

COPY NO:

TO: SECRETARY OF STATE FOR TRADE AND INDUSTRY

FROM: JOHN VICKERS
CHAIRMAN

20 May 2004

ANTICIPATED ACQUISITION BY GENERAL DYNAMICS CORPORATION OF ALVIS PLC

A REPORT TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY PURSUANT TO ARTICLE 4(2)-(5) OF THE ENTERPRISE ACT 2002 (PROTECTION OF LEGITIMATE INTERESTS) ORDER 2003

1. This report is made following the European intervention notice (the Notice) given to the Office of Fair Trading (the OFT) by the Secretary of State for Trade and Industry on 26 April 2004.

JURISDICTION

2. This transaction falls for consideration under the EC Merger Regulation (ECMR) and was notified to the European Commission on 20 April 2004. Although the European Commission has sole jurisdiction to investigate the competition aspects of the merger under the ECMR, Member States may exercise their residual power under Article 21(3) of the ECMR to take 'appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation'. Article 21(3) states that public (or national) security shall be regarded as a legitimate interest.
3. As a result of this transaction arrangements are in progress by virtue of which a concentration with a Community dimension (within the meaning of the ECMR) will arise and in relation to which a reference under section 33 of the Enterprise Act (the Act), which would otherwise have been possible, is prevented from being made by virtue of article 21(2) of ECMR. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which if carried into effect will result in the creation of a European relevant merger situation for the purposes of section 68(2) of the Act.
4. You may therefore make a reference to the Competition Commission (the CC) under Article 5 of the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003 (the Order) to address public security concerns arising from the merger.

THE PARTIES

5. **General Dynamics Corporation (GD)** is headquartered in the USA. Its principal business divisions are aerospace; combat systems; information systems and technology; and marine systems. GD supplies defence systems to the USA and other countries and is a supplier of business jets. It has two other business

activities in the USA which involve coal mining, and quarrying and gravel extraction.

6. **Alvis Plc (Alvis)** is a public limited company incorporated under the laws of England and Wales. Its business is focussed on the design, development and production of armoured fighting vehicles and military land systems.

SUMMARY OF THIRD PARTY REPRESENTATIONS

7. Following receipt of the Notice, the OFT has consulted and invited comments on the national security public interest consideration identified in the Notice. We have received representations from a number of parties that are summarised below.
8. The MoD has made representations that the merger might adversely affect the public interest on national security grounds. The MoD has identified two main areas of concern arising from this merger: the maintenance of strategic UK capabilities and the protection of classified information.
9. Regarding the maintenance of strategic UK capabilities, the MoD has stated that Alvis is the design authority for the majority of the British Army's current armoured fighting vehicle (AFV) fleet, in relation to which it possesses unique skills and knowledge. The MoD believes that it is essential for the protection of the UK's national security to ensure that Alvis is able to bid for or perform contracts either on its own or with third parties where required for the purposes of an MoD programme and to retain Alvis's capability within the UK to design, develop, operate and maintain current and possibly future AFV systems. The MoD states that without these capabilities it would be unable unilaterally to update equipment so as to maintain the operational advantage that the UK armed forces gain from having technologically-advanced and reliable equipment that is capable both of performing alongside its allies and surpassing potential adversaries. Similar views were also expressed by a number of other third parties. The MoD therefore believes that General Dynamics should give an assurance that it would continue to make available to the UK the capabilities that Alvis possesses in these areas and that such capabilities would be maintained within the UK.
10. In relation to the protection of classified information, the MoD has indicated that some of the strategic capabilities described above are dependent on access to highly classified technology and information. Some of the information is available only to UK nationals and may therefore bear a UK EYES caveat.
11. Another third party has made representations that the merger might harm UK national security if, as a result of the merger, the development programmes of Alvis's Swedish subsidiary are not made available to the MoD for the FRES programme. The MoD, in its representations to the OFT, did not identify this as a national security concern.

Undertakings in lieu

12. The MoD has identified national security concerns arising from the transaction which relate to the maintenance of a strategic capability and the protection of classified information. If you believe that the concerns raised by the MoD may be expected to operate against the public interest, you may either make a reference to the CC under Article 5 of the Order or accept undertakings in lieu of such a reference under paragraph 3(2) of Schedule 2 to the Order.
13. The draft undertakings in the attached appendix are intended to remedy, mitigate or prevent the particular effects adverse to the public interest identified by the MoD. Specifically, the undertakings seek to address the two areas of concern identified above.
14. General Dynamics has confirmed that it is willing to sign the undertakings in the form attached in the appendix.

Conclusions on national security considerations

15. The OFT is not expert in national security matters and therefore does not go beyond summarising here representations made by the MoD and other third parties.
16. The OFT has no reason to doubt the representations made by the MoD on the appropriateness of the undertakings in order to remedy or prevent the specific effects adverse to the public interest identified by it and which are briefly described above.

CONCLUSIONS

17. The OFT advises you that it is or may be the case that arrangements are in progress or in contemplation which if carried into effect will result in the creation of a European relevant merger situation for the purposes of section 68(2) of the Act.
18. It appears that this transaction raises national security concerns of the type identified by the MoD. If you believe that as a result of this merger a European merger situation will be created and that the national security concerns raised by the MoD may be expected to operate against the public interest, you may make a reference to the CC on such public interest grounds, or accept undertakings in lieu of such a reference. The MoD has prepared undertakings, to be accepted in lieu of reference to the CC, which it believes are the most effective means of remedying the national security concerns it identifies.
19. Following discussions with OFT officials, General Dynamics has confirmed that it is prepared to sign the attached draft undertakings. However, this does not bind your decision whether to accept the proposed undertakings in their current form, or in a modified version, if found appropriate following public consultation.

John Vickers
Chairman