

Unclassified

English - Or. English

15 November 2023

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

The Role of Innovation in Enforcement Cases – Note by Spain

5 December 2023

This document reproduces a written contribution from Spain submitted for Item 3 of the 141st OECD Competition Committee meeting on 5-8 December 2023.

More documents related to this discussion can be found at
www.oecd.org/competition/the-relationship-between-competition-and-innovation.htm.

Antonio CAPOBIANCO
Antonio.Capobianco@oecd.org, +(33-1) 45 24 98 08.

JT03531795

Spain

1. Introduction

1. Innovation is a key driver of economic growth and development, playing a crucial role in the creation, evolution and transformation of markets and industries. It is also very relevant to competition, so it plays an (increasingly) important role in the assessment of both merger and antitrust cases.

2. In the assessment of both merger and antitrust cases we have taken the innovation strategies of companies into account. One example of this is the assessment of potential killer acquisitions in mergers or the risks of innovative input foreclosure in antitrust. Another example is taking innovation into account in market definition, when analysing supply-side substitutability and potential competition (even if the line between the two can become blurred).

3. This contribution is exclusively focused on the assessment of innovation in mergers, where this aspect has been particularly relevant. The Spanish market share notification threshold has allowed to capture specific mergers in dynamic and rapidly evolving sectors where innovation plays a key role¹.

4. After this first introductory section, Section 2 explains the general approach of CNMC's assessment of innovation, in the specific case of merger control. Section 3 refers to the practical experience of the CNMC in analysing cases in which innovation has played a relevant role in the competitive assessment. Section 4 concludes with some takeaways.

2. General approach of CNMC's innovation assessment in merger control

5. As has already been mentioned our market share threshold for notification (together with a business turnover criterion) has proven effective to capture mergers in some dynamic and rapidly changing sectors where innovation is key², such as digital services, an area in which the CNMC has analysed 25 digital mergers in the last 4 years. More than 70% out of them were notified through the market share threshold (they would have gone under the radar otherwise, had this notification threshold not existed). Some of these operations were not eligible to the simplified form (given their potential impact on competition) and some were subject to remedies to be approved.

¹ The market share criterion has flexibility to adapt to specific circumstances (for instance, in digital activities market shares can be defined not only in terms of nominal revenue but also in terms of other indicators, like users, devices, downloads, clicks or visits, etc.). A relevant merger can be analyzed through the market share criterion even in some cases where the company is not raising substantial revenues (provided that market shares meet the quantitative threshold in metrics which might be relevant to measure the presence of the merging entities in the market). Informal communication during the pre-notification phase and a formal consultation process can give some certainty to the firms regarding the need to notify a given operation.

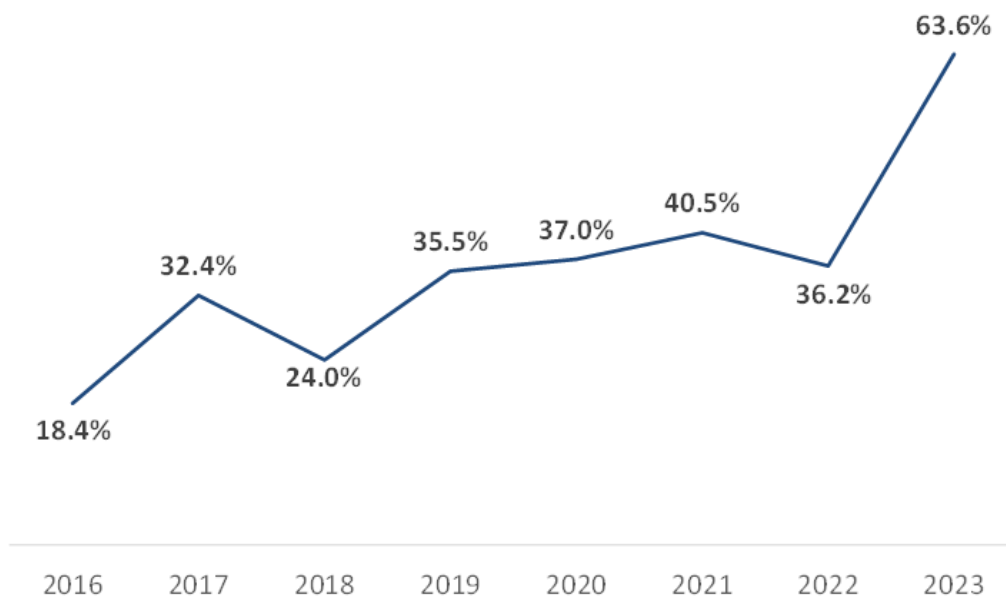
² See Spanish contribution to the OECD roundtable on "Theories of Harm for Digital Mergers" (2023).

6. The Spanish Competition Act³ includes substantive assessment criteria are flexible enough to deal with innovation as one of the key parameters of analysis of market outcomes and theories of harm. The competition authority must factor in, among others, current or potential competition, the existence of barriers to entry, the evolution of supply and demand and, in particular, the impact of the concentration on the improvement of production or commercialization systems and on competitiveness. Due regard must be given as well to the economic efficiencies arising from the concentration and the extent to which these efficiencies are passed on to intermediate and final consumers, in particular in the form of increased or improved choice and lower prices.

7. All those factors are related to innovation, and they allow the CNMC to take relevant theories of harm into account (the elimination of current or potential innovators, innovation strategies as a barrier to entry in a market, etc.), as well as introducing innovation in the competitive assessment of markets (since innovation is a driver of the evolution of supply and demand and is capable of generating efficiencies inherently linked to the concentration).

8. The CNMC has increasingly introduced innovation in the assessment of operations along the last years. In 2016-2018 a specific evaluation of innovation affected only 20-30% of cases. That percentage has gone up to 35-40% in 2019-2022 and to more than 60% in 2023.

Figure 1. Percentage of cases which have included a substantive assessment of innovation



Note: Only the cases with an ordinary (non-simplified) form have been considered.

9. The next section explains some cases where the Spanish Competition Authority has paid special heed to innovation when analysing market dynamics and theories of harm, especially in digital markets.

³ Article 10 (especially sections (c), (e), (f) and (h)) of Spanish Competition Act <https://www.boe.es/buscar/act.php?id=BOE-A-2007-12946&p=20230629&tn=1#a10>

3. The CNMC's practical experience concerning the analysis of innovation

10. Digital markets show special features, such as dynamism and zero pricing schemes (by which operators prioritise growth at the expense of revenue, at least at early stages, in order to exploit scale/learning/scope/network effects related to multi-sided platforms and big data) which turn innovation very relevant. Innovation must be factored in when analysing market outcomes but also when assessing potential theories of harm (the most prominent of which being the risk of a killer acquisition to buy a potential/nascent challenger, chilling out competition and innovation).

11. Innovation has been a key parameter in the analysis of different cases in online food delivery, antiplagiarism software, cybersecurity, online legal resources and other digital platforms. These cases are explained below.

3.1. Online food delivery sector

12. This sector has received a notable scrutiny from the point of view of merger control⁴. In one of these operations (JUST EAT/CANARY⁵), JUST EAT acquired the exclusive control of Canary Delivery Company, S.L. (CANARY), a Spanish company established in 2014 only operating in the Canary Islands. This merger was cleared without commitments in 2019, as the CNMC, after an exhaustive analysis of the case, considered that the operation could not be expected to imply a threat to competition in the relevant markets.

13. This specific case was relevant for the CNMC in learning how to assess killer acquisitions and innovation theories of harm. In that sense, the CNMC ended up concluding that the operation couldn't be assessed under a killer acquisition theory of harm, as Canary was not to exert a significant competitive pressure. It had very low turnover, just one employee and its pricing policy was similar to Just Eat.

14. Negative impacts on innovation were also discarded. Canary's R&D effort was already very low. When R&D efforts are very similar in size between the merging firms it is more likely that the consolidated entity reduces its innovation effort to exploit cost synergies. In this case, innovation effort was very different between the two parties (very low for Canary), so Just Eat was unlikely to cut R&D investment as a result of the operation.

15. So, in this transaction, the killer acquisition theory of harm and other innovation theories of harm were analysed and discarded. This merger was unconditionally cleared.

3.2. Anti-plagiarism software

16. Turnitin/Ouriginal⁶ consisted in the acquisition by Turnitin of a smaller competitor (Ouriginal) in anti-plagiarism software (APS) and other services related to education software of Ouriginal, a smaller player, by Turnitin. It was cleared in Phase I without commitments, and in its assessment, the CNMC took into consideration, among others, the parameter of innovation as a key one, due to the characteristics of the sector.

⁴ See Spanish contribution to the OECD roundtable on "Theories of Harm for Digital Mergers" (2023).

⁵ C/1046/19: JUST EAT / CANARY <https://www.cnmc.es/expedientes/c104619>

⁶ C/1220/21: TURNITIN/OURIGINAL <https://www.cnmc.es/en/node/390313>

17. In the end, the Spanish NCA concluded that, given the low R&D investment to turnover ratio of the target company and the capacity to innovate of other players in the market (including Big Tech corporations), the merger was deemed not to threaten innovation. In this case, the innovation effort was very different from one party to the other (lower for the target, Original), so Turnitin was unlikely to cut R&D investment as a result of the operation (especially taking competitive pressures into account).

3.3. Cybersecurity sector

18. Norton/Avast⁷ was a merger affecting cybersecurity solutions for final consumers, cleared in phase I without commitments. In order to assess the general impact of the operation and especially competitive constraints and the effects on innovation, the CNMC relied not only on market tests (to main competitors but also to consumer associations), but also on a thorough analysis of internal documentation (previous to the merger).

19. In terms of innovation, the CNMC also analysed the likely effects, and barriers to entry due to lock-in effects. After the assessment, it concluded that the merger was not a threat to innovation in light of the competitive landscape and the rise of cyber threats (which mean a permanent incentive to improve products' price/quality ratio).

20. Additionally, the CNMC bore in mind that in this case, innovation effort was different from party to party (lower for the target, Avast), so Norton was unlikely to cut R&D investment as a result of the operation (especially taking competitive pressures into account and the need to constantly improve products in order to meet consumer needs).

21. In terms of elaborating the theory of harm, the killer acquisition theory of harm was analysed, but the fact that the firms were carrying out different strategies in this regard led to discard that risk and the fact that the target was much less innovative than the buyer, there were other considerations that led to reject a possible negative impact of the operation on innovation: (i) the competitive landscape included Big Tech Firms that can include free products in their ecosystems; (ii) rise of cyber threats (which represent a permanent incentive to improve products' price/quality ratio); and (iii) the operation would also allow efficiencies that would spur innovation.

3.4. Online legal resources

22. Karnov / TR España / WK España⁸ was a transaction involving legal software, solutions, databases, training and publications sectors, cleared in phase I with commitments. Market shares and overlaps were sizeable in the markets of legal databases and publications (with market shares of the joint entity of 30%-40% and overlaps of 10-20%), although there were also comparable competitors.

23. In this particular merger, innovation was assessed more extensively, for two main reasons. Firstly, innovation plays a crucial role in some segments such as legal software (prediction tools, automated management of files, etc.) and, to a lesser extent, other legal solutions (databases, etc.). Secondly, the parties were close competitors, also in terms of their innovative strategies.

24. The CNMC conducted a relatively granular market test, gathering information from different participants of the market. Although the market test was not conclusive in terms of the impact of the operation on innovation, the Authority found that some factors would

⁷ C/1263/22: NORTON / AVAST <https://www.cnmc.es/expedientes/c126322>

⁸ C/1295/22 : KARNOV / TR ESPAÑA / WK ESPAÑA <https://www.cnmc.es/expedientes/c129522>

keep the incentives to innovate and increase quality. These factors were (i) the competitive pressure exerted by other relevant players of the market; (ii) the alternative offered by free solutions (even if not part of the same relevant market); and (iii) the internal documents pointing to efficiencies and maintenance of the innovation effort.

3.5. Other digital platforms

25. Wedding Planner / Zankyou⁹ consisted in the acquisition of Wedding Planner of a smaller rival (Zankyou) offering wedding planning services through an online platform. It was cleared in phase I (end of 2022) with commitments (which were not specifically related to innovation but to exclusivity clauses and potential restrictions to multihoming). Market shares of the merged entity in these markets were high (above 50%, measured in revenue, or more, when measured in web traffic through visits).

26. The effects on Innovation were one of the risks considered by the CNMC. In this sense, the market test pointed out its qualitative relevance. However, a negative impact of the operation was discarded. R&D is not quantitatively so relevant as in other digital sectors and the technology is not especially complex. Part of the innovation in the sector consists in differentiation and sophistication of services and this was not directly affected by the operation.

4. Main conclusions

27. The current enforcement of competition law is especially challenging, mainly due to the great level of dynamism of markets, and the fact that price doesn't seem to be, in many cases, the only parameter of assessment for the Authorities. In this context, non-price parameters of competition, including innovation, become extremely important.

28. The CNMC has gained experience in all these issues in recent years, thanks in part to the market share notification threshold, as well as its legal framework, which has proven effective to assess operations which may raise concerns in markets where innovation plays a key role.

29. So far, the CNMC is not aware of having faced a merger responding to the pattern of killer acquisitions, but this theory of harm has been extensively analysed.

30. All the operations described in this contribution (even those unconditionally cleared) have required markets test with a notable degree of granularity (testing different agents in terms of size and position along the value chain), and innovation has been taken into consideration when designing, conducting and assessing their results. The CNMC also tends to rely on internal documentation, (pre-existent to the negotiation of the merger) analysing, among other things, the importance given by the firms to innovation, the role it plays on their business strategies and decisions, or the level of investment devoted to it.

⁹ C/1318/22: WEDDING PLANNER / ZANKYOU VENTURES
<https://www.cnmc.es/expedientes/c131822>