

*Case No IV/M.353 -
BRITISH TELECOM /
MCI*

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**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 6(1)(a) INAPPLICABILITY
Date: 13.09.1993

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Brussels, 13.9.1993

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)a DECISION

To the notifying parties

Dear Sirs,

Subject : Case No IV/M.353 - British Telecom / MCI
Your notification of 12.08.1993 pursuant to Article 4 of
Council Regulation No 4064/89 (Merger Regulation)

On 12 August 1993, British Telecommunications plc ("BT") and MCI Communications Corporation ("MCI") notified to the Commission a series of agreements under which BT is to take a stake in MCI and both companies are to establish a joint venture to provide advanced business telecom services to multinational companies.

The Parties

- 1.. British Telecom ("BT") is the former UK monopolist telecommunications operator ("TO"), and supplies telephone exchange lines to homes and businesses; local, trunk and international (to and from the UK) telephone calls; other telecoms services and telecoms equipment for customers' premises.
- 2.. MCI is a telecommunications common carrier in the US providing a broad range of US and international voice and data communications services including long distance telephone, record communications and electronic mail services to and from the US. It is the second largest long-distance operator in the US after AT&T.

The Operation

- 3.. BT and MCI have notified the agreements between them as one operation although it comprises several different transactions:

- (i) the creation of a joint-venture, Newco, for the provision of enhanced and value-added global telecoms services to multinational businesses. The parties will contribute their existing non-correspondent international network facilities, including Syncordia, BT's existing "outsourcing" business, to Newco. BT will hold 75.1% of Newco's capital, MCI the balance. The parties will also rationalise their respective holdings in other TOs and groupings;
- (ii) BT is to take a 20% stake in MCI, thus becoming the largest single shareholder in MCI, with proportionate board representation and investor protection.
- (iii) MCI will acquire BT's existing North American subsidiary.

(i) NEWCO

Joint control

- 4.. The joint venture agreement between the parents provides for BT to own 75.1% of Newco's equity and MCI 24.9%. MCI will, however, be granted extensive consent rights over the activities of Newco, allowing it to veto any decision relating to, among other things, changes in business direction, management appointments and approval of the five year business plan and annual operating plan and budget. MCI thus has joint control with BT over Newco within the meaning of Article 3(3) of the Merger Regulation.

Joint venture performing on a lasting basis all the functions of an autonomous economic entity

- 5.. BT and MCI will transfer their existing business and facilities geared to providing global value-added/enhanced telecom services to business customers, to Newco and will also make available on an irrevocable basis all necessary intellectual property rights. The parties envisage considerable capital investment in Newco (\$1 billion over the course of the first 5 years including the businesses transferred to Newco) and Newco will employ over 1,000 people. The joint venture agreement is of indefinite duration.
- 6.. Newco is to build a global network over which to provide the enhanced services. It will sell those services exclusively to its parents and will not, as a consequence, have a direct relationship with the end customer. The parents will act as distributors of Newco's services and will have the exclusive right to promote, sell and distribute these services in their respective home territories (the Americas for MCI and the rest of the world for BT). The parents will thus set the price and other product parameters such as levels of performance and service and will be responsible for client defaults in payment. Newco will undertake not to sell its services to any entity other than its parents, and must supply its parents with services on request. Newco shall "assist" in identifying customers, "advise" on the best way to meet customers' needs and "support" the parents' account management. The parties argue that it would not be economically viable to create a separate sales force for Newco and that in any case potential customers would want the security of doing business with a supplier they already knew before entrusting something as important as their telecommunications network to them.

- 7.. The entirety of the services offered by Newco will thus be sold to its parents who will not act on the instructions of Newco as agents but rather will request the supply of services which Newco is obliged to meet (within certain limits) and decide the price and terms on which that service is to be provided to the end customer. The Commission therefore has serious doubts as to the genuine autonomy of Newco, notwithstanding the asset, financial and personnel resources to be made available to it.

Absence of coordination of competitive behaviour

- 8.. Newco services will be sold exclusively through its parents who will then sell them to end customers in their respective allotted territories: the Americas for MCI and the rest of the world for BT. The market for the provision of global advanced telecom services to MNCs is clearly itself global and the provisions in the Distribution Agreements which allot sales territories to the parents would appear to constitute an agreement to partition this market. The possibility provided for of passive sales (by which a customer might elect to be supplied by MCI outside the Americas or by BT inside the Americas), does not undermine this conclusion. Given that BT and MCI remain otherwise independent (BT's 20% stake in MCI notwithstanding - see below), these clauses would appear to indicate that the operation could have as its object or effect the coordination of the competitive behaviour of Newco's parents.
- 9.. Furthermore, there is a risk of coordination of competitive behaviour between the parents and Newco itself. Newco is to build a global, intelligent, overlay network over which it will provide a range of value-added or enhanced services defined in the Joint Venture Agreement as any international telecommunications service which regulation permits to be offered between two or more countries by the same corporate group (this definition excludes voice international simple resale and the provision of international private leased circuits as well as all services operated on correspondent basis such as normal international direct dial). These "liberalised" services include electronic mail, a range of data transmission services, video conferencing, global cashless calling and automatic call forwarding or call-back. In marketing these services to international clients such as multinationals (MNCs), Newco will in addition hope to replace the MNC's existing private network ("outsourcing" from the MNC's point of view). It will also use its expertise in running such networks to manage an MNC's existing private network.
- 10.. The parties state that they will transfer their activities in these fields to Newco. The question remains, however, whether Newco will be active upon a distinct market from its parents, and even if it is, whether the parents' activities in neighbouring markets such as domestic value-added services, international correspondent services or international private leased circuits could be expected to result in any coordination of competitive behaviour.
- 11.. In terms of international voice services, a potential NEWCO client has the alternatives of normal international direct dial services offered by TO's such as BT and MCI on a correspondent basis and that of an international private leased circuit (IPLC - a dedicated line offering a certain capacity at a fixed tariff independent of the level of usage) which it equally purchases from TO's. The exact choice will depend on matters such as usage levels, performance requirements and pricing.

Similarly for international data, a potential NEWCO customer can also opt to self-provide by purchasing transmission (and if necessary switching) equipment and attaching it to an IPLC bought from a TO. There are drawbacks in self-provision such as the variation in data protocols between national networks and the speed of transmission may be lower than for NEWCO services, but again the choice is there and the alternative adopted will reflect issues such as pricing, usage and performance.

The parties argue that the enhancements which Newco will offer in the way of a technically superior product, user-friendly attributes such as multilingualism, uniformity of standards and data protocols across the whole network and a single global point of contact with a TO for a company, place the product sets into two clearly differentiated markets. Whilst this may or may not be so, in as much as these markets were separate, they would also be neighbouring and the issue remains of whether there is a sensible competitive relationship between the two sets of markets which could allow coordination of behaviour.

12.. Newco's network is international and it will rely on local TO's to assure the final link from its nodes to a customer's premises. The parents have therefore suggested that Newco's product range is not aimed at purely national accounts since the value-added is in the global nature of the services offered. Whilst this may be true, organisations which are intensive users of telecoms but which have no sites outside their home country may turn to Newco because of the sophistication of its products for purely domestic use. This would put Newco squarely in competition with its parents in the US and the UK. Furthermore, customers may be international, but have such a concentration of traffic in either the UK or US that the relevant parent's offering could be directly competitive with that of Newco were the company to decide to forego Newco's international spread in order to get a good deal on domestic telecommunications which formed the bulk of its needs.

13.. Given that

- Newco will be selling to the same companies to which its parents will continue to provide other basic telecom services; and that
- certain products will be common to both the offerings of the parents and Newco, or if not actually common then in neighbouring markets and with a competitive relationship between them; and that
- the parents will continue to provide IPLCs which are the building blocks of self-provided network and thus will be supplying products which indirectly compete with Newco's products; and that
- for certain clients, Newco services may be an alternative to the parents' national services

the Commission considers that this operation could lead to coordination of competitive behaviour both between the parents and between the parents and the joint venture.

Conclusion

14.. In the light of the above, it must be concluded that Newco is cooperative rather than concentrative in nature and

does not constitute a concentration within the terms of Article 3 of the Merger Regulation.

(ii) BT stake in MCI

Concentration

- 15.. Under the terms of an investment agreement BT is to purchase 20% of the outstanding shares of common stock of MCI. It will be entitled to three out of fifteen seats on MCI's board and will hold a veto over certain decisions such as the issuance of fresh equity, substantial acquisitions or disposals and borrowings taking the company over a certain gearing threshold. These are normal minority shareholder protection rights and do not constitute a power of veto over competitive behaviour and commercial strategy.
- 16.. Simultaneous with the closing of the transaction MCI will adopt a shareholder rights plan under which it would take a vote of 95% of non-BT shareholders in MCI for control to pass to a third party against BT's wishes for a period of four years. For the following six years control cannot pass to a third party unless BT is given the right to compete against any such bidder in an auction process. While this effectively enables BT to block any third party from acquiring control of MCI in any other than extraordinary circumstances, it does not in and of itself confer positive control.
- 17.. In the absence of any explicit agreement between BT and MCI, or of any compelling commonality of interest between the two, it can only be concluded that BT will not acquire joint control over MCI and that this part of the notified operation does not constitute a concentration under Article 3 of the Merger Regulation.

(iii) MCI's acquisition of BT North America

- 18.. The acquisition by MCI of BT North America will not be of Community dimension since BT North America does not attain the EC turnover threshold of 250 million Ecu (USD 230 million).

Conclusion

19. In light of the above, the Commission has concluded that none of the three transactions notified to it by the parties and described earlier in paragraph 3 constitute a concentration of Community dimension. This decision is adopted in application of Article 6(1)(a) of Council Regulation No 4064/89.
20. The Commission will treat the notification pursuant to Article 5 of Commission Regulation No 2367/90 as an application within the meaning of Article 2 or a notification within the meaning of Article 4 of Council Regulation No 17/62 as requested by the parties in their notification.