DIGITAL MARKETS AND MERGER CONTROL IN THE EU: EVOLUTION, NOT REVOLUTION?

REVOLUTION

BY CATRIONA HATTON, DAVID GABATHULER & ALEXANDRE LICHY[1]

1 Catriona Hatton is a partner in the Brussels office of Baker Botts. David Gabathuler is a consultant working with Baker Botts Brussels. Alexandre Lichy is an intern in the Brussels office of Baker Botts.

I. INTRODUCTION

The digital economy is bringing about transformative change across swathes of industry through the roll-out of innovative ecosystems, including on-line platforms and the spread of new technologies and tools such as advanced machine learning, artificial intelligence and data analytics. Change is often driven by disruptive innovation with firms competing to lay claim to new markets rather than taking on existing rivals for incremental market share gains. The rapid expansion of the digital economy also has major repercussions for the established industrial order with companies finding their existing business models threatened by the rise of new technology. Accenture has estimated that 75 percent of companies that were listed in Standard & Poor's 500 Index in 2012 would not be expected to be in business by 2027 (based on the lifespan trends of firms in the Index) due in part to rapid technological change.[2]

The emergence of new business models, technologies and even markets creates particular challenges for antitrust enforcers, including when reviewing mergers. Tried and tested antitrust theories and practices may no longer withstand scrutiny in fast moving digital markets. Antitrust agencies may be tempted to develop novel theories of harm or seek additional powers to address real or perceived enforcement gaps. This article: (1) examines the proposal to introduce a new transaction value-based filing threshold in EU merger control to catch potentially market changing transactions that fail to meet the current turnover thresholds; (2) highlights the challenges faced by antitrust enforcers when defining markets and assessing market power in digital markets, including during merger reviews; and finally (3) concludes by discussing whether the European Commission's ("Commission") substantive merger assessment is able to keep in step with the advance of the digital economy.

II. PROPOSED EU TRANSACTION VALUE-BASED FILING THRESHOLD

Jurisdiction under the EU Merger Regulation[3] is dependent on merging parties meeting high turnover thresholds.[4] Transactions that meet the thresholds benefit from a "one-stop-shop" review by the Commission, generally replacing the jurisdiction of the 28 EU Member States. Conversely, transactions which do not meet the EU thresholds can still fall within the scope of one or more EU Member States' national merger control rules. In addition, there is a sophisticated referral system in place to ensure that the best placed authority(ies) is responsible for reviewing a merger within the EU.[5]

The rationale behind EU revenue based thresholds is that very high turnover can be an indicator of the economic effect of a transaction on the Internal Market.[6] Therefore, it is considered relevant as a jurisdictional test to determine whether the merger should be notified to the Commission to assess whether it may cause a significant impediment to effective competition ("SIEC") within the EU (which is the substantive test applied by the Commission when reviewing a notified transaction).

Generally, this system has been working well, not least of all because it is relatively straightforward to assess whether a filing is required. However, the advent of the digital economy has led enforcers to question the adequacy of turnover-based thresholds to catch certain mergers, particularly in fast-changing digital sectors.

---

2 The average lifespan of S&P 500 companies in 1958 was 60 years on average; by 1980 it had fallen to about 25 years and by 2012 was under 20 years. Accenture, Thriving on disruption by Nunes, Bellin & Lee, 2016, Figure 1.

3 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ("EU Merger Regulation").

4 Concentrations in the EU must be notified to, and cleared by, the Commission if they have a "Community Dimension." This is the case if the parties' combined revenues exceed certain thresholds: EUR 5 billion worldwide and EUR 250 million for at least each of two in the EU (secondary lower thresholds lay out alternative revenue-based conditions).

5 This referral system allows Member States to request the Commission to review a transaction in their place (for example, where it concerns EU wide or global markets with potential issues across multiple Member States), and vice versa, where the transaction concerns more local markets, the Member State may request the Commission to refer the merger back for local review. Furthermore, the notifying party on a deal which does not meet EU thresholds, but which triggers filings in at least three EU Member States may request the Commission to take jurisdiction instead of the national authorities.

6 Commission Staff Working Document accompanying the Document Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions, *Report on Competition Policy 2016*, page 17.

A. The Digital Sector is Characterized by a Certain Degree of Disconnection Between Value, Valuation, and Revenue

The digital economy has at least two distinguishing characteristics from many other industries, which impacts on the relevance of turnover-based filing thresholds, namely the specificity of business models in the sector and the value of certain assets that cannot be directly monetized.

First, it is common for companies in digital markets to provide services for "free" in order to gain scale, at least until they build a strong user base and are in a position to monetize their product(s) or service(s). Many then try to build a business model generating substantial revenues based on these assets, but even digital companies that have been established for a long time sometimes fail to achieve this goal (e.g. Twitter[7]).

Second, low revenue streams do not mean that an undertaking is not valuable (or valued). Certain companies' valuations bear no correlation with the revenue generated by their business. They may have a high growth potential (creating expectations surrounding future revenue) or there may be synergies between the target and the acquirer's activities (for instance a service that fails to generate revenues alone could do so once integrated within a broader ecosystem).[8]

There have already been many notable mergers in the digital sector that met the high revenue thresholds of the EU Merger Regulation and were notified to the Commission, including the acquisition by Microsoft of LinkedIn in 2016 for $26 billion and of Skype for $8.5 billion in 2011 and Google's acquisition of DoubleClick for $3.1 billion in 2007. However, the acquisition of WhatsApp by Facebook for $22 billion in 2014, notwithstanding its high profile, fell short of the notification thresholds. WhatsApp's revenue was a mere $10.2 million in 2013 despite it having more than 600 million users, many of them in Europe.

B. It Remains Uncertain Whether There is an Enforcement Gap

The observation that turnover thresholds are not always a key test for determining the significance of a transaction led to several reforms and reform attempts. In 2017, driven in part by the objective of capturing more transactions in the digital economy, both Germany and Austria amended their notification rules to include a threshold based on transaction value. It captures certain transactions where the target company has no revenues in those countries provided the target meets the somewhat vague concept of "significant domestic activity."[9] The Commission, after conducting a public consultation in 2016,[10] is considering introducing a similar threshold as a solution to what it views as a risk of under-enforcement. This proposal must be analyzed in the light of the following factors.

First, the actual extent of the alleged under-enforcement remains uncertain. In general, high revenue figures, in the EU and worldwide, are often a good initial indicator of the potential for a transaction to produce effects within the Internal Market. The explanatory memorandum accompanying the German law amending the thresholds estimated that the reformed thresholds would cause no more than three additional cases to be examined per year,[11] although practitioners expressed concerns that the new thresholds risked capturing numerous transactions with little or no domestic effects. While it is still very early to assess the merits of either prediction, the German and the Austrian competition authority have indicated that they have already received a number of filings based on the new transaction value-based threshold since the new rules were implemented.[12] As the EU transaction value-based thresholds would likely be higher than the German and Austrian ones, and would undoubtedly be combined with some additional requirement to attempt to ensure a local nexus with the EU, it is difficult to assess the possible impact of any such amendment of the EU Merger Regulation. However, there is a real risk that any expansion of the thresholds which moves

7 Twitter, in spite of its 330 million "monthly active users," has never had a profitable year since its inception in 2006. See Reuters, "Twitter says it could turn first-ever profit, shares surge," October 26, 2017, (link).

8 Acquisition prices may be further driven up by the large cash reserves owned by potential acquirers in the industry. See The Economist, "Tech firms hoard huge cash piles," June 3, 2017, (link).

9 For Germany, see the 9th amendment to the Act Against Restraints of Competition ("ARC"), published in the Official Journal on June 8, 2017 (link). For Austria, see the amendment to the Law on Competition, published in the Official Journal on April 24, 2017 (link). See also article by Schöning & Ritz "Mergers in the Digital Economy: A Practitioners' Outlook on Key Merger Control Aspects of Big Data and Innovation in the Digital Markets," in The Chronicle, *Competition Policy International*, February 2018.

10 Consultation on Evaluation of procedural and jurisdictional aspects of EU merger control, launched on October 7, 2016 (link).

11 Proposal for a 9th amendment to the ARC, October 14, 2016, page 42 (link).

12 See PaRR, "German and Austrian agencies witness merger filings under new thresholds," January 26, 2018, (link).

away from EU revenue requirements will result in over enforcement. In its public consultation, the Commission lists only two instances where a significant transaction did not meet existing thresholds and where it considered that the transaction might raise competition concerns at the EU level.[13] These cases, one of which (*Facebook/WhatsApp*) came back to the Commission for review in any event, and the other of which was reviewed at the national level, do not by themselves, make the case for reform.

Second, mechanisms that make the notification system more flexible already exist, which might further limit the added value of the proposed reform. In particular, parties to a transaction meeting the notification thresholds in at least three Member States may ask for a review of the transaction by the Commission.[14] In addition, Member States may request the Commission to review a transaction which falls below EU thresholds but has cross-border effects within the EU.[15] These correction mechanisms allow the Commission to review cases that do not fall within EU thresholds, which is significant considering that some Member States have notification thresholds that are not solely based on turnover. The *Facebook/WhatsApp*[16] merger was reviewed by the Commission (and cleared) under the referral procedure made at the request of the merging parties. Recently, the proposed acquisition of Shazam by Apple has been referred to the Commission for review at the request of the Austrian authority (several other Member States joined the request). This system, however, requires the parties or a national authority to take the initiative and ask the Commission to review the merger, which may somewhat temper the mechanism's usefulness and reliability from the Commission's perspective.

Finally, designing effective transaction value-based thresholds comes with at least two practical problems. First, the thresholds must apply in a predictable manner. The complexity of deal structures (involving assets with a fluctuating value for instance) can create uncertainty with regard to the obligation to notify – for competition authorities and companies alike. Predictability might be further reduced by the need to assess whether a transaction affects the European market (i.e. local nexus), as deal value alone does not provide this information. Concepts such as "significant domestic activity" of the target, introduced in the new German and Austrian thresholds, are not straightforward to apply in practice. The German and Austrian competition authorities are currently working on a guidance document regarding these two questions and will launch a publication consultation in March 2018.[17] Second, deal value-based thresholds must arguably integrate mechanisms to prevent parties from trying to negotiate their way around a notification obligation if they are to be seen by competition authorities as effective. At least hypothetically, parties could settle for deal values under the thresholds in order to avoid a filing requirement, whether or not the transaction might produce an effect on the Internal Market.

The Commission is yet to adopt a final position regarding the desirability of introducing transaction value-based filing thresholds. It is possible that the Commission will assess the effectiveness of the recent German and Austrian reforms before taking a formal position on the question. Overall, this debate should not obscure the fact that notification thresholds as they stand, combined with the referral mechanism, give the Commission the opportunity to assess the existence of a SIEC for the vast majority of mergers that are likely to produce potential anti-competitive effects within the Internal Market, including those between companies in digital markets.

III. MARKET DEFINITION AND MARKET POWER IN DIGITAL MARKETS

An exacting market definition exercise is normally a critical first step in identifying the competitive constraints upon parties to a merger. The EU merger control process requires notifying parties to identify the relevant markets and furnish the Commission with extensive information on "affected markets." The merger decisions often describe the Commission's findings on the definition of the relevant market(s) in quite some detail.

The Commission has tended to identify markets narrowly with product functionality and quantitative pricing tests often central to the market definition analysis. Price-based quantitative modeling techniques raise particular difficulties in digital markets due to the prevalence of multi-sided platforms with users often receiving many services at zero prices. This limits the applicability of the hypothetical monopolist ("SSNIP")

---

13 Facebook's acquisition of WhatsApp in 2014 and Abbvie's acquisition of Pharmacyclis in 2015.

14 See Article 4(5) of the EU Merger Regulation.

15 See Article 22(1) of the EU Merger Regulation.

16 Case No. COMP/M.7217 - *Facebook/WhatsApp*, decision of October 3, 2014.

17 See PaRR, supra note 12.

test[18] that seeks to gage the substitutability of different products and services based on small movements in price. The SSNIP test also fails to take into account the pricing interdependencies that exist in multi-sided markets or the importance of other elements of competition such as quality.[19] Some commentators have suggested adapting the SSNIP test to account for indirect network effects that arise in two-side sided (non-transaction) markets.[20]

An important issue when assessing the competitive impact of mergers involving multi-sided platforms is correctly determining whether the platform's activities as a whole can be characterized as a stand-alone market (i.e. normally those which facilitate transactions between users on each side of the platform) or whether it is more accurate to identify one or more distinct markets on each side of the platform.[21] Such an analysis can be complex and depends on the market dynamics in play. A platform provider may be subject to entirely different competitive constraints on one side of the platform (e.g. competition from "one-sided" firms that only compete on that particular side and not only from two-sided providers) which would not be accounted for if the market were defined to encompass the platform as a whole. The Commission's practice with regard to digital platform mergers has generally been to identify separate markets on each side of the platform. For example in *Facebook/WhatsApp*, the Commission analyzed individual markets relating to users separately from the social network provider's online advertising activity.[22, 23]

Typically, the Commission has placed significant reliance on static economic indicators such as market shares, concentration levels, profit margins, etc., to assess market power. However, in markets which are subject to rapid change, such indicators are generally too rudimentary – even assuming accurate data on the relevant metric is available in the first place. In *Microsoft/Skype*, the Commission acknowledged that in nascent and dynamic sectors, market shares can change quickly within a short period of time and only provide a preliminary indication of the competitive situation.[24] The General Court agreed with this approach and stated that in a fast-growing sector, "large market shares may turn out to be ephemeral."[25]

There is also considerable complexity in the assessment of market power in the digital arena due to the presence of network effects that can lead to exponential growth (and decline) and, in specific circumstances, to the creation of high barriers to entry. However, the interdependencies that exist between the different sides of a platform are also often undervalued when assessing the platform's market power. A platform provider's market behavior on one side of the platform may be constrained by competition existing on the other side. It may, therefore, be inappropriate to take into account only competition on one side of a digital platform when assessing market power. Moreover, users may also make use of a number of platforms in parallel ("multi-homing"), which can further constrain a platform provider's ability to exercise market power.

Competition authorities may, therefore, need to focus their analysis on a wider set of economic indicators such as network effects, entry barriers (market contestability), innovation, etc., if they are to properly assess market power in digital markets. It is noteworthy that the German competition rules have been expressly amended to require the assessment of market power in multi-sided markets or markets characterized by network effects to take into account specific factors, namely: (i) direct and indirect network effects; (ii) multi-homing behavior and switching costs; (iii) advantages of scale arising from network effects; (iv) ability to access competitively relevant data; and (v) innovation-driven competitive constraints.[26]

18 Small but Significant and Non-transitory Increase in Price test.

19 Competition authorities have also occasionally made use of the upward pricing pressure ("UPP") test to estimate the risk of anti-competitive (unilateral) effects arising from a merger. Such a test can be applied to multi-sided platforms and as such do away with the need to make use of more traditional quantitative modeling techniques to determine the contours of competition, but extensive data is typically required to perform a UPP test.

20 See Filistrucchi, Geradin & van Damme, (2012), "Identifying two-sided markets," (TILEC Discussion Paper, Vol. 2012-008), footnote 7. In non-transaction markets, the platform does not facilitate transactions between the two-sides (e.g. a media platform with readers and advertisers).

21 Graef, (2015), "Stretching EU competition law tools for search engines and social networks," Internet Policy Review 4(3).

22 Case No. COMP/M.7217 - *Facebook/WhatsApp*, decision of October 3, 2014.

23 In its *Just Eat and Hungryhouse* merger decision (Report, November 16, 2017), the UK's Competition and Markets Authority concluded that the relevant market was the (overall) market for online food platforms, including food ordering market places and the services of ordering and logistics specialists.

24 Case No. COMP/M.6281 - *Microsoft/Skype*, decision of October 7, 2011, paras. 78 and 99.

25 Judgment of December 11, 2013, *Cisco Systems v. Commission*, T-79/12, EU:T:2013:635, para. 69.

26 Section 18(3a) ARC.

IV. IS THE COMMISSION'S SUBSTANTIVE MERGER ASSESSMENT ABLE TO KEEP IN STEP WITH THE ADVANCE OF THE DIGITAL ECONOMY?

The EU Merger Regulation has proven to be a robust and flexible tool of competition law enforcement and the introduction of the "SIEC" test in 2004 is seen to have eliminated an important enforcement gap by giving the Commission the power to more readily address oligopolistic market structures, such as those that can occur in the mobile sector.[27] It should therefore be able to deal with entrenched (consumer) welfare threatening monopolies or oligopolies that emerge from the digital sector just as well as those that emerge from more traditional industries.

The ability of the current competition law rulebook, including the EU Merger Regulation to satisfactorily address possible anti-competitive conduct of tech companies has its detractors. In an opinion piece titled "Competition authorities need a digital upgrade," the FT argued that "competition regulators need to arm themselves with new concepts" arguing that the regulators treated the *Facebook/WhatsApp* merger as an advertising company buying a telecommunications company – not as a social network deepening its customer data set.[28]

The Director-General for Competition, Johannes Laitenberger has defended the EU competition law framework, emphasizing that it has been "remarkably adaptable, precisely because it is drafted in terms that allow us to address new phenomena." He cited the Commission's review of Microsoft's acquisition of LinkedIn as evidence of such adaptability.[29]

The *Microsoft/LinkedIn* decision, while it did arguably move the needle in its assessment of the impact of big data in mergers, can probably be characterized as evolution rather than revolution since it builds on the Commission's already extensive experience of reviewing mergers in digital markets, including those involving search engines, online advertising, communications apps and social networks.

In *Google/DoubleClick* (2008),[30] the Commission's analysis focused on possible foreclosure effects arising from the merger since the parties were not direct competitors in the relatively new area of ad serving technology and intermediation services for online advertisements. None of the competition analysis could be seen as departing from the standard Commission framework. This is unsurprising given that this was the first significant merger where the Commission had to assess non-horizontal competition effects following the adoption of its Non-horizontal merger guidelines.[31] Data and privacy issues did feature, but any possible competition concerns arising from a potential combination of Google and DoubleClick's data collections were swiftly dismissed by the Commission due to contractual restrictions in DoubleClick's contracts with advertisers and the apparent lack of competitive advantage arising from the combination.[32]

The *Microsoft/Yahoo! Search Business* (2010)[33] merger decision was the first merger decision involving two major search engines. The Commission carried out a detailed market investigation notwithstanding that Microsoft and Yahoo!'s combined market share in Internet search in the EU remained below 10 percent and consequently did not give rise to any affected markets in the EU. The Commission's analysis arguably remained firmly anchored in established theories of harm with their focus – in internet search – on the possible loss of innovation, potential lowering in quality of organic search (i.e. degrading results) and a reduction in choice arising from the loss of the Yahoo! platform. However, the merger gave the Commission the opportunity to deepen its understanding of specific features of internet search engines (e.g. auction system).[34]

---

27 The first Commission "gap case" was Case No. COMP/M.4748 - *T-Mobile/Orange Netherlands*, decision of August 20, 2007.

28 "Competition authorities need a digital upgrade," Financial Times, July 30, 2017.

29 "EU competition law in innovation and digital markets: fairness and consumer welfare perspective," Johannes Laitenberger Director-General for Competition, Commission, Brussels, October 10, 2017.

30 Case No. COMP/M.4731 - *Google/Double Click*, decision of March 11, 2008.

31 "Google/DoubleClick: The first test of the Commission's non-horizontal merger guidelines," Brockhoff, et al., Competition Policy Newsletter, No. 2 - 2008, page 53.

32 See Case No. COMP/M.4731 - *Google/Double Click*, decision of March 11, 2008, paras. 359-366.

33 Case No. COMP/M.5727 - *Microsoft/Yahoo! Search Business*, decision of February 18, 2010.

34 See "Economic background of the Microsoft/Yahoo! case," Amelio & Magos, Competition Policy Newsletter, No. 2 - 2010, page 49.

In *Facebook/WhatsApp* (2014), the Commission revisited the market for consumer communications services;[35] a market that had featured heavily in the Commission's *Microsoft/Skype*[36] decision (and in the decision of the General Court following the appeal by Cisco).[37] The Commission again found that the market for consumer communications apps is dynamic and fast-growing with "no significant 'traditional' barriers ... to enter the market."[38] However, the Commission focused much more on the possible impact of network effects. It found, among other things, that the low barriers to entry, the prevalence of multi-homing and switching and the lack of lock-in were important factors preventing harmful network effects from taking hold post-merger.[39] The Commission also examined potential theories of harm related to the merged entity's possible use of a broader data collection to strengthen Facebook's position in online advertising. The Commission principally rejected concerns that the merged entity would enjoy such a form of competitive advantage on the grounds that numerous alternative providers would continue to compete with Facebook post-merger. Interestingly, the Commission's decision touches upon some aspects of privacy as part of the competition assessment notwithstanding that the decision stresses the relevance of the EU data protection rules to address privacy issues.[40]

The implications of big data for competition policy played a particularly prominent role in the assessment of the *Microsoft/LinkedIn*[41] merger and the decision provides an initial indication of how competition authorities are likely to address big data aspects of mergers. The Commission again highlighted the specific function of the data protection rules, and in particular the protections offered by the new EU General Data Protection Regulation ("GDPR").[42] While the Commission identified a number of concerns arising from the proposed merger, which were addressed through commitments,[43] the decision also discussed the potential competition law concerns that could arise from the combination of competing (big) datasets notwithstanding that such elements were not present in the *Microsoft/LinkedIn* merger. The Commission indicated that the combination of two datasets could increase post-merger the parties' market power in the supply of the relevant data or could raise barriers to entry for actual or potential competitors. A combination of two datasets could also lead to a direct loss of competition even if there were no intention or possibility to combine the datasets. In addition, the Commission considered the (theoretical) possibility that the merged entity could engage in input foreclosure by denying access to an important input, namely access to LinkedIn (full) data to certain competitors (i.e. competing providers of CRM software solutions and separately competing providers of productivity software solutions). The Commission carried out a classic input foreclosure analysis and found that LinkedIn's data could not be characterized as an "important input" within the meaning of the Non-horizontal merger guidelines.[44]

The advent of big data is often cited as a potential crossroads for competition law enforcement and some commentators have questioned whether competition authorities need a digital upgrade. While the traditional approaches to defining markets and assessing market power and competition are not all well suited to these new emerging and fast moving markets, so far the EU merger framework has proven sufficiently adaptable to address novel competition issues arising in these markets. The existing framework allows the Commission to take into account the distinctive features of digital technology, such as big data on a case-by-case basis. An overhaul of the rules with sector specific focus would not seem appropriate or warranted and could result in overly interventionist enforcement, which may harm competition and innovation and ultimately consumers.

35 The Commission also examined possible competition concerns in the broad potential market for social networking services, but it did not identify any particular competition concerns, largely because the services are differentiated and WhatsApp and Facebook were not close competitors.

36 Case No. COMP/M.6281 - *Microsoft/Skype*, decision of October 7, 2011.

37 Judgment of December 11, 2013, *Cisco Systems v. Commission*, T-79/12, EU:T:2013:635

38 Case No. COMP/M.7217 - *Facebook/WhatsApp*, paras. 117 and 118.

39 The Commission also indicated that the technical integration of WhatsApp and Facebook was unlikely to be technically straightforward, but highlighted that there was already significant overlap between the two platforms.

40 For example, the decision indicates that abandoning end-to-end encryption could create dissatisfaction among the increasing number of users who significantly value privacy and security. This suggests that companies' privacy policies could be a non-price parameter of competition. See Case No. COMP/M.7217 - *Facebook/WhatsApp*, paras. 174 and 186.

41 Case No. COMP/M.8124 - *Microsoft/LinkedIn*, decision of December 6, 2016.

42 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data.

43 The commitments were not directly related to the potential competition concerns arising from a big data set. Instead, they address concerns relating to the integration of LinkedIn features into Microsoft Office as well as the denial of access to APIs and the pre-installation of LinkedIn on Windows PCs.

44 For a discussion of the case, see "Microsoft/LinkedIn: big data and conglomerate effects in tech markets," Ocello & Sjödin, Competition merger brief 1/2017 - Article 1.