

# **Completed acquisition by Interoute Communications Limited of MDNX Group Holdings Limited**

**ME/6552/15**

The CMA's decision on reference under section 22(1) of the Enterprise Act 2002 given on 3 November 2015. Full text of the decision published on 21 December 2015.

**Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.**

## **SUMMARY**

1. On 15 October 2015, Interoute Communications Limited (Interoute) acquired MDNX Group Holdings Limited, which traded as Easynet (the Merger). Interoute and Easynet are together referred to as the Parties.
2. The Competition and Markets Authority (CMA) considers that the Parties have ceased to be distinct and that the turnover test is met. The four-month period for a decision has not yet expired. The CMA therefore considers that a relevant merger situation has been created.
3. The Parties overlap in the supply of IT services in the UK. In particular, the Parties are both active in providing IT outsourcing services across a range of segments including: connectivity/networking; communications; and computing solutions. There is also a vertical relationship as Interoute provides wholesale network services, which can be used as an input for the provision of IT outsourcing services, Easynet's main business in the UK. The CMA has therefore assessed the impact of the Merger across the supply of: connectivity/networking; communications; computing; and wholesale network services in the UK.
4. With regard to the horizontal overlap in IT outsourcing services, the evidence available to the CMA supports the view that the Parties have small shares of supply, are not competing closely and that there are a number of alternative competitors.

5. With regard to the vertical relationship, the evidence available to the CMA supports the view that there are a number of alternative wholesale network services suppliers in the UK such that there is no realistic prospect that Interoute would have the ability to foreclose its IT outsourcing rivals.
6. The CMA considers that these factors, taken together, are sufficient to ensure that the Merger does not give rise to a realistic prospect of a substantial lessening of competition.
7. The Merger will therefore **not be referred** under section 22(1) of the Enterprise Act 2002 (the Act).

## **ASSESSMENT**

### **Parties**

8. Interoute is an IT services company whose services include the supply of wholesale network services and IT outsourcing services, including connectivity, computing and communications solutions. The turnover of Interoute in financial year 2014 was around £342 million worldwide and around £78 million in the UK.
9. Easynet is an IT outsourcing company offering a range of connectivity, computing and communications solutions. The turnover of Easynet in the financial year 2014 was around £222 million worldwide and around £152 million in the UK.

### **Transaction**

10. Interoute has acquired the entire issued equity share capital of Easynet.
11. The Parties informed the CMA that the Merger is also the subject of review by competition authorities in Germany.

### **Jurisdiction**

12. As a result of the Merger, the enterprises of Interoute and Easynet have ceased to be distinct.
13. The UK turnover of Easynet exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.
14. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

15. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 21 September 2015 and the statutory 40 working day deadline for a decision is therefore 13 November 2015.

## **Counterfactual**

16. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For completed mergers the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.<sup>1</sup>
17. In this case, there is no evidence supporting a different counterfactual, and Interoute and third parties have not put forward arguments in this respect. Therefore, the CMA considers the pre-Merger conditions of competition to be the relevant counterfactual.

## **Frame of reference**

18. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>2</sup>

## **Product scope**

### *IT outsourcing services – connectivity, computing and communication*

19. The Parties overlap in the supply of IT services in the UK, specifically in providing a range of IT outsourcing services. IT outsourcing services provide

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<sup>1</sup> [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D).

<sup>2</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

day-to-day management and operation of computing and processes, including infrastructure and business applications.

20. As noted by the European Commission (**Commission**) in previous decisional practice, IT services (and by extension IT outsourcing services) can be segmented into several categories according to functionality or customer type.<sup>3</sup> This view is supported by market reports by Gartner.<sup>4</sup>
21. Interoute submitted that no further segmentation of IT outsourcing services, whether by customer type or functionality, was appropriate as:
  - (a) From a demand-side perspective, customers often buy a bundle of IT outsourcing services and no customer type is uniquely placed in terms of technical requirements, risk aversion, accreditation or otherwise.
  - (b) From a supply-side perspective, all the Parties' principal competitors compete across all IT outsourcing services.
  - (c) The Commission had noted these supply-side factors in previous decisions, even if ultimately the Commission had not concluded on the product scope and had assessed the transactions on a narrower basis.
22. Nonetheless, Interoute also provided information on the Parties' more specific offerings within their IT outsourcing offering. Interoute explained that the Parties offered a range of differentiated activities within the IT outsourcing segments identified by Gartner<sup>5</sup> and broadly categorised these as:
  - (a) Network/Connectivity services: from Interoute's submissions, third party submissions and Gartner reports,<sup>6</sup> the CMA understands that this relates to managing, enhancing or maintaining connections between computer systems across geographically dispersed locations. Interoute's submissions and an Interoute internal document<sup>7</sup> indicated that the Parties' main overlapping activities in this segment relate to connectivity/network services comprising the provision of virtual private networks (VPN), in particular those enabled over a Multiprotocol Label

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<sup>3</sup> See for example, Case No COMP/M.7458 – IBM/INF Business of Deutsche Lufthansa ([IBM/INF](#)).

<sup>4</sup> Gartner, Market Definitions and Methodology: IT Services, Gartner, 29 October 2014.

<sup>5</sup> The Commission also noted that within the segment for IT outsourcing services, Gartner further identifies the following sub-segments: (a) public cloud computing services, (b) infrastructure as a service, (c) infrastructure outsourcing services (including potential further sub-segments for data centre services, network outsourcing, end-user device outsourcing, and help desk outsourcing), and (d) application outsourcing services. IaaS is a standardised, highly automated offering in which computer resources, complemented by storage and networking capabilities, are owned and hosted by a service provider and offered to the customer on demand.

<sup>6</sup> Page 24 and 27, Gartner, Market Definitions and Methodology: IT Services, Gartner, 29 October 2014.

<sup>7</sup> [REDACTED]

Switching (MPLS) network.<sup>8</sup> Interoute also explained that within the Parties' business model this encompasses network security services.<sup>9</sup>

(b) Computing services: Interoute explained that, within their businesses this encompasses a spectrum of services relating to how companies outsourced their IT infrastructure/hardware. At a minimum this includes providing the space and infrastructure to house the customer's own IT hardware (ie servers), known as co-location. Customers may additionally require that suppliers supervise/manage the hardware to varying degrees, from managing central repositories which maintain IT systems (data centre services) to offering 'managed hosting' services.<sup>10</sup> Interoute's submissions and internal documents<sup>11</sup> indicated that the Parties' computing offerings overlap across a variety of more specific services, and mainly in relation to managed hosting, where the Parties' are differentiated in their cloud versus non-cloud focus.

(c) Communication services: the provision of video and/or voice conference services between offices.

23. Interoute also noted that while it did not consider segmentation by customer type appropriate, the Parties did have differing customer focus in that Interoute's client base had a greater proportion of larger/international clients while Easynet had a greater focus on national small and medium enterprises. The CMA has considered this as part of its competitive assessment when considering the closeness of competition between the Parties.

24. Given that, as outlined above, these overall services each encompass a number of further distinct services, the CMA also considered the extent to which it was appropriate to segment these services further for the purposes of delineating the precise product frame of reference. For example, the CMA considered whether, from a demand-side perspective, MPLS VPN provision fulfils a different function to other types of network outsourcing/connectivity solutions and may even be further differentiated by the underlying technology used. Third parties responding to the CMA's investigation confirmed that there are demand and supply factors which may justify considering certain services more narrowly.

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<sup>8</sup> MPLS VPN is a technology used to create a private network between customer locations ensuring that all communications and data shared between those sites is secured.

<sup>9</sup> This primarily consists of use of 'firewalls' to prevent hacking of a private network via the internet.

<sup>10</sup> These include services where the infrastructure components are owned and managed (in terms of operating systems, storage and networking) by the supplier and offered to a customer on a virtual (via the cloud) or physical basis.

<sup>11</sup> [REDACTED]

25. The CMA has therefore considered the impact of the Merger across the supply of connectivity, computing and communications services. On a cautious basis, the CMA has also considered any more specific areas/customer groups (to the extent relevant) where the Parties' internal documents and/or third party evidence suggested that the Parties' IT outsourcing services overlapped and where it was reasonably conceivable that competition concerns could arise, namely in relation to MPLS VPN based connectivity solutions, and managed hosting. However, the CMA has not needed to conclude on the precise delineation of the product scope for the purposes of assessing the Merger since no competition concerns arise.

#### *Wholesale network services*

26. Interoute is active upstream in the supply of wholesale network services.<sup>12</sup> Interoute explained that these consist of the construction, management and exploitation of a physical network and the provision of data transport services over that network.
27. Wholesale network services are provided to customers including downstream competitors of IT outsourcing services as well as to individual companies with high capacity and service level networking requirements (for example, large online retailers).
28. The CMA understands from the Parties' submissions, industry reports and third party submissions that wholesale network services can vary according to factors such as underlying technology of the network. However, the CMA did not find it necessary to conclude on the precise product scope as it did not find any evidence during the course of the investigation to suggest that competition concerns could arise on the basis of any narrower segmentation. The CMA therefore assessed the impact of the Merger on wholesale network services.

#### *Conclusion on product scope*

29. For the reasons set out above, the CMA has considered the impact of the Merger in the following product frames of reference without the need to conclude on the precise product scope:

(a) Supply of connectivity/network services.

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<sup>12</sup> Due to historical ownership factors, Easynet also has some revenues associated with wholesale network services. However, these revenues are negligible and therefore the CMA has not considered this horizontal overlap further for the purposes of its assessment.

- (b) Supply of computing services.
  - (c) Supply of communication services.
  - (d) Supply of wholesale network services.
30. On a cautious basis, the CMA also considered more specific areas/customer groups (to the extent relevant) where the Parties' internal documents and/or third party evidence suggested that the Parties' IT outsourcing services overlap and it was reasonably conceivable that competition concerns could arise, namely in relation to MPLS VPN connectivity solutions and managed hosting.

### **Geographic scope**

#### *IT outsourcing services – connectivity, computing and communication*

31. Interoute submitted that the geographic scope of IT outsourcing is global, as all leading providers operate globally offering cross-border connectivity, communications and computing services in a single package. Interoute also referred to recent Commission decisional practice which recognised an increasing trend towards cross-border trade, though did not ultimately conclude on geographic scope.<sup>13</sup>
32. Further submissions from Interoute suggest that some specific services may also have a local element to competition. For example, Interoute acknowledge that, for customers, transferring large amounts of data or requiring quick transfers, locality of a data centre from which computing services are provided may be an important determinant to the choice of provider.
33. Third parties responding to the CMA's investigation indicated that the supply of any IT outsourcing services could vary at a local, regional or national level due to variation in competitor presence.
34. Therefore, the CMA considers that the relevant geographic frames of reference could include local areas, regions, the UK as a whole or Europe/the world. However, given that the main overlap in the Parties' activities is in the UK, the CMA has not considered it necessary to examine the impact of the transaction on a broader/international basis. Within the UK, the CMA has also not found any evidence to suggest that concerns could arise on a local or

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<sup>13</sup> IBM/INF.

regional basis. The CMA has therefore assessed the impact of the Merger on IT outsourcing services in the UK.

### *Wholesale network services*

35. Information available from the Parties internal documents, industry reports<sup>14</sup> and third party responses suggests that similar considerations apply to the supply of wholesale network services in terms of geographic scope in so far as local, regional, national and international aspects may be relevant. In addition, the CMA has not found it necessary to conclude on the geographic scope as the CMA has not found any evidence to suggest that concerns could arise on a local basis. The CMA has therefore considered the impact of the Merger on wholesale network services in the UK.

### **Conclusion on frame of reference**

36. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:
- (a) Supply of connectivity/network services in the UK.
  - (b) Supply of computing services in the UK.
  - (c) Supply of communication services in the UK.
  - (d) Supply of wholesale network services in the UK.

## **Competitive assessment**

### ***Horizontal unilateral effects***

37. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.<sup>15</sup> Horizontal unilateral effects are more likely when the merger parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in a substantial lessening of competition in relation to unilateral horizontal effects in the supply of the IT outsourcing services outlined above, namely: connectivity; computing; and communications.

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<sup>14</sup> Ovum, European Wholesale Market 2012-2013, The Big Picture.

<sup>15</sup> [Merger Assessment Guidelines](#), from paragraph 5.4.1.



### *Shares of supply*

38. Interoute provided estimates indicating that the Parties would have a UK share of supply of less than or around 5% in the provision of IT outsourcing overall and across any more specific services within their connectivity, computing and communication offering. In addition, although Interoute noted a number of difficulties in obtaining reliable estimates of narrower segments, it was able to provide a reliable estimate based on industry data of the Parties' UK MPLS VPN share of supply, which suggested that the Parties' have a combined share of supply of 5.2% (with an increment of 3.9%).<sup>16</sup>
39. The CMA has considered the Parties' submissions on this point in the context of other evidence on closeness of competition and competitive constraints from Interoute's submissions, the Parties' internal documents, industry reports and third party responses.

### *Closeness of competition*

40. Interoute submitted that the Parties do not compete closely in the provision of IT outsourcing services. In particular, Interoute submitted that:
- (a) the Parties' connectivity offering is differentiated by technology used, with Easynet having more limited ability to supply customers with high capacity requirements than Interoute;
  - (b) Easynet has a more limited managed hosting offering in particular in relation to cloud-based services; and
  - (c) Interoute has only bid to supply services to six of Easynet's top 150 customers in the last three years (five for the supply of connectivity services and one for the supply of computing services).
41. The CMA considers that Interoute's internal documents, industry reports and third party responses confirm this view. In particular:
- (a) a Gartner report highlights Easynet's less developed/limited presence in cloud-enabled managed hosting;<sup>17</sup>
  - (b) although both Parties are characterised as 'European Leaders' in a Gartner report on the supply of connectivity/'networking' services (mainly encompassing MPLS VPN),<sup>18</sup> all customers and the majority of competitors who responded were consistent in characterising the Parties'

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<sup>16</sup> Ovum, IP VPN Forecast 2013-2018.

<sup>17</sup> Page 19, Gartner, Magic Quadrant for Cloud-Enabled Managed Hosting, Europe, 30 June 2015.

<sup>18</sup> Page 2, Gartner, Magic Quadrant for Pan-European Network Service Providers, 23 April 2012.

connectivity service propositions, including MPLS VPN, as differentiated in terms of geographic focus, underlying technology, customer focus and type of service; and

- (c) all customers and the majority of competitors who responded were also consistent in indicating that the Parties' did not compete closely across the spectrum of IT outsourcing services in terms of geographic focus, underlying technology, customer focus and type of service.

### *Competitive constraints*

- 42. Customers and competitors confirmed that there are a large number of alternative providers of IT outsourcing services in the UK such that there are sufficient constraints remaining on the Parties post-Merger. A number of competitors confirmed that they competed with the Parties in the provision of IT outsourcing services. In particular:
  - (a) With regard to connectivity services, third parties identified: Verizon, BT Global Services, Orange Business Services, Vodafone, Capita, Gamma, Daisy, O2, Colt, TalkTalk and Bistech. In addition, Verizon, BT Global Services, Orange Business Services and Colt were also recognised as significant/leading suppliers by Gartner in relation to 'network services' comprising MPLS VPN and customer responses confirmed this.<sup>19</sup>
  - (b) With regard to computing services, third parties identified: Rackspace, 4NET, Freedom, Amazon Web Services, KCom, NTTX, Taylor Made, SecureVirtual, Daisy Wholesale, BT O2 as alternative suppliers.
  - (c) Alternatives named with regard to communication services were: BT, gamma, iHub, TalkTalk, Bistech, Verizon, Daisy and O2.

### *Conclusion on horizontal unilateral effects*

- 43. As set out above, the CMA considers that the evidence available indicates that the Parties are not closely competing and there are a number of alternative competitors remaining across the range of IT outsourcing services within which the Parties are active in the UK. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of a substantial lessening of competition as a result of horizontal unilateral effects in relation to the supply of connectivity, computing and communications IT outsourcing services in the UK.

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<sup>19</sup> Gartner, Magic Quadrant for Pan-European Network Service Providers, 23 April 2012.

## **Vertical effects**

44. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.
45. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be problematic where it results in a realistic prospect of a substantial lessening of competition in the foreclosed market(s), not merely where it disadvantages one or more competitors.<sup>20</sup> In the present case, the CMA has considered whether the Parties may have the ability and incentive to pursue a strategy of input foreclosure by restricting the supply of wholesale network services to downstream rivals of IT outsourcing services.
46. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) the incentive of it to do so, and (c) the overall effect of the strategy on competition.<sup>21</sup>
47. Interoute estimated that it has a wholesale network services share of [0–10]% in Europe and noted that it was likely to have a lower market share in the UK as most of its network is situated in Europe.
48. Interoute's internal documents<sup>22</sup> indicate that Interoute's share of supply in wholesale network services may be higher when considered in terms of total cross-border data transport ([10–20]%) or the proportion of long haul fibre it owns ([20–30]%).
49. However, evidence available to the CMA from third parties indicates that there is no realistic prospect that the Parties will have the ability to foreclose IT outsourcing competitors. In particular, third party responses were consistent in indicating that there are a number of alternative wholesale network services suppliers remaining in the UK, including but not limited to: BT, Verizon and NTT. Therefore, IT outsourcing competitors could avoid any foreclosure strategy by switching to alternative suppliers. In addition, no third parties raised any concerns regarding input foreclosure.

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<sup>20</sup> In relation to this theory of harm 'foreclosure' means either foreclosure of a rival or to substantially competitively weaken a rival.

<sup>21</sup> [Merger Assessment Guidelines](#), paragraph 5.6.6.

<sup>22</sup> [🔍]

### *Conclusion on vertical effects*

50. As set out above, the CMA considers that there are a number of alternative wholesale network services suppliers in the UK, such that there is no realistic prospect that the Parties would have the ability to foreclose IT outsourcing competitors. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of a substantial lessening of competition as a result of vertical effects in relation to the supply of wholesale network services.

### **Barriers to entry and expansion**

51. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might prevent a substantial lessening of competition, the CMA considers whether such entry or expansion would be timely, likely and sufficient.<sup>23</sup>
52. However, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

### **Third party views**

53. The CMA contacted customers and competitors of the Parties. No customers or competitors raised concerns regarding the Merger.
54. Third party comments have been taken into account where appropriate in the competitive assessment above.

### **Decision**

55. Consequently, the CMA 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.
56. The Merger will therefore **not be referred** under section 22(1) of the Act.

**Nelson Jung**  
**Director, Mergers**  
**Competition and Markets Authority**  
**3 November 2015**

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<sup>23</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.