Anticipated acquisition by Adobe Systems, incorporated of Macromedia, inc.

The OFT's Decision on reference under section 33 given on 16 November 2005. Full text published 9 December 2005.

Please note that square brackets indicate information that has either been excised or replaced by a range at the parties' request.

PARTIES

1. Adobe Systems Inc. (**Adobe**) focuses on software for desktop publishing ('DTP') such as the design and editing of printed material intended for publication. It is perhaps best known for its Portable Document Format (PDF) technology. More generally, it produces a range of products which enable customers to create, manage and deliver visually rich content.

2. Macromedia Inc. (**Macromedia**) centres its activities on the World Wide Web and its key software products are in this area. It is best known for 'Flash', an application development tool for the creation of rich Internet applications and content. Generally, it provides software that enables the development of internet solutions. Macromedia's UK turnover for the year ended 31 March 2005 amounted to [<£70] million.

TRANSACTION

3. Adobe intends to indirectly acquire Macromedia via its wholly-owned subsidiary Avner Acquisition Sub Inc. Under the terms of an agreement entered into on 17 April 2005, Avner and Macromedia will merge, after which Avner will cease to exist and Macromedia will become a wholly-owned subsidiary of Adobe. The transaction is valued at approximately US$3.4 billion.

4. The Antitrust Division of the Department of Justice (DoJ) has announced its clearance decision with regard to this transaction on 14 October 2005. The Spanish Competition Authority has cleared the merger on 10 November 2005.

The transaction is currently also being investigated by the competition authorities in Germany and Portugal.

5. The OFT's extended 40-working-day administrative timetable expired on 7 November 2005.

JURISDICTION

6. As a result of this transaction Adobe and Macromedia will cease to be distinct. The parties overlap in the supply of various computer software products. On the basis of information provided from the parties, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) appears to be met in respect of drawing & illustration software (with a combined UK share of supply of [60-70] per cent in 2004). The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

Product market

7. The parties both produce a range of computer software which allows text and images to be published either in print or on the web. This software is available as stand-alone products or packaged into integrated suites. The parties differ considerably in their focus, with Macromedia concentrating on the web and Adobe concentrating on desk top publishing (DTP). The investigation revealed that software products in this area are generally differentiated, with each product aimed at different customer needs. However, as a starting point it was considered that there may be an overlap in the following areas:

    - web design and development software (WDD), which allows users to create websites, based on appropriate internet industry standards such as HTML

    - drawing and illustration software (D&I), generally used to create images on a PC, using mathematical 'vector-based' technology

    - digital imaging software (DI), which is used to edit existing images using bitmap or 'raster-based' technology comprised of pixels.

8. Macromedia is particularly prominent in the WDD segment, and Adobe in the D&I and DI segment. Adobe's tools are primarily aimed at 'creative professionals' such as graphic designers and photographers, where as Macromedia's tools are aimed at professionals web developers

9. The relevant frame of reference could therefore be considered as individual market segments (as above) or on the basis of software suites which combine several of these individual software products into one package.

Demand- and supply-side substitution

10. Demand-side substitution may be limited even *within* the broad functionality-defined market segments outlined above. This is because users rarely switch between products, preferring to work with tools they are familiar with, have trained on, or which other industry professionals also use. In general, there is a tendency for professional users to converge on a single product, which becomes the 'industry standard'. Other tools within the same segment may be differentiated in terms of their target audience (e.g. professional/amateur) or intended use (for example, some products may be better for high-level tasks and others more suitable for straightforward tasks). This is reflected by the purchasing practices of many customers, who buy more than one product with the same broad functionality. Some third parties have suggested, however, that perceived differences between tools may be simply a matter of personal preference rather than any innate difference in the functionality.

11. Demand-side substitution from tools outside the broad functionality-defined market segments outlined above is limited. It is not, however, impossible, as our investigation revealed that customers sometimes use tools for functions other than their primary use. The parties also claim that open source software and freeware constitute competitive constraints, particularly in the WDD market segment. Open source software allows access to its source code, which enables users to further develop the software and benefit from software updates free of charge. Freeware is programming that is offered at no cost. However, there was a general consensus amongst third parties that these products do not offer a viable alternative (at least at present) and are not, generally, appropriate for professional use.

12. At present, many customers mix-and-match products from different suppliers, taking a 'best-of-breed' approach. However, some software is only available as part of a suite, and third parties also suggested that it is desirable to purchase tools from the same software company to reduce overheads and increase interoperability. Third parties suggested that interoperability is increasingly important and internal documents from the parties suggest the potential for enhanced interoperability between the different software tools was a major motivation for the merger. This suggests that it may be appropriate to consider the impact of the merger on competition between software suites as well as on competition between individual products within a functionality segment.

13. Supply-side substitution by software providers active outside the functionality defined market segments outlined above may also be possible. Within a market segment, existing players may be able to reposition their products to compete more closely with other products. Supply-side substitution or repositioning may be hindered by low levels of switching, R&D costs and branding. However, these barriers to entry may be less relevant to existing players seeking to re-position themselves, or for product innovations which offer a substantial improvement over existing products. The market evolution could be characterised by software producers competing to become established as the industry standard in each new market segment and then encouraging migration to that 'standard'.

PC- and Macintosh users

14. Different versions of software products are often required for PCs and Macs, and it may be relevant to consider these market segments separately. Indeed, not all producers (most notably Microsoft) will necessarily make both Mac and PC versions of their products. However, the parties themselves do produce both Mac and PC versions of their products, and state that [the majority] of the overall software developments costs are non-platform specific, i.e. adaptation costs for a specific platform account for [less than 50] per cent. The parties also submitted that platform-specific products would be more costly to market and distribute. According to the parties, in the past, all upgrades have been made available on both platforms simultaneously. Moreover, although there may be a preference for Macs in the DTP sector, there is some evidence to suggest that many creative professionals operate with both PC and Macintosh, suggesting some scope for demand side substitution. Moreover, the parties perceived Macintosh users as a vocal and influential customer group, influencing both PC and Mac sales, and claimed it would be commercially irrational not to keep the Windows and Macintosh versions of the software products on identical development tracks.

15. In light of the above, given the lack of third party comment on this issue, and noting that nothing in the OFT's analysis of the business documentation supplied by the parties indicated that the assessment in this case would warrant such a distinction, the OFT does not consider it appropriated to define separate frames of reference for PC and Macintosh software in this case.

Conclusion

16. The dynamic nature of the software industry and the degree of differentiation between products make it difficult to define the relevant product frame of reference with certainty at a specific point in time. However, for the purpose of this assessment it has not been necessary to conclude on the relevant product

frame of reference, because a realistic prospect of a significant lessening of competition (SLC) does not arise as a result of this transaction on either the narrowest frame where overlaps arise, ie at the level of individual product categories (in this case, the WDD, D&I and DI segments) or at the level of software suites incorporating these individual products.

Geographic market

17. The parties consider the geographic market for software to be global. This is because conditions for competition are very similar across the world: software companies operate on a global basis; there are no import restrictions, transport costs or technical requirements which are significant limitations; and product development and innovation takes place on an international basis and potentially benefit all customers, rather than those in just one country. The OFT has received no evidence to suggest that the geographic frame of reference should not be considered as wider than the UK, possibly global.

HORIZONTAL ISSUES

18. Because of the dynamic nature of the software sector, an examination of current competitive positions to assess the scope for post-merger price rises (static competition) may not offer a complete picture of the competitive impact of this merger. Accordingly, the extent to which the parties may, in the absence of the merger, have been in a position to exert competitive pressure on each other to develop innovative new tools (dynamic competition) has also been assessed.

WDD

19. Within this segment, Macromedia offers Dreamweaver and Adobe offers GoLive. It appears that some third parties perceive Dreamweaver to be the 'de facto' industry standard for professional web design. GoLive is predominantly sold as part of Adobe's suite of software, which makes shares of supply difficult to estimate,[1] but the nature of the market suggests that shares of supply are not necessarily indicative of the degree of competitive constraint. There is also evidence to indicate that the two products are not easily substitutable.

20. The parties have submitted that by virtue of their products' diverse functionalities and different customer bases, (as suggested at paragraph 8 above Dreamweaver targets professional web developers, whereas GoLive is used by creative professionals), there was limited competition between them pre-merger. Certainly, the evidence seen by the OFT shows that there is limited switching between the two products by customers. In addition, third parties have confirmed that the

products are very different and that Dreamweaver is often bought in addition to GoLive (when bought as part of a suite).

21. The parties have also submitted that, pre-merger, Macromedia's strongest competition has come from Microsoft, which has two main products in this segment: FrontPage, and its recently released Quartz product. FrontPage was initially launched as a consumer level product but evidence produced to the OFT indicates that it has evolved over time into a software tool meeting professional needs. [ ] and third party comment support the contention that Microsoft currently provides significant competition to Macromedia in this segment.

22. Finally, third parties have also commented that they will only upgrade to the parties' newer WDD software versions if there was a sufficiently strong business case for doing so. It appears from this that to a certain extent the parties are also constrained by their earlier WDD software versions.

23. In relation to dynamic competition, the available evidence suggests that Adobe would not have provided a competitive impetus as strong as Microsoft to Macromedia in the future, in the absence of the merger. GoLive appears to have fallen well behind Dreamweaver in terms of functionality and Adobe had not implemented any plans to compete more directly with Dreamweaver.

24. In contrast, Microsoft has been actively improving its product range in this segment. In addition to the evolution of its FrontPage product (see above) it has introduced its Expression products[2], which include Quartz Web Designer. This WDD tool is targeted at professionals and its marketing emphasises the extent to which it will be interoperable with the Expression D&I/DI tools.

25. Given the dynamic nature of the software industry, it has been suggested that the parties may also face a competitive threat from other players, which do not currently have a material presence in this segment, such as open source software suppliers. Support for this view comes from the fact that Linspire, the distributor of the open-source Linux platform, recently entered the WDD segment with its product Nvu, which appears to be targeted at Dreamweaver users.[3]

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[1] Only [less than 20] per cent of GoLive sales are made on a stand-alone basis.

[2] Expression is a family of professional tools for the design and production of enhanced user experience and rich content for the web. Its 'Acrylic Graphic Designer' is a painting and illustration tool and the 'Quartz Web Designer' a layout and design tool for creating web sites. According to the press release of 14 September 2005, Expression is intended to provide increased interoperability between, on the one hand, files types and languages and, on the other hand, design concepts.

[3] It states on its website that Dreamweaver (and FrontPage) users would find it easy to use Nvu, which offers many of the same features.

D & I

26. In this segment, Adobe produces Illustrator and Macromedia produces Freehand. In addition, Corel offers CorelDraw and Microsoft has recently released its Acrylic Graphic Designer (as part of the Expression product family). Various other products were also named by third parties as substitutable for the parties' D & I tools. As with WDD tools, many customers buy more than one product.

27. The parties estimate that the shares of UK sales in 2004 of Adobe, Corel and Macromedia are respectively [30-40] per cent, [30-40] per cent and [20-30] per cent by volume and [40-50] per cent, [30-40] per cent and [20-30] per cent by value. However, these shares of supply are not necessarily indicative of competitive constraint, and any prima facie concerns raised by them are dispelled to a large extent by the fact that Macromedia discontinued the development of Freehand in 2001 and removed the product from its suite although it is still for sale as an individual product. The lack of investment in Freehand has resulted in a significant decline in sales and suggests that Freehand pre-merger only competes with Illustrator to a limited extent. The possibility that it would have provided effective dynamic competition to Illustrator in the absence of the merger also appears remote in the circumstances.

28. In addition, third parties were generally unconcerned about the merger and confirmed that switching between D & I products was limited. Looking forward, the parties will face competition from both Corel and Microsoft. Corel's sales are said to have increased substantially in the last two years and Microsoft has recently launched its Acrylic product as part of Expression.

DI

29. In this segment, Adobe offers Photoshop and Macromedia Fireworks. Microsoft's Acrylic Graphic Designer and Corel's PaintShop Pro (aimed at photo editors) and Photo Album (aimed at digital camera owners) can also be used for digital imaging. In addition, the parties have identified DeBabelizer Pro, Graphic Converter and Media Pro as competitors in this segment.

30. Third party evidence and internal documentation confirm that Photoshop is by far the most widely used product in this segment. It is generally viewed as the 'industry standard'. Fireworks' functionality is much more limited than that of Photoshop, which is supported by the parties' estimate that [the majority] of Fireworks' users also use Photoshop. [ ] Third parties were unconcerned about the effects of the merger in this segment.

Suites

31. The OFT's investigation revealed that suites appear to be targeted at different audiences and are differentiated in terms of their functionality. The parties submit that their suites are differentiated to a degree that they do not compete to any significant extent. While there is some evidence to suggest that there are overlaps within the suites (particularly with regard to WDD tools), third parties were generally unconcerned by the merger and confirmed that the products are largely complementary, with users often buying products from various players to cover specific needs that are not catered for by only one suite.

32. Third party responses indicated that on a broad level Adobe competed more closely in the suite sector with the desktop publishing supplier Quark than with Macromedia. Various third parties commented that the market now seemed to be fairly mature with the main focus on increased interoperability. The majority of third parties also thought that the transaction might be beneficial in facilitating interoperability and therefore improve the parties' competitiveness going forward. In this regard, the main threat of dynamic competition appears to come from Microsoft's recently launched Expression products, which are also targeted at the professional segment, and are marketed on the basis of their increased interoperability. No horizontal concerns are therefore raised on a suite level.

Barriers to entry and expansion

33. Barriers to *de novo* entry into the software segments discussed above are considered significant. As mentioned above, there is a low level of switching in the established market segments (although less so in the WDD segment, which is based on open-standards) and third parties have also mentioned branding as important to customers. Such factors are considered to be less of a barrier for a major player in the wider software sector.

VERTICAL ISSUES

34. A third party submitted that Adobe might post-merger have an incentive to limit the interoperability of its products with those of third parties. No other third party expressed this concern.

35. It should be noted that both parties currently make their software development kits and file formats available on their website and have done so for years. Any change to this policy which denied software developers access to the parties' field format specifications does not appear commercially rational since this might discourage broader adoption of the parties' technologies. In any event, the parties

would continue to face competition from suppliers such as Microsoft that are not reliant on interoperability with the products of the merged entity.

THIRD PARTY VIEWS

36. The vast majority of third parties were unconcerned about this transaction. Many considered that existing competition between the parties was limited and that their ability to compete dynamically with other players would be enhanced because of increased interoperability between the parties' software tools post-merger.

ASSESSMENT

37. This transaction brings together two important international players in the WDD, D&I and DI product segments. However, in relation to the D&I and DI segments, it does not appear that this merger will result in a loss of competition to any material degree. In the DI segment, the parties' products are differentiated in terms of their functionality to the extent that customers often buy both products to meet their specific needs. In relation to the D&I segment, Macromedia discontinued development of its Freehand product in 2001 since when its effectiveness as a competitor has substantially diminished.

38. In the WDD segment, the evidence also suggests that static competition between the parties pre-merger has been limited in that their products are again differentiated and there has only been limited customer switching between them. The parties will continue to face more significant competition from Microsoft in particular, which has expanded and enhanced its product range in this segment. There is also evidence to suggest that the parties are constrained to some extent by their own earlier software versions. In addition, no concerns have been raised at a suite level.

39. In relation to all segments, the vast majority of third parties raised no concerns. The limited concerns that were raised were found not to be substantiated.

40. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

41. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.