Non-confidential Version

FRANCISCO PARTNERS/GXS COMMENTS ON THE PROVISIONAL FINDINGS REPORT IN THE FRANCISCO PARTNERS/G INTERNATIONAL MERGER INQUIRY

1. Introduction

1.1 Francisco Partners and GXS welcome the Competition Commission's provisional findings that the merger has not resulted, and may not be expected to result, in a substantial lessening of competition (SLC) within any market in the UK for goods or services.

1.2 There remain, however, a number of areas where Francisco Partners and GXS consider that the provisional findings are inaccurate or fail properly to take account of evidence submitted to the Competition Commission by GXS and by third parties. These are set out in detail below.

1.3 Francisco Partners and GXS also believe that the conclusions set out in the note of dissent are based on a flawed assessment of the facts. The issues raised by the note of dissent are also addressed in the comments below.

2. Relevant Product Market

2.1 Francisco Partners and GXS are pleased with the conclusions reached in the Competition Commission's provisional findings that the market ought to be defined much more broadly than the supply of EDI VANs to include:

- point-to-point EDI using leased lines, and similar techniques;
- traditional EDI VANs;
- traditional EDI VANs accessed via the internet;
- internet EDI VANs;
- web EDI; and
- point-to-point internet EDI, including technologies such as AS2.

2.2 However, Francisco Partners and GXS are disappointed that the relevant product market, as framed by the Competition Commission, appears to exclude any e-marketplaces and Enterprise Application Integration ("EAI") software. The Competition Commission has not taken into account the competitive constraints exerted on GXS and other EDI communications services providers by certain e-marketplaces. Nor has the Competition Commission recognised that EAI software offers equivalent functionality to other forms of Internet-based point-to-point solutions and is used by a significant number of customers in this way.

e-marketplaces

2.3 With regard to e-marketplaces, the Competition Commission has provisionally concluded, on the basis of views submitted by competitors, that although e-marketplaces generally provide a wide range of capabilities, EDI messaging is not a major component of their offering and therefore e-marketplaces are not direct substitutes for EDI VANs but complementary. The conclusion which the Competition Commission appears to have drawn is in effect that because some e-marketplaces do not compete directly with EDI VANs, no e-marketplace offers a competing service.

2.4 Francisco Partners and GXS have already submitted evidence to the Competition Commission that amply demonstrates that although not all e-marketplaces are substitutable for EDI VANs, some such as Elemica, Exostar, SITA, GNX, Transora and Covisint offer precisely the same functionality to EDI VANs. A number of these e-marketplaces emphasise their ability to offer a traditional EDI style service in their marketing.

2.5 To the extent that the services offered by these e-marketplaces involve the transfer of transactional data between trading partners, they compete directly with EDI VANs and point-to-point solutions for certain types of transaction. GXS and other EDI VANs have lost a number of important sales opportunities to these e-marketplaces. Examples include: Vodafone, Boeing and General Motors.

2.6 Furthermore, where customers are using e-marketplaces for “value-added” services (e.g. data synchronisation), the transactional data that underlies these services will be transferred via the e-marketplace where it would formerly have been transferred via an EDI VAN or other form of EDI communication service. The competitive constraint posed by certain e-marketplaces is also evident from customers’ submissions to the Competition Commission. J Sainsbury, for example, states in its written submission to the Competition Commission that web-based products and B2B exchanges are supplanting EDI. It currently uses GNX (a web-based marketplace focussing on the retail sector) for the purchase of goods for resale in its stores. Although it states that it does not regard GNX as an alternative to EDI but rather as an alternative to traditional purchasing methods (e.g. conglomerate buying), the transactions effected via GNX would previously have been undertaken using an EDI VAN or point-to-point solution. GNX therefore acts as a substitute to EDI for at least some of J Sainsbury’s traffic.

2.7 As set out above, these e-marketplaces have taken significant traffic from EDI VAN and point-to-point solutions. Even if e-marketplaces are not formally considered to be part of the same relevant product market as other EDI communication services, certain e-marketplaces clearly constrain the behaviour of EDI communication services providers. The constraint that is imposed by at least some e-marketplaces needs to be taken into account in the overall assessment, whether within the market definition, or as competitive constraints from outside the relevant market.

Internet-based point-to-point solutions

Francisco Partners and GXS welcome the Competition Commission's provisional findings that point-to-point internet EDI, including technologies such as AS2, forms part of the relevant product market. Whilst not departing from its general conclusions on the scope of the relevant product market, there are three specific areas where Francisco Partners and GXS do not agree with the Competition Commission's conclusions

EAI Software

2.8 First, the Competition Commission has argued that Enterprise Application Integration (EAI) software should not be included within the relevant product market, because despite having some communications functionality, EAI is primarily aimed at conducting application interface and translation functions, and is generally not EDI-specific.

2.9 EAI software was originally developed to manage the transfer of data between applications within a business. However, as the number of businesses transferring data B2B electronically increased, particularly with the advent of the internet as a B2B communications medium, suppliers of EAI software have generally included the capability to transfer EDI data between enterprises within their EAI products.

2.10 Where EAI software is used to transfer data B2B, it operates in the same way and provides the same functionality as other internet-based means of sending and receiving data point-to-point i.e. (i) communication and security; (ii) translation; and (iii) application interface or user interface. Although businesses do not require EAI software in order to conduct point-to-point internet EDI, those that have purchased EAI software are able to do so.

2.11 Since EAI software performs precisely the same functionality as other internet-based point-to-point EDI solutions, it is unclear why the Competition Commission has excluded EAI from the relevant product market. Where EAI software has the capability to transfer EDI data, it clearly offers an alternative to EDI VANs. Moreover, it is indisputable that whenever EAI software is *actually* used for the purpose of transferring EDI data, it is acting as a substitute to EDI VANs and other alternatives for B2B communication. In this situation, it is irrelevant what is thought to be the "primary aim" of the EAI software – the fact of its use for transfer of EDI data confirms that it is a substitute for at least the subset of users that deploy it in this way.

2.12 Even if EAI is not considered to be part of the same product market as other EDI communication services, the ability of businesses to use their existing EAI software to transfer EDI data clearly acts as a constraint on the behaviour of EDI communication services providers. The constraint imposed by EAI software needs to be taken into account in the overall assessment, whether within the market definition, or as a competitive constraint from outside the relevant market.

<u>AS2 solutions</u>

2.13 Secondly, the Competition Commission has suggested that AS2 and other point-to-point internet EDI technologies may not be suitable for certain customers including smaller customers and those without an “always-on” internet connection. Francisco Partners and GXS disagree.

2.14 The Competition Commission argues that the ability to initiate a switch to AS2 or a similar technology is available only to a limited number of users, most notably larger retailers; a point which is also mirrored in the note of dissent (paragraph 5). Although a number of large retailers such as ASDA have been at the forefront of implementing AS2 and other point-to-point technologies, Francisco Partners and GXS have already provided the Competition Commission with numerous examples of companies in other sectors (including small retailers, manufacturers and other organisations) and Government adopting AS2 and other point-to-point technologies. These include the Wolseley Group, Pets at Home, the OFSCI initiative, and moves by the NHS and the UK Government more generally. This is also reflected in the AS2 and other point-to-point products marketed by software houses, many of which are tailored to meet the needs of small and medium sized businesses and their trading communities. As increasing numbers of suppliers become AS2 enabled following the initiatives of ASDA and other companies there is likely to be a domino effect.

2.15 The provisional findings (paragraph 5.54) and note of dissent (paragraph 5) state that the specific AS2 software for which a user licence was provided by ASDA to its suppliers cannot be used without purchase of additional licences to communicate with trading partners other than ASDA. The implicit conclusion that appears to be drawn from this observation is that the initial switch to AS2 by ASDA’s trading partners will not materially increase the ease with which those trading partners would be able in future to conduct AS2-based communications with other hubs. However, such a conclusion is not sustainable: although a small one off charge (approximately £400) would be payable by a company wishing to use the software to communicate with trading partners other than ASDA, the company would not need to install new software and will already be familiar with AS2. Therefore, the most important elements of an AS2 implementation will not have to be duplicated if the customer wishes to communicate with additional trading partners in this way. In practice, the small additional fee that would be payable will have at most a negligible effect on the user’s likelihood of switching to AS2 for communication with additional trading partners, once the initial implementation has been undertaken.

2.16 With regard to the need for an “always-on” internet connection, Francisco Partners has previously submitted data from British Telecom showing that broadband connectivity is now available throughout the UK[1] and that the use of broadband connections (which

[1] Broadband is now available to 99.6 per cent of UK homes, the same proportion that has running water.

allow “always-on” internet connection) now exceeds the use of traditional dial-up connection in the UK. The requirement for an “always-on” connection cannot therefore be regarded as an obstacle to AS2 implementation for the vast majority of potential users.

Insurance

2.17 Finally, and more specifically, the Competition Commission has also suggested that a move to AS2 or similar technology is unlikely in the personal lines insurance sector because of the difficulty in achieving an industry change from the current operating model based on EDI VANs and the unsuitability of point-to-point technologies for brokers, which are often very small businesses, unless supported by an intermediary (paragraph 5.56 of the provisional findings). These comments are echoed in paragraph 6 of the note of dissent.

2.18 There is no technical or economic reason why alternative technologies (e.g. point-to-point communications using AS2) are not equally feasible options in all market segments. As the third party submission to the Competition Commission from an anonymous insurer dated April 2005 notes, the Internet is already widely used within the commercial lines insurance sector. Nor is the small size of many brokers a sufficient reason to differentiate the personal lines insurance segment from any other part of the EDI communication services market. The small size of many of the suppliers to large retailers has not prevented a high proportion of those suppliers from adopting a point-to-point solution for the purposes of their transactions with ASDA.

2.19 With regard to the purported difficulty in achieving an industry change, Francisco Partners and GXS do not consider that the incentives to switch to new technologies differ fundamentally in this sector from those in other sectors. There are a number of very large insurers in the UK, such as Aviva and Royal and SunAlliance, who are in position to effect change. Transactions between insurers and brokers are generally paid for by the insurer. There is therefore a clear incentive for these large insurers to initiate switching to alternative technologies where this would reduce their costs.

2.20 With regard to the purported unsuitability of point-to-point technologies for brokers, there are numerous examples of internet-based technologies being used by independent mortgage and general insurance brokers and by financial advisers. An example of this is Marlborough Stirling’s “The Exchange”, an internet-based service which facilitates data exchange for financial services customers via “Exweb”, including insurance brokers through “Exweb Broker”.[2] Marlborough Stirling describes The Exchange as: “*an on-line portal delivering comparative quotations from life and pensions companies to almost 20,000 independent financial advisers. The service also*

---

[2] See: http://www.marlborough-stirling.com/channels/uk/the+exchange/default.htm

allows electronic submission of applications from independent financial advisers to purchase products on behalf of their clients and other value added features ". Easylink in its hearing with the Competition Commission also referred to at least one insurance provider that was considering AS2.

2.21 In any event, Francisco Partners and GXS note that the provisional findings do not express any concern over a potential lessening of competition in the personal lines insurance sector, despite the Competition Commission's views on the likelihood of switching to AS2 within that sector. Francisco Partners and GXS agree that, irrespective of the role of AS2 in the personal lines sector, continued competition is assured by the strong position of software houses (who control customer relationships) and their ability readily to obtain wholesale EDI VAN backbone services from numerous suppliers other than GXS or G International if the merged entity were to attempt any increase in prices.

3. Relevant Geographic Market

3.1 Francisco Partners and GXS are disappointed that the Competition Commission has provisionally concluded that at present the relevant geographic market is the UK because of supposed differences in prices, the fact that many European and US EDI VAN providers do not sell in the UK, and the existence of Tradacoms as a distinct standard in the UK.

3.2 Francisco Partners and GXS consider that the reasons cited by the Competition Commission to support this conclusion do not properly reflect the relevant evidence and that there is no reason to draw the geographic market as narrowly as the UK. The Competition Commission also appears to have given insufficient weight to other evidence – including the international footprint of suppliers and customer demand for international solutions – that supports a wider market definition. Francisco Partners and GXS also consider that the arguments put forward by the Competition Commission in favour of segmenting the market nationally ignore the clear evidence of supply side substitutability.

3.3 The vast majority of third parties who commented on geographic market, including both customers and competitors, agree that the relevant geographic market was wider than the UK, or indeed that the market is global.

3.4 At the very least, the CC should conclude that (a) any differences in competitive conditions between the UK and Europe are historical in nature and that there is clear evidence of convergence (e.g. on the basis of GXS' pricing); and (b) in any event, there are minimal barriers to geographic expansion into the UK for a supplier currently active in another geography.

Tradacoms

3.5 The Competition Commission argues that the pre-eminence of Tradacoms in the UK retail sector, combined with the fact that this standard is not used in any other countries, may act as a factor which distinguishes the UK as a separate geographic market.

3.6 The use of Tradacoms is a result of the historic development of the industry not because of any unique features of the UK. The standard is used predominantly in the retail sector and is in any event being replaced by the global EANCOM standard. Standards used in all other sectors are generally global.

3.7 The Competition Commission also states some degree of special configuration may be necessary in order to transmit messages in the Tradacoms standard, and that an EDI VAN designed to transmit messages based on other standards might need adaptation to supply services to UK customers. It is not necessary for an EDI VAN to offer a Tradacoms translation capability in order <u>to transmit messages</u> in Tradacoms format. Indeed, G International operated in this way, without a Tradacoms translation capability. As Francisco Partners has also stated, if a supplier did wish <u>to operate a Tradacoms translation service</u> only minimal reconfiguration of the VAN itself would be required, which could be achieved by purchasing and installing an off-the-shelf software product.

3.8 In any event, most EDI VANs will support all standards. Those who do not can be readily reconfigured to do so.

Pricing

3.9 The Competition Commission also suggests that price differences between GXS services in the UK, Europe and the US support its conclusion on geographic market definition. In particular, it notes that GXS charges the same list prices for certain cost elements of ICS in Europe as in the UK, but for other elements UK prices are higher.

3.10 As previously stated the evidence that Francisco Partners and GXS have submitted to the Competition Commission shows that prices are converging. The Competition Commission comments in paragraph 4.29 that "GXS charge the same list prices for certain cost elements of ICS…in Europe as in the UK, but for other elements UK prices are higher". This description does not accurately reflect the evidence provided to the Competition Commission. In particular, what is missing is any attempt to assess the significance of those elements that are the same relative to those elements are different. For the new bundled ICS pricing, the only material difference in prices (other than those due to exchange rate fluctuations and rounding) is in the cost of additional mailboxes. This is only a minor element in the overall pricing for the subset of customers who make use of it, and hence is an immaterial difference either from GXS' perspective or from any individual customer's perspective. For all intents and purposes GXS' new ICS prices are therefore the same across the whole of Europe.

3.11 With the exception of Easylink, the Competition Commission has also failed to consider whether the pricing of other operators differs between countries (see Francisco Partners' mark-up of paragraph 58 of the pricing working paper). Notably, G

International prices are set at a European level, including the UK (the only difference being due exchange rate fluctuations and rounding).

US and European Providers

3.12 The Competition Commission also states that there are few providers in common between different geographic areas. In particular it states that while GXS is present in many countries, only a very few of the other US companies are present at all in the UK. Elsewhere in Europe, it states that national telecommunications companies have large shares while BT is a significant, but small provider in the UK. However, this is largely an historic position. Today there are many competitors, including recent entrants, established on an international or global basis, reflecting the international footprint of their customers' trading communities.

3.13 As Francisco Partners and GXS have previously stated, all major global providers are already present to varying degrees in the UK market. This includes all of the major US EDI VAN operators (as the Competition Commission itself accepts – see paragraphs 5.7 – 5.11). With regard to Europe (including the UK), the incumbent telecommunications providers have historically provided EDI services within their respective geographies. Francisco Partners and GXS do not, however, consider that this historic factor should be determinative of the Competition Commission's conclusions on geographic market definition.

4. Assessment of the Competitive Effects of the Merger

4.1 As set out above, Francisco Partners and GXS welcome the Competition Commission's provisional findings that the merger has not resulted, and may not be expected to result, in a substantial lessening of competition within any market in the UK for goods or services. However, Francisco Partners and GXS have a number of concerns regarding the Competition Commission analysis of the competitive effects of the merger.

Market Shares

4.2 The Competition Commission has sought to estimate market shares based on revenues of the various providers of EDI communications services. For the reasons set out below, a number of problematic issues arise from this exercise, which in combination lead Francisco Partners and GXS to believe that the table at paragraph 5.17 of the provisional findings cannot give an accurate reflection of shares of supply within the relevant market. At the very least, Francisco Partners and GXS believe that the Competition Commission should explicitly acknowledge the limitations of the data it has compiled.

4.3 First, the total market value derived from these revenue figures by the Competition Commission is £25 to 30 million, which strikes GXS, based on its knowledge of the UK market and the revenue figures publicly reported by other suppliers of EDI communications services, as an underestimate of the total market size.

4.4 Secondly, as regards the revenues attributed to AS2 and other point-to-point solutions within the market share figures, Francisco Partners and GXS understand that the Competition Commission has simply attributed to these solutions revenues lost to these solutions by EDI VAN providers. This is highly unlikely to provide an accurate measure of the relative significance of those solutions, not least for the following reasons.

(A) By focussing only on revenues lost, the exercise misses in their entirety those new customers choosing an AS2 or other point-to-point solution in preference to other EDI communications services. The revenues attributable to these customers clearly ought to be included within the relevant market and attributed to the relevant solutions; and

(B) There is no logical basis for attributing the revenues that a former supplier derived from a customer relationship to any new supplier to that customer. That is particularly so when the market is characterised by suppliers with very different charging models. The on-going cost of using a third party service provider such as an EDI VAN and the one-off costs of installing a point-to-point solution, accompanied by some on-going internal costs are unlikely to be comparable[3].

4.5 Thirdly, it is implicit in the explanation provided by the Competition Commission as to the methodology underlying its calculation of market shares attributable to AS2 and other point-to-point solutions that it has taken into account only those revenues that traditional EDI VANs providers have lost as a result of a reduction in ASDA's traffic and that generated by its trading community. It is unclear why the Competition Commission appears for these purposes to have included only ASDA and its trading community. As set out above, Francisco Partners and GXS have already provided the CC with several examples of other companies that have adopted AS2 or other point-to-point solutions. Moreover, these estimates also appear to wholly ignore traditional point-to-point solutions, which are still extensively used by manufacturers and retailers and their principal suppliers. By way of example, J Sainsbury has stated that a point-to-point connection is generally used with its largest suppliers (see the published note of the telephone conversation between J Sainsbury and the Competition Commission). These estimates are therefore likely to underestimate significantly the importance of point-to-point solutions.

4.6 Fourthly there is no indication that web EDI has been taken into consideration in the estimates of market size.

---

[3] For this reason, GXS has previously stated to the Competition Commission that shares based on volume would be a more appropriate measure.

4.7 And finally, for the reasons set out above, certain e-marketplaces and users of EAI software should also be taken into account in any market share estimates.

Treatment of Resellers

4.8 Francisco Partners and GXS also consider that the Competition Commission's analysis of the role of resellers is confused. While in some parts of the report, the Competition Commission correctly recognises that resellers are significant independent competitors (at paragraphs 5.12 and 5.72, for example), the Competition Commission does not appear to have treated resellers as independent competitors when attributing market shares.

4.9 Resellers account for a very significant proportion of EDI VAN customers. As noted at paragraph 5.72 of the provisional findings, "resellers have strong relationships with their clients and are generally regarded by them as their EDI VAN providers". Contrary to the suggestion in paragraph 3 of the note of dissent, resellers and not backbone providers determine the prices paid by their customers for EDI VAN services. They are clearly, therefore, independent competitors and ought to be regarded as such when calculating levels of market concentration. At the very least, any full analysis of the relevant market would need to present and evaluate market shares at the end-user level – i.e. including re-sellers as suppliers – as an alternative to the market shares presented in the provisional findings, which are apparently based on a mixture of services at the end-user level and at the wholesale level (i.e. provision of infrastructure to resellers).

4.10 It is also unclear why software houses supplying the insurance industry have been treated separately from other resellers.

Market Expansion and Entry

4.11 The provisional findings state that there has been no substantial entry into the UK market in recent years. Francisco Partners and GXS consider that the Competition Commission has failed to take account of the significant evidence of entry and expansion in the EDI communication services market in the UK in the last few years by suppliers of newer technologies, in particular internet VAN providers, AS2 and other point-to-point software providers, and e-marketplaces.

Use of Multiple Connections and Switching

4.12 The provisional findings (paragraph 5.48) suggest that multiple connections are used as an alternative to interconnection and not as a means of switching traffic between providers, drawing this conclusion from the results of the Competition Commission's customer survey. The survey did not address the question of why multiple connections are used, and Francisco Partners is not aware of any evidence which supports the supposition that this is a result of a concern about interconnection. The fact that the figures cited at paragraph 5.36 relating to the number of customers not using interconnections and the number having multiple connections are broadly similar does not itself demonstrate a causal link (even if one takes the figures at face value, despite the limited number of responses to the survey). In fact, multiple connections permit easy and instant switching of traffic, without any switching costs, given the prevalence of interconnects. The use of multiple connections is therefore a factor that is conducive to competition, as previously submitted by Francisco Partners and GXS.

Assessment of the effects on competition in the EDI communications services market

4.13 The Competition Commission has provisionally concluded that, following the merger, certain groups of customers (large retailers, software providers to personal lines insurance brokers and resellers) appear to have viable alternative providers and the existence of these alternatives would be sufficient to ensure that the loss of IBM as a competitor would not have a substantial effect on competition.

4.14 For other, smaller customers the Competition Commission has suggested (paragraph 5.81) that there are limited options, but that given the limited pre-merger competition between GXS and G International for these customers the merger cannot be expected to have the effect of substantially lessening competition for these customers. Whilst not disputing that the loss of IBM as an independent competitor will not have any detrimental effect on the position of these customers, Francisco Partners believes that there are viable alternatives to GXS/G International for all categories of customer.

4.15 The relative importance of the various options may differ according to the size of customer. Certain resellers, for example, may be well placed to reach smaller customers, but less focussed on meeting the demands of larger customers. However, this degree of differentiation within the market should not detract from the conclusion that all customers, including small customers, will continue to have a sufficient number of viable alternatives to GXS/G International to ensure the continuing effectiveness of competition across the EDI communication services market (notwithstanding that the principal alternatives may vary across different groups of customers).

5. Conclusion

5.1 Subject to the comments set out above, Francisco Partners and GXS invite the Competition Commission to confirm its provisional findings in its final report.