

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE****Start-ups, killer acquisitions and merger control – Note by the Russian Federation**

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1. Introduction

1. Adapting control over economic concentration to new economic realities has been a top priority for many Competition Authorities for several years now, including the FAS Russia. Challenges related to the globalization of trade, digitalization of the economy and the emergence of an increasing number of "breakthrough" innovations pose goals for Competition Authorities to review existing merger control tools.
2. The emergence of start-ups on the market that offer innovative developments and are ready to change the architecture of markets in the short term is a serious challenge for major players who quite rightly do not want to lose their market power. One solution to this problem is to take over such start-ups with the deliberate purpose of stopping their activities, in other words, "killing" them. These practices are becoming more common in sectors of the economy such as information technology, pharmaceuticals, bioengineering, food, etc. The anticompetitive nature of such transactions is obvious: they slow down the innovative development of industries, strengthen the positions of dominant companies and increase economic concentration in the relevant market.
3. At the same time such transactions often do not come to the "eyeshot" of Competition Authorities because they do not meet the threshold criteria for state control over economic concentration. Changing approaches to the consideration of such transactions is an urgent task.
4. The solution to this problem is even more urgent in connection with the spread of a new coronavirus infection COVID-19 which, it is already obvious, will significantly change the architecture of markets. Preventing increased concentration of markets and stimulating their innovative development by tracking and blocking killer acquisitions as well as setting effective conditions for transactions can be important measures to bring national economies out of the crisis.

2. Legislative aspects of merger control

5. Chapter 7 of the Federal Law of 26 July 2006 No. 135-FZ "On Protection of Competition" is devoted to state control of economic concentration and contains provisions on transactions and actions leading to economic concentration on the commodity market which are subject to control by antimonopoly bodies.
6. In accordance with Article 26 of the Law on Protection of Competition, "transactions are subject to state control and other actions with respect to the assets of Russian financial organizations and fixed assets and (or) intangible assets located on the territory of the Russian Federation, or in respect of voting shares, rights in respect of Russian commercial and non-commercial organizations as well as foreign persons and (or) organizations that supply goods to the territory of the Russian Federation in the amount of more than one billion rubles during the year prior to the date of the transaction or other action subject to state control".
7. Thus, prior approval of transactions of economic concentration is necessary if:

1. the total value of assets of commercial organizations participating in the merger or accession (and participants in their groups of persons) according to the latest balance sheets exceeds 7 billion rubles or
2. the total revenue of these persons from the sale of goods for the calendar year preceding the year of merger (accession) exceeds 10 billion rubles. This rule, however, does not apply to transactions made by the same group of persons (for example transactions between a parent and a subsidiary, mergers of business entities with more than 50 % of the shares (interests) of which the controlling person (group member) has the right to directly or indirectly dispose of).
8. When making decisions within the framework of the state control over economic concentration the Competition Authority is obliged to conduct an analysis of the state of competition in accordance with the procedure established by the Order No. 220 of the FAS Russia of April 28, 2010 "On Approving the Procedure for Analyzing the State of Competition in the Commodity Market" and make a decision in accordance with these rules. It is worth noting that the FAS Russia analyzes the state of competition not only in the market where mergers/acquisitions are taking place but also in related markets.
9. When making a decision to approve a transaction of economic concentration, the FAS Russia, on the one hand, takes into account the impact of a specific transaction on competition in this market and, on the other hand, possible positive effects on the economy even if there is a negative impact on competition.
10. When considering transactions of economic concentration, the FAS Russia uses modern dynamic approaches which analyze the consequences for markets and consumers and not just "arithmetic" approaches which imply a simple summation of the shares of companies.
11. The FAS Russia is currently working with the Association of Antimonopoly Experts on drafting Guidelines for reviewing mergers and acquisitions.

3. New approach of the FAS Russia to the assessment of transactions of economic concentration

12. The Bayer/Monsanto merger was one of the first examples during consideration of which the FAS Russia applied a new approach to evaluating economic concentration transactions.
13. In 2017-2018, the FAS has considered the merger between "Bayer AG" (Germany) and "Monsanto Company" (USA) and concluded a review of it in two phases: the competition analysis and the imposition of conditions on the merging company (7 November 2017)¹ and the final approval of the merger (20 April 2018)².
14. This merger affects the markets for the products used by agricultural producers including agricultural crops (seeds), certain crop protection products, in particular nonselective herbicides, as well as digital offerings for agriculture.
15. Both Bayer and Monsanto are vertically integrated full-cycle agrotechnology companies active in agrotechnology research and development as well as in the distribution and marketing of their products to agricultural producers.

¹ <https://en.fas.gov.ru/press-center/news/detail.html?id=52417>

² <https://fas.gov.ru/news/24815>

16. The first phase of the review corresponded to the FAS decision to impose conditions on the merging company. The conditions put forward on November 7, 2017, contained requirements to “Bayer AG” aimed at creating conditions for the development of potential competition from Russian companies.

17. In the course of this merger review, the FAS organized a series of consultations with the relevant federal authorities, as well as scientific and business communities, and foreign Competition authorities. The FAS also met the parties of the merger in order to discuss the possible negative effects the merger could have on competition as well as remedies helping to eliminate them.

18. Considering that technological transformations, including digitalization worldwide, have become key to understanding competitive dynamics in the agricultural sector, the FAS has applied new methodological approaches to identify potential anticompetitive effects of the merger both in the Russian and global markets developed in cooperation with reputable academic institutions.

19. The FAS Russia conducted a market analysis of agricultural production factors related to the transaction, including integrated agrotechnical solutions for emerging markets that were recently formed in the process of ongoing systemic technological and business transformations in the agricultural sector.

20. All these markets were analyzed by the FAS Russia in the context of the increasing globalization of the world economy and the integration of agricultural production into global value chains. This required the FAS Russia to assess not only the "horizontal" relations between market competitors but also the "vertical" interactions between different segments of global food value chains.

21. In the context of accelerating the pace of innovation in the agrotechnological sector the FAS Russia assessed not only the market shares of merging parties but also the most likely scenarios of market transformations, including changes in their competitive structure and dynamics in the short and medium term.

22. These changes are caused by the ongoing systemic shift in agrotechnology markets, which requires companies to provide integrated solutions for farmers if they want to be competitive in the global market, which include targeted crop protection solutions as well as digital solutions based on big data analysis (regarding soil, climate and other agronomic parameters) collected and processed on digital farming platforms.

23. In addition, due to the high degree of globalization of Russian agricultural production, both in terms of agricultural exports and factor imports, the above-mentioned global system transformations in the agricultural sector are being transferred to the Russian market.

24. When assessing the impact of the transaction on competition in the Russian market the FAS Russia assumed that the combined company has significant capabilities, including large genetic data, the latest technologies of accelerated genetic selection allowing the development of biotechnological seeds with predictable characteristics that are not subject to regulatory restrictions aimed at controlling the cultivation of genetically modified organisms as well as big data and algorithms for digital farming.

25. After conducting an in-depth market analysis the FAS Russia has concluded that the merger can cause the following anticompetitive effects:

- creating new and increasing existing barriers to entry in relevant markets (including those generated by introduction of closed digital agronomic platforms to the Russian market);

- enhancing incentives for anticompetitive agreements and concerted practices (considering already high level of concentration in this sector, the merger might substantially reduce a number of market players having all necessary technical and data capacities to effectively compete in the new technological and economic environment);
- increasing possibility of abuse of market power (combining innovative technologies, data, and platform solutions will allow the combined company to rapidly increase its market share up to a dominant position in a short term perspective).

26. Hence, the FAS has concluded that the merger creates substantial risks of restriction of competition, and those risks should be leveled in the course of the merger review.

27. The requirements contained in conditions imposed by the FAS on Bayer AG provide for the transfer to Russian companies of the molecular means of selection and germplasm needed to create new varieties and hybrids, with which the combined company has a strong position in the Russian market.

28. In addition, in order to develop competition in the digital farming markets the ruling of the FAS also contains obligations to provide Russian companies engaged in the development of agricultural software and applications with non-discriminatory access to digital farming platforms, including access to historical data related to the Russian Federation, as well as to the data that will be collected by Bayer AG after it commercializes its software products on the territory of the Russian Federation. Access to such data is a key factor for the development and implementation by Russian companies of their IT-developments in the field of precision farming.

29. The obligations of Bayer AG also imply the creation of a plant biotechnology research centre in the Russian Federation, which will provide practical training for Russian specialists in the field of accelerated breeding with the involvement of highly qualified specialists with significant experience in this field.

30. On April, 2018, the FAS Russia made a decision to approve the merger.

31. Considering the global nature of this transaction (the transaction is being considered in more than thirty jurisdictions), in preparing its decision, the FAS actively cooperated with foreign Competition authorities using waivers, which allow competition authorities to exchange confidential information, with the purpose of developing common approaches and synchronizing requirements for participants in the transaction.

32. Taking into account the fact that in order to monitor the fulfilment by Bayer AG of the requirements contained in the FAS ruling, as well as that special knowledge in the field of selection and IT technologies is required to efficiently transfer molecular breeding tools and germplasm, a mechanism which is new for Russian practice was used entailing the involvement of a third-party organization in the process, on the basis of which the Technology Transfer Centre was established.

33. In case the FAS Russia agreed with the "arithmetical" approach proposed by parties of the transaction of summing the company shares, the Competition Authority would have to approve this global transaction without issuing any remedies, as total shares of the combined company on relevant markets of seeds and crop protection agents does not exceed the volumes established by the Russian antimonopoly legislation.

34. Subsequently, the FAS Russia applied a new approach to controlling transactions of economic concentration and in the information technology markets. Examples include reviewing Yandex.Taxi/Uber³ and Mail.Ru/Megafon⁴ mergers.

35. In the first case, the FAS Russia conducted an analysis of the market of services for rendering information interaction between passengers and taxi drivers (the market of taxi aggregators), as well as hold a number of meetings with participants of the Russian markets of taxi and taxi aggregators.

36. A survey of market participants showed that administrative barriers to entry are characterized as easily overcome.

37. Given the fact that the market of taxi aggregators is sufficiently young and significant changes and modernization take place in this market all the time, the FAS Russia concluded that currently there are no dominating organizations but Yandex and Uber have signs of dominance that may arise in the future.

38. In order to improve the conditions for the development of competition in the market for taxi aggregators and related markets, the FAS Russia issued an order to Yandex, Uber and their joint venture to implement actions aimed at optimizing the relationship between aggregators, taxi drivers and passengers. In particular, companies are required to provide the most complete and accessible information to users about a legal entity that carries out transportation with the preservation of the history of trips; do not impose a ban on partners, drivers and passengers to work with other taxis aggregators.

39. As part of the merger the FAS Russia consulted with the Competition authorities of Kazakhstan and Belarus based on the waivers received from the companies.

40. As part of the review of another transaction in digital markets – Mail.Ru/Megafon – the FAS Russia among other things expressed concerns about the possibility of the combined company gaining competitive advantages as a result of merging large data sets. After further analysis it was found that the companies' big data is largely overlapping. In addition, similar data sets are also available to other players in this market. The FAS Russia approved this transaction.

41. Thus, in recent years there have been serious positive developments in the merger review practice of the FAS Russia: the agency focuses on particular aspects of competition development when the activities of economic entities are associated with innovations and high technologies.

4. Threat of killer acquisitions for Russian markets

42. "Killer acquisitions" refer to the acquisition of a newly emerging or potential competitor in order to stop competition or the emergence of a breakthrough technology that can change the direction of technological development of the industry. According to a well-known and widely discussed study of pharmaceutical markets⁵ at least 6% of transactions involving bio and pharma start-ups are killer acquisitions. A start-up in this industry is much less likely to bring its product to market if its development intersects with those in

³ <http://en.fas.gov.ru/press-center/news/detail.html?id=52562>

⁴ The decision of the FAS Russia on the results of consideration of the petition of PJSC "MegaFon" and LLC "Mail.Ru group" from 31.03.2017. <https://br.fas.gov.ru/ca/upravlenie-regulirovaniya-svyazi-i-informatsionnyh-tehnologiy/ag-6623-17/>

⁵ Cunningham, Colleen and Ederer, Florian and Ma, Song, Killer Acquisitions (12 September 2018, revised on April 19, 2020). Available at SSRN: <https://ssrn.com/abstract=3241707>

the product portfolios or pipelines of large pharmaceutical companies – the latter simply will not allow a small company to bring a potentially competing medicine to the stage of mass production and commercialization. Innovative development will either be shelved or will appear on the market but already under the brand of the acquiring company. The high degree of monopolization of the industry and patent "armor" contribute to the use of a strategy of killer acquisitions. This, in turn, undermines the prospects for technological development of the industry, including reducing the amount of investment in R&D and the number of new research.

43. Despite the fact that the hypothesis of killer acquisitions has been empirically confirmed in a single market – the pharmaceutical market, there is every reason to assume its applicability to other high-tech industries. As will be shown later there is a steady trend of increasing venture activity in Russia, especially during the previous three years, which is encouraged by state-funded development institutions (including accelerators and institutional venture investment funds). With the further development of innovative activity of start-ups Russian markets may also face a strategy of killer acquisitions especially from digital and pharmaceutical giants. Antimonopoly regulation can offer mechanisms to counter this strategy. A condition for the effectiveness of these mechanisms is a modification of the approach to analyzing transactions by economic concentration, the focus of which should be shifted to assessing the impact of the transaction on technological development and innovation in the industry.

5. The venture market and deals with start-ups

44. The Russian venture capital market has shown steady positive dynamics on the horizon from 2016 to 2019. The total volume of the Russian venture ecosystem in 2018 amounted to 662 million US dollars, which is 61% more than a year earlier. According to the results of the first half of 2019 the market showed a twofold growth compared to the first half of 2018, amounting to 348 million US dollars⁶.

45. The venture capital market over the past year has shown both an increase in the number of transactions (129 transactions in the first half of 2019 compared to 87 transactions in the same period of 2018) and more than double the average transaction size – 3.1 million US dollars in the first half of 2019 compared to 1.5 million US dollars in the first half of 2018⁷.

46. The basis of the venture capital ecosystem continues to make deals with companies from the IT sphere. Investors are also interested in start-ups that develop bio- and industrial technologies, medicine, and various online platforms.

47. However, transactions involving start-ups (including so-called exits from investments, in which an investor sells its share to another private or institutional investor or a major player in the relevant market) are generally not subject to antimonopoly control. One of the conditions for approval of the transaction from the Competition Authority, in accordance with the Russian legislation, is the threshold value of the company's assets object of the transaction (start-up) and its group of persons - amount of their assets must exceed 400 million rubles (equivalent to around 5.4 million dollars at current exchange rates). This condition is mandatory along with another threshold value - the total asset value of at least 7 billion rubles of the acquirer (and its group of persons) and the acquired start-

⁶RVC JSC, PwC. "MoneyTree: venture market navigator" for 2018 and the first half of 2019. P. 3, URL: https://www.rvc.ru/upload/iblock/003/MoneyTree_2019_rus.pdf

⁷ Ibid., P. 5

up (and its group of persons), or at least 10 billion rubles of their total revenue from the sale of goods for the calendar year preceding the transaction. It is obvious that not all start-ups have assets worth 400 million rubles, even taking into account the assets of the entire group of individuals that includes the start-up which is quite natural for companies at the early stages of development.

48. At the same time, transactions in relation to start-ups (especially exits from investments in which a start-up is acquired by a major player in the relevant market) can significantly affect both the state of competition (in some cases, in the deferred perspective) and equally important the direction of technological development of the relevant industry.

49. As an example the following transaction can be cited: in October 2018, "Yandex.Taxi" acquired a share of 83.3% in the service that delivers ready-to-cook fresh food "The Party of Food". The transaction amount was 13 million US dollars. During the year the second phase of the transaction was completed and the share of "Yandex.Taxi" in the start-up was brought to 100% (the amount of the second phase of the transaction was not disclosed). The service was renamed "Yandex.Chef".

50. It should be noted that FoodTech is a promising direction for the Russian market: according to experts, its volume will exceed 170 billion rubles by the end of 2020⁸.

51. At the time with the transaction, four major players were operating in the Russian segment of food delivery: "The Party of Food", "Chefmarket", "Dinner at home", and "Elementaree". The use of a strong Yandex umbrella brand as well as marketing opportunities and logistic capacities of the technology giant is likely to strengthen the position of the Yandex.Chef service in a segment in which a very small number of players still operate at the moment. Moreover, market expectations of further acquisitions by Yandex of start-ups in the FoodTech segment suggest that the company intends to repeat its strategy of expansion in the taxi service market in this sector.

52. Another example is the impact of start-up acquisitions on technological development, particularly in high-tech industries such as biotechnology, pharmaceuticals, and genetic engineering. Thus, there are two complementary trends in the global market for innovative biopharmaceuticals. On the one hand, Big Pharma companies are increasingly using the build-to-buy strategy i.e. they invest in promising scientific ideas from the point of view of a specific company's product portfolio at an early stage and subsequently buy out a start-up. On the other hand, start-ups with innovative solutions are increasingly being acquired by Big Pharma due to the latter's fear that breakthrough technologies pose a threat to the existing rental model in the industry. Thus, killer acquisitions are increasingly being made not to combat competition in markets but to combat innovative solutions that are potentially dangerous to established business models. The Russian market of biopharmaceuticals is currently growing mainly due to internal R&D local branches of Big Pharma to a lesser extent, according to the model of venture investment, but in the future we can expect that the build-to-buy and "killer acquisitions" model will be widespread in Russia as well.

53. All these developments support the need to review traditional approaches to antimonopoly control of transactions in high-tech markets. Assessing the impact of the transaction on the innovative development of the industry should also be part of antimonopoly control. For example, the transaction price can be used as auxiliary objective criteria for such control.

⁸ <https://www.kommersant.ru/doc/4250069>

6. Amendments to the Law on Protection of Competition regarding control of economic concentration

54. The FAS Russia is fully aware of the need to adapt antimonopoly regulation to changing economic realities. In the context of modern digital markets, approaches to controlling economic concentration must also change since traditional criteria based on the amount of revenue of transaction parties and the size of their assets cannot reflect the real impact of the transaction on economic conditions.

55. To date, the FAS Russia has prepared a comprehensive draft of amendments to the Russian antimonopoly legislation which following the established tradition is called the "Fifth Antimonopoly Package". The "Fifth Antimonopoly Package" is more focused on the introduction of tools and mechanisms for regulating digital markets in the antimonopoly legislation.

56. A large block of amendments concerns control of economic concentration. Among the proposed novelties of the "Fifth Antimonopoly Package" the following can be distinguished:

- introduction of a new criterion for pre-approval of transactions – the transaction volume exceeds 7 billion rubles;
- ensuring maximum transparency of information about the processing of applications;
- implementation of the Trustee institution to perform the functions of monitoring the execution of a FAS ruling;
- increasing the period for consideration of an economic concentration transaction to 9 months (currently the deadline for a Phase I decision is 3 months);
- determination of additional consequences of failure to comply with a ruling of the Competition Authority if it leads or may lead to restriction of competition: the right of the Competition Authority to apply to the court for permission to use the IP rights on the territory of the Russian Federation, if the issued ruling was related to the exercise of exclusive IP rights; the right of the Competition Authority to apply to the court with a request to prohibit (restrict) the turnover of goods produced using the IP rights on the territory of the Russian Federation by the person who was issued the ruling.

57. The adoption of the "Fifth Antimonopoly Package" will allow the FAS Russia to improve its law enforcement practice in monitoring economic concentration in digital markets. These amendments will allow antimonopoly control of M&A in digital markets including killer acquisitions of start-ups by large corporations.