

TO: SECRETARY OF STATE FOR TRADE AND INDUSTRY

FROM: PENNY BOYS, CB
EXECUTIVE DIRECTOR

19 September 2005

**ANTICIPATED ACQUISITION BY LOCKHEED MARTIN CORPORATION, THROUGH
LOCKHEED MARTIN UK HOLDINGS LIMITED, OF INSYS GROUP LIMITED**

**A REPORT TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY PURSUANT
TO SECTION 61(2) OF THE ENTERPRISE ACT 2002**

1. This report is made following the special intervention notice given to the OFT by the Secretary of State for Trade and Industry on 17 August 2005 (the Notice) pursuant to section 59(2) of the Enterprise Act 2002 (the Act).

JURISDICTION

2. The above arrangements will result in the creation of a special merger situation for the purposes of s.59(3) of the Act in that:
 - a. no relevant merger situation has been created because of section 23(1)(b) and (2)(b); but
 - b. a relevant merger situation would have been created if those enactments were disregarded;
 - c. enterprises carried on by or under the control of Insys Group Limited will cease to be distinct from enterprises carried on by or under control of Lockheed Martin UK Holdings Limited;
 - d. at least one of the enterprises concerned is carried on in the United Kingdom by or under the control of a body corporate incorporated in the United Kingdom; and
 - e. a person carrying on one or more of the enterprises concerned is a relevant government contractor within the meaning of section 59(8) of the Act and this has been confirmed to OFT by the Ministry of Defence (MoD).
3. In the Notice you stated that you believed that it is or may be the case that the national security public interest consideration specified in section 58(1) and (2) of the Act is, or may be, relevant to a consideration of the special merger situation concerned.
4. You may therefore make a reference to the Competition Commission (the CC) under section 62(3) of the Act to address public security concerns arising from the merger provided that you believe that the conditions set out in section 62(3) (a) – (c) are or may be satisfied.

THE PARTIES

5. **Lockheed Martin UK Holdings Limited (LMUK)** is based in London and is a wholly owned subsidiary of **Lockheed Martin Corporation (LMC)**, a company incorporated under the laws of the State of Maryland, USA. LMC is principally engaged in the

research, design, development, manufacture and integration of advanced technology systems, products and services.

6. **Insys Group Limited (Insys)** was formed in 2001 following a management buy-out of Hunting Engineering Limited. Insys Group Limited is based in Ampthill, Bedfordshire and is a specialist defence engineering and R&D contractor, supplying integrated system solutions to the UK and allied armed forces directly or through global prime contractors.

THE TRANSACTION

7. The proposed transaction would result in LMC, through LMUK, acquiring sole control of Insys Group Limited.

SUMMARY OF THIRD PARTY REPRESENTATIONS

8. Following receipt of the Notice, the OFT has consulted and invited comments on the national security public interest consideration identified in the Notice. In response to the consultation, representations on national security issues were received from the MoD alone. These representations are summarised below.
9. MoD comment that Insys is currently subject to Fair Trading Act 1973 Undertakings that were given in November 2001 to remedy public security concerns that arose from the acquisition by Insys of Hunting Engineering Limited. The acquisition of Insys in 2001 was a Management Buy-Out (MBO) funded by a foreign investment bank: the undertakings were given by Insys, ABN AMRO Development Capital (Guernsey) Limited and Barings (Guernsey) Limited (as Trustee of the Fifth ABN AMRO Causeway Development Capital Fund).
10. MoD state that Insys has important capabilities within the UK, in the areas of combat, weapon and communications system integration and research capabilities. These capabilities are dependent on highly classified technology and information, much of it only available to UK nationals.
11. LMUK, the UK subsidiary of LMC, now intends to acquire Insys. The MoD's concern is that following the acquisition, LMC might choose to rationalise its defence activities with the potential consequence that these essential UK capabilities could be either run down or sold off or transferred abroad to be combined with LMC's other activities in these areas. Some of the capabilities housed within Insys are unique and LMC may be keen to complement and improve their own capabilities in these areas by combining them with those of Insys. MoD state that this raises distinct concerns from those posed by the MBO funded by ABN AMRO. In addition, the move to US control raises concerns for MoD due to the US International Traffic in Arms Regulations (US ITAR), which would have profound implications for UK security of supply if UK information and technology was combined with US information and technology without UK knowledge or approval.
12. In summary, for the reasons given, the MoD contends that the proposed acquisition of Insys by LMUK is a change of circumstances, one that negates the need for the 2001 undertakings and requires new undertakings to be given by LMUK and LMC. MoD has provided the following detailed assessment of how the proposed acquisition may impact on national security.

Impact on UK National Security

13. The proposed concentration, although constituted via LMUK, will effectively lead to ultimate control and ownership of Insys by the US company LMC. MoD state that this means that LMC will be able to influence Insys in ways that could prejudice national security unless the MoD obtains assurances over certain aspects of its behaviour. A failure to obtain statutory assurances and influence over ownership could put the maintenance of strategic UK military capabilities and the protection of classified technology and information at risk. It is these two areas that MoD seeks assurances to protect.

Maintenance of Strategic UK Capabilities

14. Insys has strategic capabilities, in some cases unique, within the UK in the areas of combat, weapon and communications system integration and research capabilities. The sensitivity of some of these areas precludes any further description being provided. The MoD state that it is essential for the protection of the UK's national security that we retain the capability within the UK to develop, operate and maintain weapon systems incorporating these technologies, independently of other nations.
15. The MoD comment that following the acquisition, LMC might choose to rationalise its defence activities with the potential consequence that these essential UK capabilities could be either run down or sold off or, more likely, transferred abroad to be combined with LMC's other activities in these areas.
16. MoD therefore believes that it would be essential to obtain an assurance from LMUK and LMC that the capabilities that Insys possesses in these areas would be maintained within the UK and neither run-down nor transferred abroad, following the acquisition, without prior consultation with the MoD.

Protection of Technology and Information

17. The strategic capabilities described above are dependent, to differing extents, on highly classified technology and information.
18. If Insys, under the ownership and control of LMC, were to continue its involvement in such work, the MoD states that it would be necessary to ensure that such information was retained and protected within the UK. MoD considers legally binding undertakings from LMUK and LMC (combined with an appropriate compliance regime) would be necessary to assure the UK government that sensitive information and technology is being adequately protected.

Undertakings in lieu

19. 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 section 62(3) of the Act or accept undertakings in lieu of such a reference under paragraph 3(2) of schedule 7 of the Act.
20. 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 which may be expected to result from the creation of the special merger situation

concerned. Specifically, the undertakings seek to address the two areas of concern identified above.

21. LMUK and LMC have confirmed that they are willing to sign the undertakings in the form attached in the appendix.

Conclusions on national security considerations

22. The OFT is not expert in national security matters and therefore merely summarises here representations made by the MoD.
23. The OFT has no reason to doubt the representations made by the MoD on the appropriateness of the undertakings to remedy or prevent the specific effects adverse to the public interest identified by it and which are briefly described above.

CONCLUSIONS

24. 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 special relevant merger situation for the purposes of section 59(3) of the Act.
25. It appears that this transaction raises national security concerns identified by the MoD in its submission to the OFT. If you believe that as a result of this merger a special relevant merger situation will be created; the national security consideration specified in the Notice is relevant to the merger and taking account only of the national security concerns raised the merger may be expected to operate against the public interest, you can 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 has identified.
26. Following discussions with OFT officials, LMUK and LMC have confirmed that they are prepared to sign the attached draft undertakings. However, this does not fetter your discretion in determining whether to accept the proposed undertakings in their current form, or in a modified version, if found appropriate following public consultation.

Penny Boys, CB
Executive Director