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The Evolving Role of Non-Price Competitive Parameters in EU Merger Review

Jay Modrall (Norton Rose Fulbright, Belgium) · Tuesday, May 28th, 2024

Many of the most challenging transactions reviewed under the EU Merger Regulation (EUMR) in recent years involved their likely effects on non-price competitive factors: innovation; quality and product differentiation; data protection and privacy; sustainability; and capacity and reliability of supply. These topics are discussed briefly, or not at all, in the Commission's guidelines on the assessment of horizontal mergers (the HMG) and non-horizontal mergers (the NHMG).

Commission officials synthesized the Commission's approach to these issues in an April 2024 policy brief on non-price competition (the Policy Brief) and a September 2023 merger brief on sustainability-related aspects in EU merger control (the Merger Brief). In the Policy Brief's first article, Alexander Iken, Terézia Kiani?ková, Marion Bailly, Andrea Usai, Gabor Koltay, and Stephan Simon discuss the EU merger control framework and case practice related to non-price competition (Iken, et al.). In the second, Vasiliki Dolka, Susanna Kärkelä, Aiste Slezeviciute, and Zsolt Vertessy discuss innovation competition in pharma mergers (Dolka, et al.).

Non-price parameters of competition may play a role in various aspects of the Commission's assessment, including market definition, competitive effects, efficiencies, remedies, and possible referrals of sub-threshold transactions under the Commission's recently updated guidance on Article 22 of the EUMR. For example, non-price factors may affect the Commission's views on whether the parties are close competitors or stronger competitive forces than their market shares might indicate. Non-price parameters may also be relevant to the role of barriers to entry or expansion. A proposed transaction's potential impact on non-price competition may also constitute an independent theory of harm.

Though not official statements of Commission policy, the Policy and Merger Briefs together provide a valuable summary of the Commission's approach and overview of the Commission's recent case law.

Innovation

Iken, et al. describe innovation as "the essential driver of economic progress." While companies normally have an incentive to innovate to gain a competitive advantage, mergers can reduce this incentive, resulting in the discontinuation of existing pipeline products, reduction in future R&D

efforts, or reduction in future product market competition.

Innovation is likely to be an important competitive parameter in industries where significant R&D spending is required; markets are rapidly growing or evolving; price plays a limited role; innovation is needed to comply with new regulations or market conditions; intellectual property protection is an important competitive factor; or market positions are highly contestable. Industries in which the Commission has identified innovation as an important competitive factor include the pharmaceutical, medical device, agrochemical, financial services, and digital sectors.

Market definition. In its recent notice on market definition (the Market Definition Notice), the Commission acknowledged the difficulty of applying traditional tools like the SSNIP test in markets characterized by innovation competition. Iken, et al. observe that "innovation activities do not always target specific, existing, or future product markets, but may take place at an earlier stage, before any product market is identified." Dolka, et al. discuss market definition in relation to pipeline products, distinguishing between late- and early-stage pipeline products.

Dolka, et al. note that "the assessment of market definition is more complicated when it comes to products in development that do not fall within the established 'pipeline' assessment, but rather concern innovation and development in entirely new or nascent markets." For such cases, the Commission has developed the concept of the "innovation space." The merging parties' overlaps in innovation spaces may differ from their overlaps in product markets and pipeline products; similarly, the parties' importance as innovators may be different from their position in product markets. Although innovation spaces are briefly discussion in the Market Definition Notice, the relationship between antitrust "markets" and innovation "spaces and the metrics for assessing competitive dynamics in each are not fully explored.

Competitive assessment. Innovation competition can be an important element of the Commission's assessment of whether merger parties are close competitors or strong competitive forces. Closeness in innovation can manifest itself through competitive overlaps within each R&D stage (e.g., overlapping discovery targets/lines of research, overlapping pipelines in the discovery stage, and overlapping pipelines in the development stage), and across different stages of the lifetime of a product (e.g., discovery pipelines-to-development pipelines, overlaps, discovery pipelines to existing product overlaps, and development pipelines to existing product overlaps). The existence of such overlaps indicates that, absent the merger, the merging parties expected to divert future sales from each other by innovating, even if the outcome is uncertain. According to Iken, et al., a merger between firms with competing lines of research is likely to affect the incentives to invest in research, leading to either delay, reorientation, or discontinuation of lines of research or pipelines.

Industries with high levels of innovation may also be characterised by high barriers to entry. Innovation-intensive industries, markets, or products require significant expertise, know-how and financial investments.

According to Iken, et al., economic literature suggests that less competition typically reduces market-wide innovation, in particular in concentrated markets. The HGM specify that if a merger combines two important innovators, or eliminates a firm with promising pipeline products, the transaction can eliminate an important competitive force and lead to a significant impediment to effective competition. The innovation potential of the merging firms is taken into account, regardless of their current market position.

The Commission relies on several forward-looking criteria: R&D input (e.g., R&D spend, headcount and infrastructure), R&D output (e.g., quantitative metrics such as numbers of patents, product launches and pipeline projects and qualitative factors). The Commission looks for evidence that an incumbent firm may seek to acquire an innovative target solely to discontinue its innovation projects; a "killer acquisition." This may be the case where the parties have overlapping or duplicate pipeline products, such that the merged entity would have fewer incentives to continue all of these programs, not only for cost reasons but also in light of a heightened risk of future cannibalization.

When assessing competitive effects in innovation spaces, Dolka, et al. explain that "the Commission assesses overlaps between the merging parties' lines of research (encompassing the set of scientists, patents, assets and equipment which are dedicated to a given discovery target) and early and late stage pipeline products. This assessment usually takes into account the parties' and their competitors' general innovation capabilities beyond the competitive situation of specific marketed and pipeline products. The Commission seeks to avoid a reduction in innovation competition, for example, if the merger results in there being: (i) less competitive pressure between the players remaining in the market, which therefore have a reduced incentive to invest in or prioritise R&D; or (ii) the merged entity's innovation capabilities attaining such a size and strength that its rivals could no longer effectively compete" (footnote omitted).

Whether competitors' reactions would offset any loss of innovation competition depends among other things on the market concentration; if only a few non-merging parties constrain the merging parties, then it is more likely that the merger will lead to a significant loss of innovation competition. The Commission also looks at past experience, such as whether past waves of consolidation were followed by a reduction in innovation intensity and output.

Outside the horizontal context, innovation concerns can also take the form of foreclosure risks. Customer foreclosure strategies could stifle innovation on the emerging downstream markets or lead to a degradation of interoperability. For instance, a "vertical link could enable the acquirer to profitably foreclose competitors' access to an important input, thereby reducing their ability to develop a new downstream product."

Efficiencies. Mergers may in some circumstances enhance innovation, for example by allowing the parties to share knowledge more effectively and by internalizing knowledge spill overs. The HMG mention "new or improved products or services resulting from efficiency gains in the sphere of R&D and innovation". So far, however, the Commission has not approved a transaction on the basis of expected innovation-related efficiencies. In Dow/DuPont, the parties failed to provide sufficient evidence of efficiencies, considering that the protection against imitation in the relevant innovation spaces was strong already pre-merger, thanks to effective IP rights and product lifecycle management techniques. Hence, it was less likely that each of the two mergers would increase the incentive to innovate by internalizing significant involuntary knowledge spillovers.

Remedies. When a divestiture is required to resolve innovation competition concerns, the divested assets should comprise ongoing pipeline or R&D projects and include all know-how, patents, IP, materials, data, documentation and proprietary information and be supported by sufficient expertise and staff. Considering that R&D and pipelines are typically developed at global level, the commitments may need to include the global R&D organization, even if the markets for the underlying products are regional or national. Commitments falling short of a transfer, such as providing only licenses on R&D and pipeline projects, are typically rejected considering that competition will not be preserved on a lasting basis.

Dolka, et al. note that the risk involved in R&D activities can make finding a suitable and motivated purchaser challenging. To maximize the prospects of success, parties may need to include a so-called upfront buyer clause to ensure that the main transaction can only be implemented once the parties have found and proposed a suitable purchaser, or the Commission may set specific purchaser criteria to ensure that the buyer has the capabilities to develop, obtain approvals for and commercialise the products successfully.

Less traditional structural remedies may also be required where merging parties are engaged in R&D partnerships. Where such links gave rise to horizontal overlaps, the Commission has accepted remedies such as returning licensed rights or divesting a minority shareholding in a partner company.

The inherent uncertainties in multi-year, expensive R&D processes may also require the Commission to make use of review clauses allowing it to waive, modify or substitute the commitments if market circumstances have changed significantly and permanently.

Referrals. In 2021, the Commission published a communication announcing its intention to encourage and accept certain referrals under Article 22(1) EUMR from Member State authorities who do not have initial jurisdiction over the case. According to Iken, et al., innovation competition concerns can play a decisive role in the Commission's assessment of whether a merger case is a suitable referral candidate. Dolka, et al. note that "pharmaceutical mergers are a key target area for the recalibrated application of Article 22."

By way of example, a referral would be appropriate in cases where the undertaking at issue is (i) a start-up or recent entrant with significant competitive potential that has yet to develop or implement a business model generating significant revenues (or is still in the initial phase of implementing such business model); (ii) is an important innovator or is conducting potentially important research; (iii) is an actual or potential important competitive force or (iv) has access to competitively significant assets (such as for instance data or intellectual property rights).

Quality and product differentiation

Quality can be described, according to Iken, et al., as "a range of product characteristics, other than price, which affect the value of the product to consumers. These characteristics can include functionality, design, know-how, track record, durability, reliability, and technology. Improving product characteristics covers both providing a product of higher quality (i.e., vertical product differentiation) and serving differentiated consumer tastes (i.e., horizontal differentiation)." Quality is especially relevant in markets where product differentiation plays an important role and/or where price competition is less relevant.

Market definition. According to the Market Definition Notice, the Commission takes quality into account when defining markets – for instance when assessing demand substitution in product market definition, barriers and costs associated with switching demand to potential substitutes (e.g., due to uncertainty about the quality of alternative products), or defining markets in the presence of discrimination between customers or customer groups by offering different level of quality.

Competitive assessment. Quality can play an important role as both a parameter of differentiation and closeness of competition between the merging parties and their competitors. A merger between two quality-leaders, i.e., companies offering products or services of a particularly high quality, might result in market power going beyond what is indicated by the parties' market shares. Conversely, a merger between companies offering products of inferior quality may also result in market power going beyond what is indicated by the parties' market shares, especially vis-à-vis certain customer groups. Quality can play an important role in the assessment of whether one of the merging parties is an important competitive force and may grow going forward.

A merger can result in a degradation of quality and product variety. Empirical studies indicate that merger-induced market power increases tend to reduce incentives to provide high-quality products. Merging firms might also have an incentive to drop competing varieties within the newly combined firm to avoid cannibalization and save fixed costs. The Commission has found that a merger would result in a degradation of quality in several cases, for example concerning the quality of food, media content, of medical devices and of mobile communication networks.

Efficiencies. In several mergers, the parties argued that their transaction would result in quality improvements, which could in principle outweigh anti-competitive harms. However, the Commission found that these improvements were subject to an uncertain timeline, not verifiable and not merger-specific. So far, the Commission has not accepted an efficiency defence based on quality improvements.

Remedies. Iken, et al. point out that non-structural remedies have exceptionally been accepted where a non-horizontal merger raised concerns related to degradation of interoperability. Factors that may be relevant in deciding whether non-structural remedies would be appropriate in a specific case include that (i) the likely problematic behaviours are well-identified, (ii) the number of access or interoperability seekers is reasonable and (iii) standard terms of access or interoperability can be defined. In such cases, the merged entity has committed to make – or continue making – its product interoperable with competitors' products.

In other cases, the merged entity committed to make – or continue making – certain data available to competitors. Examples include an obligation to continue making target data available to software applications and to continue licensing application programming interfaces (APIs) or source code.

Data protection and privacy

Iken, et al. note that the use of and access to data play an important role in digital and tech mergers, whether as part of the assessment of horizontal effects stemming from data accumulation or in a vertical context where data are an important input. Data protection and privacy are relevant where companies use data collected from customers/users, potentially making data a key driver of competition and a source of competitive advantage.

Market definition. Iken, et al. note that "where privacy is an important consideration for consumers and a parameter of competition between the merging parties, the Commission will consider the level of privacy protection afforded when defining product and geographic markets," notably in cases involving digital, technological, or communication products and services, where consumers' data forms part of the product.

Competitive assessment. In sectors where data, and in particular personal data, is a source of value, privacy protection is an important competitive parameter. When assessing mergers involving companies that collect customer data, the Commission also looks at the potential use of that data post-transaction, as the merged entity could have the ability and incentive to use such data and information to put competitors at a disadvantage. The Commission takes into consideration the parties' legal obligations under relevant privacy and data protection regulations. Foreclosure concerns may also arise if a competitor offering a greater degree of privacy protection were to be marginalized (or entry of any such competitor would be made more difficult as a result of the merger).

Remedies. Where a non-horizontal merger raises concerns about access to data, the Commission has accepted remedies to ensure that markets remain open and competitive and to preserve the ability and incentives of competitors to develop their products and compete effectively.

As with remedies intended to preserve interoperability, factors indicating that such remedies would be appropriate include that (i) the likely problematic conducts are well-identified, (ii) the number of access seekers is reasonable and (iii) standard terms of access can be defined.

Sustainability

In the Merger Brief, Catherine Ellwanger, Terézia Kiani?ková, Thorsten Schiffer, and Andrea Usai (Ellwanger, et al.) note that "the Commission does not have a mandate to intervene in mergers for environmental reasons in the absence of harm to competition, [but] there is a clear trend towards the sustainability-related aspects of the Commission's merger review becoming increasingly important" (footnote omitted). Iken, et al. observe that "a merger could undermine sustainability goals by reducing investments in green technology. As such, the environmental effects of a merger can be assimilated to a specific form of innovation theory of harm. Sustainability can also be a very important consumer preference."

Sustainability considerations are most likely to be relevant where sustainable products reflect consumer preferences, or in industries driven by sustainable objectives, for example as a result of government policies or regulation.

Market definition. Sustainability-driven customer preferences affect demand-side substitutability in the Commission's definition of product market definition. Sustainability considerations may also affect geographic market definition, for example where companies try to avoid transporting products over long distances to minimize the associated CO2 emissions. Ellwanger, et al. note that "[su]stainability-driven customer preferences can determine the level of demand-side substitutability. Similarly, from a supply-side perspective, the ability of suppliers to produce green products may differ across market players."

Competitive assessment. As demand for more sustainable and environmentally friendly products grows, differences in sustainable product positioning and related R&D capabilities influence how closely companies compete. Customers' sustainability preferences, for instance, in terms of environmental costs, can also be relevant for the assessment of the merging parties' geographic closeness. Similarly, a company offering greener products may be considered as an important competitive force depending on customers' sensitivity to environmental aspects.

In industries undergoing a green transition due to customer demand or the need to meet various sustainability goals and new environmental standards, sustainability can represent a barrier to entry and expansion for market players. This may be due to high capex investments needed to become active on a certain market, the need to obtain regulatory permits and meet, often demanding, regulatory requirements.

Sustainability-related competitive effects may also be linked to innovation competition, for instance where R&D efforts relate to green(er) technologies, products, or services, such as new recycling technologies.

Efficiencies. Sustainability-related benefits may also play a role in the Commission's assessment of efficiency considerations. According to Ellwanger, et al., "[t]he existing legal framework allows the Commission to take efficiencies submitted and substantiated by the merging parties into account. Indeed, a merger may bring about improved quality products . . . [or] result in the development of newer technologies, new "green" products, and more generally "green" innovations. . . . Under the [HMG], efficiencies should, in principle occur within the markets where competition concerns are found."

The HMG do not discuss the assessment of sustainability-related efficiencies. Sustainability-related efficiencies, including the extent to which sustainability-related efficiencies must benefit customers in the same market(s) in which competitive harms may arise, are discussed in the Commission's 2023 Horizontal Cooperation Guidelines. The Commission's position in the Horizontal Cooperation Guidelines is contested, and in any case a more flexible approach is arguably appropriate in the merger context. Ellwanger, et al. acknowledge that "there is demand from some stakeholders for the Commission to consider a longer time horizon and overall benefits to society when looking at whether the conditions for efficiencies are met.

Remedies. Although the Commission has no power to unilaterally impose or choose the "greenest" remedy among several alternatives, as Ellwanger, et al. note, merger remedies can nonetheless have positive effects on the environment, as where a remedy taker goes beyond the merging parties' initial green innovation plans. In addition, where environmental aspects are considered an important parameter of competition the Commission has concerns about innovation competition, the remedy design may have to take account of sustainability considerations. Moreover, if environmentally friendly products or innovation in this field are important for the competitiveness of the divestment business, specific purchaser criteria may be necessary to ensure that the purchaser will continue to be able to successfully produce and market such products and continue to innovate.

Referrals. Ellwanger, et al. note that "[k]iller acquisitions are of concern as some small players are particularly relevant for the development of "green" innovation. As these small players' turnover may be low or even nil, their acquisition by bigger and incumbent companies may escape the usual EU and sometimes even national turnover notification thresholds." Sustainability-driven mergers may thus be good candidates for a referral.

Capacity and reliability of supply

Access to capacity is liable to be an important competitive parameter in markets characterized by capacity constraints. Iken, et al. note that in many basic industries, capacity decisions become a variable of competition that determines market power and dynamic outcomes because new plants require significant capital investment and time. Capacity can also be an important parameter of competition in network industries like aviation and telecommunications.

Competitive assessment. Where capacity expansion is a variable of competition, a merger can change the merged company's incentives to expand capacity and rivals' reaction to it. Merging producers may compete less aggressively on capacity expansions post-transaction, as they will take account of the negative effect that new capacity in the market has on the sales of the respective merging partner. The merger might not only change future capacity extensions, or lead to plant closures and capacity reduction, but also change the geographic distribution of capacity. Whether these theories of harm apply in a concrete case depends both on the level of the parties' capacity shares and the extent of spare capacities held by rivals. Anticompetitive effects are more likely if merging parties control a large part of the available capacity after the transaction and rivals have little excess capacity.

Conclusion

An impressive team of Commission officials has devoted a great deal of time to synthesize the Commission's practice and policy in assessing notified transactions' potential impact of non-price parameters of competition in the Policy and Merger Brief, and they have done the antitrust community a great service.

That said, the Policy and Merger Briefs are not official statements of Commission policy, and they are not uniformly thorough. For example, much more discussion has been devoted to the assessment of innovation- and sustainability-related considerations than to other non-price parameters. The HMG (20 years old) and NHMG (16 years old) are overdue for a comprehensive revision.

Updated versions of the HMG and NHMG would hopefully go beyond the synthesis set out in the Policy and Merger Briefs in a number of areas. For example, the concept of the "innovation space" plays a central role in the Commission's assessment of innovation competition effects, but the similarities and differences between innovation spaces and antitrust markets (and the tools for measuring concentration in each) call for further discussion.

Similarly, the Commission could provide more guidance on sustainability-related parameters of competition in the merger context. The Commission provided extensive guidance on the assessment of sustainability-related efficiencies in the Horizontal Cooperation Guidelines; its guidance on such efficiencies should at least be conformed but hopefully extended and made more flexible in the merger context. Otherwise, identifying narrower markets for more sustainable products could lead to mergers of small, sustainability-oriented companies with high shares in those narrow markets being blocked while "killer acquisitions" by large, traditional companies of small, more sustainable challengers (deemed to be active in separate markets) are approved.

Other areas calling for a more systematic update of the Commission's guidance include the treatment of data- and quality-related parameters of competition. With the Policy and Merger Briefs, DG COMP has made a good start on a more thorough and official re-assessment of these issues.

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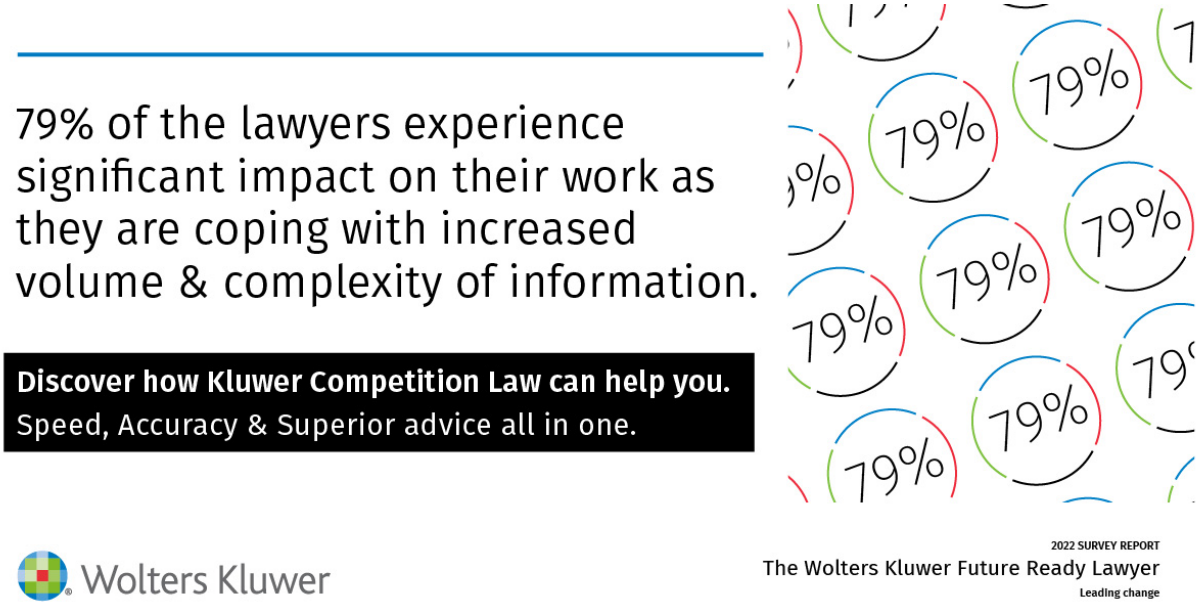

This entry was posted on Tuesday, May 28th, 2024 at 9:00 am and is filed under Art. 22, European Commission, Guidance, Innovation, Source: OECD“>Market definition, Merger control, Merger regulation, Merger Thresholds, Sustainability
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