

Enquiry Report

In the matter of a complaint filed by Iljin Electric Company Limited
versus
Siemens (Pakistan) Engineering Company Limited

1. This Enquiry Report is prepared pursuant to a complaint filed by Iljin Electric Company Limited (hereinafter “Iljin” or “Complainant”) under Section 37 of the Competition Ordinance, 2007 (hereinafter the “Ordinance”) against the issuance of No Objection Certificate to Siemens (Pakistan) Engineering Company Limited (hereinafter “Siemens”) by the Competition Commission of Pakistan (hereinafter “CCP” or the “Commission”) for the acquisition of 90% shares of Heavy Electrical Complex (HEC).

A. Factual Background

2. Briefly, the facts of the case are that on 8 May 2008 Siemens applied for a No-Objection Certificate from the Commission under Section 11(2) of the Ordinance read with Regulation 5 of the Competition (Merger Control) Regulations, 2007, for the acquisition of 90% shares of HEC through the Privatisation Commission (PC). PC has initiated the process of privatisation of HEC and only four companies were declared pre-qualified to bid, *i.e.*, Siemens, Iljin, Areva, and Pak Elektron Limited (PEL).
3. On 16 May 2008, the Commission granted the requested NOC to Siemens. In its competitive analysis for the intended acquisition of HEC by Siemens, the Commission accepted the submission of Siemens that the relevant product market is composed of power transformers of various voltage ratings.
4. On 17 July 2008, the Commission received a letter from the Managing Director of Iljin stating therein certain objections

regarding the issuance of NOC to Siemens and requested the Commission to reconsider its decision with respect to the issuance of NOC to Siemens and to withdraw the same.

5. On 4 August 2008, Iljin applied to the CCP for a NOC for the intended acquisition of shares of HEC through the PC. The NOC to Iljin was issued on 11 August 2008.
6. On 4 August 2008, Iljin also filed a complaint under Section 37 of the Ordinance, 2007 read with Regulation 17(2) of the Competition (General Enforcement) Regulations, 2007 against Siemens.

B. Submissions by Iljin

7. The contentions raised in the complaint against the issuance of the NOC to Siemens are summarised below:
 - (i) Iljin is a prominent international company, registered in the Republic of Korea, specialising in the production of power transformers, including exporting the same to Pakistan since 2006.
 - (ii) Iljin has a host of investment opportunities in the global arena, but because of established business relationships in Pakistan and out of a desire to contribute to Pakistan's economic growth, Iljin wishes to allocate its technological and financial resources to Pakistan by participating in the privatisation of HEC.
 - (iii) Siemens has a "dominant" position in the 132kv power transformer market in Pakistan. The intended acquisition of HEC by Siemens will further strengthen its dominance and lead to creation of a monopoly in the power transformer market and, therefore, could lead to an abuse

of dominant position under Section 3(2) and 3(3) of the Ordinance.

- (iv) The geographic market for 132kv power transformers is the whole of Pakistan. The main consumers are the National Transmission and Distribution Company (NTDC) and nine other distribution companies *i.e.*, IESCO, KESCO, PESCO, etc. The power transformer market in Pakistan consists of three products, *i.e.* (i) 132kv (ii) 220kv and (iii) 500kv. Each constitutes a separate market since these products are not substitutable. Currently, Siemens holds 65.5% of the 132kv market while HEC holds 20.7% of the same. Siemens and HEC are the only two local manufacturers in 132kv market. If the intended merger is allowed between Siemens and HEC, their combined market share would exceed 86% of the 132kv market and would establish the monopoly of Siemens in the 132kv product market as it would exceed the dominance thresholds under the Ordinance. Allowing the intended merger to take effect would be in violation of Section 11(1) and could lead to an abuse of dominant position under sub-sections (2) & (3) of Section 3 of the Ordinance.
- (v) Siemens has intentionally misled the Commission by not providing the relevant facts for the issuance of NOC. The Commission should have conducted a second-phase review of the merger-acquisition for effective compliance of the Ordinance.
- (vi) Siemens has a history of attempting to curb competition in Pakistan. Siemens has provided incorrect information to FBR, falsely claiming that it was a producer of 220kv

transformers and succeeded in increasing the import duty for 220kv transformers from 5% to 20%. This was done when Siemens began to acquire production capacity for 220kv transformers. The objective behind raising the import duty was to restrict import competition in 220kv transformers. Siemens has yet to acquire the capacity to manufacture 220kv transformers in Pakistan. Subsequently, upon a complaint filed by WAPDA with the FBR, the said import duty was reduced to 5%.

(vii) The intended merger will also remove an effective competitor *i.e.*, Iljin, from the market. The actions of Siemens in this regard are *mala fide*, since it has failed to provide accurate and honest information to the Commission under the merger regulations.

(viii) Finally, it has been prayed that the NOC issued to Siemens be withdrawn under Section 11(14)

8. Upon receipt of the complaint, the Commission considered it appropriate to enquire into the matter under Section 37(2) of the Ordinance, 2007, and therefore, the enquiry was initiated. Copy of the complaint along with other documents filed by Iljin was sent to Siemens to have the contentions of both parties on record.

C. Submissions by Siemens

9. Siemens submitted its reply dated 5 September 2008 to the Commission, which is summarised as under:

(i) Siemens has refuted the claim of Iljin that it (Iljin) is a prominent and international company in the production of heavy electrical transformers.

(ii) Siemens also denied the statement provided by Iljin in its complaint that it has a host of international opportunities

in the world and because of its established business relationship in Pakistan, it has participated in the privatisation process of HEC to contribute to the economic, technical, and financial growth of Pakistan. Furthermore, the allegation that Siemens has a dominant position in the Pakistani power transformer market is also denied.

- (iii) The market segmentation as stated by Iljin in its complaint is unreasonable. The power transformer market cannot be segmented into primary voltage ratings. There are three important factors for the purpose of considering the product market: (i) the product's characteristics (ii) price and (iii) intended use as provided in the definition of the relevant market under the Ordinance, 2007. The basic characteristic of the product remains the stable distribution of electricity. Price cannot be considered a critical distinguishing factor as it is a "buyers" market in Pakistan and the sellers have very little negotiating strength. The intended use of all power transformers is the same, namely to provide a mechanism whereby voltage is stepped-up and stepped-down through the process of electro-magnetic induction.
- (iv) The geographic market definition of power transformers cannot be limited to Pakistan as this product has global demand.
- (v) Siemens is not in a dominant position in the instant matter as the transformer market could not be segmented according to voltage ratings.
- (vi) Siemens obtained the NOC based on correct and *bona fide* disclosure of proper material and documents. Siemens also

highlighted the fact that Iljin too has obtained the required NOC from the Commission.

10. The Commission, vide its office order dated 8 August 2008, constituted an Enquiry Committee, which was subsequently reconstituted on 11 September 2008 to comprise of the Chairman and Member (Monopolies and Trade Abuses) to inquire into the matter and recommend an appropriate course of action.
11. Both parties were provided an opportunity to explain and clarify their positions before the Enquiry Committee on 12 September 2008 in Islamabad.

D. Issues and Analysis

12. The issues raised in the complaint are:
 - (i) Whether the Commission had erred in defining the relevant product market as power transformers of different voltage ratings, *i.e.*, 132kv, 220kv, and 500kv, while issuing the NOC to Siemens.
 - (ii) Based upon the findings in (i) above, whether Siemens holds a dominant position in the relevant market and whether its intended merger with HEC would lead to a violation of sub-section (1) of Section 11 and Section 3 of the Ordinance.
 - (iii) Whether Siemens has obtained the NOC from the Commission by submitting misleading and false information which calls for initiation of proceedings under sub-section (14) of Section 11 of the Ordinance.
13. We address the above issues *ad seriatim*:

D. (i) Whether the Commission had erred in defining the relevant product market

D. (i) a. Definition of Relevant Product Market

14. At the outset, we must note that the central question in any competitive analysis of a merger is whether the combination will create or strengthen a dominant position, allowing it to raise prices above competitive level without loss of sales that would make the price increase unprofitable. To identify this market power, merger analysis proceeds by defining the relevant market, and takes into account a host of other factors.
15. A relevant product market is, generally, defined by taking into account “all those products or services which are regarded as interchangeable or substitutes by the consumer by reason of the products’ characteristics, prices and intended uses.”¹ However, in the case of a horizontal merger where merging parties have production facilities, which can readily be used to produce other products as well, then all such products are counted while defining the relevant product market.² Moreover, in a case where products are not good substitutes but are complementary to each other, as is the case in the instant complaint, then the range of products may be grouped to measure market power.³

¹ Section 2(k) of the Ordinance.

² See Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 Columbia L. Rev. 1805 at page 1860 (1990).

Supply Substitution. -- Although a product as presently manufactured may not be an adequate substitute for another, if the production process could be redesigned promptly and cheaply to produce the second product, then that potential “supply substitution” must be counted in the product market. See also *Brown Shoe Co. vs. U.S.* 370 U.S. 294; 82 S.Ct. 1502 (1962).

³ Pitofsky, *Id.* at page 1862.

In a cluster market, a range of products can be grouped together to measure market power, even though they are not good substitutes, because they are related or complementary in production or distribution. . . . In the industrial market, an example would be various pieces of oil pipe handling equipment used in downhole oil drilling. (See e.g., United States v. Hughes Tool Co., 415 F. Supp. 637, 641 (C.D. Cal. 1976)).

16. In Brown Shoe Co. vs. U.S.⁴, the case involved a merger between Brown shoe, the third largest and Kinney, the eighth largest shoe manufacturer by dollar volume in the United States. The District court below defined the relevant product markets as ‘men’s,’ ‘women’s,’ and ‘children’s’ shoes separately rather than defining the relevant market as all new shoes. The U.S. Supreme Court cautioned against drawing product markets too narrowly. “[T]he boundaries of the relevant market must be drawn with sufficient breadth to include the competing products of each of the merging companies and to recognize competition where, in fact, competition exists.”⁵ The Court, in discussing the criteria that may define a “submarket,” observed that:

[t]he boundaries of such a submarket may be determined by examining such practical indicia as *industry or public recognition of the submarket as a separate economic entity, the product’s peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors.*”⁶ [Emphasis added]

Thus, to define a line of product into submarkets the above-stated criteria should be taken into consideration.

17. Iljin rests its case on the ground that the relevant product market is that of 132kv transformers only, and if the acquisition of HEC by Siemens is allowed it will create dominant position of Siemens in the 132kv transformers product market. In its complaint at Para A(2), Iljin states as reproduced below:

(2) HEC is one of the industrial units of State Engineering Corporation and is engaged in the manufacturing of power transformers of different types with primary voltage rating of 66kv and 132kv.

Later at Para B(1), Iljin states:

(1) That, for the purposes of this complaint the relevant geographical market is the whole of Pakistan and

⁴ 370 U.S. 294; 82 S.Ct. 1502 (1962).

⁵ *Id.* at 326.

⁶ *Id.*

relevant product market is the 132kv Market. Given that no undertaking in Pakistan manufactures 220kv and 500kv transformers and since both the Respondent [Siemens] and the *HEC only produce 132kv transformers* their merger will *only affect the competition in the 132kv Market*. Accordingly, the relevant market is 132kv Market spread over whole of Pakistan. [Emphasis supplied].

18. We find that the above-quoted two paragraphs from the complaint are self-contradictory and factually incorrect. HEC is in the business of manufacturing new power transformers of the voltage rating 220/132/11kv, and provides repair/rehabilitation services for “all types of power transformers.”⁷ Siemens is in the business, among others, of manufacturing power transformers of voltage rating of up to 220kv/250mva.⁸ Both parties manufacture transformers of 220/132/11kv voltage rating, and therefore it is not appropriate to define the relevant product market in terms of 132kv transformers alone, as asserted by Iljin.
19. Notwithstanding our conclusion with respect to the relevant product market above, we examined this issue further as it is pivotal to our enquiry. At the hearing conducted pursuant to the complaint on 12 September 2008, counsel for Iljin stated that Siemens had obtained the NOC for the intended acquisition of HEC on the basis that all types of transformers (132kv, 220kv, and 500kv) constituted one product market in Pakistan, whereas each transformer of specific voltage rating constitutes a separate product submarket. Three factors were asserted to determine the product in a relevant market as provided under the Competition Ordinance, 2007, namely (i) substitution (ii) price and (iii) intended use of the product in the relevant market. Iljin is of the

⁷ See HEC’s profile available at Privatisation Commission’s website at: <http://www.privatisation.gov.pk/industry/PDF%20File/HEC%20Profile.pdf>; see also Engineering Development Board of Pakistan’s website at: <http://www.edb.gov.pk/Corporations/SEC/HEC.pdf>.

⁸ <http://www.siemens.com.pk/Transformers.html>

view that these categories of transformers cannot be substituted with each other. Costs and intended use are quite different; therefore, these transformer types cannot be clubbed in one product market. The counsel did not offer any other argument in addition to the general three-prong test laid down in Section 2(k) of the Ordinance for defining submarkets within the market of transformers. Also, counsel of Iljin could not provide any judicial precedent, either from within Pakistan or from any other jurisdiction, regarding the segmentation of power transformers market into categories based on voltage ratings.

20. On behalf of Siemens, it was submitted that the three transformer categories in question, *i.e.*, 132kv, 220kv and 500kv, constitute one product market. All three categories of transformers are made on one assembly line using similar machines/equipment. As for substitutability, the view of Siemens is that it is wrong to suggest that one type of transformer cannot be substituted for another because, admittedly, a power transformer of whatever size or capacity is electrical equipment in which voltage is “stepped up” or “stepped down” through the process of “electro-magnetic induction” for efficient transmission of power – the basic characteristics remain the same. A power transformer will remain a power transformer irrespective of its primary or secondary voltage rating. Power transformers of various sizes are used in a power network facility just as fasteners of different sizes are used to make furniture and it would be rather difficult to try to separate the market for large fasteners from that of small fasteners. To support his view, the counsel of Siemens quoted an EU case decision (Case No COMP/M.3296 – Areva/Alstom T&D) in which product categories were defined but market segmentation was not done as it was considered as having negligible impact on competition.

21. During the course of hearing, Iljin requested that time be granted to submit documents/evidence to substantiate that the three types of power transformers cannot be manufactured at one facility. The response of Siemens to this was that the Commission and the Complainant could visit its manufacturing site. To resolve the issue, the parties were required to submit an independent expert's opinion as to whether all three types of transformers can be produced on one assembly line without involving substantial effort. In this regard, Siemens sent us a report prepared by an independent engineer stating therein that all three types of transformers can be manufactured on one assembly line and that the equipment used for such assembly/production line remains substantially the same. In this connection, we quote below from the views expressed by Mr. Khalid Pervez, an independent engineer whose opinion was solicited by Siemens.

It is concluded that one does not need different manufacturing setups to produce power transformers of different voltage ratings. Power transformers of 66kv, 132kv, 220kv, and 500kv voltage ratings could be and are being manufactured at the same manufacturing facility and with the same machines.

22. Siemens also sent us a video about the manufacturing equipment and assembly line of its factory that produces transformers. We have observed that the assembly line and the equipment used is the same for manufacturing of different types of transformers.

23. In this regard, Iljin failed to comply with our direction, even after lapse of the granted time (which was extended despite time constraints) for submission of the requisite opinion, albeit Iljin did submit a plethora of documents which have been examined by us. We find that Iljin has merely provided an international standards document, a two-liner testimonial from the General Manager, PEPCO, and design specifications of WAPDA. These documents do not answer the question put to both Iljin and

Siemens in a clear and unambiguous manner during the course of hearing. The documents submitted by Iljin are not relevant to the question that was asked. Hence Iljin has not been able to discharge the onus of substantiating its submission.

24. Applying the criteria laid down in Brown Shoe to define submarkets (see Para 16 above) we conclude that the record supports the view of Siemens that power transformer markets cannot be segmented. The power transformers of various voltage ratings are recognized by the industry as a single product line; power transformers of various voltage ratings can be manufactured in the same plant; power transformers have similar characteristics; and the vendors and customers for power transformers are largely the same.

D. (i) b. Market Shares & Market Power

25. Having concluded the question of relevant product market, while it is not important any more to address the issue of market shares and market power, we would nonetheless like to deal with these matters.

26. At Para A(8) of the complaint, Iljin states:

(8) Presently, the Respondent holds 65.5% of the 132kv Market while the HEC holds 20.7% of the same market. Accordingly, if the Respondent is allowed to merge with the HEC their combined market share will exceed 86%. A factsheet containing details of the Respondent's and the HEC's respective market share is annexed to this complaint as Annexure E. This fact sheet is independently verifiable from the utilities companies.

Note 3 to the Annexure E states: "Market share was calculated by dividing the MVA sum of purchase orders (132kv and 220kv) of the main customers aforementioned at Note 1 by the MVA sum of successful orders of each company for a specific year."

We find Iljin's calculation of market shares flawed. Market share for 132kv transformers cannot be calculated by dividing the MVA sum of purchase orders for 132kv and 220kv by the MVA

sum of successful orders of each company. Further, if both Siemens and HEC, as asserted by Iljin, do not manufacture 220kv transformers then it is not clear why the purchase orders for 220kv transformers were taken into consideration for calculating the market shares for 132kv transformers.

27. Market shares as calculated by Iljin revealed that the market share of local undertakings is a dynamic factor – it does not exhibit any consistent pattern and varies considerably from year to year. Moreover, the calculation of market shares by Iljin was based on current market conditions and it failed to take into account future market growth and dynamics. Merger analysis is about future market conditions and probable future conduct of the merged entity; therefore, future market growth and dynamics are essential elements of analysis.⁹
28. During the arguments on the question of relevant product market, counsel for Siemens submitted that price is not a pivotal factor in this case as the market in Pakistan is a “buyers” market and not a “sellers” one thereby allowing buyers to dictate their terms to sellers. While we feel that counsel has somewhat misunderstood the concept of “price” in determining the relevant product market,¹⁰ we feel that his argument of “buyers” versus “sellers” market is important in determining market power and in addressing the central question to merger analysis as laid out in Para 14 above, that is, whether the merger will create or strengthen a dominant position, allowing the merged entity to

⁹ See for example, *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974). The US Supreme Court held that current production of coal was a poor measure of future competition and that uncommitted coal reserves should be used instead.

¹⁰ The criterion of price in determining relevant product market refers to an increase in price which affects the cross-elasticity of demand between the product itself and substitutes for it. It is the change in price, from the consumer perspective, that affects its elasticity of demand for the substitute. This is different from the bargaining power between the buyer and seller for the price of product, as conceived by the counsel for Siemens.

raise prices above competitive level without loss of sales that would make the price increase unprofitable.

29. Courts have taken the impact of powerful buyers in counteracting increased sellers concentration after a merger into account,¹¹ and we are inclined to agree with the counsel of Siemens that the power transformers market is that of buyers and not of sellers. As a practical matter, it seems that in this market, most situations are somewhat monoposomistic in flavour. There is no doubt in our mind that transformers of such size and type can only be utilised by WAPDA, NTDC, and other large power distribution companies in Pakistan. We feel there is a fair element of validity in the underlying argument of Siemens.

D. (i) c. Other Arguments

30. Iljin, in its complaint, has maintained that the grant of NOC to Siemens for the purpose of its intended merger with HEC has disadvantaged its position. Iljin could not substantiate this claim. In fact, it was admitted that there are only two prospective bidders for HEC, *i.e.* Siemens and Iljin. If this is the case, we wonder what is the true intention behind the filing of the complaint against Siemens. If the intention is to take Siemens out of the bidding process by having its merger NOC withdrawn by the Commission, then in such a situation, Iljin would be the only bidder for HEC, given that Areva and PEL have not obtained NOCs from the Commission so far. This fact weighs against the withdrawal of the NOC issued to Siemens, taking into account public interest considerations. We note that Iljin has not given any credible data, information, or documents supporting its stance that it has been disadvantaged by the issuance of the impugned NOC to Siemens.

¹¹ *United States v. Country Lake Foods*, 1990-2 Trade Cas. (CCH) ¶ 69,113 (D.Minn.1990).

31. Further, it is noteworthy that power transformers are being imported into as well as exported out of Pakistan and the consumers , *i.e.*, buyers such as NTDC and the distribution companies are tendering and asking for bids on a global basis. Therefore, under such circumstances, imports of power transformers could be considered an essential feature in determining whether the intended merger is likely to result in a violation of Section 11(1) of the Competition Ordinance, 2007. Since power transformers are both imported from and exported to various countries (at least within the vicinity of Pakistan, if not beyond) we feel it may be possible to make out a reasonable case that the geographical market for power transformers extends beyond Pakistan's borders but this has not been put forward in concrete terms during the proceedings.
32. In light of the foregoing, we conclude that the Commission did not err in defining the relevant product market while granting the NOC to Siemens.

D. ii. Whether Siemens Holds a Dominant Position in the Relevant Market.

33. Based on the findings in (i) above, it would appear to us that Siemens does not have a dominant position nor would the intended merger constitute a violation of the prohibition of subsection (1) of Section 11 or give rise to the likelihood of violation of Section 3.

D. iii. Whether Siemens has Submitted Misleading and False Information.

34. It was argued by the counsel of Iljin that the NOC granted to Siemens should be withdrawn because Siemens had provided false and misleading information for the issuance of the NOC and attempted to substantially lessen competition by establishing or intending to establish a monopoly in the power transformer

market. We have already discussed in detail the factors to be considered in a product market and concluded that the three power transformers, *i.e.* 132kv, 220kv, and 500kv, can be collectively considered as a single product market in the instant case. We do not find any credible basis to conclude that Siemens has provided misleading or false information to the Commission in order to obtain the NOC for the intended merger with HEC.

E. Recommendations

35. In light of the foregoing, we conclude and recommend that:
- (i) Iljin has not been able to establish a case against Siemens with regard to the provision of misleading and incorrect information for obtaining the impugned NOC from the Commission.
 - (ii) No case is made out by the Complainant for the withdrawal of the NOC granted to Siemens by the Commission.
 - (iii) The complaint has no merit and, therefore, no further proceedings should be initiated under Section 11(14) or any other provision of the Ordinance.

Dated: 6 October 2008, Islamabad

Dr. Joseph Wilson
Member

Khalid A. Mirza
Chairman