Merger Regulation in the Digital Economy and the Forgotten Goal of Innovation

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Abstract

The pursuit of the consumer welfare goal has not achieved competitive markets but instead resulted in highly concentrated markets in the digital economy with one or two market leaders. Markets that should be dynamic and innovative are controlled by powerful online platforms that thwart innovation and eliminate potential rivals through killer acquisitions.

This paper argues that safeguarding innovation and in particular disruptive innovation should play a much more explicit part in the European Commission's merger control especially in digital economy markets, where innovation is key to a healthy dynamic market. This could be achieved by adopting a stricter merger review process that places emphasis on whether innovation and potential competitors are negatively affected by the merger also in the long-run. The paper argues that to achieve this a move away from the traditional price-based focus in merger reviews in line with the consumer welfare framework is required towards a structural approach that considers the impact on the market in the long-run and the dynamic aspects of the mergers under review, but this will occasionally require the Commission to say 'no' to mergers. The result however, would be the safeguarding of innovation, the key to a healthy economy in the EU.

Introduction

In recent years there has been a wave of mergers in digital economy markets, referred to as 'killer acquisitions' that have given rise to doubt about whether the EU competition rules are effective.[1] Whilst there is nothing unusual about mergers in emerging markets and in fact the majority never falls

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[1] Colleen Cunningham, Florian Ederer and Song Ma, 'Killer Acquisitions' (2018) SSRN Electronic Journal, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3241707 (accessed 30 April 2021).

within the scrutiny of competition authorities[2], these particular mergers have been conglomerate mergers between a large global corporation and a minor upstart and the price tag for the minor upstart was unusually high. Or more precisely, it was an acquisition by one of the 'Big Five' tech giants (Alphabet, Amazon, Meta (Facebook), Apple, and Microsoft – hereinafter referred to as the 'Big Five') of a small innovative start-up.[3] To name a few of such mergers hitting the headlines were: *Google/Doubleclick*[4], *Microsoft/Yahoo*[5] *Facebook/WhatsApp*[6], *Microsoft/LinkedIn*[7] and *Apple/Shazam.*[8]

Post-merger review indicates that these acquisitions result in the strengthening of the market power held by the large corporation allowing it to access related markets and eliminate potential competitors. The mergers and the aftermath raise questions as to why the European Commission permitted the mergers to go ahead, when from an outsiders' perspective there were clear concerns that the merger would not only eliminate a potential competitor but also curve future innovation in the area to the benefit of incumbent companies.[9]

This paper argues that innovation should play a much more explicit part in the European Commission's approach in its merger control especially in digital economy markets, where innovation is key to a healthy dynamic market. Whilst innovation appears thriving, the mass acquisitions of smaller start-ups by larger conglomerates in the digital market pose a significant anticompetitive threat,[10] which will ultimately result in an oligopolistic market structure or at worst a monopoly that will then be in control of the innovation agenda in the market. The truth is the markets are becoming more concentrated and less competitive and the current merger regulation policies driven by the European Commission's flawed consumer welfare approach are partly to blame for this, leaving the digital economy markets open for exploitation of the 'Big Five'.

[2] McLean, Andrew 'A Financial Capitalism Perspective on Start-up Acquisitions: Introducing the Economic Goodwill Threshold Test' Centre for Law Economics and Society, Research Paper Series 2/2020, July 2020, https://www.ucl.ac.uk/cles/sites/cles/files/cles_2-2020_final.pdf (accessed 30 April 2021), p. 2.

[3] Between the five of them they have bought a staggering 700+ companies since 1987. Apple reportedly purchased 100 companies since 2015 meaning that it would acquire a new company every 3-4 weeks. Harper, J. 'Apple buys a company every three to four weeks' 24 February 2021, BBC News, https://www.bbc.co.uk/news/business-56178792#:~:text=Apple%20has%20acquired%20about%20100,executive%20Tim%20Cook%20has%20revealed. (accessed 30 April 2021) – see also Diana L Moss, 'The Record of Weak US Merger Enforcement in Big Tech' (American Antitrust Institute White Paper, July 2019).

[4] European Commission, COMP/M. 4731 *Google/DoubleClick,* 11 March 2008.

[5] European Commission, COMP/M.5727 *Microsoft/Yahoo! Search Business*, 18 February 2010.

[6] European Commission, COMP/M.7217 *Facebook/WhatsApp*, 3 October 2014.

[7] European Commission, COMP/M.8124 *Microsoft/LinkedIn*, 6 December 2016.

[8] European Commission, COMP/M.8788 *Apple/Shazam*, 6 September 2018.

[9] Carl Shapiro 'Antitrust in an Age of Populism' International Journal of Industrial Organization 61 (2018) 714-748 at 739-40, see also Tim Wu, "The case for breaking up Facebook and Instagram", The Washington Post, 28 September 2018 https://www.washingtonpost.com/outlook/2018/09/28/case-breaking-up-facebook-instagram/ accessed 31 December 2019 (hereinafter referred to as Wu (2018b). Undoubtedly, the acquisition of small start-ups at a very high price also encouraged others to form similar start-ups in the hope of being equally acquired by such future acquisition, see McLean *Supra* n. 2, p. 1.

[10] Cunningham et al. *Supra n. 1*, , , see also Kenneth Arrow, 'Economic Welfare and the Allocation of Resources to Invention' in Universities-National Bureau Committee for Economic Research, Committee on Economic Growth of the Social Science Research Council, The Rate and Direction of Inventive Activity: Economic and Social Factors (Princeton University Press 1962).

These killer acquisitions or 'start-ups acquisitions' depending on the industry as many start-ups in the digital economy will become an integrated part of the larger conglomerate, whereas in the pharmaceutical industry they tend to become completely terminated,[11] slip through the Commission's net for two major reasons: 1) because the merger notification threshold test which is centred around the turnover of the companies is too high to capture many of the start-ups acquired and 2) the substantive legal test is too focused on current competition concerns and short-term goals with limited ability to consider future anticompetitive effects especially in relation to innovation.[12]

This paper centres around the latter issue, i.e. the problems raised by the application of the substantive test in the EU Merger Regulation (hereinafter the EUMR)[13] and argues that the consumer welfare goal is not effective in achieving healthy and innovative markets in the digital economy. A renewed focus on market structure as a key competition policy goal should be adopted and safeguarding innovation should play a central role in digital economy markets merger regulation than is currently the case.

From a broader perspective, the paper also taps into the current debate about the goals of the competition rules[14] and argues that it is essential that the goals are not just about 'consumer welfare' but broader and focusing also on the competitive structure of the market as well overall economic welfare. This will allow for innovation to become a more explicit freestanding goal from that of consumer welfare at least under merger regulation.[15]
This is essential to ensure that innovation is safeguarded and acknowledged as central to better the overall economic welfare of the European Union. Such a shift in focus is also necessary to adapt the competition rules to what is happening in the real world, namely the evolution of what are considered valuable assets from physical objects to data, human attention and intellectual property rights.[16]

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[11] McLean, *Supra n. 2*, p. 3 and see also Cunningham et al. *Supra n. 1.*
[12] McLean, *Supra n. 2*, p. 2.
[13] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, *OJ L 24, 29.1.2004, p. 1–22*.
[14] Tim Wu 'After Consumer Welfare, Now What? The 'Protection of Competition' Standard in Practice' CPI Antitrust Chronicle April 2018 (hereinafter referred to as Wu, (2018a), Harlan Blake and William Jones, 'In Defense of Antitrust', 65 COL. L.REV. 377 (1965); Robert Pitofsky, 'The Political Content of Antitrust', 127 U. Penn. L. Rev. 1051 (1979), L. Sullivan 'Economics and More Humanistic Disciplines: What Are the Sources of Wisdom for Antitrust?' 125 U. Penn. L. Rev. 1214 (1977), K. Elzinga 'The Goals of Antitrust Other than Competition and Efficiency, What Else Counts?' 125 U. Penn. L. Rev. 1191, 1196 (1977),R. Lande 'Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged', 34 Hastings L.J. 65 (1982–83), Lina Khan, The Ideological Roots of America's Market Power Problem, 127 Yale L. J. 960 (2018); Ariel Ezrachi EU Competition Law Goals and the Digital Economy' (June 6, 2018). Oxford Legal Studies Research Paper No. 17/2018, SSRN: https://ssrn.com/abstract=3191766 (accessed 27/01/2022); Line M. Khan 'Amazon's Antitrust Paradox' The Yale Law Journal 126 (2017), 710-805, Albert Allen Foer and Arthur Durst 'the Multiple Goals of Antitrust' The Antitrust Bulletin Volume: 63 issue: 4, page(s): 494-508 and Shapiro (2018) *Supra n. 9*.
[15] See European Commission Competition Policy Brief 'EU Merger Control and Innovation' April 2016, ISBN 978-92-79-54733-1 (https://ec.europa.eu/competition/publications/cpb/2016/2016_001_en.pdf, accessed 7 September 2019).
[16] Wu, Tim 'Blind Spot: The Attention Economy and the Law' 2017, https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3030&context=faculty_scholarship, accessed 31 December 2019, at 39.

The rest of the paper is divided up into the following four sections: Section 2 explores the digital economy and highlights the anti-competitive threats that start-ups acquisitions pose to the markets. Section 3 reviews the consumer welfare goal applied to the competition rules and in particular its impact on mergers and merger control, Section 4 focuses on the innovation assessment undertaken by the Commission in start-up acquisitions and the final section concludes.

Section 2: The digital economy and the anti-competitive start-ups acquisitions

The digital economy consists of markets which primarily rely on the internet, information and communications technologies for trade to offer products and services. The nature of these markets makes them fast-moving, innovative and importantly disruptive to traditional markets allowing them to become more dynamic thereby benefitting consumers in a variety of positive ways by giving access to new services, cheaper products through new and efficient distribution systems.[17] Precisely for this reason the digital economy markets have proven difficult to evaluate.[18] In addition to their dynamic nature, which creates competition not just within the market but also for the market (sometimes referred to as 'creative destruction'[19]), they often operate from (online) platforms with two or more customer groups attached. The markets often have strong network effects and rely heavily on data and intellectual property rights to offer their products and/or services.[20]

Consequently, innovation is central to the growth of digital economy markets. The challenge is therefore to ensuring open access to allow for a competitive process where innovative start-ups can flourish alongside incumbent companies. The theory goes that the constant innovation in these markets will tip the market in favour of the newest or most advanced products. Accordingly, claims have been made that monopolies or companies with significant market powers in these markets are in fact fragile and ever-shifting depending on which innovation wins the race. However, this is a one-dimensional picture of these markets, as other forces such as direct and indirect network effects, Big Data and IP rights also influence the competitive structure in these markets and will slow down, if not eliminate, the potential for creative destruction and instead lead to static competition.[21] Global corporations such as the 'Big Five', therefore either buck the trend as they are clearly not fragile monopolies or more likely they highlight the problem: that multi-sided platforms and strong network effects will destroy innovation and dynamic markets. Consequently, it is a myth that market power held by incumbents in these markets is fragile.

Owing to the consumers in in two or multi-sided markets with strong network effects place value on the products and services according to the strength of network effects (both direct and indirect effects), i.e. how many other people are using the product or service rather than merely the price of

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[17] Jacques Crémer, Yves-Alexandre de Montjoye and Heike Schweitzer 'Competition Policy for the Digital Era' Report for the European Commission, Brussels 2019, at 20, https://ec.europa.eu/competition/publications/reports/kd0419345enn.pdf accessed 26 August 2019)
[18] Wu (2017), *Supra n. 16* , at 3.
[19] Jerry Ellig and Daniel Lin 'Dynamic Competition Theories' in Jerry Ellig (ed.) *'Dynamic Competition and Public Policy, Technology, Innovation and Antitrust Issues'*, Cambridge University Press,2001, at 18-19.
[20] Crémer et al. *supra* n. 17 at 35.
[21] Steve Anderman 'The Competition Law/IP 'Interface': An Introductory Note', p. 8-9 in Steve Anderman (ed) *'The Interface between Intellectual Property Rights and Competition Policy'* Cambridge University Press, 2007 at 10-11.

the product,[22] mergers in these markets need to be reviewed under a slightly different lens than mergers in traditional markets.[23] This is further exacerbated by the fact that in two or multi-sided markets, the platform owner frequently provides products or services free of charge to some of its customer groups, as is the case with Google, where the consumer gets to use the search engine for free. The non-price nature of the market blurs the traditional understanding and assessment of markets and the value of the products or services.[24] However, whilst the customer may not pay in monetary terms for these products or services, they often pay with providing their personal data to the company. The true cost of giving away this data is difficult to assess for the consumers, because they are too remote from it and therefore cannot 'feel' the costs.[25]

There is therefore a push for ensuring that mergers involving Big Data undergo greater scrutiny in the substantive assessment process, due to the concerns of the impact the transaction of personal data from one company to another may have on data protection,[26] but also because of the competitive advantage that the merged company may gain from obtaining and combining personal data as was the case in *Facebook/WhatsApp*.[27]

This can be difficult for competition authorities to assess given that these are not always measured in monetary terms, although companies picking up the same data can at least be assumed to be potential competitors. As rightly noted by Stucke and Grunes: 'The reality is that many of the current analytical economic tools do not address the Big Data issues. Competition authorities have good tools to assess price effects. But competition officials have less sophisticated tools to assess mergers' effects on non-price competition, including the impact on quality of free goods in two-sided markets and the degradation of privacy protection.'[28]

Whilst many of these characteristics are not new to the competition authorities and present in other types of markets, the combination of these within one particular market as is the case for digital economy markets denotes that the digital economy has a 'competition-to-dominance trait',[29] meaning that the market characteristics lend themselves to 'automatically' creating market power for the company that fulfils certain conditions. Therefore, even though these markets are still in their infancy, or perhaps *precisely* because these markets are in their infancy, digital economy markets

[22] Ibid.

[23] Simon Bishop and Mike Walker 'The Economics of EC Competition Law: Concepts, Applications and Measurements' 3rd edition, Sweet and Maxwell, London 2010, paras 7.082-7.084 and Wu (2018b).

[24] See Wu (2017) *supra* n. 16.

[25] See Monopolkommission 'Competition policy: The challenge of digital markets Special Report by the Monopolies Commission pursuant to Section 44(1)(4) of the Act Against Restraints on Competition Summary' S11 <http://www.monopolkommission.de/images/PDF/SG/SG68/S68_summary.pdf>accessed 25 November 2017.

[26] Big Data falls under the new EU General Data Protection Regulation and would need to comply with these rules before the data can be passed onto competitors, Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), *OJ L 119, 4.5.2016, 1–88.*

[27] *Facebook/WhatsApp*, *supra* n.6, paras 184-89.

[28] Maurice Stucke and Allen Grunes 'Debunking the Myths Over Big Data and Antitrust' CPI Antitrust Chronicle (May 2015) at 5.

[29] See OECD (2020) Abuse of Dominance in Digital Markets, https://www.oecd.org/daf/competition/abuse-of-dominance-in-digital-markets-2020.pdf (accessed 29 March 2022) and OECD (2019), Competition for the Market: Background note by the Secretariat, https://one.oecd.org/document/DAF/COMP/GF(2019)7/en/pdf. (accessed 29 March 2022).

should be closely monitored by the competition authorities to ensure that these markets remain competitive and do not settle into oligopolies with a handful of core players. In fact, for certain online services the market place has already converged towards a monopoly or oligopoly players (i.e. the Big Five dominate online shopping, internet searching , social media etc.), that control the network infrastructure to such an extent that they can detect, with the help of data analytics, possible competitors early on and suppress or absorb them, making them in fact extraordinary market players.[30] It may be too late for these markets to be turned back into dynamic competitive markets, however for related markets there is still hope that these could remain competitive if a greater focus is placed on innovation – or at least the control of innovation.

Unfortunately, both the European Commission and the US Federal Trade Commission[31] have, with some variations in approach, facilitated that convergence by allowing several mergers to go ahead in already highly concentrated markets as will be discussed in greater detail in Section 3.

Section 3: The consumer welfare goal and its negative impact on merger control

In new, emerging and dynamic markets, merger control is likely to be the first line of competition law enforcement that companies meet. Merger control therefore is at the forefront of the development of future markets and crucial for steering such markets towards the creation of strong and effective competitive environments. The importance of merger control has been further heightened by the rapid increase in mergers and acquisitions in data-driven and digital markets over the last ten years, and this trend is set to continue if not increase further if the competition authorities do not change course.[32] The result is that markets are becoming more and more concentrated, which would then also limit competition within the markets.[33] In addition, mergers can lead to other anti-competitive effects such as foreclosing markets for new rivals or reduce the incentive to innovative for both the merging parties and the market as a whole, all of which could lead to the increase of prices for consumers in the long run.[34]

That said, a merger can have pro-competitive effects for instance by increasing cost efficiencies and distribution systems, or create synergies that enhance innovation for the merged entity[35] and thereby

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[30] For example in 2017 Alphabet, Amazon, Apple, Meta and Microsoft spent a total of $31.6bn on acquisitions of start-ups, The Economist, 2 June 2018, 'American tech giants are making life tough for startups' https://www.economist.com/business/2018/06/02/american-tech-giants-are-making-life-tough-for-startups accessed 30 December 2019. See also Bourreau, Marc and de Streel, Alexandre, Digital Conglomerates and EU Competition Policy, 11 March 2019, https://ssrn.com/abstract=3350512, accessed 30 December 2019.

[31] Julie Bort, The FTC Approves Facebook's Purchase of Instagram, BUSINESS INSIDER, 22 August 2012, http://www.businessinsider.com/theftc-approves-facebooks-purchase-of-instragram-2012-8, accessed 31 December 2019 and Parmy Olson, Facebook closes $19 billion WhatsApp deal, FORBES (Oct. 6, 2014), https://www.forbes.com/sites/parmyolson/2014/10/06/facebook-closes-19-billion-whatsappdeal/#7885fbf45c66, accessed 31 December 2019.

[32] OECD 'Data-Driven Innovation: Big Data for Growth and Well-Being' October 2015 https://www.oecd.org/sti/data-driven-innovation-9789264229358-en.htm, accessed 20 January 2020 and Falk Schönning and Christian Ritz 'Mergers in the Digital Economy: A Practitioners' Outlook on Key Merger Control Aspects of Big Data and Innovation in Digital Markets' CPI Antitrust Chronicle February 2018, p. 2.

[33] For a discussion of this, see Shapiro (2018) *supra* n. 9 and Bourreau and de Streel *supra* n.30.

[34] See Case No COMP/M.7932, Dow/DuPont, Commission decision of 27 March 2017.

[35] See Case No COMP/M.4854, TomTom/TeleAtlas, Commission decision of 14 May 2008.

reducing costs for consumers or provide better quality products. It must also be recognised that many start-ups are excessively keen to be bought out during the venture capital process and see this as a lucrative outcome for them (as well as their venture capital funders) rather than as a termination of their company.[36] Furthermore, on occasions the start-ups may not have survived but for the merger.[37] The start-ups acquisition therefore represent in some cases a positive impact on the market as it stimulates initial innovation. However, it also means that if a start-up deploys an acquisition as its ultimate exit strategy, it will tailor its innovation to reach the interest of the large conglomerates in the market. It will therefore be more likely to engage in products similar to those of the large conglomerate's in order to attract its attention rather than developing disruptive innovation that may place it in a competitive position to incumbents in the market.[38] As McLean notes, this means that whilst we may see innovation as thriving in the digital economy markets, the reality might be that this innovation is sub-optimal and indulging of current products rather than disruptive.[39]

Merger control is therefore a balancing act between the pro- and anti-competitive effects that a merger can bring to a market, but each merger cannot be seen in isolation, but must be assessed in relation to the market and its structure.

The European Commission undertakes merger review in line with its general competition policies of ensuring

'better quality goods and services at lower prices. Competition policy is about applying rules to make sure companies compete fairly with each other. This encourages enterprise and efficiency, creates a wider choice for consumers and helps reduce prices and improve quality…The Commission mobilise competition policy tools and market expertise so that they contribute to the Union's jobs, growth and investment agenda including areas such as the digital single market, energy union, financial services, industrial policy and the fight against tax evasion.'[40]

In other words, the Commission follows a 'consumer welfare' approach in its competition policy as a result of having introduced the so-called 'more economic approach'[41] in the early 2000s when it

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[36] Mark A Lemley and Andrew McCreary, 'Exit Strategy' (2020) Stanford Law and Economics Olin Working Paper 542, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3506919 (accessed 4 May 2021).
[37] Ibid. p. 5.
[38] McLean, *Supra* n. 2, p. 4.
[39] Ibid.
[40] European Commission 'Competition, Overview: Making Markets better http://ec.europa.eu/competition/general/overview_en.html (accessed 4 June 2019), note that the term 'innovation' is absent, however, see also Commission Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31, 5.2.2004, p. 5–18 , para. 8 and European Commission Competition Policy Brief 'EU Merger Control and Innovation' *supra* n. 15.
[41] The modernisation was a reform of the EU competition rules both in relation to their enforcement (see Commission Press Release 'Commission finalises modernisation of EU antitrust enforcement rules' IP/04/411, Brussels 30 March 2004 http://europa.eu/rapid/press-release_IP-04-411_en.htm?locale=en, (accessed 30 May 2019)) and application, which supported the Commission's move to introduce an approach to the application of the competition rules which was more economic-based than previously. In particular, the Commission was keen to focus on the effects of the behaviour of the companies in alignment with the consumer welfare standard - see Liza Lovdahl Gormsen 'The Conflict between Economic Freedom and Consumer Welfare in the Modernisation of Article 82EC' European Competition Journal (2007) Vol. 3 no. 2, 329-344. It should also be noted that the modernisation was inspired by the US Antitrust law approach, which was domineered by Bork's

embarked on a modernisation of the competition rules. The current EUMR was also included in this modernisation process, [42] which saw a change in the substantial test of mergers. Whilst there was a debate to introduce the US 'substantially lessening of competition' test, the EU eventually settled for its own test: 'significantly impede effective competition'.[43] The test is designed to be broader than the previous test and allow for mergers to be caught that would not necessarily reach a dominant position in a market, but would nevertheless affect competition in a negative manner.[44] Yet, it appears that despite the broadness in the test, there are still mergers slipping through the net that risks impede effective competition by eliminating an innovation start-up company.

Previously, the Commission was more concerned with the structure of the market to ensure effective competition,[45] similarly to the CJEU's approach.[46] The current substantive test still requires the Commission to review the structure of the market including actual and potential competitors and in doing so also consider that competition remains effective in the relevant market/s.[47] Additionally, it must assess 'the market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition.'[48] There is therefore nothing wrong with the wording of the SIEC test. The problem lies with its application.[49]

The requirement that the interest of 'intermediate and ultimate consumers' must be considered and a demonstration of consumers benefitting from the merger allows the Commission to steer merger regulation towards a consumer welfare goal.

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thinking from the 1960s (Robert Bork, Legislative Intent and the Policy of the Sherman Act, 9 J. L. & ECON 7 (1966 and see also the infamous book: Robert Bork *'The Antitrust Paradox: A Policy at War With Itself'* p. 91, Basic Books 1978, reprinted in 1993).

[42] M. Monti 'The Future for Competition Policy in the European Union' Merchant Taylor's Hall, London, 9 July 2001, SPEECH/01/340, http://ec.europa.eu/competition/speeches/index_speeches_by_the_commissioner.html (accessed 30 May 2019).

[43] The EUMR *supra* n. 13, Article 2(3).

[44] See Ibid. recital 25.

[45] Speech of Deputy-Director General (Mergers) at DG Comp, Charles Esteva Mosso 'The Contribution of Merger Control to the Definition of Harm to Competition' GCLC Conference, Brussels, February 2016, http://ec.europa.eu/competition/speeches/text/sp2016_03_en.pdf (accessed 4 June 2019).

[46] See case C-501/06p *GlaxoSmithKline v Commission,* ECLI:EU:C:2009:610, [2009] ECR I-9291, para. 63, see also case T-168/01 *GlaxoSmithKline Services Unlimited v Commission,* ECLI:EU:T:2006:265, [2006] ECR II-2969, para. 109, case C-6/72 *Europemballage Corporation and Continental Can Company Inc. v Commission* ECLI:EU:C:1973:22 [1973] ECR 215, para. 25 and C-8/08 *T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-4529, ECLI:EU:C:2009:343, paras. 38-39, for a further discussion of this from a US perspective see Khan (2017) *Supra* n. 14.

[47] The EUMR, *supra* n. 13, Article 2.

[48] Ibid. Article 2(1)b.

[49] See Khan (2017), *supra* n.14 at 739 and Council Economic Advisers 'Benefits of Competition and Indicators of Market Power' Council Economic Advisers Issue Brief, April 2016, https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf (accessed 23 January 2020).

Whilst it must be acknowledged that there have been certain positive results springing from the more economic approach not least because it created a greater focus on the economic aspects of competition law and policy[50], the consumer welfare goal in itself is too narrow to effectively cope with the many policy aims that are currently challenging the competition rules, particularly where such welfare is determined by proxies of price and output.

There is therefore a conflict within the Commission's approach itself to competition law – the consumer welfare framework as the chosen framework is not the best suited to achieve all the policy aims that the Commission wishes to pursue. Moreover, the consumer welfare framework has yet to be fully endorsed by the CJEU, which has remained reluctant to do so in case law. The CJEU has continued to insist that the consumer welfare goal have to be reached through the creation of an effective competitive process in the market place.[51] The clear concern with the consumer welfare goal is how to combine it with the other central goal specific to EU competition law that of the creation of the internal market and the goals of fairness and freedom in business transactions as well as other social aims which have dictated previous EU competition law cases.[52]

As regards the digital economy, the consumer welfare framework poses other shortcomings in ensuring that new innovative markets remain innovative *and* competitive. Owing to the fact that the consumer welfare framework is too short-sighted and will not find that a merger poses a problem to competition if it does not immediately result in the acquisition of market power. There is an assumption that the increase of market power will attract new entrants to a market, however, the evidence provided by private equity and venture capital investors suggest that the opposite is happening in digital economy markets.[53] These markets are not only becoming more concentrated, the corporate profits yielded from digital markets and the tech sector in particular is increasing and platform leaders in these markets have astronomical market caps, earning excess profits whilst shielding behind high barriers to entry.[54] Companies like Amazon are operating a different business strategy by not chasing profits, but growth and diversification.[55] This strategy has permitted Amazon to become a successful market leader, whilst avoiding antitrust law suits.[56] Amazon appears to diversify to pursue the development of its own product ecosystem, which allows for further differentiation, weakens competition and ultimately allows it to become a gatekeeper for access to certain products, platforms and also for access to consumers.[57] Some have argued that diversification

[50] See cases such as *Post Danmark I*, C-209/10, EU:C:2012:172 and COMP/37.792 *Microsoft* 24 March 2004.
[51] See case C-501/06p *GlaxoSmithKline, supra* n. 46 para. 63, see also case T-168/01 *GlaxoSmithKline*, *supra* n. 46, para. 109, case C-6/72 *Continental Can*, *supra* n.46, para. 25 and C-8/08 *T-Mobile Netherlands*, *supra* n.46, paras. 38-39.and Bishop and Walker *supra* n. 23 at 20-21 and Ibáñez Colomo, P. (2016), "Beyond the 'more economics-based approach': a legal perspective on Article 102 TFEU case law.", Common Law Market Review, Vol. 53/3, pp. 709-739.
[52] R.J. Van den Bergh and P.D. Camesascca *'European Competition Law and Economics: A Comparative Perspective'* 2nd ed., Thomson, Sweet & Maxwell, 2006, at 39-53 and more generally Renato Nazzini *'The Foundations of European Union Competition Law, The Objectives and Principles of Article 102*' Oxford University Press, Oxford 2011, and Bishop and Walker, *Supra* n. 23.
[53] Terrell McSweeny and Brian O'Dea 'Data, Innovation, and Potential Competition in Digital Markets – Looking Beyond Short-term Price Effects in Merger Analysis' CPI Antitrust Chronicle February 2018, at 12.
[54] Shapiro (2018), *supra* n. 9 at 736-37.
[55] Khan (2017), *supra* n. 14 at 747-55.
[56] Ibid at 755-56.
[57] Bourreau and de Streel, *supra* n. 30 at 7 and 10.

can be as a result of excess capacity of key resources.[58] Amazon claimed this was one of the reasons behind its venture into the cloud services market with Amazon Web Services.[59] Another and perhaps more fitting understanding of Amazon's buoyant expansion, is effectively economies of scope related to the general-purpose technologies developed by Amazon. For instance, Amazon's server farms permit Amazon to deliver e-commerce services worldwide and have more recently been its gateway to the distribution of movies and television.[60] Needless to say that the data Amazon gather from searches by consumers on its app and website is also applied in similar manner to support its further expansion as well as manipulation of consumers to purchase related products and services.[61]

If markets are becoming more concentrated and less competitive it is worth questioning if the consumer welfare framework is working optimally? There is certainly evidence on both sides of the Atlantic that the consumer welfare framework needs reviewing.[62] This debate is very much flourishing in the US, but in the EU the debate has been quieter. Perhaps because of the internal conflict that already exists between the Commission and the CJEU? The jury effectively is still out on the consumer welfare framework. Yet, it has to be acknowledged that the consumer welfare framework is not fit for purpose in particular, if the Commission is sincere about achieving its broader policy aims. As Eleonor Fox notes: 'The point is not that welfare economics ignores strategic behaviour and long-run effects... The point is that all welfare analysis is narrowly confined to one question: Will producers limit output and thereby "waste" society's resources? This is not the central question of antitrust.'[63] The competition rules are about protecting and increasing competition.

Consequently, there are some who argue for a full abandonment of the consumer welfare framework and instead focus on ensuring an effective competitive process and market structure.[64] Others suggest a readjustment of the consumer welfare theory, highlighting that the problem lies with an oversimplification and misuse of economics.[65] In relation to mergers, the suggestion has been for the competition authorities to simply be more robust in rejecting mergers and in particular in digital economy markets that are in their infancy and where innovation take centre stage.[66] '[Some] courts and enforcers have taken flexibility too far, allowing mergers to proceed based upon dubious economic arguments about concentration, entry, expansion, and efficiencies.'[67] Both arguments therefore demonstrate that in the digital economy the consumer welfare framework does not actually seem to favour the consumers, but instead a small group of large corporation that has taken a

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[58] Ibid. at 7.
[59] Ibid.
[60] Ibid. at 8.
[61] Hal Singer, "How to stop Amazon from swallowing the Internet", Forbes, 28 January 2019, https://www.forbes.com/sites/washingtonbytes/2019/01/28/how-to-stop-amazon-from-swallowing-the-internet/ accessed 30 December 2019.
[62] See for instance recommendations in Crémer et al. *supra* n. 17 at 3, Wu (2017) *supra* n. 16 and Khan (2017), *supra* n. 14.
[63] Eleanor M. Fox 'Modernization of Antitrust: A New Equilibrium' 66 Cornell Law Review 1140 (1981), at 1174.
[64] Khan (2017), *supra* n.14 at 803.
[65] Wu (2018a) *supra* n. 14 at 3, see also Jonathan Baker and Carl Shapiro 'Reinvigorating Horizontal Merger Enforcement' in Robert Pitofsky 'How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on US Antitrust' Oxford University Press, New York, USA 2008.
[66] McSweeny O'Dea, *supra* n.53 at 13.
[67] Baker and Shapiro, *supra* n. 65 at 235.

stronghold in significant markets and platforms and therefore competition has been restricted and innovation potentially halted.

The Commission is reviewing the turnover threshold to a transaction value-based filing threshold to capture the review of more mergers similar to *Facebook/Whatsapp*.[68] This would allow certain outlying mergers to be captured for review, which would previously not have fallen within the European Commission's core ambit.[69] However, a change to the jurisdictional threshold alone is unlikely to address all problems raised by the digital economy. There are still concerns that such mergers would not only eliminate a potential competitor but also curve future innovation in the area.[70]

So, whilst the merger threshold is being addressed, the substantive test has been left untouched. The initial explanation for the permission of the start-ups acquisitions could be found in a reluctance by the Commission in interfering with the development of these markets under the assumption that the markets will develop more naturally without ex-ante regulation by competition authorities.[71] This argument is supported by Adam Smith's theory of the invisible hand, neoclassical economics theories and those of the Chicago School.[72] Accordingly, a merger may not hinder competition as long as economic welfare remains unharmed.[73] This is further supported by the argument that competition authorities are unlikely to be able to assess the effects of a particular merger with adequate accuracy over a sufficiently long-term perspective and for this reason the authorities are reluctant to interfere.[74] In these circumstances, the short-run view is seen as an acceptable proxy for the long-run.[75] This argument has been applied in particular to digital economy markets, and further expanded through the notion that due to their volatile nature, being fast-moving and dynamic aggressive merger enforcement should be avoided.[76] The competition authorities on both sides of the Atlantic have been content to follow this line of reasoning because it is more difficult to obtain sufficient proof that conglomerate mergers in the digital economy markets would significantly impede upon future competition in comparison to horizontal mergers in traditional markets.[77] 'This is inherently a difficult

[68] *Facebook/WhatsApp*, *supra* n. 12. The adoption of a transaction value threshold is still under review by the Commission (Vestager, SPEECH, 'Dealing with mergers in a digital age', *ULB Competition Law Tuesdays, Brussels,* 18 June 2019, https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/dealing-mergers-digital-age_en (accessed: 19 August 2019)) and will closely monitor experiences from Austria and Germany that recently adopted this threshold as an addition to the standard turnover threshold (Christian Burholt, Andreas Traugott, Fiona Carlin and Jane Hobson 'New Value-based Filing Thresholds in European Merger Control Regimes – Implications for Healthcare and Life Sciences Companies', Global Compliance News, 1 November 2017 https://globalcompliancenews.com/new-value-based-filing-thresholds-in-european-merger-control-regimes-20171101/ (accessed 18 August 2019)).

[69] It should be noted that the EUMR have an additional safety cap that of Art 22 which permits Member States to refer mergers to the Commission 'that does not have a Community dimension within the meaning of Article 1 but affects trade between Member States and threatens to significantly affect competition within the territory of the Member State or States making the request.'

[70] Schönning and Ritz , *Surpa* n. 32 p. 2, Shapiro(2018) *supra* n. 9 at 739-40, see also Wu (2018b) *supra* n. 9.

[71] See Crémer et al., *supra* n. 17 at 50.

[72] McSweeny and O'Dea, *supra* n. 53 at 13 and Shapiro (2018), *supra* n. 9 at 738-41.

[73] Giorgi Monti 'EC Competition Law' Cambridge University Press, Cambridge 2007, at 23.

[74] McSweeny and O'Dea, *supra* n. 53 at 10.

[75] Fox, *supra* n. 63 at 1177.

[76] Ibid. – see also Shapiro (2018), *supra* n. 9 at 740-41.

[77] Shapiro (2018), *supra* n. 9 at 740.

thing to predict, and even harder for the government to prove as the merging firms themselves actively seek to convince the court otherwise. And such obstacles are even harder in the high-tech sector, where products and services have overlapping functionality and can change significantly over relatively short periods of time.'[78]

These arguments coupled with the strict timetable that the Commission itself has established to adhere to in its 'one-stop-shop' merger review[79] and the immediate impact on the market (yes or no to the merger) leaves the Commission in an awkward position. Unfortunately, the Commission has taken the stance of not intervening in the market presumably for the fear of affecting its development and thereby chilling innovation, or perhaps more likely the fear of getting it wrong (false positives).[80]

Nonetheless, academic research highlights that robust merger regulation in these types of markets is essential to ensure that the markets remain competitive and innovative.[81] As demonstrated by Shapiro, mergers between future rivals generally slow down innovation.[82] In fact the benefits of stopping incumbent companies with significant sustainable market power buying up smaller start-ups that left alone would be challengers to the incumbent companies increases the larger the incumbent companies are.[83] False positives are therefore acceptable to avoid the false negatives, i.e. the mergers that eliminate the challengers of the large incumbent companies.[84]

From an EU perspective, it will therefore make sense to focus on the structure of the market to ensure effective competition remains in the market. As indicated above, the wording of the SIEC test will allow for this. It is all about the application. There is therefore a need for attention upon the enforcement policies in markets that are in their infancy. Instead of a hands-off approach that permits large incumbents buying up small start-ups, the competition authorities should apply a 'hands-on' approach by being vigilant in their assessment of mergers, provide a greater focus on innovation, and the structure of the market. By doing so, there is also an opportunity to address the sub-optimal innovation taking place as a result of the eagerness by start-ups to be bought up by the larger conglomerates, as if this exit strategy becomes more limited, the start-ups will be forced to consider developing more 'outside of the box' innovation or disruptive innovation instead of the imitation innovation of the larger conglomerates that these start-ups often engage in currently.[85]

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[78] Ibid. at 741.
[79] The EUMR, *supra* n.13, Article 10.
[80] Shapiro (2018), *supra* n.9 at 741, however note *Apple/Shazam supra* n. 8 para. 162, where the Commission comments on this stance.
[81] See Reinhilde Veugelers 'Innovation in EU Merger Control: Walking the Walk' (2012) Bruegel Policy Contribution (http://bruegel.org/wp-content/uploads/imported/publications/pc_2012_04__FINAL.pdf accessed 26 August 2019).
[82] See Carl Shapiro 'Competition and Innovation: did arrow hit the bull's eye? In Josh Lerner, Scott Stern (eds) 'The Rate and Direction of Economic Activity Revisited' National Bureau of Economic Research 2012 (https://www.nber.org/chapters/c12360.pdf accessed 27 August 2019).
[83] Shaprio (2018), *supra* n. 9 at 741.
[84] Ibid. – see also Alan Devlin and Michael Jacobs 'Antitrust Errors' William & Mary Law Review, Vol. 52, p. 75, 2010. Note also that false negatives can have significant economic and social costs if the competition authorities would have to break up the merged entity at a later stage due to abuse of dominance – see for instance Wu (2018b), *supra* n. 9.
[85] See Cunningham et al, *Supra* n. 1.

To be blunt: the consumer welfare theory whilst offering a simplified economy approach to assess competition cases, which perhaps have been of benefit to judges who struggle with the amount of economic documentation, has nevertheless lost touch with the purpose of competition law. It has been allowed to be manipulated by parties to further a particular outcome in their individual cases thereby allowing for global corporations to steer the digital economy markets towards oligopoly and large conglomerates. The competition authorities need to take back control of these markets and as rightly noted by Shapiro it can be started by a simply more robust approach to merger control and saying 'no'.[86]

Section 4: The importance of 'innovation' in start-ups acquisitions and how to say 'no'

Article 2 of the EUMR clearly sets out that not only must the Commission review the effect the merger has in the market, it must also assess the effects on innovation ('the development of technical and economic progress'[87]) and actual and potential competitors,[88] in other words, there are already tools available to the Commission to say 'no' to mergers that does not benefit innovation, the Commission just needs to adjust its approach.

Innovation

Innovation in its simple form can be defined as consisting of 'the discovery, development, and commercialization of new and improved products and processes.'[89] It can be divided into several types of forms such as discrete and complex innovation describing the complexity of the innovation by how it is protected through intellectual property rights such as patents.[90] Other ways of looking at inventions is dividing them in categories of disruptive and sustaining innovation. The latter is focused on improving existing products, whereas disruptive innovation could oust current or traditional business models through creating cheaper and more convenient products.[91] Disruptive innovation as a type of innovation is particular noticeable in the digital economy markets.

Whilst innovation has been hailed as central to competition in the digital economy as well as other markets such as pharmaceuticals and telecommunications, 'the academic literature shows there is no automatic relationship between mergers and innovation'.[92] In the EU there has been little focus on the relevance of innovation in mergers and the fact that merger regulation can effectively be applied to promote innovation seem to have gone unnoticed until recently.[93] Although, the Commission has

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[86] Shapiro (2018), *supra* n. 9.
[87] The EUMR, *supra* n. 13, Article 2(1)(b).
[88] Ibid. Article 2(1)(a).
[89] Michael A. Carrier 'Innovation for the 21st Century, Harnessing the Power of Intellectual Property and Antitrust Law' Oxford University Press, Oxford and New York 2009, at 19.
[90] Ibid. at 26.
[91] Ibid. at 26-28.
[92] Veugelers, *supra* n. 81 at 8.
[93] See European Parliament 'The Contribution of Competition Policy to Growth and the EU2020 Strategy, IP/A/ECON/ST/2012-25 July 2013 PE 492.479, Table 5, p. 29 (http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/492479/IPOL-ECON_ET(2013)492479_EN.pdf accessed 26 August 2019), Petit, Nicolas, Significant Impediment to Industry Innovation: A Novel Theory of Harm in EU Merger Control? (February 4, 2017).

noted in its policy briefs that '[innovation] is a critical component for the success of the Commission's top priority of boosting jobs, growth and investment'[94]. There are of course two aspects to reviewing innovation in merger regulation, one is firstly whether the merger will increase innovation or the incentive to innovate.[95] This was considered in *Hutchinson 3G Italy/Wind*, where the merging parties claimed that the merger through increased investment would be advantageous to create dynamic efficiency and thereby be an incentive to innovation.[96] The second aspect is to ascertain whether the merger will restrict or eliminate (potential) innovation.[97] This was illustrated by the Commission in the *Dupont/Dow* merger, where the Commission stated that it had concerns that the merger would 'lead to a reduction of innovation in crop protection *as a whole*.'[98] (emphasis added) This approach is novel in the fact that the Commission has previously only reviewed reduction of innovation 'through the combination of firms with strong capabilities to innovate in a specific direction'.[99] Whilst this was applied in a horizontal mergers, there is nothing to stop the Commission also adopting a similar approach to conglomerate mergers. Innovation is explicitly mentioned in the EU Horizontal Merger Guidelines as one of the criteria against which to assess the likely effects of a merger, and also whether the merger eliminates an 'important competitive force'.[100] The Commission seems keen to learn from its mistakes and has in the recent *Meta/Kustomer* merger[101] only approved it based on some significant commitments by the parties, again illustrating that although it was not a 'no' to the merger, it certainly was not either a straightforward roll over 'yes'. The two cases are positive developments for generating more emphasis on innovation as a central factor in merger decisions.

The debate about the relationship between mergers and innovation originates from a wider debate regarding competition and innovation. There are generally two camps as to how to best promote innovation with Schumpeter leading the argument that market power is essential for the innovator to

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https://ssrn.com/abstract=2911597 accessed 26 August 2019, Pola Karolczyk and Kyle Le Croy 'Navigating the Digital Age: The European Commission's Differing Approaches to Merger Control and Abuse of Dominance in the Digital Sector', CPI Chronicle, February 2018, at 45, Raphaël De Coninck 'Innovation in EU merger control: in need of a consistent framework' Competition Law and Policy Debate Vol. 2, issue 3, Sept. 2016, 41-51.

[94] European Commission Competition Policy Brief 'EU Merger Control and Innovation', *supra* n. 15 at 1 and Haucap, Justus, and Joel Stiebale, Research: Innovation Suffers When Drug Companies Merge, Harvard Business Review, 3 August 2016, available at https://hbr.org/2016/08/research-innovation-sufferswhen-drug-companies-merge, accessed 20 January 2020 (hereinafter referred to as Haucap and Stiebale (2016a)).

[95] This was the case in European Commission, Case No COMP/M.6992, *Hutchinson 3G UK/ Telefonica UK*, Commission decision of 11 May 2016, see also Laitenberger, Johannes 'Competition and Innovation' CRA Annual Conference, Brussels 9 December 2015 https://ec.europa.eu/competition/speeches/text/sp2015_04_en.pdf regarding European Commission, *TomTom/TeleAtlas, Supra* n. 35.

[96] *Hutchinson 3G Italy/ Wind JV, supra* n. 95.

[97] See European Commission, Case No COMP/M.7275, *Novartis/GlaxoSmithKline oncology business*, Commission decision of 28 January 2015; European Commission, Case No COMP/M.7559, *Pfizer/Hospira*, Commission decision of 4 August 2015; European Commission, Case No COMP/M.7278, *General Electric/Alstom (thermal power – renewable power and grid business)*, Commission decision of 23 February 2015.

[98] European Commission Press Release 'Mergers: Commission opens in-depth investigation into proposed merger between Dow and DuPont Brussels, 11 August 2016 (https://europa.eu/rapid/press-release_IP-16-2784_en.htm accessed 26 August 2019).

[99] Petit, *supra* n. 93 at 5.

[100] Horizontal Mergers Guidelines, *Supra* n. 40, paras 37-38.

[101] European Commission Press Release 'Mergers: Commission clears acquisition of Kustomer by Meta (formerly Facebook), subject to conditions', 27 January 2022, https://ec.europa.eu/commission/presscorner/detail/en/IP_22_652, accessed 29 March 2022.

fund expensive research and development costs (although Schumpeter also noted that this was limited to situations where there were still competition *for* the market),[102] whilst others lead by Arrow strongly advocate that competition will allow innovation to flourish.[103] The two theories however can be compatible when reviewing them as following on from each other: Arrow's theory sets the scene: a competitive environment will initially impel innovation, however, as Schumpeter holds some market power, prospect of higher profits, and reaping the benefits of the innovation will incentivise a company to continue to innovate and compete.[104] However, according to Arrow's replacement theory, this incentive to continue to innovate may be diminished through mergers: an incumbent acquiring a smaller start-up is less likely to continue the start-up's products if these are similar or overlapping with those of the incumbent's.[105] And here of course comes the sting in the tail, as was mentioned above, that the start-ups in digital economy markets are applying an exit strategy of getting bought up and therefore specifically targets incumbents with products similar to the incumbents to spark interest.[106] There is therefore a vicious circle at play in the digital economy markets, which favours large conglomerates and their innovation agendas and which does not encourage disruptive innovation that would be more beneficial to the society as a whole.

Whilst Arrow's theory has prevailed as evident in both the EU Horizontal Merger Guidelines and the US 2010 Horizontal Merger Guidelines which in particular states: 'Competition often spurs firms to innovate. The Agencies may consider whether a merger is likely to diminish innovation competition by encouraging the merged firm to curtail its innovative efforts below the level that would prevail in the absence of the merger.'[107] The problem remains: innovation is not seen as a standalone goal and the focus by the competition authorities has been much more on the short-term effects on the competitors rather than the market as such.

A merger review should balance short-term harm against potential long-term efficiencies emerging from the merger or vice versa – short-term efficiencies generated from the merger against long-term harm to innovation. In the *Microsoft/Yahoo* merger, which was a horizontal merger between Microsoft and Yahoo's search engine business and for that reason innovation was looked at in some detail. The Commission noted that an '…important dimension of competition between search engines is their ability to innovate. Search engines not only try to develop new services (leap-frog innovation) but also constantly strive to innovate incrementally on existent services in order to be able to deliver

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[102] See Joseph Schumpeter 'Capitalism, Socialism and Democracy' Routledge, New York 2003, at 87-106 and Tom Nicholas 'Why Schumpeter was Right: Innovation, Market Power, and Creative Destruction in 1920s America' The Journal of Economic History 63(4) [2003], pp. 1023-1058.

[103] Kenneth J Arrow 'Economic Welfare and Allocation of Resources for Invention' in The Rate and Direction of Inventive Activity: Economic and Social Factors' Princeton University Press 1962, p. 619-24.

[104] See also Shapiro (2012), *supra* n. 82.

[105] Arrow, *Supra* n. 10, p. 619-24 – see also Cunningham et al. *Supra* n. 1, p. 2, Saami Zain, 'Suppression of Innovation or Collaborative Efficiencies?: An Antitrust Analysis of a Research & Development Collaboration That Led to the Shelving of a Promising Drug' (2006) 5 John Marshall Review of Intellectual Property Law 347, 350 et seq, and David Hamilton, 'Silent Treatment: How Genetech, Novartis Stifled a Promising Drug' (2005) Wall Street Journal A1.

[106] See for instance, James Titcomb 'Microsoft to buy LinkedIn in $26 billion' The Telegraph, 13 June 2016 https://www.telegraph.co.uk/technology/2016/06/13/microsoft-to-buy-linkedin-for-26-billion/ accessed 26 November 2021 and Lemley and McCreary, *Supra* n. 36.

[107] U.S. Department of Justice and Federal Trade Commission 2010 Horizontal Merger Guidelines, para. 6.4 (https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf accessed 26 August 2019).

better services to both advertisers and users.'[108] It then went on to consider whether innovation by the merging parties would be negatively affected by the merger and found that this was not the case, because Yahoo was a weak and declining innovative force in the market and had been so for some time prior to the merger.[109] The Commission also reviewed whether post-transaction the parties would be less inclined to innovate and noted: '…that economic theory is ambiguous regarding the incentives to innovate depending on the level of concentration in a given market. The Commission therefore has to assess the facts of the case and to analyse the incentives and capabilities of the merging parties and its impact on other players in the market…'[110] Unsurprisingly, the parties argued that the merger itself would be a strong incentive for them to innovate and better allow them to compete for users against Google.[111] The Commission agreed with this view, finding the merger to be likely to be pro-competitive and providing the parties an opportunity to become a more effective competitor of Google.[112]

The circumstances surrounding the *Microsoft/Yahoo* merger are different to many other mergers under scrutiny in digital economy markets. This merger was between two companies that have some significant market power in other markets – at least that is the case for Microsoft. In the market for search engines, both are relatively small (the Commission found that they would have a combined market share of well below the horizontal merger guidelines threshold of 25 percent in the markets post-merger)[113]and they would be competing directly against Google, a company with significant market power in the market. Thus, whilst the merger did eliminate a competitor, it would effectively create a stronger competitor against Google and this seemed to be a central attraction for permitting the merger. However, the Commission did not consider what impact the merger would have on the other players ability and incentive to innovate in the market also competing against Google such as Ask, AOL and Sezam. In other words, permitting the merger seemed to be more to do with developing a thorn in the side of Google than a true assessment of the consequences of the merger in the market. As noted by Bourreau and de Streel mergers in digital markets can amplify certain anti-competitive effects and indeed disincentivise innovation amongst competitors.[114]The merger could therefore be a final straw for the smaller competitors in the market to give up and exit. In this case, the Commission, although considering 'innovation', was too keen to accept the parties of the merger's arguments with limited reflection on the impact of the wider market and its structure.

Similarly, in a study of mergers in the pharmaceutical industry Haucap and Stiebale identify that (horizontal) mergers in high R&D intensity markets will decrease innovation for both the merged entities and the non-merged competitors.[115] Furthermore, the study revealed that not only is there a negative impact on innovation for the merged entity but also on competitors. Surprisingly, the study

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[108] *Microsoft/Yahoo*, *supra* n. 5 para. 109.
[109] Ibid. paras. 141 and 145-46.
[110] Ibid, para. 203.
[111] Ibid, paras. 206-213.
[112] Ibid. paras. 226 and 256.
[113] Ibid. paras. 112, 115, 120-22, and 130.
[114] Bourreau and de Streel, *supra* n. 30 at 33-34.
[115] Haucap, Justus and Stiebale, Joel (2016): How mergers affect innovation: Theory and evidence from the pharmaceutical industry, DICE Discussion Paper, No. 218, ISBN 978-3-86304-217-2, Düsseldorf Institute for Competition Economics (DICE), Düsseldorf, https://www.econstor.eu/bitstream/10419/130193/1/856561223.pdf accessed 29 December 2019 (hereinafter referred to as Haucap and Stiebale (2016b)).

also identified that there was a correlation between the negative impact on the competitors' expenditures on innovation and the size of the acquired party – the negative impact increased the smaller the company.[116] Although the study recognised that innovation is a difficult factor to measure and forecast, it flagged that it is not necessarily the mergers involving or resulting in higher market shares that the competition authorities have to worry about. Instead, it is the impact the merger may have on innovation. In particular, the mergers creating the most negative impact on innovation are those where there are overlapping research projects, i.e. where the merging companies are working on parallel projects that may in the future develop into competing products if the companies were not permitted to merge.[117] The findings of this study are in line with those of others who noted that the conglomerate mergers in digital market economies are not promoting innovation, but instead motivates start-ups to create 'me-too' products rather than developing disruptive innovation that would significantly challenge incumbents in the markets.[118] If the Commission could get onboard with these findings a merger like *Microsoft/Yahoo* might have been granted greater attention and the same can undoubtedly be said for the *Facebook/WhatsApp* merger.

The EU Non-Horizontal Merger Guidelines are a little unhelpful on this front as they note that in practice the Commission will not investigate non-horizontal mergers unless the merging companies will have market power[119] or if that is not the case, where the merger 'involves a company that is likely to expand significantly in the near future, e.g. because of a recent innovation.'[120] This statement indicates that whilst innovation is acknowledged as being able to play a part upon the effects of competition in vertical and conglomerate mergers, this role is considered less significant to the one it plays for the assessment of horizontal mergers.[121] Whilst this potentially can be justified when it comes to traditional markets, this cannot be said to be the case for digital economy markets where the markets are fast-moving and dynamic meaning that there is scope for amalgamation of markets in particular as products are in a constant evolution and reworked.[122] The potential to negatively affect innovation in these types of markets should therefore be high on the list of concerns by the competition authorities. Crémer et al. put it simply: 'the best way to handle acquisitions [by dominant platforms of small start-ups with a quickly growing user base and significant competitive potential] is to inject some 'horizontal' elements into the 'conglomerate' theories of harm'.[123] To be more robust towards conglomerate mergers it is recommended that the Commission revise its EU Non-Horizontal Merger Guidelines to match today's digital economy markets, where innovation also for conglomerate

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[116] Ibid. at 25.
[117] Ibid. at 23.
[118] McLean, *Supra* n. 2, p. 4.
[119] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C265, 2008, para 23, see also T-5/02 *Tetra Laval BV v Commission of the European Communities*, ECLI:EU:T:2002:264, para. 155 confirming this approach by the Courts.
[120] The EU Non-horizontal merger Guidelines, *supra* n. 119, para. 26 – see also *Googel/DoubleClick*, *supra* n. 4, para. 216.
[121] See European Commission, Case No COMP/M.5984, *Intel/McAfee*, Commission decision of 26 January 2011. European Commission, Case No COMP/M.6564, *ARM/Giesecke & Devrient/Gemalto*, Commission decision of 6 November 2012 – two vertical mergers, where the Commission assessed whether the merging companies were able to leverage into downstream markets as a result of their strong position as innovators in the upstream market. Concerns regarding innovation were however considered.
[122] Crémer at al., *supra* n. 17 at 35.
[123] Ibid. at 11.

mergers can have a significant impact on the development of the markets. Market structure is therefore key.

Haucap and Stiebale's study was focused specifically on horizontal mergers in the pharmaceutical industry and R&D intensive markets, nevertheless, there are undoubtedly parallels that can be drawn and lessons that can be learned from this study in relation to the digital economy markets and conglomerate mergers. Most prominently, that when considering the impact on innovation this cannot merely be isolated to the merging entity, but has to be reviewed within the market/s as a whole and what impact the merger may have on innovation in that market. As noted above, the *Dupont/Dow* merger is the trend setter on this, where the Commission found that the merger would have a negative impact on innovation on the market as a whole and perhaps signals a new approach. Previously, in the *Pfizer/Hospira* merger[124], the Commission only approved the merger on condition that Pfizer sold its European rights to an arthritis drug it was developing, because Hospira already had a competing drug and the Commission was concerned that Pfizer's research on the drug would be stopped as a result of the merger.[125] It shows the Commission's awareness that companies are increasingly defending themselves by eliminating innovation competitors through mergers.[126] It is therefore disappointing to see that the Commission itself has not fully drawn the link to digital economy markets were conglomerate mergers are prevalent.

In none of the mergers under review in this article was the *Pfizer/Hospira* proposition considered. In fact, very little was mentioned regarding innovation in any of these cases besides the *Microsoft/Yahoo* merger. In *Facebook/WhatsApp,* the Commission actually stated that if the merged entity should raise prices and stop innovating, 'customers could easily switch to competing services which are available free of charge and which will provide new features and better quality features'.[127] While it may be the case that customers could migrate to Viber, Signal or WeChat for free instead of WhatsApp and MeWe, Minds and Sociall for Facebook, the Commission has in this comment forgotten about the network effects involved. It is not an individual's sole discretion to migrate – it requires the individual's social network to also migrate with that person and that is a process that takes much longer than a mere download of an app even if 'multi-homing' is available. There is therefore an element of lock-in effect with these types of communication tools amongst consumers, which was not fully investigated or perhaps acknowledged by the Commission. In this respect the Commission merely noted that 'the pre-existing network effects would be unlikely to be substantially strengthened by the Transaction.'[128] This statement did not take into account the secondary networks at play, and whilst there was no strengthening of the networks, there was certainly also no weakening them either. Moreover, the Commission made an assumption that by switching the consumers will automatically move onto products which were of better quality and with new features.[129] Not only is this a peculiar suggestion but the Commission is also effectively predicting that there will be no impact on innovation as a result of the merger. Given the results of Haucap and Stiebale's study this may be too optimistic an assumption to make and it indicates that the Commission should be much more cautious in its merger review before permitting mergers to go ahead. This further supports the argument for detailed

[124] *Pfizer/Hospira, supra* n. 97.
[125]Ibid. Commitments to the European Commission, Section B.
[126] Haucap and Stiebale (2016b), *supra* n. 115.
[127] *Facebook/WhatsApp*, *supra* n. 6, para. 94, see also paras. 108-115.
[128]Ibid. para. 140.
[129] Ibid. para. 94.

investigation and understanding of the market and its structure before permitting the merger or simply saying 'no'. Similarly, Crémer et al. point out that in market settings characterised by 'a high degree of concentration and high barriers to entry, resulting…from strong positive network effects, possibly reinforced by data-driven feedback loops' the merger of a dominant company with a small start-up can result in the strengthening of the dominant company's position even without an actual market overlap and more importantly result in the reduction of independent innovation.[130] There are therefore strong signals that point towards a need for a review of the Commission's approach to non-horizontal mergers, but it may just be a case of review of attitude and understanding of the market, rather than a full-blown legal change.

In comparison, in *Apple/Shazam,* the Commission noted that whilst the merger took place in a digital economy market which should be volatile, fast-moving and innovative, Shazam had in fact been present in the market for the last 20 years, so could not be classified as a start-up and moreover, it found that there was no indications of recent disruptive entry or innovation in the market for dedicated music recognition apps for smart mobile devices.[131] This is a rather complicated way of stating reality: that the market had in fact matured and could be assessed as a traditional market and this is perhaps where the rest of the digital economy markets are headed if we do not preserve the dynamic aspects of them and permit start-ups time to grow and innovate before allowing mergers with digital giants.

To sum-up, innovation is not reviewed by the Commission with enough scrutiny and care in non-horizontal merger reviews as would be essential to fully ensure that innovation in the markets as a whole is not negatively impacted by mergers in digital economies. Empirical evidence demonstrates that it cannot be ruled out that non-horizontal mergers does not affect innovation negatively both for the merged entity and its competitors,[132] and this leads therefore to a conclusion that the Commission's merger review needs updating to be broader in its scope than what the consumer welfare framework permits, i.e. it needs to look to long-term effects in the markets to promote innovation and importantly the right kind of innovation, i.e. disruptive innovation.

Potential Competition

In most cases, the merger, especially when it comes to killer acquisitions, is not just about stifling innovation, but also about a stronger market player seeking to purchase a potential competitor to eliminate future competition and diversify to obtain a greater stronghold in a particular market.

Under EU merger regulation the elimination of a potential competitor or future competition is in principle categorised as a horizontal issue.[133] However, as noted in *Microsoft/LinkedIn*, conglomerate mergers can generate non-coordinated effects in form of foreclosure effects, which can impact upon actual or potential competitors. '…foreclosure effects may arise when the combination of products in related markets may confer on the merged entity the ability and incentive to leverage a strong market

[130] Crémer at al., *supra* n. 17 at 112-13.
[131] *Apple/Shazam*, *supra* n. 8, paras. 162-63.
[132] See Bourreau, and de Streel, *supra* n. 30 and Haucap and Stiebale (2016b), *supra* n. 115.
[133] The EU Horizontal Merger Guidelines, *supra* n. 40, para. 5.

position from one market to another closely related market by means of tying or bundling or other exclusionary practices. While tying and bundling have often no anticompetitive consequences, in certain circumstances such practices may lead to a reduction in actual or potential competitors' ability or incentive to compete.'[134] This can result in a reduction in the competitive pressure on the merged entity and permit it to increase prices.[135] Awareness of potential competition and assessment of the effect the proposed merger may have on potential competition is therefore closely linked to that of innovation. As noted by Crémer et al. 'At the time of the acquisition there may not yet be a substantial horizontal overlap between the "core" market dominated by the acquirer and the separate (but typically related) market served by the startup. While the elimination of potential competition may suffice to raise competitive concerns, it may be difficult to prove the existence of potential competition with a sufficient degree of certainty.'[136] They therefore suggest that new theories of harm are needed to be explored in digital economy markets because these markets are often characterised by a few large firms with 'highly entrenched positions of dominance' in an expanding digital ecosystem.[137] This aligns with the findings regarding the Commission's approach to innovation: the Commission will need to review its approach to non-horizontal mergers and take a more cautious approach when these mergers are taking place in digital markets, because these markets and their structures are not as straightforward as more traditional markets.

On the other hand, it must also be considered that mergers can generate efficiencies and there are therefore 'costs' associated with a more restrictive approach to mergers that eliminate potential competition. The ability for start-ups to be bought up by larger incumbents may in itself be an incentive to innovate, and as discussed above, it is a well-known exit strategy by many start-ups funded by venture capital funding.[138] There could therefore be some initial reduction in the number of start-ups coming onto the markets by not permitting such mergers, until venture capital funding companies catch up with new exit strategies. .[139]

This assumption should be contrasted with the reality that Google has bought up one company every month since 2001,[140] not all companies were bought for an excessive price like Motorola Mobility for instance, which was bought for $12.5 billion.[141] If small start-ups are gambling their innovation against this – and the evidence is out there that they are doing so[142], the innovation achieved is likely to be sub-optimal as it is not about being disruptive and competitive, but appearing lucrative to a large conglomerate.[143] Moreover, there is no guarantee that the acquisition price will be excessively large. The result on the consumers however is profound as they lose out on the choice of suppliers with each start-ups acquisition and the potential elimination of a new and exciting product or service.[144]

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[134] *Microsoft/LinkedIn*, *supra* n. 7, para. 185.
[135] Ibid.
[136] Crémer et al., *supra* n. 17 at 112.
[137] Ibid.
[137] Ibid.
[138] See Lemley and McCreary, *Supra* n. 36.
[139] McSweeny and O'Dea, *supra* n. 53 at 12.
[140] https://en.wikipedia.org/wiki/List_of_mergers_and_acquisitions_by_Alphabet accessed 30 December 2019.
[141] Bourreau and de Streel, *supra* n. 30 at 2.
[142] Cunningham et al., *Supra* n.1.
[143] McLean), *Supra* n. 2, p. 2.
[144] Cunningham et al., *Supra* n.1.

In the *Facebook/WhatsApp* merger, despite noting that the lines are blurred between social networking services and consumer communications apps,[145] the Commission found that due to 'multi-homing', low barriers to entry and expansion, the merger would not have a negative impact on competition and in fact found that the companies had considerable differences between them in terms of functionalities and focus that they were not close competitors and a potential market for social networking services.[146] Whilst this may have been an appropriate assumption to make in a traditional market, the digital economy markets work differently and as discussed above in relation to Amazon, diversification is key to obtain a secure stronghold, if not a gatekeeper position in digital economy markets for these large conglomerates.[147] Although it can be accepted that proof of starts-ups planning to enter the core market of the conglomerate is difficult to obtain,[148] the fact that the two products were rated by the Commission itself as complimentary should have permitted the Commission to see that the purchase of WhatsApp by Meta (Facebook) essentially eliminated a future competitor to Meta. Yet with the narrow short-term focus applied by the Commission such considerations were not allowed for and the acquisition was permitted to go ahead.

Another example of the Commission's short-sightedness is found in another conglomerate merger, Google*/Doubleclick* , where the then newly adopted non-horizontal merger guidelines were applied and followed by the Commission. The Commission looked at the horizontal effects of the merger and potential foreclosure effects. It did not find that the merger would restrict competition advertising servicing market because DoubleClick already faced strong competition from other companies and Google was seen to only provide ad servicing technology as an ancillary service to its online ad space and not as a standalone service.[149] Although there were some overlaps horizontally, the Commission concluded that this was minimal and unlikely to constraint the parties horizontally.[150] The Commission investigated whether there were any foreclosure effects as a result of the merger and found that there were significant entry and competition in online ad intermediation and prevalence of multi-homing.[151] Therefore, although the companies post-merger would control a large intermediation platform and be a leading supplier of ad servicing tools for display ads, the Commission concluded that the merged entity would not have the ability or incentive to engage in foreclosure strategies.[152] The Commission did however recognise that given Google's strong position in the search ad segment the merged entity would have the ability to foreclose rivals by bundling the provisions of online advertising space for search ads or the provision of (search) intermediation services with DoubleClick's ad serving technology. The Commission did not delve on the consequences of such foreclosure. Whilst the Commission's assessment of Google and DoubleClick's positions in the market pre- and post-merger was thorough and gave a sensible picture of the industry, the assessment did not deal with the impact that the merger would have on the market longer-term and nor was the assessment detailed enough to consider the consequences of any potential economies of scope and diversifications as a result of the merger. The Commission merely stuck to the known markets.

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[145] *Facebook/WhatsApp*, *supra* n. 6, para. 52.
[146] Ibid. para. 158.
[147] See Wu (2018b), *supra* n. 9 and Bourreau and de Streel, *supra* n. 30.
[148]Crémer et al., *supra* n. 17 at 119.
[149] *Google/DoubleClick*, *supra* n. 4, para. 192.
[150] Ibid. para. 194.
[151] Ibid. para. 305.
[152] Ibid, paras. 310 and 325-329.

It is correct to be concerned that the assessment of potential competition in a merger review is not easy to perform – in particular obtaining evidence of what the parties are intending to do in the future can be difficult. Maybe they would not always know themselves what strategies to pursue long-term as unexpected challenges and opportunities (in the form of a new product for instance) may arise. These uncertainties will need to be weighed against the efficiencies (in particular dynamic efficiencies) and benefits the merger proposes to achieve. The cases reviewed above suggest that this is the approach adopted by the Commission. The Commission is highly reliant on the evidence provided to it by the merging parties whilst also being under a certain amount of time pressure. The assessment is therefore limited to the possible options that are as close to the current situation and the Commission does not consider alternative options such as the start-up merging with another competitor in the market or not merging at all. From a practical perspective, it has to be acknowledged that not every alternative can be reviewed, however, this should not mean that the Commission automatically permits these mergers, instead the approach should be more cautious and inquisitive asking the companies to provide further information of their future intentions, to to ensure the market remains dynamic and innovative, occasionally that would mean saying 'no'.[153]

Conclusion

Recent start-ups acquisition cases in the digital economy market demonstrate that the Commission has not found its feet in these markets and is still struggling with understanding the intensions behind the mergers and the consequences of them upon the markets, and in particular future innovation. That said, there is evidence of the Commission learning on the job. In *Facebook/WhatsApp*, the Commission's assessment of user data and its application was minimal and short-sighted, in *Microsoft/LinkedIn* and again in *Apple/Shazam*, reviewed respectively two and four years later, the Commission offered more detailed assessments of the data transfer between the parties, although it still concluded in both cases that the data increment would not provide a significant competitive advantage to the merged entity.[154] However, the Commission's increased focus and better understanding of the impact data can have as an asset to a company to manipulate and stifle innovation in the market should be applauded, it is after all a small step in the right direction to ensure that markets remain competitive, but it would be sensible to reflect this in an updated version of the non-horizontal merger guidelines.

Part 5: Concluding Remarks

This paper has demonstrated that whilst the Commission views innovation as one of its primary goals, it does not follow through to achieve that in the enforcement of the competition rules and in this case, its merger review. The consumer welfare framework does not aid the current competition rules and guidelines in achieving the optimal goals set by the Commission, in particular, as innovation seems to have been left off the chart despite playing a crucial role in digital economy markets.

One reoccurring concern that we are faced with when highlighting the need for a stronger focus on innovation, is how to assess this in practical terms. As mentioned by Joskow and Klevorick: '…one is confronted with the difficult task of inferring long-run market outcomes from observable short-run behavior and short-run market conditions. Any such inference entails uncertainty and hence the

[153] See Shapiro (2018), *supra* n. 9.
[154] *Apple/Shazam*, *supra* n. 8, paras. 196-259 and *Microsoft/LinkedIn, supra* n. 7, paras. 179-80.

possibility of error; an assessment of long-run considerations is necessarily "speculative and indeterminate."'[155] No one is arguing against the fact that it is difficult to predict things and in particular the future as the dissenting FTC Commissioner in the US *Google/DoubleClick* merger inquiry highlighted in her decision by saying: 'I dissent because I make alternate predictions about where this market is heading…'[156]

However, this does not mean that competition authorities should shy away from engaging in the enforcement of the competition rules even if it raises difficult questions.

In the US this issue has quickly reverted into a debate about the cost of errors and the probability of achieving false positives versus false negative outcomes in cases.[157] This has not yet been part of the agenda in the EU, where the discussion is still focused upon the economic question of whether innovation will be stifled through mergers.[158] Empirical studies suggest that mergers will inhibit innovation not just for the merging entity itself but also in the markets where the merging entity is active.[159] Moreover, this effect is amplified when the merger is between a large incumbent and a smaller-start-up.[160] The current approach by the Commission to conglomerate mergers do not take this into consideration as can be seen from merger reviews such as *Facebook/WhatsApp* and *Google/DoubleClick* assessed above, where the question of innovation was hardly touched upon.

Instead, the Commission approach is based on the consumer welfare framework which apply short-term proxies to evaluate the consequences of the merger in question. These proxies do not effectively consider aspects such as diversification and envelopment of smaller competitors, and gatekeeper control of ecosystems, which all play significant roles in digital economy markets and how digital conglomerates operate.

To allow innovation, and in particular disruptive innovation, and dynamic efficiencies to flourish in digital economy markets, this paper is advocating the simple solution of focusing on the structure of the market, instead of the competitors to ensure effective competition and allowing the markets to remain contestable. However, this alone is not enough. There must also be greater focus upon the enforcement policies in markets that are in their infancy and as such it would be sensible to see this reflected in the Commission's non-horizontal merger guidelines. Instead of a noninterventionist approach to large incumbents buying up small start-ups, the Commission must make provisions for innovation by being more cautious in its assessment of mergers involving digital conglomerates, this means that occasionally, the Commission will have to say 'no'.

[155] Paul L. Joskow and Alvin Klevorick 'A Framework for Analysing Predatory Pricing Policy, The Yale Law Journal, 1979, Vol 89 (2), p213-270, at 217.
[156] FCT, *In the matter of Google/DoubleClick* (FCT File No 0710) Commissioner Pamela Jones Harbour.
[157] See Shapiro (2018), *supra* n. 9 and Devlin and Jacobs, *supra* n. 84.
[158] See Haucap and Stiebale (2016b), *supra* n. 115, Petit, *supra* n. 93, De Coninck, *supra* n. 93 and Bourreau and de Streel, *supra* n. 30.
[159] Cunningham et al. *Supra* n. 1.
[160] Shaprio (2018), *supra* n. 9 at 741.