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The Concept of Potential Competition – Note by BIAC

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More documents related to this discussion can be found at
https://www.oecd.org/daf/competition/the-concept-of-potential-competition.htm

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Business at OECD (BIAC)

1. *Business at OECD* (BIAC) appreciates the opportunity to make this written contribution to the hearing on potential competition.

1. Introduction

2. The current debate regarding the nature of potential competition, particularly in relation to innovative markets, has gained significant attention. In this submission, certain principles which ought to be considered in the context of "potential competition" are emphasized, such as the importance of retaining objective, evidence-based analysis in assessing the impact of potential competition in merger reviews. It is clear that subjective and speculative assessments have consequences. Before amending evidentiary thresholds or introducing reverse onuses on large firms, there must be credible and compelling legal and economic justifications to do so.

2. The Role of Potential Competition

3. Potential competition, at least as it is generally understood in the context of mergers, tends to refer to the competitive significance of a recent or prospective market entrant. The 2010 *U.S. Horizontal Merger Guidelines*, for example, recognize that:

> *A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.*[1]

4. The complexities associated with identifying potential competition in digital markets has many commentators, academics and agencies questioning whether it is necessary and justifiable to amend the rules to lower the prosecuting standard.[2] This is most notable in relation to so-called "killer acquisitions," where the theory of harm is that the acquiring entity could eliminate or limit any expansion efforts by the target entity, or "reverse killer acquisitions," where the theory is that the acquirer may mothball its own innovation efforts in favor of the acquired assets. These theories of harm require agencies to project outcomes that are less than probabilistic and further in the future than mergers involving typical "entry" arguments, often in the absence of clear evidence as to the eventual outcome of entry. These concerns have arisen in technology markets as well as several other markets, such as pharmaceuticals and agro-chemicals.

5. One transaction, in the railway sector, seems to typify the debate. Shortly after the European Commission prohibited the Siemens/Alstom transaction in February 2019, the

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[1] U.S. DEP'T OF JUSTICE & FEDERAL TRADE COMM'N, HORIZONTAL MERGER GUIDELINES § 5.3 (2010), *available at* https://www.justice.gov/atr/file/810276/download [hereinafter U.S. HORIZONTAL MERGER GUIDELINES].

[2] *See* John M. Yun, *Potential Competition, Nascent Competitors, and Killer Acquisitions*, *in* GAI REPORT ON THE DIGITAL ECONOMY (2020), *available at* https://gaidigitalreport.com/2020/08/25/killer-acquisitions-and-nascent-competition/.

French and German governments issued a Manifesto for a European Industrial Policy fit for the 21st Century.[3] In particular, the manifesto sought a revision of the European Commission's approach to transactions to "take greater account of competition at the global level, potential future competition and the time frame when it comes to looking ahead to the development of competition."[4] The criticism leveled against the Commission at the time was that it did not account for the fact that market entry would take place by Chinese state-owned competitors outside the two-year timeframe indicated in the Commission's 2004 Horizontal Merger Guidelines, which states:

> *The Commission examines whether entry would be sufficiently swift and sustained to deter or defeat the exercise of market power. What constitutes an appropriate time period depends on the characteristics and dynamics of the market, as well as on the specific capabilities of potential entrants. However, entry is normally only considered timely if it occurs within two years.*[5]

6. Indeed, the *U.S. Horizontal Merger Guidelines* highlight, amongst other things, the importance of timing. In this regard, "[t]he Agencies will not presume that an entrant can have a significant impact on prices before that entrant is ready to provide the relevant product to customers unless there is reliable evidence that anticipated future entry would have such an effect on prices."[6]

7. The parties in Siemens/Alstom were not able to credibly show that potential rivals could influence the competitive strategies of the merging firms. The longer the timeframe, the more speculative arguments about market entry (or not) become and "may lead to a high degree of uncertainty and increase the risk of arbitrary decision-making."[7] Establishing the "swiftness" and "sustainability" criteria in the 2004 EC Guidelines is particularly difficult if potential competitors are outside the jurisdiction of the reviewing authority and do not provide the information required to enable a full assessment.

8. In March 2021, the European Commission adopted guidance to Member State competition authorities (the Article 22 Guidelines) that touches precisely on the points raised by the Franco-German Manifesto.[8] Although the new Article 22 Guidelines relate

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[3] A Franco-German Manifesto for a European industrial policy fit for the 21st Century (Feb. 19, 2019), *available at* https://www.gouvernement.fr/sites/default/files/locale/piece-jointe/2019/02/1043_-_a_franco-german_manifesto_for_a_european_industrial_policy_fit_for_the_21st_century.pdf.

[4] *Id*. at 3.

[5] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 2004 O.J. (C 31) 5, ¶ 74 [hereinafter EC Merger Guidelines]. Ex post analysis also suggests that while there may be start-ups who could have "made it on their own," likewise there are significant players who could also loose significant market presence. For instance, in 2008 Nokia was considered the dominant provider in mobile handsets. The market structure has clearly changed. From a policy perspective, it is important to therefore consider not only the likelihood of small start-ups being able to "make it on their own" but also large firms needing to innovate.

[6] U.S. HORIZONTAL MERGER GUIDELINES, *supra* note 1, § 9.1.

[7] Ioannis Lianos, *The Future Of Competition Policy In Europe: Some Reflections On The Interaction Between Industrial Policy And Competition Law* 22 (CLES Policy Paper Series 1/2019, 2019), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3383954.

[8] Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases, Brussels, C(2021) 1959 final (Mar. 26, 2021), *available at*

only to the European Union's particular procedure that allows Member State agencies to refer transactions to the Commission for review, these new Guidelines provide further thoughts on "actual or potential important competitive force" going further than the Commission's 2004 Horizontal Merger Guidelines.[9] The new Article 22 Guidelines consider that a merger could eliminate a future competitive force e.g. where the target as:

> *(1) a start-up or recent entrant with significant competitive potential that has yet to develop or implement a business model generating significant revenues (or is still in the initial phase of implementing such business model); (2) is an important innovator or is conducting potentially important research; (3) is an actual or potential important competitive force; (4) has access to competitively significant assets (such as for instance raw materials, infrastructure, data or intellectual property rights); and/or (5) provides products or services that are key inputs/components for other industries. In its assessment, the Commission may also take into account whether the value of the consideration received by the seller is particularly high compared to the current turnover of the target.*[10]

9. The notions expressed of "significant competitive potential," actual or potential important competitive force, as well as reference to significant revenues, importance of innovation or research, significant assets or key inputs/components for other industries are very broad. Naturally, the greater the agency's discretion in any merger control analysis (notably if not accompanied by clear analytical framework) the lower the legal certainty will be for companies that wish to assess potential investments. For legal certainty to be ensured, nascent competition must be more than merely possible but probable and, importantly, provable to a credible standard of proof. While acknowledging that one cannot remove subjectivity or discretion entirely, it is imperative that competition law rules are developed and enforced in an objective and evidence-based manner. The law must remain clear, certain and capable of being transparently applied. Good competition law principles require a transparent and economically sound structural approach to analyzing the effects of mergers. This well-established principle is expressly recognized in case law[11] and is contained in several enforcement guidelines including guidelines published by the European Commission as recently as 2018 which states "*defining the relevant market is of fundamental importance as effective competition can only be assessed against this definition.*"[12]

https://ec.europa.eu/competition/consultations/2021_merger_control/guidance_article_22_referrals.pdf [hereinafter Article 22 Guidelines].

[9] *Id.*, ¶ 19. The 2004 Horizontal Merger Guidelines contains comparatively little guidance on potential competition, referring to recent entrants, innovators that merge their "pipeline" of products or a short reference to a firm with a relatively small market share potentially being an important competitive force if it has promising pipeline products. EC Merger Guidelines, *supra* note 5, ¶¶ 37-38.

[10] Article 22 Guidelines, *supra* note 8, ¶ 19.

[11] *See* Continental Can v. Comm'n, 1973 E.C.R. 215, ¶ 32 ("[T]he definition of the relevant market is of essential significance for the possibilities of competition can only be judged in relation to those characteristics of the products in question by virtue of which those products are particularly apt to satisfy an inelastic need and are only to a limited extent interchangeable with other products.").

[12] Guidelines on market analysis and the assessment of significant market power under the EU regulatory framework for electronic communications networks and services, 2018 O.J. (C 159) 1, ¶ 24 (emphasis added).

10. Although a member state may make an assessment of the affected market prior to a referral, the new Article 22 Guidelines appear to side-step the quintessential principle in competition analysis of having to first define the relevant product and geographic market. The same can be said with respect to the recent joint statement of the Competition and Markets Authority (CMA), Australia Competition and Consumer Commission (ACCC) and Bundeskartellamt (Joint Statement).[13] The Joint Statement refers to agencies being required to "increasingly review[] mergers in dynamic and fast-paced markets. These mergers can involve hundreds of products or services in related markets, as well as products and services in earlier research and development stages."[14] The Joint Statement proposes that structural rather than behavioral remedies should be preferred in light of the "increasing complexity of dynamic markets and the need to under-take forward looking assessments."[15] The Joint Statement is silent on whether reference to the "market" includes specifically defining the "relevant market". We note that assessing "market power" in the absence of defining "relevant markets" would represent a serious departure from established and accepted norms of competition analysis and could introduce a risk of conjecture in the assessment of potential competition.

11. Certain members of the international competition community have discussed a range of reforms which will ensure the onus is placed on large tech companies to demonstrate the efficiencies which arise from a merger (including vertical and conglomerate mergers).[16] Significant reforms such as lowering the standard of proof or reversing the burden of proof should only be considered where the economic evidence clearly supports such a significant change in the rights of the parties and where such changes are likely to lead to more predictable and objective outcomes. Otherwise, there is a material risk that decisions will be based on perception, bias, or other factors divorced from sound economic analysis.

12. The U.S. Congress' 2020 House Majority Report suggests that agencies do not need to know if the "potential or nascent competitor would have been a successful entrant in a but-for world" but that the mere existence isolates them from acquisition (even if acquisition is their exit strategy).[17] The House Majority Report also suggests codifying a presumption against acquisitions of start-ups by dominant firms, including those operating in adjacent or related markets (which appear to be a naked cap on growth) without considering the pro-competitive nature of transactions or the rights of the parties to freely choose their business partners. Mergers involving large or dominant companies need to be carefully reviewed to ensure that such mergers would not harm competition or consumers. This typically requires a case-by-case approach. Mergers may often be pro-competitive,

[13] Competition & Mkts. Auth., Bundeskartellamt & Austl. Competition & Consumer Comm'n, Joint Statement on Merger Control Enforcement (Apr. 20, 2021), *available at* https://www.gov.uk/government/publications/joint-statement-by-the-competition-and-markets-authority-bundeskartellamt-and-australian-competition-and-consumer-commission-on-merger-control/joint-statement-on-merger-control-enforcement.

[14] *Id.*

[15] *Id.*

[16] *See* Cristina Caffarra, Gregory Crawford & Tommaso Valletti, '*How tech rolls': Potential competition and 'reverse' killer acquisitions*, VOXEU (May 11, 2020), *available at* https://voxeu.org/content/how-tech-rolls-potential-competition-and-reverse-killer-acquisitions.

[17] Majority Staff of H. Comm. on Judiciary, Subcomm. on Antitrust, Commercial & Admin. Law, Rep. on Investigation of Competition in Digital Markets 394 (Oct. 4, 2020), https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf [hereinafter House Majority Report].

even those involving large or dominant companies, and hence legislative reforms operating on the basis of wholesale prohibitions that dispense with a case-by-case competitive effect assessment lack economic foundation and put at risk potentially beneficial mergers. In our view, given the adoption by virtually every OECD member state of merger guidelines that apply decades of sound economic logic, there is clearly a balance to be struck between static market analysis and blanket prohibitions based on wholesale presumptions that "big is bad." This balance is best struck using a case-by-case, economically sound, evidence-based, competitive effects approach. Where such an analysis demonstrates that a merger of a potential competitor is competitively harmful, then the merger should be challenged and blocked.

13. Cremer et al. point out that broadening the concept of potential competition might significantly increase the number of possible competitors and therefore the assessment of market power of the acquirer. "It may then be difficult to show that the number of other potential competitors remaining in the market after the merger would not exert sufficient competitive pressure in the future."[18] The result of a broadened concept of potential competition "could be more 'false negatives' instead of fewer."[19] The problem remains an evidentiary one; the proof required to demonstrate that a start-up intends to enter the acquirer's core market may be difficult to obtain or verify.[20]

14. It should not be controversial to say that concerns that are unsupported by evidence should not be the basis for decision-making. While it may be politically attractive to suggest that authorities be more confident in taking speculative decisions, the impact on the investment climate should not be ignored. Merger regimes where risks are harder to assess will affect investment decisions. Investment capital will tend to flow to those jurisdictions where business and legal certainty is higher. Divergent approaches to the assessment of potential competition in digital markets may well also increase the risk of forum shopping as new start-ups might prefer to establish themselves in jurisdictions where a potential acquisition is less likely to be scrutinized against subjective standards.

15. Digital markets are complex and dynamic, but this seems to motivate agencies to be better equipped in understanding digital markets rather than lowering the prosecutorial standards, such as by introducing reverse presumptions. Mergers cannot, irrespective of the evidentiary standards, be accurately and consistently reviewed if the relevant markets are not understood. Accordingly, any response to concerns in merger analysis should be evidence based, procedurally transparent, and proportionate to the identified harm to competition.

16. While this paper does not focus specifically on digital markets, in the context of whether reverse onus or anti-competitive presumptions are being contemplated, the following questions, inter alia, are important and should be central to the debate as to whether the rules need to change:

[18] Jacques Crémer, Yves-Alexandre de Montjoye & Heike Schweitzer, *Competition Policy for the Digital Era: Final Report* 119 (2019), *available at* https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf.

[19] *Id*. at 119.

[20] Many start-ups may have high hopes and prospects of being successful. Establishing a degree of probability that would give rise to concerns about whether the start-up would in fact achieve such ambitions (absent the acquisition by a well-resourced acquiring entity) is difficult to quantify. Economically, one way to consider this is to consider what percentage the start-up has of being successful (absent a merger) and then apply that same percentage to all possible pro-competitive consequences that may have come about as a result of the merger.

- Whether acquisitions of products which are at an early stage of development could accelerate or decelerate the time it takes to get that product to market and the quality of the product to be delivered to the market.
- Whether there are reasons that "buying" rather than "building" is an efficient or inefficient strategy.
- Whether the merger might increase or decrease innovation incentives by altering either appropriability or innovation efficiencies.[21]
- Whether the incentives to innovate will be altered if "potential competitors" are no longer able to be acquired.
- Whether the relevant product or service market has been static or dynamic.

17. Accordingly, while we recognize that competition law enforcement is not static and that market structures and dynamics may require a re-think of how competition law is framed and developed, competition laws have typically been developed or applied differently when there is clear and overwhelming economic evidence which justifies a departure from the status quo.

18. Whether there is sufficient analysis and evidence to conclude that competition agencies are persistently making type II errors (i.e. approving anti-competitive mergers) which justifies a departure from traditional evidentiary standards is not apparent.[22] Notably, the Report of the Digital Competition Expert Panel states that "the majority of acquisitions by large digital companies are likely to be either benign or beneficial for consumers, though a minority may not be", and that "[t]here is no need to shift away from [the current, mainstream framework for competition], or implement a blanket presumption against digital mergers, many of which may benefit consumers" and that "[a] presumption against all acquisitions by large digital companies is not a proportionate response to the challenges posed by the digital economy."[23]

19. In assessing whether a merger is likely to harm competition, it is vital that there remains an objective, and economically defensible standard against which to evaluate the evidence and form a decision on a case-by-case basis. Digital markets may present new and complex theories of harm which may justify increased scrutiny, but that increased scrutiny should be viewed rather as a screening exercise to identify which mergers the

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[21] *See* Yun, *supra* note 2 (providing a useful perspective on these points). Additionally, COVID-19 has demonstrated that collaboration can be good for innovation. *See* Mukhisa Kituyi, *COVID-19: Collaboration is the engine of global science – especially for developing countries,* WORLD ECON. FORUM (May 15, 2020), *available at* https://www.weforum.org/agenda/2020/05/global-science-collaboration-open-source-covid-19/. *See also* Press Release, South African Competition Comm'n, Competition Commission Publishes Final Report Of Its Covid-19 Impact Study 1 (Apr. 25, 2021), *available at* http://www.compcom.co.za/wp-content/uploads/2021/04/COMPETITION-COMMISSION-PUBLISHES-FINAL-REPORT-OF-ITS-COVID-19-IMPACT-STUDY-1.pdf (noting that the block exemptions which were granted to industries to ease the burden of the pandemic had an overall positive effect and that "[t]hese block exemptions allowed market players to collaborate and coordinate their response to the crisis to mitigate the negative economic and social impact of the crisis.").

[22] *See* Yun, *supra* note 2 (providing a useful perspective on these points).

[23] Unlocking Digital Competition, Report of the Digital Competition Expert Panel 12, 101 (Mar. 2019), *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785547/unlocking_digital_competition_furman_review_web.pdf

agencies should dedicate additional resources to investigate as opposed to introducing anti-competitive presumptions—at least without compelling evidence that agencies are not able, under existing and traditional rules, to identify and remedy *ex ante* mergers which may have a credible risk to consumer welfare.

20. In assessing potential competition in merger review, there are certain overarching guiding criteria which ought to be followed such as:

- As BIAC noted previously, "the observable competitive relationship between the parties should be a starting point for evaluating the potential for competitive concern. Thus, the initial consideration should be to evaluate whether the nascent competitor currently sits in a horizontal, vertical or adjacent relationship to the acquirer."[24] Against this historical backdrop, potential competition has proven a concern more often in horizontal mergers.
- The extent to which the "potential competitor" is unique (owing to some form of superior intellectual property or other assets/advantages). The Cremer Report suggested "high growth" products might justify attracting greater anti-trust scrutiny.[25]

3. Potential Competition and Unilateral Conduct Enforcement

21. Certain jurisdictions have developed legislation in order to protect a specific class of competitors (such as small or previously disadvantaged firms) in order to promote their participation in the market.[26] It is in this context that "potential competition" also features although there are inherent industrial policy objectives underpinning the amendments.

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[24] OECD, Start-ups, Killer Acquisitions and Merger Control –Note by BIAC, DAF/COMP/WD(2020)29, ¶ 13 (June 4, 2020), *available at* https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2020)29&docLang uage=En. *See also* OECD, Vertical Mergers in the Technology, Media and Telecom Sector–Note by BIAC, DAF/COMP/WD(2019)73, ¶¶ 2-3 (June 4, 2019), *available at* https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2019)73&docLanguage=En

There is a general consensus that vertical mergers result in significant efficiencies and should be presumptively viewed as beneficial to competition. Vertical mergers combine firms that produce complements and thus generally incentivize the merged firm to reduce prices, expand output and increase investment. This is also the case with vertical mergers in the technology, media and telecom sector, which are subject to continuing and rapid technological change that blurs the lines between traditional levels of the supply chain.

Business at OECD therefore believes that when reviewing vertical mergers in this sector, competition authorities should (i) recognize the significant efficiencies reflected by vertical mergers; (ii) employ a traditional competitive effects analysis, including focusing on theories of harm based on either input or customer foreclosure ; (iii) carefully consider remedies to ensure significant efficiencies are achieved and the remedies do not distort the relevant market, for example, by preventing the merged entity from entering into certain types of contracts that may be beneficial to suppliers or customers; and (iv) not try to achieve other public policy goals through merger review.

[25] Crémer et al, *supra* note 18, at 116.

[26] *See, e.g.*, South Africa's amended price discrimination provisions which have prohibited volume-based rebates per se, if it leads to a pricing differential which impedes the ability of the designated class of competitors to compete. This is regardless of whether volume-based rebates are linked to clear efficiencies and/or whether suppliers are ultimately engaging in consumer welfare enhancing.

While ensuring a more competitive environment by increasing the participation of smaller market participants is laudable and would benefit competition and consumers, an express market intervention to achieve that objective risks shoring up inefficient competitors, which may have an adverse effect on consumers, which is not justified.[27]

22. We also have observed other attempts to prevent large players from entering new markets. For example, the 10th Amendment to the German Competition Act seeks (among other things) under the new Section 19a, those companies designated as “undertakings of paramount significance for competition across markets” from expanding into new markets and leveraging their market position from their traditional market into the new market. Any consideration of action in this regard should be weighed against the idea of promoting entry and potential competition, as action to limit entry in some instances may insulate existing markets from expanded competitive pressure, particularly where the number of potential entrants is limited by large capital requirements or the need for complementarities with existing businesses.

4. Conclusion

23. The assessment of potential competition in merger analysis is not novel. While agencies are encouraged to better understand complex and dynamic markets (as many have done or are actively doing), objective and evidence-based decision remains critical to ensuring continued, respected review processes. Before “rules” are changed, clear and compelling justifications are required in order to demonstrate that the current processes and rules are inadequate.

[27] *See* Michael-James Currie, South Africa’s amended price discrimination provision: an analytical framework in relation to the grocery retail market (2020) for a comprehensive view of unilateral enforcement and potential competition. Instead of protecting the competition process, the amendments to South Africa’s price discrimination provisions pose a material risk to pro-competitive and consumer welfare enhancing pricing strategies being undermined in favor of shoring up a class of inefficient competitors.