

ANALYSIS OF AGREEMENT CONTAINING CONSENT ORDER TO AID PUBLIC COMMENT

In the Matter of Emerson Electric Co. and Pentair plc, File No. 161-0221

I. INTRODUCTION

The Federal Trade Commission (“Commission”) has accepted, subject to final approval, an Agreement Containing Consent Orders (“Consent Agreement”) from Emerson Electric Co. (“Emerson”) and Pentair plc (“Pentair”) (collectively, the “Respondents”) that is designed to remedy the anticompetitive effects that would likely result from Emerson’s proposed acquisition of Pentair’s valves and controls business.

Pursuant to a Share Purchase Agreement, dated as of August 18, 2016, Emerson proposes to acquire the equity interests of certain subsidiaries of Pentair in exchange for cash considerations of approximately \$3.15 billion (the “Acquisition”). The proposed Acquisition would combine the two largest suppliers of switchboxes, which are industrial valve control products, in the United States. The Commission’s Complaint alleges that the proposed Acquisition, if consummated, would violate Section 7 of the Clayton Act, as amended, 15 U.S.C. § 18, and Section 5 of the Federal Trade Commission Act, as amended, 15 U.S.C. § 45, by substantially lessening competition in the United States market for switchboxes.

The proposed Decision and Order (“Order”) requires Emerson to divest Pentair’s switchbox manufacturer subsidiary, Westlock Controls Corporation (“Westlock”), to Crane Co. (“Crane”) no later than ten days after the Acquisition is consummated. The divestiture requires Emerson to transfer to Crane all of the facilities, personnel, confidential information, and intellectual property associated with the design, manufacture, and sale of Westlock’s products, which will allow Crane to effectively compete in the switchbox market.

The Commission has placed the Consent Agreement on the public record for 30 days to solicit comments from interested persons. Comments received during this period will become part of the public record. After 30 days, the Commission will again review the Consent Agreement, along with any comments received, and decide whether it should withdraw from the Consent Agreement, modify it, or make the Order final.

II. THE RESPONDENTS

Emerson, headquartered in St. Louis, Missouri, is a diversified global manufacturing company that provides a variety of products and services for the industrial, commercial, and consumer markets. Through its Automated Solutions segment, Emerson is a leading manufacturer of industrial equipment and instrumentation, including valves, actuators, regulators, and switchboxes, which it sells to customers in, among others, the oil and gas, refining, chemical, and power generation industries.

Pentair, headquartered in London, United Kingdom, with a main U.S. office located in Minneapolis, Minnesota, is a global water, fluid, thermal management, and equipment protection company. The Pentair Valves & Controls business manufactures valves, fittings, actuators, and controls, including switchboxes, for a broad array of industrial markets.

III. THE RELEVANT MARKETS

The relevant product market at issue in this transaction is switchboxes. Switchboxes are devices that monitor and control isolation (or “on/off”) valves, which control the flow of liquids or gases through pipes in industrial applications, including the oil and gas, chemical, petrochemical, and power generation industries. Switchboxes consist of a hard outer case, which often is made of explosion-proof material, containing switches and other electrical components that detect the position of a valve—that is, whether it is open or closed—and communicate that position via a visual display and/or digital signals to the facility’s workers and control room. Switchboxes are ancillary components that are typically bundled together with a valve, an actuator (a device that physically opens and closes a valve), and other control products into an “automated” isolation valve, which can open and close automatically without manual intervention. Because switchboxes perform a unique and essential role in the efficient and safe operation of industrial plants and facilities, there currently are no practical alternatives to switchboxes.

The United States is the relevant geographic market in which to assess the competitive effects of the Acquisition. The United States operates distinctly compared to international markets. Unlike international markets, the domestic market relies heavily on distributors, so competition takes place at both the distributor and customer level. Moreover, customers in the United States have distinct brand preferences for leading switchbox brands. Because switchboxes are frequently used under hazardous conditions in which safety is critical, brand reputation and product reliability are very important to customers. As a result, U.S. customers are unlikely to turn to brands that are not well established in the United States in response to a small but significant non-transitory increase in price.

Pentair’s “Westlock” and Emerson’s “TopWorx” switchbox businesses are the two largest suppliers of switchboxes in the United States, with a combined market share of approximately 60%. Other than Westlock and TopWorx, there are few suppliers with appreciable market shares. Each of these suppliers has substantially smaller market shares than either Westlock or TopWorx. In addition, there is a fringe of small manufacturers with very small market shares. The switchboxes produced by these smaller suppliers are not widely accepted by customers in the United States. The Acquisition would substantially increase concentration levels in the U.S. switchbox market and would result in a highly concentrated market. Under the *Horizontal Merger Guidelines*, the increase in concentration would presumptively create or enhance market power.

IV. EFFECTS OF THE ACQUISITION

Absent a divestiture, the proposed Acquisition would likely harm competition in the U.S. switchbox market. Emerson and Pentair are each other's closest competitors in this market, and customers benefit from that competition through lower prices and increased product innovation. TopWorx and Westlock are the most widely used and highly regarded brands of switchboxes in the United States and, for many customers, are the only acceptable brands of switchboxes. By eliminating competition between Emerson and Pentair, the Acquisition likely would produce unilateral effects in the form of higher prices and reduced innovation.

V. ENTRY

Entry into the U.S. market for switchboxes would not be timely, likely, or sufficient in to deter or counteract the anticompetitive effects of the Acquisition. The competitive strength of TopWorx and Westlock largely reflects their brand reputation for reliability and durability, which could not be quickly replicated by a new entrant. In addition, customers will typically only purchase switchboxes from approved suppliers and are reluctant to consider unproven manufacturers. This is because customers place a premium on safety, and product failure could cause costly and potentially dangerous disruption to critical applications. Any new entrant would need to not only undertake a lengthy and costly process of new product development, but would also need to undergo rigorous vetting, testing, and approval to become viable alternatives for many customers. Given the difficulty in overcoming these obstacles, it is unlikely that a new entrant or existing lower-tier competitor could effectively restore the competition lost through this Acquisition.

VI. THE PROPOSED CONSENT AGREEMENT

The proposed Consent Agreement remedies the competitive concerns raised by the Acquisition by requiring Emerson to divest Pentair's Westlock subsidiary to Crane, a publicly traded manufacturer of highly engineered industrial products, including industrial valves. The proposed divestiture includes everything needed for Crane to compete effectively in the U.S. market for switchboxes.

Crane, headquartered in Stamford, Connecticut, is a 162-year old company with a long history as a significant competitor in the U.S. industrial valves market, providing it with the industry experience and expertise necessary to replace the competition that would be lost due to the Acquisition. Crane's portfolio of valves complements the switchbox and other valve control products that Westlock manufactures, but Crane does not sell any products that compete with Westlock. Crane has a substantial U.S. infrastructure and customer base, including many of the same customers as Westlock, and pre-existing relationships with many of Westlock's distributors. Crane is thus well positioned to acquire and integrate Westlock and maintain the benefits of competition in this market.

Under the terms of the Order, Emerson must divest all of Westlock's businesses and assets to Crane, including Westlock's manufacturing facility located in Saddle Brook, New Jersey, and all of the confidential information and intellectual property related to Westlock's

product portfolio. Emerson must also allow Crane to have access to and hire any Westlock employees who were engaged in the research, development, manufacturing, marketing, or sales of Westlock's products. In order to ensure that the divestiture will succeed, the Order requires the Respondents to enter into a one-year transitional services agreement with Crane for certain functions that Pentair performed for Westlock (such as accounts receivable, tax, legal, payroll, benefits, and other related functions). In order to preserve competition with Emerson, the Order requires Emerson to institute procedures that protect sensitive non-public information regarding Westlock's business from the Emerson business people in competing lines of business. It also restricts Emerson from instituting patent infringement suits against Crane for the Westlock switchbox product lines that are currently being marketed or in development.

The Respondents must complete the divestiture no later than ten days after the consummation of the Acquisition. If the Commission determines that Crane is not an acceptable acquirer, the Order requires the Respondents to unwind the sale and accomplish a divestiture of Westlock to another Commission-approved acquirer within 180 days of the date the Order becomes final. Further, the Order allows the Commission to appoint a monitor to ensure that the Respondents expeditiously comply with their obligations under the Order and a Divestiture Trustee to accomplish the divestiture should the Respondents fail to comply with their divestiture obligations.

VII. OPPORTUNITY FOR PUBLIC COMMENT

The purpose of this analysis is to facilitate public comment on the Consent Agreement to aid the Commission in determining whether it should make the Consent Agreement final. This analysis is not intended to constitute an official interpretation of the proposed Consent Agreement and does not modify its terms in any way.