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*Case No IV/M.683 -
GTS-Hermes Inc. / HIT
Rail BV*

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

Article 6(1)(b) NON-OPPOSITION
Date: 05/03/1996

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 05.03.1996

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sirs,

Subject: Case N° IV/M.683 - GTS-Hermes Inc/HIT Rail BV

Notification of a concentration pursuant to Article 4 of Council Regulation N° 4064/89

1. On 2 February 1996, the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EC) No 4064/89⁽¹⁾ by which the undertakings GTS-Hermes Inc. (GTS) and the parties from 2 to 12, the latter acting through HIT Rail B.V. (HIT Rail), acquire within the meaning of Article 3 (1) b of the Council Regulation joint control of their 50/50 joint venture Hermes Europe Railtel B.V. (Hermes).
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation No 4064/89 and does not raise serious doubts as to its compatibility with the common market and within the functioning of the EEA Agreement.

I. THE PARTIES

3. GTS develops and operates a broad range of value-added telecommunications services, primarily in the Commonwealth of Independent States, Central Europe and Asia. In Western Europe, its only activity is a joint venture with the PTO in Monaco.
4. The ten European national railway undertakings, the parties from 2 to 6 and 8 to 12, are principally active in the transportation of freight and passengers, mainly within their national territories. In addition, most Railways have other business activities, e.g. travel agencies, banking, mechanical fabrication, electronic and data-processing services, energy and real estate management.

⁽¹⁾ OJ No L 395 of 30.12.1989; Corrigendum OJ No L 257 of 21.09.1990, p.13.

5. Racal-BR Telecommunications Ltd. (Racal) is part of the Racal Electronics group. Its main activity is the provision of the business and operational telecommunications services to British Railways Board in the United Kingdom excluding Northern Ireland together with the maintenance of railway-specific terminal systems. Racal's network facilities are those originally operated by British Railways Board and therefore national. The Racal Electronics group does not provide international transmission capacity to third parties.

II. THE OPERATION

6. GTS, the ten above mentioned national railway undertakings and Racal intend to create a joint venture Hermes, which will introduce a pan-European telecommunications network dedicated to the cross-border transport of telecommunication traffic primarily along the rights of way of the railway undertakings by public network operators, carrier consortia, cellular telephone companies and other authorised telecommunication operators.

III. CONCENTRATION

7. Hermes will be controlled equally by GTS and the parties from 2 to 12, who will act together through HIT Rail. HIT Rail is used in order to facilitate decision-making amongst the parties from 2 to 12 and to ensure that they speak and act as one.
8. HIT Rail is a Dutch company in which the parties from 2 to 12 have equal voting rights in the general meeting, where decisions are taken by a simple majority. The supervisory board consists of 7 members, one from each of the parties from 2 to 12, rotating periodically. The general meeting reserves certain issues for its own decision, including the appointment of the representatives of HIT Rail on Hermes. At least six of the parties from 2 to 12 must agree on a proposal in the general meeting. This configuration ensures that the parties from 2 to 12 can exercise a decisive influence with the other acquiring company, GTS, over Hermes and avoids the situation where that other acquirer could exercise sole control because of their inability to reach a unified position on any decision.⁽²⁾
9. The railway undertakings and Racal act through HIT Rail which was originally formed in 1990 for the purpose of managing international IT projects for its members. In this role, HIT Rail has been involved in two or three joint projects of the Railways, the most important of which is Hermes-plus, a project providing for network signalling and ticketing systems. Its primary function now is to serve as a vehicle through which the railway undertakings and Racal jointly participate in Hermes. Furthermore, Racal has a common interest with the railway undertakings. Racal represents the privatized telecommunications activities of British Railways. It is partner of Hermes because with respect to Hermes it has the same kind of business and interest as the railway undertakings.
10. GTS and HIT Rail basically have equal rights as shareholders. Decisions of the General Assembly are adopted on the basis of a two-thirds majority unless and until either GTS or HIT Rail holds two thirds of the votes, in which case simple majority suffices, except for some decisions which require unanimity. At the moment, both companies have a 50% share. GTS and HIT Rail are also equally represented on the Supervisory Board, where

⁽²⁾ See Commission decision IV/M.102 - TNT/Canada Post and others

decisions are taken by simple majority. In case of deadlock, there is no casting vote but provision exists for further discussions and final reference to an independent committee of experts. The Supervisory Board has complete and exclusive power to supervise the policy of the Management Board and the general course of affairs of Hermes and its business.

11. Hermes will operate as an independent economic entity which possesses all the assets and resources to act autonomously on the market. It will obtain the necessary rights of way and/or dark fibre from the Railways, through negotiations at arm's length, or from third parties. It will have complete end-to-end operational control of its network. Hermes acts as a single entity in selecting its prime contractor for the construction of the network. It will act autonomously in relation to its customers, which may include the Railways and GTS. The provisions of infrastructure facilities by Hermes to the Railways and GTS will be on an arm's length basis.
12. The creation of Hermes does not give rise to coordination of the competitive behaviour of the parties. None of the parent companies is active in the market of the joint venture, which is the market for carrier's carriers. According to the Phoenix notice under Regulation 17/62 art 19 (IV/35.617, 15 December 1995), the market for carrier's carrier services comprises the lease of transmission capacity and the provision of related services to third-party telecommunications traffic carriers. Some of the parent companies are active on a market which is downstream from the joint venture's market, which is the market for carriers⁽³⁾. GTS and Racal are presently active in the field of telecommunications services but not in the same geographical markets. Even if the national railway companies enter into national joint ventures with other telecommunications services operators, it is unlikely that they will become competitors as they will probably operate only on a national basis. The Railways are active in a market which is upstream from the Hermes's market as they will provide networks to Hermes. However, they will each provide a network for a different geographical market.

IV. COMMUNITY DIMENSION

13. The present operation has a Community dimension within the meaning of Article 1(2) of the Merger Regulation. The worldwide turnover of all the undertakings concerned amounted, in 1994, to more than ECU 5 billion ([...]⁽⁴⁾) and more than two of the undertakings achieved a Community-wide turnover of more than ECU 250 million. The undertakings concerned did not achieve more than two-thirds of their respective Community-wide turnover within one and the same Member State.

V. ASSESSMENT UNDER ARTICLE 2 OF THE MERGER REGULATION

A. Relevant product market

14. In the terminology used in the Commission's Phoenix notice Hermes will be a carrier's carrier. More specifically Hermes will provide infrastructure services similar to dedicated transit services - ie the transport of traffic over permanent dedicated facilities through the network of the transit carrier, using a high-bandwidth digital circuit used for both voice and data services.

⁽³⁾ See par. 14 f.

⁽⁴⁾ Deleted for publication

15. This kind of business of a carrier of telecommunications carriers differs generally from the business provided by a telecommunications carrier, i.e. of a typical services provider. The latter typically provides services to end-users, i.e. the typical customer of a services provider. The business of a carrier's carrier is broadly described as providing capacity and related services for these telecommunications operators, i.e. a kind of wholesale.
16. Two different types of business can be regarded as forming a pan-European carrier's carrier market: the provision of bandwidth (in Mbit/s) interlinking the switch locations of carriers, and the provision of switched-minute services (in millions of paid minutes), taking telephone calls from one carrier and either terminating these calls upon a company's own switched network infrastructure, or passing them to another carrier for the final stage. The traditional way of providing cross-border services to end users is to make separate arrangements with a range of other carriers. In future, especially because of the formation of alternative national telecommunications services providers, these carriers might seek to entrust the transport of international traffic to a single provider or a small number thereof.
17. Hermes will provide two categories of transmission capacity:
 - During its start-up period Hermes will supply cross-border basic transport capacity (point-to-point) targeted at carriers requiring large bandwidth capacity between two gateway points,
 - With the commencement of the liberalisation of telecommunication infrastructure markets in the EU from 1996 Hermes will provide instead a pan-European virtual private transport network supplying bulk capacity to carriers who will sub-supply to end-users.
18. According to the parties these services should be located in two separate product markets: the first is merely an alternative to the traditional point-to-point connections offered by PTOs by combining two or more half-circuits; the second is a part of a new and distinct product market - the provision of pan-European transport networks - which in consequence of liberalisation will develop as the role of traditional PTOs on the market for international infrastructure services gradually decreases.
19. For the purposes of the present decision the Commission can leave open the definition of both the product markets involved, since on the narrowest definitions - those given by the parties - no competition problems arise.

B. Relevant geographic market

20. Hermes will initially supply its telecommunications network between some of the countries whose railway undertakings participate in the operation; it will then extend its activities to other countries in the present network. It is possible that railway undertakings in other countries in the EEA will join the operation at a later date. The Commission accordingly concludes that the relevant product market is at least EEA-wide.

C. Competitive Assessment

21. In the first market described by the parties - cross-border basic transport capacity (point-to-point) - Hermes will compete with PTOs and will have an insignificant share.

22. The parties claim that, since the second market described by the parties - the provision of pan-European transport networks - is new, no valid market share data are available. However, market players with global network infrastructures or regional ones will be in a position to provide a variety of services to telecommunications carriers. If the creation of a pan-European network like that one of Hermes is part of an already existing carrier's carrier market, the creation of a market dominating position cannot be expected because of the market power of the national PTOs. Only if the provision of a pan-European network by the parties creates a new product market, will it be possible to conclude that, as the first entrant into it, Hermes will in the immediate future enjoy a very high share, possibly even 100 pc, of this new market.
23. Even if a seamless pan-European telecommunications network is a product of its own, the Commission is confident that the potential competitors of Hermes are equally or more powerful and that Hermes will have no opportunity to foreclose the market. The principal source of such competition is the national PTO operators; as the national regulation of telecommunications, the main barrier to entry, diminishes in the next few years, they will have the capacity to combine into a pan-European network resources (particularly infrastructure) which are much greater than those available to the parties. Furthermore, the national PTO operators are dominant in the field of cross-border traffic with respect to the existing connections between the several PTOs which enable cross-border telecommunications to take place at the moment. Another type of infrastructure suitable for telecommunications is that of the national energy and water undertakings; already the electricity grid in Germany is used as the infrastructure for telecommunications,⁽⁵⁾ and there is no reason why following the liberalisation of telecommunications energy and water undertakings should not in cooperation with telecommunications operators create cross-border networks of comparable strength to those of Hermes. Competition could also be provided by such telecommunications consortia as Unisource Carrier Services, Orion and Atlas/Phoenix; these consortia have the advantage of vertical integration both upstream and downstream, whereas Hermes will have to negotiate with each of the railway companies on an arm's length basis and will not have the resources to supply telecommunications services to end-users. Furthermore, one has to take into account that the proposed Hermes infrastructure still has to be set up. Further market entries can already be expected from 1 January 1998.
24. Therefore, even if the business of Hermes is regarded as a new product, it cannot be foreseen that the formation of Hermes will lead to the creation of a market-dominating position. Furthermore, this conclusion is underlined by the fact that the potential customers of Hermes are strong and well informed companies which have considerable buying power and will be able to limit the market power of any supplier of carrier's carrier services, especially with respect to existing alternatives.
25. The proposed concentration therefore does not raise serious doubts as to its compatibility with the common market.

VI. ANCILLARY RESTRAINTS

26. The parties have requested that certain restrictions be considered as ancillary to the concentration. To answer their request, the assessment made below is also related to the question whether a provision is an integral part of the operation.

⁽⁵⁾ Commission decision IV/M.618 Cable & Wireless/Vebacom

27. HIT Rail and GTS agree not to assist or cooperate in the development of any other pan-European Telecommunications operator while HIT Rail and GTS remain shareholders in Hermes; for HIT Rail the obligation continues for a further year. The evaluation of this clause must take account of the characteristics peculiar to concentrative joint ventures. This prohibition on the parent undertakings competing with the joint venture aims at expressing the reality of the lasting withdrawal of the parents from the market assigned to the joint venture. However, insofar as this clause is a restriction of competition, it can be regarded as an ancillary restriction.
28. The parties agree not to disclose confidential information relating to Hermes. This restriction is directly related and necessary to the implementation of the concentration. Therefore it can be regarded as ancillary to the concentration.
29. Hermes agrees not to provide telecommunication network facilities services at a national level, unless on the application of a customer the relevant national railway consents. Insofar as this is only a definition of the scope of business of Hermes, it can be regarded as an integral part of the concentration, since it reflects the decision of the parent companies to limit the business of the joint venture to international services. Nevertheless, the second part of the clause leads to the conclusion that the limitation is not an integral part of the concentration as this part of the clause in question provides an exemption from the limitation. This part of the clause therefore cannot be regarded as an integral part of the operation. Furthermore, as this clause imposes an obligation only on Hermes, it cannot be regarded as ancillary to the concentration.
30. Hermes will not be obliged to obtain dark fibre and rights of way from the railway companies; nor will the railway companies be obliged to supply those assets to Hermes. Rights of way and related agreements will be concluded on an arm's length, commercial basis. This clause is not restrictive of competition.
31. However, Hermes will be obliged to negotiate with the railways concerning contracts for the installation and maintenance of the network; only if fair and commercial terms cannot be agreed will Hermes be entitled to contract with other suppliers. This provision cannot be regarded as directly related and necessary to the implementation of the concentration. Therefore it cannot be regarded as ancillary to the concentration.

VII. 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 functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation N° 4064/89.

For the Commission,