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Platform mergers: Tips for getting the deal through

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The European Commission's Chief Competition Economist in a recent presentation specifically referred to the notion of "platform envelopment" and the possibilities of leverage.[1] His social-media posts about the power of search engines and browsers to gain advantages in other areas, such as videos, maps and shopping, suggest a sense of insecurity about the growing influence of data-driven platforms. What does this mean for strategic transaction advisors and companies that plan to undertake platform mergers?

This article will explore the concept of "platform envelopment," analyze its possible application to a platform-merger scenario and suggest an approach to antitrust risk assessments that could be undertaken by transaction advisors and merging parties at the pre-deal stage.

EU merger control — searching for a buzzword

Margrethe Vestager, the European Commissioner for Competition, has voiced concerns about how a "gatekeeper" role controlling access to data and information would allow platforms to reinforce their power across the digital ecosystem. She has made comparisons between platforms and the giant global conglomerate Buy n Large in the film *Wall-E*. Usually it is difficult to displace an existing platform due to network effects[2] and customer switching costs.[3] It may be possible, however, for a new entrant to succeed if it is able to offer an innovative product.

As an alternative to this strategy of creative destruction, leadership in a platform market can be established without a revolutionary innovative functionality through a "platform envelopment" strategy.[4] Platform envelopment entails one platform provider adding another platform's functionality to its own, and then offering a multi-platform bundle. Through this strategy, a provider in one platform market will tie its functionality to that of the target market. This will leverage the shared user relationships and common components[5] from the existing platform market to enter a second platform market.

The practices of tying, bundling and leveraging that can be part of a platform envelopment strategy have in the past been examined by the European Commission in the context of conglomerate mergers.[6] In this era of distrust over the concentration of big-data ownership, the European Commission may not be averse to combining modern concepts, such as platform envelopment, and reinterpreting the existing EU competition rules and case law on tying, bundling and leveraging to address the particularities of online platforms.

The European Commission could extrapolate the concept of platform envelopment to a merger scenario, thus suggesting a possible harm to competition as a result of the implementation of a platform envelopment strategy. One scenario could be an acquisition by a provider in one platform market of a target firm that is in another platform market, where there are strong competitors to the target firm. The European Commission could propose that the platform enveloper would: (i) likely erect new barriers to entry because the merged entity will be able to take advantage of the shared user community, components and data aggregation; and (ii) existing or potential competitors would be unable to compete effectively since they cannot take advantage of cross-subsidies or offer a similar bundle of products and services.

Planning matters

Big Tech critics are calling for a more rigorous enforcement of competition rules when reviewing platform mergers. In response, European Commission officials seem to be keen to define new legal tests, analytical methods and possibilities for reinterpreting existing rules to review platform mergers.

In the last fifteen years, no deal has been blocked by the European Commission solely on the basis of concerns about conglomerate effects. The evidentiary threshold for establishing a significant impediment of effective competition in the case of platform mergers is the same as any other transaction in another sector. Meeting this test is particularly difficult in the context of a transaction that results only in conglomerate effects. This, together with the dynamic nature of the digital sector — where a large number of businesses or business plans are created and then fail — makes the test even harder to meet.

However, this does not mean that platform mergers will be automatically cleared. Transaction advisors and merging parties should expect a more rigorous examination of proposed platform mergers. They will need to modernize their approach by anticipating antitrust risks, such as potential divestitures or behavioral remedies, lengthy investigations and burdensome information requests at the stage of a feasibility analysis. The following are some of the issues that merging parties should consider at a pre-deal stage:

- **Platform envelopment**. Merging parties should expect to provide detailed information as to whether the merged entity would be able to combine data sets. For example, parties should be ready to respond to questions regarding the possibility (even if remote) of achieving interoperability, matching user accounts of the purchaser and target, tying and bundling of products, etc. Data sets could relate to personal, location, response, social behavior and browsing information. The

European Commission will examine the ability and incentive of the merging parties to create a unique database — one that would become an essential input, which no competitor would be able to duplicate to compete with the merged entity.
- **Economic analysis** – A cost-benefit analysis of the ability and incentive of the merged entity to engage in a platform envelopment strategy by simulating the costs and margins and the resulting effect on competition may be undertaken to dispel concerns of foreclosure effects.
- **Remedies**. The European Commission can impose remedies to alleviate concerns, which can be structural or behavioral promises from merging parties. A remedies strategy should be part of early deal discussions.
- **Timeline**. A long prenotification process should be built into the transaction timetable.
- **Internal documents**. There will be a focus on past practice and strategic rationale for the deal. As a result, parties will be expected to respond to burdensome document requests within a short time period, and prepare for discussions or presentations by corporate executives to the European Commission officials.

Controlling the controllables

The European Commission is cognizant that platforms may help cut costs and improve services, but it is also concerned that platform markets are showing signs of becoming more concentrated. It is clear that platform companies that want to merge and use data will have to work harder to explain what they want to do and why to secure a merger-clearance decision.

A time-bound merger review process could raise questions that may catch merging parties by surprise, as it is difficult to anticipate comments the European Commission will receive from third parties and the questions that may follow as a result. It is therefore important for transaction advisors and merging parties to drive the narrative with the European Commission, especially during the pre-notification stage when the merger is not public, with the key objective of building credibility and occupying mind space that will be useful after the formal notification. This can be done by engaging in a proactive antitrust assessment, designing a flexible remedy strategy and defining a clear approach for producing strategy documents and economic studies that explain business-case scenarios — before the merger is made public. The priority at the pre-deal stage should be to set out a road map for dealing with problematic issues that have been identified early.

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[1] Presentation of the European Commission’s Chief Competition Economist, 5 December 2018.

[2] Direct network effects arise when users of one product directly benefit if there are more users of the same product. Indirect network effects exist when the value of a service or product for a specific group of users increases with the number of users of another group. Network effects could lead to strengthening a company’s market

power or even create a lock-in effect for customers. The risk of tipping is strong if there are strong network effects. Tipping means that a market is ultimately served by only one platform, and other providers leave the market.

[3] Examples of customer switching costs include barriers to content or data portability that may be technical or contractual, and difficulty in recreating the trust mechanism of user ratings and reviews.

[4] Thomas Eisenmann, Geoffrey Parker and Marshall Van Alstyne, "Platform envelopment," *Strategic Management Journal*, 25 April 2011.

[5] In their paper, Eisenmann et al. point to the use of common components, such as optical disk readers, circuits for generating video output and a power supply in both video game consoles and DVD players. An example of using common components online is the website gov.uk. It saves time with reusable, accessible components for forms, navigation, panels, tables and more. See https://www.gov.uk/service-manual/technology/using-common-components.

[6] Conglomerate mergers are transactions where there are no horizontal overlaps (the parties are not currently competing in the same product market) or vertical relationships (supplier-customer) between the parties to a transaction. Under certain circumstances, conglomerate mergers may raise competitive concerns (conglomerate effects), where the merging firms are suppliers of complementary, non-competing but closely related products. Transactions giving rise to conglomerate effects are generally not considered to raise competition concerns.

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