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

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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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BEUC

1. Introduction

1. BEUC welcomes the discussion on how to use merger control to tackle potential negative effects of acquisitions of start-ups, and so-called “killer acquisitions”. Economic evidence suggests that the elimination of potential competition in the shape of nascent firms could be a serious issue in some markets leading to significant consumer harm.¹ At the same time, it is important that merger control does not harm innovation or pro-competitive mergers, which would also harm consumers. Many key innovations have come from start-ups rather than established market players. Innovation incentives are therefore critical. The merger control analysis of large incumbents buying up start-ups is therefore complex. This does not mean, however, that this analysis should not be undertaken. Ignoring the issue would guarantee under-enforcement errors which would continue to penalise consumers.²

2. Evidence from multiple studies suggests that concentration levels have risen across many sectors and that, at least in some cases, this increased concentration has led to increased prices and to reduced consumer choice and innovation. Anticompetitive acquisitions of start-ups by incumbents that eliminate potential competition would exacerbate this, particularly in the digital and life science sectors.

3. As outlined in the OECD Background Note, start-up acquisitions can take two forms. First, “killer acquisitions”, where the purpose of the incumbent’s acquisition is to remove a competing product from the market (whether the start-up’s or the acquirer’s product)³. Second, incumbents’ acquisitions of nascent potential competitors aimed at controlling the competing product rather than killing it outright.⁴ Both of these could potentially be harmful to consumers by reducing competitive pressure, leading to higher prices and/or quality degradation, but killer acquisitions go one step further in categorically eliminating consumer choice. As the harm is a question of degree, for ease of reference the following analysis will refer to both collectively as acquisitions of nascent rivals.

4. Given that such acquisitions have for the most part fallen outside the scope of merger review, the scale and scope of this potential harm are unknown. However, studies

¹ Killer Acquisitions - Cunningham, Colleen and Ederer, Florian and Ma, Song, (“Killer Acquisitions (2018)”, updated April 19, 2020). Available at: <https://ssrn.com/abstract=3241707>;

Antitrust Limits on Startup Acquisitions - Bryan, Kevin and Hovenkamp, Erik, (“Antitrust Limits on Startup Acquisitions (2019)”) (March 10, 2019), page 2. Available at: <https://ssrn.com/abstract=3350064>. Report of the Digital Competition Expert Panel - Unlocking digital competition (2019), (“Furman Report (2019)”), page 49. Report available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf.

² “The economic literature demonstrates that vibrant innovation and entry is the most important source of consumer welfare over time”- Stigler Committee on Digital Platforms, Final Report, September 2019, page 36 (“Stigler Report (2019)”). Available at: <https://research.chicagobooth.edu/stigler/media/news/committee-on-digital-platforms-final-report>.

³ Killer Acquisitions (2018).

⁴ OECD Secretariat Background Note Start-ups, Killer Acquisitions and Merger Control, para.15.

that have specifically looked at this issue suggest that the problem may be significant.⁵ Until very recently, such acquisitions have not even been reviewed and therefore certainly not prohibited, suggesting that there may well have been harmful under-enforcement by agencies.⁶ While obviously not all acquisitions of nascent rivals will be harmful, the fact that the enforcement pendulum has to date only swung in one direction means that it is high time to address this issue.⁷

5. BEUC therefore strongly welcomes the OECD's work to establish the best way forward for agencies in this important area of merger control.

2. 2. Ensuring that start-up and killer acquisitions are subject to merger review

6. To date, the prevailing merger control thresholds in Europe, and indeed at EU level, are generally defined in a way that is unable to catch acquisitions of potential nascent rivals,⁸ as the majority of these thresholds are based on turnover.⁹ This also means that the scale of potentially harmful acquisitions of nascent rivals to date, beyond the recent studies into specific industries, is unknown and may have been significantly underestimated. Market share thresholds may be better able to catch such acquisitions, depending on how they are formulated. Making sure that such mergers are reviewed for potential anticompetitive effects is therefore the first problem that must be solved.

7. Several options to catch this type of merger have been considered. In BEUC's view, a general lowering of turnover thresholds would not be efficient. However, adding a transaction value threshold to existing turnover thresholds might be a useful way to catch acquisitions of nascent rivals.¹⁰ A high purchase price for a company with minimal turnover suggests that the acquirer thinks it is highly valuable. This in turn suggests that it is likely to be considered competitively relevant and thus losing this potential competition might be

⁵ Killer Acquisitions (2018).

⁶ Furman Report (2019), page 91.

⁷ The ability of the market to self-correct, which has at times tilted the balance against intervention, should not be assumed in the digital economy, see BEUC Report on The Role of Competition Policy in Protecting Consumers' Well-being in the Digital Era, page 16. Available at: http://www.beuc.eu/publications/beuc-x-2019-054_competition_policy_in_digital_markets.pdf; Stigler Report (2019), pages 7ff, 31 and 80-81; Ex-post Assessment of Merger Control Decisions in Digital Markets, Lear Report to the CMA, June 2019,), page iii, ("Lear Report (2019)"). Available at: <https://www.learlab.com/publication/ex-post-assessment-of-merger-control-decisions-indigital-markets/>.

⁸ This lack of regulatory scrutiny also applies in other jurisdictions, Stigler Report (2019), page 9. Killer Acquisitions (2018) provides evidence that this a significant concern in the pharmaceuticals sector.

⁹ The UK share of supply test is more flexible than turnover/market share tests. However, the Furman Report (2019), page 94, concluded that use had not been made of this flexibility in the tech sector. Some recent merger decisions in the UK would suggest that this may however now be changing.

¹⁰ BEUC believes that the evidence base to seriously consider this has moved on significantly since the 2017 European Commission Public Consultation on Evaluation of procedural and jurisdictional aspects of EU merger control, and indeed since the European Commission Report on Competition Policy for the digital era - Jacques Crémer, Yves-Alexandre de Montjoye, Heike Schweitzer, ("Report on Competition Policy for the digital era"), see p. 113-116. Available at: <https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf>.

Transaction value thresholds have been introduced for example in Germany and Austria and are being considered elsewhere, e.g. Korea. See also the Furman Report (2019), page 94-5; Stigler Report (2019), page 16 on digital markets.

material.¹¹ Nexus issues would also need to be considered in introducing any new threshold.¹²

8. An alternative approach, suggested for example in Norway, France, the Netherlands, Italy, Australia and the Furman Report for the UK Treasury¹³, would be to impose a notification or prior information obligation on particular companies, such as digital platforms of systemic importance. However, whilst multiple studies point to under-enforcement in the tech sector, focussing only on digital would seem short sighted, given the strong evidence of harmful “killer acquisitions” in life sciences.

9. BEUC would not favour an *ex post* approach. Aside from the harm suffered by consumers before an *ex post* review identifies the harm, unravelling mergers effectively so that the competitive situation returns to the pre-merger state is likely to be complex, if not impossible, and behavioural remedies, even if these could be genuinely effective, would involve long-term compliance burdens on regulators and companies.

3. Retroactive action

10. Tackling under-enforcement may require not only changes to ensure that this does not continue in the future but also to undo harms that have already occurred, to the extent possible in the light of the *ex post* weaknesses mentioned above. BEUC therefore welcomes initiatives to review past acquisitions and, in very exceptional cases, given the implications for legal certainty, to take appropriate steps to remedy serious harms through unwinding or behavioural remedies.

4. How to assess start-up and killer acquisitions

11. In BEUC’s view, it is important when considering whether acquisitions of nascent rivals are likely to be anticompetitive, not only to evaluate the effects of incumbents buying up potential nascent competitors (horizontal mergers) but, certainly at least in the digital sector, to also include more conglomerate or ecosystem type mergers and to think broadly in multisided markets and consider leveraging practices, even if it is recognised that this is complex.¹⁴

12. The large digital platforms are continually expanding their reach across digital markets as their acquisition trail has shown.¹⁵ Two very recent examples would be Google’s proposed takeover of Fitbit¹⁶ and Facebook’s proposed acquisition of Giphy. It will be essential for agencies to consider the broad potential effects of these mergers and not to be too narrow in their thinking. Otherwise, these already highly concentrated markets risk

¹¹ Lear Report (2019), page iii-iv.

¹² See also EU Merger Control: BEUC’s comments on jurisdictional thresholds, available at: https://www.beuc.eu/publications/beuc-x-2017-010_comments_on_eu_merger_control.pdf

¹³ Furman Report, pages 95, 139.

¹⁴ Report on Competition Policy for the digital era, page 112, 116-124.

¹⁵ Ibid, page 110; See Lear Report (2019) page ii and 44, which also notes that the majority of acquisitions by Google, Facebook and Amazon are not horizontal; Furman Report (2019), page 91-92.

¹⁶ See BEUC’s report on concerns in relation to this merger. Available at : http://www.beuc.eu/publications/beuc-x-2020-035_google-fitbit_merger_competition_concerns_and_harms_to_consumers.pdf

becoming further closed to independent innovation and the current tech giants will continue to expand across ever larger digital spaces. Platform envelopment theories may be relevant in this analysis.¹⁷ Given the critical role of data, network effects, economies of scale and scope in digital markets and leveraging strategies, there would seem to be a real risk that the emergence of new challengers to today's giants would become less and less likely in the absence of effective merger control of nascent rival acquisitions.¹⁸

13. The merger control assessment of acquisitions of nascent rivals presents, however, a greater challenge than the assessment of other mergers. Predicting the future without a past or even a present (*status quo*) as a guide to the target company's market role and behaviour is inevitably going to be more difficult.

14. Traditional economic theories and econometrics, particularly based around pricing predictions as a result of the merger, are unlikely to be as useful as in other merger analyses. This will be the case all the more in digital markets, which are often characterised by zero pricing. For the reasons set out in paragraphs 11-12 above, while substitutability will be a starting point, the competitive analysis cannot end there. Agencies will need to consider other, more qualitative and financial, parameters of competition.

15. In BEUC's view, the key counterfactual should not be the *status quo* but whether the start-up would be a credible independent player, and thus an effective competitive constraint absent the acquisition, and whether acquisition by another company would result in less competitive harm. Again, it is recognised that these questions are not necessarily easy to answer. The analysis will also need to define the relevant timeframe for assessment. The default two-year forwards period foreseen for example under the EU Guidelines on the assessment of horizontal mergers¹⁹ (which are in any event being reconsidered) may not be appropriate for start-ups²⁰ and may need to be considered flexibly according to the industrial sector at stake. The relevant timeframe in the pharmaceutical sector is likely to be different to that in digital markets.

16. Other relevant questions, beyond those considered generally in merger analysis, would include: does the start-up offer a critical new innovation that offers a type of product/service not currently on the market, whether this is a valuable new drug, medical device or a digital service with revolutionary privacy protections, for example? Is there likely to be substantial demand for the product? Are there other potential start-ups that could credibly fill the gap left by the merger? Is the market already so concentrated that the loss of one potential competitor would be especially significant? Would the merger create significant problems of access to data? Would innovation be harmed in a particular sector if start-ups could not sell to incumbents? Would investment capital dry up in these circumstances, or does over-reliance on incumbents actually stifle innovation?²¹ Are there overriding, and importantly credible, efficiency arguments (investment levels, speed to market, enhanced product quality) or synergy arguments in favour of the merger?

¹⁷ For example: Harnessing Platform Envelopment in the Digital World, Padilla Jorge and Condorelli, Daniele. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3504025

¹⁸ Lear Report (2019), page xiv and 44; Stigler Report (2019), page 7-8.

¹⁹ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, para. 74. Available at: [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0205\(02\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004XC0205(02)&from=EN)

²⁰ See also Lear Report (2019), page 46.

²¹ Lear Report, page 7, 135-138; Stigler Report (2019), page 9 and 75-78. Furman Report (2019), page 37.

17. It is not necessary to predict that a start-up would become a major competitor in the future for its acquisition to be anticompetitive. We know from merger control in many sectors that small “mavericks” can play an important role in ensuring competitiveness and innovation in markets.

18. The track record of the would-be acquirer in killing/otherwise harming innovation or other competitive parameters after previous nascent rival acquisitions would probably be a further useful guide to potential anticompetitive effects of a proposed merger. The studies already undertaken in digital markets would be useful for this analysis.²² Agencies could however usefully broaden their retrospective reviews to have this tool available across other markets to make the best assessments possible of future start-up acquisitions.

19. Evidence for agencies to evaluate these questions would probably need to be qualitative and financial, rather than quantitative. This evidence should include pre-existing specialist industry reports, analyst and potential investor reports, as well as financial reporting materials of the merging parties, and internal analysis done by market players. It would be important for agencies to have the tools and resources to access such materials and produce their own evidence. Access to internal company documents of merging parties (which, together with the price the acquirer is willing to pay,²³ are often instructive on the strategic goals, intentions and capabilities of the parties) is already widely used in merger control. To properly investigate acquisitions of nascent rivals will, however, require agencies to be able to access analyses by a wider group of players including competitors, potential alternative purchasers of, or investors in, the start-up (including their valuation analyses of the start-up), customers, suppliers, potentially companies in neighbouring markets as well as sector reports which are likely to be behind pay walls. In addition to this type of qualitative and financial documentary evidence, specifically seeking the views of all market participants, including consumers, will be essential. Behavioural insights may also be useful, particularly in consumer-facing markets like digital.²⁴

5. Burden/Standard of Proof

20. As the OECD Secretariat Background Note points out “Currently, merging firms, and not consumers, enjoy the benefit of the doubt when transactions are assessed.”²⁵

21. There is increasing evidence that this policy choice has led to higher profits for companies and higher prices for consumers.²⁶ BEUC would therefore support the idea of introducing a rebuttable presumption that acquisitions of nascent rivals by entrenched dominant companies would be anticompetitive, shifting to the merging parties the burden of proof to the contrary in such circumstances.²⁷ This approach would be in line with other

²² Lear Report (2019); FTC to Examine Past Acquisitions by Large Technology Companies, 11 February 2020. Available at: <https://www.ftc.gov/news-events/press-releases/2020/02/ftc-examine-past-acquisitions-large-technology-companies..>

²³ Although it would always be necessary to verify alternative explanations for purchase prices.

²⁴ See BEUC’s contribution to the European Commission’s consultation on the shaping of competition policy in the era of digitalisation. Available at: https://www.beuc.eu/publications/beuc-x-2018-084_beuc_response_shaping_of_competition_policy.pdf.

²⁵ See OECD Secretariat Background Note Start-ups, Killer Acquisitions and Merger Control, para 136.

²⁶ Ibid, para 158.

²⁷ BEUC Report: The Role of Competition Policy in Protecting Consumers’ Well-being in the Digital Era. Available at: http://www.beuc.eu/publications/beuc-x-2019-054_competition_policy_in_digital_markets.pdf; Après moi, le

asymmetric proposals to regulate competitive harms in highly concentrated sectors, for example, the ideas being considered in the EU Digital Services Act that certain types of conduct by digital platforms of systemic importance, such as self-preferencing, are presumed harmful.

22. Recognising that this is controversial,²⁸ other halfway houses could be considered such as shifting the burden of proof based on an analysis of the expected level/quantum or chance of harm, changing from a ‘balance of probabilities’ test to a ‘balance of harms approach’.²⁹ Such approaches may be challenging to implement in practice and would seem to raise greater issues of legal certainty for both companies and agencies alike than the reversal of the burden of proof in clearly defined circumstances. Another alternative would be to adopt a presumption that above a specified high market share, any increment would be deemed harmful to competition and thus preclude a merger clearance.

6. Remedies

23. The remedy to an anticompetitive acquisition of a nascent rival may not necessarily be a prohibition. Other solutions such as access remedies (in particular for data), or compulsory licencing³⁰ (on FRAND terms) might be suitable alternatives in some cases.

7. Risk aversion by competition agencies

24. Whilst BEUC recognises that prospective analysis in nascent rival acquisitions, even using the types of evidence described above, will necessarily be more speculative than more standard merger control analysis, BEUC supports the view that to ensure that this type of merger (and, in fact, effective enforcement of competition issues generally) is correctly dealt with by competition agencies in the long term, they should be less risk averse, in particular in sectors where under-enforcement against acquisitions of nascent rivals is likely to be particularly critical due to network effects, economies of scale and scope, tipping risks, etc. Without taking borderline cases, it will not be possible to identify the right level of enforcement to the benefit of markets and consumers in the long run.³¹

déluge!Tech giants in the digital age, Valletti Tommaso, (2018). Available at: <https://ecp.crai.com/wp-content/uploads/2018/12/Tommaso-Valletti-2018.pdf> (slide 5); Big Tech Mergers – Motta, Massimo and Peitz, Martin, (2020), page 33-34. Available at: <https://www.crctr224.de/en/research-output/discussion-papers/discussion-paper-archive/2020/big-tech-mergers-massimo-motta-martin-peitz>; Stigler Report (2019), page 16-17.

²⁸ For example, the Furman Report (2019) is concerned that this could disincentivise efficient mergers, although as other reports have suggested that the majority of mergers are value-depreciating, one could question the real extent of this concern. KPMG has for example, estimated that less than a third of mergers increase value to the company and as many as 53% actually destroyed value, Unlocking shareholder value: The keys to success, 1999. Available at: <http://people.stern.nyu.edu/adamodar/pdfiles/eqnotes/KPMGM&A.pdf>.

²⁹ Furman Report (2019), page 99-101, 120-121.

³⁰ Antitrust Limits on Startup Acquisitions (2019), page 4.

³¹ See also Lear Report (2019), page iv.

8. Conclusion

25. BEUC welcomes the debate on how best to deal with the important competition policy issue of start-up and killer acquisitions under merger control. Whilst this issue is complex, in BEUC's view, inaction is not an option.

26. Although this issue concerns other sectors, notably life sciences, BEUC sees addressing merger control as one necessary element to redress the current precarious competitive situation in some digital markets, together with *ex ante* regulation of particular types of conduct by digital platforms of systemic importance and measures to pre-empt the tipping of markets.

27. Finally, in BEUC's view, whilst appreciating the existence of differences between legal orders, the greater the sharing of ideas and experience on this topic across jurisdictions, the greater the chance of getting the analysis right.