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Start-ups, killer acquisitions and merger control – Note by Spain

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More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/start-ups-killer-acquisitions-and-merger-control.htm>

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1. Introduction

1. The nationwide authority in charge of the application of competition law provisions in Spain is the Comisión Nacional de los Mercados y de la Competencia (hereinafter, the ‘CNMC’), which is an integrated authority not only empowered to oversee mergers and acquisitions and potentially anticompetitive practices, but also provided with jurisdiction to enforce sector-specific regulation, and with the ability to prepare studies evaluating the functioning of market forces in relation to particular activities and particular industries and, more generally, to engage in advocacy.
2. The inspection, investigative, enforcement and fining powers of the CNMC as Competition Authority are aimed at the effective performance of its functions, that is, to preserve, guarantee and promote the existence of effective competition. In order to achieve those goals it is important to take into consideration all the recent changes in the actual economic framework, especially the ones related to technology, digital markets or platform’s evolution.
3. In this contribution, we will describe the main features in the identification and analysis of killer acquisitions in competition proceedings carried out by the CNMC, focusing on notification thresholds (section 2), theories of harm (section 3), counterfactual assessment (section 4), efficiencies (section 5) and some initial conclusions (section 6).

2. Notification thresholds

4. It is commonly acknowledged that current merger notification thresholds are typically based on the annual turnover of the undertakings involved in the merger. That is the reason why, as many nascent firms or start-ups do not yet generate enough turnover to trigger those thresholds, many competition authorities are unable to investigate and intervene in certain cases where high potential for future competition is not reflected by current turnover.
5. In response to that, potential policy options to ensure potentially problematic acquisitions are captured by merger control have been primarily focused on, on the one hand, lowering the existing turnover-based notification thresholds, and on the other hand, introducing additional thresholds based on transaction value. This second option of introducing additional transaction value-based thresholds is the common suggestion in the ongoing policy debate, and some States, such as Germany and Austria have already introduced it, as although for some the reduction of turnover-based notification thresholds might be the most straightforward option to ensure that acquisitions of nascent start-ups with low turnover get notified, it is also a problematic option.
6. However, some jurisdictions, including Spain, have an additional threshold in place that takes into account the market shares of the companies concerned. This type of threshold has proven effective to capture many mergers in the digital sphere.
7. According to the Spanish legal framework, mergers are subject to control by the CNMC and therefore need to be notified and to be authorized by the NCA prior to their implementation when at least one of the following two circumstances applies:

1. As a result of the merger, a share equal to or greater than 30 percent of the relevant product or service market is acquired or increased at a national level or in a defined geographic market within the country. However, this threshold is increased to 50% if the acquired assets or acquired company's turnover does not exceed 10 million euros.
2. The aggregate turnover in Spain of all the participants in a merger exceeds 240 million euros in the last financial year, provided that at least two of them have an individual turnover in Spain of more than 60 million euro.
8. In any event, regardless of whether any of the above thresholds is met, for an economic concentration to be reportable to the CNMC, it must not have a Community dimension, as provided for in Article 1(2) and 1(3) of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation).
9. Consequently, Spain's Law on Defence of Competition establishes a system of compulsory advanced monitoring by CNMC for any concentration representing a certain market share or a certain amount of turnover, both based on the relevance that such operations have either for the markets being affected by the concentration (market share threshold) or for the Spanish economy in general (turnover threshold).
10. The market share threshold presents as a potential drawback an increase in uncertainty for the notifying parties, however, appropriate communication channels with the competition authority¹ may effectively mitigate that risk.
11. All in all, the notification threshold based on market shares have proved to be particularly useful with the advent of the digital economy. It has been a useful tool for the Spanish competition authority
 - to review potentially worrisome mergers that would have escaped scrutiny otherwise,
 - and to refer to the EC these kinds of potentially worrisome mergers when they had an international reach but lacked a Community dimension under the EC Merger Regulation.
12. Thanks to this market share threshold, many transactions have been referred to the EC, such as the **Facebook/Whatspp** merger (under art. 4(5) of the Merger Regulation) or the **Apple/Shazam** (under art. 22 of the Merger Regulation).
13. This explains why the debate about introducing a new threshold focused on the potential growth of the firms, such as the value-based one, has not gained traction in Spain, and neither has the one about lowering the existing one based on the amount of turnover; the Authority has not identified that its current notification threshold fails to capture relevant mergers in the digital economy, including those that may be called killer acquisition.
14. So in this sense, the Spanish Competition Authority has not identified to date any killer acquisition not reviewed because of an excess of flexibility of the system, as the background note provided by the Committee suggests. Moreover, Spain's double criteria for notification, which is a significant feature that distinguishes it from many other member

¹ In order to provide certainty to undertakings, in addition to informal contacts, prior to the submission of the notification they can formulate a consultation about whether the thresholds for mandatory notification are met (article 55.2 of the Spanish Competition Act). This consultation will be solved in a maximum of three months. Moreover, there is extensive case law regarding market definition as all decisions are published.

state's system or from the European Commission one, classifies as reportable many mergers that would not be considered so in other jurisdictions, although, market share criteria is associated to a static scenario.

15. Despite this, and as far as the efficiency's evaluation of our system is concerned, it is important to mention that market shares assessment is typically being complemented by an analysis of other features of the relevant market, such as its expanding or dynamic nature, barriers to entry and expansion, the competitive dynamics and business models as well as the regulatory context of which the practices or transactions are a part. As a result, it is not altogether unusual for the CNMC not to identify concerns even when the parties' market shares can be considered indicative of a position of super-dominance or quasi-monopoly.

16. Nevertheless, even when concerns have been raised, it is also true that market shares have been only the starting point of the analysis. The assessment of the CNMC is of course complemented by an evaluation of the market structure, the competitive dynamics and business models as well as the regulatory context.

17. In terms of specific merger cases handled by the CNMC that may illustrate the features typically linked to killer acquisitions, there are four remarkable ones. The Authority finally approved all these cases, although with commitments in two of them, after having found that there was no evidence to prove that they were effectively killer acquisitions.

18. As the term "killer acquisition" was coined in reference to pharmaceutical markets, it seems appropriate to start by mentioning a case that affected two companies that only overlapped in R&D for the zika virus vaccine². Concerns that this merger could constitute a killer acquisition as regards this vaccine were, however, dismissed in view of the fact that both companies were at an early stage of their investigations, so there was great uncertainty as to their respective likely success, and there was strong potential competition. Indeed, 45 alternative lines of investigation were reported by the WHO, several of which had entered into clinical trials.

19. As to digital platforms case *Just Eat/La Nevera Roja*³ which was cleared in 2016, which is worth noting. It involved the acquisition by JUST EAT, a multinational online platform offering food delivery services to restaurants and consumers, of a local rival. The merger was cleared in Phase I subject to commitments that consisted in removing exclusivity clauses in contracts with restaurants for a certain period.

20. Although it is well known, it is important to point out that the particular sector of the case has undergone substantial transformation with the rise of the Internet, particularly in recent years with an activity that involves two sides: food delivery platforms deal with restaurants, on the one hand, and with end-users, on the other. The interplay of the two sides of the market is a source of network effects, and, in spite of the very high market shares of the merging parties, the CNMC was satisfied with the mentioned commitments. Those remedies were aimed at preventing the merged entity from entering into exclusivity agreements with restaurants that could, in turn, hinder the entry and expansion of competing platforms.

21. Following the transaction, the parties would have had a joint market share of over 70%, which can be preliminary indicative of a dominant position. However, the market share of the acquired company was nearly 25%, which represented already an important

² C/0972/18 EMERGENT BIOSOLUTIONS INC. -EBS- / PAXVAX HOLDING

³ C/1046/19 JUST EAT / CANARY

participation in the market. In addition, the parties had similar strategies and the target had been operating in the market for a number of years. Consequently, the Authority did not perceive the operation as a killer acquisition.

22. Another relevant case is *JUST EAT/CANARY*⁴, in which, again, the multinational offering food delivery services to restaurants JUST EAT acquired the exclusive control of Canary Delivery Company, S.L. (CANARY), a Spanish company established in 2014, and only operating in the Canary Islands. This merger was cleared without commitments in 2019, as the CNMC, after an exhaustive analysis of the case, considered that the operation could not be expected to involve a threat to competition in the relevant markets. The competitive landscape had changed significantly since the previous merger with a number of strong players successfully entering the market.

23. In this particular case, the CNMC assessed, among many other aspects, whether CANARY was a fast-growing company in the Canary Islands that had the potential to exert significant competitive pressure, but this was rejected taking into consideration various factors. On the one hand, CANARY, which had been operating for several years, had a low turnover and only one employee. Additionally, it did not invest in R&D, and its pricing policy was very similar to JUST EAT's. As a result, the target could not be considered an innovative or aggressive competitor and the CNMC ruled out the possibility of treating the operation as a killer acquisition.

24. The fourth remarkable case in which the CNMC assessed the possible impact on technological innovation to rule out negative effects that normally arise as a result of killer acquisitions is *Easypark – Activos Ivia*⁵. This case involved the acquisition by EasyPark España S.L.U. (EASYPARK), company specialized in providing collection services for regulated parking by computer apps in 20 Spanish municipalities, of exclusive control of certain assets owned by Ingeniería Vial S.L. (IVIAL), focused on, among other activities, the provision of collection services by mobile applications, in regulated parking areas.

25. In this case, although with the transaction EASYPARK entered into a number of local markets for payment services by mobile applications in regulated parking area and reinforced its position in others, there were a number of significant competitors and low switching costs for consumers.

26. Additionally, the CNMC highlighted the fact that EASYPARK was a multinational company enjoying superior technology and higher level of investment in R&D&I than the target, being capable, as a result, to offer a higher volume of services, so negative effects in innovation were dismissed. Thus, the CNMC concluded that the merger did not harm competition.

3. Theories of harm

27. Another key issue is the one related to the possibility of conceiving new approaches to theories of harm in the event a killer acquisition potentially exists.

28. At an EU level, calls to revisit the substantive theories of harm applicable to this kind of transactions to a more rigorous analysis and to minimise the risk of under-enforcement have been made.

⁴ C/1046/19 JUST EAT / CANARY.

⁵ C/1076/19 EASYPARK - NEGOCIO SISTEMAS APARCAMIENTO IVIAL.

29. The theories of harm taken into account by the Spanish Competition Authority can be described as traditional, or mainstream, representing well-established approaches to enforcement. In this sense, the authority has sought to respond, in particular, to the creation and/or the strengthening of a dominant position flowing from the exclusionary effects of exclusivity clauses.

30. In terms of practical examples, in *Just Eat/La Nevera Roja*, the CNMC pointed out in its analysis that, despite existing barriers to entry and expansion, the market was growing and far from maturing. In addition to that, the scope for entry and expansion was all the more likely considering that a large number of international players operated food delivery platforms. In such circumstances, the only threat to competition was the risk that restaurants would not (or no longer) multi-home. Accordingly, the remedial measures sought to ensure that rival platforms would be able to conclude agreements with restaurant and to benefit from network effects as much as the new entity.

31. But in terms of identification of potential killer acquisitions analysis, even before the operation, both JUST EAT and LA NEVERA ROJA enjoyed significant economies of scale and network economies, thanks to the high volumes of orders they handled, which was reflected in the greater attractiveness of their restaurant commissions, and which led competitors to deploy alternative competitive strategies, such as promoting their own delivery networks or focusing on higher value-added niches. So taking this into consideration, it could be inferred that LA NEVERA ROJA actually had a consolidated position in the market and could not, consequently, be treated as a nascent firm.

32. It should also be borne in mind in this sense, that this is a market with significant barriers to expansion, to the extent that heavy investments in advertising and marketing are necessary to achieve significant scale, and the fact that LA NEVERA ROJA had already entered into those investments reveals a non-lack of resources in terms of ability to develop individually without needing to be acquired to subsist.

33. The CNMC has also analysed innovation related theories of harm. As previously mentioned, in the EASY PARK case negative effects in the incentive to innovate were deemed unlikely in light of the fact that the acquiring company's technology and investment in innovation significantly exceeded the target's. Moreover, the acquirer continued to face competition in the affected market, which ensured that, along with the capacity to innovate, it maintained the incentive to do so.

34. In addition to this, it is important to remark that the CNMC does not ignore the relevant impact data can have in competition, especially in digital markets as data, particularly data collected from consumers, can be considered a really valuable asset. Therefore, and along with the role data can play when analysing potentially exclusionary effects, such aspect is evaluated together with potential innovation in order to identify whether or not the acquired undertaking could be considered a potential competitor.

4. Assessing the counterfactual

35. Another crucial issue when evaluating potential killer acquisitions is the counterfactual analysis.

36. The counterfactual to a merger involving a well-established or incumbent company and a start-up could be that the start-up would develop to become an innovative and strong competitor. However, the likelihood of the start-up becoming a competitor could be very difficult to assess. The more information available to the NCA regarding the rationale of

the acquisition, the better the position it will be in to understand if the merger is aimed at eliminating entry threats.

37. Taking into consideration the great level of uncertainty associated to these cases, there has been discussion in some EU countries, and indeed at a EU level, about what are the best ways for agencies to proceed, in terms of relevant timeframe to consider in such cases or evidence should they rely on.

38. Such discussions have not been particularly intense in Spain during recent years. The approach of the CNMC in terms of evaluating the counterfactual, as with theory of harm, can be deemed mainstream, which means that, when analysing the possible negative impact in competition of a merger, the Authority raises two possible scenarios in terms of deciding the imposition of commitments, including and not including them.

5. Efficiencies

39. One last element to take into consideration when discussing killer acquisitions is the possible existence of efficiencies, as it is one of the costs to be considered in the event of blocking acquisitions that might impede future effective competition. Such inherent cost could appear because some acquisitions that may be potentially pro-competitive could also be blocked.

40. In this sense, some of these efficiencies might emerge from, for example, cost reductions, network effects or complementarities. However, the key in terms of evaluating and trying to identify them is that such efficiencies and effects of suspected ‘killer acquisitions’ should be jointly assessed.

41. As previously mentioned, the CNMC has not yet dealt with any case in which such a deep analysis and balance of potential “killing effects” and efficiencies has been needed or where the parties have claimed that such efficiencies could outweigh the negative effects of a given transaction, but it is true that as a result of the special features associated to digital economies and multi-sided markets, a dynamic approach in the evaluation of mergers is becoming more and more commonly added to the traditional static one. This new approach is based, among other things, in the identification of possible efficiencies and innovation that may arise from operations, so in that sense, the Spanish Competition Authority is incrementally introducing this perspective.

6. Initial conclusions

42. In summary, the current Spanish framework ensures most potentially anticompetitive mergers on the digital sector are notified and assessed. When analyzing mergers with a digital component the possibility of a killer acquisition is an aspect that we systematically take into account and about which we gather information, developing a specific analysis that has to do with the growth potential of the target company in the absence of the operation, the rationale of the operation and its efficiencies.

43. Moreover, a case-by-case and context-specific analysis for mergers, which should always be thorough in any sector, is of particular relevance in digital markets.

44. As a specificity of the digital sector, given the importance of data as an asset in digital markets, data both collected from users and generated from their activities constitutes an important competitive asset and probably, the buying company goal of acquiring the data available to the target company should be taken into account together

with potential innovation as an element to check when the innovative target can be a potential rival coming from a related market.