Summary of Commission Decision

of 5 March 2008

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

(Case COMP/M.4747 — IBM/Telelogic)

(Only the English version is authentic)

(2008/C 195/05)

On 5 March 2008, the Commission adopted a Decision in a merger case under Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, and in particular Article 8(1) of that Regulation. A non-confidential version of the full decision can be found in the authentic language of the case and in the working languages of the Commission on the website of the Directorate-General for Competition, at the following address:

http://ec.europa.eu/comm/competition/index_en.html

1. INTRODUCTION

1. On 29 August 2007, the Commission received a notification of a proposed concentration pursuant to Article 4 and following a referral pursuant to Article 4(5) of Regulation (EC) No 139/2004 ('the Merger Regulation') by which the undertaking International Business Machines Corporation ('IBM') acquires within the meaning of Article 3(1)(b) of the Merger Regulation control of the whole of Telelogic AB ('Telelogic') by way of purchase of shares.

2. After examination of the notification, the Commission concluded on 3 October 2007 that it raised serious doubts as to its compatibility with the common market and the functioning of the EEA agreement. The Commission therefore initiated proceedings in accordance with Article 6(1)(c) of the Merger Regulation.

2. THE PARTIES

3. **IBM** ('the notifying party'), a US company, is active worldwide in the development, production and marketing of a variety of information technology ('IT') products, software and services.

4. **Telelogic** is a Swedish company active in the development and sale of software development tools ([1]).

3. ARTICLE 4(5) REFERRAL

5. On 28 June 2007, the Commission received a referral request from the notifying party pursuant to Article 4(5) of the Merger Regulation. Since the notified concentration is capable of being reviewed under the national competition laws of 10 different Member States and no Member State expressed its disagreement with respect to the request to refer the case to the Commission, the decision concludes that it is deemed to have a Community dimension.

4. THE RELEVANT MARKETS

4.1. Relevant Product Market

6. The proposed transaction has an impact on the software development tools industry. Software development tools are used to create new and to develop existing software applications. Both IBM and Telelogic are suppliers of software development tools.

7. In a previous decision, the Commission left open the question of whether an overall market for software development tools exists, or whether distinct product markets within the area of software development tools have to be defined.

8. The decision concludes that the relevant product markets in which the proposed concentration might have a significant competitive impact are the following:

— the market for *Modelling tools*, whether or not this market is further subdivided between UML ([2]) and non UML tools, tools for IT applications and tools for systems software and for different customer groups,

— the market for *Requirements Management tools*, whether or not this market is further subdivided between tools for IT applications and tools for systems software and for different customer groups.

9. However, due to the heterogeneous nature of Modelling and Requirements Management tools the two product market definitions only can provide a broad framework for the competitive analysis of the proposed transaction.

([1]) Occasionally, Telelogic and IBM are collectively referred to as 'the parties'.

([2]) UML (Unified Modelling Language) can best be characterised as a general-purpose, open, and standardised modelling language.

4.2. **Relevant Geographic Markets**

10. The in-depth investigation indicated that, apart from language customisation, suppliers offer the same Modelling and Requirements Management tools throughout the world, and customers tend to buy the same products for their different divisions or business units regardless of their geographic location.

11. The decision leaves the exact definition of the relevant geographic markets open in the present case, as the conclusion of the competitive assessment remains unchanged under a worldwide or an EU-wide definition.

5. **COMPETITIVE ASSESSMENT**

12. The decision to initiate proceedings identified three theories of harm: (i) unilateral price increases; (ii) decreased incentives for innovation; and (iii) decrease in interoperability of software tools.

5.1. **Unilateral price increases**

13. For Modelling tools, the industry analyst Gartner estimates the parties' combined 'market share' at 68 % worldwide (IBM: 48 % and Telelogic: 20 %), and 69 % in Europe (IBM: 45 % and Telelogic: 25 %). According to corrected market share data submitted by IBM the merged entity would arrive at a joint worldwide market share for Modelling tools of [30-40] %.

14. For Requirements Management tools, Gartner estimates the combined 'market share' of the parties at 62 % worldwide (IBM: 25 % and Telelogic: 37 %) and 65 % in Europe (IBM: 22 % and Telelogic: 43 %). According to corrected market share data submitted by IBM, the merged entity would arrive at a joint worldwide market share for Requirements Management tools of [20-30] %.

15. While Gartner's estimates appear to be too large, IBM's estimates would not appear to be entirely correct either, as they underestimate the parties' own license revenues and overestimate the importance of small vendors. In the Decision, the Commission estimates the worldwide combined market share of the parties at [30-40] % for Modelling tools (or at [50-60] %, if only UML tools are considered), and at [20-30] % for Requirements Management tools.

16. However, given the heterogeneous nature of Modelling and Requirements Management tools caution is required when using market shares as a direct proxy for market power in the present case. In view hereof, the potential anti-competitive effects of the merger have primarily been assessed on the basis of an analysis of closeness of substitution.

17. An analysis of the functionalities of the respective Telelogic's and IBM's Modelling and Requirements Management tools confirms that significant differences exist between the tools of both companies. The specific qualities and functionalities of Telelogic's Modelling and Requirements Management tools make them more suitable for use by system customers than by IT customers. On the other hand, a comparison of the qualities and functionalities which are of particular interest to IT developers indicate the opposite: IBM's Modelling and Requirements Management tools are more suitable than Telelogic's tools for use by IT customers.

18. The differences in functionalities and commercial focus between Telelogic's and IBM's Modelling and Requirements Management tools are also reflected in the type of customers each of these companies serve. Telelogic's customers are primarily active in typical system sectors, such as aerospace and defense, communications and automotive sectors. IBM's customers are more concentrated in the IT, the financial and public administration sectors.

19. The in-depth investigation, which included the sending of three rounds of detailed requests for information, interviews with customers and competitors and an analysis of win/loss data, confirmed that Telelogic's Modelling and Requirements Management tools cannot be considered as close substitutes to IBM's Modelling tools.

20. Even if some customers would consider Telelogic's and IBM's offerings as (relatively) close substitutes for certain uses, the limited number of occasions in which this would be the case, would not allow the merged entity to increase prices post merger. There is a sufficiently large group of suppliers of Modelling and Requirements Management tools with functionalities close to that provided by IBM's and Telelogic's tools, which would render such a price increase unprofitable. The circumstance that a procurement decision (especially for big orders) is often taken on the basis of a tender-like procurement process implies that in such cases market shares of IBM and Telelogic play a less important role.

5.2. **Decreased incentives for innovation**

21. In the decision to initiate proceedings, it was noted that some customers voiced concerns that there would be less innovation as a direct consequence of the lack of effective competition in Requirements Management and Modelling tools after the proposed concentration. Therefore in the course of the in-depth investigation, the Commission has examined whether or not the merged IBM/Telelogic would have reduced incentives to innovate in comparison to the incentives of IBM and Telelogic separately (i.e. in the absence of the notified transaction).

22. The in-depth investigation revealed however that competition between IBM and Telelogic has not been a major driver for innovation in the recent past. Innovation in the software development industry has primarily been spurred by customer's needs as well as by improved standards for UML.

23. Further, as demonstrated above with respect to both Modelling and Requirements Management tools, IBM's and Telelogic's products are not close substitutes, as they generally address different types of customers and different types of needs. Therefore, the removal of the competition between IBM and Telelogic as a result of the proposed transaction would not result in the elimination of a major factor of innovation in the markets for Modelling and Requirements Management tools.

24. Therefore, the decision concludes that the proposed transaction is unlikely to reduce the pace of innovation in the markets for Requirements Management and Modelling tools in the near future.

5.3. **Decrease in interoperability of software tools**

25. The decision to initiate proceedings raised concerns that the merged entity would have less incentive to provide open interfaces that allow integration with third parties' software development tools. In particular, one competitor of the parties (Microsoft) advanced the argument that the merged entity would have the ability and the incentive to foreclose its competitors on the markets (or market segments) for Integrated Development Environments (IDEs) software, Software Change and Configuration Management (SCCM) tools, and Application Server Software Platforms (ASSP).

26. The decision concludes however, that the characteristics of the markets for Modelling and Requirements Management tools, especially for high-end tools in these two markets, rule out a successful foreclosure strategy. While it would be technically possible for IBM to obscure communication protocols and file formats to thwart interoperability with third parties' tools, the merged entity would have no incentive to engage in such a strategy, as the potential costs would far outweigh the potential benefits.

6. **CONCLUSION**

27. The Commission concludes in the Decision that the proposed concentration will not give raise to any competition concerns as a result of which effective competition would be significantly impeded in the Common Market or in a substantial part of it. Consequently, the Commission intends to declare the concentration compatible with the Common Market and the EEA Agreement, in accordance with Article 8(1) of the Merger Regulation and Article 57 of the EEA Agreement.