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Anticipated acquisition by Atlas Copco Kolfor Limited of the air compressor rental business of Aggreko plc

ME/3983-08

The OFT's decision on reference under section 33(1) given on 18 February 2009. Full text of decision published 27 February 2009.

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**Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.**

#### **PARTIES**

1. **Atlas Copco Kolfor Limited** (Atlas), based in Dundee, is a wholly owned subsidiary of Atlas Copco AB, an international industrial group headquartered in Stockholm, Sweden. Atlas manufactures specialist machinery, including air compressors, generators and power supplies for sale or rent.
2. **Aggreko plc** (Aggreko), listed on the London Stock Exchange, is a global operator exclusively in the rental of power generation, temperature control and air compression services and equipment.

#### **TRANSACTION**

3. The proposed transaction consists in the transfer to Atlas of employees and assets, including fleet, spares, inventory and goodwill, that comprise Aggreko's air compressor rental operations in the UK (the Target business). The parties notified the transaction on 15 December 2008, the administrative target date for the OFT's decision is 18 February 2009.

#### **JURISDICTION**

4. As a result of this proposed transaction, Atlas and the Target business would cease to be distinct. According to the parties' estimates, their combined share of the UK supply on rental terms of a specific category of air compressor, oil-free air compressors, amounts to around [30-40] per

cent.<sup>1</sup> On this basis, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **MARKET DEFINITION**

5. Air compressors function by storing volumes of air under pressure. When released under controlled conditions, such pressure is capable of delivering pneumatic energy to drive mechanisms in a variety of industrial and (albeit on a smaller scale) domestic applications.
6. Some typical applications include the operation of:
  - factory machinery and control systems
  - construction, drilling, lifting and mining equipment
  - petrochemical and nuclear equipment
  - underwater equipment and machinery, and
  - light industrial and domestic apparatus such as nail guns, staplers, spray guns and sanders.

## **PRODUCT SCOPE**

### **Rental of air compressors**

7. The parties submit that customer demand for the supply - on rental terms – of air compressors is a function of one of two types of requirement: 'planned' or 'emergency'.
8. Planned contracts in the rental sector are of variable duration (from around a single week to several months) and are negotiated, often in the context of maintenance and service agreements, to allow for the provision of replacement compressor output during scheduled maintenance or over periods when additional capacity is required.
9. Emergency contracts are entered into only when a crucial machine in the customer's fleet or installation breaks down and there is insufficient back-up capacity to make up for any critical shortfall. Generally speaking, they are of shorter duration than planned contracts. In emergency situations, customers seek to negotiate the delivery on rental terms of a required specification of air compressor in as short a time as feasible. Customers have indicated to the OFT that the current location and the estimated delivery time of the candidate machine, taking account of any foreseeable

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<sup>1</sup> The parties submit that it is not possible to accurately calculate levels of customer demand in this particular segment. Their estimates are therefore modelled on the basis of various reasoned assumptions.

delays that can arise in shipment and installation, are therefore the crucial considerations that drive their choice of supplier.

10. The available evidence indicates that customers are currently constrained in the choice of supplier in emergency situations. Such constraints are posed by (a) the imperative to quickly make up for any shortfall in air compression capacity and (b) by the customer location and the location (usually a supplier's depot) of the most accessible (time being of the essence) air compressor unit that both meets the customer's requirements and is available for hire. Such demand characteristics typically provide that only on very limited occasions do customers in emergency situations have a choice between suppliers able to rent out an air compression unit of the required size and specification – and also able to commit to competing delivery timelines. The OFT considers that the merger will have no significant impact on the prevailing shortage of opportunities for customers to exert leverage on terms and conditions for rental supply in emergency situations. Emergency rental contracts are therefore given no separate consideration in the context of this decision.

#### **Categories of air compressor**

11. In a previous case, Atlas/ABAC,<sup>2</sup> the OFT considered the air compressor sector from a sale rather than a rental perspective.
12. In the context of that decision, the OFT noted that air compression can be achieved using different types of technology. 'Piston' air compressors, for example, are used largely for intermittent operations whereas 'rotary' air compressors are used principally for continuous operation. Such air compressors are built to various size, capacity and power specifications and are designed to be either stationary or portable and (depending on the lubrication requirements within the compression mechanism) to operate either with or without oil-injection.
13. Ultimately, however, the OFT decided in Atlas/ABAC that there was no need to reach any conclusion on the possible delineations of the product scope.

#### **Oil-free versus oil-injected air compressors**

14. In the present case, the parties reaffirm that, within the rental segment, air compressors are available in a range of sizes and specifications, including oil-injected models at one end of the spectrum to so-called 'class zero' oil-free compressors at the other.<sup>3</sup>

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<sup>2</sup> Anticipated acquisition by Atlas Copco Italia SPA of ABAC Aria Compressa SPA – 2007

<sup>3</sup> Class zero machines are compliance certified that they carry zero risk of oil contamination. Atlas rents out machines that have class zero certification. Aggreko does not.

15. A substantial body of third party comment supports the parties' proposal that customers switch between renting models at both ends of the spectrum and also between the rental of oil-injected compressors which are 'technically oil-free' by virtue of having oil filters attached. The parties submit that such filters can be either pre-installed when the product is shipped or, at the cost of a few hundred pounds, purchased and installed by the customer.
16. Furthermore, the parties argue that there are no regulatory requirements that impact on any customer's choice to install or to rent oil-free as opposed to oil-injected machines.
17. A competitor submitted to the OFT that the lubrication oil in air compression systems used in the manufacture of products for human consumption would be classified as 'food grade' according to FDA standards.<sup>4</sup> Without expressing any specific concerns with regard to the impact of the merger, a minority of third party comment suggests that the decision to procure purely oil-free air compressors exclusively is a function of aversion to the risk, however slight, of oil contamination – particularly in industries such as the production of food and drink.
18. The OFT spoke to one customer in the food and drink sector who had chosen to install a purely oil-free air compression system and one who used oil-injected air compressors with filters.
19. The parties also provided documentary evidence in the form of promotional literature published by a competitor, Kaeser, which designs filtered oil-injected air compressors for permanent installation in the brewing, dairy and food sectors.
20. In the present case, the OFT also considers, on the basis of the available evidence and of third party comment, that the decision to procure, from within the whole range of available air compressors, a unit of a particular specification and size – whether for sale or rental – is one based on the individual customer's operational requirements and on its own preferences. For the purposes of this assessment, it is therefore not appropriate to focus on any artificially segmented delineations within the overall air compressor rental segment.

### **Geographic scope**

21. In Atlas/ABAC, although noting that the manufacture of air compressors takes place on a pan-European basis, the OFT's competition assessment proceeded on the cautious hypothesis that the relevant geographic scope was no wider than the UK.

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<sup>4</sup> United States Food and Drug Administration

22. In the present case, third party comment broadly supports the parties' proposal that it is appropriate for the geographic focus of the competition assessment of the rental segment to be the UK. On the basis that suppliers of air compressors for rent could be situated up to 400 miles away, one customer submitted that the location of the supplier was not an important factor when selecting air compressors for rental contracts.
23. The OFT's analysis is therefore focused on the merger's effects on competition at the national level.

## **HORIZONTAL ISSUES**

24. The parties estimate that, based on calculations for the year 2007, Atlas' share of supply within the overall air compressor rental segment will increase by around [5-10] per cent to around [10-20] per cent by value (based on revenue from rental contracts) and by around [0-5] per to around a total of [5-10] cent by volume (based on the number of air compressors in the parties' and their competitors' fleets).
25. In terms of scale, the merged entity will be the fourth largest player by value (behind Speedy, Coates Offshore and Airpac) and the fifth largest by volume – the number of air compressor units in its fleet amounting one tenth of the total number in Speedy's fleet.
26. On the basis of the above indications that the merged entity will be constrained going forward by a significant number of larger competitors, the OFT considers that the merger will not give rise to a significant lessening of competition at the horizontal level.

## **VERTICAL ISSUES**

27. As well as being present in the rental segment, Atlas is also active in the upstream manufacture and sale of air compressors. Two competitors proposed that Atlas does not sell certain categories its oil-free compressors in the wider market place.
28. Atlas submitted that it sells most types of its air compressors to third parties and makes service technicians available to supplement their sales. It clarified, however, that it does not sell its model of diesel driven portable oil-free compressor. This is on the basis that global demand is low and, in Atlas' view, would not justify the requisite investment in training sufficient technicians to maintain these compressors. Atlas further submits that, in any event, an equivalent diesel machine can be purchased by rental providers from other compressor manufacturers such as Ingersoll Rand, Sullair and CompAir.

29. Evidence from third parties indicates that a number of them both purchase and rent air compressors from Atlas. No concerns were raised as to possibility of not being able to do so as a result of the merger.
30. Further evidence from another third party, who previously replaced all of its oil-injected fleet supplied by one manufacturer with those of another manufacturer, also indicates that there is no scope for the merger to have adverse effects as a result of foreclosure of the supply to competing rental companies of air-compressors manufactured by Atlas.

### **THIRD PARTY VIEWS**

31. All of the customers who spoke to the OFT were unconcerned by the merger.
32. One competitor raised a concern that the merger would create a substantially larger Atlas with the potential to dominate and eventually to extend into that competitor's core market. The market share data and number of alternative suppliers discussed above do not corroborate this view.

### **ASSESSMENT**

33. The parties overlap in the rental of air compressors that provide pneumatic energy for various types of mechanical processes in industries such as manufacturing, construction, drilling and lifting.
34. The evidence available to the OFT indicates that there is not appropriate to reach any conclusion on the precise delineation of the relevant product and geographic frames of reference. For the purposes of its assessment therefore, the OFT's analysis focuses on the rental supply of air compressors within the UK.
35. Based on the parties' calculations for the year 2007, Atlas' share of the supply of overall air compressor rental segment will increase by around [5-10] per cent amount to around [10-20] per cent by value (based on revenue from rental contracts) and by around [0-5] per to around a total of [5-10] cent by volume (based on the number of air compressors in the parties' and their competitors' fleets).
36. In terms of scale, the merged entity will be the fourth largest player by value (behind Speedy, Coates Offshore and Airpac) and the fifth largest by volume – the number of air compressor units in its fleet amounting one tenth of the total number in Speedy's fleet.
37. On the basis of the above indications that the merged entity will be constrained going forward by a significant number of larger competitors,

the OFT considers that the merger will not give rise to a significant lessening of competition at the horizontal level.

38. The available evidence also indicates that there is no scope for the merger to have adverse vertical effects as a result of foreclosure of the supply to competing rental companies of air-compressors manufactured by Atlas.
39. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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