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***Case No COMP/M.3720 -
BAES / AMS***

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**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 Where possible the information omitted has been replaced by ranges of figures or a general description.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.3720 – BAES / AMS
Notification 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 by which the undertaking BAE SYSTEMS plc (“BAES”, UK) acquires within the meaning of Article 3(1)(b) of the Council Regulation control of the whole of the UK operating branch of AMS NV (“AMS Limited”) by way of purchase of shares.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation No 139/2004 and does not raise serious doubts as to its compatibility with the common market and 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. AMS NV 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. AMS’ UK operating branch AMS Limited is active in the land and naval

¹ OJ L 24, 29.1.2004 p. 1.

defence electronics markets, including radar and simulation & training systems for the land and naval military markets.

4. On 27/01/2005, BAES and Finmeccanica entered into a framework agreement concerning the Eurosystems project. This project involves the acquisition of sole control by BAES over most of the business of AMS Limited, the UK operating branch of the AMS NV JV between BAES and Finmeccanica. The business to be acquired does not include the civil air traffic control and air traffic management systems, which will be acquired by Finmeccanica. This acquisition constitutes a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.
5. The Eurosystems project also involves a number of acquisitions by Finmeccanica, which are reviewed in a separate decision.

II. COMMUNITY DIMENSION

6. The combined aggregate worldwide turnover of the undertakings concerned exceeds € 5000 million (BAES: € 18,168 million, AMS Limited [...] in 2003). The aggregate Community-wide turnover of the undertakings concerned exceeds € 250 million (BAES: € 7,107 million, AMS Limited: [...] 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 notified operation, therefore, has a Community dimension according to Article 1(2) of the Merger Regulation.

III. RELEVANT MARKETS

The relevant product market

7. This case concerns Defence electronics systems, which 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 cases². Land systems will not be further addressed as, except through AMS Limited, BAES is not present in this sector.
8. With regard to naval systems, both AMS Limited and BAES (via Atlas and Saab) are active in naval Combat Management Systems ("CMS"), which involves the integration of sensors, weapon systems and data communication so as to provide early warning of attacks and to convey information to the operations centre. As stated in previous Commission decisions³, distinct markets can be identified for CMS systems for surface ships on the one hand and submarines on the other hand. A further sub-segmentation would be possible by size of vessel and between CMS for nuclear or conventional submarines. Another market within the naval systems segment is that for Naval weapon and fire control systems, which encompass all aspects of weapon planning, threat assessment, assignment and control. A third relevant product market on which both AMS Limited and BAES are active is that for the provision of naval simulation and training services.

² Inter alia Case IV/M.894, Rheinmetall/British Aerospace/STN Atlas

³ Ibidem, see footnote 3.

9. Also, the parties have identified Command, Control, Communications Computing, Information, Surveillance and Reconnaissance systems (“C4ISR”) as an emerging market. C4ISR are more complex Command, Control, Communication and Information (“C3I”) systems with added intelligence functionality.
10. The market investigation has broadly confirmed this market definition approach. In any case, for the purpose of the present decision, the precise definition of product markets can be left open, since in no alternative product markets 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.

The relevant geographic market

11. For defence markets, a distinction is traditionally made between those countries where the Ministries of Defence, being the ultimate customers, award contracts to domestic suppliers 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 usually considered national in scope where there is a national supplier, and otherwise EEA-wide or worldwide.
12. The parties have put forward arguments to support their view that the relevant geographic market 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, in addition to the international procurement policy lead by the UK MoD and the creation of a Europe-wide defence procurement agency between the UK, France, Germany, and Italy.
13. Respondents to the market investigation agree in general that national defence suppliers enjoy a certain 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.
14. 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 wider geographic markets. 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.
15. In any case, for the purpose of the present decision, the precise geographic scope of defence 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

16. Horizontal overlaps are limited to naval systems, where both the AMS businesses to be acquired, currently jointly controlled by BAES and Finmeccanica, and BAES' existing affiliates, Atlas and Saab, are active. Considering the relevant market to be that for all naval systems in the world, the new entity would have a worldwide market share of below 10% for the reference period 2001-2003. Other world-wide players include the US defence contractors Lockheed Martin ([20% - 30%]), Northrop Grumman ([10% - 20%]), Raytheon ([10% - 20%]), as well as EU players such as Thales and to a lesser extent Ultra Electronics. Also when considering the market to be EEA-wide in scope, the transaction would not lead to combined market shares above 15% as AMS on the one hand and BAES' existing affiliates have rarely competed against each other within the EEA.
17. If naval systems were to be assessed on a national level, no overlaps would arise as Atlas and Saab have not made sales in the market where the AMS acquired business has been active (UK).
18. A further segmentation on the basis of product markets indicates that AMS Limited on the one hand and Atlas/Saab on the other hand have limited overlap in product offering. For CMS for surface ships, Atlas and Saab offer solutions for small ships while AMS sells primarily to large and complex ships. The market investigation has indicated that the parties have rarely competed against each other in the past, with the only competition over the past 5 years being for medium-size ships outside of the EEA. With regard to CMS for submarines, AMS focuses on nuclear submarines, whilst Atlas and Saab target conventional (i.e. non-nuclear) submarines. The market investigation has confirmed the limited degree to which the parties compete against each other in the field of naval systems for surface ships and submarines.
19. Equally so, AMS and BAES focus on different businesses within the market for naval weapon and fire control systems and within the simulation & training services market. Saab's products targets less complex ships than those of AMS Limited, and, to date, Saab has only provided systems for ships equipped with Scandinavian-developed missile solutions. The market investigation has confirmed that AMS and Saab have not competed against each other on a national level over the past five years. On a world-wide market for all weapon and fire control systems, the new entity would have a combined market share of less than 5% (AMS Limited [...] and Saab [...]). Also when considering the market to be EEA-wide in scope, the transaction would not lead to combined market shares above 15%.
20. AMS Limited's C4ISR solution have limited functionalities compared to the complex integrated systems offered by Saab in this emerging market and there are other alternative suppliers in the EEA such as Thales, EADS or in the United States.

Vertical relationships

21. Since BAES is a defence prime contractor, the acquisition of its currently jointly controlled AMS UK business leads to vertical links between defence platforms (such as naval surface vessels, nuclear submarines, guided weapon systems and warfare systems) with AMS' electronics systems on a national (UK) level. Considering naval systems on either a world-wide or an EEA basis would not lead to vertically affected markets.
22. A naval systems' competitor to BAES claims that post-merger, it might be foreclosed from the UK naval CMS market. This third party has teamed with AMS to integrate its US proprietary engagement capability technology ("CEC") onto a UK Frigates programme. Post transaction, the third party alleges, AMS would no longer be available as an independent party to provide such integration services, and there is no present or potential alternative supplier to AMS for these services in the UK. Post transaction, BAES would be in a position to deny competitors access to the AMS integration expertise and this would give BAES a significant advantage on future naval CMS / CEC integration procurements in the UK and on future naval surface ships procurement in the UK. Such foreclosure, combined with BAES' already strong positions for naval CMS and naval platforms construction would block competition for naval CMS by raising rivals' costs.
23. To the extent that the concentration, providing BAES with a shift from joint to sole control over AMS, could increase the ability and incentive for BAES to foreclose, the market investigation has not confirmed that such foreclosure is likely to materialise. CEC is a proprietary, US-developed technology that takes the form of a "black box" [...] so that it can interact with their US counterparts in a joint operation. The supply of this equipment on UK surface ships has been agreed directly between the US MoD and the UK MoD. Due to national security reasons, only US companies, such as Lockheed Martin and Raytheon, can supply these CEC black boxes. Whilst AMS, and in future BAES, may interface the black box with its wider CMS system and radars, it has no access to its technology. Whilst BAES is likely to be associated in future CEC integration contracts, only US companies will be considered for CEC supplies. In this context of supply dependency, it is unlikely that BAES would be in a position to influence the UK MoDs decision to whom future integration contracts will be awarded. Rather, it can be expected that the UK MoD will order BAES to team up with the CEC supplier for integration services as it has done in the past.
24. Even when BAES would be in a position to impede or deny access to CMS, integration services or supply of other subsystems to the warship platform, it is unlikely that the UK MoD would allow BAES to do so for existing programmes or ordered naval vessels. For new programmes, BAES may try to leverage its position in CMS or as a naval vessel manufacturer / prime contractor in order to capture a higher degree of the total naval vessel contract. In any case however, the UK MoD would still retain the ability to select a different CMS supplier or to insist that BAES –being the prime contractor- organises a transparent CMS sub-contract competition. The market investigation has indicated that the UK MoD was at the forefront of the opening up of the European defence material procurement markets in order to achieve greater performance of its equipment and platforms and to obtain the "best value for money" from its suppliers. In this context, the UK MOD would oppose further vertical integration if such would not correspond to its requirements. Hence, the new entity does not have an incentive to foreclose its competitors but should rather select the most interesting offer from a price / performance point of view for the equipments integrated on its platforms through open competition. Denying prime contractors access to CMS

would in such case conflict with its profit-maximising strategy whilst impeding naval systems competitors access to its naval vessel platforms could endanger winning the prime contractor selection bid. Finally, it should be noted that this type of anti competitive behaviour will also be restrained by the undertakings imposed by the UK government on the merger between MES and British Aerospace in 1999, obliging BAES to refrain from favouring in-house supply in the context of sub-contracting activities for products or services where a competitor with an industrial base in the UK is active.

V. CONCLUSION

25. 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.
26. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it 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