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Case No IV/M.1396 - AT&T / IBM GLOBAL NETWORK

Only the English text is available and authentic.

REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
Date: 22/04/1999

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.04.1999
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In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus […]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sirs,

Subject: Case No IV/M. 1396 – AT&T / IBM GLOBAL NETWORK
Notification of 18.03.1999 pursuant to Article 4 of Council Regulation No 4064/89

1. On 18.03.1999**,** the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89 as amended ("the ECMR") by which AT&T Corp. (hereinafter "AT&T" and referring to the AT&T group of companies) notified an operation whereby it would acquire from International Business Machines Corporation ("IBM") the IBM Global Network ("IGN") business.

I THE PARTIES

2. AT&T is a telecommunications common carrier in the United States providing a broad range of US and international voice and data communications services, including long-distance and on-line Internet services to and from the United States.

3. IBM is a corporation organised under the laws of the State of New York. It is the ultimate parent of the IBM group of companies, which develops, manufactures and markets hardware, software, and services, principally in the information technology area.

4. IGN currently forms part of an IBM division called “IBM Global Services, Network Services”. IGN provides a portfolio of managed network services for connectivity, collaboration and network outsourcing that can be customized to help IBM’s customers and their customers gain competitive advantage via the Internet and other public and private networks worldwide. The services concerned, which are described in more detail below, are integrated, managed and delivered over the IBM network.

II THE OPERATION AND THE CONCENTRATION

5. By the notified operation AT&T Corp will acquire sole control of the IGN business and assets. AT&T will purchase the physical and logical infrastructure of the IGN network, including the associated facilities currently in place, as well as software. About 5000 employees of IBM will join AT&T as part of the acquisition. AT&T will also purchase part of the existing corporate and consumer customer base, including communications network management contracts with IGN’s corporate customers. The operation constitutes a concentration within the meaning of Article 3(1)(b) of the ECMR.

6. The agreements under which the purchase is to take place leave open the possibility that AT&T might at some later stage transfer any or all of the acquired assets either to BT or to the AT&T/BT global joint venture. It is understood by the parties that the scope of this decision is limited to the transfer of the assets in question to AT&T. Insofar as any further onward transfers would fall to be considered under the ECMR, they would need to be assessed under a separate notification

III COMMUNITY DIMENSION

7. After making adjustments to reflect turnover attributable to undertakings acquired or disposed of since its most recent set of audited accounts, the world-wide turnover of AT&T for the 1997 accounting year was just over EUR 45 000 million. The world-wide turnover in 1997 of IGN was [not more than about EUR 1800 million].

8. The determination of Community-wide turnover under the Merger Regulation involves the allocation of turnover on a geographical basis. There are various possible methods of allocating revenue earned by telephone companies providing services which generate revenue outside the country in which they are based. On all the variants proposed, AT&T and IGN each have Community-wide turnover exceeding ECU 250 million. AT&T and IGN do not both achieve more than two-thirds of their Community-wide turnover within one and the same Member State. Accordingly the concentration has a Community dimension within the meaning of Article 1 of the ECMR. However, it does not fall to be treated as an EFTA co-operation case.

IV COMPETITIVE ASSESSMENT

Relevant product markets

9. For the purposes of assessment, the parties developed a ‘value chain’ model whereby different types of telecommunications services could be ranked in terms of the extent of ‘value added’ components they contained. At the bottom of the chain (considered as level 1) were basic telecommunications services. These consist essentially of the provision of telecommunications transmission capacity between two different points offered as a stand alone product. Examples of products/services falling into this category are domestic local and long-distance leased lines, International Private Leased Circuits

(IPLCs), wholesale International Direct Dialling (IDD), as well as indirect services such as switched transit, hubbing and re-origination.

10. Level 2 would consist of end to end telecommunications services. These would involve adding physical and logical layers, such as interconnecting routers and switches, and the physical management of such devices. A Level 2 service would also be characterised by an ability to adapt the service to the customer's transport needs and to make the service available for immediate use upon request. Examples of service falling into this category are the provision of managed bandwidth, basic Virtual Private Network, Frame Relay, and Asynchronous Transfer Mode services. These, and other, products taken together as packages have been considered as a market for the provision of packages of customised value-added and enhanced global corporate telecommunications services for the purposes of the analysis of Case No. IV/JV.15 – BT/AT&T. This definition includes a limited number of products defined at Level 3 below.

11. Level 3 would involve the provision of essentially the same services, but with a much higher degree of management by the service provider. This might include the physical and logical management of the customer's network and premises devices, potentially through to the desktop. Services at this level range from managed Internet access, file transfer, transaction routing and universal messaging services to managed data network services ("MDNS") and network outsourcing services. 'MDNS' refers to a set of end-to-end managed data network solutions which combine the management of transport elements, the physical and logical management of network equipment as well as other transport services. 'Network outsourcing' is where the customer transfers the responsibility for the operation of an existing network to a third party service provider. Such arrangements extend the service provider's role into the customer's premises and sometimes into the customer's local area network ("LAN") itself. One general feature distinguishing Level 2 from Level 3 is that a provider of level 3 services supplies a "managed solution" to the customer telecommunication needs, in the sense that it would be expected, with a higher management input, to determine where and when a possible failure may occur on the customer's network and intervene accordingly, whereas a level 2 supplier of more basic services might take a reactive approach and wait to be informed of faults before putting them right.

12. Level 4 covers services including the highest degree of IT functionality, by which the supplier is closely involved within the customer's activities, acting within its LAN and managing both IT and communications equipment on the customer's premises, or managing customer's applications and content. Services at this level would include the provision of IT-intensive communications services, such as content hosting services, EDI service, managed workgroup services, and corporate messaging services.

13. In the parties view, the four levels in the value chain do not of themselves represent separate markets. Relevant product markets could be defined very narrowly in respect of each type of service line within each level. More widely defined markets might cover several product lines, and the boundaries need not necessarily be co-terminous with the boundaries of the levels identified by the notifying parties. Thus services at the lower or higher end of a given level may well be economic substitutes for similar services in an immediately adjacent level: for example, a straightforward Internet access service (Level 2) may in certain circumstances be a substitute for a managed network service (Level 3).

14. Under these circumstances, there are two possible ways to define relevant product markets. The first way would be to define markets on a service by service basis. If two

services are widely separated on the value chain continuum, there may be a much lower degree of substitutability than for two adjacent services. A customer seeking a level 4 type highly ‘managed’ package may not regard the provision of basic leased lines (level 1) as a competing service offering.

15. At the other extreme, it might be argued that a very wide product market exists covering a broad spectrum of all services falling under the ‘managed solutions’ umbrella. However, from the market investigation, it seems unlikely that level 2 services exercise a competitive constraint on the offering of managed solutions. It could be argued that customers could either purchase level 2 services and then self-provision their management or could directly buy "managed solutions". A number of respondents to market investigations offered the view that, for large corporations, the increasingly technical nature of the services involved meant that, in the majority of cases, self-provision could no longer be regarded as an effective alternative to the buying-in of expertised telecommunication services. Accordingly the widest relevant market which was thought to exist was one covering all managed solutions services, but excluding self-provided services.

16. Against this background, the assessment was carried out by looking at the narrowest possible product markets which might exist, based on service lines, and progressively widening the definition to cover all the areas of overlap between AT&T and IGN.

Geographic market

17. The parties consider the geographic market for the types of services which they provide to be world-wide. Enquiries made during the course of market investigations largely substantiated this view. The conditions or prices under which such services were offered did not depend on the geographical location of either the provider or the consumer. Accordingly the market was taken to be worldwide.

Competitive assessment

18. In terms of overlap AT&T is active in Levels 1, 2 and 3, including through the proposed BT/AT&T joint venture,whereas IGN is active largely in Level 3 but also to a limited extent in levels 2 (file transfer and transaction routing) and to a limited extent in level 4.

Service lines overlaps

19. In terms of service lines, overlaps occur in three main areas. These are, first, in *network outsourcing*, between IGN’s Network Outsourcing Services and AT&T Solutions Network Outsourcing; second, in *MDNS*, between IGN’s Internet Direct Dedicated Access Services and in AT&T’s WorldNet Managed Internet Service; and finally in *internet access services*, between IGN’s Internet Connection Services and AT&T’s WorldNet Business Dial Service.

20. If the markets are considered as global, then the overlap in internet access services, would also extend to the Internet service offered by @Home, a US Internet service provider previously controlled by TCI and controlled by AT&T following completion of TCI’s merger with AT&T.

21. Both parties are involved in Level 4, but only in a very limited way. This arises through the delivery of the IT component of network outsourcing services (“NOS”) and MDNS

contracts. Where this arises, AT&T will take over formal responsibility for the management of the contract including the IT component, but will sub-contract the delivery of the IT component back to IBM).

The relationships are set out in the table below:

IGN services	**AT&T Service**	**Estimated Level**
Internet Connection Services	WorldNet Business Dial Service @Home	Level 2
File Transfer and Transaction Routing		Level 2
	Easy Link e-mail service	Level 2
	AT&T Solutions MNS services	Level 2/3
Universal Messaging		Level 3
MDNS - SNA high speed services; - SNA Leased Line Services; - SNA Remote Access Services; - Multiprotocol Private Data Network; (PDN) Dedicated Access Services; - Multiprotocol Remote Access Services; - TCP/IP Secure Dedicated Access Services; - TCP/IP Remote Access Services; - Internet Direct Dedicated Access Services	Worldwide Managed Internet Services	Level 3
Network Outsourcing Services/Custom Network Services	AT&T Solutions Network Outsourcing	Level 3/4

22. If markets are defined on the narrowest levels according to the service lines identified in the chart above, no overlaps arise for the services for which no comparable services are identified as being supplied by the other party, namely AT&T's MNS services, IGN's Managed Messaging Service, E-mail services and IGN's File Transfer and Transaction Routing.

Quantification of service lines overlaps

23. The table below shows worldwide revenues based on these narrowest service categories. The market share is derived by setting revenues for each of the relevant service lines against estimates of the total market size. The most conservative estimates made by the two notifying parties were made by IBM, on the basis of advice from independent consultants, whom they employed on a regular basis for the purpose of giving IBM the most objective view of market opportunity. These figures, which are also included in the table below, do not take account of the money spent on internal self-provision, that is, market opportunities which would be potentially available if all the firms currently self-providing their in-house services (on the basis of external supplies of Level 1 and/or 2 services), were to turn to an outside supplier.. The relevant figures were :

Service segments	IGN worldwide share	AT&T share worldwide	Combined share	Most conservative estimate of market (mEUR)
Internet Access Services	[0-5%]	[0-5%]	[less than 15%]	[…]
MDNS	[10-15%]	[0-5%]	[less than 15%]	[…]
Outsourcing	[0-5%]	[5-10%]	[less than 15%]	[…]

24. It could be argued that, because of the BT/AT&T transaction (see case No. IV/JV.15 BT/AT&T, Decision of the Commission of 30 March 1999), the market share of BT should also be taken into account for the purpose of assessing this transaction. However, even if that were done, BT-Concert market share would be [less than 15%] for outsourcing and [less than 15%] for MDNS.

Overlaps on wider market definitions

25. Slightly wider markets can be drawn either by combining one or more of the segments in the table above. For example, if all managed solution services were taken as a market together, these would involve taking MDNS, Outsourcing and AT&T's MNS activities as in the table and Universal Messaging. The parties' estimates of the world-wide breadth of this market, based on independent published sources, ranged from […] at the smallest to […] or more world-wide. However, the size of the market would be just […] if it included only level 3 or 4 services. The parties combined share would be [less than 15%], with the share rising to [less than 20%] if BT's share were to be taken into account. Again no competition concerns would arise.

26. As a check on whether these figures produced an accurate reflection of market reality the Commission surveyed a sample of customers for the services in question, in order to establish whether the customers themselves believed they had a choice of supplier (other than AT&T and IBM) for the products and services. The companies surveyed were randomly selected from a list of companies which had sent RFPs ("request for proposals") either to IGN and/or to AT&T, over the past year. The responses indicated that the customers were not substantially concerned by the transaction, and believed there was an adequate number of other potential providers in the market. A number also referred to the possibility of self provision as an additional competitive constraint. However, in view of the relatively low market shares, it was not necessary to determine whether self-provision did indeed provide a competitive constraint and the question was not pursued further.

Vertical effects

27. The issue was considered as to whether AT&T, through its participation with BT in their global joint venture (Case No. IV/JV.15 – BT/AT&T, Commission decision of 30 March 1999) might be in a position to limit the supply of basic telecommunications services, ie

Level 1 and Level 2 services, to competitors. However, in view of the finding that the BT/AT&T transaction neither created nor strengthened any dominant position at Level 1 or 2 which could be leveraged downstream, and thus the operation was found to be compatible with the common market, it can be taken that no vertical effects sufficient to give rise to competition concerns arose. In any event, there were examples of competitors in the supply of managed solutions services who were not 'facilities-based' in their own right and survived by leasing basic telecoms services such as EDS. In addition, there was no evidence to suggest that a competitor in this particular sector suffered any cost disadvantage as a result of operating this way. Accordingly this issue was not pursued further.

V ANCILLARY RESTRAINTS

28. The parties have sought clearance of a non-compete obligation in one of the relevant purchase agreements, whereby IBM undertakes, for a period of five years following the sale of IGN, not to recreate a facilities-based network or to engage in any business the primary purpose of which is the provision of access to and transport service on a facilities-based or leased line-based network owned by IBM.

29. This clause is considered directly related and necessary to the concentration because it guarantees to AT&T the full value of the assets transferred, which include both physical assets and intangible assets, including goodwill and know-how. The five year period is necessary for AT&T to gain the loyalty of customers and to assimilate and exploit the transferred know-how.

30. The relevant sale agreements also include provisions whereby AT&T Solutions (part of the AT&T group) is awarded a five-year contract for a significant proportion of IBM's global networking needs, with revenues of approximately […] in the first year and reducing minimum annual revenue levels in each subsequent year.

31. The provision described above would not in practice restrict competition because under the terms of the non-compete clause, IBM would not be competing for AT&T's business with them during the duration of the contract. But in any event a certain time period is necessary for IBM to adjust from services previously internalised to services being provided by a third party. However, a period of five years appears to be excessive to enable a company to sever economic flows which have been externalised following a divestiture and eventually substitute market-place offerings. This is even more the case in the telecommunications industry where technological changes are taking place at a fast pace. Accordingly insofar as the clause is considered a restriction of competition, it is considered as directly related and necessary to the transaction for three years from the date of this decision.

VI CONCLUSION

32. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This

decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No 4064/89.

For the Commission,