

Kluwer Competition Law Blog

Merger Regulation and the Digital Economy; Are Competition Authorities Up to the Task?

Willard Mwemba (Mergers and Acquisitions Division, COMESA Competition Commission) · Thursday, August 1st, 2019

Introduction

1. Most Competition Authorities the world-over that are involved in *ex-ante* or *ex-post* merger review process use tools that are in some way universally accepted. This is because these tools have been developed and tested over time. Some of these tools include the merger notification thresholds for determining nexus, the market definition tools to determine the confines within which the competition law and policy should be applied when reviewing a particular transaction and the substantial lessening of competition test to determine the extent to which a certain transaction would significantly diminish competition in particular as a result of creating or strengthening a position of dominance.
2. It has been observed that the pace at which these tools are developed and become universally accepted is slow and several factors may account for this among the main ones the differences in policy objectives among the different jurisdictions and to an extent experimentation to determine if these tools are efficient and effective. However, markets are not evolving at such a slow space especially with the exponential technological advancement in the last quarter of the 20th century up until now in the 21st. Such developments may pose challenges for competition authorities as some transactions though anti-competitive may escape the application of competition laws because of obsolete competition substantive and procedural rules. Competition Authorities should rethink the current competition tools and develop tools that will be relevant in this era of technological advancement.

What is the Digital Economy?

3. Simply put, the digital economy involves all those commercial activities that are arising from the use of different platforms such the internet and mobile technology and are characterised by network effects. The digital economy has resulted in the interconnectedness of people, businesses and computer in a seamless fashion through use of data and algorithms. It has accelerated the speed at which people

conduct their affairs and overcome the challenges raised by geographical proximity.

4. The Organisation for Economic Cooperation and Development in its 2012 hearing on the digital economy described the digital economy as follows:

“The digital economy comprises markets based on digital technologies that facilitate the trade of goods and services through e-commerce. The expansion of the digital sector has been a key driver of economic growth in recent years and the shift towards a digital world has had effects on society that extend beyond the digital technology context alone”.

5. The foregoing description does exude challenges that are likely to be encountered in the regulation of transaction in the digital economy due to their diverse interface and interactions with related and interrelated markets.

Merger Regulation in the Digital Economy

6. Merger Regulation is an important and unique aspect of competition regulation. This is because it usually involves the restructuring of undertakings to achieve efficiencies and growth and thereby benefit consumers, the ultimate goal of competition law and policy. Therefore, mergers are not put in the same class of other anti-trust conduct that usually result in detriment in the market. It is also important to recall that most jurisdictions have an *ex-ante* merger review process, meaning that mergers are reviewed on the basis of probabilities as the effects of the merger on the market have not manifested at the time of the review and herein lies the challenge. A poor assessment of a merger may result in two outcomes. The first one is the clearance of a merger that will actually result in anti-competitive effects on the market. The second one is the prohibition of a merger that would have resulted in efficiencies and benefits to the consumer. It is therefore important that competition authorities have an accurate understanding of the tools at their disposal, comprehensive understanding of the markets involved and adequate and effective tools to analyse these markets. In the digital economy, all these factors mentioned become a challenge. It has been observed that in recent times, competition authorities, developed and developing do not have adequate tools and they lack thorough understanding of the digital economy to effectively address mergers in this industry.

Capturing Mergers in the Digital Economy

7. Mergers in the digital economy have seen a tremendous surge in modern times. According to the Anti-Trust Chronicle, as the fast-moving digital economy has quickly grown, mergers in this sector have continued to increase in numbers. Antitrust regulators, private practitioners and undertakings have had to face this challenge head-on.[1] The capturing of these mergers is based on the tools established to capture traditional mergers. However, this has raised challenges. Most competition authorities capture mergers that have local nexus on the basis of

merger notification thresholds. The merger notification thresholds are premised on turnover, assets, market shares or transaction value. As regards the thresholds based on turnover and market shares, it can be observed that a merger that involves two firms in the digital economy may not always meet the turnover thresholds and this may result in the failure to review a merger that may have anti-competitive effects on procedural grounds. Fortunately, in COMESA, the Competition Regulations under Article 24(6) may require such mergers to be notified even where they do not meet the merger notification thresholds if the Commission is convinced that the merger is more likely than not to raise competition concerns.

8. It has been observed that in digital markets, some firms may not have immediate turnover and they may be offering some of their services free of charge. The profits and significant turnover may not be the immediate objective but the creation of network effects which is the critical mass required for the new firm to begin realising meaningful revenues. Therefore, such companies may have a good and significant number of users but the turnover figures may be misleading. Such a challenge arose in the 2014, US\$19 billion merger between Facebook and WhatsApp. Despite this very large transaction value, the merger escaped notification to the European Commission because it did not meet the notification thresholds under the European Merger Regulations.
9. Similarly, such transactions may escape notification in jurisdictions where notification thresholds are based on market shares. Market shares appear to be a vague and opaque method of determining merger notification thresholds. This is because the determination of market shares would require the definition of the relevant market, an exercise that is not free from difficulty. In digital markets, this becomes even more challenging as competition authorities appear not to have expertise to understand these markets. As there are several overlaps and interconnections in the digital economy, accurate definition of the market may be a challenge and therefore the market shares.
10. To address this problem, competition authorities especially the Federal Cartel Office of Germany and the European Commission have taken the lead in discussions and looking for the solution. As early movers, Austria and Germany amended their competition laws in order to react to such new developments in the digital economy. Among the changes, it has been clarified that services that are rendered free of charge to consumers may nevertheless constitute a market in terms of competition law. This is particularly relevant for multilateral online platforms such as search engines, comparison websites, hotel booking portals or social networks, which offer their services for no fee.[2] It will be interesting to see how this will reconcile with the definition of an undertaking which in most competition jurisdictions is defined as any person, public or private involved in an economic activity. The definition of economic activity is likely to be on the spotlight in such future cases. In Germany, Under new laws, merger control will be required if the value of the consideration for a transaction exceeds €400 million in Germany (€200 million in Austria) even if the companies involved do not meet the domestic revenue thresholds.[3]
11. It is interesting that most commentators and experts in the field of competition law including the author have given scathing attacks on the determination of merger notification thresholds based on transaction value. The argument has been that a

transaction value is not a true reflection of the economic activity of the merging parties as it is possible to have a merger with a huge transaction value but relatively low economic activity in a particular jurisdiction. The converse is also true. It does appear that in the digital economy, the transaction value may give a crude indication of the importance of a particular transaction in a particular jurisdiction.

12. The main challenge with merger notifications based on transaction values may be the lack of local nexus, a virtue in determining transactions on which competition authorities may claim jurisdiction. Therefore, to address this potential challenge, the International Competition Network (ICN) in 2017 recommended the following:

“Jurisdictions may supplement their material nexus thresholds with additional, ancillary thresholds, but those thresholds alone should not be sufficient to trigger a merger notification requirement in the absence of a material nexus to the reviewing jurisdiction. Examples of such additional and cumulative screens include thresholds based on the worldwide activities of the parties or the value of the transaction”.

13. While the above guidance by the ICN is helpful, it does not completely resolve the problem. How will local nexus be determined without reference to assets, turnover and market shares in the reviewing jurisdiction? Will nexus be required by simply some level of activities such as the users of the platform in a particular jurisdiction? These are matters that should be discussed extensively.
14. Another worrying trend as regards global mergers in the digital economy is that while the advanced competition jurisdictions have reviewed a good number of such mergers, very few have been reviewed by their counterparts in the developing world. Could it be because of the challenges elucidated above? Most likely yes in addition to challenges related to expertise in the digital economy, the extra-territorial application of laws to such transactions and the permeation of such transactions to several jurisdictions. It is surprising that while Facebook and Whatsapp are popular platforms in Africa, the merger was not notified to any competition authority in Africa.

Substantive Assessment of Mergers in the Digital Economy

15. The assessment of mergers in the digital economy also presents challenges. Some of them have already been alluded to in the sections above. For example the definition of the relevant market, the determination of market shares and market power and the drafting of remedies among others. Further, it has been observed that the digital economy has brought significant benefits to the consumers and contributed to the overall performance of the global economy. Therefore, it is important to ensure that the application of merger laws to these transactions do not stifle innovation by hindering such mergers. At the same time, it is important to safe guard the swallowing up of start-ups by the incumbents who may be mindful of the levels of competition such start-ups may bring about. All these concerns can only be avoided if new tools that are comprehended by competition practitioners are developed.

16. Theories of harm shall have to be redefined. For example, just like any other merger, transactions in the digital economy can result in foreclosure concerns. A merger in the digital economy may lead to a concentration of data for example and may restrict access to this data especially for the start-ups to whom this data may be indispensable. Such a merger would be anti-competitive on the face of it but care has to be taken before arriving at such a conclusion because not only the quantity of the data is important here but the quality and its indispensability to other market players. Also if such data can easily be accessed from other sources, then such a merger may not be anti-competitive. However, coordinated effects may also be possible in such mergers as firm activities in the digital economy transcends several markets. Foreclosure effects may also occur from a vertical perspective if the transaction enables the merged entity to restrict or deny companies on upstream or downstream markets access to the data.[4] In their joint paper on Big Data and Competition, the French and Germany competition authorities also raised the concern that parties to a merger might use their up or downstream access to users to gather data which they could then use to boost their position in the vertically connected market.[5]

Remedies

17. The drafting of remedies in the digital economy is critical. Usually competition authorities prefer structural remedies as opposed to behavioural remedies in that they resolve the concern immediately and they do not require *ex-post* However, structural remedies may not always be easy in the digital economy. It has to be observed that in this market, data is part of the assets and sometimes a significant portion of the assets of an undertaking. It may sometimes be difficult to separate this data from an undertaking in a commercially viable way as it is closely interlinked to other data sets not so relevant to the transaction. In such cases, behavioural remedies would be imposed but in such a situation, they may not be easy to draft, let alone monitor due to lack of expertise. Further, it has been observed that in traditional markets, most of the remedies are imposed for a period of 3 to 5 years. This may be a relatively long period of time in the digital economy which is fast evolving and the behavioural remedies may become irrelevant in a matter of months.

Conclusion

18. The challenges presented by merger regulation in the digital economy cannot be overemphasised. In as much as the digital economy has resulted in disruptive technologies that have benefited consumers, they should be closely monitored in order for the benefits not to be eroded by anti-competitive tendencies. At the same time, care has to be taken to ensure that innovation is not hindered by unnecessary regulation. This will require competition authorities to move fast to develop competition tools relevant to address competition matters in the digital economy. This challenge is not just daunting for developing countries but developed countries as well. However, the developed countries can lead the way as they have resources

for such exercises. Germany and the European Commission are already leading the way and the effectiveness of the tools they are developing remains to be seen.

[1] Competition Policy International. Anti-trust Chronicle - The Digital Economy. February 2018

[2] Mergers and the digital economy; White & Case LLP. Under "Settings", <https://www.lexology.com/library/detail.aspx?g=e642fc40-b55d-4dfc-88d3-23620ab583c8> (accessed on 26 May 2019).

[3] Ibid

[4] See Germany FCO, Big Data und Wettbewerb

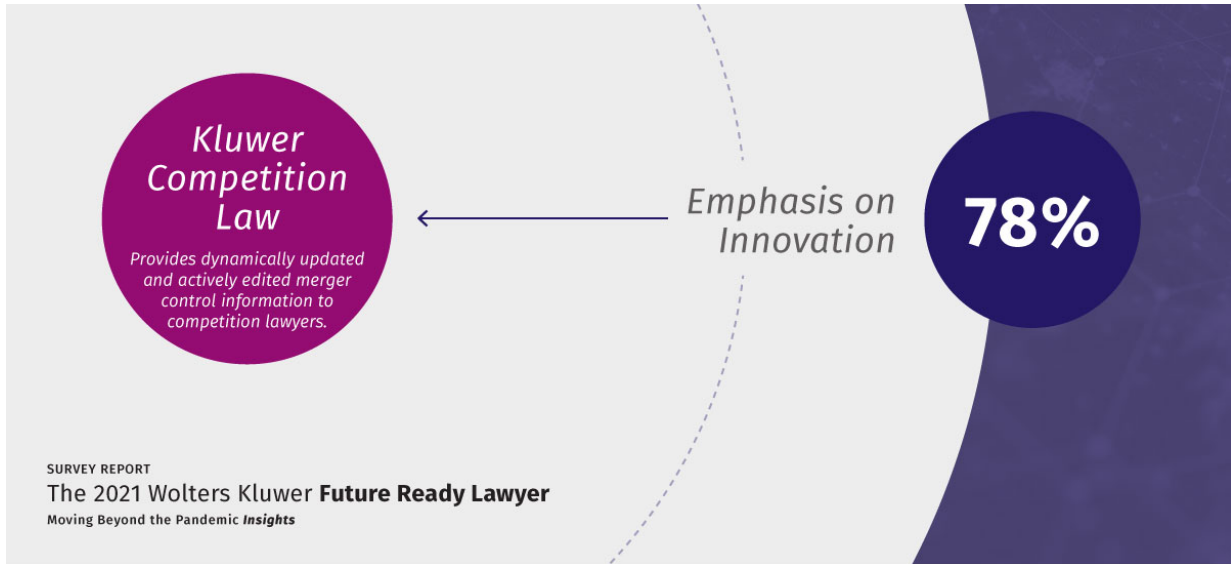
[5] See Autorite de la concurrence and FCO: Competition Law and Data (2016), p. 16.

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