

Anticipated acquisition by Parker Hannifin Corporation of Domnick Hunter Group plc

The OFT's decision on reference under section 33(1) given on 20 September 2005. Full text of decision published 6 October 2005.

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' request.

PARTIES

1. **Parker Hannifin Corporation** (Parker) is a leading worldwide supplier in the motion and control technologies and systems, providing precision engineered solutions for a wide variety of commercial, mobile, industrial and aerospace markets. Parker's Filtration Group manufactures a wide range of industrial filters. Parker's turnover in the UK for the financial year 2004 was around £ [] million.
2. **Domnick Hunter Group plc** (Domnick) is an international group of companies specializing in the design and manufacture of filtration, separation, and purification products and technologies for a wide range of markets. Domnick's turnover in the UK for the financial year 2004 was £ [] million.

TRANSACTION

3. Parker intends to acquire the entire issued share capital of Domnick by means of a recommended offer to be made for Domnick by Parker's wholly owned subsidiary, Parker Hannifin International Corporation.
4. The transaction was announced on 2 August 2005. On 5 August 2005, the parties notified the proposed acquisition to the OFT by way of a Merger Notice. The statutory deadline is 20 September 2005.

JURISDICTION

5. Parker and Domnick will cease to be distinct as a result of these arrangements. The acquisition satisfies the share of supply test set out in s23(1)(a) of the Enterprise Act

2002 ('the Act') and qualifies as a relevant merger situation because the parties together supply a share greater than 25 per cent of on site gas generation equipment.

RELEVANT MARKET

6. The parties overlap in the manufacturing and supply of filtration equipment, in particular, liquid filtration, compressed air treatment and gas generation products. Filtration equipment is used in manufacturing processes to remove impurities in air, gas, steam and liquids.

Product market

Liquid filtration

7. Liquid filters are used in a wide variety of industries (i.e. beverage, pharmaceutical) for the purification of final or intermediate products. They essentially take one of three forms: strainers, bags or cartridges. Each of them comprises two complementary components: (i) a housing and (ii) an element. The element is a consumable part and needs to be replaced over time.
8. Parker and Domnick manufacture and supply a wide variety of liquid filters (both housings and elements). Both parties principally supply cartridge filters. Neither party makes or sells strainers. Parker does not make or sell bags in the UK.
9. On the demand side, the parties indicated that both elements and housings are generally low cost relative to the other equipment that they are used with, such as chemical reactor plus pumps or small scale reverse osmosis plant. Third parties indicated that customers will often choose to buy the cheapest filter element available, although this is within a given quality range.
10. On the supply side, most manufacturers supply a range of elements that can be used in the housing of other manufacturers. The interchangeability of elements into different housings indicates that they would form separate relevant frames of reference. No firm conclusion is necessary on this point because even by focusing narrowly on each individual component (the approach adopted below) no competition concerns arise.

Compressed air treatment

11. Compressed air treatment is designed to remove the impurities present in atmospheric air and produced in the compression process itself, including solid contaminants (i.e. dust, rust), water and water vapour and oil residues or vapour. The equipment mainly – but not exclusively - takes the form of filters and dryers. Filters are all described as cartridge filters. The filter elements are consumables and needs to be replaced over time. Dryers can be supplied in a variety of techniques (adsorption, refrigeration and membrane).

12. Both parties manufacture and supply housings and elements. However, while Parker has only recently launched a range of membrane dryers in the US, Domnick supplies the full range of dryers.
13. On the demand side, some customers are original equipment manufacturers (OEMs)¹, which source a large proportion of compressed air treatment equipment from compressed air treatment equipment manufacturers, like Parker and Domnick, and sell them as a bundle of products, often re-branded. Due to the high purchasing volumes, they can achieve a discount. These customers are regarded as competitors. The rest of the customers are either distributors (wholesalers) or end-users, which may also source from a number of different manufacturers (e.g. a filter from Parker and a dryer from Domnick) for their own use. Parker believes that its largest customers either dual-source or multi-source their compressed air treatment equipment. Supply contracts with compressor manufacturers are generally of one to three years duration. Contracts with other (non-compressor) manufacturers tend to be shorter and usually do not exceed one year. Contracts are rarely exclusive. There are no formal bidding processes.
14. OEMs account for approximately [] per cent of Parker's total sales of compressed air treatment equipment. The balance of sales in Europe is made to end-users through distributors ([] per cent) or Parker's sales offices ([]). Approximately [] per cent of Domnick's sales are to OEMs, [] per cent to distributors and [] per cent to end-users. Third party evidence indicates that customers can buy the components separately, and do not need to buy the 'bundle' of products from one manufacturer. Also, not all manufacturers manufacture all of the components. For example, Parker has only recently started manufacturing some dryers.
15. Most manufacturers supply housings and elements together and the majority of them manufacture elements that are designed to fit into other manufacturers' housings.
16. In the light of the above considerations and for purpose of this decision, each piece of a filter – housing and element – and dryers could comprise separate relevant frames of reference. However, no firm conclusion is necessary on this point because even by focusing narrowly on each individual component (the approach adopted below) no competition concerns arise.

Gas generation

17. Gas generation equipment (gas generators) is used to provide customers with on-site supply of gas at specified flow rates and purity levels. Gas generators are capable of generating up to 200 tonnes of gas per year. There are two methods: (i) pressure swing adsorption (PSA) is a process which physically separates the molecules of gas from each other; and (ii) membrane generators force compressed air through hollow

¹ These include manufacturers of air compressors (e.g. []).

fibres with holes in the walls to permeate the smaller molecules and capture the other gases.

18. The parties, which mainly supply equipment for small volume nitrogen generation, manufacture components for both PSA and membrane. Parker manufactures PSA gas generators in the US and membrane generators in the US and the Netherlands. Domnick uses PSA technology and manufactures gas generators in the UK. Both parties supply gas generators in the UK.
19. On the demand side, the parties submitted that gas generators could compete with gas cylinders – suitable for up to six tonnes per year - and on-site storage tanks (bulk liquid supply) – but only to the extent they are capable of producing up to 200 tonnes per year.² The parties maintained that they do not compete for customers who require more than 200 tonnes per year, i.e. some bulk supply customers and cryogenic on-site generation customers³. Gas generators appear to offer greater convenience, a continuous supply and improved safety.
20. A customer of cylinders may choose to switch to gas generators. Its decision is made mainly on the basis of saving money over time as the investment can be paid off over a few years. Once a customer has switched it is unlikely that it would go back to cylinders. It appears that although gas generators are an alternative to gas cylinders and bulk liquid supply, they are not bought in the same way.
21. On the supply-side, the parties suggest that the two methods, PSA and membrane, are substitutable to some degree. Third party evidence is mixed but generally there does appear to be some substitution.
22. In the light of the above, gas generators could constitute a separate frame of reference. No firm conclusion is necessary on this point because even in the narrowest frame of reference no competition concerns arise. For completeness the supply of cylinders and bulk liquid supply will be considered, as these are alternatives that appear to provide some competitive constraint on gas generators.

Geographic market

23. The parties submit that the relevant frame of reference for process liquid filtration, compressed air treatment and gas generators is global.
24. In all sectors of the filtration industry, transport costs appear to be low. For instance, transport costs for compressed air filters and gas generators are in the range of

² On-site storage tanks (bulk liquid supply) could generate up to 800 tonnes per year.

³ Cryogenic on-site generation is used for large volumes of gas generally over 800 tonnes per year. A plant is installed on a customer's site by a gas company to generate nitrogen and oxygen by the fractional distillation of liquid air. The liquid air is produced by cooling ambient air under pressure.

between one and four per cent of the total cost of a piece of equipment, depending on the product line, weight, volume and destination of shipment.

25. Manufacturers generally operate on a global basis. Parker sells [] per cent of its compressed air treatment equipment in Europe, while manufacturing is based at two plants in the US for sale primarily in North America but with shipments to Europe and Asia; there is a distribution centre in the Netherlands. Domnick makes [] per cent of its compressed air treatment equipment sales outside of Europe, and [] per cent are outside of the UK. Domnick manufactures compressed air filters (elements and housing) in the UK and Germany and ships them worldwide, with a significant proportion supplied in the US. Domnick's dryers are manufactured in Germany, Italy and the UK and shipped worldwide. There are a number of suppliers of gas generators in the UK, and a high level of imports.
26. Most third parties indicated that over the last three years UK prices have not changed significantly, relative to worldwide prices. To the extent they have, they have generally moved with worldwide prices. This suggests that products supplied across the world do provide a competitive constraint on each other. International steel prices have been a major factor in recent price setting. It is possible that global prices for gas generators do constrain UK prices, however, the information has been limited.
27. The parties submitted that filtration products must usually comply with international standards so that they can be sold worldwide.
28. For the purposes of this decision, it is unnecessary for the OFT to conclude on geographic frame of reference because competition concerns do not arise on either a UK or global basis in respect of either product. Share data on both bases are considered below.

HORIZONTAL ISSUES

Liquid filtration

29. The parties provided shares of supply data in liquid filtration segmented by product components. Their combined shares are always below [0-10] per cent, and increments are only up to one per cent. Due to these low shares of supply, an assessment of barriers to entry and buyer power in this segment is not necessary.

Compressed air treatment

30. Table one below provides the parties' shares of supply in compressed air treatment segmented by product components. The merger will not lead to any combined shares of supply being greater than [20-30] per cent, and increments are never greater than [0-10] per cent.

Table 1: Shares of supply in the manufacture of compressed air treatment equipment

	Parker		Domnick		Parker/Domnick	
	<i>Global</i>	<i>UK</i>	<i>Global</i>	<i>UK</i>	<i>Global</i>	<i>UK</i>
Filter housings	[0-10]	[0-10]	[5-15]	[15-25]	[10-20]	[20-30]
Filter elements	[0-10]	[0-10]	[5-15]	[15-25]	[10-20]	[20-30]
Dryers	[0-10]		[10-20]		[10-20]	

Source: best estimates from the parties

Note: Share of supply figures based on value.

31. Although Domnick appears to be the number one supplier in the UK, Parker is one of the smaller suppliers. The merged entity will face competition from a number of manufacturers including Donaldson (Ultrafilter), SPX, Walker, Headline, PSI Global, BEA Filter and Mikropor.

Barriers to entry

32. The parties consider that barriers to entry are generally not high. However, they pointed out that they may be higher in some sectors (i.e. the military vehicle market).
33. Third party evidence on barriers to entry is mixed. Some third parties consider that technical know-how and access to distribution channels were barriers to entry. Another third party said that barriers to entry were high for some technologically sophisticated products (i.e. a desiccant compressed air dryer). Another third party pointed to the rapid growth in low cost economies to suggest that barriers to entry were low.

Buyer Power

34. The parties maintain that compressed air treatment is characterised by a high degree of buyer power. Some of their customers are global businesses in the form of compressor manufacturers and OEMs, which have significant purchasing power and switch frequently in their choice of compressed air treatment equipment supplier.
35. This view was supported by most third parties. OEMs are able to negotiate high buying volumes at special discounts, which permit them to offer equipment at reduced net prices.

Gas generation

36. Table two below provides the parties' shares of supply in gas generators and the broader segment of small volume gas supply. The merger will not lead to any

combined shares of supply being greater than [30-40] per cent, and the increments to market shares are never greater than [5-15] per cent.

Table 2: Shares of supply in the manufacture of gas generators and small volume gas supply

	Parker		Domnick		Parker/Domnick	
	<i>Global</i>	<i>UK</i>	<i>Global</i>	<i>UK</i>	<i>Global</i>	<i>UK</i>
Gas generation equipment	[20-30]	[0-10]	[5-15]	[20-30]	[30-40]	[25-35]
Small volume gas supply⁴	[0-10]	[0-10]	[0-10]	[0-10]	[5-15]	[0-10]

Source: best estimates from the parties.

Note: Share of supply figures based on value.

37. The merged entity will face competition in the UK from a number of manufacturers including Peak ([15-25] per cent); Claind ([5-15] per cent); and, others (including Texol, N2 and Erre Due) ([40-50] per cent). There are also other gas generation equipment manufacturers in operation worldwide who are currently not active in the UK. These are potential entrants to the UK, and include Generon, Branick and Onsite.
38. Gas generators for small volume gas users account for 30 per cent of all small volume gas supply. There are a number of companies who supply the rest of small volume customers. These are gas supply companies and include large global companies such as Air Liquide, Praxair, BOC, Linde and Air Products. They supply gas in cylinders and bulk liquid gas.

Barriers to entry and expansion

39. The parties do not consider barriers to entry to be high in the manufacturing of gas generators. For instance, Claind, a competitor set up eight years ago, has now achieved a UK share of supply in gas generators of around [5-15] per cent (around three per cent in the supply of small volume gas).
40. The parties have also pointed to a number of US gas generators manufacturers who do not currently operate in the UK. The parties consider that it may be possible and relatively easy for these companies to enter the UK.
41. Most third parties consider that barriers to entry in membrane generation equipment are low. One third party suggested that most desiccant dryer manufacturers would have the capacity to expand and produce gas generators.

⁴ This includes gas generators, gas cylinders and bulk liquid supply (below 200 tonnes per year).

Buyer power

42. The majority of the parties' customers are small volume users of gas unlikely to have any countervailing buyer power. However, customers are generally likely to have a choice of both suppliers and the method/source of gas.
43. Large companies buying and re-branding may have some buyer power as they buy the products and re-sell them under their own brand (i.e. Domnick sell some of their gas generators to the gas supply company BOC).

THIRD PARTY CONCERNS

44. The majority of third parties were unconcerned about this merger.
45. A third party raised concerns that the merger would enable the parties to increase market power in the provision of liquid filtration products. Another third party has raised concerns about access to distribution channels in compressed air treatment equipment. None of these concerns appear to be substantiated.

ASSESSMENT

46. This inquiry focused on the parties' overlaps in the UK supply of both compressed air treatment and gas generation products. While the merged entity will have combined shares of supply in the UK of up to [20-30] per cent and [25-35] per cent respectively in these segments, these are not considered material given that numerous suppliers remain, barriers to entry appear to be low, there is some buyer power and third parties were generally unconcerned.
47. Consequently, the OFT does not believe that it is or may be the case that the creation of this merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

48. This merger will therefore not be referred to the Competition Commission under section 33 (1) of the Act.