

CMA's review of the undertakings given by BAE Systems

Initial request for evidence

Summary

1. The CMA has decided to review the two undertakings that remain following the merger of British Aerospace and Marconi Electronics Systems in 1999. This review will assess whether there has been a change of circumstances such that the undertakings should be retained, varied or released.
2. BAE Systems plc (BAES) is a defence, aerospace and security products and services company with global sales of £17.9 billion in 2015, employing around 82,000 people, of which 33,000 are employed in the UK. BAES is heavily involved in a number of strategic Ministry of Defence (MOD) defence projects.
3. BAES has submitted that the defence industrial landscape has changed since the undertakings were put in place and that BAES has itself changed as a result of this and its business transformation. It also told us that the compliance requirements are a burden that stifles its competitiveness. BAES has asked the CMA to remove the undertakings to allow for these changes in circumstances.
4. The panel of independent CMA panel members who will act as decision-makers in the review are: [John Wotton](#), [Jayne Scott](#), and [Rosalind Hedley-Miller](#). The CMA anticipates that the review will be completed in the first half of 2017. The group of panel members will be advised by a case team of CMA staff. The CMA will also, when appropriate, seek the advice of the MOD, who procure the UK's defence products and services, and other interested parties.

Background to the review

5. In 1999 British Aerospace merged with Marconi Electronic Systems. The transaction was assessed by the Office of Fair Trading (OFT) under the merger provisions of the Fair Trading Act 1973.
6. To address competition and other public interest concerns, BAE Systems gave fifteen undertakings, in lieu of a reference to the Monopolies and

Mergers Commission (MMC), to the then Secretary of State for Trade and Industry on 28 March 2000.

7. The undertakings have been subject to three reviews to date. On 10 January 2002, BAES was released from one of the obligations in the undertakings which had become redundant. On 29 September 2005, the undertakings were varied again to allow for the extension of the then Compliance Officer's appointment. A further review was conducted in 2006 which led to a further variation, with most of the obligations in the undertakings being removed on 2 February 2007.
8. The undertakings now consist of two provisions after February 2007. These are the following:
 - (i) **The appointment of a Compliance Officer** – BAES is obliged to appoint a Compliance Officer to facilitate and oversee compliance with the undertakings, including through annual reports to the OFT (now CMA) and the Ministry of Defence (MOD); and
 - (ii) **Access by Prime Contractors to BAE Systems In House Suppliers** – to make available on request and on fair, reasonable and non-discriminatory terms access to its capabilities to other actual or potential third party Prime Contractors to permit them to bid for or undertake work on MOD programmes and, relatedly, to seek the prior written consent of the OFT (now CMA) before entering into certain teaming agreements involving another BAE Systems company.
9. The Access undertaking related originally to concerns that, following the merger, BAES could distort competition at the Prime Contractor level. In December 2006, the OFT decided to retain this to protect the potential for effective competition with BAES production capacity for the following specific sectors:
 - (a) warship-building;
 - (b) combat aircraft; and
 - (c) general munitions.
10. The CMA will review the extent to which the capacity dominance of BAES has changed over time.

BAES's request for a review of the case

11. BAES has requested a review of the undertakings by the CMA by reason of a change in circumstances. BAES has provided details concerning its view that the undertakings are no longer justified for the following reasons which apply to the various areas of defence activities it undertakes in the UK:
 - (a) the MOD no longer uses the prime contractor model such that competition in warship building and general munitions is no longer relevant;
 - (b) over and above its stated intentions, the MOD has no demand or no plans to have demand in the known future for the relevant equipment;
 - (c) BAES no longer controls UK production in some cases as a result of competition from overseas providers and in others as a result of closures or sales of its relevant businesses; and
 - (d) the undertakings were not put in place, and should not be retained, as a general regulatory measure.
12. BAES also noted that ensuring compliance with the undertakings leads it to incur annual costs of approximately £400,000 to £500,000.

Request for evidence

13. The CMA would be interested to hear the views of all interested parties regarding whether the undertakings currently in place should be varied, removed or retained.
14. We invite parties to provide us with submissions and evidence (including original documentation and analysis) regarding (a) the specific areas we have identified below and (b) whether there are further areas we have not identified.
15. The following questions seek to draw out the evidence we are particularly keen to receive, though parties' submissions should not necessarily be limited to these areas. Equally parties wishing to provide us with a submission are not obliged to answer all of these questions.
 - (i) How has MOD's procurement strategy changed since the undertakings were initially put in place? To what extent does the MOD currently use the prime contractor model? Is this the same for all areas of procurement? What impact has this had on competition in these areas?

- (ii) How has competition in the supply of UK defence products and services changed since a) the undertakings were originally put in place; and/or b) since the last review of the undertakings in 2006?
 - (iii) How has BAES's provision of products and services changed over this period?
 - (iv) How has the geographic scope of defence procurement changed over this period: which products or services are procured on a UK, European or global basis? How and why has this changed over time?
 - (v) How has the creation of the Single Source Regulations Office (SSRO) changed the procurement landscape in the UK? Does the existence of the SSRO effect the need for the undertakings?
 - (vi) Should the review consider the undertakings across all sectors, or are there reasons to take a sector by sector approach (eg separate assessments for land, maritime, air)? Is there any evidence that BAES' share of capacity has changed over time in these sectors?
 - (vii) What would be the impact if the undertakings were released (ie no longer applied)? Specifically, would there be significant competition concerns? Would there be any impact on national security capabilities?
 - (viii) If the undertakings were released would there be any change to the efficiency of defence spending?
 - (ix) On balance, should the undertakings be varied, retained or released?
16. Please provide supporting evidence to your answers. Anyone with an interest in sharing their views should do so by 17.00 on Wednesday 7th September 2016 either by sending an email to: baesreview@cma.gsi.gov.uk, or by writing to:
- Matthew Lewis
Project Manager
BAES Project Review
Competition and Markets Authority
Victoria House
Southampton Row
London WC1B 4AD
17. Please note that we may publish responses, or refer to responses in any subsequent report. If you wish to submit a response containing information or evidence that you consider to be confidential, please submit both a

confidential and non-confidential version, and provide an explanation as to why you consider the material to be confidential. For further information please refer to *Transparency and disclosure – statement of CMA’s policy and approach: CMA6*.¹

18. There will be a further opportunity for parties to comment during the course of the review.

¹ [Transparency and disclosure – statement of CMA’s policy and approach: CMA6](#).

CMA's prioritisation principles

1. The CMA's decision to conduct a review of the remaining undertakings given by BAES is based a number of factors that suggest it is now an appropriate time to devote resources to undertake this review. Such factors include:
 - The CMA considers the undertakings meet the strategic significance criteria given that the defence sector and BAES's involvement in this is significant; together with the annual compliance costs involved.
 - The CMA recognises that there has potentially been a change of circumstance to consider and the timing of this review is sensible now that the Government's Strategic Defence and Security Review has concluded.
 - The CMA has the capability to pursue a proportionate review during the latter half of 2016 and the first quarter of 2017.

Background to the legislative framework for the review

2. The BAES undertakings were accepted by the Secretary of State under section 75G of the Fair Trading Act 1973. The undertakings were first given by BAES following its merger with Marconi in 1999 and have been subsequently varied following an OFT review in 2006.
3. The CMA has a statutory duty, by virtue of paragraph 13 of Schedule 24 of the Enterprise Act 2002 as amended by the Enterprise and Regulatory Reform Act 2013, to keep under review the carrying out of undertakings accepted under section 75G of the Fair Trading Act 1973. From time to time, the CMA must consider whether, by reason of any change of circumstances, an undertaking is no longer appropriate and either:
 - (i) one or more of the parties to it can be released from it, or
 - (ii) it needs to be varied or to be superseded by a new undertaking
4. If it appears to the CMA that the undertaking has not been or is not being fulfilled, that any person can be so released or that the undertaking needs to be varied or superseded, the CMA has a duty to give such advice to the Secretary of State as it may think proper in the circumstances.
5. As set out above, the CMA's role in a review of these undertakings is to advise the Secretary of State for Business, Energy and Industrial Strategy (BEIS) under Section 75J of the Fair Trading Act 1973 on whether the

undertakings should be retained, varied, or released. The decision will be made by the Secretary of State.

Indicative timetable

6. The CMA anticipates the following indicative timetable for this review:

Decision to proceed with review	Summer 2016
Group of Panel Members Appointed	
Initial request for evidence	
Consideration of Initial evidence gathering and main party submissions	
Hearings with interested parties	Autumn 2016
Provisional Decision published	Winter 2016/17
Final Decision Published	Spring 2017