

# Kluwer Competition Law Blog

## EU Merger Control and the Innovation Theory of Harm: Fake News?

Gavin Bushell (Baker McKenzie, Belgium) · Friday, March 3rd, 2017

We live in a rapidly changing world. The monikers of change are well known to all of us.

Trump. Brexit. Eddie Jones.

The future is unpredictable. As Joe Cocker sang, “*who knows what tomorrow brings*”?

But let’s climb aboard Elon Musk’s innovative SpaceX Falcon 9 for a moment. Let me take you to another world.

The EU Merger Regulation Planet. On this rock, the buzzwords today are different. Its inhabitants are babbling words with a new urgency.

“*Research*”, “*R&D power*”, “*patent portfolio strength*” and “*innovation*”.

On this planet, the ruling body – the “*European Commission*” – has a different perspective on what is to come. The distant future is discernible. It is reasonably predictable. Someone seems to have an idea of what tomorrow brings.

What am I talking about? Well, the role of innovation in EU merger control assessment.

“*Innovation? That’s not new!*”, you may say, “*it’s in the Horizontal Merger Guidelines!*”. And you would be right.

But there are two recent developments that are raising valid questions about the role and importance that innovation plays in the competitive assessment.

### The first development

The established, traditional EU Merger Regulation (EUMR) analysis has been to scrutinize market-to-pipeline and pipeline-to-pipeline overlaps to determine whether a merger would eliminate potential competition.

Recent decisional practice affirms this approach. You may have seen this in recent cases such as *GE/Alstom*, *Novartis/GSK Oncology Business*, and *Covidien/Medtronic*. The European Commission’s approach is well-documented, for example, in its Competition Policy Brief of April

2016 (see [here](#)).

The European Commission is giving renewed attention to innovation. That should not be surprising, given the current European Commission's current mandate.

In President Juncker's 15 July 2014 address to the European Parliament, he stressed that "*Jobs, growth and investment will only return to Europe if we create the right regulatory environment and promote a climate of entrepreneurship and job creation. We must not stifle innovation and competitiveness...*".

Naturally, the sharp-edged tool of the EUMR is at the service of this agenda. And rightly so, innovation should be protected. Consumers should expect and benefit from more innovative products and services. Article 2(1)(b) EUMR compels the European Commission to take into account "*the development of technical and economic progress*".

However, one recent EUMR trend indicates that the European Commission is increasingly looking further back into the pipeline in its assessment.

That is to say, that not only near-to-market pipeline products (e.g. Stage III in pharmaceutical clinical trials) are being scrutinized, but that the Commission is asking for data and documents on early stage pipeline products (e.g. in Stage I and/or II).

This clearly goes beyond the two-to-three year horizon typically used by the European Commission (and arguably beyond what is "*reasonably foreseeable*" under its own Horizontal Merger Guidelines).

It's like the High School Athletics Coach being forced to take a tour of the maternity ward to select her next best sprinters.

You think I joke. But my partner Fiona Carlin is fond of reminding me that only approximately 11% of pharmaceutical products in Stage I clinical trials actually get to market.

Forcing companies to reveal more of, and defend, the early stages of the pipeline, and to produce evidence for a far-distant counterfactual, risks inviting disproportionate intervention. Worse still, key industries such as pharmaceuticals, medical devices and tech companies will face a greater threat of Type I errors.

But that's not the most concerning trend folks. And I do not refer to the European Commission's suggestion to reform the EUMR thresholds to introduce a value-based threshold (see [here](#)).

### **The second development**

The other trend is that European Commission appears to want to go further. With a non-product-specific "*innovation competition*" theory of harm.

The thinking appears to be nascent, but it is being deployed in cases today (e.g. in cases such as *Dow/DuPont* (currently nearing the end of Phase II) and possibly *Bayer/Monsanto* (currently in pre-notification)).

The apparent concern is that a merger may impact on innovation where the merging parties are two of a very limited number of firms that can develop new products in a particular field.

So far from looking at specific products in a pipeline (or even market-facing activities), the European Commission is asking “*are these the companies most likely to compete against each other to develop products, as yet unknown, in a certain field?*”

Taking my earlier analogy further, this time the High School Athletics Coach is not being asked to determine whether the new-born looks like a sprinter. The poor Coach is being asked to bless (or not) the engagement of a couple who may – one day – have a child, who may take to athletics, and may become a sprinter.

The European Commission is suggesting that: (i) mergers involving important innovators; (ii) in largely concentrated industries with high barriers to entry; (iii) with no history of innovations from companies outside the sector; (iv) are likely to lead to an overall reduction in innovation efforts and, therefore, to a reduction in the number and quality of new products.

The nascent thinking appears to be that such mergers could be treated as presumptively anticompetitive.

My fear is that this may create a de facto “*by object*”-type presumption for R&D mergers, against which it is very difficult for the parties to argue.

Rather worryingly, the basis for the new model is unclear. But it appears that the European Commission is working on a number of analytical frameworks in order to assess such mergers.

One of these appears to be a market share analysis derived on patent portfolio “*strength*”. By looking at the number of patents that each merging firm has, together with the number of citations to those patents contained in third party patents, the European Commission appears to be attempting to estimate the parties’ roles as innovators.

There is, however, no clear indication as to how such an analysis can be taken to measure “*market power*” or indeed how this and other analytical frameworks can be used to quantify anticompetitive harm – that relates to any actual market.

Without clarity on the quantification of harm, it would appear to be difficult to see how the merging parties could bring forward synergies estimations and show that the merger is overall pro-competitive.

This development is a real concern.

It is worth recalling that the European Commission’s own State Aid R&D&I guidelines explicitly confirm that the “*primary activities of research organisations and research infrastructures [even if privately owned], in particular independent R&D for more knowledge and better understanding...are generally of a non-economic character*”.

In addition, State Aid can be fully authorised to companies engaged in “*fundamental research*”, which means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct commercial application or use in view.

That being the case, if the European Commission has no issue with Member States funding companies undertaking fundamental research, why should it intervene when two such companies

merge their research activities?

So what wind blows this nascent thinking? Well, of course, the stentors of this new theory point to “*the economic literature*”. So that must make it okay then.

Economic literature is another form of intellectual property. Economic literature that is compelling and well-regarded today, may be obsolete tomorrow. Some economic literature will point one way; other literature, in the opposite direction. Possibly there is a pipeline of economic literature that will develop over time? Who is to say that one body of literature should prevail? Or indeed any?

It’s tempting to dismiss economic literature. And we certainly should not do that. But what I am suggesting is that we should not expose companies to intellectual speculation – or new theories of harm – without a critical mass of convincing evidence that there is a real concern about the impact on innovation.

We need legal certainty in the EUMR process. Not more confusion or more red tape.

That means a predictable framework. A sensible lens. “*Reasonably foreseeable*” should be what we take it to mean today. Two-to-three years. Max.

We should not ask the European Commission to predict who will win the World Cup in 2030.

I would recall the *obiter* of the General Court in a recent and well-known judgment:

*“the consumer communications sector is a recent and fast?growing sector which is characterised by short innovation cycles in which large market shares may turn out to be ephemeral. In such a dynamic context, high market shares are not necessarily indicative of market power and, therefore, of lasting damage to competition” ...*

and “*given the high number of potential business models and the lack of reliable market data relating to their potential implementation in these nascent markets, it cannot be the task of merger control to predict the model which will make internet video telephony profitable in the marketplace and thus be viable in the future*”.

The very industries most likely to be affected by these more invasive assessments, are the very same industries that are most likely to change rapidly in future. Strong patent portfolios may be present today, but irrelevant tomorrow.

The EUMR should not intervene in the research evolution process. If it does, what is predictable is that the European Court of Justice may get to opine. But that, of course, may be too late for the merger parties in the sorry case that gets held up. And who wants their case to be the test bed?

I digress. But what does all of this mean in practice? For clients?

### **Some practice points**

Well, it is hard to say whether this is a temporary thought bubble that will soon disappear, or whether we are passing the verge of a new frontier in merger control in Europe with a renewed focus on innovation.

I see at least three practice points:

1. Merging companies will need to engage in strategic deal planning covering innovation where relevant: to assess carefully not only the pipeline overlaps, but also the extent to which the parties are important innovators. Be aware that this development opens a new flank for third party complaints. Careful thought should be put into (i) demonstrating the overall benefits of the transaction despite any apparent reduction in R&D, and (ii) potential remedy strategies to address any pipeline specific or innovation competition theory of harm. However, I would note that asymmetries of information may not allow the parties to be fully prepared on strategy (e.g. the target may not wish disclose fully its R&D efforts in due diligence, third party R&D efforts will be secret, etc).

2. The already painful pre-notification process will become more so: if the transaction is likely to be an “*innovation competition*” candidate, expect the pre-notification process to be more drawn out and costly than normal. The European Commission will likely ask for even more voluminous data (e.g. details of patent portfolios and licensing arrangements, details of third parties’ patent citations to the parties’ patents, etc) and internal documents (e.g. proposed integration documents, strategy papers, innovation landscape papers, patent litigation-related communications and analysis, etc). This is likely to slow down the pre-notification process and soak up internal resources within the IP area.

3. Document creation guidelines are increasingly important. The European Commission relies on contemporaneous, pre-existing internal documents (including emails) to conduct its assessment, and support a theory of harm. Ensuring that R&D related documents are appropriately prepared, not only to address traditional antitrust compliance concerns, but also to anticipate any innovation competition concerns, or to substantiate any innovation efficiencies, would be prudent.

It is not clear whether this innovation competition theory of harm will take root. Unlike the dear leaders on the EU Merger Regulation Planet, I cannot predict the long-term future.

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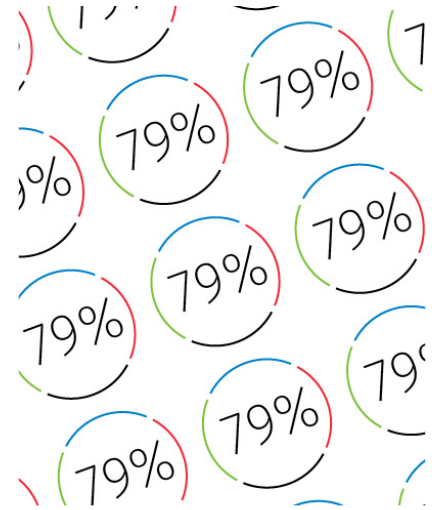
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