

***Case No COMP/M.3649 -
FINMECCANICA /
BAES AVIONICS &
COMMUNICATIONS***

Only the English text is available and authentic.

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

Article 6(1)(b) NON-OPPOSITION
Date: 14/03/2005

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 14.03.2005

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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 Where possible the information omitted has been replaced by ranges of figures or a general description.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 parties

Dear Sir/Madam,

Subject: Case No. COMP/M.3649 - FINMECCANICA/BAES AVIONICS & COMMUNICATIONS

Case No. COMP/M.3735 - FINMECCANICA / AMS

Notifications of 07/02/2005 pursuant to Article 4 of Council Regulation No 139/2004¹

1. On 07/02/2005, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 139/2004 ("Merger Regulation") by which the undertaking Finmeccanica S.p.A. ("Finmeccanica", Italy) acquires within the meaning of Article 3(1)(b) of that regulation control of the whole of UK avionics activities and the military communications business of BAE SYSTEMS plc ("BAES", UK) by way of purchase of shares and assets. On the same day, Finmeccanica notified a related proposed concentration pursuant to Article 4 of the Merger Regulation by which it acquires within the meaning of Article 3(1)(b) of that regulation control of the whole of the Italian operating branch of AMS ("AMS SpA", Italy) and the AMS's air traffic control business.
2. After examination of the notification, the Commission has concluded that the notified operations constitute a single concentration that falls within the scope of the Merger Regulation and does not raise serious doubts as to its compatibility with the common market and the EEA Agreement.

¹ OJ L 24, 29.1.2004 p. 1.

I. THE PARTIES AND THE OPERATION

3. **Finmeccanica** is active principally in the defence and aerospace sectors, such as the design, manufacture and support of aircraft, helicopters, satellites, missile systems, radar, avionics and communication systems, naval systems and armoured vehicles. **BAES** is an international manufacturer of defence and commercial aerospace systems, including military aircraft, surface ships, submarines, radar, avionics, communications, electronics and weapons systems. Its UK avionics activities include radar, electro-optics, electronic warfare systems, mission avionics systems and Communication, Navigation and Identification systems. BAES' military communications business includes military ground communication systems and military naval information and communication systems. **AMS** is jointly controlled by BAES and Finmeccanica. It is active in the land and naval defence electronics markets, and in the air traffic control and air traffic management systems civil markets.
4. On 27/01/2005, BAES and Finmeccanica entered into a framework agreement concerning the Eurosystems project. This project involves three acquisitions by Finmeccanica. First, Finmeccanica will integrate BAES Avionics UK with its own activities in these markets into a newly created company. BAES will initially have a 25% stake in this company, but this shareholding will not confer it with more rights than those usually accorded to minority shareholders. Specifically, BAES will not be able to appoint directors in the newly created company. BAES' avionics activities in North America, Australia and its joint controlling participation in Saab are not part of the business to be acquired by Finmeccanica. Second, Finmeccanica's subsidiary Selenia Communications Limited will acquire BAES military communications activities. Third, Finmeccanica will acquire sole control of AMS SpA and the AMS's air traffic control business through a share transfer with BAES which will acquire in turn sole control of the UK operating branch of AMS. The other activities of AMS, in particular its UK operating branch AMS Ltd, will be acquired by BAES.
5. Finmeccanica's acquisition of (i) BAES' UK avionics, (ii) BAES' military communications business and (iii) AMS SpA, the Italian operating branch of AMS, and AMS' air traffic control and management business are interconditionally linked from a legal and commercial point of view, will be simultaneously concluded and implemented, concern related industries and involve the same acquirer. For these reasons, the Commission considers that these acquisitions constitute a single concentration within the meaning of Article 3(1)(b) of the Merger Regulation.
6. BAES' acquisition of the UK operating branch of AMS constitutes a separate concentration within the meaning of Article 3(1)(b) of the Merger Regulation that is reviewed in Case COMP M.3649.

II. COMMUNITY DIMENSION

7. The combined aggregate worldwide turnover of the undertakings concerned exceeds € 5000 million (Finmeccanica: € 7,497 million, BAES' acquired business: € [...], AMS SpA: 448 million in 2003). The aggregate Community-wide turnover of the undertakings concerned exceeds € 250 million (Finmeccanica: € 5,995 million, BAES' acquired business: € [...], AMS SpA: 277 million in 2003). None of the undertakings concerned achieves more than two-thirds of its aggregate Community-

wide turnover in one and the same Member State. The concentration therefore has a Community dimension according to Article 1(2) of the Merger Regulation.

III. RELEVANT MARKETS

The relevant product market

8. This case concerns military avionics, military communications, electronics systems for defence applications and Air Traffic Control and Management systems.

Military Avionics

9. In previous cases², the Commission has identified two segments within military avionics: (i) sensor avionics, which may be further divided into radar, electro-optical and electronic warfare systems, and (ii) mission avionics, which may be further divided into flight and CNI avionics. Whilst there may be a limited degree of supply-side substitutability, there is no substitutability from the demand side. In fact, each of the military avionics products can be considered as a distinct market as they are conceived, designed and manufactured according to the very specific requirements of the applications they serve.
10. Within the segment for sensor avionics, radars are systems based on electromagnetic beams used to provide external data relating to potential targets or threats. There are various types of radars depending on the platforms on which they are installed (aircraft, naval platforms, on land, etc.) and according to the function they serve (fire control, maritime patrol, early warning, approach radars for air-traffic control, etc). Electro-optic systems are active or passive systems used in military applications such as targeting, fire control or surveillance. Electronic warfare systems are used to determine, exploit and prevent hostile use of electromagnetic waves.
11. Within the segment for mission avionics, flight avionics systems include avionics integration systems, cockpit instrumentation and central computer systems. CNI systems comprise aircraft communication, landing aids and inertial systems and identification systems.

Military communications

12. Military communication systems include ground and naval information and communication systems. In previous cases³, the Commission has identified different segments within military communication systems depending on the functionality, the platform (ground, air, sea) and the force for which they are intended. Following the Commission's previous analysis, a distinction can be made between (i) military ground communications systems and (ii) military naval information and communication systems.

² See Case COMP/M.2931 Finmeccanica / Marconi Mobile Holdings.

³ See Case COMP/M.1121 Alcatel / Thomson SA – Thomson CSF

13. Military ground communication systems include systems for strategic and tactical (fixed and mobile) application by military forces, national security forces and governmental bodies.
14. Naval information and communication systems are similar to military ground communication systems but adapted to naval requirements.
15. The market investigation has broadly confirmed this market definition approach for both avionics and communications although third parties have emphasised the need for narrower market segmentation for some equipment. In any case, for the purpose of the present decision, the precise definition of the relevant product markets can be left open, since in no alternative product market will the proposed operation significantly impede effective competition in the common market or a substantial part of it, in particular, as a result of the creation or strengthening of a dominant position.

Defence electronics systems

16. Defence electronics systems provide command, control and information functions to enable military decision making and planning. The parties suggest separating land and naval systems, which is consistent with the Commission's approach in previous cases⁴.

Air Traffic Control and Management systems

17. Air Traffic Control and Management systems ("ATCM") consists of equipments, systems and services to support air traffic services and airport management organisations and could be defined as a relevant product market.

The relevant geographic market

18. 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 tenders. The relevant geographic market is therefore considered national in scope where there is a national supplier, and otherwise the EEA or worldwide.
19. The parties have put forward arguments to support their views that the relevant geographic markets for many defence-related products are becoming worldwide. In that respect, they have pointed out several occasions where national defence systems tenders were won by non-national suppliers, the international tendering procurement of the UK MoD, joint programmes (such as Eurofighter) and the creation of a Europe-wide defence procurement management agency between the UK, France, Germany, and Italy.

⁴ Inter alia Case IV/M.894, Rheinmetall/British Aerospace/STN Atlas

20. Respondents to the market investigation agree in general that national suppliers enjoy a strong advantage over the competitors in those military markets where a national producer is active. 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 has a general policy of inviting tenders from international prime contractors, the outcome of past procurements suggests that there remains a substantial national preference in practice.
21. However, Finmeccanica'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. It follows that such developments and initiatives in the defence sector could lead to European geographic defence markets in the future. The Commission is carefully following these developments and initiatives and will assess their impact on the competition in defence equipment markets.
22. In any case, for the purpose of this decision, the precise geographic scope of the relevant markets can be left open, since on neither a national, an EEA nor a world-wide basis will the proposed operation significantly impede effective competition in the common market or a substantial part of it, in particular, as a result of the creation or strengthening of a dominant position.

IV. COMPETITIVE ASSESSMENT

Horizontal relationships

Military Avionics

23. Finmeccanica's and BAES' combined worldwide and EEA market shares are below 15% for all types of avionics equipments. At national level, excluding the Eurofighter sales, the transaction does not give rise to competitive overlaps as BAES is not active in Italy, whilst Finmeccanica is not active in the UK, apart from the market for CNI where their combined market share is below 5% (BAES [...] % and Finmeccanica [...] %).
24. The Eurofighter program ("EFA") is a multinational collaborative program between the UK, Germany, Italy and Spain to develop and manufacture a multi role combat aircraft. The participation level of the equipments suppliers in the program is directly linked to the number of aircraft ordered by each country (UK, 33%, Germany 30%, Italy 19% and Spain 14%). Over the 2001-2003 timeframe, Finmeccanica supplied EFA with mission avionics, airborne radar, electronic warfare and CNI. Taking into account this contribution, the only significant overlap with BAES' avionics activities in the UK is for electronic warfare systems, where the acquisition would lead to a [60% - 70%] market share on a national basis. However, within the context of the EFA national workshare arrangements and the resulting specific procurement conditions, market shares do not reflect market power and all production contracts have already been awarded for the EFA Tranche 1. The market investigation has also demonstrated the presence of credible competitors in the market for avionic equipment in the UK, such as Smiths or Thales.

Military communications

25. Finmeccanica's and BAES' combined worldwide and EEA market shares are below 15% for both military ground communication systems and military naval information and communication systems. At national level, BAES is not active in Italy for military communication systems, whilst a combined Finmeccanica - BAES market share is below 15% for both military ground communication systems and military naval information and communication systems in the UK

Defence electronics systems and Air Traffic Control and Management systems

26. Finmeccanica's acquisition of sole control over the Italian AMS activities (defence electronics systems and ATCM) does not give rise to horizontal or vertical overlaps. Given that Finmeccanica is not active either in Defence electronics systems outside AMS or in civil air traffic control, either on a world-wide, EEA or national level, the dissolution of the AMS joint venture is not liable to create competitive concerns on the relevant markets.

Vertical relationships

27. Finmeccanica, through its fully-owned subsidiary AgustaWestland, is a major manufacturer of military helicopters. On a 10-year average basis, the company has a world-wide market share of around [10% - 20%]⁵. Looking at the installed base of UK military helicopters, it has a market share of around [80% - 90%], which indicates its importance as both a prime contractor and manufacturer of military helicopters in the UK market. BAES Avionics produces military helicopter avionics products and, on a national basis, holds strong market positions in a number of avionics markets in the UK. Excluding EFA sales, the new entity would have a [30% - 40%] market share for Airborne radars, [30% - 40%] for electro-optics and [20% - 30%] for electronic warfare systems. Hence, the concentration gives rise to vertically affected markets in the UK.
28. A third party, competing with AgustaWestland as a prime contractor for UK defence helicopters, has stated that Finmeccanica's acquired control over BAES avionics' business would enable it to achieve a greater degree of control over the complete helicopter avionics system with the effect of reducing the level of competition for avionics components. It is further alleged that, after the acquisition, Finmeccanica would have the incentive and ability to impede competing helicopter prime contractors' access to important avionics systems – such as the BAES supplied Blue Kestrel Airborne Radar (“BKAR”) on a specific helicopter platform for which this third party is the prime contractor– thereby obtaining a significant competitive advantage in future UK prime contracting competitions for defence helicopters.
29. The market investigation has not confirmed that such foreclosure is likely to materialise in future competitions for either avionics sub-systems or helicopter prime contracting. First, whilst the Finmeccanica will gain strong market positions for

⁵ Market shares based on value for a more restricted timeframe (2001-2003) show that AgustaWestland would have a worldwide market share slightly in excess of [25% - 35%]. However, there are no vertically affected markets on a worldwide level as Finmeccanica's and BAES' combined worldwide market shares are below 15% for all types of avionics equipments. For the same reasons, no vertically affected markets arise on the basis of an EEA market.

certain avionic equipments, it will not hold uncontested positions for any equipment. In each market, alternative avionics suppliers that are not vertically integrated into helicopter platforms are active. Such viable alternatives exist both within Europe (Thales, Smiths) and in the US (Honeywell, Rockwell Collins, Northrop Grumman – Litton and Raytheon). Second, even when Finmeccanica would be in a position to impede or deny a prime contractor's access to a particular important avionics system, it is unlikely that the UK MoD would allow Finmeccanica to do so for existing programmes or ordered helicopters⁶. Regarding the BKAR, the market investigation has shown that it concerns UK proprietary developed radar technology, for which the UK MoD holds IP rights⁷. In this context, it is unlikely that Finmeccanica could impede access to BKAR, either for new installation, upgrade or integration on UK military platforms.

30. On the other hand, for new programmes, Finmeccanica may well be able to offer helicopter platforms with an increased proportion of in-house avionic products. In this case, the UK MoD would still retain the ability to select avionics suppliers or to insist that Finmeccanica –being the prime contractor- organises an open and transparent competition for avionics sub-contracts. Given that the UK MOD would oppose such further vertical integration, should it not correspond to its requirements, the new entity will not have an incentive to foreclose its avionics competitors. Denying prime contractors access to avionics would in such case conflict with its profit-maximising strategy whilst impeding avionics competitors access to its helicopter platforms could endanger winning the prime contractor selection bid.
31. Other respondents to the market investigation have not raised competition concerns.
32. For the same reasons, it is unlikely that foreclosure could materialise on the markets for UAVs (unmanned aerial vehicles, for which Finmeccanica holds around [0% - 10%] of the UK market) and BAES' avionics ([45% - 55%] of the market for radars).
33. In light of the above, the transaction does not raise concerns of foreclosure in markets for avionics subsystems for defence platforms.

⁶ The current level of vertical integration is relatively modest. Less than 20% of AgustaWestland's avionics are Finmeccanica parts (mostly mission systems) and 10% are BAES parts (electronic warfare systems).

⁷ The development of the BKAR by BAES was funded by the UK MoD and the radar is only used on UK Navy platforms.

V. CONCLUSION

34. It can therefore be concluded that the concentration will not significantly impede effective competition in the common market or in a significant part of it, in particular as a result of the creation or strengthening of a dominant position.
35. For the above reasons, the Commission has decided not to oppose the notified operations and to declare the concentration compatible with the common market and 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)
Neelie KROES
Member of the Commission