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Theories of Harm for Digital Mergers – Note by Austria

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1. Digital markets can differ in many aspects from traditional markets. Mergers in digital markets challenge the traditional merger policy and traditional theories of harm. This has been in parts already addressed with new or modified traditional instruments and theoretical concepts as well as adoptions of the legal framework on national as well as supranational level. This contribution provides an overview to the specific questions that mergers in digital markets raise and the associated current answers.

2. Theories of harm can especially occur if mergers are not underlying scrutiny. However, in digital markets competition authorities did not scrutinize many acquisitions. This is mainly a result of the role of revenues in digital markets and the revenue based thresholds of merger control regimes. The precondition to theories of harm in digital markets is consequently an adequate notification threshold capturing the specific features of digital markets.

3. Whereas on traditional markets revenues usually reflect the market position of a company, this is not necessarily the case in digital markets. Companies that generate currently only low or no revenues can have in digital markets strong market positions or a high market potential. Commercially valuable data or a significant amount of active users that allows the realization of network effects can for instance create strong market positions even in the absence of revenues. Zero monetary price services are observable in many digital markets that are organized as multisided platforms with significant network effects.

4. In many jurisdictions, mergers fall under the merger control regime if the revenues of the acquiring company as well of the target company are above certain thresholds. Consequently, using only revenue based thresholds risks that a competition authority does not scrutinize potentially anti-competitive mergers in digital markets. Due to the rise of digital markets and the various competitive issues that are coming along with it, there is a need to fine-tune merger control, which starts already at its very beginning: the thresholds under which mergers are obliged to be notified.

5. To address this gap in the merger control that emerged by the rise of digital markets, Austria introduced in 2017 together with Germany a transaction value threshold, which complemented the existing thresholds where only revenues are relevant. This additional threshold orientates to some extent at the ‘size of transaction test’ in the US-American merger policy.[1] According to this test, a merger needs to be notified when its transaction value exceeds a certain threshold.[2] In contrast to the US-American transaction test, considers the transaction value threshold in Austria and Germany other criteria than domestic revenues as a proxy for domestic activities. [3]

[1] Erläut dt BReg, pp. 72

[2] Section 7A Clayton Act, 15 U.S.C. para. 18a.

[3] The test for the obligation to notify under the transaction value threshold consists out of four criteria: (i) Worldwide aggregate revenues > EUR 300 m, (ii) aggregate revenues in Austria > EUR 15 m, (iii) transaction value > EUR 200 m, and (iv) target company has significant domestic activities; see Para. 9 (4) KartG and for a discussion of the concept of significant domestic activity in the transaction value threshold in Austria see Ivanova & Thanhäuser (2022). Erhebliche Inlandstätigkeit bei digitalen Plattformen. Wirtschaft und Wettbewerb.

6. The Austrian Cartel Court brought already with some decisions more clearance to the questions of what a domestic activity is and when it is significant. In one previous decision, the Cartel Court found that a considerable share in a market or segment could constitute a *significant activity*. In the Salesforce/Tableau decision, [5-10] % shares in the software-segment for modern business intelligence platforms surpassed for the court the threshold of significant domestic activity.[4] Concerning the use of digital platforms, the Austrian Cartel Court found that a domestic activity of a platform could arise not only from its direct use but also from its indirect use. In the Facebook (Meta) / Giphy decision, Giphy's [0.5-1] m indirect monthly active users in Austria built the basis for the Cartel Court's conclusion that 'the threshold of marginal activities was clearly surpassed.'[5]

7. From its introduction in November 2017 until December 2022, 121 mergers were notified under the transaction value threshold. Among them 21% were mergers in digital markets and additional 4% were in the field of electronics. One of these cases was brought to in-depth investigation to the Austrian Cartel Court (phase II) which cleared the acquisition with remedies.[6] Also on the level of the European Union, changes have been made or are discussed. According to the Digital Markets Act declared Gatekeeper need to inform about their acquisitions. Moreover, the interpretation of Article 22 is recently again under discussion.[7]

1. Merger Control

8. When assessing competitive effects of notified mergers in digital markets it is important to take its specific features into account that may vary from traditional markets. In contrast to traditional markets in digital markets, business models tend to be organized as (multisided) platforms that are usually embedded in ecosystems including several digital services or products. Enormous economies of scale due to negligible marginal costs and the importance of data are further typical to digital markets.[8] Consequently, direct or indirect network effects, zero monetary price services, the collection and proceeding of data are amongst others challenging traditional merger control. Similar to the thresholds for an obligation to notify also modifications in the merger control in digital markets are needed. These modifications concern the instruments for assessing a merger as well as the legal framework of merger control.

1.1. Market Definition

9. Defining markets is the standard precondition for theories of harm. How to define markets in the digital sphere is a widely discussed issue.[9] Instruments that are used to define traditional markets one can usually not apply one to one for defining digital markets. Its challenges can be well illustrated by an example. Let us assume a platform with two distinct user groups, A and B. The platform offers zero monetary price services, i.e. $p_A = 0$, to

[4] Austrian Cartel Court, 22.4.2021, 27 Kt 9/21g - Salesforce / Tableau.

[5] Austrian Cartel Court, 22.7.2021, 28 Kt 6/21y-7 - Facebook (Meta) / Giphy.

[6] BWB-Z/5549 and Austrian Cartel Court, 28 Kt 8/21t, 28 Kt 9/21i - Meta (Facebook) / Giphy

[7] See for example EC, M.10188 – ILLUMINA / GRAIL.

[8] See for example Crémer et al. (2019). Competition policy for the digital era.

[9] See for example Franck & Peitz (2019). Market Definition and Market Power in the Platform Economy, CERRE.

user group A (e.g. consumers) and services for a monetary price of $p_B > 0$ to user group B (e.g. vendors or advertisers). Members of user groups A exert B indirect network effects through the platform.

10. In traditional markets, the hypothetical monopolist test, which is also called SSNIP test, is the traditionally used instrument for defining markets.[10] SSNIP is the abbreviation for 'small but significant non-transitory increase in price'. This test usually considers a price increase of 5 - 10 %. Obviously, a standard SSNIP test fails in our example for user group A as the platform offers to a zero monetary price services. Although the platform charges a monetary price for its services to user group B, also for this platform side a standard SSNIP test may fail. Here the issue in defining the markets arises from the multi-sidedness of the platform. Indirect network effects make the decisions of user group A and B interdependent. Consequently, the reaction to a price increase for user group B may also affect the other user group A, which in turn may affect user group B and so on (feedback loop across user group A and B).[11]

11. A way to overcome the first issue with defining markets in our example is to ask for the reaction to decreased quality instead of increased prices. Therefor one can apply the quality-adjusted version of SSNIPP test, the so-called 'small but significant non-transitory decrease in quality' or SSNDQ test. The EC applied already such a quality-based approach in a recent case to define the relevant market.[12] The SSNDQ test is also a suggested tool in the EC's current draft of a new Market Definition Notice.[13] However, the application and assessment of a SSNDQ test open new questions. First, it is not clear how to ask for the response a 'small but significant non-transitory decrease in quality'. Whereas formulating a price increase of 5-10% in a questionnaire is usually relatively easy as well as easy to understand for its respondents, the formulation of a 5-10% quality deterioration that the respondents correctly understand can be a difficult challenge. This is especially the case if for instance a merger leads not to a decrease of the current quality level but in future to a decreased quality compared to a counterfactual with higher innovation levels. Second, in contrast to the SSNIP test quantifying the results of a SSNDQ test can be difficult or even impossible.

12. To address the second issue with defining a market arising from indirect network effects one needs to consider feedback loops in the assessment of the SSNIP test. The profitability of a 'small but significant non-transitory increase in price' should therefore also take into account any effects resulting from the reaction of users of the other platform side. Due to feedback loops arising from indirect network effects a SSNIP test can provide misleading results if it considers only the reaction to a price increase of members of user group B without taking the reaction of user group A into account.

13. Beyond these problems in applying a SSNIP test in digital markets, in general the use of a SSNIP test can be problematic in digital markets. Many platforms seek to create their own markets with differentiating their services from competing platforms. For instance, different functionalities or different user bases can already make a - at least short

[10] See also European Commission (1997). Notice on the definition of relevant market for the purposes of Community competition law.

[11] This feedback loop is also called call this feedback loop 'attraction spiral', see Belleflamme and Peitz (2021). The Economics of Platforms - Concepts and Strategies.

[12] EC, AT.40099 – Google Android

[13] EC (2021). Evaluation of the Commission Notice on the definition of relevant market for the purposes of Community competition law.

run - substitution of a communication service difficult or even impossible. For many commentators the focus of merger control should be consequently more on theories of harm than on market definitions.

1.2. Theories of Harm

14. The features of digital markets require a specification of traditional theories of harm as well as new theories of harm. As mentioned already above, for example zero monetary price services and network effects are common features of digital markets. Both challenge traditional theories of harm and instruments capturing it. Moreover, the dynamic environment of digital markets can make it difficult to find the correct counterfactual for the merger, i.e. the alternative situation that would have appeared without the merger.

1.2.1. Horizontal Theories of Harm

15. Beyond the problems zero monetary price services bring for defining a market, it makes also a revision of standard horizontal theories of harm necessary. As here a post-merger price increase is not relevant, a standard horizontal theory of harm that predicts higher prices after a merger may fail in this case. To address this, for a horizontal theory of harm quality-adjusted prices seem to be useful. In merger control practice, the gross upward pricing pressure index or GUPPI is a common tool for the economic analysis of unilateral effects in mergers with differentiated products.[14] In many digital markets, evaluating the competitive harm in horizontal mergers requires a quality-based approach that incorporates also externalities such as network effects. Neglecting the multi-sided nature of a platform might lead to biased conclusions. The GUPPI has been already adopted for two-sided markets.[15] However, this adoption makes its computation more complex and the GUPPI loses its advantage of a simple and fast performable application.

16. While the monetary price of a zero-price service stays unchanged - at zero -, the quality of a service can decrease as a result of a merger compared to a counterfactual with the higher pre-merger innovation level. This shows that innovation and its dynamics can be in digital markets more relevant when formulating a theory of harm than the price pressure, which traditional horizontal theories of harm predict.

17. Another challenge for traditional theories of harm is the counterfactual. As already mentioned above, platforms typically do not generate revenues in their first years where many of them mainly focus on growth. For example, a platform with a monetizing strategy based on advertising first needs to attract many users to the platform before it can attract advertisers. Especially when platforms are acquired in such an early stage, finding an appropriate counterfactual appears to be a challenging task. Without current competition in a market between acquirer and target, a merger can still lead to a loss of potential or dynamic competition.[16] Hence, in digital markets a horizontal theory of harm it is even more needed to consider horizontal post-merger effects even in the in the absent of pre-merger horizontal overlaps between acquirer and target.

[14] See Salop and Moresi (2009). Updating the Merger Guidelines.

[15] See Affeldt, Filistrucchi & Klein (2013). Upward Pricing Preassure in Two-Sided Markets. The Economic Journal.

[16] See for example CMA, Final Report Meta (Facebook) / Giphy.

1.2.2. Vertical Theories of Harm

18. Direct or indirect network effects can for instance play an important role in vertical theories of harm in digital markets. However, the role of network effects is here not clear by default as network effects can be pro-competitive as well as anti-competitive.[17]

19. When competitors are relevant for the generation of network effects, they can be pro-competitive. Then the merging companies have due to network effects less incentive to foreclosure. This can be the case for the example of a platform with indirect network effects between its two user groups, consumers and vendors. As the vendors are here essential for the generation of indirect network effects, customer foreclosure becomes costly for the platform. Although, the merged entity may have in such a case less incentive to full foreclosure, partially foreclosing competitors by charging higher commissions and fees or lessening quality of services can still be a profitable strategy.

20. On the other hand, network effects can be anti-competitive when competitors are adverse for the generation of network effects. In a case where a service is integrated in many platforms and foreclosing this service can 'steal' users or traffic, network effects can reinforce incentives to full or partial input foreclosure.[18]

21. When applying instruments to measure vertical effects of mergers in traditional markets - like for example vertical arithmetic or the vertical GUPPI (vGUPPI)[19] - one needs to take the competitive role of the associated network effects into account. Otherwise, without considering the relevant network effects such instruments result in either too pro-competitive or too anti-competitive conclusion.

1.2.3. Data and Conglomerate Theories of Harm

22. Typically, data plays an essential role in the digital economy. However, data is not homogeneous. The value of data is not always the same. It depends on the type, quantity and variety of data and its sources. In general, four categories of data exist: user data, contextual data, analytics data, and search data. Matching different datasets can for instance make originally worthless data very valuable. There are economies of scale and economies of scope in play.[20] Data can be valuated very differently across platforms. Broadly speaking, the value of data for a platform depends on the platform's business model and whether it is embedded in an ecosystem or not.

23. For business models that focus on the monetization through advertisements, data can be more valuable than for other business models as targeted ads require data. Across platforms, the scale of data collection is very unequally distributed. Noticeable, the two

[17] So far, the economic literature has still made relatively little contributions to the question of vertical merger effects in platform economies.

[18] See for example Meta (Facebook) / Giphy, https://www.bwb.gv.at/en/news/detail/facebook-giphy-merger-afca-files-request-for-examination-with-cartel-court

[19] See for example Pittman (2017). Three Economist's Tools for Antitrust Analysis: A Non-technical Introduction, Competition Authorities in South Eastern Europe; Moresi & Salop (2013). vGUPPI: Unilateral Pricing Incentives in Vertical Mergers. Antitrust Law Journal.

[20] See also CMA (2020). Online platforms and digital advertising market study. Appendix F: the role of data in digital advertising

major platforms for online advertisement, Google and Meta (Facebook), possess by far the largest volume of data.[21]

24. In ecosystems with many different platforms/services, data can be of higher value. Within ecosystems, matching and merging datasets from different (owned and operated) sources enables more and better opportunities. This brings advantages in monetizing data. Also allow ecosystems the cross subsidization for services to collect data.

25. This brief sketch on the role of data in digital markets reveals the challenges data brings for merger control. Quantifying and valuating data can be difficult. Some recent acquisitions seem to be highly motivated in having access to the target's data. In mergers between firms active on different markets, data generated on one market can be used (in combination with other datasets) on the other market or on new markets.[22] Recent economic literature suggests that data can be both, pro-competitive and anti-competitive. Consequently, data-driven merger can derive a data theory of harm or an efficiency argument.[23]

26. For assessing horizontal, vertical as well as data and conglomerate effects of mergers in digital markets, internal documents can build a good first fundament for the formulation of theories of harm. The information provided by internal documents can illustrate well the plans and considerations of a merger by the merging entities but also hint to its counterfactual. Internal documents can for example reveal that the acquirer's main motivation relies on the access to the target's data and provide data theory of harm. Requesting internal documents, however, needs to be well considered. While missing relevant information by requesting narrowly internal documents, wide requests may yield to a flood of documents that ties too many capacities and, hence, may paralyze the assessment of the competitive aspects of the merger.

1.3. Standard of Proof

27. Additionally to the market dominance test Austria introduced in 2022 the 'significant impediment to effective competition' or SIEC test.[24] An effects-based approach seems to be a more useful for the here sketched challenges of digital markets. For example without precise market definitions, it is usually difficult or impossible to prove dominance. Similarly, for vertical theories of harm - especially in the case that one or more relevant markets cannot be precisely defined - proofing dominance can be hassle. The SIEC test focuses on the competitive effects of a merger. For capturing the challenges of digital markets as well as its dynamics this test of proof is therefore superior to a rather static attention on market structures on which the dominance test relies.

[21] See also CMA (2020). Online platforms and digital advertising market study. Appendix F: the role of data in digital advertising, Figure F.1.

[22] See for example the Google / Fitbit discussion: https://cepr.org/voxeu/columns/googlefitbit-will-monetise-health-data-and-harm-consumers; https://cepr.org/voxeu/columns/why-i-agree-google-fitbit-decision

[23] See de Cornière & Taylor (2021). Data and Competition: a General Framework with Applications to Mergers, Market Structure, and Privacy Policy. TSE Working paper.

[24] The AFCA has been already before promoting the introduction of the SIEC test. See https://www.bwb.gv.at/fileadmin/user_upload/PDFs/Stellungnahme_GD_KaWeRAEG.pdf

2. Concluding Remarks

28. Mergers in digital markets are a specific challenge for merger policy. This contribution sheds light on some issues related to mergers in digital markets. Specific features of digital markets derive specific issues that cannot simply be addressed with applying traditional theories and instruments. Some of these issues have been already addressed with new or modified traditional instruments and theoretical concepts. The legal framework has also already been on national as well as supranational level adjusted to the challenges of digital markets.

29. Assessing ex-ante effects is a typical challenge of merger control. This is especially the case for mergers in digital markets. Plenty of recent ex-post evaluations may provide for challenges that haven't been addressed yet useful lessons.[25] For other issues there are no appropriate answers found yet. This is also because some specific features of digital markets can be ambiguous in respect to its competitive effects. Due to the dynamics of digital markets, new issues will certainly arise. The rising importance of digital markets, hence, already brought and will bring in future dynamics into the merger policy.

[25] For example EC, AT.39740 Google Search (Shopping), AT.40462 Amazon Marketplace, and AT.40703 Amazon - Buy Box.