Office of Fair Trading

Completed acquisition by Thomson Reuters (Legal) Limited of the 'Abacus' Suite of products from Deloitte LLP

CR/58/09

The OFT's decision on reference under section 22(1) given on 17 December 2009. Full text of decision published 6 January 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Thomson Reuters (Legal) UK ('Thomson Reuters')** is a wholly-owned subsidiary of Thomson Reuters plc, a provider of information services to companies in the financial, legal, tax and accounting, scientific, healthcare and media industries. In the UK, Thomson Reuters supplies a number of tax accounting and compliance products. Its principal tax accounting product in the UK is 'TaxStream'. Its personal and corporate tax compliance products are its 'Digita' suite of products.

2. **The Abacus suite of products ('Abacus')** helps corporations and their advisers plan, comply and remit income taxes and value added taxes. Formerly owned by Deloitte LLP ('Deloitte'), the business surrounding Abacus is based in London and includes 40 employees that have now been transferred to Thomson Reuters ('Abacus business'). Abacus was formerly marketed and sold in the UK by Deloitte LLP and Sage (UK) Limited (pursuant to a non-exclusive agreement between Sage and Deloitte). Thomson Reuters advised the OFT that it intends to continue this non-exclusive agreement with Sage post-merger.

3. Abacus's UK turnover for the financial year ending 31 March 2009 was £[ ].

TRANSACTION

4. On 14 September 2009, Thomson Reuters announced that it had entered into an agreement with Deloitte to acquire the Abacus business for a consideration of £[ ]. The transaction was completed on 1 October 2009.

JURISDICTION

5. As a result of this transaction Thomson Reuters and the Abacus business have ceased to be distinct. The parties overlap in the supply of tax accounting and tax compliance software to small- and medium-sized enterprises (SMEs) in the UK, with a combined share of supply of [35-45] per cent.[1] The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is therefore met.

6. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

Product scope

Tax compliance software

7. Tax compliance software helps companies to calculate their retrospective tax liability and to comply with relevant tax reporting requirements. It is used both by corporations—where the tax compliance and reporting function is performed in-house—and accounting firms, where companies choose to out-source this function.

8. Thomson Reuters' 'Digita' software and Deloitte's 'Abacus' software are both tax compliance programs, however pre-merger the only customer overlap between users of these programs was in SME accounting firms.

[1] It is important to note that the 'share of supply' test is not a 'market share' test and the goods or services to which the jurisdictional test apply need not apply to the relevant economic market. In this case, and as discussed later, tax compliance and tax accounting software were found not to be in the same market.

The starting point for the process of market definition therefore begins with these customers.

9. The OFT considered whether it would be appropriate to include the supply of tax compliance software to larger accounting firms. However, market enquiries revealed that these companies tend to require software with substantially more functionality than smaller firms due to the greater number of clients they have and the greater complexity of the tax returns that they are required to file. Indeed, larger accounting firms surveyed told the OFT that software supplied by the parties to SME accounting firms would not be likely to be suitable for their needs.

10. Although some software developers said that it would be possible to develop software to service large accounting firms, others said that high customer switching costs (discussed later) meant that customers would be unlikely to switch away from their current provider in the event of a small but significant non-transitory increase in price (SSNIP). Similar considerations apply to large corporations.

11. The OFT also examined whether it would be appropriate to include SME corporations in the relevant market. Thomson Reuters advised that virtually none of the companies which supply tax compliance software to SME accounting firms also supply SME corporations, where Abacus and AlphaTax have most of the market.[2] The OFT understands that this is because SME corporations are generally much larger than SME accounting firms and therefore tend to require greater functionality in their tax compliance software.

12. That said, some software developers said that, although it would take some time, developers of programs targeted at smaller companies could add the functionality required by larger firms. However, as discussed later, high switching costs for larger companies mean that it may not be viable for these companies to switch in the event of a SSNIP.[3] Indeed, one market participant told the OFT that it may take only a few weeks to convince a small accounting firm to switch but that years of persistent effort may be required to convince a FTSE 100 company to do likewise.

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[2] Thomson Reuters submitted that Sage has a very small share of 'SME/other' corporate customers in the UK.

[3] Switching costs are discussed later at paragraphs 39 to 42.

13. In light of the above, the OFT considered the narrowest plausible candidate market was for the supply of tax compliance software to SME accounting firms.

Tax accounting software

14. Tax accounting software allows companies to manage their ongoing and future tax liabilities. Whereas tax compliance software is used to help companies calculate their retrospective tax liabilities and file tax returns, tax accounting software is used more for internal purposes such as earnings projections. Market enquiries indicated that tax accounting software differs substantially from tax compliance software, and has more limited functionality. Market participants were unanimous in advising the OFT that these products are not substitutable for one another.

15. While Thomson Reuters has a tax accounting product, 'TaxStream', Abacus was not supplying one pre-merger. As such, there is no pre-existing overlap in this area. Nevertheless, the OFT was made aware of conglomerate concerns that the merger may give rise to competition issues arising from the ownership of TaxStream and Abacus by one company.[4]

16. Market enquiries revealed, however, that companies have a number of options for their tax accounting needs. They can out-source to an accounting firm, they can use spreadsheet software or they can use a specialist program such as TaxStream.

17. On this basis, the OFT considered that the relevant market was wider than just tax accounting software, and also included general spreadsheet solutions such as Excel.

Geographic scope

18. Thomson Reuters supplies its tax compliance offering, Digita, throughout the UK, and Abacus is also used by customers throughout the UK. Thomson Reuters submitted that although tax compliance regulations vary from country to country, there is no regional variation and therefore the relevant tax compliance software market is national. Market enquiries did not reveal any evidence to suggest the market was anything other than

[4] See paragraphs 27 to 36 for discussion of conglomerate issues.

national: there is no evidence of regional pricing and all competitors compete on a national basis. The OFT therefore considered the market to be at least national, although it did not need to conclude on the precise scope.

19. As with tax compliance software, there did not appear to be any elements of local competition in the tax accounting software market. Indeed, given market enquiries revealed that spreadsheet programs such as Excel – which are used throughout the world – were a viable option for many companies, the OFT considered the market may well be wider than the UK. Nevertheless, given it does not affect the analysis, the OFT did not need to conclude on this.

HORIZONTAL ISSUES

Supply of tax compliance software to SME accounting firms

20. On the narrow candidate market for the supply of tax compliance software to SME accounting firms, Thomson Reuters estimated it has a combined post-merger market share of approximately [10-15] per cent. However, Thomson Reuters submitted that the apparent overlap between Digita and Abacus pre-merger was in fact between Digita and the Abacus 'white label' products supplied by Sage. Under the terms of the reseller agreement, Sage sets the licence fee paid by customers and Thomson Reuters receives a royalty of [ ] per cent of all revenues from Abacus. As such, Thomson Reuters submitted that all the revenue from the pre-merger sales will not be internalised post-merger, implying that its market share of [10-15] per cent post-merger over-states its competitive position.

21. While a post-merger market share of less than 15 per cent would ordinarily not be expected to indicate horizontal issues arising, the OFT nevertheless considered evidence on competitiveness of the market to verify this.

22. Thomson Reuters also submitted tender data for all bids won and lost in 2008 and in 2009 to date in support of the proposition that Sage and Digita were not close competitors pre-merger. According to this data, of the business that Thomson Reuters bid for but lost, most went to [ ], followed by [ ] and [ ].

23. Market enquiries supported Thomson Reuters' views. Customers and competitors surveyed indicated that, in the supply of tax compliance software to SME accounting firms, Iris is the market leader. Thomson Reuters estimated that Iris has a market share of approximately [60-65] per cent, although estimates from third parties were lower (not exceeding 50 per cent). The other major supplier to this segment identified by third parties is CCH, and the OFT understands there are a number of smaller players—for example, 14 are listed on the HMRC website—that supply tax compliance software suitable for SME accounting firms.

24. Evidence was also received indicating that the market is very competitive, with customers being able to secure price and term improvements by operating competitive tender processes. Some customers indicated they had been able to secure substantial savings by 'playing off' competitors, including Digita and Sage, against each other. Overall, customers considered they would continue to have ample choice post-merger.

25. Finally, the OFT considered what implications, if any, Thomson Reuters terminating the Abacus re-seller agreement with Sage would have for competition. As noted above, Sage sells Abacus 'white label' as part of a suite of products to SME accounting firms. Sage said that it had a number of options should Thomson Reuters terminate the agreement: it could develop its own tax compliance software (which it previously supplied to customers), acquire a company which owns a tax compliance solution or partner with one in a joint venture.

Conclusion

26. In light of the above, the OFT considered Thomson Reuters is likely to continue to face sufficient competition from other suppliers of tax compliance software post-merger.

CONGLOMERATE ISSUES

27. Conglomerate concerns can arise in mergers where the merged firm can foreclose competition by tying or bundling products together, for example so that it can offer 'must have' products or a unique range of products that give it market power via its portfolio.

28. As a pre-condition to such foreclosure, the merged entity must have market power in at least one market that can be leveraged into another and there must be a large enough common pool of customers for the bundled or tied products. Given his ability to foreclose, the OFT will examine whether there is an incentive to foreclose and whether foreclosure has anti-competitive effects (recognising that bundling and tying of complementary products can often be pro-competitive).

29. The OFT received a complaint from one firm suggesting that the merger would raise competition concerns of this type, arising from Thomson Reuters' joint ownership of its tax accounting software, TaxStream, and Abacus post-merger.

30. According to the complainant, customers are increasingly demanding an integrated solution for their tax accounting and tax compliance needs and the merger would allow Thomson Reuters to market such a solution to Abacus' existing customer base (where it has approximately [40-45] per cent of the corporate market, according to Thomson Reuters). The concern is that these customers will take this combined product and then be 'locked in' to using Thomson Reuters as the costs of switching away from such a bundle would be prohibitive. This would also foreclose rival companies seeking to develop and market a similar bundle in future and therefore result in a substantial lessening of competition.

Ability to foreclose

31. Thomson Reuters told the OFT that its tax accounting product, TaxStream, was only launched in 2008. Although it is expected to increase its sales revenues in 2009, market enquiries revealed that companies have a range of options for their tax accounting needs (see paragraph 16). As such, the OFT is satisfied that Thomson Reuters does not have market power in tax accounting software. Consequently, the OFT assessed whether Abacus had market power in tax compliance software that it could leverage into tax accounting software.

32. As discussed earlier at paragraphs 20 to 26, above, Abacus and Thomson Reuters overlap only in the supply of tax compliance software to SME accounting firms and the merger does not create market power there. However, Abacus is used by a significant number of large corporations in the UK. According to Thomson Reuters, it is used by [50-55] per cent of

FTSE 100 companies, [20-25] per cent of FTSE 250 companies and [40-45] per cent of SME or other corporations. Some of these shares are at a level that may, at face value, indicate the existence of market power (albeit market power that is not enhanced by the merger).

33. However, Abacus' main competitor for these larger customers is AlphaTax, which supplies virtually all the remaining companies that Abacus does not supply. Customers surveyed indicated that there is competition between the two and that they have been able to play the two off against each other to obtain better contractual terms. As such, the OFT was satisfied that Abacus is not a 'must have' product.

34. Neither did the OFT's market enquiries support the idea that there is a large pool of common customers for tax compliance and accounting software that Thomson Reuters could bundle its products to, post-merger. Indeed, a number of companies surveyed, particularly large ones, tended to exhibit a desire for 'best in breed' solutions, partly to avoid reliance on one supplier. Some smaller market participants also advised that manually re-keying data into different software packages allowed the data to be re-checked for accuracy.

35. On this basis, the OFT does not believe there to be a realistic prospect that Thomson Reuters would have the ability to foreclose competitors post-merger. Given this, it is not necessary for the OFT to examine its incentives to foreclose nor the likely competitive effects, if any. Notwithstanding this, some market participants could see value in an integrated tax accounting and tax compliance solution.

Conclusion

36. In light of the above, the OFT did not consider there to be a realistic prospect that competition concerns of a conglomerate nature may arise as a result of the merger.

Barriers to entry and expansion

37. Market enquiries revealed that the two key barriers to entry and expansion are the time taken to develop software, and overcoming customer switching costs (that is, establishing a reputation).

38. Software developers said that it was relatively easy to develop tax compliance software. For example, one competitor advised that it could develop a new program in under a year if needed. Similarly, another competitor, whose clients are SMEs, indicated that it could expand its service offering to suit larger clients should the need arise. The process would involve adding additional functionality, or 'modules', required by larger firms such as group tax functionality.

39. Nevertheless, there was virtually universal acceptance of the proposition that customer switching costs are a significant barrier to entry and expansion. Customers surveyed indicated that there are major costs involved with switching suppliers. Depending on the size of the company, market enquiries revealed it can take anywhere from a couple of weeks to six months or more to transfer over the relevant data from one system to another. While some competitors indicated that they have software that facilitates switching from their competitors, a number of customers advised that switching is difficult because it involves a lot of manual keying of data.

40. Market participants also told the OFT that the financial cost of purchasing a new software package can be up to five times the annual licence fee. In addition to this, there is also the labour costs associated with transferring data.

41. Finally, customers indicated that the disruption caused by switching also makes it unattractive. For example, one large company said that, were it to switch suppliers, the process would need to take less than two months to ensure the new system was ready in time to file the next quarterly returns. Indeed, it said that one of the key reasons why it would not consider switching to companies which supply software to SMEs was because these companies did not have the resources to complete the switching process fast enough. Market enquiries indicated that the time, cost and level of disruption tends to increase proportionately to the size of the customer.

42. In light of the above, the OFT considered that barriers to entry and expansion to supply small firms were likely to be relatively low, with moderate barriers for supplying SMEs and high barriers to supplying large firms. Nevertheless, given Thomson Reuters is likely to face sufficient in-

market competition post-merger, the OFT did not need to conclude on this point.

THIRD PARTY VIEWS

43. Most market participants did not raise any concerns with the merger, with most of those surveyed indicating that Digita and Abacus were not especially close competitors pre-merger. Although Sage was identified as a competitor to Digita, market participants identified Iris as the market leader and CCH also as a competitor for SMEs. A number of other, smaller companies were also named.

44. The OFT received one complaint suggesting the merger would allow Thomson Reuters to raise barriers to entry and foreclose competitors by offering a bundled tax accounting/tax compliance solution.

45. Some market participants submitted that they thought the merger may have pro-competitive effects, as it would allow Thomson Reuters to market Abacus to accounting firms. Having previously been owned by Deloitte, market participants suggested that other accounting firms did not use Abacus because they did not want to purchase software from a competitor.

ASSESSMENT

46. Pre merger, Thomson Reuters' 'Digita' product and Deloitte's 'Abacus' competed in the supply to SME accounting firms of tax compliance software.

47. The OFT considered the narrowest plausible candidate market in this case to be the supply of tax compliance software to SME accounting firms, but did not need to conclude on this point. Given conglomerate concerns were raised by one market participant, the OFT also considered the effects on tax accounting customers more widely.

48. The only overlap between Thomson Reuters and Abacus was in the supply of tax compliance software to SME accounting firms, where Thomson Reuters' Digita and Deloitte's Abacus had a combined market share of approximately [10-15] per cent. This was an indirect overlap, however, as

Abacus was supplied to these customers, pursuant to a reseller agreement, by a third party, Sage.

49. Market enquiries indicated that the merged entity is likely to continue to face significant competition in the supply of tax compliance software to SME accounting firms, with the vast majority of customers identifying Iris as the market leader, with CCH also likely to provide an effective constraint and Sage continuing to be partly independent of Thomson Reuters. Evidence received during market enquiries suggested that customers are able to negotiate better prices and contract terms by playing suppliers off against one another.

50. One market participant suggested that the merger may allow Thomson Reuters to offer bundled tax accounting and compliance software, foreclosing competition. However, the OFT found that Thomson Reuters did not have sufficient market power to give it the ability to foreclose in this manner.

51. Market participants identified software development and switching costs (reputation) as the major barriers to entry. Switching costs were likely to be more significant for larger customers.

52. 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

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