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CMA provisionally finds that Hitachi/Thales merger raises competition concerns at Phase 2

On 8 June 2023, the Competition and Markets Authority (CMA) provisionally found that Hitachi Rail's proposed acquisition of Thales' ground transportation business could reduce competition in the supply of digital mainline and urban signalling rail systems, impacting cost and service quality for passengers. This follows an in-depth phase 2 investigation by the CMA.

Background

Hitachi is a provider of transport solutions, including rail signalling systems. The ground transportation systems business of Thales is also active in the supply of rail signalling solutions and ancillary activities. Signalling systems form an integral part of railway infrastructure, helping to maintain passenger safety by controlling the movement of trains and maximising capacity on railway networks.

In November 2020, the British rail regulator, the Office of Rail and Road (ORR), launched a market study into the supply of signalling systems. The market study focused on supply chains "*for the delivery of significant signalling projects*". The ORR published its final report a year later. It found that there were essentially two main players active in the market for the supply of major signalling projects in Great Britain - namely Siemens and Alstom. Following its market study, the ORR made a number of recommendations intended to increase competition from alternative suppliers, including Hitachi and Thales.

In August 2021, Hitachi agreed to acquire Thales for €1.66 billion. The CMA launched a phase 1 investigation regarding the proposed acquisition on 14 October 2022, later referring it to phase 2 on 23 December 2022.

Central to the CMA's investigation was the potential impact of the acquisition on Network Rail and Transport for London (TfL). Network Rail, the primary customer for mainline signalling systems in Great Britain, is planning to upgrade much of the country's rail signalling system over the next decade. By around 2035, TfL similarly is expected to tender for the re-signalling of the Piccadilly and Bakerloo lines on the London Underground.

The CMA's provisional findings

The CMA launched its phase 2 investigation to examine its main concerns that the acquisition could potentially reduce competition in two key markets:

- the supply of digital mainline signalling systems and related services (digital mainline signalling systems); and
- the supply of communications-based train control signalling systems and related services (CBTC signalling systems) - these are the type of signalling used on metro systems, for example on some lines of the London Underground.

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Digital mainline signalling systems

As regards the impact of the merger on the supply of mainline signalling systems in Great Britain, the CMA's independent Inquiry Group found that Thales and Hitachi are well placed to compete with each other in this market. The CMA noted that the parties' competitive strengths with respect to management and technical expertise give them a significant advantage against other competitors, with only a limited number of competitors likely to constrain the merged entity, should the merger go ahead. The CMA found that rivals, together or in isolation, are not likely to offset the loss of competitive constraint that would result from the merger.

The CMA concluded that a reduction in the number of credible bidders competing for digital mainline signalling projects could result in additional costs for Network Rail and negatively impact the digitalisation of the UK rail network.

CBTC signalling systems

The Inquiry Group also considered the impact of the merger on the supply of CBTC signalling systems, in the context of upcoming projects to replace the signalling systems on parts of the London Underground network.

The CMA considered that technological expertise, experience on comparable complex projects, local knowledge of London Underground systems, capacity, and price were areas in which prospective suppliers compete for upcoming TfL projects. It found that Thales was one of the two suppliers (Siemens being the other) with experience of delivering signalling projects on the London Underground. In the CMA's view, Hitachi would be a potential credible competitor for TfL tenders due to its experience in delivering CBTC projects in Europe. The CMA therefore concluded that the transaction could reduce the limited number of suppliers with the capabilities to challenge Thales, reducing competition for future urban signalling tenders in London and in the wider UK.

Overall, the CMA's Inquiry Group provisionally concluded that the merger is likely to reduce choice, options, and competition in markets which are, according to the CMA, already highly concentrated. In the CMA's view, this could lead to "*worse outcomes for Network Rail and London Underground with an adverse knock-on effect on passengers and taxpayers*".

Potential remedies

As is typical, the CMA is considering three possible remedies to address the concerns it has identified: prohibition of the transaction, full or partial divestiture of Hitachi's and Thales' signalling businesses, and/or behavioural remedies.

The CMA has stated its initial views on each of these remedies:

- It considers that prohibition would be an effective remedy as it would "*represent a comprehensive solution to all aspects of the [substantial lessening of competition] the Inquiry Group has provisionally found*".
- It remains open to options relating to any divestiture package but indicates they are "*likely to give rise to significant effectiveness risks*". Its 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.
- In line with its strict approach to assessing behavioural remedies, the CMA considers that there are significant risks in designing effective behavioural remedies that could comprehensively address its concerns and the adverse effects it has provisionally found. It considers that it would not be possible to specify with sufficient precision the form of conduct or market outcome required to address its concerns.

Next steps

The CMA is now consulting on its provisional findings and potential remedies, with a view to addressing its concerns about the merger "*in a way that protects passengers and delivers the government's objective for a more reliable, efficient and modern railway*". The CMA's final decision is expected by 11 August 2023.

Hitachi has stated that regulatory approvals for the transaction have been secured in all other relevant jurisdictions except the EU, where the company is hoping to obtain clearance from the European Commission this summer. It remains to be seen whether the Commission will follow the CMA in its findings or if it will follow the pattern of approvals seen in other jurisdictions.

OTHER DEVELOPMENTS

ANTITRUST

HKCC launches educational campaign on resale price maintenance

The Hong Kong Competition Commission (HKCC) recently launched an educational campaign on resale price maintenance (RPM). The campaign aims to raise public awareness on RPM and encourage compliance in respect of vertical pricing practices between suppliers and distributors/resellers. This is notwithstanding that there is currently not yet any case law on RPM in Hong Kong, as the first RPM case has not yet been heard by the Competition Tribunal (for details, see our December 2022 Briefing).

As part of the campaign, the HKCC introduced a new brochure on RPM (RPM Brochure) that explains the potential harms of RPM. According to the HKCC, fixed or minimum resale prices set by a supplier can harm price competition between distributors/resellers, which may result in consumers paying higher prices. RPM may also prevent the emergence of new discount distributors or resellers, as RPM will prevent them from offering discounts on the products in question.

Overall, the RPM Brochure largely mirrors the points set out in the HKCC’s Guideline on the First Conduct Rule. The HKCC warns suppliers to exercise caution when implementing RPM arrangements, particularly when one or more of the following factors apply:

a. the sole intention of the parties concerned is to restrict price competition;

b. there is already a lack of competition between different brands of the product concerned;

c. the products affected are unlikely to require investment by distributors/resellers (e.g. training, after-sales services);

d. there are no apparent pro-competitive efficiencies stemming from the arrangement; and/or

e. the RPM is not part of a coordinated price campaign for a franchise distribution system or a new product entering the market.

GENERAL COMPETITION

European Commission issues consultation in relation to its evaluation of the FDI screening regime

On 14 June 2023, the European Commission launched a consultation on the current framework for the screening of foreign direct investment (FDI) in the EU. The current EU FDI regime is set out in Regulation 2019/452, and the consultation is part of the evaluation required by the Regulation, with the aim of ensuring that the FDI regime remains fit for purpose in a changing global security context.

Issues identified by the Commission under the current regime, which the consultation aims to explore, include the fact that the current framework is limited to investments by legal or natural persons from non-EU countries. This means that most investments by EU companies ultimately owned or controlled by non-EU persons are not included. In addition, Member States can decide not to control FDIs coming into their country, the sectorial coverage of screening mechanisms is uneven, and the coverage of transactions is uneven. Furthermore, there is little homogeneity in the procedural aspects of national investment screening systems.

The purpose of the consultation is to gather evidence for an evaluation and possible revision of the Regulation. The Commission has indicated that areas for improvement that it will be considering include: options on cooperation among the network of screening authorities (technical and procedural improvements); the degree of convergence in Member States' screening mechanisms; the types of investments covered; the focus on transactions that could have a bigger impact on security or public order; and the division of responsibilities between Member States and the Commission.

The consultation is open until 14 July 2023. Stakeholders can submit their responses through this link. The Commission will present a report to the European Parliament and Council by the end of 2023.

CMA Chief Executive Sarah Cardell's speech on competition and innovation

On 16 June 2023, the CMA Chief Executive Sarah Cardell delivered a speech on competition and innovation at the University of East Anglia. The speech responded to recent suggestions that the CMA may not be paying sufficient attention to the impact of its work on innovation and growth and also that prospective new powers for the CMA under the Digital Markets, Competition and Consumers Bill would undermine innovation and growth across the UK economy.

Ms Cardell emphasised that competition, as a key driver of innovation and growth, has always sat at the heart of the CMA's work and highlighted five examples of the CMA's current and future work where the interaction between competition and innovation is key. First, she highlighted the role of merger control in protecting effective competition, indicating that the CMA prevents just a handful of problematic deals each year, and that innovation can form the basis for clearing deals. Ms Cardell gave the recent clearance of the Viasat/Inmarsat merger as an example of this. Secondly, she cited the CMA market study into mobile ecosystems and investigations into Google's Play Store and Apple's App Store as an example of non-mergers work that involved taking action to "*unlock more competitive and innovative markets*". Thirdly, she cited the role of the newly established Microeconomics Unit as a testament of the CMA's dedication to ensure that competition is working well to improve productivity and growth. Fourthly, she said that the Digital Markets Unit within the CMA and the new digital markets regime will help ensure that we can all continue to enjoy the benefits that digital markets provide, by delivering a level playing field. Finally, she mentioned the CMA's initial review of AI foundation models, with the aim of helping this technology to develop in ways that ensure competitive markets and effective consumer protection.

The Chief Executive concluded by saying that the CMA plays a crucial role in protecting and promoting competition and innovation. This is also reflected in the priority given to innovation and growth in the CMA's Annual Plan and in the strategic steer from the government. Moving forward, the CMA will continue to do all it can to promote open and competitive markets, creating the best conditions for businesses to innovate and thrive in ways that benefit people as consumers and the UK economy as a whole.

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