



Case summary

27 April 2020

Following extensive investigations, the Bundeskartellamt clears the acquisition of Vossloh Locomotives GmbH by the Chinese company CRRC Zhuzhou Locomotives Co.

Sector:	Shunters
File number:	B4-115/19
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In its decision of 27 April 2020, the Bundeskartellamt cleared the proposed acquisition of the German shunter manufacturer Vossloh Locomotives GmbH, Kiel (in the following: **Vossloh Locomotives**), by the Chinese rolling stock manufacturer CRRC Zhuzhou Locomotives Co., Ltd. (Zhuzhou, People's Republic of China) without remedies in second phase proceedings.

CRRC Zhuzhou Locomotives Co., Ltd. is a subsidiary of CRRC Corporation, Ltd. (Beijing, People's Republic of China, in the following: **CRRC**). CRRC is a publicly traded company 51% of which are owned by the Chinese state – via the holding company CRRC Group Co., Ltd. and the State-owned Assets Supervision and Administration Commission SASAC. CRRC is the world's largest manufacturer of rolling stock but has so far sold its products predominantly in China. In Europe, the company's success has been limited despite its intensive efforts in recent years.

Vossloh is a manufacturer specialising in shunters and the market leader in Europe. The company produces powerful locomotives which are also suitable for operation on public rail networks and not only on private industrial estates. In 2014, Vossloh AG, domiciled in Werdohl, already decided to sell its subsidiary and has since then not invested in new traction technologies.

The decision is based on two important particularities: First, it was foreseeable that the market shares of both the target company and the acquiring company would change during the forecast period; and second, the particularities associated with the acquisition by a Chinese state-owned company had to be taken into consideration within the context of making a forecast-based decision. These particularities are outlined below following the market definition.

I. The relevant shunter market

The proposed acquisition affects the market for the production and distribution of shunters in the EEA and Switzerland.

Railroad companies and industrial businesses use shunters for the marshalling of trains or the loading of wagons in marshalling yards or larger industrial facilities (such as steelworks, refineries, mining and chemical plants, or harbour facilities). Shunters are sometimes also used on the public rail network, for example, to transport wagons from one location to another or to move maintenance trains or rescue trains.

Shunters must be equipped with special features which already have to be taken into account during the construction phase. Since they frequently change direction during the marshalling of trains, shunters usually have a central driver's cabin in which two control stations are located; mainline locomotives, in contrast, usually have two driver cabins, one at each end of the locomotive. There is only one-way substitutability between mainline locomotives and shunters: Larger shunters which are equipped with the required track control technology and which have been approved can replace smaller mainline locomotives; mainline locomotives, however, can replace shunters only in marginal areas.

In geographical terms, the relevant market extends across the EEA and Switzerland. There are still considerable differences in terms of track control technology and driving voltage, resulting in the fact that locomotives still have to be approved for each individual country in which they are intended to be used. The approval requirements differ considerably in this respect. This is also reflected in the fact that the vehicles of important competitors domiciled in Eastern Europe have not been approved for operation in most Western European countries. Due to harmonisation efforts at a European level, which have also resulted in substantial changes to the approval process, markets are expected to continue to merge in the coming years, which is why the Bundeskartellamt based its deliberations on the assumption of a uniform market including the entire EEA and Switzerland.

II. Changes in the market positions of the companies involved

When analysing the conditions of competition, the Bundeskartellamt had to take into account several particularities shown by the market for shunters:

For one thing, the market concerns a durable economic good and only a comparatively low number of these goods are sold annually, which is subject to large variations. In

addition to industrial customers and their rather steady demand for rolling stock as part of smaller orders, also state-owned railway companies order larger quantities of rolling stock from time to time. Therefore, the market volume and the sales figures of the individual buyers vary significantly from year to year. Instead of considering the sales figures of a single year, the Bundeskartellamt therefore based its analysis on a period of five years.

For another thing, in many cases there is a considerable delay between awarding a contract and delivering the vehicles. Especially if a customer requests shunters with special features, which is often the case with regard to major contracts from state-owned railway companies, the first vehicles can be provided only two to three years later. This is not least due to the complex approval procedure which rail vehicles have to pass. With regard to major contracts, there is also the period for delivery, which, depending on the number of units, can also be several years. For this reason, the Bundeskartellamt based its analysis on a longer forecast period of five to ten years instead of the usual three to five years.

Lastly, this case is special because it is foreseeable that the market positions of both Vossloh and CRRC will change. Over the past years, Vossloh's competitiveness has suffered and in the future the company's market position will be weaker than suggested by the market shares it held over the past years. CRRC, however, is only beginning to enter the market and is currently establishing its position in the market, so that it can be expected to strengthen its market position in the coming years. So far, the company has received only a few shunter orders but it has not yet been able to deliver the corresponding vehicles. Consequently, the historical market share data relating to both companies provide only limited information as to their market positions in the future. This applies all the more since, according to the assessment of the Bundeskartellamt, the market volume will simultaneously increase due to technical developments – especially due to the availability of environmentally friendly traction technologies such as hybrid or so-called dual mode locomotives.

The Bundeskartellamt's forecast already takes into account these foreseeable changes by not simply taking the historical market share data as a basis for the projection but correcting these data based on the foreseeable changes. In dynamic developments, the possibilities for a more exact quantification are, however, very limited. Therefore, the Bundeskartellamt drew up the forecast on a qualitative basis by way of an extensive assessment of all relevant factors influencing the situation.

Changes in market conditions also create considerable forecast uncertainties. Nevertheless, the fact that a market is in a dynamic phase cannot as such result in the assumption that any merger would have to be accepted as unobjectionable. It has to be ensured, however, that the standards of proof relating to administrative decisions are always met. The Bundeskartellamt accounted for this tension by creating various scenarios. In this way, the division forecast and considered several realistic market developments which can result from the way in which the relevant factors influencing the situation are expected to develop.

In the present case, the Bundeskartellamt analysed the matter extensively. The analysis first started with extrapolating the data regarding the historical market positions; these data were subsequently adjusted based on the changes already foreseeable today. These include, for example, the order situation, success in recent tender procedures relating to major contracts, technological standards and the companies' resources.

III. Involvement of state-owned companies from centrally planned economies

The acquisition of German companies by businesses from China is the subject of public debate at present. With regard to competition law, the question as to how economic power affects the functioning of competition is particularly relevant. Numerous parameters relating to the scope of competitive action and market behaviour play an important role for the forecast. But not all aspects that are discussed in the context of the public debate are relevant in this regard. Some of the various distortions of competition mentioned by European manufacturers rather relate to trade policy or procurement law issues, which cannot be solved using the tools provided by competition law.

The involvement of a state-owned company domiciled in a centrally planned economy results in several particularities with regard to the analysis under competition law. The reason for this is that the scope of action and the limits applicable to private companies, on the one hand, and state-owned companies domiciled in centrally planned economies, on the other hand, differ substantially. The particularities of state-owned companies from centrally planned economies in terms of merger control raise new questions for competition law: Until now, no centrally controlled economy has intended to open up new markets in other countries by using its state-owned companies.

The Bundeskartellamt identified several particularities, which are important from a merger control perspective:

The first particularity is the size of the affiliated group of companies. The extent to which affiliated state-owned companies are vertically integrated is considerable in a centrally planned economy. This creates network effects. In addition, the level of vertical integration in an affiliated group of state-owned companies from centrally planned economies is particularly high because many input products can be manufactured internally – sometimes far upstream in the supply chain.

Under German law, the affiliation clause pursuant to Section 36(2) German Competition Act (*GWB*) is decisive when it comes to assessing the size of the affiliated group of companies. The assumption that an enterprise is controlled by the enterprise holding a majority ownership as set out in Section 17(2) German Stock Corporation Act (*AktG*) applies in the present case because the People's Republic of China indirectly holds a majority in CRRC's shares. The investigations carried out by the Bundeskartellamt have also shown that it is the express intention of the State-owned Assets Supervision and Administration Commission SASAC to exert influence on essential aspects of the economic practices of its state-owned companies. Moreover, internal documents have shown that CRRC strongly bases its actions on the provisions set out in the currently applicable 13th Five-Year Plan.

Therefore, the affiliated group of companies pursuant to Section 36(2) *GWB* at least includes all companies in which China holds a majority share. This is important with regard to the scope of the information that needs to be provided in the notification. The present case has shown that the information which is to be provided in the notification pursuant to Section 39(3) *GWB* on the affiliated companies, at least on those companies that are active in the relevant sector and in upstream or downstream markets, is important for the evaluation in terms of substance since both the scope of competitive action and the technological abilities are affected by the extent of the affiliated group of companies. Therefore, joint ventures particularly with Western manufacturers are of great importance in China.

In the present proceeding, the Bundeskartellamt encountered some challenges in the course of carrying out its investigations into the affiliated group of companies. For example, the requested information was not provided in full and in good time in response to all official requests for information. This is particularly true for information regarding affiliated companies. In this connection, the option of suspending the deadline due to the incomplete notification or applying the stop-the-clock regulation set out under Section 40(2) sentence 5 *GWB* – so far only applicable to a limited extent – proved important.

In addition to the size of the affiliated group of companies, the ability and the willingness to implement low-price strategies is the second particularity. These aspects are crucially important with regard to the expected market behaviour and the changes to the market conditions brought about by the merger.

Systematically underbidding competitors may result in substantially distorted market positions. However, it is not possible to simply apply the abuse control requirements relating to predatory pricing strategies to merger control in order to assess this question. In particular, the possibility of recoupment does not provide relevant information on the likelihood of a low-price strategy in the context relevant here: The reason for this is that in a centrally planned economy, political requirements may also play a part in this optimisation effort in addition to economic – that is economically rational – goals, which are set by the country's political players authorised to take decisions and which are reflected in the five-year plan or in national industrial strategies, for example.

The risks associated with low-price strategies create an area of conflict since low prices are not generally considered anti-competitive. The endeavour to strengthen a company's own market position by offering low prices is inherently competitive. For the purpose of entering a market, it may even be necessary to accept losses for a certain period of time. However, low prices that are not fully based on comparative cost advantages in the medium term run the risk of damaging competitive structures. The question as to whether or not this is to be expected significantly depends on the possibilities and incentives relating to the implementation of such low-price strategies.

In this context, access to financial resources and subsidies as well as CRRC's previous practices become important. The way in which the acquirer behaves in other markets – especially when it comes to setting prices – may also provide indications in this regard.

As a state-owned company subsidised in the context of two important strategic plans of China – namely “Made in China 2025” and “Belt and Road Initiative” – CRRC's access to financial resources is exceptional.

This includes subsidies provided by the state. State subsidies can considerably distort competition. In order to rule out any distortions caused in this way, the European Union has provided rules on state aid in Articles 107 ff. TFEU with regard to trade between Member States; compliance with these rules is monitored by the EU Commission, a forceful supranational authority. A similar legal framework with a corresponding degree

of transparency and public enforcement does not exist with regard to state subsidies in China.

CRRC indeed enjoys advantages due to receiving state subsidies. For example, the company openly recorded subsidies in the amount of approx. EUR 75 million in its 2018 annual report. In its assessment, the Bundeskartellamt assumed, however, that additional hidden subsidies are granted. Especially the EU Commission's report "Commission Staff Working Document: On Significant Distortions in the Economy of the People's Republic of China for the Purpose of Trade Defence Investigations" of 20 December 2017 (available at https://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf; in the following: **EU Commission's report on China**), which was cited in numerous anti-dumping decisions of the EU Commission as proof that impermissible subsidies had been granted, outlines an extensive system of financial subsidies provided by the Chinese state. This includes guaranteed sales in the protected home market, reduced prices for primary products, subsidies for research and development and access to cheap loans from state-owned banks.

For the assessment of CRRC's scope of action, the fact that granting a loan in China is an important instrument to provide financial resources to state-owned companies is also significant. The Chinese banking sector is characterised by a large share of state-owned banks, which are used strategically to achieve the goals set by state planning by, for example, financing state-owned (sister) companies regardless of their financial situation and the associated credit risk with loans at interests rates that are not in line with the market. If state-owned companies are no longer able to service their loans, the Chinese government occasionally prevents insolvency and – despite little prospect of loans being repaid – arranges for refinancing, debt restructuring or a bailout.

Against this background, CRRC has extensive possibilities for implementing low-price strategies. Based on CRRC's previous behaviour in foreign markets and also internal documents, it can be concluded that CRRC strategically uses low prices in order to expand its market position in foreign markets. This is indicated, for one thing, by the ordered shunters CRRC sold to DB and the Hungarian RCH, and, for another, by individual locomotive and railcar contracts concluded in other European countries. In addition, over the past years CRRC has won numerous important tender procedures relating to metro trains in the USA by offering particularly low prices.

Lastly, the forecast has to take into account that a large number of decisions against Chinese state-owned companies have been handed down by the European Commission

due to dumping practices, a significant part of which are still in force at present. These decisions were rendered against companies belonging to the same group and therefore to the same owner. They serve as an indication of the company's willingness to offer prices which, in order to increase sales, are so low that the company accepts the risk of breaching anti-dumping provisions. In this regard, it is of importance that some vehicle components such as steel and aluminium wheels or tyres for lorries and buses have also been the subject of anti-dumping decisions handed down by the European Commission. This illustrates that the People's Republic of China, the indirect owner of CRRC, still supports anti-competitive low-price strategies as defined in anti-dumping regulations implemented by its subsidiaries in countries of the EEA.

IV. Forecast

To forecast the merger effects, the Bundeskartellamt first outlined scenarios regarding the development of the market positions of Vossloh and CRRC without the merger; these were based on the principles relating to the forecast in a dynamic market environment as outlined above. In a second step, the Bundeskartellamt then excluded those scenarios which can no longer occur in the event of a merger. With regard to the remaining scenarios, the Bundeskartellamt then considered whether they allowed a sufficiently reliable conclusion to be drawn as to the question of whether the prohibition requirements are met. Ultimately, the Bundeskartellamt was not able to establish this unequivocally and thus cleared the proposed merger.

Based on the turnover generated between 2014 and 2018, Vossloh's market shares amounted to [40 to 50]%. The lead over its next largest competitor, the Czech company CZ Loko, was significant, especially in view of the fact that CZ Loko does not offer shunters that have been approved for use in Germany or France. CZ Loko is therefore to be classified as a remote competitor.

With regard to the assessment of Vossloh's further development without the merger, the Bundeskartellamt considered it decisive that the company's competitiveness had considerably suffered over the past years. Important investments, especially in modern traction technologies, were not made due to the long sales process. Developing a hybrid or dual mode shunter costs millions and requires several years of advance planning. At the same time, Alstom, Stadler and Toshiba newly entered the market in the past few years. These companies are established manufacturers which have high levels of expertise also with regard to other rolling stock and which already sell finished products on the market today or have at least been awarded major contracts in the context of which

they develop innovative products. This resulted in a competitive gap between Vossloh and its competitors.

The Bundeskartellamt considered the scenario in which no buyer is found for Vossloh and the parent company Vossloh AG quickly ceases the company's operation to be the lowest scenario. In this scenario, Vossloh's market share would possibly drop to zero within the next three years.

The Bundeskartellamt also created two intermediate scenarios in which Vossloh continues its operation. In the lower intermediate scenario, Vossloh AG fails to find a buyer for Vossloh but continues business operations without providing the financial resources necessary for Vossloh to restore its competitiveness. In this scenario, the Bundeskartellamt expects Vossloh's market share to decrease slowly, and in five to ten years' time the share will have dropped significantly below the market dominance threshold.

In the upper intermediate scenario, Vossloh receives the financial resources necessary for the restoration of its competitiveness after a buyer has acquired the company or Vossloh AG has changed its strategy. In this case, the Bundeskartellamt considers it possible that the market share is approx. 40%, but it cannot predict these figures with the necessary degree of reliability. It is also possible that the market share reaches 30% or possibly even less. In this context, the question as to the extent of Vossloh's loss of competitive strength in the past years in relation to new competitors is crucially important. The Bundeskartellamt was not able to reliably exclude that Vossloh had suffered huge competitive losses which made it impossible for Vossloh to regain its old strength within the forecast period even if a committed new owner could be found.

In the highest scenario, the Bundeskartellamt lastly considered the case that Vossloh would win DB's currently conducted tender procedure for the provision of 200 dual-mode locomotives. The result of the tender procedure was still unclear at the time of the decision. In this scenario, Vossloh's market share would increase even further but drop again – still within the forecast period.

With regard to CRRC, the Bundeskartellamt expects in a lower scenario that the company will manage to enter the market within the next five to ten years – due to the fact alone that CRRC has already been awarded contracts with the German DB and the Hungarian RCH. The Bundeskartellamt assumes that CRRC will be able to establish a secured market position within the next five to ten years. In the view of the Bundeskartellamt, it

can be, however, ruled out that CRRC could reach a dominant market position based on its own efforts within the forecast period. The reason for this is that due to the huge delay between the award of a contract and the provision of the goods on the shunter market, it is impossible for the company to establish the necessary reputation within the forecast period, especially with regard to the durability and reliability of its products. The Bundeskartellamt therefore expects CRRC's market share to amount to approx. 10% in five to ten years.

In a higher scenario, the Bundeskartellamt again assumed that the company may possibly win DB's tender procedure for dual-mode locomotives; this would result in a temporary increase in CRRC's market position, which would subsequently drop again, however.

If the two companies merge, the lowest scenario (exit from the market) and the lower intermediate scenario regarding Vossloh (further loss of competitive strength due to a lack of financial resources) no longer need to be considered, because CRRC will provide Vossloh with the necessary financial means resulting in the fact that the further loss of competitive strength can be ruled out. The upper scenarios relating to Vossloh and CRRC (winning the tender procedure for dual-mode locomotives) no longer have to be considered in more detail since they are, on the one hand, unreliable and, on the other hand, irrelevant for the assessment because they do not depict the development including the weakest realistically possible market position which can be achieved by the merged company.

Therefore, the combination of the upper intermediate scenario relating to Vossloh and the lower scenario relating to CRRC had to be considered when assessing the merger effects.

The Bundeskartellamt cannot reliably forecast the probability of the merger leading to a dominant market position within the next five to ten years. In this regard, the Bundeskartellamt took into account that CRRC is able to contribute complementary technical skills, especially with regard to the handling of high voltage railway electricity and hybrid drives. The effects of a low-price strategy within the framework of a two-brand strategy were also taken into account. However, the possibility remains that during Vossloh's phase of economic weakness, which it will have to go through during the next two to four years, competitors will be able to gain a strong foothold in the market, which cannot be adjusted at a later stage. In this case, the low-price strategy CRRC is expected to implement could no longer substantially change the market conditions since the new competitors would have already become too important for customers.

In addition, it was possible to rule out any significant unilateral or coordinated effects.

On these grounds, the proposed merger ultimately had to be cleared.