
Completed acquisition by IBM United Kingdom of Schlumberger Business Continuity Services

The OFT's decision on reference under section 22 given on 6 August 2004

PARTIES

1. **IBM Corporation (IBM)** is a worldwide supplier of computer products (personal computers, servers, storage systems, software) and services (business consultancy and IT infrastructure services), including business continuity and disaster recovery services. In the year ending 31 December 2003, IBM's worldwide turnover was approximately \$89 billion. IBM's worldwide turnover in the area of overlap – business continuity and disaster recovery services (BCDR) – was approximately £[]m, around [] per cent of which was generated in the UK.
2. **Schlumberger Business Continuity Services (SBCS)** is the BCDR unit of **SchlumbergerSema**, itself the IT division of **Schlumberger Limited**, a U.S.-based global oilfield and information services company. In the year ending 31 December 2002, SBCS had UK turnover of approximately £[]m.

TRANSACTION

3. The UK business of SBCS was offered for sale by SchlumbergerSema by way of competitive tender, won by IBM's UK subsidiary, IBM United Kingdom Ltd. The statutory deadline is 7 August 2004.

JURISDICTION

4. As a result of this transaction, IBM and SchlumbergerSema's BCDR services have ceased to be distinct. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. A relevant merger situation has been created.

RELEVANT MARKET

5. The parties overlap in the supply of BCDR services in the UK.

Product market

6. The term BCDR services encompasses a broad range of business continuity solutions (such as IT outsourcing, hot-sites, cold sites, high availability services, quick-ship solutions, storage area networks, mobile recovery solutions and work group recovery sites) designed to ensure that businesses can continue to operate in the event of a disruption. BCDR services generally fall into two broad categories: (i) IT Disaster Recovery services (ITDR), which focus on dedicated hardware and software for backup and recovery of large and mid-range IT systems; and (ii) Business Continuity Services (BC), which focus on the provision of fully-equipped temporary office facilities and other business premises with the necessary equipment to enable staff to be relocated and business operations to continue with minimal disruption.
7. ITDR solutions vary depending on customer requirements. These are dictated by (i) the computer platform(s) used by the customer; (ii) the customer's degree of tolerance in relation to data loss and recovery time, and (iii) whether the customer requires dedicated disaster recovery facilities or would consider (cheaper) solutions shared with other customers. A hot-site is a fully-equipped and networked data centre available to customers in the event of IT disaster; it tends to be a more expensive solution meeting large-scale needs such as mainframe users, though such sites are frequently offered on a shared basis between customers to reduce costs; quick-ship services involve rapid delivery of IT equipment to a location after a disaster. While businesses often utilise a mix of solutions to meet varying needs, the solution must be tailored to their IT platform; a hot-site, for example, must replicate the exact platform environment (e.g. IBM z/Series mainframe) the customer uses and an alternative platform cannot be substituted.
8. *Distinctions within BCDR.* The parties contend that BC and ITDR are closely integrated solutions that are developed and usually sold together, with suppliers buying in services that they cannot provide in-house. In their view, customers purchase across a range of services and no clear differentiation was indicated either in terms of products purchased or categories of customer. In the OFT's view, while BC and ITDR may be complementary services, demand-side substitutability considerations do not support collapsing the distinction between them. As to differentiations within ITDR, there is support from third parties for the proposition that ITDR services form a continuum within which there are trade-offs between price, location, quality and speed of recovery, and whether the recovery facility is dedicated or shared.

9. *In-house supply.* The parties characterised internal solutions (i.e. in-house provision by the customer) as the major competitive constraint on BCDR suppliers, arguing that IBM's BCDR prices have dropped [] per cent in the 'work area' and 'mainframe' segments since November 2000 as a result of this pressure and competitive bidding by suppliers.
10. *Mainframe hot site customers.* Unlike other BC and ITDR segments, mainframe hot site customers face a substantially more limited choice of external suppliers – the parties and SunGard in relation to IBM mainframe platforms, and Schlumberger, SunGard and ICL/Synstar in relation to ICL platforms. Moreover, in contrast to the general views summarized above, certain respondents suggested that other ITDR (or BC) solutions did not represent competitive alternatives for mainframe hot site customers and/or customers for whom continued functioning of IT systems was mission-critical and thus required instantaneous and complete data recovery in event of disaster. The degree to which mainframe users had competitive alternatives to hot sites was critical in previous antitrust scrutiny of this sector. In late 2001, the U.S. challenged SunGard's acquisition of Comdisco, Inc., arguing that the merger substantially lessened competition – creating a duopoly with IBM – on a market defined as 'shared hot site services for customers with mainframe and midrange computer processing centers' in the United States.¹ The U.S. District Court ruled against the government on market definition, noting that it had not adequately justified its exclusion of internal hot sites and quick-ship solutions from the relevant market and thus failed to prove that there were 'a substantial numbers of [U.S.] customers for whom there were no competitive alternatives' to shared hot sites.²
11. Unlike the U.S. context, it is unnecessary here to reach a definitive view on the appropriate frame of reference, in particular as the transaction raises no significant concerns, confirmed by the general lack of UK customer complaint. Nonetheless, the above considerations do suggest that BC and ITDR are conceivable product frames of reference and dictate that careful attention be given to the transaction's impact on IBM mainframe hot site customers (IBM is not active in hot sites for non-IBM platforms). In-house supply as a constraint will be considered in the OFT's competitive assessment.

Geographic market

12. The parties state that all major suppliers are present throughout the UK and that many customers, particularly larger customers, contract on a national basis. As to ITDR, there has been no contrary evidence to suggest a frame of reference

¹ *United States v. SunGard Data Systems, Inc.* 172 F.Supp.2d. 172 (D.D.C. 2001) available at <http://www.dcd.uscourts.gov/01-2196a.pdf>, p. 15.

² *Ibid*, p. 38 and generally pp. 19ff.

narrower than UK-wide. Third parties were mixed in their response as to whether the location of their BC service is critical; such services may be thought to be more regional in nature given that they facilitate the continued working of employees. However, evidence indicates that customers are willing to travel significant distances in relation to BC sites, and a continuous chain of substitution may exist between overlapping geographic regions.

13. Accordingly, the relevant geographic frame(s) of reference is best viewed as UK wide, though narrower frames do not lead to a different conclusion in this case.

HORIZONTAL ISSUES

Market shares

BC and ITDR services

14. The parties will supply 15 per cent of all outsourced BCDR services postmerger, increment 5 per cent;³ other suppliers include SunGard (17 per cent) and Hewlett Packard (5 per cent); if in-house provision is included, IBM's postmerger share of supply is 8 per cent. The parties have not supplied share of supply data for ITDR or segments thereof; for BC their estimates relates to work area recovery capacity, for which the combined share is [40-50] per cent (increment [<2] per cent). Aside from mainframe hot site services (considered below), there are numerous suppliers in each segment and the share increments are likely to be small: as the parties point out, their activities are largely complementary, with [>75] per cent of IBM's revenue coming from ITDR and [>75] per cent of Schlumberger's from BC, a view supported by IBM's internal documents and customers. The parties' data on recent bidding also appears to show a lack of substantial head-to-head bidding competition and no customers raise concerns in relation to specific BC or ITDR segments.
15. A third party did raise concerns in relation to BC services in London, but on its own figures, the increment in share is 1 per cent, and other evidence suggests the parties' shares do not raise concerns.

IBM mainframe hot site services

16. The parties estimate that of the [] UK users of IBM's high-end enterprise servers, the zSeries, [<25] per cent use a recovery service offered by the parties; the

³ This estimate is based on IDC figures for 2002 and includes leading suppliers of outsourced BCDR services and smaller companies whose activities are primarily focused on BCDR consulting often to facilitate in-house solutions. Removing smaller companies would give the parties 26 per cent of supply of BCDR services (increment 9 per cent).

remaining customers source from SunGard or employ an internal solution. While it appears uncontested that SunGard is the leading pre-merger supplier of such services by some margin, share estimates vary, independent figures are not available, and these services are generally put out to tender. Thus, irrespective of the exact distribution of shares, the key question posed by the OFT is whether the merger raises concerns by reducing the number of external providers of hot-site services for IBM mainframes from three to two.

17. The weight of response from affected UK customers suggests Schlumberger has not been perceived, at any event in recent years, as a significant competitive constraint that would be eliminated by the merger; as such customers are not in the main unsophisticated, it is appropriate to accord their absence of concern considerable weight. One plausible explanation for the apparent lack of direct competition between the parties for mainframe hot-site contracts relates to the platforms supported. Unlike both IBM and SunGard, Schlumberger has hitherto supported only previous-generation 31-bit IBM mainframe platforms, while IBM's current generation of mainframe, the zSeries, employs 64-bit technology. A random sample of customers tended to support IBM's assertion that the segment is declining as most 31-bit customers will upgrade to 64-bit in the near future. While Schlumberger could be regarded as a potential competitor in 64-bit, it has not upgraded its hot-site offerings and there is no evidence to suggest that this potential amounted to a significant competitive constraint; on the contrary, its IBM mainframe customers account for only [> 10] per cent of its total revenue and it has lost several such customers annually.
18. Should IBM withdraw hot-site (among other forms of) support for 31-bit technology to increase migration to 64-bit systems, it is not clear that such a practice, reflecting technology markets, is related to the merger; in any event, SunGard is free to remain active in the supply of both 31- and 64-bit systems.
19. Some customers identified in-house supply as an option, but it is not clear for how many this would be true, whether switching would be sufficient to render a universal price increase by external suppliers unprofitable, and whether price discrimination would enable a profitable price increase against a subset of IBM mainframe customers unable or unwilling to switch to internal supply.
20. Customers did not raise any concerns about the merger increasing IBM's ability to price discriminate. In contrast, another respondent alleged that IBM's access to information about the sale of its hardware used in self supply gives IBM the ability to discriminate against customers who had not made such purchases and as such were less likely to self supply in response to a price increase. It is not clear that the merger significantly enhances any such potential, which presumably existed pre-merger and did not confer a leading pre-merger position on IBM among

external suppliers. Post-merger, customers continue to have the external option of SunGard to discipline any such conduct (while as noted, Schlumberger was not regarded as an important constraint).

21. In sum, while the relative weight that should be attached to the following factors is unclear, and may vary by individual customer, the following factors appear individually or in aggregate to be responsible for the general absence of UK customer concerns: (i) Schlumberger is a diminishing presence in this segment in the UK and was not an important competitive constraint pre-merger; (ii) two highly credible alternative bidders, SunGard and IBM, appear to be sufficient choice of external supplier; (iii) in-house supply is an option for at least some UK customers. In addition, it is conceivable that to the extent customers consider total lifecycle cost when purchasing an IBM mainframe, ITDR cost is a factor and an uncompetitive price on this aspect may contribute to switching to other platforms, though it is questionable whether this holds true when the ITDR component is a small percentage of total lifecycle cost.

Barriers to entry and expansion

22. The parties allege that barriers to entry in all segments are low. In ITDR services generally, the cost of hardware is declining and often shared, specialist software is not required and computer systems can be leased. There is evidence of new entry in recent years, particularly from telecoms companies. There has been no new entry in to mainframe hot sites over the past five years as this is a declining segment.
23. In the BC segment an entrant can easily obtain office space, desks, PCs and telephony equipment. Even where office space is in demand, customers seem prepared to travel significant distances to back-up sites. Aside from the mainframe hot-site segment, entry barriers for most BCDR segments appear to be low.

Buyer power

24. Third parties agreed that customers exercise leverage in price negotiations within BCDR as a result of the choice of suppliers and their ability to mix and match solutions from multiple vendors. As noted, choice of external supplier is substantially less in IBM mainframe hot-site recovery services but customers were generally unconcerned.

VERTICAL ISSUES

25. There are no vertical issues associated with this acquisition.

THIRD PARTY VIEWS

26. Customers, including customers of Schlumberger for IBM mainframe hotsite services, were generally unconcerned. Other third parties raised concerns addressed above.

ASSESSMENT

27. The parties overlap in the supply of BC and ITDR services. No substantiated concerns were raised in relation to BC services. As to ITDR, evidence suggests a general continuum of services across which there are trade-offs in price and quality; customers can switch between different services, and purchase a complete package of services from a variety of suppliers provided that they continue to meet their disaster recovery objectives. In addition, in-house provision of various such services is increasingly viable and the threat of firms switching to self-supply acts as some constraint on the parties. Third party inquiries did not elicit significant concerns in relation to ITDR or any segments thereof except IBM mainframe hotsite services.
28. It is unclear whether sufficient IBM mainframe hotsite customers in the UK have economic substitutes from among other ITDR services to render a price increase by one or more external suppliers unprofitable. It was unnecessary to take a firm view, however, as affected UK customers did not generally regard Schlumberger as an important competitive constraint lost through the merger. The above analysis considers in more detail various factors that may contribute to UK customers' general lack of concern.
29. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

30. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.