REFERENCE RELATING TO THE ANTICIPATED ACQUISITION BY HITACHI RAIL, LTD OF THALES SA'S GROUND TRANSPORTATION SYSTEMS BUSINESS

Notice possible remedies under Rule 12 of the Competition and Markets Authority Rules of Procedure[1]

Introduction

1. On 23 December 2022, the Competition and Markets Authority (the **CMA**), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the **Act**), made a reference to its chair for the constitution of a Group of CMA Panel Members (the **Inquiry Group**)[2] regarding the anticipated acquisition (the **Merger**) by Hitachi Rail, Ltd (**Hitachi**) of Thales SA's Ground Transportation Systems Business (**Thales**) for further investigation and requiring it to report within a period ending on 8 June 2023.

2. Hitachi and Thales are together referred to as the **Parties**.

3. In its provisional findings on the reference notified to the Parties on 8 June 2023, the Inquiry Group, among other things, provisionally concluded that the Merger would result in the creation of a relevant merger situation, and that the creation of that situation may be expected to result in a substantial lessening of competition (SLC), as a result of horizontal unilateral effects in:

   (a) the supply of digital mainline signalling systems and related services (digital mainline signalling systems) in Great Britain (**GB**); and

   (b) the supply of CBTC signalling systems and related services (CBTC systems) in the United Kingdom (**UK**).[3]

4. Our analysis provisionally indicates that the SLCs may be expected to result in adverse effects, with the Merger likely to result in the removal of a direct and significant constraint on each of the Parties in the supply of digital mainline signalling systems in GB and removal of a potential entrant in CBTC

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[1] See Rules of procedure for merger, market and special reference groups: CMA17.
[2] Under Schedule 4 to the Enterprise and Regulatory Reform Act 2013.
[3] Digital mainline signalling systems and CBTC signalling systems are described in detail in the background section of the Provisional Findings.

systems for future London Underground projects compared to what would otherwise be the case absent the Merger.

5. This Notice sets out the actions which the Inquiry Group considers it might take for the purpose of remedying the SLCs and/or any resulting adverse effects identified in the Provisional Findings[4] (the **Remedies Notice**). This notice of possible remedies is intended as a starting point for discussion with the Parties and third parties, including customers and competitors. A remedies working paper, containing a detailed assessment of the different remedies options and setting out the Inquiry Group's provisional decision on remedies, will be sent to the merger parties for comment (but not published) at a later date in the investigation.[5]

6. The CMA invites comments on possible remedies by **17:00 (UK time) on 22 June 2023**.[6]

Criteria

7. In deciding on a remedy, the CMA shall in particular have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to remedy the SLC and any adverse effects resulting from it.[7]

8. To this end, the CMA will seek remedies that are effective in addressing the SLC and its resulting adverse effects and will select the least costly and intrusive remedy that it considers to be effective.

9. The CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects.[8]

The CMA's initial views on possible remedies

10. In merger inquiries, the CMA will generally prefer structural remedies, such as divestiture or prohibition, rather than behavioural remedies because:

    (a) structural remedies are likely to deal with an SLC and its resulting adverse effects directly and comprehensively at source by restoring the rivalry that would be lost as a result of the merger;

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[4] See Provisional Findings published on the CMA website.
[5] Merger Remedies: CMA87 (December 2018), paragraph 4.64.
[6] Responses to the Notice of Possible Remedies are typically requested within 14 days of publication of the Notice (and in any event, no less than seven days) so that they can be considered before response hearings (CMA2 Mergers: guidance on the CMA's jurisdiction and procedure: CMA2 (January 2022), paragraph 13.1).
[7] Sections 35(4) and 36(3) of the Act.
[8] Merger Remedies: CMA87 (December 2018), paragraphs 3.3 and 3.4.

(b) behavioural remedies may not have an effective impact on the SLC and its resulting adverse effects, and may create significant costly distortions in market outcomes; and

(c) structural remedies do not normally require ongoing monitoring and enforcement once implemented.[9]

11. The CMA will also consider whether a combination of measures is required to achieve a comprehensive solution – for example whether any behavioural remedies would be required in a supporting role to safeguard the effectiveness of any structural remedies. The CMA will evaluate the impact of any such combination of measures on the SLC or any resulting adverse effects.

12. Other competition authorities are investigating the Merger. The CMA will liaise with them in relation to possible remedies.

13. For the purpose of this consultation, the CMA sets out below its initial views on the following possible remedies:

(a) Prohibition;

(b) Divestiture of Hitachi's or Thales' signalling businesses, in full or in part; and

(c) Behavioural remedies.

Prohibition

14. Prohibition of the Merger would result in Hitachi and Thales continuing to operate under separate ownership as independent competitors. It would therefore prevent the provisional SLCs from arising in any relevant market.

15. The CMA's initial view is that prohibition would be an effective remedy as it would represent a comprehensive solution to all aspects of the SLCs the Inquiry Group has provisionally found (and consequently any resulting adverse effects) and the risks in terms of its effectiveness are very low.

Divestiture

16. In evaluating possible divestitures as a remedy to the SLCs it has provisionally found, the CMA will consider the likelihood of achieving a successful divestiture and the associated risks. In reaching its view, the CMA

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[9] Merger Remedies: CMA87 (December 2018), paragraph 3.46.

will have regard to the following critical elements of the design of divestiture remedies (which are considered in the following sections):

(a) the scope of the divestiture package;

(b) identification of a suitable purchaser; and

(c) the effectiveness of the divestiture process.

17. Divestitures may be subject to a variety of risks that may limit their effectiveness in addressing an SLC. The three broad categories of risks that may impair the effectiveness of divestiture remedies are:

(a) Composition risks – risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the market.

(b) Purchaser risks – risks that a suitable purchaser is not available or that the Parties will dispose to a weak or otherwise inappropriate purchaser.

(c) Asset risks – risks that the competitive capability of a divestiture package will deteriorate before completion of the divestiture, for example, through the loss of customers or key members of staff.[10]

Considerations for the design of effective divestiture remedies

The scope of the divestiture package

18. In defining the scope of a divestiture package that will address any SLCs, the CMA will normally seek to identify the smallest viable, stand-alone business that can compete successfully on an ongoing basis and that includes all the relevant operations pertinent to the area of competitive overlap.[11] The CMA will generally prefer the divestiture of an existing business, which can compete effectively on a stand-alone basis, to the divestiture of a part of a business or a collection of assets.[12]

- *UK divestiture*

19. The SLCs the Inquiry Group has provisionally identified in the supply of digital mainline signalling systems and CBTC systems cover GB and the UK

[10] Merger Remedies: CMA87 (December 2018), paragraph 5.3
[11] Merger Remedies: CMA87 (December 2018), paragraph 5.7
[12] Merger Remedies: CMA87 (December 2018), paragraph 5.12

respectively. A divestiture package comprising the UK digital mainline signalling systems or CBTC systems operations of either Hitachi or Thales could provide possible solutions to these provisional SLCs.

20. However, evidence the CMA has received to date shows that the GB digital mainline signalling systems and UK CBTC systems operations of both Hitachi and Thales are delivered as part of larger global businesses, with intellectual property (IP), staff expertise and other competitive capabilities being shared between UK and global operations. Divestiture packages comprising solely UK operations and assets would therefore need to be 'carved out' of the larger global businesses. The CMA's initial view is that this may lead to significant risks concerning:

(a) the identification of the assets to be carved out;

(b) the allocation of assets shared between UK and non-UK operations, in particular the R&D operations;

(c) the treatment of IP; and

(d) the transfer of the assets to a divestiture business or purchaser.

21. The CMA found that the Parties compete for GB digital mainline signalling systems and UK CBTC systems tenders using non-UK projects as references for UK tenders, relying on their global experience and assets. The CMA's initial view is that, in order to be able to compete effectively, a divestiture business would need to demonstrate and be able to draw on an international track record. This would require the inclusion of non-UK operations in the divestiture package. The CMA discusses the extent to which this track record could be provided by a potential buyer in the section on identification and availability of suitable purchasers below.

- *Other divestiture options*

22. A full divestiture remedy would comprise the sale of either of the Parties' global signalling businesses to a suitable purchaser. In the case of Thales this would be tantamount to prohibition of the Merger. For Hitachi it would mean separating its signalling business from its wider rail operations and divesting it before acquiring Thales, which would give rise to carve-out and other execution risks.

23. The CMA has received evidence indicating there are potential interdependencies between the respective digital mainline signalling services and CBTC systems businesses of each of Hitachi and Thales. Although the extent of interdependencies varies between the Parties, our initial view is that

additional composition risks (in addition to those which arise from the carve out of the signalling business) would arise from having to split the digital mainline signalling services and CBTC systems businesses to create separate divestiture packages for each SLC, and that any divestiture should therefore comprise a single package from either Hitachi or Thales.

24. Any partial divestiture would need to include all assets and competencies which under a separate ownership would be able to compete in any current and future digital mainline signalling services and CBTC systems tenders in GB and the UK respectively. Therefore, considerations regarding the composition of the partial divestiture would need to be made not only in the context of the current Network Rail Train Control Systems Framework (TCSF) tender but also any other future tenders procured by infrastructure managers in the UK for digital mainline signalling services and CBTC systems.

25. A partial divestiture would be anything short of a full divestiture of either of the Parties' global signalling businesses but larger in scope than either of the Parties' UK based operations, which could take the form of but is not limited to:

    (a) the European signalling business of either of the Parties; and

    (b) the European signalling business with specific assets and/or capabilities from non-European operations of either of the Parties that are essential to ensure the divestment package exerts effective competitive constraints which would otherwise be lost as a result of the Merger.

26. While our information gathering on potential remedies remains at an early stage, the CMA has identified significant risks related to any possible partial divestiture and would need to ensure that any remedy of this type had an acceptable risk profile. In particular, in relation to composition risks linked to the existence of the potential dependencies between digital mainline signalling services and CBTC services offerings, reliance on global capabilities and difficulties in identifying and separating required assets. These separated assets would then need to be capable of competing effectively under separate ownership.

27. A divestiture of a mixture of assets from both Parties (eg including assets from one of the Parties in relation to digital mainline signalling services and of the other Party for CBTC systems) (a so-called 'mix-and-match' approach) may create additional composition risks meaning the divestiture package would not function effectively. Therefore, if partial divestiture of a set of assets or parts of a business is proposed, it would normally be preferable for all the assets to be provided by one of the merger parties unless it can be demonstrated to our

satisfaction that there is no significant increase in risk from a mix-and-match alternative.[13]

28. The CMA's initial view is that any divestiture package (with the possible options set out above but which are in no way exhaustive) is likely to give rise to significant effectiveness risks. The CMA invites views on the scope of an effective divestiture remedy, including:

(a) what assets would be required in the divestiture package to ensure that the remedy is effective, and, in particular, that the Merger does not result in a loss of competitive conditions in the context of the existing and any future tenders are preserved;

(b) whether there are any risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate as an effective competitor in the relevant markets;

(c) the carve-out risks set out in paragraph 20 (and other carve-out risks that may be relevant to our assessment) and how they might be mitigated;

(d) how the geographic scope of the divestiture package could be broadened (eg including operations and assets from outside the UK) to address scope risks; and

(e) any other elements that may be required.

Identification of a suitable purchaser

29. The CMA will wish to be satisfied that a prospective purchaser:

(a) is independent of the Parties;

(b) has the necessary capability to compete;

(c) is committed to competing in the [relevant] markets; and

(d) will not create further competition concerns.[14]

30. In this case, we invite views on:

[13] Merger Remedies: CMA87 (December 2018), paragraph 5.16.
[14] Merger Remedies: CMA87 (December 2018), paragraphs 5.20 and 5.21.

(a) whether a global track record of supplying digital mainline signalling systems and/or CBTC systems are essential criteria for a suitable purchaser;

(b) the extent to which the ongoing TCSF tender may affect the CMA's assessment of purchaser suitability;

(c) whether there are any other specific criteria to which the CMA should pay particular regard in assessing purchaser suitability;

(d) whether any additional criteria would shrink the pool of potential purchasers;

(e) whether there are risks that a suitable purchaser is not available or that the merger parties will divest to a weak or otherwise inappropriate purchaser; and

(f) circumstances that would make it necessary to require an upfront buyer.[15]

Effective divestiture process

31. An effective divestiture process will protect the competitive potential of any divestiture package before disposal and will enable a suitable purchaser to be secured in an acceptable timescale. The process should also allow prospective purchasers to make an appropriately informed acquisition decision.[16] The CMA invites views on the appropriate timescale for achieving a divestiture.

32. The CMA will consider what, if any, procedural safeguards may be required to minimise the risks associated with this divestiture.

33. The CMA invites views on whether the Parties should be required to appoint a monitoring trustee to oversee the divestiture(s) and to ensure that the business/ assets to be divested is/are maintained during the course of the process.

34. The CMA will have the power to mandate an independent divestiture trustee to dispose of the divestiture package if:

(a) the merger parties fail to procure divestiture to a suitable purchaser within the initial divestiture period; or

[15] Merger Remedies: CMA87 (December 2018), paragraph 5.28.
[16] Merger Remedies: CMA87 (December 2018), paragraph 5.33.

(b) the CMA has reasons to expect that the merger parties will not procure divestiture to a suitable purchaser within the initial divestiture period.

35. In unusual cases, the CMA may require that a divestiture trustee is appointed at the outset of the divestiture process. The CMA invites views on whether the circumstances of this Merger necessitate such an approach.

Behavioural remedies

36. Behavioural remedies are designed to address an SLC and/or its adverse effects by regulating the ongoing conduct of parties following a merger. The CMA will generally only use behavioural remedies as the primary source of remedial action where:[17]

(a) Divestiture and/or prohibition is not feasible, or the relevant costs of any feasible structural remedy far exceed the scale of the adverse effects of the SLC;

(b) The SLC is expected to have a short duration; or

(c) Behavioural measures will preserve substantial relevant customer benefits (RCBs) that would be largely removed by structural remedies.

37. Behavioural remedies generally give rise to risks around specification, circumvention, market distortion and/or monitoring.

38. During our investigation, we received submissions from the Parties stating that it is possible to compete through licensing agreements or via a consortium with one or more OEMs[18] in the digital mainline signalling systems market in the UK without owning proprietary technology. This position has not been confirmed during our investigation to date.

39. Our initial view is that, based on our guidance, a behavioural remedy is very unlikely to be an effective remedy, and that there are significant risks in designing effective behavioural remedies that could comprehensively address the SLCs and resulting adverse effects the Inquiry Group has provisionally found. The CMA currently considers that it would not be possible to specify with sufficient precision the form of conduct or market outcome required to address effectively the SLCs and resulting adverse effects identified in the Provisional Findings.

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[17] Merger Remedies: CMA87 (December 2018), paragraph 3.48.
[18] Companies who own the signalling products used on particular projects.

40. The CMA will however consider any behavioural remedies put forward as part of this consultation, including any behavioural remedies that may be required in a supporting role to safeguard the effectiveness of any structural remedies. The CMA will evaluate the impact of any such combination of measures on the provisional SLCs or any resulting adverse effects.

Other possible remedies to address the provisional SLCs

41. The CMA will consider any other practicable remedies – whether structural or behavioural in nature – that the Parties, or any interested third parties, may propose that could be effective in comprehensively addressing the SLCs the Inquiry Group has provisionally found in this case and any resulting adverse effects.

42. Where the Parties propose remedy options for the CMA's consideration, engagement by us on remedies with limited prospect of being effective can reduce our ability to engage on remedies that have a greater prospect of being effective. Therefore, in keeping with our guidance on remedies, and in view of the statutory deadline for the CMA to publish its final decision on any SLCs and remedies, the CMA will not conduct a detailed consideration of the Parties' proposed remedies unless the Parties demonstrate that their proposed remedy options will address effectively all of the SLCs and their resulting adverse effects identified in the Provisional Findings.[19]

Cost of remedies and proportionality

43. In order to be reasonable and proportionate, the CMA will seek to select the least costly remedy, or package of remedies, that it considers will be effective. The CMA will also seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects. Between two remedies that the CMA considers equally effective, it will choose that which imposes the least cost or restriction.

44. When considering relevant costs, our considerations may include (but are not limited to):[20]

(a) Distortions in market outcomes;

(b) compliance and monitoring costs incurred by the Parties, third parties, or the CMA; and

[19] Merger Remedies: CMA87 (December 2018), paragraph 4.57.
[20] Merger Remedies: CMA87 (December 2018), paragraph 3.10.

(c) the loss of any RCBs that may arise from the Merger which are foregone as a result of the remedy.

45. The CMA invites views on what costs are likely to arise in implementing any remedy option(s).

Relevant customer benefits

46. In deciding the question of remedies, the CMA may have regard to the effects of any remedial action on any relevant customer benefits in relation to the creation of the relevant merger situation.[21]

47. Relevant customer benefits are limited by the Act to benefits to customers in the form of:

(a) 'lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom (whether or not in the market(s) in which the SLC has occurred or may occur); or

(b) greater innovation in relation to such goods or services'.[22]

48. The Act provides that a benefit is only a relevant customer benefit if:

(a) it accrues or may be expected to accrue to relevant customers within the UK within a reasonable period from the creation of the relevant merger situation and as a result of the creation of that situation; and

(b) it is unlikely to accrue without the creation of that situation or a similar lessening of competition.[23]

Next steps

49. Interested parties are requested to provide any views in writing, including any practical alternative remedies they wish the CMA to consider, by **17:00 (UK time) on 22 June 2023** (see Note (i)). For comments submitted by email, these should be sent to Hitachi.Thales@cma.gov.uk.

50. A copy of this notice will be posted on the CMA website.

Stuart McIntosh
Inquiry Group Chair

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[21] Section 36(4) of the Act, see also Merger Remedies: CMA87 (December 2018), paragraphs 3.15 and 3.16.
[22] Section 30(3) of the Act, see also Merger Remedies: CMA87 (December 2018), paragraph 3.17.
[23] Section 30(3) of the Act, see also Merger Remedies: CMA87 (December 2018), paragraph 3.19.

8 June 2023

This notice of possible actions to remedy, mitigate or prevent the provisional SLC or any resulting adverse effects is made having regard to the Provisional Findings announced on 8 June 2023. The main parties have until **17:00 (UK time) on 29 June 2023** to respond to the Provisional Findings. The CMA's findings may alter in response to comments it receives on its Provisional Findings, in which case the CMA may consider other possible remedies, if appropriate.