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EU Clarifies Merger Control Aspects of Outsourcing Projects

The European Commission ("the Commission") has recently provided up-to-date guidance on the Commission's role in reviewing outsourcing transactions under Council Regulation 139/2004 (the "Merger Regulation"). In July 2007, the Commission adopted a Consolidated Jurisdictional Notice (the "Notice") which expressly addresses merger control aspects of outsourcing projects.

Whilst the Commission has already reviewed a number of outsourcing agreements (in late December, for example, the Commission handed down its decision in relation to IBM's outsourcing to AT&T), this Notice has consolidated and updated previous notices and arguably signals a renewed interest in reviewing outsourcing activity. Most deals will be approved within five weeks, but a small number that need greater scrutiny could take up to four months to get the go-ahead from the Commission.

Under the EC merger control regime, the Commission has jurisdiction over a transaction if it constitutes a "concentration," which can either be a merger between previously independent undertakings, or the acquisition of control of the whole or parts of an undertaking by one or more other undertakings.

The Notice describes the circumstances under which an outsourcing arrangement might be considered an acquisition of control. The Commission recognizes that outsourcing contracts can take several forms. Where cases of simple outsourcing do not involve any transfer of assets or employees to the outsourcing services provider, the Commission considers this type of arrangement to be similar to a normal service contract. Even if the outsourcing service provider acquires a right to direct those assets and employees of the customer, no concentration arises if the assets and employees will be used exclusively to service the customer.

However, if the outsourcing service provider also takes over assets and personnel associated with the activity that was previously handled by the customer internally, a concentration may arise if the assets constitute *the whole or part of an undertaking*, i.e., a business with access to the market.

This requires that the assets previously dedicated to in-house activities of the customer will enable the outsourcing service provider to provide services not only to the outsourcing customer, but also to third parties. If the transferred assets include at least those core elements that would allow an acquirer to build up a market presence in a time frame similar to the start-up period for joint ventures, a concentration may arise.

This means that where an outsourcing supplier is buying all or part of the IT assets being outsourced by a company — such as a joint venture arrangement — the deal may need to go to the Commission for approval.

If, on the contrary, the assets transferred do not allow the supplier to develop a market presence, the Commission takes the view that the transaction will not result in lasting changes in the market structure and the outsourcing contract is again considered similar to a normal service contract. It does not therefore constitute a concentration that is reviewable by the Commission. The recent decision in *AT&T/IBM* provides an example of the kind of outsourcing agreement that will be viewed

as a concentration by the Commission. Under the terms of the agreement, IBM will outsource the delivery and management of much of its global telecommunications services (GTS) operations to AT&T. AT&T acquired IBM's global network in 1999.

Since then, the companies have a long-standing relationship whereby IBM has subcontracted to AT&T the provision of certain telecommunication services for IBM and its customers. Under this new agreement, IBM will outsource further parts of its GTS business (functions and personnel) to AT&T in order to offer seamlessly integrated IT, network, and managed network solutions to customers by focusing on each company's core competency.

The deal did not raise competition concerns and was therefore reviewed and cleared under the Commission's 'simplified procedure' because of low market shares. However, this decision does serve as an indication that businesses should undertake a careful analysis of planned outsourcing arrangements ahead of time to evaluate whether they need to be filed with the Commission, and take account of the extra time required to gain clearance prior to being able to close the deal.

The Notice also contains a detailed description of the circumstances under which a joint venture for the provision of outsourcing services will be considered a "concentration." In this section of the Notice, the Commission takes the view that the joint venture typically cannot be considered to be full-function (leading to a concentration) if it provides its services exclusively to the client undertaking and is dependent for its services on input from the service provider. The same applies if any third-party revenues are likely to remain ancillary to the joint venture's main activities for the client undertaking.

At the same time, the Commission makes clear that there can be outsourcing situations where the joint venture partners, for example, for reasons of economies of scale, set up a joint venture with the perspective of significant market access. This will qualify the joint venture as full-function and therefore as a concentration under the Merger Regulation.

Only concentrations with a "Community dimension" trigger an EU merger control filing requirement. Therefore, as a second step in determining the jurisdiction of the Commission, the operation needs to meet certain turnover thresholds, contained in Article 1 of the Merger Regulation. The primary threshold test for deals that will need Commission approval is met if the undertakings concerned have a combined group turnover of €5bn (£3.4bn) globally and if at least two of them have turnover exceeding €250m in Europe. A second set of more complex alternative thresholds may apply as specified in the Merger Regulation if the primary thresholds are not met.

Summary

This Notice is a timely reminder that outsourcing arrangements can require merger filings in the EU. Companies will have to factor this extra time, and the possible delay into their outsourcing plans from the start. Advice should also be obtained early into the procurement to ascertain the likelihood of the transaction requiring a review. Suppliers should also be aware of the number of deals they have in a particular sector.

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