

***Case No COMP/M.3491 -
BAE SYSTEMS / ALVIS***

Only the English text is available and authentic.

**REGULATION (EC) No 139/2004
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 10/08/2004

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 10-VIII-2004
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In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

**Subject: Case No COMP/M.3491 - BAE Systems/Alvis
Notification of 08 July 2004 pursuant to Article 4 of Council Regulation
No 139/2004¹**

Dear Sir/Madam,

1. On 08/07/2004 the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 by which the UK company BAE Systems ("BAES") acquires within the meaning of Article 3(1)(b) of the Council Regulation sole control of the whole of the UK company Alvis plc, by way of an agreed bid.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EC) No 139/2004 and does not raise serious doubts as to its compatibility with the common market and with the functioning of the EEA Agreement.

I. THE PARTIES AND THE OPERATION

3. BAES is an international manufacturer of defence and commercial aerospace systems, including military aircraft, surface ships, submarines, radar, avionics, communications, electronics and weapons systems. Among its subsidiaries is RO Defence (RO).

¹ OJ L 24, 29.1.2004 p. 1.

4. Alvis is active in the design, development and production of armoured fighting vehicles and military land systems. Among its subsidiaries are Vickers Defence (UK) and Hägglunds (Sweden).

II. CONCENTRATION

5. Pursuant to the Offer announced on 3 June 2004 and posted 1 July 2004, BAES intends to acquire the remaining 71% of the share capital of Alvis through a recommended public offer (BAES already owns a 29% stake in Alvis), and thus to acquire sole control over that company. The operation therefore constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

III. COMMUNITY DIMENSION

6. The combined aggregate world wide turnover of the undertakings concerned exceeds € 5000 million² (BAES: € 18,171 million, Alvis € 504 million in 2003). The aggregate Community-wide turnover of the parties exceeds € 250 million (BAES € [...] million, Alvis € [...] million in 2003). The parties do not achieve more than two-thirds of their aggregate Community-wide turnover in one and the same Member State. The notified operation, therefore, has a Community dimension according to Article 1(2) of the Merger Regulation.

IV. COMPATIBILITY WITH THE COMMON MARKET

A. Relevant product markets

7. The acquisition concerns the defence sector, in particular armoured combat vehicles (ACV) and related sub-systems, in particular weapon systems. If a suitable product is not available off-the-shelf, the respective Ministry of Defence (MoD) will select a prime contractor to lead a project to develop a new combat vehicle. In general, manufacture under ACV programmes is carried out by the prime contractor or a member of the prime contracting consortium, but it may be different for off-the-shelf products and even in some cases for programme products in the future. MoD of Member States that do not have ACV capabilities tend to buy off-the-shelf, although they may also engage in a project (often in cooperation with other countries) for the development of an ACV when none of the currently existing products meet their requirements.
8. The notifying party has suggested to make a distinction between prime contracting, the supply of specific systems, in this case in particular ACV platforms, to the prime contractor and the supply of subsystems to systems (ACV) suppliers or prime contractors. The prime contractor has a role as project manager or systems integrator and does not necessarily have to have own, in-house capabilities for the defence system in question. However, the past experience in Europe has shown that in almost all cases the role of the prime contractor was given to a supplier of the defence systems so that prime contractor and supplier of the specific systems were identical. Although this might change in the future, the question whether prime contracting and supply of

² Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25).

specific systems are two separate markets can be left open in the present case since the competitive assessment would not materially change.

9. According to BAES the market for ACV platforms can be segmented by weight, since there is a general correlation between the weight of the vehicle, its mobility and its fire power. BAES suggests three classes of weight: (i) Heavy vehicles (>40to), (ii) medium weight vehicles (15-40to) and (iii) light vehicles (<15to). Heavy vehicles would encompass main battle tanks and self-propelled artillery; engineering and Infantry fighting vehicles (IFV) would belong to the medium weight vehicles, whereas command, liaison and reconnaissance vehicles would belong to light vehicles. It is, however, not necessary to make a final decision with regard to the precise definition of ACV, as the concentration would not significantly impede effective competition in the EEA or any substantial part of it on any alternative market definition considered.
10. Weapon systems are usually defined by range, rate of fire, lethality or technical capability. BAES considers that the relevant product market is that for all weapon systems for use on armoured vehicles. BAES and Alvis have overlapping activities only in a subsegment of weapon systems, the segment for turreted mortar systems. A mortar is an indirect fire weapon, which is available as a man-carried version, towed by a motor vehicle, floor-mounted on an ACV or turreted. A turret consists of a protected shell that houses the gun barrel, possibly other weapon systems, a fire control system, communication systems and possibly a navigation system. The turret enables the weapon to be rotated and elevated and is mounted onto the vehicle chassis. Therefore, turreted mortars are the upper end of mortar systems in terms of rate of fire, mobility and level of protection of the crew.
11. It has been suggested that turreted mortars form a market of their own. However, there seems to be a continuum of mortar systems based on cost and capability. The top end, the advanced mortar system (AMOS), has a twin barrel and a rate of fire of 26 rounds per minute. The next best system, the armoured mortar system (AMS), has only half the rate of fire, 13 rounds per minute, but is half as heavy [...] as the AMOS. Next are floor-mounted mortars, sometimes referred to as clam-shelled mortars, which are lighter and do not provide the same level of protection, but may attain a rate of fire similar to the AMS. Therefore, it is the decision of the respective MoD what level of capability it wants to acquire. It is, however, not necessary to make a final decision with regard to the precise market definition for mortar systems, as the concentration would not significantly impede effective competition in the EEA or any substantial part of it on any alternative market definition considered.
12. Other markets that can be considered as vertically related to ACV are control, command and communication systems, fire control systems, weapon systems and ammunition, which can all be considered as distinct markets. As the transaction does not give rise to horizontal overlaps (Alvis does not manufacture these systems or ammunition, other than the AMOS) or foreclosure concerns there is no need to further define these markets.

B. The relevant geographic markets

13. For defence markets, a distinction is traditionally made between those countries where the Ministries of Defence, being the ultimate customers, award contracts to a domestic supplier on the one hand, and those countries without a national supplier on the other hand. In the latter case, existing products rather than tailor made programmes are

procured, and prime contractors are usually selected on the basis of open international competitions. The relevant geographic market is considered national in scope where there is a national supplier, and otherwise international. The notifying party endorses this definition for the present case, which is in line with previous Commission decisions in the defence sector³.

14. Respondents to the market investigation agree in general that national suppliers enjoy a certain advantage over the competitors in those military markets where a national producer is active. However, BAES's competitors also point to a progressive internationalisation, even in Member States with national suppliers. The respondents consider that the cost rationalisation which is sought by procurement agencies and shrinking budgets for defence equipment relative to its increasing sophistication will result over time in a wider geographic market. The evidence available does not support that the market has evolved to such extent. On the basis of procurement data of the past six years, it can be concluded that Member States with indigenous production aim to preserve their defence capabilities through national preferences. Also, for historical reasons, national players tend to be better placed to meet the national MoD's bid requirements in terms of technical features and qualification evidence. Whilst the UK, Alvis' and BAES's home market, has the general policy of inviting tenders from international prime contractors, the outcome of past procurements of ACVs and subsystems suggests that there remains a substantial national preference in practice. For those Member States without national capabilities, the relevant market is the EEA or worldwide.

V. ASSESSMENT

Horizontal overlaps

15. Military markets are characterised by the fact that the ultimate customers are the MoDs, who exercise strict control over the production of military products including ACV and its sub-systems. The bidding nature of the market and the preference for national suppliers are a general feature in the selection of defence-related products. ACV are high value military products, the procurement of which is very lumpy, as the useful life of these vehicles mostly spans a period of 20 to 30 years, with midlife modernization and/or upgrading programmes being usual.
16. On the basis of markets defined by weight there are only two overlaps of BAES and Alvis in the EEA. These overlaps occur in the UK on the basis of a market for heavy and medium weight ACVs. BAES was selected as the prime contractor for upgrading the self-propelled artillery system AS90. However, since Alvis does not offer self-propelled artillery or the chassis for such a system there is no real overlap in the market for heavy weight ACVs. In addition BAES won the prime contract for 65 units of an engineering vehicle, the Terrier, which is a medium weight ACV. The chassis of the Terrier will be manufactured by Corus, which made its entry into the market for ACVs with this contract. Alvis' engineering vehicles, the Trojan/Titan, the CRARRV and the Alvis Moelv AEV, are all mounted on a main battle tank chassis belonging to the market for heavy weight ACVs, and are, therefore, not direct competitors to BAES' Terrier. Moreover, although Alvis is also active in the market for medium weight

³ See inter alia Decision COMP/M.1745: EADS of 11 May 2000 and Case No COMP/M.2938: SNPE / MBDA / JV of 30 October 2002

ACVs, it has not delivered any ACV in the UK during the last 10 years since no competition for medium weight ACVs other than the one for the Terrier was held. There is, therefore, no addition of market shares either.

17. It could, however, be argued, that on the level of prime contracting, the proposed transaction would lead to a loss in potential competition. Alvis has the capabilities to bid for an engineering vehicle in the medium weight ACV or to act as a prime contractor for an artillery system such as the AS90. Indeed, BAES and Alvis have bid against each other in relation to the Terrier. However, the UK MoD has stated publicly that it will invite global competitors to tender in any future procurement process and that it believes that there are potentially 10 firms able to provide prime contracting services in the ACV sector.⁴ There is, therefore, no competition problem on the UK market for ACVs with regard to horizontal actual or potential overlaps.
18. With regard to mortar systems there is no overlap in any geographic market. However, the takeover of Alvis means that BAES would, post merger, have control over the only two existing 120mm breech loaded turreted mortar systems currently available for offer off-the-shelf in the EEA. The Amoured Mortar System (AMS) was originally developed jointly by BAES' subsidiary Royal Ordnance and the US-firm Delco, now a subsidiary of General Dynamics. BAES is the owner of the core IP rights of AMS, excluding the fire control system and drives. Alvis, through its subsidiary Alvis Hägglunds, owns 50% of HägglundsPatria, which is the supplier of the Advanced Mortar System (AMOS), the other turreted mortar system. The current operation will, however, not lead to any anticompetitive effects, even though the two systems appear to be the closest substitutes.
19. First, the AMS is currently not an off-the shelf system but needs further development after the split of BAES and Delco in 2002. [...] Second, in the defence industry, the customer, i.e. the Ministries of Defence, are monopsonist buyers which specify their own requirements making each competition quite distinct. It is, therefore, important to assess whether sufficient viable alternatives will remain post-merger. The market investigation has indicated that this is the case. There are several suppliers of 120mm mortars including TDA (France), Rheinmetall (Germany), RUAG (Switzerland) and Soltam (Israel), which offer floor-mounted solutions. These are systems which have been quoted by a majority of MoDs as well as competitors as being in competition with turreted mortars. These suppliers would also be able to develop a turreted mortar system within a relative short time period of time should demand for such systems grow.
20. Third, few MoDs have expressed a keen interest in acquiring such systems. Turreted mortar systems are a niche market. The AMS has won one contract for 73 units supplied to the Saudi Arabian National Guard in the 1990s. The development of the AMOS was driven by the Swedish and Finnish MoDs who are also the lead customers. The notifying party has submitted a list of 10 existing or anticipated competitions for mortar systems in Europe. Discounting the two orders by the programme customers for AMOS, Finland and Sweden, there are 8 competitions where at least one of the two turreted mortars systems were offered or will be asked to bid. In six of these

⁴ See the decision of the OFT of 21 November 2003 when BAES acquired a 29% stake in Alvis <http://www.of.gov.uk/nr/rdonlyres/3944f03f-35e9-4cfc-90b4-62f0a7b43c7b/0/alvis.pdf>, at paras 13 & 17.

competitions non-turreted mortars were offered as well. Four countries have decided against a turreted mortar. Two projects are frozen, and, in the case of one of these two countries, it is unclear whether it will be revived. In the two remaining countries the MoDs are in the process of preparing an invitation for tender for 2006 and 2007 respectively. However, the specifications concerning the mortar are not yet finalized, and may eventually be such as to not to exclude non-turreted mortars. This result shows that AMS and AMOS face competition from non-turreted mortars, to which they have lost major competitions, e.g. Germany orders Wiesel ACVs with a floor mounted mortar.

21. The proposed operation will therefore not significantly impede effective competition in the EEA or any substantial part of that area.

Vertical relationship

22. BAES offers communication, command and control systems, weapon systems, fire control systems and electro-optical systems for ACVs. Alvis is, through a joint venture, only active in one segment of the market for weapon systems, namely turreted mortars. On a worldwide basis, the parties' combined market share in any of these markets is submitted to be less than 25%.
23. It is normal business for ACV producers to integrate a range of subsystems, which often come from third parties, in their vehicle. Refusal to supply a weapon system to a competing ACV producer would prevent competing ACV producers from participating in tenders only if customers (i.e. MoDs) expressed a strong preference for a specific subsystem. In fact, the market investigation showed that, for off-the-shelf products, MoDs tend to leave the choice of sub-systems to the prime contractor. Moreover, the fact that BAES's market share for any of the above subsystems is below 25% shows that the position of BAES is not such as to be able to foreclose competition.
24. Competitors to the parties claimed furthermore that post-merger, they might be foreclosed to supply sub-systems where the new entity will be able to source these internally. However, the market investigation has not pointed to sub-systems markets where the parties would hold particularly strong combined positions, and there exist alternative independent suppliers of ACVs that are not vertically integrated into subsystems. Secondly, even when the new entity would be in a position to replace third party sub-system suppliers with a BAES product, it is unlikely that the MoD would allow BAES to change the ACV configuration for existing programmes or ordered vehicles. On the other hand, for new programmes, BAES may well be able to offer an ACV with an increased quantity of BAES sub-systems. In this case, apart from the absence of leading positions, MoDs would still retain the ability, whether or not in the context of off-set arrangements, to include other sub-systems suppliers in future programmes or as part of an off-the-shelf product adapted to the requirements or preferences of the MoD. Also, even without specifying a particular sub-system, governments may require transparent sub-contract competition. It is therefore expected that the transaction does not raise concerns of foreclosure in markets for subsystems.
25. In view of the foregoing, it can be concluded that the proposed operation would not, in any of the markets considered, significantly impede effective competition in the EEA or any substantial part of that area.

VI. CONCLUSION

26. For the above reasons, the Commission decides not to oppose the notified operation and to declare it compatible with the common market and with the functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EC) No 139/2004.

For the Commission

(Signed)

Poul NIELSON
Member of the Commission