# THE ROLE OF INNOVATION IN MERGER CONTROL – A HOT TOPIC

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## I. INTRODUCTION

While the U.S. and EU antitrust agencies have previously mentioned "innovation" as a relevant factor in their merger control analyses, recent statements and enforcement actions on both sides of the Atlantic reflect the agencies' growing emphasis on innovation in their merger investigations and decisions.

In the United States, both FTC Chairwoman Edith Ramirez and FTC Commissioner Maureen Ohlhausen have made this clear in recent statements. In 2014, Chairwoman Ramirez said:

> Promoting competition in high-technology markets is...a priority. Innovation drives economic growth and expands consumer welfare. Innovation also plays a central role in the competitive dynamics of high-tech markets. Firms in this sector are more likely to compete on the basis of new products and business models rather than on price. So the risk of harm to competition and consumers through a lessening of incentives to innovate tends to be more acute.

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> Consistent with our 2010 Horizontal Merger Guidelines, we will be on the lookout for transactions in this area that raise competitive concerns.[3]

Earlier this year, Commissioner Ohlhausen said: "Transactions combining tech firms can raise some of the most interesting and difficult issues in merger review, such as defining the relevant market in a certain way for the very first time or evaluating competition not just for a share of customers, but for the market as a whole."[4]

Last month, Acting Associate Attorney General Bill Baer said: "We legitimately worry about non-price effects. We take into account the impact of a merger on innovation, on the intensity of research and development, and on the quality of products and services."[5]

The message from the other side of the Atlantic is similar. In April, EU Competition Commissioner Margrethe Vestager gave a speech entitled "Competition: the mother of invention." She said: "One of the simplest defenses against innovation is to buy up rivals that create innovative products. That's why, when we look at high-tech mergers, we don't just look at whether they may raise prices. We also assess whether they could be bad for innovation." She went on to explain that:

> Our rules decide which mergers need to be notified to us based on the turnover of the companies involved. So when someone buys up an innovator, with a lot of good ideas but not yet much in the way of sales, we might not even have the chance to look at whether that merger will be bad for innovation. That's why I announced last month that we're looking at whether to change the thresholds for notification, to make sure we get a look at this type of merger.[6]

Shortly after taking office last year as the Director-General of DG Competition, Johannes Laitenberger explained said that innovation analysis plays two roles in European Commission competition law enforcement: "First, we regard innovation as one of the efficiencies that may justify agreements or mergers that would be anti-competitive otherwise. Second, in the interest of competition and consumers, we must protect dynamic industries from mergers and anti-competitive practices that may threaten their efforts to innovate."[7]

This approach is mirrored in a Competition policy brief the European Commission published in April 2016. Called "EU Merger Control and Innovation," the policy brief explains

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[3] Interview with FTC Chairwoman Edith Ramirez, ABA Section of Antitrust Law, The Mergers & Acquisitions Committee, Volume XIV, No. 2, Spring 2014.

[4] Maureen K. Ohlhausen, Commissioner, U.S. Federal Trade Commission: "Antitrust Tales in the Tech Sector: Goldilocks and the Three Mergers and Into the Muir Woods." Antitrust in the Technology Sector: Policy Perspectives and Insights from the Enforcers, Palo Alto, CA, January 26, 2016.

[5] Acting Associate Attorney General Bill Baer Remarks at American Antitrust Institute's 17th Annual Conference, June 16, 2016, available at https://www.justice.gov/opa/speech/acting-associate-attorney-general-bill-baer-delivers-remarks-american-antitrust-institute.

[6] Margrethe Vestager, EU Commissioner for Competition, "Competition: the mother of invention", European Competition and Consumer Day, Amsterdam, The Netherlands, April 18, 2016.

[7] Director-General of DG Competition Johannes Laitenberger, "Competition and Innovation", CRA Annual Brussels Conference – December 9, 2015.

the European Commission's approach in recent merger cases. It notes that "The EU framework for merger control allows the Commission to assess the impact of mergers and acquisitions on innovation. The framework puts the competitive harm caused by reduction of innovation on an equal footing with increased prices and reduced output. [...]."[8] The policy brief refers to provisions in the European Commission's Horizontal Merger Guidelines[9] and Non-Horizontal Merger Guidelines[10] that cover the treatment of innovation in merger analysis, and it explains that innovation can affect the assessment of market power, efficiencies and remedies in merger control.[11]

## II. POLITICAL CONTEXT

As the statements from antitrust officials on both sides of the Atlantic demonstrate, innovation is an increasingly significant factor in merger control enforcement. There are several reasons for this development. First, because technological development is now fundamental to business success in so many industries, assessing the impact of mergers on innovation now plays a key role in merger control. This applies not only to technology industries, of course, but also to other industries such as pharmaceuticals, medical devices, energy, mobile telecommunications and others.

Second, innovation is at the heart of wider policies than simply antitrust or merger control. In the European Union, the current European Commission led by President Juncker laid out an ambitious political agenda entitled the "Europe 2020 strategy"[12] when it came into office. The Europe 2020 strategy focuses on delivering growth through more effective investment in education, R&D, sustainability, job creation and poverty reduction. Innovation is one of five ambitious goals by which the European Commission hopes to achieve the goal of becoming an "Innovation Union."[13]

In the United States, President Obama's Administration adopted a "Strategy for American Innovation" and in his 2015 State of the Union Address, President Obama said: "Twenty-first century businesses will rely on American science and technology, research and development...I want Americans to win the race for the kinds of discoveries that unleash new jobs."[14]

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[8] EU Competition policy brief 2016-01 "EU merger control and innovation", April 2016.

[9] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2004/C 31/03)

[10] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings (2008/C 265/07)

[11] EU Competition policy brief 2016-01 "EU merger control and innovation", April 2016, p. 3

[12] Communication from the Commission: EUROPE 2020 A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final.

[13] Ibid, page 5.

[14] White House Press release: The White House Releases New Strategy for American Innovation, Announces Areas of Opportunity from Self-Driving Cars to Smart Cities, October 21, 2015.

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In this article, we consider how the U.S. and EU antitrust agencies assess the impact of a merger on innovation. Merging parties may argue that their merger will improve the merged company's ability to innovate, and innovation-based arguments may also be used to demonstrate that current market shares are not indicative of the parties' potential future market power. Innovation can also affect the definition of the market affected by the merger (the relevant market) – if the industry is evolving rapidly, the relevant market may be broader than a static snapshot of the current offerings available to consumers. On the other hand, the antitrust agencies may consider that the merger will result in the termination of promising innovation work by one or both of the merging companies or that it will reduce the merged company's incentive to innovate in the future. Thus, as we demonstrate below, merging parties should consider the potential procompetitive and anticompetitive effects of their merger on innovation from the outset and be prepared for discussions about this hot topic with the agencies reviewing their merger.

## III. THE EUROPEAN PERSPECTIVE

As stated above, innovation is a crucial part of the political agenda set by the European Commission's "Europe 2020 strategy."[15] Competition policy can contribute to these political goals in a number of ways. Obvious examples include state aid for innovative projects and antitrust enforcement in the area of standard essential patents. The role that merger control can play in relation to innovation generally has gained attention only recently. Interestingly, when the European Parliament published a study on "The Contribution of Competition Policy to Growth and the EU 2020 Strategy"[16] in 2013, the authors of the study did not highlight merger control as capable of having an impact on the "Innovation Union" – only antitrust, liberalization, and sector specific measures were mentioned.

The European Commission has focused on the effects of a merger on innovation in a number of decisions in the last few years. Indeed, the potential loss of innovation can go to the heart of the alleged anticompetitive effects of a merger, as the following decisions show.

In its decision on the acquisition of Alstom's energy business by General Electric in 2015,[17] the European Commission considered that Alstom was an important innovator on the market for heavy duty gas turbines and was concerned about the loss of Alstom as "an independent innovator" as a result of the merger. The European Commission said:

> Alstom's heavy duty gas turbine technology is one of the most advanced, flexible and cleanest available, particularly well-suited to meet European

[15] Communication from the Commission: EUROPE 2020 A strategy for smart, sustainable and inclusive growth, COM(2010) 2020 final, page 20.

[16] European Parliament, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy, "The Contribution of Competition Policy to Growth and the EU 2020 Strategy", July 2013.

[17] Case COMP/M.7278 GENERAL ELECTRIC / ALSTOM (THERMAL POWER - RENEWABLE POWER & GRID BUSINESS), decision of September 8, 2015.

> customers' requirements for operational flexibility. The transaction as notified would have reduced customer choice, R&D and innovation, with serious risks that certain Alstom heavy duty gas turbine models would be discontinued and that the newly developed and most advanced model (GT 36) would not be commercialised.[18]

To address the European Commission's concerns, the merging parties offered to divest Alstom's heavy duty gas turbine technology for certain existing and next generation gas turbines to a third party, together with Alstom's R&D engineers and two test facilities i.e. "advanced R&D capabilities and incentives to continue pushing innovation in this important market for Europe."

Also in 2015, the European Commission cleared the acquisition of GSK's oncology business by Novartis subject to divestment commitments to ensure that the merger's impact on innovation would not impede competition. The European Commission's concerns related to both late-stage (phase III) and earlier stage (phase I and II) pipelines in connection with the same drugs – the latter not traditionally being a focus of the European Commission's concerns in pharmaceutical mergers. As Director-General Johannes Laitenberger has explained: "Novartis would likely have stopped developing two innovative drugs to treat certain cancers when acquiring similar drugs from GSK [,,,,,,,] the clearance included a novel remedy. Not only did the companies divest the drugs of concern and the clinical trial programme, but Novartis committed to co-fund the clinical trials."[19]

While the regulatory requirements for the testing of newly developed pharmaceuticals make it relatively easy for the European Commission to establish a theory of harm based on innovation, assessment of the impact on innovation is not limited to life sciences mergers.

For instance, when the European Commission opened an in-depth investigation into ASL's acquisition of space company Arianespace in 2016, it based its decision to do so on the potential impact of the merger on innovation in the satellite manufacturing business: "Overall, the Commission is at this stage concerned that the transaction might lead to higher prices, less customer choice and a reduction in research and development efforts in the satellite, launcher and launcher equipment and launch services markets."[20]

In May 2016, the European Commission prohibited the proposed acquisition of O2 by Hutchison[21] not only because of concerns about price and consumer choice but also because of harm to innovation. Commissioner Vestager said:

> We had strong concerns that consumers would have had less choice finding a mobile package that suits their needs and paid more than without the deal. It would also have hampered innovation and the development of network

[18] Commission Press Release IP-15-5606 of September 8, 2015.
[19] "Competition and Innovation", CRA Annual Brussels Conference – December 9, 2015.
[20] Commission Press Release IP-16-430 of February 26, 2016.
[21] Case COMP/M.7612 - HUTCHISON 3G UK / TELEFONICA UK.-

infrastructure in the UK, which is a serious concern especially for fast moving markets.[22]

While the innovation argument in that case may have been specific to the underlying network technology involved, mergers in the mobile and telecommunication sectors are generally likely to trigger assessments of their impact on innovation – as are mergers in other sectors as well.

As EU Commissioner Vestager said in a speech on May 24: "[...] protecting innovation is an essential part of competition enforcement. And not just in obvious high-tech industries like IT."[23]

Further, as Director-General Johannes Laitenberger noted last year, merging parties may argue that their proposed merger will have positive effects on innovation, i.e. it will generate procompetitive efficiencies.[24]

In line with the European Commission's Horizontal Merger Guidelines, the European Commission may conclude that the innovation efficiencies - if merger specific, verifiable, and likely to be passed on to consumers - outweigh any impediment to competition the merger will cause – although examples of such decisions are rare.

Typically when analyzing efficiencies, the European Commission will examine the rationale for the merger. For example, the merging parties may claim that the merged entity will combine R&D programs that will lead to more innovation on the market affected by the merger rather than loss of competitive innovation between the parties had they remained independent.

Efficiency claims relating to investment in innovation in mobile telecommunication networks were raised in two mobile telecommunications mergers in Ireland and Germany in 2014. The European Commission analyzed whether the mergers would bring material additional benefits in terms of network coverage, speed and quality. In both cases, it concluded that any improvements would be limited and would not outweigh the consumer harm the merger gave rise to and/or would be not merger-specific.[25] These decisions illustrate how high the threshold for acceptance of an efficiency argument by the European Commission is.

## IV. THE U.S. PERSPECTIVE

[22] Commission Press Release IP-16-17/04 of May 11, 2016.
[23] Margrethe Vestager, EU Commissioner for Competition, "How competition supports innovation", Regulation4Innovation, Brussels, May 24, 2016.
[24] "Competition and Innovation", CRA Annual Brussels Conference – December 9, 2015, p. 5.
[25] See Case No. COMP/ M.6992, Hutchison 3G UK/Telefónica Ireland, Commission decision of May 28, 2014, section 7.10., and Case No. COMP M.7018 Telefónica Deutschland/E-Plus, Commission decision of July 2, 2014, sections 6.9, and 6.10.

The U.S. antitrust agencies' approach to innovation in merger cases is largely the same as the European Commission's. The U.S. agencies' most recent edition of the Horizontal Merger Guidelines, issued in 2010, includes an entire section titled "Innovation and Product Variety" explaining how the agencies view the potential impact of a merger on competition. First, the agencies note the broad principle that "[c]ompetition often spurs firms to innovate" – with the implication that reductions in competition will commensurately reduce the remaining firms' incentive to innovate. More specifically, the agencies posit that a merger may harm innovation "by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger," either by creating a "reduced incentive to continue with an existing product-development effort" or by "reduc[ing the] incentive to initiate development of new products."

The guidelines also note that mergers can have a procompetitive effect on innovation. In particular, "[w]hen evaluating the effects of a merger on innovation, the Agencies consider the ability of the merged firm to conduct research or development more effectively," and "[t]he Agencies also consider the ability of the merged firm to appropriate a greater fraction of the benefits resulting from its innovations." On the other hand — just as the European Commission is skeptical of innovation-based efficiencies defenses — the U.S. guidelines question whether reductions in R&D costs can be cognizable efficiencies in many cases because they may be "difficult to verify" or "result from anticompetitive reductions in innovative activities." The guidelines do not attempt to reconcile this stated reluctance to count R&D cost savings as cognizable efficiencies with their acknowledgment of the potential procompetitive benefits of the combined firm's ability to retain a larger proportion of the gains from its innovations.

In practice, the U.S. agencies' merger investigations regularly consider the effect that a pending merger may have on innovation, and many of the complaints filed by the agencies regarding mergers that were blocked or permitted with remedies discuss the impact of those potential mergers on innovation competition. For example, DOJ's complaint in its recent challenge to the proposed Halliburton/Baker Hughes merger, which ultimately resulted in the parties abandoning the deal, repeatedly cited likely reductions in competition to develop key emerging technologies because the merging parties "possessed unrivaled…research and innovation capabilities" and they "play leading roles in driving technological innovation" in the industry.[26]

The proposed merger between Applied Materials and Tokyo Electron, the two largest providers of semiconductor manufacturing equipment, is another recent example. The parties abandoned the merger in the face of a likely DOJ challenge. DOJ informed the parties that it was particularly concerned about "the development of equipment for next-generation

[26] Complaint, *United States v. Halliburton and Baker Hughes* (April 6, 2016), available at https://www.justice.gov/opa/file/838651/download.

semiconductors,"[27] and the parties' proposed remedy did not address this reduction in innovation competition for the semiconductor manufacturing equipment of the future.

DOJ also focused on innovation in its challenge to AT&T's proposed acquisition of T-Mobile in 2011. DOJ's complaint argued that T-Mobile's primary business strategy was to "find innovative ways to overcome scale disadvantages" and that its goal was to "break down industry barriers with innovations."[28] For example, DOJ alleged that T-Mobile was "an innovator in terms of network development and deployment," and that AT&T repeatedly had to respond to T-Mobile's innovations. Following DOJ's challenge, the parties ultimately abandoned the transaction.

In some cases, the FTC and DOJ may investigate whether innovation by one of the merging parties could lead to potential competition that would be eliminated by the merger. This means that in dynamic markets, even a relatively small competitor may be a much more significant competitive constraint than its current market share would indicate, so the merger may raise competition concerns. This can be the case, for example, where the smaller player has promising pipeline products. In one recent case, the FTC sued to block Steris Corp.'s acquisition of Synergy Health on the theory that even though Synergy was only a small player in the U.S. sterilization market, it was set to become a significant threat to Steris by importing X-ray technology that it had developed in Europe.[29] The court ultimately rejected the FTC's motion for a preliminary injunction because the parties proved that Synergy had canceled the project, but the case demonstrates the U.S. antitrust agencies' willingness to challenge mergers even where the merging parties are not currently strong competitors.

## V. DEFINING INNOVATION

The antitrust agencies' recent cases and policy statements underscore the importance of innovation for merger control assessment, but the term "innovation" remains ill- or un-defined. Unlike revenues, volumes or market shares, innovation cannot be assessed based on equivalent hard data. Since the guidelines do not precisely describe the concept of innovation, the antitrust authorities are left – or, to put it another way, have discretion - to establish their own approach on a case-by-case basis.

In some industries such as pharmaceuticals or medical devices, innovation can be assessed relatively easily by reviewing clinical trials and analyzing the parties' produce development pipelines. However, in other industries, the task is much less straightforward. In such cases, the agencies consider all available evidence in assessing potential effects on

[27] U.S. Dep't of Justice, Press Release, "Applied Materials Inc. and Tokyo Electron Ltd. Abandon Merger Plans After Justice Department Rejected Their Proposed Remedy" (April 27, 2015), available at https://www.justice.gov/opa/pr/applied-materials-inc-and-tokyo-electron-ltd-abandon-merger-plans-after-justice-department.

[28] Complaint, United States v. AT&T (August 31, 2011), available at https://www.justice.gov/opa/documents/Justice-ATT-TMobile-Complaint.pdf.

[29] Complaint, *FTC v. Steris Corp. and Synergy Health PLC* (May 29, 2015), available at https://www.ftc.gov/system/files/documents/cases/150529sterissynergytro.pdf.

innovation, including the merging parties' internal data and documents and information provided by customers, competitors and experts, to gain insights and form their own views on innovation and potential future market trends in the case in question.

## VI. CONCLUSIONS

The emphasis that the antitrust agencies are increasingly placing on innovation analysis in merger reviews leads to the following conclusions.

With increasing technological development across many industry sectors, the importance of innovation in the assessment of mergers is likely to increase even further and become a standard feature of merger investigations in the United States and Europe.

To assess these issues, the antitrust agencies increasingly require access to the internal documents and data of the merging parties and third parties. Thus, more litigation-type document production requests are increasingly becoming part of merger investigations by the European Commission as well as the U.S. antitrust agencies.

Lastly, antitrust agencies in the European Union and United States - and elsewhere around the world – increasingly cooperate with each other when they are reviewing the same merger. The assessment of the impact of a merger on innovation and how to address any concerns about that impact will therefore become part of the increasingly global dialogue about mergers in the same way as other effects of a merger on competition already are.