

## **Res Publica – Written evidence (CMP0030)**

### **Markets and the New Monopolies.**

Something has gone wrong with our markets and something has gone wrong with our competition law. That is the contention and argument of this paper. There is increasing evidence of market concentration across a range of industries, a rise in economic rent, a fall in new market entry and a corresponding and evidenced threat to innovation. We argue that these outcomes have arisen in part at least because of the conceptual failure of competition law to grasp the problem, the insufficiency of the tools they use especially the consumer welfare standard as currently understood, ineffective merger control and lack of enforcement of the laws on vertical restraints. We speak to the legal thresholds, methodology and management practices and policies which have contributed to these outcomes. To exemplify and make our case we focus on the most egregious and telling issues and cases in the technology and media markets, providing examples of cases of assessment failures and highlighting the wider consequences of a failure to act and very real threat to future economic freedom from a monopolised market place.

Part I of this paper outlines the issues and problems we face in the broader economic context, followed by proposals for reform in Part II.

#### **1 Part I: Issues and Problems we face**

##### **Economic outcomes**

- 1.1 We briefly outline below the recent evidence of economic outcomes. The data that we have has mostly come from US markets but the question is – why would Europe or the UK for that matter be any different? The same economic forces are in play and very similar competition law and criteria govern all these markets. So, we would contend that in this regard what holds true in the United States will most likely hold true in Europe and the UK. It is remiss of our own competition authorities both in Europe and the UK not to have commissioned or done the work that has been completed in the US, we hope this omission will be reflected upon and rectified soon.
- 1.2 Regardless, debate on market concentration and other issues about the monopolisation of markets has proceeded apace in the United States. This has been highlighted by publications during 2016 from the Obama Administration’s Council of Economic Advisors and recent material from the *Economist*, following Brookings, and as noted is mostly based on US statistics. Increasing concentration has in fact been identified across a range of industrial sectors.<sup>1</sup> The economic indications are compelling and

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<sup>1</sup>See “Seven wonders: tech stocks”, *The Economist*, 31 May 2017 available here: <https://espresso.economist.com/03492e99e42e7ea8480cdfb4899604f5?fsrc=scn/fb/te/b/ed/sevenwonderstechstocks20170601espresso>

See

the social consequences profoundly disturbing. They include a slowdown in the creation of new businesses, and declining dynamism, with market exit rates remaining roughly constant but, most significantly, with market entry reducing. Since there are increased barriers to entry, one clear potential factor is the advantage accruing to incumbents over time. The following table is from the Obama administration Council of Economic Advisors issue brief updated May 2016:

**Change in Market Concentration by Sector, 1997-2012**

Industry	Revenue Earned by 50 Largest Firms, 2012 (Billions \$)	Revenue Share Earned by 50 Largest Firms, 2012	Percentage Point Change in Revenue Share Earned by 50 Largest Firms, 1997-2012
Transportation and Warehousing	307.9	42.1	11.4
Retail Trade	1,555.8	36.9	11.2
Finance and Insurance	1,762.7	48.5	9.9
Wholesale Trade	2,183.1	27.6	7.3
Real Estate Rental and Leasing	121.6	24.9	5.4
Utilities	367.7	69.1	4.6
Educational Services	12.1	22.7	4.2*
Professional, Scientific and Technical Services	278.2	18.8	2.8*
Arts, Entertainment and Recreation	39.5	19.6	2.5*
Administrative/ Support	159.2	23.7	1.6
Health Care and Assistance	350.2	17.2	0.8*
Accommodation and Food Services	149.8	21.2	0.1
Other Services, Non-Public Admin	46.7	10.9	-0.2*

Note : Concentration ratio data is displayed for all North American Industry Classification System (NAICS) sectors for which data are available from 1997 to 2012. \* indicates that the percentage point change is calculated using only taxable firms in that industry, as its 1997 revenue share data are only available for the 50 largest taxable firms and the 50 largest tax-exempt firms as separate categories, rather than for all firms combined. Performing this same calculation using data for only tax-exempt firms results in two additional industries showing a decline in concentration (Arts, Entertainment and Recreation, and Educational Services) , while one shows a slight uptick (Other Services). Source: Economic Census (1997 and 2012), Census Bureau.

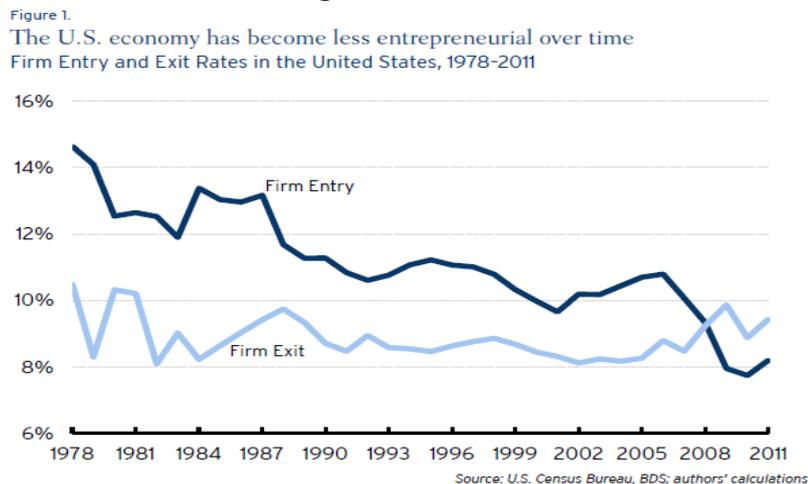
1.3 The majority of industries have seen increases in the revenue share enjoyed by the 50 largest firms between 1997 and 2012; see above. Along similar lines, the *Economist* (2016) found that in 42 percent of the roughly 900 industries examined, the top four firms controlled more than a third of the market in 2012, up from 28 percent of industries in 1997. Of course, an

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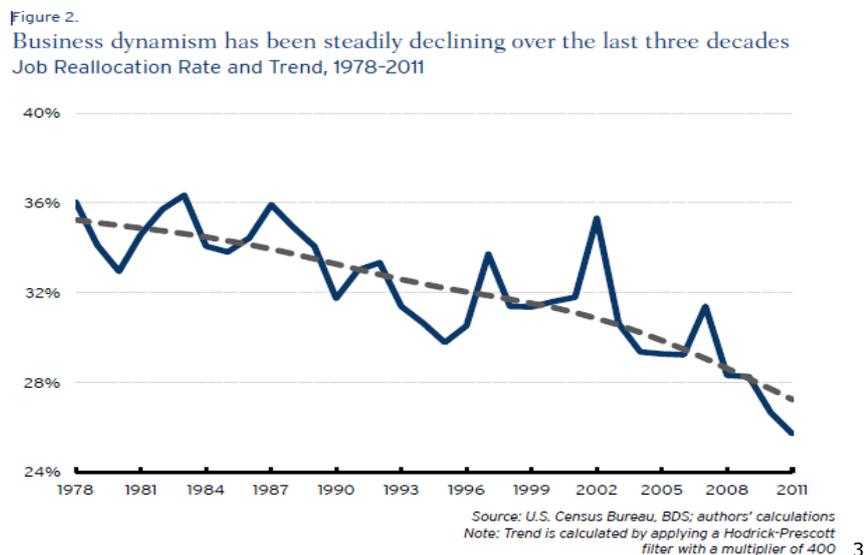
See Center for American Progress: Reviving Antitrust, June 2016 available here: <https://www.americanprogress.org/issues/economy/reports/2016/06/29/140613/reviving-antitrust/> And has been seen in the tech sector with cases being brought by the US authorities.

increase in revenue concentration at the national industry level is neither necessary nor sufficient to indicate increases in market power as a legal matter, but it is an indicator of a key issue.

1.4 Returns on investment capital have increased,<sup>2</sup> and entry levels have decreased, with increasing levels of exit:



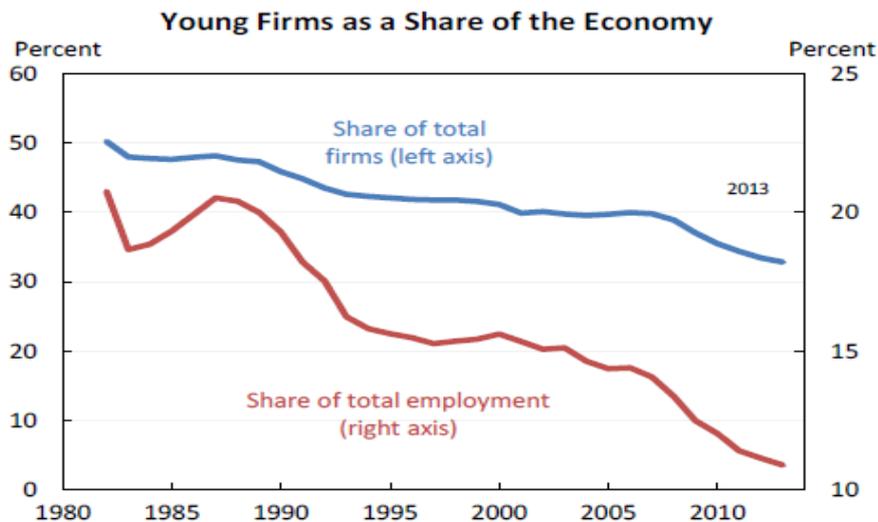
1.5 Labour markets are becoming less dynamic, with less movement between firms. This may well be related to the fact that firms now inhabiting markets tend to be older, and given that markets involve a small number of larger firms, opportunities for movement will be reduced by comparison with market structure where there are a large number of smaller firms.



1.6 Young firms being those that are less than 5 years old, have been declining as a share of the total numbers of firms in the US economy:

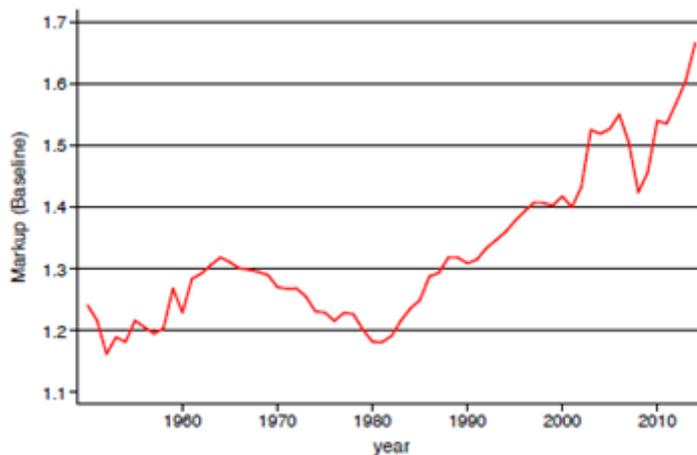
<sup>2</sup>Brookings economic studies May 2014 see Declining Business Dynamism in the United States Hathaway and Litan

<sup>3</sup> Brookings economic studies May 2014



1.7 Shares of income going to capital has risen with income going to labour falling, notably since 2000.

1.8 Moreover, recent research into the rise of market power from De Loecker and Eeckhout<sup>4</sup> has also indicated that price markups have increased dramatically in recent years. The figure below represents the weighted average markup across the US economy over time, where weights are based on firm levels sales. It demonstrates that average markups have risen since the 1980's. This research suggests that in 2014 the average firm charges 67% over marginal costs, compared to 18% in 1980.

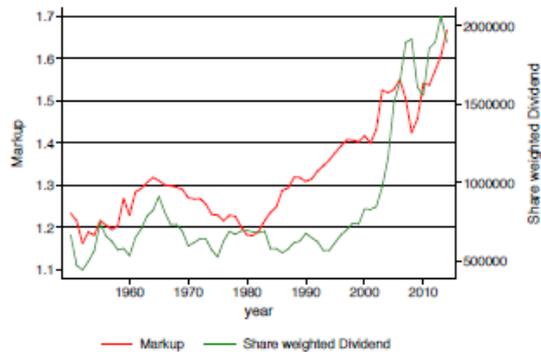


1.9 Increasing markups suggest that the margin of revenue over variable costs has increased. That does not necessarily imply that firms are making higher profits. If, for example the source of the increase in markups is technological change that reduces variable costs, and the same technological change increases the fixed costs, then markup is not synonymous with profits. Consider high tech firms that produce software products that need one big upfront investment and then can be scaled nearly without any additional cost. Such technological change will lead to higher markups (due to lower variable costs), but prices will not drop

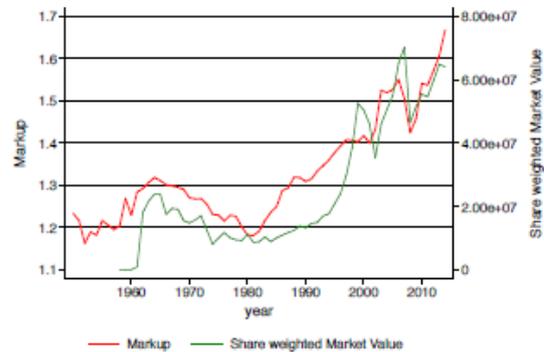
<sup>4</sup> The Rise of Market Power and Macroeconomic Implications August 4<sup>th</sup> 2017.

because firms need to generate revenue to cover fixed costs, and profits will continue to be low overall.

1.10 In order to investigate whether firms that were able to raise markups were also increasing profits the authors assessed the mark ups and dividend growth together and found the following:



(a) Average Dividends (weighted)



(b) Average Market Value (weighted)

1.11 The graphs above clearly illustrate that there is a strong correlation between increasing markups and increasing dividend growth. In simple terms those firms that raise price have been able to increase profits and dividends, indicating an increasing level of market power. Questions have also been raised about why high rates of profit have not stimulated sufficient entry by new competitors to force profit rates to converge rather than diverge?<sup>5</sup>

1.12 From a financial perspective, it is clear that the increasing concentration of industry leads to increasing returns. In the words of one Goldman analysis:

*"Oligopolistic market structure can turn a cut-throat commodity industry into a highly profitable one. Oligopolistic markets are powerful because they simultaneously satisfy multiple critical components of sustainable competitive advantage— a smaller set of relevant peers faces lower competitive intensity, greater stickiness and pricing power with customers due to reduced choice, scale cost benefits including stronger leverage over suppliers, and higher barriers to new entrants all at once."*<sup>6</sup>

1.13 In oligopoly, stable income and less pressure to innovate may have contributed to the outcome. Jason Furman<sup>7</sup>, Chairman to the then Obama Presidency's Council of Economic Advisors provided a detailed description of these issues and referred to the fact that return on invested capital has

<sup>5</sup> See Center for American Progress: Reviving Antitrust, June 2016 available here: <https://www.americanprogress.org/issues/economy/reports/2016/06/29/140613/reviving-antitrust/>

<sup>6</sup> Goldman Sachs Global Investment Research, "Does Consolidation Create Value, The Case for Disruptive Change" (2014)

<sup>7</sup> **Beyond Antitrust: The Role of Competition Policy in Promoting Inclusive Growth** Jason Furman Chairman, Council of Economic Advisers Searle Center Conference on Antitrust Economics and Competition Policy Chicago, IL September 16, 2016

risen dramatically, specifically in healthcare and information technology, at the same time as other measures point to a reduction in competition.<sup>8</sup>

1.14 For the above outcomes to have occurred under the noses of the current antitrust authorities suggests that the current system is in some ways flawed or not adequate at recognising and preventing the increasingly oligopolistic outcomes that have taken place. In the next section possible reasons for the anti-competitive outcomes we have seen are examined.

### **Legal thresholds for merger control contributing to high levels of concentration and unwelcome economic outcomes?**

1.15 The current European system of merger control, including in the UK, is a system that sees only part of the picture of economic activity. The system currently allows major firms, even those that are dominant in already concentrated sectors, to buy up smaller businesses, with such transactions being outside the thresholds for merger control, since such thresholds are judged by turnover rather than by value, and hence avoid routine scrutiny by the authorities.<sup>9</sup>

1.16 Google has acquired at least 215 businesses since 2001, but its rate of acquisition has increased in recent times, with 167 since the beginning of 2008,<sup>10</sup> the date from which the EU Commission recently found Google to be dominant, following a 7 year enquiry. Facebook has acquired 69 companies<sup>11</sup> since 2007, and at an increasing rate. A formal investigation or finding of dominance has yet to be made, but with its 2bn user base, massive investment and high barriers to entry, with stable market share and no meaningful alternative since Myspace in 2006, Facebook could, we venture to suggest, be dominant.<sup>12</sup>

1.17 The reasons for acquisitions are many and varied with the direct benefits to the acquirer including additional product ranges, increased efficiency and, operational and system improvements. In any such acquisition, for whatever reason, an already dominant player may be enhancing its dominance and raising barriers to entry by other firms. A concentration in an oligopolistic market may also reduce the innovation incentives for other players in the market.

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<sup>8</sup> See further Furman and Orszag 2015.

<sup>9</sup> See the leading example of Facebook's acquisition of WhatsApp

<sup>10</sup> 2017 Crunchbase inc.

<sup>11</sup> 2017 Crunchbase inc.

<sup>12</sup> WhatsApp may have become that meaningful alternative but was bought by Facebook. Jason Furman has also observed: "One type of business model that has flourished with digitization is the "platform" model, which relies heavily on network effects to grow because the primary product is access to other customers. Examples include payment platforms like PayPal, sales platforms like eBay, and social networks like Facebook. Switching costs for customers are particularly high in these markets—no one wants to be the first and only user of a platform—and these network effects can act as a barrier to entry."

1.18 In some cases the anticompetitive consequences may be more blatant. Buying up by the dominant player of the most likely successful entrant that might displace the current incumbent involves taking out a competitor before it has time to grow. This has been described as a “Kill in the Crib” strategy by one US commentator.<sup>13</sup> It is known to be of concern to the EU Commission and the German competition authority. As described recently in Vox:<sup>14</sup>

*“Today’s technology giants have become a lot more savvy about anticipating and pre-empting threats to their dominance. They’ve done this by aggressively expanding into new markets and by acquiring potential rivals when they’re still relatively small. And, some critics say, they’ve gotten better at controlling and locking down key parts of the internet’s infrastructure, closing off paths that early internet companies used to reach a mass market.*

*As a result, an industry that used to be famous for its churn is starting to look like a conventional oligopoly — dominated by a handful of big companies whose perch atop the industry looks increasingly secure.”*

1.19 The jurisdictional thresholds that set the starting point for merger review in the EU and UK are also inappropriate for technology and online media markets. As mentioned earlier they are defined mainly in terms of rules concerned with the **turnovers** of the target and acquiring entities. These thresholds were developed for administrative convenience and to allocate basic responsibilities between the EU and member states, at a time when most businesses generated revenue from contracts with customers. They are inappropriate for a digital economy where value, for advertising purposes in online markets, is often represented by the number of visitors to a website. It is readily apparent that there is huge value in millions or billions of users seeing millions of adverts, and that companies generating huge attention are of enormous interest to advertisers. Turnover thresholds may well have contributed to hundreds if not thousands of tech sector mergers being completed “under the radar” and the increased levels in the concentration of the sector over time.<sup>15</sup>

1.20 A few years ago, Eric Schmidt, CEO of Google, admitted that the strategy was to purchase beneath the thresholds for merger notification when he said that “Google made the decision last year to accelerate the acquisition of companies below the HSR threshold, or the amount that is subject to FTC notification requirements and a waiting period”<sup>16</sup>

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<sup>13</sup> Scott Clelland at Precursor Inc. presumably with reference to Zeus’s wife Hera’s attempt on Hercules life by introducing snakes into his crib.

<sup>14</sup> <https://www.vox.com/new-money/2017/7/11/15929014/end-of-the-internet-startup>

<sup>15</sup> For example, *Business Insider* estimates that Google has acquired on average almost one company a month since 2001 (see: <http://www.businessinsider.com/important-google-acquisitions-2014-8?IR=T> ). If we look back only to January 2014, Google has acquired 70 companies (according to Wikipedia) in those 29 months, averaging at over two companies a month.

- 1.21 Criticism has also been made of those mergers within the thresholds and subject to authority control because of the narrow interpretation of the legal test that has been applied. Over the past 20 years the defendants of mergers have been able to promote and obtain clearances for deals where they can show efficiency benefits in the merger and post-merger competition being likely to deliver benefit to consumers.<sup>17</sup>
- 1.22 A 'consumer welfare' standard is embraced by the US authorities and is also prevalent in UK and EU merger control. The approach to consumer welfare may have led to a focus on short term benefits to consumers, not reprehensible in itself, but it could have tended to feed the authorities' increasing predilection toward detailed consideration of the modelling of company data from the merging parties, with perhaps less attention paid to the ecosystems and market structure that the mergers inhabit. Legally, in the UK and Europe the test is not confined only to consumer welfare,<sup>18</sup> and could allow the authorities to take into account other factors, such as the effects of the transaction on innovation.

### **Methodology failures: authorities' difficulty in identifying innovation.**

- 1.23 Merger control, and indeed all full assessments of competition, require the authorities to look forward and understand the dynamic of competition in a relevant market. Of the thousands of mergers that take place every year, jurisdictional thresholds mean that only a small sample are subject to scrutiny.<sup>19</sup> Alternative sources of direct competitive substitutes arise from new technology, and auxiliary ways of meeting similar demands. Market players will understand the market and which new products meet demand (or which companies are rapidly expanding and becoming a competitive threat), far more quickly than the authorities. This is because firms in markets monitor competitive activity and take special care. Authorities can't hope to do the same but could do better than they currently do. At present the information gathering in the authorities is backward looking, static and based on historic statistics and past histories.
- 1.24 Even the task of measuring competition is complicated. In digital markets, it is especially difficult. Usually, economists use prices as indicators of the

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<sup>16</sup> <https://techcrunch.com/2011/07/13/eric-schmidt-on-googles-acquisition-strategy/>

<sup>17</sup> See in particular the criticisms of Harry First & Spencer Weber Waller, *Antitrust's Democracy Deficit*, 81 FORDHAM L. REV. 2543 (2013); see also the promotion of a total welfare standard rather than a consumer welfare standard in the work of Roger Blair and Daniel Sokol: Welfare Standards and US and EU Antitrust <http://scholarship.law.ufl.edu/facultypub/360>

<sup>18</sup> See the recent speech by US Senator Orrin Hatch espousing consumer welfare and condemning proposals in the Democrats Better Deal which he called "Hipster Antitrust"

<sup>19</sup> In the EU and the US, horizontal mergers, above the relevant notification thresholds are subject to the highest scrutiny by the authorities. Those mergers have been examined, and tested against the question of whether they substantially lessen competition or enhance dominance<sup>19</sup> or tend to monopolise markets<sup>19</sup>.

level of competition. In technology markets, where one side of the market is provided free of charge, the usual tools do not apply easily. Businesses on the internet are often complementary, so companies may subsidise one side of the market by profiting from the other side of the market. For example, social media sites often offer free services to users and charge for advertisements. However, the lack of high prices for consumers does not mean that consumer harms or other wider risks do not occur. As noted by one eminent US economist:

*"The large companies that dominate search and social networking may be able to acquire inefficient power in ads or control people's access to news. Another concern is that instead of raising prices or reducing quantity, these companies may reduce innovation."*<sup>20</sup>

- 1.25 System failure also includes the failure to appreciate the importance of innovation and market structure that certain types of mergers "**crowd out the horizon**" and limit access to customers. Changing the approach would involve authorities gathering more and different evidence of the effect of such transactions on innovation, and the innovation enhancing properties of dispersed market structures and sources of innovation.<sup>21</sup> The current data driven focus is based on historic information, and constrains a wider consideration of market structure and its relationship to innovation.<sup>22</sup>

### **Methodology failures: digitisation affecting markets and creating a confusing place for competition assessment?**

- 1.26 Voices have been raised for some time about monopolies existing in places where the law can't find them. John Naughton writing in the Guardian recently suggested that competition law analysis of markets "lacks common sense".<sup>23</sup> Perhaps there is something wrong with the system and tools used for analysis? Andreas Mundt, President at the German competition authority appears to agree that the system doesn't work well in technology markets and needs to be reformed.<sup>24</sup>

- 1.27 Confusion could be arising, in part, because current antitrust law takes as a starting point current consumer choices in terms of current products and services, substitution in terms of product characteristics, and then

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<sup>20</sup> See Jason Furman's work, referred to at footnote 8 above.

<sup>21</sup> See for example very detailed upward pricing pressure analysis in EU mobile telecommunications mergers.

<sup>22</sup> See the work of F M Scherer: **F. M. Scherer: Industrial Economy, Digital Economy and Innovation** and Philip Aghion: [https://scholar.harvard.edu/files/aghion/files/innovation\\_and\\_top\\_income\\_inequality.pdf](https://scholar.harvard.edu/files/aghion/files/innovation_and_top_income_inequality.pdf) on innovation and market structure

<sup>23</sup> See for example John Naughton writing in the Guardian 25<sup>th</sup> June 2017: [https://www.theguardian.com/commentisfree/2017/jun/25/tech-giants-no-contest-on-competition-law-amazon-whole-foods?CMP=share\\_btn\\_link](https://www.theguardian.com/commentisfree/2017/jun/25/tech-giants-no-contest-on-competition-law-amazon-whole-foods?CMP=share_btn_link)

<sup>24</sup> See, for example, Andreas Mundt's comments in this interview: [https://www.competitionpolicyinternational.com/wp-content/uploads/2016/07/AC\\_july-2016.pdf](https://www.competitionpolicyinternational.com/wp-content/uploads/2016/07/AC_july-2016.pdf)

examines substitution in terms of those characteristics and prices, as well as gathering evidence and information on them and the geographic areas in which the relevant products and services are supplied. Enormous amounts of evidence are gathered whether in merger cases or cases concerning the abuse of dominance or cartels.<sup>25</sup>

- 1.28 For those used to looking at offline goods markets such as beans or potatoes, cars or cameras, the online world can be a confusing place. Take, for example, telephone answering machines. They existed at a time when there was a market for physical tape players attached to fixed telephones. All the components in the box that recorded, or 'taped' messages from telephones were manufactured and there was an aftermarket for spare tapes, heads and head cleaning equipment. The physical product of the tape recorder was in a market that was disrupted by supply side alternatives: the recording service can now be provided by software on a chip in a network or handheld device. CDs and CD systems are another example of digitisation, where tracks are now stored on servers in "the cloud" or hard drives of one sort or another. These are examples of physical goods currently existing in markets, alongside many others, which are in the process of being "digitised". Substitution from the digital services eliminates the demand for products in physical goods markets.
- 1.29 "Digitisation" is then the process through which markets for goods and services are substituted by computer code, so messages and music, and many other products and services, can be accessed online. The code can exist in a microchip or software that can be accessed inside a mobile device, or a computer server or provided centrally in the telecoms network, or embedded as service at low cost from a cloud computing service provider on servers anywhere worldwide. Products can be contained or controlled by online gatekeepers in what is confusingly described as "a platform" or communication system of one type or another.<sup>26</sup>
- 1.30 The key issue for authorities facing the challenge of market assessment in a competition case is that demand side analysis is important and tells us what customers are looking for, but that currently supplied products which meet that demand cannot be the end of the enquiry. The investigation of substitution has to give equal if not more prominence to forward-looking supply side alternatives that would or could meet the same need. Supply side factors and the analysis of potential competition requires a different starting point, and a different enquiry would mean different evidence being gathered at a much earlier point in the enquiry.

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<sup>25</sup> See for example that the Commission gathered 5.2 terabytes of search results in the Google case, and more routinely the quantities of documents gathered as a matter of routine in merger and cartel cases.

<sup>26</sup> See Nicholas Carr's *The Big Switch: Rewriting the World from "Edison" to "Google"*, January 2009.

- 1.31 It also needs to be recognised that online markets often have different economic characteristics from goods and services markets in other industrial sectors. It is often argued that the tools available to the authorities don't need to be changed. That is as may be, but they will need to be used differently. For example, online markets may have a tendency toward monopoly or oligopoly because of enormous economies of scale and scope. High scalability of online businesses, accessing worldwide demand from software and services-based systems which don't require much, if any, additional investment to meet that demand is one well known feature. Economies of scope<sup>27</sup> are not often referred to and may be prevalent in online markets or platform businesses. These are efficiencies formed by variety not volume. Economies of scope involve lowering average cost by producing more types of products. Network industries are characterised by what technical economists call cost subadditivity, which means that it is cheaper to produce A and B together rather than separately; this means that economies of scope allow increasing ranges of goods.
- 1.32 For those conducting competition analysis there is an increased need to focus on the supply side, since substitutes for existing products meeting existing demands may come from left field and be produced more efficiently by online suppliers adding to their range of existing products.
- 1.33 Online businesses may also benefit from network externalities available from producing software-based products and services at low incremental cost to meet potentially worldwide demand, for which each additional user obtains the benefit of being served by the same system. Left alone, markets may rapidly become dominated because competition can be 'for the market'. Barriers to entry can become enormous very quickly, before anyone else can enter at equivalent scale or reach equivalent numbers of customers at similarly low costs. Swift intervention may be needed to prevent dominance from occurring.<sup>28</sup> All would suggest a need for closer scrutiny of those sectors with these economic characteristics: close scrutiny of tech/telecoms sector deals may thus be needed.
- 1.34 The current approach of the authorities typically, and not unreasonably, starts with the products that are the subject of the enquiry. Existing products meets current demand and supply some useful information about

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<sup>27</sup> John C. Panzar; Robert D. Willig (May 1981). "Economies of Scope". American Economic Review. **71** (2): 268–272. JSTOR 1815729.

<sup>28</sup> The Intel, Microsoft and Google cases have all taken about 10 years. There are also, many examples in economic literature and antitrust case law where returns to scale can accrue to firms that can provide broader ranges of services off common cost technology platforms, meeting the needs of different categories of customer on different sides of the markets in as many ways as possible, where all contributions are contributions to the common platform. Additional users may benefit from the network effect of joining the biggest and most widespread network; all driving lower cost output per product and additional benefits to existing and new members, making bigger networks inevitably more attractive to customers. See for example the work of Katz and Shapiro "Systems Competition and Network Effects"

URL: <http://www.jstor.org/stable/2138538> and the work of Jean Tirole and Patrick Ray at the Toulouse school who have often led the thinking in this area.

the nature of demand and supply, but not enough information about actual and potential alternatives and market structure.

- 1.35 The enquiry does encompass effects on innovation, but such effects can be hard to assess, because of the inherent uncertainty associated with R&D, because of the difficulty of evaluating an organisation's innovation capabilities, and because these effects are often more distant and in the future. However, they can be very important, due to the critical role of innovation in generating long-term consumer benefits.<sup>29</sup> In practice, investigations look into demand and supply, but may be ignoring vital information about alternative disruptors or alternative sources of supply. Digitisation makes the enquiry doubly challenging for authorities as does the fact that they are set up to investigate each matter from scratch. This may lead to misunderstandings of the market and failure to appreciate the true nature and conditions of competition that is taking place or will be likely to take place post-merger.
- 1.36 We refer at 2.15 below to the work of Phillippe Aghion on innovation, and suggest that it provides a direction in which further investigation of evidence of innovation in markets by competition authorities can be undertaken in particular cases.

### **Sub-Optimal and Optimal outcomes**

- 1.37 There is nothing inevitable about technology markets being competitive. Left alone they will inevitably be dominated. This is as a result of certain features of the economic fundamentals that operate in such markets, which drive returns to scale and where bigger firms can provide broader ranges of services off common cost technology platforms, meeting the needs of different categories of customer on different sides of the markets. Additional users may benefit from the network effect of joining the biggest and most widespread network. Smaller rivals with better ideas, and products more suitable for meeting consumer needs on their merits, may simply not make it in competition with established forms. If this happens, innovation dies on the vine.
- 1.38 Technology markets may also lead to the early winners taking the whole market and to players becoming entrenched through the swift establishment of scale, to the exclusion of other players and leading to a market structure that inhibits innovation. Access to worldwide demand and low costs of production may allow organisations to grow very swiftly and they can become embedded through network effects, entrenching their position. This may be achieved through the acquisition of smaller and

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<sup>29</sup> See for example Carl Shapiro's seminal explanation of changes to US merger guidelines that have progressed over time in the following **the 2010 horizontal merger guidelines: from hedgehog to fox in forty ...** unfortunately the world's antitrust authorities have adopted similar if not identical approaches to mergers that do not adequately deal with digitisation and its consequences. The most recent guidelines place an increased emphasis on innovation, but perhaps too much emphasis is placed on detailed data gathering of historic price and product information in an attempt to accurately model the future.

innovative firms or, under commercial agreements, through technology transfers. These agreements may also be restrictive of competition and foreclose entry. A combination of mergers and restrictive commercial agreements can contribute to the further entrenchment and concentration of the markets. Problematically, a combination of system blindness to innovation mergers, and the existing relaxed rules and de-prioritisation of enforcement on vertical agreements may have now significantly, if not permanently, altered the structure of markets to the benefit of increasingly entrenched players, limiting the horizon of opportunity for smaller businesses.

1.39 Following the Commission's decision to abandon its control over notifications in 2004, restrictions in vertical agreements have been deprioritised. The vertical agreement block exemption only applies based on percentage of relevant market.<sup>30</sup> The threshold is based on a market that cannot easily be defined. This can be seen as yet another 'loophole' given market definition problems. The Commission's review of online markets in 2015, alongside CMA studies,<sup>31</sup> shows restrictive vertical agreements are now widespread. A failure of enforcement may thus have reinforced concentration, operating as it has in parallel with limited scrutiny through merger control.

### **Examples of assessment failures**

#### **Example 1: Anti-competitive Horizontal Merger: Facebook/WhatsApp**

1.40 The above merger once more testifies to the need for the competition system to advance competition on the merits of products and services, and to promote innovation rather than to promote success in businesses based on exploitation of legal loopholes. The practice of internet companies in targeting acquisitions beneath the relevant turnover thresholds and the consequent risks to competition that such transactions can pose, whether they are horizontal or vertical mergers, is once again exemplified.

1.41 To state the obvious, industry in this sector has become increasingly concentrated. The Facebook/WhatsApp case is a clear example of industry concentration and the direct horizontal overlaps between social media services provided by Facebook, with communications provided by WhatsApp. We would refer to the fact that direct horizontal overlap is disclosed in the Commission decision where it indicates that in the period between December 2013 and April 2014, between [20-30]% and [50-60]% of WhatsApp users already used Facebook Messenger and between [70-80]% and [80-90]% of WhatsApp users were Facebook users and were therefore already within the reach of Facebook Messenger. Conversely, over the same period 60% to 70% of Facebook Messenger active users already used WhatsApp<sup>32</sup>

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<sup>30</sup> See VBER 2010

<sup>31</sup> See Oxera study for CMA into online market practices.

<sup>32</sup> See para 140 **Case No COMP/M.7217 - FACEBOOK/ WHATSAPP Article 6(1)(b)**

1.42 The Commission decision clearing the merger ignored the complaints of third parties in that case about overlapping data having considerable value when targeting customers for advertising, and while the Commission has revisited the fact that Facebook misled it over the ease of integration of databases, and has fined Facebook for misleading information, depressingly and unsurprisingly it has done nothing about the substantive issue; the transaction involved a clear reduction in competition and increase in horizontal concentration.

### **Example 2: Anti-Competitive Vertical Merger: Google/Beat that Quote**

1.43 Another merger example would be when Google bought Beat that Quote. In that case Google acquired a small online insurance provider. Immediately following the acquisition, Google promoted Beat that Quote into its search rankings ahead of more relevant rivals. Given past experience, this outcome was likely and was the subject of third party complaints. The OFT (the CMA's predecessor), in allowing the transaction to proceed, suggested that it would be economically non-feasible for Google to self-promote because promotion of Google's newly acquired own products would forego revenue from the products of others.<sup>33</sup> The economics looked compelling: Google could no doubt show that as a matter of consumer welfare it would be in Google's interests to promote all and sundry, and not promote its own products, at least in the short term. The deal was allowed to proceed. Google almost immediately promoted its new product in its search results to the detriment of rivals.<sup>34</sup> The practice of self-promotion and prominent display is the subject of the Commission's recent € 2.42bn fine on Google. It is once again predictable that UK authorities bought their own theoretical analysis rather than investigating innovation effects.

1.44 What could be measured in the merger control process was revenue from others and the likely losses if Google took the risk of promoting its own products into the rankings ahead of others following its acquisition. What couldn't easily be measured was post-merger incomes, likely effects on innovation and strategic foreclosure in the interest of Google's platform more generally.<sup>35</sup> Google has been fined the highest ever fine for the

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**NON-OPPOSITION Date: 03/10/2014 – available at:**

**[http://ec.europa.eu/competition/mergers/cases/decisions/m7217\\_20141003\\_20310\\_3962132\\_EN.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m7217_20141003_20310_3962132_EN.pdf)**

<sup>33</sup> The OFT concluded that *"the evidence did not suggest that the merger added to any incentive that Google may have had to foreclose rival consumer finance PSCs on the basis that it would be foregoing greater upstream profits on lost advertising than it would be gaining on extra PCS sales downstream"*. See full decision here: <https://assets.publishing.service.gov.uk/media/555de311ed915d7ae200005f/Google-BeatThatQuote.pdf>

<sup>34</sup> See <http://i-comp.org/blog/2011/google-further-expands-in-vertical-search/>

<sup>35</sup> See, for another example, 21<sup>st</sup> Century Fox announced acquisition of Sky. The deal looks to be one where 21<sup>st</sup> Century Fox, which makes films, a high risk product, may be seeking to promote its own products on the Sky digital distribution platform, to secure

practice of self-promotion and product placement through which it promoted its own products into its search engine results. Complaints concerning that practice and its anti-competitive potential were well known to the authorities when Beat that Quote and other mergers were taking place but the mergers was nonetheless allowed to proceed.

### **Example 3: Anti-Competitive Vertical Merger? Amazon/Wholefoods?**

- 1.45 Take, for example, Amazon's recent successful bid for Whole Foods.<sup>36</sup> Amazon has been investigated by the authorities for its activities as an online bookseller.<sup>37</sup> Amazon clearly sells books, but in doing so built a technology platform, and logistics and delivery system that is capable of delivering anything from groceries to golf balls. When it announced the acquisition, costing \$13.7 billion, Amazon's own shares rose by \$11bn. Competitors such as Walmart, that compete with Whole Foods in US food retailing, found that their shares dropped. If, for example, the deal delivers synergies and Amazon uses them to deliver lower prices and faster delivery of food, perhaps combining free film on Amazon Prime with free pizza from Whole Foods, then consumers will have better products and lower prices and nothing to complain about?
- 1.46 What is it that the financial markets think could happen? Maybe Amazon will sell its Whole Foods products over its brilliant delivery system and promote them against those of Walmart? Will Walmart be able to respond? Does a combination of alternative businesses exist to provide pressure on the new Amazon? Finally, will the authorities "get" this?
- 1.47 As anticipated, the transaction was considered under the traditional analysis as a merger not taking place between two players at the same level of trade. Books and golf balls and food are not substitutes. So it was held that no direct horizontal competition would be directly reduced between Amazon and Whole Foods. Whereas the authorities should have looked at whether competitors such as Walmart could have alternative technology platforms that they could combine with, so that the post-merger firm would face genuine competitive pressure and meet any structural threat from the new and combined Amazon foods business.
- 1.48 On a traditional analysis the transaction could be argued to be in the "consumer interest" if alternative tech/food businesses can be created to compete with the merged firm or if post-merger alternatives are many and varied. Perhaps this is why the authorities found it unproblematic, as it is a vertical integration and they see vertical integration as the provider of

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revenues and make its investments pay off more quickly. The Commission recently cleared the deal on a similar basis to the OFT assessment in Google/Beat that Quote.

<sup>36</sup> <https://www.bloomberg.com/news/articles/2017-06-16/amazon-to-acquire-whole-foods-in-13-7-billion-bet-on-groceries>

<sup>37</sup> See EC case here: [http://ec.europa.eu/competition/elojade/isef/case\\_details.cfm?proc\\_code=1\\_40153](http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_40153)

efficiencies that may be passed on to consumers. In Amazon's defence after all, it will be said, if Amazon can do this so can others, and it would be more efficient for alternative vertically integrated platforms to provide their products and services over fast and efficient technology platforms. Another grocer could merge with another technology platform.<sup>38</sup>

- 1.49 The clear difficulty with such an approach is that it can be taken only so far before vertical integration between the technology platform and the retail outlet stifles competition in the downstream market, raises barriers to entry for non-integrated rivals and leads to a world dominated by a so called "efficient oligopoly".
- 1.50 The effects on alternative players and the innovation process do not often receive the same degree of attention as the issues for consumers directly arising from the transaction. The deal may for instance raise a major issue in data markets and markets where the accumulation of data over individual household or customer buying patterns is concerned, and where a full range of services can be offered to meet the increasing needs of consumers purchasing over Amazon's systems, watching Amazon-supplied films and eating food from Amazon, and suppliers using Amazon's delivery systems. The structural issue for smaller players supplying customers using Amazon or competing with either party may be very significant. Combinations of user data may be removed from view and unavailable to current suppliers and advertisers, depriving market players of significant sources of data and insight into demand. Innovation in many markets may suffer. Such is the peril of vertical integration, which involves the combination of a consumer staple such as food with a powerful provider of a general purpose technology in a data driven age.
- 1.51 When considering such issues, the evaluation of convenience and benefit to users of the post- merger firm's products by comparison with others will be difficult. Room exists for many to do what Amazon could do, and it would be a brave official that blocks such a deal based on the idea that Amazon can be expected to become a market dominator on the basis that it can execute better, faster, and more effectively in meeting customer needs than a variety of different alternatives. But the point remains that there are un-investigated portfolio, and joint and common cost effects and some platforms are so dominant that it is an open question as to whether a competitive market structure exists or can exist.
- 1.52 ***Even if the transaction delivers efficiencies, the modelling of consumer welfare benefits and post-merger prices will be difficult and the loss of third party innovation will be difficult to measure and assess.*** However, the reaction of financial markets is that Amazon's

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<sup>38</sup> Since Google says that Google shopping is a competitor to Amazon, perhaps its next acquisition will be a grocer? Indeed, see Walmart and Google's latest venture: <http://money.cnn.com/2017/08/23/technology/google-walmart-amazon-shopping/index.html>

record of flawless execution indicates that it will do very well post-merger and its rivals will fare badly.

### **Abuse of dominance: vertical foreclosure and vertical agreements in the tech and telecoms sector.**

- 1.53 The record of the authorities in tackling abuse of dominance in the technology sector is, at best, patchy. Following liberalisation of telecoms in the late 1990's, the markets for the provision of communications services and infrastructure, which is part of the giant circuit board on which higher levels of technology run, were opened up to competition. In doing so, liberalisation paved the way for the technology stack to be disaggregated and different forms could operate in the different layers in the stack. Services such as internet services could be provided over basic telecoms infrastructure. Whole industries were created. The incumbent telecoms operators in local markets in the EU and elsewhere had every incentive to abuse their dominance over their parts of the supply chain in local markets in the face of entry from players such as BT, AT&T, MCI and Sprint that were expanding globally. Many did so, with BT and its new entrant competitors taking action against the local incumbents, in conjunction with authorities such as the Commission, to keep markets open and competitive, leading to notable cases in the Court of Justice.<sup>39</sup>
- 1.54 Aside from regulation creating liberalisation in basic telecoms, the enforcement of the law by the authorities in newly liberalised markets is vital to prevent abuse of dominance through foreclosure of entry. Similarly, control over gatekeepers affecting the next level up in the technology stack, is critical if players are not to dominate the entire system. At first sight, the Commission appears to have prioritised vertical access issues and enforcement, and taken cases both in the telecoms and in the tech sector, with actions against Apple for pricing of iTunes, territorial restraints in online music on iTunes, and access to the app store by developers, leading to changes in Apple's guidelines to ensure non-discriminatory access to the Apple store.<sup>40</sup> It also took action against Amazon for e-book pricing and IBM for maintenance bundling.<sup>41</sup> The same enforcement pattern can be seen in the Commission's investigation into restrictions relating to Thomson Reuters Instrument codes ("RICs")<sup>42</sup> used to run financial software.
- 1.55 However, in truth, these are rare cases when looked at against a backcloth of the vast number of agreements entered into between different levels in supply chains affected by the online revolution. Following the Commission's decision to abandon its control over notifications in 2004, the

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<sup>39</sup> See for example Commission vs France (on the services directive) Commission vs Germany (on ADSL pricing and national regulation of prices, TeliaSonera ECJ 2011 on the long running exclusionary practices of the incumbent.

<sup>40</sup> European Commission, Antitrust: Statement on Apple's iPhone policy changes, Press release of September 25, 2010.

<sup>41</sup> See, for example, on the Apple store: [http://europa.eu/rapid/press-release\\_IP-17-97\\_en.htm](http://europa.eu/rapid/press-release_IP-17-97_en.htm) and see IBM case details here: [http://ec.europa.eu/competition/elojade/isef/case\\_details.cfm?proc\\_code=1\\_39692](http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39692)

<sup>42</sup> Case AT.29654 – *Reuters Instrument Codes*

decentralisation of enforcement led to an inevitable non enforcement or enforcement gap over vertical agreements. Revision to the vertical agreement block exemptions left vertical agreements with a notional 'safe harbour' based on percentage of relevant market.<sup>43</sup> The threshold can be seen as yet another 'loophole' as it is notoriously difficult to define markets and assess market share in markets that are digitising and dynamic, which is a characteristic of the tech sector.

- 1.56 The evidence that has emerged from the Commission review of online markets in 2015,<sup>44</sup> alongside market studies conducted for the CMA into common business practices,<sup>45</sup> shows that the anticompetitive vertical agreements are very widespread and that many industries are now riddled with such practices. The effects from such a failure of enforcement will mean that firms have become insulated from competition and there is a risk they have reinforced industrial concentration and constrained innovation.
- 1.57 The use and implementation of new technologies, and new processes, systems and know-how, is the way that advances in productivity typically occur.<sup>46</sup> Support for productivity- enhancing innovation and tech start-ups is given via tax breaks in the UK. Abuse of dominance through vertical agreements that foreclose competition and retard economic or technological progress is something that should, by the same logic, be condemned twice; once because it involves an abuse of market power that increases inefficiency and deserves a general prohibition, and a second time because it involves an abuse that relates to technical progress, and inevitably affects productivity and innovation, which are important public goods that need to be promoted in the wider public interest.
- 1.58 Instead of vigorous enforcement, since the abandonment of the notification system by the EU Commission, decentralisation of antitrust enforcement in the EU in the early 2000's has been left in the hands of "self-certification", with those participating in agreements or subjected to verticals having to assess the risks themselves. This means that there is no scrutiny or threat of scrutiny or oversight of many agreements. Self-certification has not worked out well (see also its effects in financial services more generally) and could be revisited.
- 1.59 Restrictions of competition and accumulation of market power may happen in many ways. A successful tech, fintech, or biotech start-up may eventually exit through a sale to an existing industry player. Very few reach terminal velocity and become fully fledged vertically integrated operators, or float their businesses on public markets. Alternatively, vertical integration through acquisition, technology transfer agreements, or

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<sup>43</sup> In both TTBER and VABER. E.g. the market share threshold is defined in Article 3 Commission Regulation (EU) No 330/**2010** of 20 April **2010**

<sup>44</sup> E commerce enquiry alongside the Digital Single markets strategy

<sup>45</sup> See Oxera study for CMA into online market practices.

<sup>46</sup> Neelie Kroes was at one time quoted as suggesting that 50% of productivity gains came from new technology and indeed, in Article 101 terms, if an anticompetitive agreement has redeeming procompetitive technological or economic features, it may be regarded as economically progressive and benefit from the exemption criteria in article 101 (3).

exclusive tie ups mean that more established players may be able to benefit from new innovation through buying the smaller firms, or the established players capture the benefits without having to buy out the smaller and more innovative business in full. Such agreements may simply reinforce dominance and become foreclosure agreements vis-à-vis third parties when entered into with dominant players.

1.60 When combined, the issue of perhaps defective market analysis and the commercial exploitation of the merger thresholds, taken together with a relaxed approach to vertical mergers, vertical foreclosure, and vertical agreements may have created a cocktail of circumstances that have contributed toward more concentrated markets and ones that function badly in the promotion of innovation.

1.61 If the industry is concentrated, and the retail horizon is crowded out, the risk is that the fruits of innovation will then be captured by the existing firms. Over time, innovation and dynamic competition suffer.

### **Example of vertical foreclosure 'Google style' a confusion of activity with progress?**

1.62 On the 27<sup>th</sup> June 2017, the Commission found that Google is dominant in online search and that it has abused that dominance by promoting itself in its own rankings by comparison with other competing products. The case is like the old case involving computer systems that were used by airlines in the 1980's to promote their own products. Both cases involve the exploitation of the limited space on a computer screen for the attention of the viewer and the demotion of competing products out of sight, and out of mind. It represents the enforcement of the law against abuse and vertical foreclosure. Nothing new then.<sup>47</sup>

1.63 The case is already well known for the size of the fine imposed. The Commission's fine is a big one. At €2.42 billion, it's one of the highest ever fines, and the highest ever for abuse of dominance. Perhaps those concerned about enforcement of the rules should applaud. However, the facts that are the subject matter of the case stretch back to a change in Google's strategy toward online shopping and vertical search engines in the mid 2000's. The Commission refers to 2008. The practices have continued for approximately 10 years. The original complaints were filed in 2009.

1.64 The Commission has indicated also that there are at least two other vertical foreclosure cases against Google, if not more, in the pipeline.<sup>48</sup> It sees the

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<sup>47</sup> Save perhaps for the remedies or lack thereof. By comparison airline reservation systems have been subject to the Computer Reservation System regulation since 1989. There are also strong parallels with the Commission's case against Microsoft where it bundled operating system software with window media player.

<sup>48</sup> See Margrethe Vestager's comments here: [https://twitter.com/dw\\_europe/status/879715619331035136](https://twitter.com/dw_europe/status/879715619331035136)

decision as precedent setting, and the decision may eventually lead to the type of extensive remedy packages we have seen in other cases.<sup>49</sup>

1.65 As a consequence, despite the size of the fine, the case currently stands for the proposition that abuse of dominance will pay the abuser. This is both a financial gain and the gain of position and dominance over time, where the benefits accrued are maintained despite the efforts of the authorities. As such it represents a confusion of activity over progress. Activity is represented by the authorities doing work and taking cases. Progress would be a change in the abuser's behaviour, of which we have yet to see any evidence.

### **Economic incentives: fines and profits.**

1.66 Laws often incentivise desirable behaviour by reinforcing preferred outcomes with financial incentives. Company behaviour is thus conditioned and driven by operating within the law to meet profitable goals.

1.67 Oddly, competition law allows for damages actions to be brought against abusive dominant companies, and fines to be levied on them, but then as a matter of principle, because damages are quantified against the claimant's losses not the defendant's gains, also allows market abusers to keep the gains and profits from their wrongdoing.

1.68 The law needs to be respected to be worthy of its name, and in social terms, the signal sent by enforcement activity needs to be that breaking the law is unacceptable. The Google case is also a strong signal that breaking the law pays handsomely. To a generation of technologists and entrepreneurs brought up on the mantra much loved by Silicon Valley companies of "**Move Fast and Break Things**"<sup>50</sup> the law is just another obstacle, and breaking it all in a day's work.

1.69 In taking so long to reach its decisions, it is likely that the EU Commission, alongside other enforcement bodies, have reinforced bad behaviour created a new antitrust paradox; where it has failed to enforce the law, monopoly or oligopoly has blossomed.

### **Impacts on freedom of expression**

1.70 Antitrust or competition law has roots in preserving democratic freedoms both in the US/UK and continental Europe. The law was originally motivated by legislators to address broad political issues and the risk to democracy of

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<sup>49</sup> Or meet the requirements of effectiveness indicated in the Ufex case C 119/97 before the Court of Justice.

<sup>50</sup> See the book of the same title by Jonathan Taplin which refers to this practice by major tech firms

a small number of major payers controlling large sections of the economy. In both EU and US systems, concerns over the control of society by a small number of powerful industrialists, and the impacts of such concentration on freedom of expression and the press, were and have continued to be issues that the law addresses.<sup>51</sup>

- 1.71 Unfortunately, in the EU at least, the impacts on plurality of the media are also looked at in a bifurcated process that has also probably contributed to a reduction in the number and types of media outlet, and reduced plurality. Merger control at EU level, and national parallel jurisdiction, addresses the “competition issues” where the thresholds happen to be triggered. Plurality of the media is then looked at under local national rules. The plurality issue is a policy concern about a diverse and broad range of sources of news and editorial viewpoints being available to people generally. An immediate observation is that unless plurality control can override efficiency then having plurality control will be pointless. However, if merger control allows deals that improve efficiency then it will create scale competitors outside the plurality rules, and the plurality controls will be effectively undermined because the market structure will have changed.
- 1.72 The effects on concentration may be compounded because of a mixture of legal definitions under national broadcasting and plurality laws, which have led to a system that is applying plurality rules to part of the market only, thereby allowing other parts of the market to operate with greater degrees of freedom. In the EU the system of merger control does not catch transactions beneath the turnover thresholds.
- 1.73 Facebook’s acquisition of WhatsApp is one example. It is also an example of a media transaction that was not subject to scrutiny, as social media is not subject to the same plurality rules as other forms of media such as traditional broadcasting. Social media concentration can thus take place outside the scrutiny of the authorities, particularly for smaller deals. The outcome is increasing levels of concentration, which in turn may lessen both individual and collective sources of free expression.<sup>52</sup>
- 1.74 Perhaps this is the reason that Alan Rusbridge, former editor of **The Guardian** newspaper, believes Facebook sucked up nearly £20m of the newspaper’s digital advertising revenue. If such players can accumulate market power over income they can threaten diversity of supply and

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<sup>51</sup> See for example the origins of the FTC in the US designed to curb the power of the trust and the Ordoliberal tradition in Germany where the rules based system is designed to address both political and economic power, contained in the ideas of a ‘social market’ economic model.

<sup>52</sup> In some cases national laws control only public service (old school) broadcasters that compete with social media, and in other cases they do take social media into account when considering plurality issues in reviewing consolidation through merger control. See for example Ofcom’s current review of 21<sup>st</sup> Century Fox and Sky and its assessment criteria for media plurality.

capture increasing amounts of advertising revenue, depriving other media businesses of the source of revenue needed to support their business. Unless plurality control can override merger control, and prevent a merger which is allowed or takes place and is justified on consumer welfare and efficiency grounds, then mergers will take place for efficiency reasons, and be allowed, and having subsequent plurality control will be pointless.<sup>53</sup>

1.75 Given the importance of the medium through which news and other content is communicated, whether on Facebook or other social media and online communications platforms, concentration can currently take place that affects attractiveness to advertisers and revenue streams on which freedom of expression depends, and the narrow view of the authorities means that effects are out of sight, and out of mind.

### **Conclusions to Part I**

1.76 In these expanded comments we have referred to the broader issue of the wider economic and social impacts which are being identified from increasingly concentrated market structures.<sup>54</sup>

1.77 Economic evidence is never complete and, while tending to demonstrate certain causes, may be insufficient to constitute legally compelling proof of wrongdoing. It could be observed that concrete proof is rarely possible and that optimal outcomes need to be achieved given limited information. Risk of unwelcome outcomes would then counsel for greater vigilance and enforcement over vertical agreements, and caution in allowing potentially concentrative mergers to proceed.<sup>55</sup>

1.78 The available evidence is, however, also consistent with market structure contributing to the high levels of insecurity and dislocation visible in large sections of society, and the feelings of alienation seen in the political world in recent times. If people feel that their jobs are insecure, their employer has a grip on their work and their work-life chances are limited to a small number of large employers, they can be expected to feel exploited and alienated.

1.79 On a personal level, reduced opportunities affects confidence. The promise of free markets to increase economic prosperity is only true if it is experienced. Increased personal freedom, and freedom to create and express is undermined if, instead of broader and deeper levels of

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<sup>53</sup> Current non- economic public interest merger controls include prudential regulation media plurality defence and security, and could well include scrutiny of Critical national infrastructure along the lines of the US CIFIUS system

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See

[https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160502\\_competiti\\_on\\_issue\\_brief\\_updated\\_cea.pdf](https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160502_competiti_on_issue_brief_updated_cea.pdf)

<sup>55</sup> As suggested by Carl Shapiro in his report on revision to the horizontal merger guidelines.

prosperity, the fruits of many people's efforts are captured by the few. In addition, if prospects are limited and people feel a level of economic dependency and increased uncertainty, there are undoubtedly risks to freedom, not merely freedom of expression.

1.80 Change to our system of enforcement is needed and below in Part II of our paper, proposals for change to address the issues identified are made.

## **2 Part II: Proposals for reform**

2.1 This Res Publica Brief calls for change to the competition system. It identifies failures of outcome, based on current system failures, discussion of optimal outcomes, and calls for dialogue on potential solutions, including greater enforcement, compliance and monitoring of the system.

### **Failure of outcomes for the economy and society more generally**

2.2 As suggested by a former head of the US Department of Justice, the more important that innovation becomes to society, the greater the need to enforce the law.

2.3 The UK has low productivity and increasing inflation. Added to general uncertainties in the world, we are also facing Brexit, potentially the biggest shock to the economy in a lifetime. Economic growth, productivity improvements, and worthwhile jobs for people now, and in the future, are the challenge for all governments.

2.4 We at Res Publica believe this means putting more emphasis on innovation. Greater levels of innovation, and increased opportunities, means emphasis on choice, and that means emphasis on market structure and entry by small business. Small businesses are vital because they represent about half of all job growth.<sup>56</sup>

2.5 Technology is also at the core of strategically important UK industries such as financial services and defence, where the UK has comparative advantages and world leading capabilities that should be built on for the future. It is also clear that general purpose technologies such as computing and communications can have major productivity benefits to wide sectors of the economy more generally. Conversely, where general purpose technologies are not operating competitively, broad sectors of the economy can be held back. Technology-dependent sectors can be expected to suffer more seriously than others where technology is less mission critical, but

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<sup>56</sup> World Economic Forum paper "Collaborative Innovation, Transforming Business, Driving Growth 2015 which also references "Recent research by the OECD shows that young firms, mostly SME's, are responsible for at least 50% of job growth. "

with all sectors of the economy dependent on the digital revolution, complacency is not an option.

- 2.6 Small businesses require confidence in the future. Small business involves a sense of ownership and changes the way people think about themselves. Entrepreneurship reinforces certain values. Values like opportunity and responsibility, both for ourselves and to others, be they customers, employees or suppliers. We understand that succeeding or failing on our own merits changes the way people look at themselves and the world. However, opportunity has to be truly open and the economy free for each and every one of us to pursue our own goals. Fear of failure corrodes confidence, and a sense of purpose needs daily sustenance.
- 2.7 People won't be willing to spend money, sweat, time and tears on their own venture if the market is rigged against them. People are willing to take risks, but not foolish risks. Innovation, like entrepreneurship, is risky. It costs money. It takes time. It often fails. Therefore, common sense tells us that there will be a lot less of it if markets are not open to competition from businesses that have a better idea. Currently the tech sector will buy out better ideas and stifle innovation; excluding competition to ensure greater success for the existing major players.
- 2.8 High levels of concentration are the enemy of small business and innovation. Market structure is important. It is worth remembering how antitrust law came about, originally in the US:

*"Small businesses were an important constituency that helped to pass the Sherman Act in 1890. Then, small businesses were concerned that the railroads, which at the time enjoyed regional monopolies, were charging non-competitive and discriminatory shipping rates, and discriminating against certain customers for their own advantage. In addition, small businesses were concerned about the tactics of the Standard Oil company, and other trusts, that controlled, among others, the fuel oil, sugar, tobacco, cotton seed oil, and whiskey markets. The trusts employed predatory tactics against small businesses and drove out entrepreneurs with coercive threats of "sell or be ruined."<sup>57</sup>*

- 2.9 Today's railroads are the information superhighways that have been supported and created by successive governments. The internet was born as a government program and nurtured by regulatory benefits. Loopholes, whether by accident or design, have been exploited by the major players for the gain of the established players, and society's loss.

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<sup>57</sup> See speech by Adam Golodner, Chief Of Staff Antitrust division January 2000 "Antitrust innovation, Entrepreneurship and small business"

2.10 The competition law system is designed to be a social safety net, correcting market failures as and when they arise. It is concerned with the interests not only of consumers but also of producers and in ensuring that the systems innovates in the general interest. The connection with social justice has been lost and needs to be re-established.

2.11 The objectives of the law are broad enough for a wider set of factors to be taken into account. A clear statement of the law by the Court of Justice of the EU in the seminal TeliaSonera case:

*"The function of those rules is precisely to prevent competition from being distorted to the detriment of **the public interest, individual undertakings and consumers**, thereby ensuring the well-being of the European Union (emphasis added)."*

2.12 The system in the UK, EU and US has similar goals. As suggested some years ago by the Chief of Staff of the Antitrust division at the US Department of Justice:

*"The antitrust laws help to sustain this entrepreneurial spirit by ensuring that markets are open, and that new businesses can compete, and, if they build a better mousetrap, -- have the chance to succeed. The importance of this role can't be overstated: in keeping markets contestable, **the antitrust laws enrich our social fabric, and country, as well as our economy.**"<sup>58</sup>*

2.13 Outcomes require measurements and enforcement requires testing effective remedies against market outcomes. The authorities measure their activity in terms of cases taken, and books full of cases stand in silent testament to regulatory failure.

2.14 Action to ensure competition and innovation thrives is possible and now vital, given the broad ranges of services and products offered by the major platform owners,<sup>59</sup> their economies of scale and scope, and massive

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<sup>58</sup> See note 2 above, also Joel Klein AAG DOJ stated in April 2000 at the height of the tech boom merger wave: *"The more important that innovation becomes to society, the more important it is to preserve economic incentives to innovate. Timely and effective antitrust enforcement may be essential to preserving the kind of environment in which companies new and old, large and small, can be confident that there will be no anticompetitive barriers to bringing their new products and services to market."* Statement to the Committee on judiciary US HoR.

<sup>59</sup> In 2016, a House of Lords Select Committee found that *"The markets in which online platforms operate are characterised by accelerated network effects. These may fuel exponential growth, increase switching costs, increase entry barriers for potential competitors and lead to monopolistic outcomes. Firms that succeed in harnessing these network effects may become the main platform in a sector, gateways through which markets and information are accessed. This can reduce choice for users and mean that*

investments in assets and intellectual property portfolios designed to create unassailable barriers to entry. We are optimistic that despite system blindness and mistakes that have been made to date, they can be rectified. We outline possible reasons for the current position below, followed by possible proposals for change.

### **Current system failures:**

2.15 We contend that the following 7 areas demand change:

- a. **The current focus on consumer welfare is misplaced.** In practice, the current system is overly focused on short term consumer welfare, based on what can be measured in the short term.<sup>60</sup> A greater focus on productive efficiency, with the goal of increasing innovation, and opportunity, has suffered.

Most recently Tommaso Valetti, now chief economist at the EU Commission, and his colleagues have identified in a research paper that horizontal mergers in oligopolistic markets reduce innovation.<sup>61</sup> It follows that any horizontal mergers that are not caught by the system can have a damaging effect on innovation. This supports the established orthodoxy, but also reinforces the need for extra vigilance.<sup>62</sup>

Indeed, the EU has to an extent been leading the way in this respect, raising innovation concerns in a number of merger situations in the last few years – although there is undoubtedly more that can be done. One example of this is in the Novartis/GlaxoSmithKline merger, where concerns were raised about the parties' oncology business, where the Commission required the parties to divest one of the pipeline projects in order to mitigate risks to innovation.<sup>63</sup> Another example where

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*they become an almost unavoidable trading partner for businesses. Such platforms are likely to possess a significant degree of market power." See Online Platforms and the Digital Single Market, published 20 April 2016.*

<sup>60</sup> See for example the practice of competition authorities in merger control focusing on short term pricing effects and upward pricing pressure analysis, which, while part of the evidence base, is over emphasised at the expense of assessment of levels of innovation and assessment of evidence of innovation intensity.

<sup>61</sup> See SSRN id 2999178.pdf Horizontal mergers and product innovation Federico, Langus and Valetti July 2017

<sup>62</sup> Competition authorities typically maintain that horizontal mergers risk reducing innovation incentives. For example, the U.S. Horizontal Merger Guidelines state that "competition often spurs firms to innovate". Similarly, the E.C. Horizontal Merger Guidelines maintain that effective competition benefits consumers by promoting innovation, and that a merger may deprive consumers of this benefit. The U.K. Merger Assessment Guidelines posit that rivalry between firms creates incentives to introduce new and better products. The problem is that many if not most mergers don't have to be notified for review.

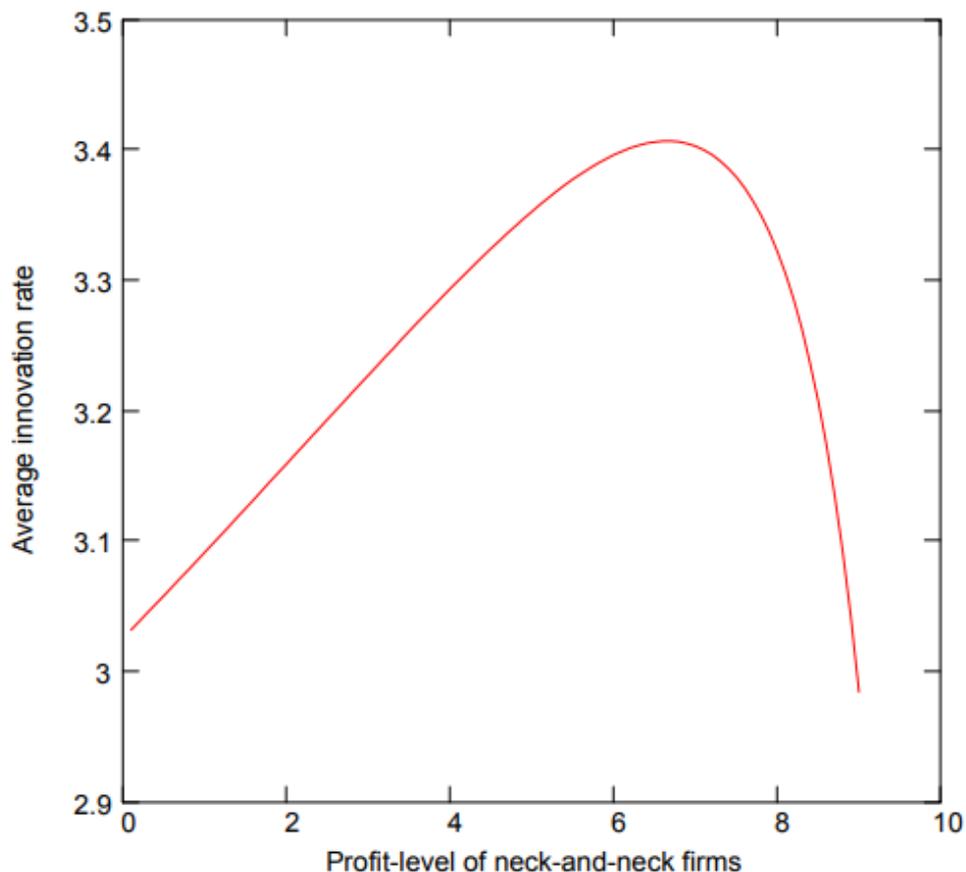
<sup>63</sup> See EC decision here:

[http://ec.europa.eu/competition/mergers/cases/decisions/m7275\\_20150128\\_2012\\_41](http://ec.europa.eu/competition/mergers/cases/decisions/m7275_20150128_2012_41)

innovation concerns were addressed by the Commission is the General Electric/Alstom merger, where concerns were raised about the impact on innovation in the energy sector.<sup>64</sup> Again, the Commission approved the acquisition of Alstom's energy business by General Electric subject to divestment of central parts of Alstom's heavy duty gas turbines business. The recent Dow/DuPont decision continues in this vein, as approval to the merger was given conditional on divestment of DuPont's global pesticide business over innovation concerns about reduced numbers of new "active ingredients" in the pesticides business to be developed per year by the merged entity.<sup>65</sup>

There is considerable discussion of the need for authorities to move to more of a general welfare approach. The work by Philippe Aghion, FM Scherer and others have pointed to the importance of market structure for innovation, which may not be fully assessed or properly considered in the current framework. Carl Shapiro, when commenting on the revisions to the US merger guidelines introduced in 2010, accepted that *"innovation can be hard to assess, because of the inherent uncertainty associated with R&D, because of the difficulty of evaluating an organization's innovation capabilities, and because these effects are often more distant in the future"*.

We also know from the work of Philippe Aghion and his colleagues that there is generally an increase in innovation with competition, that large numbers of companies and highly competitive markets drive up innovation, but that very high levels of competition can reduce innovation.<sup>66</sup>



As competition decreases, the equilibrium profit level  $\pi_0$  of neck-and-neck firms increases, resulting eventually in a fall in the economy-wide rate of growth.

From a policy perspective, if an optimal outcome is to be achieved, considerable care needs to be taken over the activities taking place in, and structure of, competition in markets, implying a considerably greater industry focus is needed by our competition authorities in their understanding, and forward looking assessments of the market and how the dynamic operates over time. This will require organisation and process changes.

- b. **The current merger control system does not address innovation mergers: thresholds could be changed but assessment practices also need to change.** EU Competition Commissioner, Margrethe Vestager in April 2016, in her speech "Competition the mother of invention" recognised the vital importance of innovation and the need for scrutiny. She also recognised the failure of the current system in that it does not catch or scrutinise mergers between major

players and innovative upstarts.<sup>67</sup> One former official has commented that the internet market has “become concentrated via largely unfettered, serial, early-stage acquisitions<sup>68</sup>”

For those used to looking at offline goods markets such as beans, or potatoes, cars or cameras, the online world can be a confusing place. Physical goods are in the process of being substituted by online alternatives, or “digitised”. Digitisation is the process identified by Nicholas Carr in his book, the Big Switch, through which goods and services are substituted for by computer code, so messages and music and products and services for their recording and playback are now provided over platforms.

Reform means much more careful assessment of the supply side and market structure. Demand side analysis is important, but, given digitisation, currently supplied products meeting current demand cannot be the end of an antitrust enquiry. The investigation of supply side substitution has to give equal prominence, if not more, to forward-looking supply side analysis of alternatives that would or could meet the same need. If not, the system is blind to new developments meeting current needs and fails to understand the true nature of competition taking place.

Change to merger control has recently taken place in Germany following concerns that turnover thresholds are the wrong test since they don’t capture transactions that are important but where the target has a low turnover. The jurisdictional thresholds that set the starting point for merger review in the EU and UK are set partly as a political compromise to allocate work between authorities, such that bigger transactions which tend to be more pan-European or global are dealt with under the one stop shop approach in Brussels. For this reason Germany has recently changed its law to adopt a value based threshold aimed at catching such mergers and subjecting them to more careful scrutiny. The EU has been consulting on making changes to the thresholds on a similar basis.<sup>69</sup> If Brexit happens, the UK will have to revisit its system and merger control tests and has an opportunity to effect change.

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<sup>67</sup> 18<sup>th</sup> April 2016

<sup>68</sup> See Scott Cleland at Precursor.com e.g. Google 206 acquisitions in 19 years with increasing numbers in recent times.

<sup>69</sup> Both in the UK and the EU, calls for greater alignment with the merger controls over Critical National infrastructure (CNI), which exist in other countries for security and strategic industry purposes have become ever louder and are now in the Conservative Party manifesto. Against this background, change to merger control is needed, and Brexit provides a timely opportunity with a need for closer alignment of merger control with domestic UK economic policy, designed to support innovation, aligned with needs of society in the UK.

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- c. **Innovation- enhancing collaboration, the role of the state and state aid.** The current system provides only weak signals to beneficial collaboration. This is because the current law prohibits all agreements subject to certain “safe harbours”<sup>70</sup> that are defined in EU wide block exemptions. The EU also administers a system of state aid which may allow acceptable forms of intervention which would otherwise distort the market.

This is an out of date approach toward enforcement based on an out of date administrative system, and one that has to change with the UK leaving the EU, given that some form of funding of R&D is needed. We have also overlooked the importance of collaboration and market structure for the commercialisation of basic research where public/private as well as multi-private firm collaborations are vital to the effective commercialisation of modern innovation. Persistent productivity failure could be derived from failure to collaborate effectively and commercialise when public funding has been provided.<sup>71</sup> Increasing productivity is driven by the use of new processes, often requiring collaboration, and new ways of working, with productivity per worker often being driven by the adoption of new technology in existing firms and new or improved products and services being created that tap into existing or latent demand.<sup>72</sup> Indeed, the EU has estimated that 50% of all productivity gains can be attributed to technological improvements<sup>73</sup> and small and medium-sized businesses are known to drive innovation and job creation.

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<sup>70</sup> Also known as “Block Exemptions” under EU block exemption regulations; which are complex and may not apply to many beneficial real-world situations, or difficult to apply with any certainty since they are based on inherently uncertain “market share” thresholds; in technology markets such thresholds lack precision. .

<sup>71</sup> See House of Commons Briefing Paper Number 06492, *Productivity in the UK*, 27 April 2017, which refers to the UK’s “persistent weakness in productivity”.

<sup>72</sup> 10/5/2017 - Businesses need to step up the adoption of cutting-edge technologies, materials and processes if countries are to reap their full potential in terms of productivity gains, according to a new OECD report. Action on multiple fronts is required. It includes encouraging life-long skills development and greater interaction between industry and education, improving conditions for business creation and development, and supplying the infrastructure needed by firms using advanced, digital technologies. Assisting research and technological scale-up and establishing agencies to aid the spread of technological innovation are also key. The report is available at:

<http://www.oecd.org/industry/the-next-production-revolution-9789264271036-en.htm>

<sup>73</sup> See the World Economic Forum’s Global Competitiveness Report 2014-2015, which

As noted in the Hargreaves Report,<sup>74</sup> and commentary on the Strategy for American Innovation, product innovation is rarely linear. Products and services are not invented fully formed in the R&D laboratories owned by a single firm. The innovation process is much more dynamic and interactive and has to be to discover latent demands. It takes place in places where the new is tested, tailored, and tinkered with by multiple market-facing organisations often developing and using applied research in collaboration with universities. At least, that is the approach successfully adopted in the US. It also depends on the integration of ideas from a wide range of organisations.

In the UK and the EU we have, in general, banned collaboration and made it illegal, subject to exemption on a self-certified basis. This creates peculiar risk assessments and strange consequences; we have seen that the tech sector is riddled with anti-competitive practices from the Commission's e-commerce sector results, but lack of clear safe harbours may also have led to risks not being taken when they could have been and where beneficial economic outcomes would have been desirable.

For smaller firms to collaborate they need to know whether their agreements are beneficial and acceptable or not. At present the system is unintelligible and complex, often requiring legal advice that is too expensive for smaller businesses to obtain. The system should support the commercialisation of R&D and support smaller businesses and be pro-innovation through collaboration.

We believe the current law is incoherent. It condemns acceptable forms of collaboration alongside others. How is a digital firm going to know what is acceptable or not? There is no longer an administrative system under which firms can obtain assurance that their collaborations are ok. In digital start up land, any cost and any cash out is avoided. These businesses husband and nurture scarce cash for growth. Some will argue that self-certification is possible: loss of the administrative system has placed the emphasis on assessment by lawyers. However the cost of lawyers is easily borne by major existing players and less affordable by innovative entrants. More fundamentally why would we add additional burdens to those we want to encourage?

We suggest that the current CMA notification system should be enhanced and smaller businesses encouraged to obtain safe harbour protection under CMA administrative guidance.

When considering whether agreements are anti-competitive, it must be remembered that while agreement between producers to fix prices and cartels should be prohibited, collaboration is critical for future

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describes "technological readiness" as the 9<sup>th</sup> of 12 pillars of competitiveness.

<sup>74</sup> Report available here:

[http://orca.cf.ac.uk/30988/1/1\\_Hargreaves\\_Digital%20Opportunity.pdf](http://orca.cf.ac.uk/30988/1/1_Hargreaves_Digital%20Opportunity.pdf)

development and growth. Firms are increasingly collaborating with other parties, moving to more open forms of innovation which are needed in increasingly complex environments. Commercializing innovations with other parties may enable firms to accelerate the pace of commercialisation and speed up time-to market and useful product improvements.<sup>75</sup> Furthermore, such a shift mirrors expectations of a change in revenue sources; a recent A.T. Kearney study on "Collaborative Innovation in Digital Europe" found that 71% of respondents expected more than a quarter of revenues to be generated through collaborative innovation by 2030.<sup>76</sup>

Another aspect of current competition policy is that it is not closely coupled with other forms of government intervention, known in the EU as state aid. The relationship between government-funded R&D, government procurement, and commercialisation is not coherent. When it comes to competing with other global economies such as the United States, our track record in the UK on the collaboration possible between the private and public sectors is unimpressive.<sup>77</sup> By comparison, in early 2011, the US White House, in its Strategy for American Innovation-Securing Our Economic Growth and Prosperity noted that:

*"One central market failure is in the field of basic research. Basic research typically does not have direct commercial payoffs. Yet breakthroughs in basic research underpins downstream commercial ideas which can bring enormous commercial benefits. For example engineering builds on Newton's laws of motion, the biotechnology industry builds on Watson and Crick's discovery of the structure of DNA, and the dot.com industry builds on government and university development of the internet."*<sup>78</sup>

The US administration adopted a more interventionist stance. It actively fostered commercialisation of R&D and took a range of actions, including major investment in R&D and coordinated commercialisation to get invention from universities to cross the "Valley of Death" into commercial implementation, so that the US economy adopts and uses new technology. This continues today in the face of global competition, with US institutions concerned about a risk

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<sup>75</sup> See also Masters of Innovation: Building the Perpetually Innovative Company by K. Engel, V. Dirlea, S. Dyer and J. Graff, March 2015

<sup>76</sup> See also Chesbrough, H. and Schwartz, K. (2007), Innovating business models with co-development partnerships, Research-Technology Management, Vol. 50 No. 1 11. OECD Science, Technology and Industry Scoreboard 2013. 12. Chesbrough, H.W. (2003b), Open Innovation: The New Imperative for Creating and Profiting from Technology, Harvard Business School Press, Boston, MA.

<sup>77</sup> See page 6 of the World Economic Forum Paper, "Collaborative Innovation, Transforming Business, Driving Growth", 2015: US public/private scientific collaboration is almost double that in the EU, and new technologies are commercialized with 17% more license and patent revenues from abroad.

<sup>78</sup> See also TNO report the policy mix for ICT innovation in the Netherlands: in search of new instruments, policy coherence and impact, which also noted that R&D market failure is mainstream and noted the work of Nelson 1959, Arrow 1962, Oxera 2005.

of a US innovation deficit, as countries such as China, South Korea and Singapore are far outpacing the US in terms of the annual percentage growth of R&D funding.<sup>79</sup> Intelligent purchasing and using the purchasing power of the state has been central to the US position. The policy is supported by the massive levels of government spending on military and general government demand for technology products and services. It is no accident that the US has commercialised better and the leading players in the new economy are all from the US.

It is also widely accepted that the funding of basic research is a role for the state, because the market will not deliver. The next step, the commercialisation of the benefits of publically funded developments is under-examined, poorly promoted or protected from exploitation, and risks capture by existing market players. This requires our attitude to collaboration, and commercialisation through collaboration among industry participants and government, whether direct through grant funding or indirectly through its purchasing practices, to change radically.<sup>80</sup>

The Obama Administration in the US also took a series of actions including executive orders to ensure that competition was enhanced and innovation improved. In particular action was taken to ensure that standard essential patents were not used as a mechanism for competitive “hold up”.

In the UK we are so far behind in our approach to nurturing inventors and innovation that we do not even have a clear mechanism for patenting software.

- d. **Our system of enforcement is too slow.** Where merger control applies it is generally dealt with in commercially realistic timeframes. The same cannot be said about enforcement of the law against abuse of dominance, where, notoriously, cases take years to even establish an infringement.<sup>81</sup> Saying that whole industries are blighted in the meantime does not bring home the full force of the effect on individuals trying to run their businesses, the corrosion of confidence of small businesses, and the enduring damages to people’s lives and our society.

This applies to enforcement in the US as well as the UK: The Center for American Progress’ report notes that, although the guidelines changed, enforcement has continued to be permissive, despite the fact

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<sup>79</sup> Association of American Universities September 23 2014 memorandum on the strategy for American Innovation.

<sup>80</sup> US programs such as the National Network for Manufacturing Innovation (NNMI), the Semiconductor Technology Advanced Research network (STARnet), Innovation Corps (I-Corps), the i6 Challenge and the NIH Research Evaluation and Commercialization Hub (REACH) and concept funding programs that increase innovation, technology transfer and commercialisation are models that government could emulate.

<sup>81</sup> See for example the Intel, Microsoft or Google investigations.

that of the 21 mergers analysed exceeding the merger guideline threshold, 85% resulted in higher prices. As industries became more concentrated, the indication is that mergers are more likely to result in higher prices: *"of industries with six or fewer remaining competitors post-merger, nearly 95% of mergers resulted in anticompetitive outcomes."*<sup>82</sup>

Indeed, the Center for American Progress suggests that the authorities should rely on networks of experts where they cannot know of understand the complexity of the modern market, allowing a more rigorous review. They quote Beth Noveck, former US deputy chief technology officer, as stating, in reference to the work of regulatory review, that *"using expert-network platforms can only democratize what are nor comparatively closed processes that typically rely on the same people to participate."*<sup>83</sup> We see considerable force in this argument, which would both allow the authorities to benefit from external and specialised help, and allow them to reach decisions more efficiently and faster.

Failure to enforce the law means that we fail to keep markets open and functioning. The point appears to be well recognised by the authorities. For example, Commissioner Vestager has said:

*"So one of our basic jobs, as competition enforcers, is to make sure that companies don't abuse their power to hold back innovation."*

However, if in the meantime they take years and years and years to investigate and then breach goes unpunished and markets are distorted, with innovation held back. Why is this case? Further discussion is needed by the factors that may affect speedy outcomes probably include:

- i. **Management experience:** where heads of authorities have limited litigation experience is it fair to give them a mandate to take and manage litigation?
- ii. **Processes and procedures** adopted also typically mean that people are assembled to deal with specific transactions, investigations and issues rather than being organised into industry specific groups. The complexity of the modern economy demands greater specialisation, particularly to facilitate speed of understanding and more rapid decision making.

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<sup>82</sup> P. 15, Marc Jarsulic, Ethan Gurwitz, Kate Bahn and Andy Green, *Reviving Antitrust: Why our Economy needs a Progressive Competition Policy*, Center for American Progress, June 2016.

<sup>83</sup> P. 18, Marc Jarsulic, Ethan Gurwitz, Kate Bahn and Andy Green, *Reviving Antitrust: Why our Economy needs a Progressive Competition Policy*, Center for American Progress, June 2016.

- iii. **Timescales** are measured in the time taken to achieve perfect administrative outcomes, rather than provide the response needed by markets in market defined timescales. Our authorities need to move at internet speed.

We support the statements made by Andreas Mundt President of the Federal Kartellamt in Germany:<sup>84</sup>

*"Digitalization is revolutionizing all sectors of the economy. This is a challenging development not only for the business community but also for competition authorities. Digitalization and the competitive assessment of the global Internet giants is currently one of the most important issues for competition authorities around the world. There are many new questions on how competition law should be enforced in these days of digital revolution."*

- e. **The management structures are inherently cumbersome.** The debate leading to the restructuring of the CMA raised questions about the need for a more streamlined enforcement system, with an ability to take decisions more swiftly. The structure is expressly required to be reviewed under the enterprise act in the next few years. Both Brexit and the statutory deadline for review provide opportunity to review the methods, management and structure of the authorities. This should be grasped, with a view to speeding up decision making, with faster enforcement.
- f. **The current system lacks democratic oversight.** The system is modelled on the EU administrative system. That system is often derided for its democratic deficit. The EU system also inherently allows a conflation of both policy-making and the efficient administration and implementation of policy and priorities. Policy-making is, in a more trusted system of government, a matter for democratically elected ministers, while administration and enforcement is, in our view, for administrative and enforcement bodies. In the UK we have a Ministerial steer that is designed to provide direction from democratically elected ministers.

In the UK, a refocusing of the competition authorities' attention on innovation, among other things, was pressed for by Government in 2013.<sup>85</sup> The ministerial steer was created and included reference to innovation. By and large, however, that steer has not led to any

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<sup>84</sup> Competition Policy International February 15 2017

<sup>85</sup> See Consultation Document on the creation of the CMA, "Towards the CMA", available here:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/212285/CMA1 - Towards the CMA.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212285/CMA1_-_Towards_the_CMA.pdf) - Foreword by David Currie: "The CMA will play a vital role in promoting competition and consumer protection across the UK, making markets work better for consumers and **helping to foster innovation**, growth and enterprise, the key to the delivery of future consumer benefit." [Emphasis added]

discernible change in the approach of practice of the authorities. Much more needs to be done and a case for more detailed government policy setting followed by clear properties defined by government laid down, such that authorities do not take unto themselves the discretion to determine their own priorities or do other than enforce the law without fear or favour, quickly. The UK has to review whether a change to a more prosecutorial model is appropriate by 2019.<sup>86</sup> It is hoped that such a change could now take place, with a renewed mandate and remit.

Brexit provides an opportunity to revisit the Ministerial Steer and address the goals and purpose of competition policy afresh. That steer should, in our view seek to ensure that decisions are taken quickly, that breach is not tolerated, and that the focus of the public enforcement of the law promotes innovation to a greater extent.

- g. **Compensatory damages for breach of the law mean the lawbreaker can profit from its wrongdoing.** In simple terms it doesn't pay for dominant companies to comply. Neither does the law properly strip cartelists of the benefit of their cartels. The current system for those that can provide evidence of harm, causation and loss can then take years of expensive private litigation claiming damages for breach of the law which leads, at best and if successful to compensation.

In the US the system recognises the perpetrators, whether individual or collectively, profit from their wrong doing and strip them of their ill-gotten gains. The current position in the UK sets up the wrong incentives. Compensation for only those that can afford to take cases and prove harm is a wholly inadequate basis to ensure compliance. For example, if a major tech platform abuses its dominance, excludes smaller rivals from the market and reaps huge rewards, claims for compensation don't strip the abuser of the benefits of its illegal actions. Worse still, small rivals may be crushed. Business may become worthless overnight. Even taking a claim would often be financially impossible in such circumstances. The signal sent to other players is that big companies rule.

A system where small pay-outs to small players is a misguided system supporting major players and not innovation. The English courts have established that there is a right to exemplary damages and the common law recognises that in certain circumstances the rule of law demands an account of profits or the disgorgement of unjust

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<sup>86</sup> The UK Secretary of State has to lay before Parliament a report on the outcome of the review of the Competition Act within five years of the 2013 Enterprise and Regulatory Reform Act, which came fully into force in April 2014. See: <http://www.fieldfisher.com/publications/2013/06/reform-of-the-uk-competition-regime-the-competition-provisions-of-the-enterprise-and-regulatory-reform-act#sthash.Cdhk8s4J.dpbs>

enrichment. Going forward it should be clarified that the rule of law demands that justice does not allow the guilty to profit from their own wrong. Incentives toward compliance need to be re-set.

Moreover, the investigation and enforcement of abuse of dominance in Microsoft, Intel and Google, despite the size of the fines, currently stand for the proposition that a strategy of “walking slowly backwards” will pay the abuser. In social terms the signal sent to a generation of technologists and entrepreneurs is appalling.

**Proposals for reform in response to the House of Lords questions raised in the call for evidence :**

***What should competition policy in the UK set out to achieve? What guiding principles should shape the UK’s approach to competition policy after Brexit?***

- 2.16 **Merger control**. As found by the previous House of Lords Select Committee investigation into online platforms, “*current merger control should be modified to prevent the acquisition of smaller digital tech firms by large online platforms from escaping scrutiny*”.<sup>87</sup>
- 2.17 Not only could this involve change to include within merger control jurisdiction change to value of transaction, as has taken place in Germany, but would in our view involve an assessment of the impact of a merger on the structure of the market and innovation risks posed by that merger for that market and more widely for the UK, would need to be assessed.
- 2.18 Current proposals to introduce merger control over Critical National Infrastructure need to be progressed and a clear definition of what is Critical National Infrastructure created focused on a narrow and clear definition of strategic interests and security concerns. We will provide further briefing on the current approach adopted in CIFIUS separately.
- 2.19 Similarly, in reforming merger control, the current regime for reviewing plurality of the media needs to be aligned such that its processes and timeframes are brought together with the timeframes and processes for the reforms to merger control more generally.
- 2.20 The assessment of dominance and antitrust also needs to take account of the impact of abuse on market structure innovation and choice, and not be overly motivated by efficiency concerns.
- 2.21 **Speed**. The slowness of competition enforcement, particularly in antitrust cases, as exemplified by the ponderous Google case, is cause for concern in

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<sup>87</sup> See Report here:  
<https://www.publications.parliament.uk/pa/ld201516/ldselect/ldcom/129/129.pdf>

fast-moving markets: we echo the House of Lords Recommendation that the Competition authorities make greater use of 'interim measures' impose time limits on commitment negotiations, and take additional steps to make enforcement more responsive.<sup>88</sup>

- 2.22 **Process reforms.** Change is needed to speed up processes and practices. Simple things like types of data, length of submission, use of modern technology, timescales and page limits for submissions and decisions. The output has to be faster decision making and prosecution of breach.
- 2.23 **Institutional change.** The current system of law is based on a European administrative model. By comparison the US adopts a more "Anglo-Saxon" approach, giving the Department of Justice the role of prosecutor of those that break the law. Timidity in prosecution is the hallmark of administrations that have not been set up, staffed and organised for the purpose. Prosecution of the law without fear or favour means taking cases and probably losing a few. This isn't foolhardy courage, but where cases are not tried, bad behaviour continues unchecked. An enforcer's job, done well, changes the climate and the culture. Change means that people do things differently every day. Behaviour changes. As anyone who has been on a diet knows, constant reinforcement is necessary. The UK has to review whether a change to a more prosecutorial model is appropriate by 2019.<sup>89</sup> It is hoped that such a change could now take place, with a renewed mandate and remit.
- 2.24 **Pro innovation competition law and policy.** The Ministerial Steer needs to be reviewed and greater emphasis placed on innovation given the issues identified in this paper. The UK will need to review and create new block exemptions and domesticate EU competition law, as soon as possible, in the light of impending Brexit. In doing so there is an opportunity to adopt more pro-small business and pro-innovation approach to the interpretation and application of competition law.
- 2.25 **Collaboration agreements and commercialisation agreements.** Clear safe harbours are needed for collaboration between small businesses that supports and promotes innovation, collaboration and commercialisation of innovation. For example, the technology transfer block exemption needs to be revisited and recast, among others. The R&D block exemption and the approach that the UK takes toward commercialisation and government procurements needs to be reviewed and reformed.
- 2.26 **Compensatory damages for breach of the law mean the lawbreaker can profit from its wrongdoing.** Because compensation does not

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<sup>88</sup> See Report here:

<https://www.publications.parliament.uk/pa/ld201516/ldselect/ldcom/129/129.pdf>

<sup>89</sup> The UK Secretary of State has to lay before Parliament a report on the outcome of the review of the Competition Act within five years of the 2013 Enterprise and Regulatory Reform Act, which came fully into force in April 2014. See:

<http://www.fieldfisher.com/publications/2013/06/reform-of-the-uk-competition-regime-the-competition-provisions-of-the-enterprise-and-regulatory-reform-act#sthash.Cdhk8s4J.dpbs>

deprive the lawbreaker(s) of the profits of wrong doing, the basis for damages for breach of competition law should be revisited with the default setting turned to one of disgorgement of ill-gotten gains rather than simple compensation for the victims. This is a particular problem where the perpetrator is a dominant online platform because its actions affect many smaller businesses, to only provide compensation to the small players for their small losses, rather than deprive the platform of its gains. Since the platform's gains can be many times the size of the small player losses compliance is unprofitable.

2.27 This leads to the unjust position that continued compliance is unprofitable. In simple terms breaking the law pays the wrongdoer. The idea that compensation is enough where price fixing cartels and such practices, is also peculiar. The English courts have established that there is a right to penal damages on an exceptional basis and the common law recognises that in certain circumstances that the rule of law demands an account of profits or the disgorgement of unjust enrichment. Competition policy and the gains from a truly innovative market place are a public good; society benefits from general compliance. The law should specifically seek to ensure that justice does not allow the guilty to profit from their own wrong.

2.28 Further responses to issues identified by the House of Lords:

### ***Antitrust***

- ***Post-Brexit, to what extent should the UK seek to maintain consistency with the EU on the interpretation of antitrust law? What opportunities might greater freedom in antitrust enforcement afford the UK?***

As described above we believe that the law is sufficiently broadly based to accommodate a greater emphasis on innovation and choice. There is thus no need for change to the substantive legal provisions but a great need to change the policy priorities, approach and practices and procedures of the authorities. The opportunities for fuller enforcement of anti-trust would potentially be the benefits of more open markets and the manifest economic and wider social benefits that they would bring. Productivity gains in the short term could be very significant.

- ***Will Brexit impact the UK's status as a jurisdiction of choice for antitrust private damages actions?***

Brexit could impact the UK's status as a jurisdiction of choice. The current system of law in the Netherlands in particular is improving and EU and domestic court enforcement may in the future operate in a more coordinated fashion, being managed within the same political system. Lack of experience with disclosure in continental jurisdictions and time limits for limitation periods may benefit the UK, but it has to be noted that recent English court cases have acted to the detriment of the UK position in this

regard, with both restrictive interpretations of the ability to obtain damages, length of the time period over which damages can be accrued, and in the light of overly long official enquiries and restrictive application of the opportunities for collective actions, all of which potentially undermine the position for plaintiffs in the English courts and the UK position as an attractive location for such cases in the future.

- ***Post-Brexit, what is the likelihood of UK authorities conducting parallel investigations with the European Commission or national competition authorities of EU Member States? What would the implications of this be?***

The authorities currently collaborate through a loose intergovernmental arrangement, the ICN, which can be expected to continue.

- ***Is a post-Brexit competition cooperation agreement in the mutual interest of the EU and the UK? What provisions would be necessary for such an arrangement to be effective?***

In short it will continue to be in the economic interests of the UK and EU to collaborate, as is the case today, but post Brexit political motivations may be harder to determine and we should not be complacent.

- ***How will Brexit affect the CMA's ability to cooperate with non-EU competition authorities? What impact might there be, if any, on the UK's influence in developing global competition policy?***

The CMA could, if it adopted a leadership role, lead the world in addressing the manifest economic consequences that arise from historically lax enforcement of the system. This could drive economic and social benefits to the UK more generally. The last 18 months have seen a considerable increase in the levels of activity at the CMA which should be encouraged and supported, with a renewed emphasis on innovation, and choice.

- ***Will it be necessary for the UK and EU to agree a transitional arrangement for antitrust enforcement after the UK's withdrawal from the EU? If so, what transitional issues would such arrangements need to address?***

We believe that transitional arrangement will be needed for ongoing cases, transfer of cases between authorities, cases straddling the exit date and the like, whether mergers or broader antitrust enforcement activity and enquiries.

## **Mergers**

- ***What opportunities does Brexit present for the UK to review national interest criteria for mergers and acquisitions? What might the advantages and disadvantages of this be?***

We have provided above detailed views on change to the assessment criteria and merger thresholds. The advantages are all to be expected from properly functioning and open competitive markets together with additional social benefits from an approach that supports innovation.

- ***Does the Competition & Markets Authority (CMA) have the capacity to manage an anticipated increase in UK merger notifications post-Brexit? Could regulators with concurrent competition powers, e.g. Ofgem and Ofcom, play a greater role?***

Capacity management could be easily addressed if the UK were to take a sensible and practical approach to mergers that raise no competition concerns. Currently many mergers are notified to the EU authorities that have to be notified under mandatory filing requirements, whether or not they raise substantive issues. A simple liaison and assessment triage system would be possible whereby a deal notified in Brussels but which raised no concerns would not require further notification in London. Transactions likely to raise concerns could be called in. The current system is voluntary and much could be achieved using the confidential guidance procedure, which would be in the interests of all concerned, within the current voluntary notification system.

- ***How burdensome would dual CMA/European Commission merger notifications be for companies?***

As described above a pragmatic approach could be taken that would not have major impact, but some quantitative assessment could be made by the CMA focused only on increased workload for current EU phase 2 deals.

- ***How likely is it that parallel merger reviews by the European Commission and CMA would lead to divergent outcomes? What would be the likely implications of such a scenario?***

Authorities can be expected to seek avoid divergent outcomes, but, as a matter of principle, there is some scope in the current system and it is logically inevitable that the jurisdiction with the strictest approach to enforcement will generate the most attention. By the same token the weakest and most ineffective jurisdiction will receive the least attention. Stricter enforcement has manifest economic benefits and any marginal increase in resources should be calculated, bearing in mind the potentially enormous economic and social benefits from more open and better functioning markets.

- ***Do either the CMA or the European Commission currently cooperate with other non-EU national competition authorities on concurrent merger reviews?***

Yes in loose terms through the approaches and coordination of process in the ICN. The EU and CMA also has regular cooperation with the USA, Australia, New Zealand, and Canada. See, for example, EU US cooperation best practices.<sup>90</sup> Post-Brexit, new agreements will need to be reached with a series of countries to mirror the EU position.

- ***Will it be necessary for the UK and EU to agree a transitional arrangement for merger control after the UK's departure from the EU? If so, what transitional issues would such an arrangement need to address?***

In brief the answer would be yes, and would need to be aligned in the same ways as the approach toward merger control, in accordance with our responses to the same issue above for merger control. Such arrangements will need to be concluded as soon as possible to maximise certainty for business.

### ***State Aid***

We have provided our general views on state aid above and will provide further specific comments in due course where appropriate.

15 September 2017

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<sup>90</sup> EU-US 'Best Practices on Cooperation in Merger Cases'.