included a management structure, the transfer of the customers and of the existing sales-force, the transfer of the shareholding in joint venture agreement for the manufacturing of UPS devices, supply agreements, and R&D resources.

The market test underscored that the fate of the MGE brand was a particularly important issue. Schneider originally proposed a temporary license of the MGE brand to allow some time for the acquirer to re-brand the products. However, according to respondents, the viability of the divested package would be seriously jeopardized if it was acquired by a company — such as an investor — without its own brand for UPS devices and therefore unable to replace the MGE brand with its own recognized brand. The licensing for a limited period of the MGE brand for the 0-10kVA activity would have therefore not been sufficient for such an acquirer. Schneider agreed to address this concern by offering as an option the divestiture of the brand MGE for the 0-10kVA segment, should the divested business be acquired by a new or minor actor in the industry.

**Conclusion**

The final remedies package submitted by the merging parties was sufficient to remove the Commission’s competitive concerns. The Commission thus cleared the operation in first phase with conditions. While this case may in certain respect seem a classic example – risk of creation of a dominant position that was resolved by the submission of structural remedies –, the above analysis shows that such “classic” merger cases often raise significant technical, legal or policy issues: identifying these issues early on and proactively seeking for solutions then is necessary if the merger is to be cleared in Phase I.