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MERGER CONTROL IN DYNAMIC MARKETS – Contribution from BIAC

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Merger Control in Dynamic Markets

- Contribution from BIAC –

1. Introduction

1. *Business at OECD* appreciates the opportunity to submit these comments to the OECD Global Forum on Competition roundtable on merger control in dynamic markets. Competition policy and merger review in dynamic markets is a key concern to the business community. This contribution builds on previous submissions of *Business at OECD* in relation to merger analysis—in particular those regarding dynamic efficiencies,[1] non-price effects[2] and remedies.[3]

2. Competition authorities have traditionally favored a rather static approach to competition policy over dynamic considerations. This has significant implications for mergers not only in high technology markets but also in traditional industries characterized by converging markets or potential competition based on disruptive business models which may not only feature price competition, but also be characterized by significant product and process innovation.

3. *Business at OECD* underlines that in respect of dynamic as well as all other markets, it is very important for competition authorities to maintain an approach to merger review that promotes predictability and legal certainty for the merging parties and broader business community. Nevertheless, merger control in dynamic markets needs to take better account of dynamic effects including innovation incentives, network effects and market tipping, competition in multi-sided platforms or conglomerate effects, including the possibility of leveraging via bundling or tying to extend or preserve market power.[4]

4. Recognizing the inherent difficulties of a forward-looking analysis in markets characterized by dynamic competition, *Business at OECD* offers four recommendations:

- First, legislators and competition authorities should consider whether the available tools are entirely adequate when reviewing mergers in dynamic markets. Tools that focus on static competition based on traditional market definitions do not always

[1] OECD, Dynamic Efficiencies in Merger Analysis 248-260 (2007), available at http://www.oecd.org/daf/competition/mergers/40623561.pdf [hereinafter OECD Dynamic Efficiencies].

[2] Business at OECD, Discussion Points Presented by Business at OECD (BIAC) Competition Committee to the OECD Competition Committee: Non-Price Effects of Mergers (June 6, 2018), available at http://biac.org/wp-content/uploads/2018/05/BIAC_CC_Non-Price-Effects-of-Mergers_2018-05-22_FINAL1.pdf [hereafter Business at OECD Non-Price Effects].

[3] Business at OECD, Discussion Points Presented by the Business at OECD Competition Committee to the OECD Competition Committee: Vertical Mergers in the Technology, Media and Telecom Sector (June 7, 2019), available at http://biac.org/wp-content/uploads/2019/06/CC_Vertical-Mergers-in-Techonology_2019-05-28_FINAL3.pdf.

[4] See Jacques Crémer, Yves-Alexandre de Montjoye & Heike Schweitzer, Competition policy for the Digital Era, Final Report Prepared for the European Commission 105 et seq. (2019), available at https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf.

capture the unique characteristics of competition in dynamic markets. This may lead to over-enforcement, harming consumers in the short run as a result of foregone synergies and reduced incentives to innovate in the long run. Relatedly, market definition as a tool to identify and quantify market power needs to be adjusted to account for the realities of demand and supply side substitution in multi-sided markets or markets driven by platform competition.

- Second, competition authorities should consider how to adequately incorporate dynamic efficiencies in their analysis and update or develop relevant guidance. Although consideration of dynamic efficiencies may involve certain complexities, their inclusion in the analysis may have a significant impact on the quality of outcomes.
- Third, given the challenges associated with measuring competitive effects and dynamic efficiencies over the short run, competition authorities should, in appropriate circumstances employ a longer timeframe when reviewing mergers in dynamic markets considering market specific investment and innovation cycles.
- Fourth, competition authorities should avoid lowering the standard of intervention by acting on new theories of competitive harm in dynamic markets without the necessary factual and economic evidence that the merger before them requires remedial measures. In dynamic markets, remedial measures should be structured in order to offer the merged firm the best opportunity to innovate and compete effectively in a future environment that remains uncertain and is likely to undergo a rapid rate of technological change.

2. Static and Dynamic Competition in Merger Review

5. Competition authorities have traditionally employed analytical tools that predominantly assess static competition in merger review. This is understandable, as historically, competition policy developed in the context of business markets that for the most part were not characterized by dynamic innovation. The markets analyzed through the lens of static competition included not only manufacturing and consumer industries, but also industries such as agriculture, resource extraction and energy. While innovation has by no means been absent from these sectors, historically they have been far less dynamic than certain key markets in the present information-based and technology-driven economy. Competition authorities therefore have appropriately relied on tools that assess competition in traditional industries on a static basis. As noted by the Secretariat, in increasingly dynamic markets, continued reliance on tools that measure static competition alone over dynamic competition may lead to over-enforcement and have a negative effect on consumers by denying them the benefits of potential dynamic efficiencies and merger enabled synergies. [5]

6. Competition authorities have employed a variety of tools to assess the competitive effects of a proposed merger, including price, volume and market shares. For example, the U.S. competition authorities often rely on market share evidence calculated on the basis of the Herfindahl-Hirschman Index in merger review. Such tools rely on evidence from the

[5] OECD, Merger Control in Dynamic Markets, Background Note by the Secretariat 5 (Oct. 28, 2019), available at https://one.oecd.org/document/DAF/COMP/GF(2019)8/en/pdf [hereinafter OECD Dynamic Markets, Background Note].

recent past or current state of a market. Thus, even assuming that the market delineation is appropriate, these quantitative indicators fail to capture a significant source of competitive pressure in dynamic markets—potential competition and technology-driven expansion by new and existing rivals.[6]

7. When reviewing mergers in dynamic markets, however, where these traditional tools indicate potential competition concerns, competition authorities should be willing to go beyond the static analysis to then employ tools and accept economic evidence that captures and reflects dynamic competition. For example, competition authorities may consider placing less emphasis on market shares or other static measures of concentration in dynamic markets where the positions of market participants tend to change rapidly.[7] This is because innovative products and processes often result in the fluctuation of market shares between and amongst current market participants and new entrants, as well as potential entrants with disruptive business models. This can be particularly true where there are successive generations of technology, sometimes based on new platforms that can reset the competitive dynamic and lead to new market leaders.

8. Market definition is another important area that merits a more flexible approach in the case of dynamic markets. It is often difficult to properly assess the dynamic nature of competition when competition authorities define and impose static market definitions. On the one hand, unduly narrow markets may result in under-enforcement in cases where one of the merging parties is a potential competitor but has limited means to expand in the near term. On the other hand, however, narrow markets may ignore the competitive pressure exerted by innovative firms in neighboring markets and dynamic incentives to stay ahead of competition. On balance, the risk of over-enforcement is significant since narrow market definitions may ignore the impact of rapid technological change on products and services not previously viewed as substitutes.

9. Accordingly, competition authorities should be careful to avoid relying solely on narrow and static market definitions that are not flexible enough to recognize and address the impact of dynamic competition. This is particularly true in the context of the technology, media and telecom sector that is undergoing a period of continuous and rapid technological change. Against this background competition agencies should update relevant guidance or develop best practices on how to deal with indirect network effects and multi-market presence, while explicitly clarifying that the definition of relevant markets does not preclude the outcome of a fully-fledged competitive assessment especially in platforms markets. During such a process, the (dis-) advantages of employing a multi-market approach over a single-market approach as well as new thresholds and

[6] Indeed, empirical studies have shown that market structure, as presently defined by reference primarily to market shares and ease of entry, provides at best a very crude signal of the likely impact a merger or single-firm conduct will have upon future competition. See Comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University, on the U.S. Antitrust Agencies' Proposed Update of the Antitrust Guidelines for the Licensing of Intellectual Property (Sept. 19, 2016), available at http://sls.gmu.edu/gai/wp-content/uploads/sites/27/2016/07/GAI-Comment_DOJ-FTC-Updated-IP-Guidelines_9-19-16_FINAL.pdf [hereinafter GAI Comments].

[7] Industries marked by dynamic competition frequently involve "[f]luctuations in market share . . . as firms are constantly forced to reevaluate the effectiveness and attractiveness of their product offerings." See Andrew Tepperman & Margaret Sanderson, Final Report Prepared for Competition Bureau: Innovation and Dynamic Efficiencies in Merger Review 20-21 (Apr. 9, 2007), available at https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cra-final-report-on-efficiencies-2007-04-09-e.pdf/$FILE/cra-final-report-on-efficiencies-2007-04-09-e.pdf.

screening tools should be discussed. Therefore, flexibility in market definition may be beneficial in dynamic markets where market conditions are ever evolving.

10. Although it may present a challenge for competition authorities to assess how competitive actions taken today will affect future market conditions, adopting a dynamic approach has the potential to improve competition policy and analysis, and ultimately benefit consumers.[8]

11. Over the years, *Business at OECD* has stressed the importance of competition and merger control policy that is based on well-established economic insights. This is important for the business community and consumers more broadly, because it promotes predictability and legal certainty in merger review and reduces the risk and incidence of both type 1 (false positives) and type 2 (false negatives) errors. This is not inconsistent with the introduction of modifications to the analytical tools used in a merger control regime, where appropriate, to adapt to changing circumstances, provided that such change is pursued in an economically sound manner that is predictable and consistent with evidence-based enforcement.

12. With sufficient guidance to the business community, competition authorities should be open, in appropriate cases, to adopting a more dynamic vision. The goal is not to replace but to complement the current static approach focused on short-term effects by also taking into account the realities of dynamic and often vibrant competition. Such flexibility would contribute to the achievement of key policy goals, in particular the maintenance of competitive markets that are favorable to the development of innovation, with a view to maximizing long-run consumer welfare and overall social welfare.[9]

3. Dynamic Efficiencies in Merger Review

13. Competition authorities routinely assess the competitive effects of mergers, including the efficiencies that arise as a result of a proposed merger. Competition authorities should assess dynamic efficiencies in conjunction with productive and allocative efficiencies. Dynamic efficiency claims deserve special consideration, as they are more likely to bring benefits to consumers than static efficiencies.[10]

14. As sustainable economic growth and improved wealth per capita uniquely depend on technical progress (Solow theory of growth), dynamic efficiencies are essential for the economic performance of a state. Against this background and given the economic importance of dynamic efficiencies for sustainable economic development, it may be time to move the consideration of efficiencies to the competition assessment stage to encourage a more balanced consideration of efficiencies.

15. Dynamic efficiencies are those efficiencies that are likely to arise through the "optimal introduction of new products, the development of more efficient productive

[8] Douglas H. Ginsburg & Joshua D. Wright, Dynamic Analysis and the Limits of Antitrust Institutions, 78 Antitrust L.J. 1, 2 (2012).

[9] Business at OECD Non-Price Effects, supra note 2, ¶ 38.

[10] OECD Dynamic Markets, Background Note, supra note 5, at 5.

processes, and the improvement of product quality and service."[11] Measuring dynamic efficiencies may present certain challenges, due to the fact that innovation itself raises measurement problems more complex than certain of the static measurements employed in conventional merger review. For example, there are no robust models of innovation that can link the rate of innovation to industry concentration, and there is significantly more uncertainty surrounding product and process innovation, and the effects thereof, than in merger review focused merely on price and output.[12] While challenging to assess, competition authorities, including the Canadian Competition Bureau, have recognized that dynamic efficiencies are "vital for driving economic growth and ultimately consumer welfare."[13]

16. De facto, dynamic efficiencies lead to the reduction of marginal cost per unit thanks to technological improvements. Competition authorities should not take a purely short-run view, they must think about the long-term effects of mergers (or prohibitions of mergers). Competition authorities must work to assess dynamic efficiencies using all the tools available to them. In particular, they should not dismiss such efficiencies with the argument that their contribution to investment and innovation is not verifiable.[14] In the context of merger control, where a forward-looking assessment is required, the standard for verifiability of dynamic synergies or pro-competitive effects should be no higher than that for the standard of proof to raise competition concerns.

17. Competition authorities should further incorporate dynamic efficiencies into their merger analyses. For example, the EU Horizontal Merger Guidelines explicitly acknowledge the potential pro-competitive effect of efficiencies.[15] However, to date, the practical role of dynamic efficiencies within the EU Commission's analysis of proposed mergers has been extremely limited. This likely can be explained, in part, by the measurement problems discussed above, as well as the fact that quantitative tools to assess dynamic efficiencies are less developed. However, the net result is that EU competition law enforcement does not support an adequate evaluation of the role played by efficiencies, with the result that static competition (i.e., prices and output) are given more analytical weight.[16]

18. *Business at OECD* encourages competition authorities to assess dynamic efficiencies through an evidence-based process that provides predictability and legal certainty to the merging parties and the broader business community. Competition authorities may consider employing a more fact-intensive analysis.[17] For example, competition authorities may accept evidence of dynamic efficiencies from merging parties that are able to "demonstrate plausible and likely qualitative improvements" in products

[11] See Competition Bureau Canada, Merger Enforcement Guidelines ¶ 12.17 (2011), available at https://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-meg-2011-e.pdf/$FILE/cb-meg-2011-e.pdf [hereinafter Canadian Merger Guidelines].

[12] Tepperman & Sanderson, supra note 7, at 9.

[13] OECD Dynamic Efficiencies, supra note 1, at 270.

[14] Lars-Hendrik Roëller, Challenges in EU Competition Policy 14 et seq (2010).

[15] Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings, 2004 O.J. (C 31) 5, ¶ 77 (EC) [hereinafter EC Merger Guidelines].

[16] Business at OECD Non-Price Effects, supra note 2, ¶ 37.

[17] Ginsburg & Wright, supra note 8, at 6.

and/or processes as a result of the merger.[18] Competition authorities may also assess and give analytical weight to innovative inputs that may be correlated with innovative output, including certain R&D spending,[19] measuring scientific research activity,[20] as well as evidence of innovation in market outcomes.[21]

19. Competition authorities should engage in a comprehensive or holistic analysis of the likely competitive effects of a merger in dynamic market that incorporates the anticipated impact of dynamic efficiencies into the analysis. Such an approach can be contrasted to merger reviews and analyses that are artificially bifurcated into separate analyses of identifiable anticompetitive effects of a merger, on the one hand, and potentially offsetting efficiencies, including dynamic efficiencies, on the other. This latter approach may result in over-enforcement and welfare losses due to the fact that the evidentiary burden for establishing efficiencies – both static and dynamic – is often very high and in practice seldom met.[22]

20. *Business at OECD* therefore encourages competition authorities to thoroughly analyze claims of dynamic efficiencies put forward by merging parties, in order to ensure that potential innovation and social welfare is not lost as a result of over-enforcement.

4. Merger Review Timeframes

21. Assessing the relevant timeframe in merger review is a practical difficulty, and competition authorities around the world have responded to this difficulty by implementing a range of timeframes. For example, the EU merger guidelines adopt a sliding scale approach where "the later the efficiencies are expected to materialize in the future, the less weight the Commission can assign to them,"[23] the Korea Fair Trade Commission recognizes "efficiency gains to be created over five years with depreciation applied"[24] and the Canadian Competition Bureau applies a two-year timeframe.[25]

[18] OECD Dynamic Efficiencies, supra note 1, at 122.

[19] Industries in which companies make substantial and ongoing R&D expenditures tend to be more innovative; however, greater R&D spending will not always be correlated with greater innovation in the market; for example, a merger that reduces R&D spending may be beneficial if it allows the same level of R&D to be conducted more efficiently. See GAI Comments, supra note 6, at 7-9.

[20] As measured by publications in scientific journals.

[21] Tepperman & Sanderson, supra note 7, at 20.

[22] See, e.g., Case T-175/12, Deutsche Börse v. Comm'n (Mar 9, 2015), available at https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62012TJ0175_INF&from=EN; Case T-194/13, United Parcel Service, Inc. v. Comm'n (Mar 7, 2017), available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62013TJ0194. See also, David Cardwell, The Role of the Efficiency Defence in EU Merger Control Proceedings Following UPS/TNT, FedEx/TNT and UPS v Commission, 8(9) J. of Eur. Competition L. & Prac. 551 (2017).

[23] EC Merger Guidelines, supra note 15, ¶ 83.

[24] OECD Dynamic Efficiencies, supra note 1, at 181.

[25] The 2011 revisions to the Merger Enforcement Guidelines removed the explicit reference to two years but state "the beneficial effects of entry on prices in this market must occur quickly enough to deter or counteract any material price increase owing to the merger, such that competition is not likely to be substantially harmed." Canadian Merger Guidelines, supra note 11, ¶ 7.3.

22. A shorter timeframe for merger review, such as two years, likely does not provide a sufficient opportunity for meaningful analysis of the competitive effects of a rising number of mergers in dynamic markets, particularly where the investments are necessarily long-term in nature. While certain static anticompetitive effects of a proposed merger may occur shortly after a merger closes, the pro-competitive benefits of innovation and other dynamic efficiencies often take longer to be realized. In addition, adequate post-merger integration to realize merger-specific efficiencies usually takes longer than a year. This is particularly true for industries with long-term investment cycles such as telecommunications. Accordingly, insistence on a strict short-run timeframe for merger review is likely to be counter-productive and have the effect of reducing the analytical weight granted to valid dynamic considerations.

23. A competition authority's ability to make accurate predictions about a merger depends on its ability to draw inferences relevant to future market conditions from the facts presented to it by the merging parties and the marketplace. Competition authorities may be hesitant to employ a longer timeframe to assess competitive effects and dynamic efficiencies because the relevance and reliability of inferences to be drawn from this evidence can diminish the farther into the future analyses look.[26] This challenge to a competition authority's ability to reach accurate predictions may be compounded by the lack sufficient probative or reliable evidence to assess innovation and dynamic efficiencies claims in the first place.

24. Keeping in mind such limitations, competition authorities nonetheless should balance the potential decreased accuracy of predictions made further into the future against the potentially pro-competitive effects of longer-term innovation and dynamic efficiencies that are anticipated to materialize as a result of a proposed merger outside of a fixed shorter timeframe. Moreover, just as it is critical to look at dynamic mergers in light of the circumstances of the industry, it is equally important to consider the applicable timeline for investment and return as it relates to the specific facts of the industry under review.

5. The Role of Remedies in Dynamic Merger Review

25. *Business at OECD* continues to endorse carefully considered remedies where there is sufficient factual and economic evidence that a merger requires remedial measures. Enforcement action, if ultimately taken, can have an important influence on decisions made in the marketplace. Accordingly, when choosing between a structural remedy, behavioral remedy, or a combination of both remedies, competition authorities should be mindful of the need to carefully tailor the specific remedy to the circumstances of the transaction to address the structure of the market and/or the post-merger conduct of the merged firm.

26. Structural remedies directly intervene in the competitive structure of a relevant market to address the anti-competitive effects of a merger, and typically involve a divestiture of assets or shares. Structural remedies aim to restore the level of competition that existed prior to the merger by allowing the entity who obtains the divested assets to exert competitive pressure on the merged firm and within the market more generally post-merger.[27] Behavioral remedies modify or constrain the merged firm's behavior and aim to

[26] OECD Dynamic Efficiencies, supra note 1, at 223.

[27] Massimo Motta, Michele Polo, & Helder Vasconcelos, Merger Remedies in the European Union: An Overview, 52 Antitrust Bull. 603, 606 (2007).

prevent the merged entity from acting in a way that could have effects that diminish competition. Common behavioral remedies include firewalls, non-discrimination provisions, IP licensing, transparency requirements, anti-retaliation provisions and prohibitions on certain contracting practices.[28]

27. In dynamic markets in particular, the most effective remedial measures are often structural. Structural remedies address the anti-competitive effects of a merger in a market as it currently exists and allow the merged company to operate unencumbered by restrictions and obligations imposed through behavioral remedies. This can be important in dynamic markets where companies must be free to innovate and respond to changing competitive conditions.

28. Behavioral remedies, however, can also be a useful tool in alleviating potential competitive effects in dynamic markets. Any behavioral remedial measures imposed should be properly time-limited and flexible. Behavioral remedies are necessarily implemented in the context of an existing competitive landscape and can create static rules that do not always account for dynamic changes in a market. This is particularly challenging for any sector of the economy experiencing rapid technological change. To counter these effects, these remedies should be made reviewable at the request of the merged entity if conditions change.

29. *Business at OECD* encourages competition authorities to ensure there is sufficient factual and economic evidence supporting any imposition of a remedial measure in a case. If it is determined that a remedy is necessary, the remedy should be carefully considered to avoid imposing a chill on the merged firm's ability to innovate and effectively compete in a dynamic market.

[28] See, e.g., the Ticketmaster/LiveNation merger where the Canadian Commissioner of Competition and U.S. Department of Justice sought and obtained firewall behavioral remedies. Press release, Gov't of Canada Competition Bureau Canada, Competition Bureau Requires Divestitures by Ticketmaster-Live Nation to Promote Competition (Jan. 25, 2010), available at www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03191.html; Press Release, U.S. Dep't of Justice, Justice Department Requires Ticketmaster Entertainment Inc. to Make Significant Changes to its Merger with Live Nation Inc. (Jan. 25, 2010), available at https://www.justice.gov/opa/pr/justice-department-requires-ticketmaster-entertainment-inc-make-significant-changes-its.

6. Conclusion

30. *Business at OECD* underlines that in respect of dynamic as well as all other markets, it is very important for competition authorities to maintain an approach to merger review that ensures predictability and legal certainty for the merging parties and broader business community.

31. Market definition is an important area that merits a more flexible approach in the case of dynamic markets. Competition authorities should be careful to avoid reliance on fixed or static market definitions that are not flexible enough to recognize and address the impact of dynamic competition. This is particularly true in the context of the technology, media and telecom sector that is undergoing a period of continuous and rapid technological change.

32. Although it may present a challenge for competition authorities to assess how competitive actions taken today will affect future market conditions, adopting a dynamic vision has the potential to significantly improve competition policy and analysis, and ultimately benefit consumers as well as society at large.