
Anticipated acquisition by Websense Inc of SurfControl plc

The OFT's decision on reference under section 33(1) given on 6 July 2007. Full text of decision published 1 August 2007.

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

PARTIES

1. **Websense Inc (Websense)** is a US-based provider of software-based secure content management (SCM) solutions. The core product base of Websense is web filtering solutions. For the year ended 31 December 2006 Websense had a global turnover of \$179 million (approximately £90 million).
2. **SurfControl plc (SurfControl)** is a UK public company and has operations worldwide, primarily in the USA, UK and Australia. SurfControl provides a range of IT security solutions, focussing primarily on SCM, and within SCM, on content filtering (web and email). Its UK turnover for the year ended 30 June 2006 was [
£70 million].

TRANSACTION

3. On 26 April 2007 Websense and SurfControl reached agreement on the terms of a recommended pre-conditional cash offer for the entire issued and to be issued ordinary share capital of SurfControl. The 40-working-day administrative deadline expires on 6 July 2007.

4. This transaction has also been notified in the USA and received regulatory approval on 4 June 2007.

JURISDICTION

5. As a result of this transaction Websense and SurfControl will cease to be distinct. The transaction satisfies the share of supply test under section 23 of the Enterprise Act (the Act) as the parties' combined share of supply in the UK for web-filtering solutions exceeds the 25 per cent threshold.
6. 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 submit that there are three areas of functionality within SCM solutions:
 - i. virus/malware protection - that is securing computers and IT networks against virus software or code, and the removal of any viruses that may be introduced
 - ii. email filtering/content management - monitoring of email usage, protection of email systems against 'spam' or mass emails and protecting emails against malicious content, and
 - iii. internet/web filtering/content management - as with email filtering this usually has an integrity of use element and a security element.
8. The parties overlap only in the supply of web filtering software. They submit that the relevant frame of reference should be considered to be all forms of content filtering. In particular, they contend that IT security products should not be sub-segmented on the basis of function as competitors would frequently offer the

same functionality across a range of different product types or offer products with overlapping combinations of functionality. Also, IT security providers would (indirectly) compete for the same overall pool of IT spend.

Demand-side substitution

9. Most of the independent evidence before the OFT indicated that web content filtering and email content filtering should be considered separately. Third party responses also indicate that web filtering and email filtering could be purchased as separate products as well as a complete solution, depending on customer preference. Competitors have indicated that these products are complements rather than substitutes. When faced with a price increase, customers would be unlikely to switch funds from one to the other but rather would look for an alternative product within that segment.

Supply-side substitution

10. One respondent indicated that at \$3-4 million the cost of switching supply from web to email filtering would be similar to the cost of new entry and would take around 18 months. However, the parties and some independent evidence provided several examples of supply-side switching in the last three years.
11. On the available evidence the necessary time-scale for switching is unclear. Therefore, the OFT has taken a cautious approach and, for the purpose of this assessment, has considered web and email content filtering separately. For completeness we have also considered the broader product markets of all SCM solutions. It is not necessary to conclude on the most appropriate product scope in this case, as competition concerns do not arise even on the narrowest possible delineation.

GEOGRAPHIC MARKET

12. In Symantec/Veritas¹ the EU Commission did not conclude on the

¹ Comp/M.3697.

geographic scope for security software and storage software but noted that vendors typically operate on a global basis. In Adobe/Macromedia², the OFT found no evidence to contradict that software markets are broadly global.

13. The parties submit that the geographic scope should be global, as most IT security providers operate and compete with each other on a global basis. All customers who responded, including those currently using a UK supplier, stated they would consider using global suppliers if prices increased post-merger.
14. It is not necessary to conclude on the geographic scope as the competitive assessment would not materially change on a UK or global basis.

HORIZONTAL ISSUES

SCM solutions

15. Globally the parties hold a combined share of supply of [0-10] per cent in SCM solutions. The three leading competitors have shares ranging from approximately 10 to 34 per cent. The share data supplied by the parties is confirmed by share data from independent sources and third parties. On a UK basis, the parties' combined share of supply would amount to [0-10] per cent.
16. On that basis and in the absence of any third party concerns in this segment, the transaction is not considered to raise any competition concerns in the supply of SCM solutions.

Web filtering

17. Various sources estimate the parties' joint share of supply globally at between [40 to 50] per cent (increment [10 to 20] per cent). The merged entity will be the largest supplier in global web content filtering. The parties estimate that their combined share of supply in the UK would be broadly similar to the global figure

² Anticipated acquisition of Adobe Systems, Inc. of Macromedia, Inc., OFT decision of 16 November 2005.

and the OFT has received no evidence to suggest otherwise.

18. The parties refer to at least 15 other suppliers of web filtering solutions and third party respondents named over ten alternative suppliers. Half of the customers who responded stated that they considered the market to remain very competitive post-merger. An independent report made available to the OFT also confirms that there are several other companies in the sector exerting a strong competitive constraint on the parties, such as Symantec, 8E6 Technologies and Marshall, with a tail of 'emerging' companies' (for example Clearswift and Blue Coat).
19. The parties have submitted that the most recent available shares of supply above are based on 2005 revenue and due to the dynamic nature of the industry, this may no longer reflect the competitive constraints they currently face. There is also evidence to suggest that the parties will face increased competitive pressure from other large IT security vendors entering the market, following the recent trend towards integrated SCM solutions. For example, Microsoft acquired Futuresoft's 'DynaComm i:filter' in 2006 which enabled it to integrate web filtering into their broader IT security product offering.
20. The majority of customers that responded had no concerns and considered the market to be competitive, with several alternative suppliers present whom they could switch to. One respondent submitted that they sold similar products to the parties from four other suppliers and that they would switch if prices increased post-merger. While one customer did raise some concerns about the transaction, it was unclear whether these related to the degree of post-merger competition; the same respondent confirmed that they had switched supplier in less than 6 months in the past and listed five alternative suppliers.
21. On balance, the OFT therefore considered that post-merger, several strong competitors would remain and no competition concerns arise in web filtering.

Barriers to entry and expansion

22. The parties assert that the recent dynamics of competition in web filtering demonstrate that there are no substantial barriers to entry. Examples of recent entrants that have been particularly successful include Trend Micro, Blue Coat, Cearsswift, IronPort and MessageLab.
23. One third party competitor suggested that the costs facing new entrants into web filtering would be in the region of \$3-4 million excluding sales and marketing costs and suggested it could take about 18 months. However, in light of the evidence of recent entry above, the OFT considers that in any event, the cost of entry is not prohibitive. In the absence of competition concerns, it has not been necessary to conclude on the extent to which barriers to entry may exist.

Buyer power

24. Five customers responded that they have at least some negotiating power and four of these considered that this would not be significantly diminished as a result of the acquisition.
25. Whilst it appears that larger buyers have at least a degree of buyer power it has not been necessary to conclude, as the acquisition does not give rise to competition concerns.

THIRD PARTY VIEWS

26. The majority of third parties contacted did not raise any concerns about this transaction. The concerns raised have been dealt with above. All respondents, including those who have raised concerns, have mentioned several other suppliers that would continue to constrain the parties post-merger.

ASSESSMENT

27. The parties principally overlap in the supply of web filtering products. Post-merger they will hold a combined share of [40-50] per cent in this segment (both UK and globally).

28. However, independent reports available to the OFT and third party responses indicate that post-merger several other competitors will continue to constrain the merged entity, in particular Symantec, 8E6 Technologies, Clearswift and Blue Coat. In addition there is evidence of a growing trend towards integrated SCM solutions which has attracted several large IT security companies, which will further constrain the parties going forward.
29. 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

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