II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 14 May 1997

declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement

(Case No IV/M.856 — British Telecom/MCI (II))

(Only the English text is authentic)

(Text with EEA relevance)

(97/815/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to the Agreement on the European Economic Area, and in particular Article 57 thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], as amended by the Act of Accession of Austria, Finland and Sweden, and in particular Article 8 (2) thereof,

Having regard to the Commission Decision of 30 January 1997 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the concerns expressed by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations [2],

Whereas:

(1) On 18 December 1996 the UK company British Telecommunications plc ('BT') and the MCI Communications Corporation ('MCI') notified their intention to effect a full merger between the two companies.

(2) After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EEC) No 4064/89 ('the Merger Regulation').

I. THE PARTIES

(3) BT's principal activity is the supply of telecommunications services and equipment. Its main services and products are local and long-distance telephone calls in the United Kingdom, the provision of telephone exchange lines to homes and businesses, international telephone calls made from and to the United Kingdom and the supply of telecommunications equipment for customers' premises. BT also has a joint venture (called Springboard) with News International in the United Kingdom for Internet access and content and also has a United Kingdom marketing agreement with BSkyB. BT is also active internationally,

[1] OJ L 395, 30. 12. 1989, p. 1; corrected version, OJ L 257, 21. 9. 1990, p. 13.
[2] OJ C 372, 9. 12. 1997.

notably in Europe through the existing Concert joint venture with MCI, and through other European joint ventures.

(4) MCI is a diversified communications company which offers its customers a portfolio of integrated services, including long distance, wireless, local, paging, messaging, Internet, information services, outsourcing and advanced global communications in the United States of America. MCI ist also active internationally, notably in the rest of the Americas through Concert. MCI has an interest in a joint venture in the US with News Corporation for satellite TV services. This interest in the joint venture is held through shares in various News Corporation companies. MCI currently holds a licence for satellite broadcasting in the US.

II. THE OPERATION

(5) MCI will be merged into a BT subsidiary incorporated in Delaware, USA, and will cease to have a separate legal existence. The BT subsidiary will be renamed MCI Communications Corporation. Thereupon BT's name will be changed to Concert plc, which will be incorporated in London but with headquarters in both London and Washington.

(6) Concert plc will be organized along geographic and customer lines. Business and consumer services will continue to be sold in the United Kingdom and the United States, under the BT and MCI brand names respectively and through separate operations. A number of new divisions will be formed from the current operations of the two companies including a global systems integration division, an international division, a division responsible for multimedia and a division responsible for global alliances and joint ventures.

III. CONCENTRATION

(7) The proposed operation is a full merger between BT and MCI within the meaning of Article 3 (1) (a) of the Merger Regulation. Upon the merger becoming effective, the existing shares in MCI will be cancelled and MCI shareholders, other than BT, will receive a proportion of Concert plc's depositary shares.

IV. COMMUNITY DIMENSION

(8) BT's worldwide turnover in the financial year 1995/96 was in excess of ECU 17 billion. MCI's worldwide turnover for the calendar year 1995 was in excess of ECU 11 billion. BT's Community-wide turnover for the year 1995/96 was also in excess of ECU 17 billion. MCI is a US-based company, and its revenues are treated for accounting purposes as being earned in the United States. There are various possible approaches to the question of geographical allocation of turnover earned by telephone companies on international calls. The parties have provided figures based on different calculation methodologies. On all the variants proposed, MCI's Community-wide turnover in 1995 exceeded ECU 250 million. The parties do not achieve more than two thirds of their Community-wide turnover within one and the same Member State.

(9) Accordingly, the concentration has a Community dimension within the meaning of Article 1 of the Merger Regulation.

V. COMPATIBILITY WITH THE COMMON MARKET AND WITH THE FUNCTIONING OF THE EEA AGREEMENT

A. Relevant product markets

(10) In their submission the parties contended that there was virtually no horizontal overlap between BT and MCI, save in two areas: the market for services provided through the Concert joint venture; and audioconferencing. The market in which the Concert joint venture is active is the global telecommunications services market, supplying value added and enhanced services to multinational business users.

(11) The parties are both carriers in their respective domestic markets. This includes the following areas: domestic public switched voice services, enhanced value added services, private leased lines, and international telecommunications.

(12) Within these general areas several markets were identified by the Commission as being relevant for the assessment of the proposed merger, including international voice telephony services, value added and enhanced services, telex, audio and videoconferencing and calling cards. However, the subsequent inquiry has shown that on some of these markets the existing competitive conditions would not be affected to any significant extent as a direct result of the proposed operation, either because there would be no overlap between the parties' activities (telex and videoconferencing) or the overlap would be minimal (calling cards under a broad market definition). Although the market for value added and enhanced services has been defined in previous decisions as global (see part V.B — Relevant geographic markets), the possible competition concerns arising from the bringing together of the two companies' activities in this area were addressed in Commission Decision 94/579/EC

of 27 July 1994 relating to a proceeding pursuant to Article 85 of the EC Treaty and Article 53 of the EEA Agreement (Case IV/34.857 — BT-MCI) the initial BT/MCI Concert joint venture[3]. In any event this is not an affected market within the meaning of the Merger Regulation. Therefore this assessment focuses only on the markets for international voice telephony services and audioconferencing, where, according to the results of Commission's investigations, the merger between BT and MCI would have an impact on competition.

International voice telephony services

(13) Currently international voice telephony services are still mainly provided through the use of public switched networks in both the originating and terminating countries of a call. Interconnection between the domestic networks of any pair of countries is provided by the use of transmission capacity on the international facilities existing between the countries concerned. A preliminary question arises as to whether satellite and cable are substitutable networks for the purposes of delivering calls, or whether they should be regarded as separate. The parties in their submission have identified a number of ways in which satellite fails to provide a satisfactory substitute for terrestrial or undersea cable (for example, inherently greater signal propagation delay time, echo effects, susceptibility to environmental or climatic conditions such as heavy rain). These views have been confirmed by numbers of respondents, who said they did not regard satellite as a satisfactory substitute for cable. For these reasons it is considered appropriate for the assessment of the proposed merger to regard cable and satellite as not substitutable for the provision of international voice telephony services at the required standards.

(14) International direct dialled calls (IDD) still account for the largest share of international voice telephony services. IDD is an automatic method of making or receiving telephone calls over the public switched telephone network. Arrangements are made for the calls to be carried by international operators over the correspondent transmission facilities provided between them. Customers for IDD telephony services are either at the wholesale or the retail level. Wholesale customers are mainly telecoms companies who buy switched interconnection with international transmission facilities owned by existing facilities based operators. Retail customers are both business and residential end-users.

(15) International voice telephony services also are provided through the use of international private leased circuits (IPLCs) hired from facilities-based operators. IPLCs are thus another way in which international facilities are made available to customers. They are contracts for utilization of international transmission capacity on a purchase basis, typically by either telephone operators or retail business customers with high utilization needs. At present, IPLCs are provided and charged in half circuits. In the United Kingdom, BT or Mercury provide a UK termination, and a notional half of the international section, and a distant correspondent provides the other half-circuit and termination in its country.

Audioconferencing

(16) Audioconferencing is a liberalized service pursuant to Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services[4], as last amended by Directive 96/19/EC[5], and consists essentially of the supply of telephone conferences. It involves the use of a computer managed system (known as a 'bridge') in which telephone conversations with several conference participants are joined. The conference may be facilitated by an operator or set up automatically. The bridging equipment maintains audio volume and clarity and permits participants to be called into the conference by the conference operator prior to the conference ('call-out' conferences), or to call in at a pre-arranged time ('call-in' conferences).

(17) From the point of view of end-users, audioconferencing can be regarded as being a distinct relevant market. Possible functional demand substitutes (such as videoconferencing or the organization of meetings) are significantly more expensive and it is unlikely that users of audioconferencing services would switch to such alternative arrangements in response to a small but significant permanent increase in the prices for this service.

(18) The parties are both active in the provision of audioconferencing services in the United Kingdom. MCI, through its indirectly wholly owned subsidiary Darome Teleconferencing UK ('Darome'), provides audioconferencing services in the United Kingdom and, to a lesser extent, elsewhere in Europe.

[3] OJ L 223, 27. 8. 1994, p. 36.

[4] OJ L 192, 24. 7. 1990, p. 10.

[5] OJ L 74, 22. 3. 1996, p. 13.

B. **Relevant geographic markets**

International voice telephony services

(19) The parties are both active in the provision of international voice telephony services. Both are licensed to operate as international facilities operators in their respective countries and MCI has been recently granted an international facilities licence in the United Kingdom. Both own interests in transatlantic submarine cables. From the consumers' point of view, the relevant geographic market for international voice telephony services has to be defined with reference to call traffic routes between any country pair, since different international routes cannot be considered as viable demand substitutes. From the supply side, according to most of the operators contacted by the Commission, the possibility of hubbing, i.e. re-routing US-UK traffic through third countries, does not appear to be a viable commercial possibility at present, since under the existing system of accounting rates and proportionate return it would be more expensive than using direct routes. Furthermore, two distinct geographic markets can be identified within any international route, each comprised of the originating bilateral traffic from the countries concerned. Although some opportunities exist for customers to take advantage of price differentials between any pair of countries (for example through calling cards and callback services), for the time being these alternatives do not seem to represent a significant competitive constraint on domestic incumbent operators. Therefore the relevant market for the assessment of the proposed merger is the UK market for the provision of international voice telephony services on the UK-US route.

(20) The parties have provided maps showing existing transatlantic submarine cable capacity. According to those maps, there are five principal cables — TAT8, PTAT1, TAT9, TAT11 and TAT12/13 — which carry that traffic and which run between the United Kingdom and the East Coast of America. These are the cables identified as relevant to the assessment of the proposed merger.

Audioconferencing

(21) In their notification, the parties present the audioconferencing market at a national level, although they argue that the grographic scope of the relevant market is broader or moving to a broader scope. Responses to the Commission inquiry suggest that the market could in principle be regarded as national.

(22) According to market sources, the bulk of audioconferencing takes place within a national market. Customers tend to look for supplies primarily in the country from which they are operating, although there can also be international arrangements, in particular between the United States and the United Kingdom. The supply of audioconferencing services requires a dedicated sales force in the country where the service will be supplied. Customers do not generally purchase the service globally or internationally, even if an audioconference includes participants from different countries.

C. **Competitive assessment**

Market shares in international voice telephony services on the UK-US route

(23) With revenues from UK customers of ECU [. . .](6) million, BT accounts for [. . .](7) of the UK market for outbound IDD calls along the UK-US route. Mercury has [. . .](8) of the traffic and others (mainly resellers) account for [. . .](9). In terms of settlements paid by US correspondents on the US-UK route, BT's market share for inbound traffic appears to be even higher, with revenues of ECU [. . .](6) million, representing [. . .](7) of the market. Mercury, with [. . .](8), accounts for the remainder.

(24) In respect of IPLCs, BT has a market share of [. . .](7), with Mercury accounting for the remainder. These shares have been stable over the past three years.

(25) BT still also enjoys a very strong position in the domestic markets. BT's market share for national trunk amounts to some [. . .](10), with revenues of more than ECU [. . .](6) billion. For UK national private circuits, BT has a market share of [. . .](10) by volume, with Mercury having [. . .](9), and others accounting for the remainder. In respect of the local loop, BT, with revenues of ECU [. . .](6) billion, accounts for [. . .](10) of the market.

(6) In the published version of the Decision, some information has been omitted and some figures replaced by ranges, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.
(7) Between 50 % and 70 %.
(8) Less than 35 %.
(9) Less than 15 %.
(10) Over 75 %.

(26) The high market share of BT in the provision of international voice telephony services on the UK-US route, is underpinned by its current control of the local loop in the United Kingdom. Given the time leads and investments required for the development of local networks, BT's current dominant position in this market is likely to remain in place in the near future.

The accounting rate regime

(27) Currently, the bulk of international telephone calls are IDD. These are handled on a 'correspondent' basis, in which at least two international operators are involved in the process of originating and terminating (i.e. delivering) the call. The system for determining and settling the required level of payment between an originating and terminating operator for the exchange of international call traffic is known as the accounting rate regime.

(28) An accounting rate is a negotiated rate between international carriers, premised on the idea that the carriers jointly provide international telephone services by handing off traffic to each other at the half-way point between two countries. Therefore, an accounting rate is a specialized form of interconnection tariff, that treats international traffic differently from domestic traffic, in effect bundling the provision of an international half-circuit, the connection to an international gateway switching in the destination country, and the domestic termination of the call by carriers at each end.

(29) The accounting rate system was originally devised at a time when each country had a monopoly provider of international services. When the telecoms market in one country of a given country pair is liberalized, the problem then arises of redressing the balance of the relationship between the monopoly provider, and the suppliers of international telecoms services in the liberalized country. This is why regulatory intervention took place in the form of proportionate return and parallel accounting arrangements. Under the proportionate return rule any international carrier in the liberalized country that enters into an operating agreement with a foreign correspondent in a non-liberalized country should receive an allocation of return traffic from the foreign correspondent that is proportionate to the amount of traffic that the carrier sends outbound to the foreign correspondent. Parallel accounting requires that no carrier can agree with a correspondent on a termination price which is different from the price charged by the same correspondent to other competing carriers in the same originating country.

(30) The amount paid by the originating operator to the terminating operator for completing calls is usually half the accounting rate, and is known as the settlement rate. In practice operators set off the settlement rates they owe to each other, and if call traffic is in balance between the two countries concerned, very little money changes hands. But where the traffic flows are greater in one direction than the other — as it is currently the case between the United States and the United Kingdom, with more call traffic flowing to the United Kingdom than is returned in the opposite direction — net cash flows result. An operator who terminates more traffic than he originates will find his settlement revenues from the originating telephone operator exceeding the settlement costs he is obliged to pay out for the termination of his own outgoing calls.

(31) Over time the cost of international telecommunication has dropped, in recent years quite sharply, as a result of the reduced cost of both switching and transmission technology. However accounting rates generally have not fallen in line with the fall in underlying costs. Furthermore, collection charges on end users are still set high enough to cover all the notional settlement rate costs, despite these being well above the costs to the telecoms operators on each side of handling the traffic on the same route.

The new regulatory framework and its impact on the development of competition

(32) The proposed merger takes place in the context of a progressive move of many national regulatory regimes towards full liberalization of their telecoms markets. This process has been recently taken a stage further in the United Kingdom by the Government's decision to open up the international facilities market, followed by the issuing of 45 new international facilities licences (IFLs) in January 1997, many granted to US carriers, and by the removal of proportionate return requirements at the UK side. On the US side, according to the new rules recently laid down in the Flexibility Order of the Federal Communications Commission (FCC) ([11]), US carriers will be permitted to negotiate alternative settlement payment arrangements that deviate from the accounting rate regime with foreign correspondents in countries which satisfy the 'effective competitive opportunities' test (ECO) adopted by the FCC, or in any case where the US carrier can demonstrate that the deviation from the existing regime will promote market-oriented pricing and competition, while precluding abuse of

([11]) FCC's Fourth report and order in the matter of international accounting rates, adopted on 26 November 1996.

market power by the foreign correspondent. The new rules also provide that, in order to get the relevant FCC authorization, carriers who negotiate alternative settlement arrangements affecting more than 25 % of the outbound or 25 % of the inbound traffic on a particular route will have to demonstrate that the terms are not unreasonably discriminatory, or will have to offer such terms on a non-discriminatory basis to competing carriers.

(33) As a result of these regulatory developments, the option now exists for an international carrier licensed in both the United States and the United Kingdom of providing telephony services between these two countries on an end-to-end basis, by terminating calls at the foreign end of its own international facilities and getting direct access to the unbundled functions of the domestic network of the foreign country, as well as whatever facilities of its own it has established there.

(34) Although it seems reasonable to expect competition to develop further in the next few years on the route between the United States and the United Kingdom as a result of the new regulatory framework described above, there is still considerable uncertainty as to how and within what time-frame the market will actually move away from the existing regime of accounting rates to a system of genuine cost-based termination charges.

(35) In this respect, it is worth considering that the prevailing accounting rate regime provides incumbent telephone operators with very few incentives to move to genuine cost-based interconnection pricing. Present collection charges to end users reflect the whole notional settlement rate paid to a foreign terminating carrier, whilst settlement revenues from incoming traffic are not taken into account. Therefore, since accounting rates are still above cost, incumbent telephone companies earn significant net revenues from switched international traffic. On the US-UK route, this is especially true for UK incumbents, for whom the existing traffic imbalance with US carriers is such as to generate a volume of settlement inflows significantly larger than their settlement outpayments to US correspondents. However, even for US carriers who currently have a net outflow of settlement payments, the revenues from return traffic still leave them better off than they would be if collection charges to end users were to be based on the true costs of processing calls.

(36) Given the lack of incentives on current incumbents to move away from the accounting rate system, the growth of competition, at least in the short to medium term, is likely to depend to a large extent on the entry of new operators. However, some possible constraining factors, such as access to transatlantic transmission capacity, as well as domestic interconnection with transatlantic cable capacity and local loop termination at either end, appear to be of key relevance in this respect, and therefore have to be taken into account in the assessment of the proposed merger.

(37) During the investigation of this merger, a number of competitors have argued that equal access should be imposed in the United Kingdom as a condition of approval of the merger. Other competitors have expressed the opposite view arguing that the current system does not constitute a real barrier. Equal access implies that customers making international calls have to dial the same number of digits to select any long distance carrier. Under the current regulatory framework, BT would be the carrier selected by default, whereas customers need to dial additional digits to select any other carrier. The Commission has concluded that the notified merger itself has no impact on the possible difficulties competitors might have as a result of the UK regulations regarding numbering, which already existed before.

Capacity on transatlantic transmission facilities

(38) Existing transatlantic submarine cable capacity was largely developed by consortia of telephone operators, who each have percentage interests in the cable relating to their level of contribution to the costs of the venture. At the time of constructing the cable, each consortium member will purchase the capacity it requires (referred to as assigned capacity). However, a cable is usually built with spare capacity, and this is normally held in common reserve. Members of the consortium can have this capacity assigned to them, subject to the agreement of other consortium members, provided they pay the historic costs and maintenance and servicing charges in respect of the share they are acquiring.

(39) Capacity in the common reserve consists of whole circuits and is generally sold as such. However, the regulatory rules which, until recently, prevented a telephone operator from holding a facilities licence at both ends of an international cable, meant that whole circuits as such could be used only for transit. If a circuit were to be used for the direct exchange of bilateral IDD traffic over the public switched network, it was necessary to configure it in the form of a matching half circuit, that is to say, ownership of a whole circuit would be split 50:50 between the two facilities operators at each end of the cable. Each operator would have to be in possession of the relevant international facilities licence in the country from which he was operating. IDD traffic could then be exchanged between the two on a correspondent basis. As an alternative to outright ownership of half circuits (only possible for operators who were members of the original cable consortium) half circuits might be leased or assigned in the form of an indefeasible right of user (IRU — see recital 41). On the UK-US transatlantic route, a UK operator will own eastern half circuits (from the United Kingdom to mid-Atlantic) which are matched with western half circuits owned by a US operator. Whole circuits in the ownership of a single consortium member could be used for transit, or might be of value against the possibility of liberalization at the foreign end. Alternatively they might have been leased out as IPLCs.

(40) Once the cable is brought into service, it is usually impossible to enter the consortium on the same equity basis as the original participants. Any third party wishing to acquire access must obtain it from the existing incumbents. It has a choice of trying either to obtain access to circuitry already assigned to consortium members, or to capacity held in common reserve.

(41) In order to acquire already assigned capacity which has been configured as a matching half circuit, it is normally necessary to obtain the agreement from the owners of both ends of the relevant half circuit. Each half of the circuit can be leased out, typically for periods of about a year, but longer periods can be available. Alternatively the capacity can be assigned on an IRU basis for the life of the cable (IRUs are akin in many respect to ownership, but generally provide no equity in the cable, nor do they confer any vote on the relevant management committees for the cable). Where, as would normally be the case, each end of the circuit is owned by a different operator, it is normally necessary to get the consent of the owners of both ends before any one end of a matched half circuit can be assigned.

(42) Where a third party wishes to obtain access to capacity held in common reserve, it will need to intercede with one or more consortium members in order to get the capacity assigned to the appropriate member(s), at which point IRUs can be assigned to the third party. The mechanisms by which such decisions are made, or how prices and terms are agreed, are not fully transparent.

Availability of capacity on transatlantic cables

(43) As regards current ownership of transatlantic cable capacity, BT and MCI, together with AT&T, are among the largest owners on the cables identified as relevant to this assessment (see part B — Relevant geographic markets).

(44) The question of how much capacity is actually available to BT and MCI has proved complex. On both the eastern and the western ends of the relevant transatlantic cables, an important share of existing capacity is allocated to non-US or non-UK operators who are not licensed to provide voice telephony services on the US-UK route. Therefore, their capacity is currently used essentially for transit purposes (i.e. as an intermediate link for carrying traffic going to some other countries) on the basis of long-term contracts with their foreign-end correspondents, which in turn implies that non-negligible switching costs would have to be borne if this capacity were to be re-allocated to the UK-US route. On the basis of calculations made from figures provided by the parties, once these operators are left out of consideration, BT owns some [...](12) of total allocated capacity on the eastern end of the relevant transatlantic cables, MCI about [...](13), AT&T about [...](13) and Mercury about [...](13), whereas other US carriers such as MFS/Worldcom and Sprint would each have less than [...](13). On the western end, BT would be entitled to some [...](13), MCI about [...](14), AT&T about [...](15), MFS/Worldcom and Sprint each about [...](13), and Mercury about [...](13). These data imply that BT has the largest single share

(12) Between 40 % and 50 %.
(13) Less than 25 %.
(14) Less than 30 %.
(15) Between 40 % and 50 %.

of capacity on the eastern end, and MCI and BT together are the second largest owners on the western end.

(45) The parties have confirmed that if all BT-MCI matched capacity and all BT and MCI whole circuit capacity were combined, it would be possible to carry all of BT's and MCI's current US-UK traffic in both directions. They also say that other carriers, such as AT&T, have enough capacity to be able to self-correspond for the entirety of their current switched traffic on the US-UK route. They have however, argued that for a more appropriate calculation of their capacity entitlements along the US-UK route, it would be necessary to exclude capacity which they either currently use or have acquired for transit purposes (i.e. to carry traffic terminated by correspondents in countries other than the United Kingdom or the United States) as well as their capacity in cables which also land in countries other than the United Kingdom, as far as this capacity is assigned to different routes.

(46) All the relevant transatlantic cables also have landing points in countries other than the United Kingdom (such as France, Spain and Ireland) and circuits are usually bought for carrying traffic on specific routes. However, as confirmed by responses from major competitors, unlike other cables, circuits bought on TAT 12/13 for the US-France route could in principle also be utilized for US-UK traffic subject to the consent of consortium members, since the specific configuration of the cable (designed as a ring system between the United States, the United Kingdom and France) allows for traffic to be routed either way round the ring.

(47) The issue of transit capacity is more difficult since almost all of the parties' overlapping capacity is made up of whole circuits which have only recently been acquired on TAT 12/13 and hence are still unused. Therefore, unlike the transit capacity owned by non-US or non-UK operators, this capacity could in principle be allocated to the UK-US route without the parties having to incur significant switching costs. In any case, even if the capacity which the parties claim to be reserved for their transit needs was left out, if similar deductions were also made for the parties' major competitors on the UK-US route, the proposed merger would still result in an overlap of about [. . .](16) of the overall eastern end capacity (or 126 2Mbit circuits on an estimated total of [. . .](17) 2Mbit circuits), the overwhelming part of which is on TAT 12/13, significant enough to reinforce the already strong position held by BT.

(48) Furthermore, according to data provided by the parties, at the date of notification there was still sufficient unallocated capacity in TAT 12/13 to accommodate the needs of newly licensed operators in the United Kingdom. However, at the last allocation round in TAT 12/13, which took place in January 1997, BT and MCI, bought significant amounts of new capacity ([. . .](18) and [. . .](18) 2Mbit/s whole circuits, respectively). Other consortium members, such as AT&T, also bought capacity according to their percentage ownership in that cable. These acquisitions have been on a scale sufficient to provoke complaints from prospective operators (i.e. those who have recently been granted international facilities licenses in the UK) that there is now virtually nothing left for new operators on that cable. Indeed, only [. . .](19) of the design capacity of this cable (corresponding to about [. . .](19) of total capacity on all the relevant transatlantic cables) remains unassigned. However, currently outstanding request from consortium members on TAT 12/13, including BT and MCI themselves, greatly exceed the amount of this common reserve capacity making it even more difficult for new operators to enter the market.

(49) The parties contend that, irrespective of whether there is currently adequate spare capacity on existing cables, large amounts of additional capacity will soon be made available as a result of both the prospective upgrading of TAT 12/13 (which, by the introduction of new transmission technology, would double the system's current capacity) and the coming on stream of new cables, such as the planned Gemini cable venture between MFS and Cable & Wireless (which is expected to double the total existing transatlantic capacity).

(50) Notwithstanding expected new capacity developments, consortium members will still have options in the allocation of any extra-capacity resulting from the upgrading of TAT 12/13. Furthermore, since the additional capacity resulting from the upgrading of TAT 12/13 or the full entry into service of the new Gemini cable is not likely to

(16) Less than 15 %.
(17) Deleted. Business secret.
(18) Deleted. Business secret.
(19) Less than 15 %.

become available before the end of 1998, the question still remains as to whether it will be sufficient to keep pace with the continuing increase in demand. There is a general consensus that the demands on cable capacity are set to rise and some respondents expect that, due to the extremely high capacity requirements of the Internet community, and the large number of prospective new entrants following the forthcoming liberalization of European telecoms markets, even this additional capacity will soon be insufficient or, will at best, offer only temporary relief. It may be recalled that TAT 12/13 entered into full service only at the beginning of 1996, and that it took only six to nine months for requests for additional allocation from existing operators to exhaust virtually all of the remaining capacity available on that cable.

(51) Consequently, the entry of new facilities operators in the market for international voice telephony services on the US-UK route will to a large extent depend on whether and on what cost terms sufficient capacity will be made available to them by the incumbent carriers. As far as the parties are concerned, there are no specific obligations on them to release capacity and they could refuse, for example, if they felt they needed the capacity themselves.

Domestic interconnection with transatlantic cable capacity and local loop termination

(52) Any traffic carried on an international cable has to pass through the cable head facilities at each end in order to be terminated in the country concerned. Through backhaul facilities, international calls are run from the cable landing station to some suitable point of interconnection with a domestic network and then to a local network (the 'local loop') for final delivery.

(53) International calls are at present charged to corresponding operators according to the settlement rate system, where non-cost-based charges are agreed for terminating calls originating from abroad. This reflects the traditional market structure for international calls where nationally based monopoly carriers agree to terminate each other's traffic. In the United Kingdom the granting of 45 new international facilities licences should encourage competition in this area and a move to cost-based termination.

(54) The Community directives currently in force in this area (Directive 95/62 of the European Parliament and of the Council of 13 December 1995 on the application of open network provision (ONP) to voice telephony) [20] and Directive 90/388/EC set out specific rules to ensure that reasonable requests for interconnection are met on the basis of non-discriminatory, proportionate and transparent terms and conditions. Under those rules, Member States are to establish directly the necessary conditions and requirements for interconnection if commercial negotiations do not lead to an agreement within a reasonable period and they are to ensure that the cost accounting systems used by the operators with regard to the provision of voice telephony and public telecommunications networks identify the cost elements relevant for pricing interconnection offerings.

(55) BT is also obliged under its licence in the United Kingdom to publish separate accounts for its business activities (including interconnection services). It is also obliged to publish, amongst other things, its cost-oriented charges for interconnecting services and the costs from which such charges are derived. BT is currently obliged to provide other operators with access to cable landing stations and interconnection to its switched network, both at cost-based terms. BT is also subject to no-undue-discrimination and fair-trading conditions in its licence. Access to BT's facilities is therefore to be provided on the same terms to other operators as those on which BT provides access and services to itself.

(56) Oftel, the UK telecomunications regulator, currently sets the interconnection charges for BT services to other licensed UK network and ISR operators. Charges are set on a fully allocated cost basis. For the future, it is anticipated that, from October 1997, BT will set its own charges within a defined framework. BT's interconnection charges will be based on long-run incremental costs and, where there is no effective competition for services, will be subject to price caps. Oftel will set the initial rate which will be subject to a price cap reducing the real charge each year to reflect expected efficiency improvements. Under this framework, two baskets of interconnection services will be established. Call termination will be strictly regulated as a bottleneck service in separate basket. Other services, such as in-span handover and customer-sited handover, will be subject to their own separate price caps.

(57) In relation to backhaul, prices are based upon *droit-de-passage* prices which are comparable to the

[20] OJ L 321, 30. 12. 1995, p. 6.

prices offered for other inland private circuits. Separate prices have been offered for backhaul in the market for some months. Oftel is monitoring the prices offered by BT closely. The entrance of alternative backhaul providers in the market, such as Energis and MFS, makes it reasonable to expect that competition in the supply of these facilities will develop further in response to increasing demand from the newly licensed operators in the international voice telephony market.

Impact of the merger

(58) By bringing together BT's and MCI's cable capacity on the UK-US route, the merger would provide the parties with the possibility of 'self-corresponding', that is to say, they could carry their transatlantic traffic over end-to-end connections owned entirely by them. The merged entity would therefore be able to internalize settlement payments for all of the traffic which BT and MCI currently send to each other on a correspondent basis as well as to benefit from the more efficient use of transmission capacity which it would be allowed to use because of the time zone differences between the United States and the United Kingdom.

(59) This possibility of self-corresponding is not available at present to any other existing competitor on the UK-US route having a significant outbound traffic from the United Kingdom. Given their large traffic volume and the internalizing of settlement payments, the parties would have a cost structure not easily replicable by others. In its decision to open a second-phase investigation in the present case, the Commission had doubts that this possibility could lead to hubbing and traffic diversion on US-Europe routes in a way which could have weakened the competitive position of BT's competitors in the United Kingdom. The second-phase enquiry has shown, however, that the precise pattern of such traffic diversion would depend also on the reaction of competitors and therefore cannot be established with certainty. Moreover, since the undertakings submitted by the parties (see part VI below) will facilitate self-corresponding by other carriers, the issue of traffic diversion does not need to be analysed any further.

(60) In principle, any move away from the accounting rate regime to a system of cost-oriented termination charges is to be considered as a positive development of competition, provided that sufficient competitive constraints make it possible for consumers to benefit from lower charges. Given BT's and MCI's combined position on the UK-US cable capacity and BT's position in the generation of outbound traffic from the United Kingdom, the merged entity would be in a position to prevent other incumbents from providing end-to-end services for a significant volume of traffic. The merged entity could thereby prevent the development of a sufficient competitive constraint on the UK-US route for the expected benefits to be passed on to consumers of international voice telephony services in the United Kingdom.

(61) That is mainly due to the fact that, because of BT's dominant position in the market for international voice telephony services on the UK-US route, most of the US carriers' transatlantic cable capacity is made up of western half circuits currently matched with BT at the eastern end. BT's consent would thus be required in order for them either to obtain whole circuits by swapping part of their western capacity with BT's relevant half circuits, or to have their western half circuits matched with other UK correspondents. Since commercial agreements between capacity owners would have to be reached, the time required for any such reconfiguration would depend to a large extent on BT's willingness to cooperate.

(62) Furthermore, the existing accounting rate regime generates few incentives for all incumbent operators to move to cost-based termination rates because it allows them to earn significant revenues from setting collection charges to end-users higher than the true cost of processing calls. It seems therefore reasonable to argue that, in the market for international telephony services on the UK-US route, the pace at which competition can be expected to take place and benefits from lower provision costs to be passed on to consumers depend to a large extent on the entry of new international facilities operators. In order to gain market shares, they will have to offer attractive collection rates to customers and are likely to be more willing than incumbent carriers to by-pass the accounting rate system, either by trying to negotiate cost-based termination charges with foreign operators, or by finding ways of self-corresponding.

(63) Many of the new facilities licensees in the United Kingdom are already active in the business of international simple resale (ISR). They provide services, mainly at the wholesale level to domestic network operators and to large retail business customers, on authorized international routes (including UK-US), by hiring IPLCs from either BT or Mercury and carrying traffic on those lines. However, although the use of private circuits allows ISR operators to by-pass the accounting rate regime

and enables them to offer rates usually below those of incumbent facilities-based operators, IPLCs are only provided on a retail cost-plus basis, which makes them significantly more expensive than IRU capacity. Access to IRU capacity at reasonable terms and conditions thus appears to be an essential requirement for permitting the entry of the new IFL operators, and thereby the full development of competition on the UK market for international telephony services.

(64) As illustrated above, there is currently a capacity shortage on existing transmission facilities between the United Kingdom and the USA, as well as substantial uncertainty as to whether additional capacity on planned cables will be sufficient to accomodate the needs of a rapidly increasing demand. In this context, given the parties' capacity entitlements particularly on the UK end of existing transatlantic cables, the proposed merger, as notified to the Commission, would be likely to strengthen BT's dominant position in the market for international voice telephony services on the UK-US route.

(65) Such a reinforcement would result from the parties' increased control of cable capacities and from their unique position to self-correspond in a way which would not be available to their existing competitors. Furthermore, the combination of BT's and MCI's cable capacities would allow the merged entity further to restrict or control the entry opportunities for the prospective new operators. The notified merger would therefore enable BT to weaken significantly the development of effective competitive constraints on its market behaviour in the provision of international voice telephony services on the UK-US route. However, the undertakings submitted by the parties (see part VI below) to make available all their overlapping transatlantic cable capacity resulting from the merger and to ease self-corresponding by established competitors remove the competition concerns outlined above.

Audioconferencing

(66) BT and MCI, (the latter through Darome), compete in the United Kingdom in the supply of audioconferencing services. Darome also operates in the Community in Germany, France and Ireland. Darome's main revenues in the Community are generated in the United Kingdom. Darome also subcontracts services to Mercury, the revenues for which account for an additional [...](21) of the total UK market. The parties estimated that BT has a market share of about [...](22) in the United Kingdom and [...](23) in the Community as a whole. They estimate MCI's shares as [...](23) in the United Kingdom and [...](24) in the Community as a whole.

(67) The combined market shares of BT and MCI in the provision of audioconferencing in the United Kingdom present the following picture:

	1993	1994	1995
BT	(1)	(1)	(1)
MCI	(1)	(1)	(1)
Combined	(1)	(1)	(1)
Others	(1)	(1)	(1)
Market value (million Ecus)	(1)	(1)	(1)

(1) Deleted. Business Secret.
(*Source:* parties' notification).

(68) None of the other competitors account for a market share exceeding 10 %. The combined share of BT and MCI has been growing significantly during the last three years, reaching a level of [...](25) in 1995.

(69) The parties have stressed that those figures represent their best estimates, since reliable figures on total market are not available. Independently of the accuracy of the figures, it is clear that the notified merger leads to the combination of the two main competitors in this market, the remaining suppliers accounting only for a small fraction of the combined BT/Darome value sales.

Barriers to entry

(70) The parties have argued that the notified transaction does not create or reinforce a dominant position in the supply of audioconferencing services in the United Kingdom because the market is relatively immature and growing at high rates each year (the table in recital 61 shows that the market has almost doubled in the period 1993-95). This high growth should attract entry, in particular because barriers are relatively low. The parties have indicated in this respect that exclusive distribution does not play a

(21) Less than 15 %.
(22) Between 50 % and 60 %.
(23) Between 30 % and 40 %.
(24) Less than 25 %.
(25) Over 80 %.

significant role in this market; and that the investments necessary to start up an audioconferencing business are relatively low. Furthermore, they have indicated that the existing regulatory controls in the United Kingdom would prevent the merged entity from discriminating against potential competitors regarding terms for granting access to basic services.

(71) The Commission's inquiry has confirmed that the necessary investments to set up an audioconferencing business are limited. A small start-up company might have total fixed assets worth less than £ 1 million. In terms of equipment, basically a bridge is required, costing less than £ 500 000. For audioconferencing, there is no need for on-premises equipment at the customers' site. It has to be concluded that investment in equipment is not the main obstacle to entering the market.

(72) According to market sources, however, the fact that the audioconferencing market is expanding at high rates does not make entry easier. The market is growing basically by reason of increased use of audioconferencing services by established customers, rather than by reason of an increase in the number of customers. According to those sources, this renders entry more difficult, since the entrant has to make BT and Darome customers switch to a new, unproven supplier.

(73) If investment requirements are relatively low, barriers to entry might be important since audioconferencing is more software/service led than hardware/technology led. In this context, the reputation and proven record of incumbents might prove difficult to challenge, in particular since audioconferencing services typically represent only a fraction of the costs of the telecommunication services.

(74) Revenues from audioconferencing arise from invoicing the client for the service as such (managing and monitoring the audioconference by a service operator, typically the supply of minutes or tapes recording the audioconference) and for the call minutes used by the participants to the audioconference. The revenue arising from the minutes of traffic reverts to the telecommunication operator owning the lines over which the calls are made, and not to the audioconference service provider. This makes it more difficult for a new entrant to generate sufficient revenues to make entry attractive. Furthermore, the very strong position of a combined BT/Darome entity, accounting for about [. . .] [26] of the market, makes it more difficult for an entrant to generate the minimum revenue to be profitable.

[26] Over 80 %.

(75) It appears, therefore, that barriers to entry can be substantial and can effectively prevent entry at a sufficient scale to compete with a merged BT/Darome. The operation as notified, would then create or reinforce a dominant position in the provision of audioconferencing services in the United Kingdom. However, the undertaking submitted by the parties (see part VI), by which Darome will be divested, should effectively address the competition concerns outlined in the preceding paragraphs.

VI. UNDERTAKING SUBMITTED BY THE PARTIES

(76) In order to resolve the concerns raised by the Commission about the proposed merger's likely impact on competition, the parties have offered to enter into the following commitments:

'1. *Cable capacity between UK and US at the Eastern end*

The Commission's concern was that, in the context of the UK-US international direct dial ("IDD") and international private leased circuits ("IPLCs") services, there was a potential bottleneck on the eastern end of the transatlantic cables used to carry such services between the United States and United Kingdom.

In order to achieve clearance of the proposed concentration (the "merger") between British Telecommunications plc ("BT") and MCI Communications Corporation ("MCI"), the notifying parties undertake for 12 months from the date of the Commission's decision clearing the merger:

(a) that the number of circuits representing the parties' current "overlapping" (*) capacity as is designated to provide such services between the United Kingdom and United States will be made available without delay for sale on TAT 12/13 (either the eastern half or on a full circuit basis) on an indefeasible right of user ("IRU") basis to any new international facilities

(*) Overlapping capacity is the increment to eastern end capacity acquired by the merged entity as a result of the acquisition of MCI's capacity. Capacity terminating in the United Kingdom and used or designated for extension to third countries, or capacity terminating in third countries and not used or designated for extension to the United Kingdom, is excluded.

operators ("IFL operators") in the United Kingdom. (This applies to 126 2 Mbit whole circuits).

In the event that additional "overlapping" capacity is acquired from the currently remaining design capacity on TAT 12/13 that is to be allocated amongst co-owners in or about June 1997, the number of the circuits representing the additional overlap will also be made available without delay for sale on an IRU basis.

Circuits made available in accordance with this paragraph will be sold on a non-discriminatory cost basis agreed with the Office of Telecommunications ("Oftel"), i.e. based upon the sum of the capital cost of the capacity, interest and maintenance charges less BT's share of the TAT 12/13 consortium's profits made by selling the capacity at a price above its modern equivalent asset valuation. BT will apply this formula until such time as another basis may be agreed with Oftel.

The circuits referred to in this paragraph (a) will be offered for sale as a priority to UK IFL operators who are neither co-owners nor affiliated with a co-owner in TAT 12/13; and to UK IFL operators who are co-owners or affiliated with a co-owner in TAT 12/13 but whose existing ownership interest does not exceed 0,2 % of the design capacity of the system, on the understanding that this capacity is not designated for transit.

In the event that the offered capacity is not fully taken up by 31 December 1997, it will be made available to operators on a basis to be agreed with the Commission;

(b) to convert BT's UK/US IPLCs (eastern end half circuits) currently used for international simple resale ("ISR") into IRUs at the request of the ISR operator. (This applies to the equivalent of [. . .](27) half circuits).

BT undertakes to convert such IPLCs into IRUs in such a manner that ISR operators who become IFL operators will be in the same financial position as if their IPLCs had been scheduled to terminate on the date on which the conversion takes place;

(c) to sell to US correspondents or to their UK affiliates, at their request and without delay, eastern end matched half circuits currently owned by BT and used for the joint provision of IDD/IPLC service with these correspondents. (This applies to [. . .](28) half circuits); and

(d) upon request of the Commission, to submit a report on the status of the implementation of this undertaking (including the use of non US-UK capacity on TAT 12/13).

The transfer of eastern end capacity will be in accordance with BT's UK licence conditions and subject to the supervision of the UK's independent regulatory authority, Oftel.

2. *Audioconferencing*

The Commission expressed its concerns over the combined share that would result if the audioconferencing businesses of BT and MCI in the UK were to be merged.

The parties agree to arrange for the divestment of the audioconferencing business carried out by Darome in the UK (the "Business"), as a going concern, on the following basis:

(a) the parties shall, with effect from completion of the merger, use their best efforts to arrange the sale of the Business, at fair market value, including all its assets and intellectual property rights required for its current operations;

(b) the parties shall maintain the Business as a legally separate entity and shall operate it in a manner which enables it to maintain its viability, marketability and value pending its sale and final disposal;

(c) prior to the sale of the Business, the parties shall hold separate the Business from the audioconferencing business of BT in the UK. Structural changes to the Business, until the date of such sale, shall not be undertaken by the parties until two weeks after the parties shall have informed the Commission of any such proposed change and the Commission shall not have explicitly opposed such proposed change in writing;

(27) Deleted. Business secret.

(28) Deleted. Business secret.

(d) prior to the sale of the business, the parties ensure that the Business is managed separately from the audioconferencing business of BT in the United Kingdom, with separate management. The parties shall not appoint or second employees from BT's audioconferencing business to the management of the Business;

(e) the parties shall ensure that the audioconferencing business of BT does not obtain any business secrets relating to the Business;

(f) the parties shall, as soon as reasonably practicable after receipt of the Commission's decision clearing the merger, submit to the Commission a list of three nominations of accountancy firms or investment banks. One such firm or bank shall be appointed, subject to the approval of the Commission, as an independent expert. Such expert shall, if the Commission so requests, report to the Commission and the parties on whether or not the parties are complying with subparagraph (b) above;

(g) if, after [. . .][29] from the date of completion of the merger (the "first stage"), the Business has not been sold, the parties shall appoint, subject to the approval of the Commission, a trustee in relation to the Business (such trustee may be the expert appointed in accordance with subparagraph (f) above). The terms of appointment shall be such that the trustee shall use his best efforts to sell the Business at fair market value and such other terms as may be agreed between the parties and the Commission within [. . .][29] from the end of the first stage (the "second stage");

(h) if the trustee has not sold the Business in accordance with subparagraph (g) above by the end of the second stage, the trustee shall be obliged to sell the Business for the best possible price he is reasonably able to obtain within [. . .][30] from the end of the second stage. (The remaining terms and conditions of the trustee's appointment shall continue to apply.); and

(i) the parties or the trustee, as the case may be, shall notify the Commission in writing of the identity of the proposed purchaser of the Business. If, within 10 working days of receipt of such notification, the Commission has not informed the parties in writing to the contrary, the proposed purchaser shall be deemed to be acceptable to the Commission.

3. *General matters*

These commitments shall cease to have effect if the merger is not completed'.

VII. ASSESSMENT OF THE UNDERTAKING

Cable capacity between the United Kingdom and United States at the eastern end

(77) The commitments offered by the parties with regard to their current and prospective overlapping capacity on TAT 12/13 should be sufficient to allow for the entry of new IFL operators at prices corresponding to BT's true cost of purchasing capacity from the cable consortium. TAT 12/13 is the newest and largest transatlantic cable between the United Kingdom and United States and capacity on that cable is said to be much cheaper than the next cable in order of ascending cost on the same route. Furthermore, the parties' capacity on TAT 12/13 will be made available, on request, on a whole circuit basis, which is likely to ease the entry of prospective competitors, since they will not necessarily have to pay call termination charges to any correspondent on the other end, nor to persuade that correspondent either to offer cost-based termination rates or to sell to them IRUs on its matching half circuits.

(78) Many of the new facilities licence holders are already active as resellers. In recent years telecoms companies practising ISR have been the most effective competitive challenge to the BT-Mercury duopoly in the United Kingdom. However, resellers can only operate by hiring IPLCs from either BT or Mercury at retail prices, which inevitably limits their competitive impact on the market behaviour of incumbent facilities-based operators. At present they face the same problem as any new entrant seeking cost-based facilities, namely little available capacity, but their problem is exacerbated by the financial burden of existing IPLCs, which they must continue to pay for or face penalties for early cancellation. BT's commitments to allow ISRs to convert existing IPLCs to IRUs on the terms and conditions illustrated above should address the problem by enabling those companies to transform their leased lines to cost-based facilities networks.

(79) Finally, the parties' existing competitors could in principle decide to respond to the merger either by self-corresponding or by re-arranging traffic flows between themselves in order to keep up with

[29] Deleted. Business secret.
[30] Deleted. Business secret.

BT/MCI's enhanced competitive position. However, they may be prevented from doing this as long as many of the US carriers' existing half circuits remain configured with BT at the eastern end, as at present. It would be relatively simple, from a technical point of view, to reconfigure such circuits in order to have them no longer matched with BT, but this would require BT's consent, which might not be readily forthcoming. The alternative of acquiring new capacity would not be available until new cables came on stream. The offer to allow BT's US correspondents to reconfigure their half circuits currently matched with BT at the eastern end should increase the speed at which competitors can either get access to end-to-end transatlantic circuits in order to self-correspond themselves, or to change their own existing correspondent relationships on the UK-US route.

(80) The effect of the commitments submitted by the parties will be that (i) cable capacity will be made available to new entrants, and (ii) established incumbents which already have access to cable capacity will be in a position to self-correspond in the UK-US route if they so wish. Therefore, any reinforcement of a dominant position arising from the notified merger is effectively removed by the commitments.

Audioconferencing

(81) The parties' commitment to arrange for the divestiture of Darome implies that there should be no further concentration of supply of audioconferencing services in the United Kingdom arising from the notified operation, nor any addition of sales and market shares to the pre-merger position of BT's audioconferencing business in the UK.

(82) For these reasons the Commission considers that the parties' undertaking, provided it is properly discharged, should serve to address the competition concerns outlined above and ensure that the proposed merger does not result in a reinforcement of BT's dominant position in the market for international voice telephony services on the UK-US route, nor in the creation or reinforcement of a dominant position of the merged entity in the UK market for audioconferencing services.

(83) The Commission will monitor the implementation of that undertaking by requesting reports as and when appropriate in accordance with paragraph 1 (d) of the parties' undertaking.

VIII. CONCLUSION

(84) The concentration notified by BT and MCI on 18 December 1996 relating to the full merger between the notifying parties should be declared compatible with the common market and the functioning of the EEA Agreement subject to the condition of full compliance with the commitments made by the parties, in their undertaking to the Commission, in respect of their current and prospective capacity entitlements on submarine transatlantic cables and the Darome audioconferencing business, as set out in recital 76 of this Decision,

HAS ADOPTED THIS DECISION:

Article 1

The concentration notified by BT and MCI on 18 December 1996, relating to the full merger of their respective businesses, is declared compatible with the common market and the functioning of the EEA Agreement subject to the condition of full compliance with the commitments made by the parties, in their undertaking to the Commission, as set out in recital 76 of this Decision.

Article 2

This Decision is addressed to:

British Telecommunications plc
81 Newgate Street
London EC1A 7AJ
United Kingdom

and

MCI Communications Corporation
1801 Pennsylvania Avenue, NW
Washington, DC 20006
USA.

Done at Brussels, 14 May 1997.

For the Commission
Karel VAN MIERT
Member of the Commission