frontier economics

The new age of antitrust

A VIEW ON THE YEAR AHEAD

Competition matters were in the public eye last year as rarely before, raising questions as to whether the structure of competition law needs to be updated for the modern age. Claims that globalisation has resulted in markets becoming more concentrated have led to calls for a revised approach to antitrust, while the rise of a clutch of technology giants has fuelled global concerns that competition law may be unable to deal with the issues they raise. Even in more traditional industries regulators are getting tougher and investigating with unprecedented rigour. This bulletin looks at how the authorities have been reacting to these developments and how their responses might influence case work in 2018 and beyond.

As we enter 2018, competition authorities around the world are under public pressure as market developments – most obviously in 'big tech' – have sparked concerns that competition law enforcement, as it currently stands, is not fit for purpose. There is unease, first expressed in the US, that markets are becoming more concentrated and that profits across the economy are increasing, perhaps driven by increased market power.[1] The Economist magazine has voiced similar worries, focusing in particular on the control of data and the power of internet giants such as Google, Amazon, Facebook and Apple.

Competition authorities are reacting to this changing environment by looking to sharpen old tools. They're also seeking to use the flexibility of the current framework to construct new economic theories of harm that tackle these emerging issues. This bulletin explores these developments. In particular, it describes how older theories of harm have been upgraded and made more sophisticated; it identifies innovative theories that capture behaviour that would previously have been difficult to regulate; it then looks at how the authorities have been rising to the challenges posed by large online firms.

Toughening up the tools of antitrust

Coordination

At the heart of the concern that markets have become too concentrated is the view that the incentives for oligopolies to compete have diminished. Each rival knows that any attempt at aggression would be met with a swift response and so prefers instead to coordinate its behaviour with its competitors.

Tacit coordination (as opposed to explicit cartel agreements) is not illegal in and of itself. But regulators can intervene to stop mergers that might make such coordination easier. The importance of coordinated effects as a tool of merger enforcement was largely substantially reduced after a successful appeal of the landmark Airtours decision in 2001, which rejected the European Commission's somewhat ad hoc approach to its analysis of the deal. The Commission preferred to pursue cases on the basis of unilateral concerns, and revisions to the merger test following the EC Merger Regulation in 2004 gave it greater scope to do so.

[1] Shapiro, Antitrust in a time of populism, October 2017, https://faculty.haas.berkeley.edu/shapiro/antitrustpopulism.pdf

However, concerns about coordinated effects are making a comeback. In the merger between Italian mobile operators Hutchison and Wind, the Commission for the first time made a detailed finding of coordinated effect concerns against the merging parties after a detailed Phase 2 investigation. Elsewhere, the Commission has actively pursued remedies in cases where it considered that even very small players constituted an “important competitive force” – a concept closely linked to the ability of a small ‘maverick’ firm to disrupt coordination between larger players.[2]

More generally, concerns that market structure is limiting competitiveness are on the rise. BEREC, the collective body of European Telecoms regulators, continues to push for greater powers to regulate what it terms “tight oligopolies” that might fall short of the evidential hurdle of establishing coordination (so-called “joint dominance”). Outside the telecoms sector, some researchers are building an evidence base that a high degree of common ownership by a small number of investment funds is eroding competition. The OECD held a discussion on the topic in December 2017, and it was ominous that the Commission carried out a detailed analysis of common shareholding for the Dow/DuPont merger in 2017. Its report cited some of the academic evidence and concluded that the agro-chemical industry was one with “a concentrated shareholder structure” and that “the presence of [a] significant level of common shareholding tends to lower rivalry”.[3]

Excessive pricing

Article 102 TFEU prohibits the abuse of dominant market positions. Typically, authorities are concerned about the means by which a dominant position is created or preserved (so-called exclusionary abuse cases), rather than the end that is thus gained (excessive prices). In part, this may reflect the case precedent in relation to excessive pricing cases. This identifies no clear benchmark against which prices may be judged to be excessive, and requires a consideration of whether the price was “unfair”.[4]

However, recent years have also seen a revival of excessive pricing cases, across a variety of jurisdictions. The Italian Competition Authority found in 2014 that Aspen Pharma had increased the prices of certain cancer drugs by an excessive amount (and the EC opened similar cases against Aspen in other jurisdictions in May 2017). In the UK in 2016, the Competition and Markets Authority (CMA) made a similar finding against Flynn Pharma and Pfizer in connection with the price of phenytoin, an anti-epilepsy drug. The CMA announced in November 2017 a provisional finding against Concordia over the excessive pricing of liothyronine, a thyroid hormone, and has another excessive pricing case in the pipeline in relation to hydrocortisone, a steroid medicine.

One area which might lead to investigations follows a case involving the Latvian Collecting Society (LCS), which is responsible for licensing the public performance of musical works and collecting the resulting royalties. The Latvian Competition Authority argued that the fees charged by the LCS were considerably in excess of those levied by collecting societies in Lithuania and Estonia. The European Court of Justice (ECJ) found that a rate could be qualified as “appreciably higher” if it was both significantly higher and persistent, although the court did not formally define significance.

Appeals against several of the pharmaceutical cases are underway. It will be interesting to see whether, if the appeals are rejected, competition authorities are emboldened to cast their nets wider than the pharmaceutical sector (we return to this issue below).

Bundling and foreclosure

Competition authorities have typically treated mergers of complementary products more leniently than horizontal mergers. Vertical issues have rarely resulted in material concerns, at least since the publication of the EC’s non-horizontal merger guidelines in 2007.

However, there are signs that non-horizontal mergers may be attracting greater scrutiny. In 2017, the Commission blocked the proposed merger between Deutsche Börse AG and the London Stock

[2] For example, the divestment of Vodafone’s fixed internet and TV business following its joint venture with Ziggo in the Netherlands.

[3] EC Dow/DuPont decision of July 23, 2017 – Section 8.6.4.1 to 8.6.4.3.

[4] See the small number of cases explored in: http://ec.europa.eu/competition/international/multilateral/2011_oct_excessive_prices.pdf

Exchange Group (LSEG) at least partly on vertical grounds, due to LSEG's ownership of LCH.Clearnet, a provider of clearing services. The Commission expressed concern that the merged entity would be able to use LCH.Clearnet to foreclose rival suppliers of trading and other services. Furthermore, it rejected the parties' proposed remedy – the divestment of part of LCH.Clearnet – on the grounds that the divested business would itself be vulnerable to vertical foreclosure. And in 2016, the CMA forcibly unwound the acquisition of Trayport by ICE – a tie-up between a trading exchange and a provider of software used by traders on that exchange – on purely vertical grounds. The decision was upheld on appeal in 2017.

The analytical tools for testing non-horizontal concerns are also improving. The Tesco/Booker merger in the UK, which was primarily a vertical transaction between a grocery retailer and a wholesaler, resulted in extensive scrutiny throughout 2017 before it ultimately won unconditional clearance in December. This case contained the most extensive economic analysis yet seen of the incentives for a merged entity to engage in foreclosure of its rivals.

In the US, the decision of the DoJ in November 2017 to litigate the proposed AT&T/Time Warner merger on the basis of vertical concerns (the parties are a telecoms/infrastructure provider and a supplier of TV content) has also been viewed as a break from normal practice. Merging parties in 2018 would therefore be advised to take non-horizontal issues seriously.

Dynamic competition and innovation

The 2017 merger between Dow and DuPont raised concerns in the EC about a reduction in innovation in the pesticides sector, prompting it to require the divestment of a substantial part of the merged entity's global R&D capability. The Commission put considerable thought into the analysis of innovation competition and the economic incentives for firms to invest after their merger. Senior EC economists have subsequently published theoretical papers investigating this issue (and supporting the findings in the case of Dow/DuPont).[5]

The EC and other authorities have historically been concerned about overlaps in innovation pipelines, where merging parties have products in the R&D phase that will subsequently compete with their existing products. The novel development in the Dow/DuPont case was that the Commission was worried about a reduction in future, unspecified R&D rather than about products that were some way down the R&D pathway.

There is an analogy here with the CMA's approach to prospective competition in retail merger cases. Typically, the CMA has been bothered about overlaps in both existing sets of stores and stores that are on the drawing board and may create further overlaps. In the 2014 *Pure Gym/The Gym* case, the CMA identified an additional concern around a "loss of future competition in unspecified areas" – in other words, that the merging parties might scale back their expansion plans in areas that were not currently on the radar. This concern was exacerbated by the fact that the merging firms were the only gym chains that had a particular low-cost business model, and that both were expanding rapidly.

Both examples appear to reflect a desire by the authorities to maintain existing levels of dynamic competition, not just static competition. Again, this suggests that merging firms should consider carefully the implications of their transaction for medium-term investment and innovation decisions, and not just for current or shorter-term levels of competition.

Information exchange

Competition authorities have increasingly been raising concerns about the nature of information exchanged between firms. Any sharing of information on future price intentions with direct competitors has been proscribed since at least the 2009 opinion of Advocate General Juliane Kokott in the *T-Mobile* case in the Netherlands. More recently, the authorities' eye has turned to areas where it may be more ambiguous whether the information that is being shared is for benign reasons (e.g. to facilitate commercial transactions) or for malign reasons (e.g. to coordinate future conduct).

[5] Federico, Giulio and Langus, Gregor and Valletti, Tommaso M., A Simple Model of Mergers and Innovation (June 29, 2017). CESifo Working Paper Series No. 6539. Federico, Giulio and Langus, Gregor and Valletti, Tommaso M., Horizontal Mergers and Product Innovation: An Economic Framework (July 10, 2017).

One area that has been of particular interest in this context is wholesale financial services. The EC has prosecuted a number of cases in major over-the-counter (OTC) markets in recent years: interest rate derivatives, credit derivatives and foreign exchange derivatives. OTC markets are those where financial products such as bonds, shares and derivatives are traded bilaterally as opposed to through a central exchange. They account for a substantial proportion of the activity of the wholesale financial sector. Such markets are opaque – there is no clear, single, measure of the "price" of the product at any point in time – and feature actors whose role is to help intermediate between buyers and sellers of the products.

In each of these cases, anti-competitive information exchange has been at the heart of the EC's concerns. In particular, the dual role played by banks and brokers as both buyers and sellers of the product has made it difficult for the Commission to distinguish between benign and malign behaviour. For instance, when a bank approaches another bank in connection with a trade, is this a genuine requirement for the trade to happen or an attempt to coordinate the prices charged to third parties? If banks discuss common issues around market infrastructure – such as central clearing or standardising contract terms – are they acting to ensure the efficiency of the market or to foreclose potential competitors? A number of these cases have been either settled or dropped by the Commission, but two remain under appeal: ICAP in the Yen Libor case and JP Morgan, HSBC and Crédit Agricole in the Euribor case. ICAP was successful in part of its appeal at the EU General Court at the end of 2017, while the Euribor appeals are currently in front of the General Court.

The new battlefield regulating 'Big Tech'

The new economy is likely to be at the sharp end of antitrust regulatory interest. Competition authorities will continue to expand their scrutiny of large online firms, particularly the "GAFAMs" (Google, Amazon, Facebook, Apple and Microsoft). A wider debate is taking place about the appropriate nature and extent of supervision of these firms, including competition regulation. *The Economist* has been especially active in pushing the idea that there should be greater competition oversight of large online firms, pointing to their control of large quantities of customer data. The magazine has suggested greater scrutiny of the merger activity of these firms.[6] Other commentators have expressed similar views.

Competition authorities are increasingly active in identifying concerns with behaviour by the GAFAMs that falls within their remit. The EC fined Google €2.42bn in June 2017 for abuse of dominance related to preferential treatment given in its search results to its own comparison shopping service. The Commission has two other investigations into Google underway, in relation to Android and AdSense, and has concluded that its comparison shopping findings provide a framework for further cases.

Facebook has also been the subject of competition scrutiny, primarily at national level. A preliminary assessment by the Bundeskartellamt in December 2017 explicitly identifies concerns about the social network's control of data, specifically data garnered from third-party websites. Facebook is also under investigation by the French competition authorities in relation to the online advertising market.

Amazon has also come under investigation by the Bundeskartellamt in connection with price parity clauses. More recently, it has been the subject of scrutiny in the US following its acquisition of Whole Foods and a widely read article in the Yale Law Journal entitled "Amazon's Antitrust Paradox".[7] Amazon and Apple agreed to cease exclusivity arrangements in audiobook supply and purchase early in 2017, although Apple's recent issues with the EC have related more to its tax affairs than to competition concerns per se.

Microsoft's acquisition of LinkedIn led to potential non-horizontal merger effects. The EC was concerned that Microsoft could have used its strong position in software and operating systems for desktop computers to give LinkedIn preferential treatment, to the detriment of other professional social networks. Microsoft was obliged to give commitments to allay such concerns. It agreed to maintain interoperability between its software and alternative social networks, and to ensure that LinkedIn was not required to be pre-installed on new Windows computers. The EC was not, however, concerned

6 The Economist, "The world's most valuable resource: regulating the internet giants", May 6, 2017.

7 "Amazon's Antitrust Paradox", Lina Khan, Yale Law Journal, vol.126 no.3 (available at https://www.yalelawjournal.org/note/amazons-antitrust-paradox).

about the combination of the two merging firms' data from the perspective of advertisers, pointing to the large quantity of alternative data in existence.

Given mounting public pressure on governments and regulators in relation to the behaviour of large online firms, it seems likely that regulators will continue to test and probe these firms for competition violations. Combining our two key themes, one may expect that national and supranational competition authorities will become increasingly creative in finding ways to use their powers to scrutinise the GAFAMs. One further example of this unfolding trend is that Germany has amended its merger notification thresholds, previously based on turnover, to include a "value of transaction" test. In principle, this will allow the Bundeskartellamt to scrutinise acquisitions of firms which at present have only limited turnover in Germany but may grow rapidly in future – and hence would be subject to the value of transaction test. It has been suggested that this change in the law was a reaction to Facebook's acquisition of WhatsApp in 2014.

Conclusion

Competition authorities have substantially expanded the scope of their investigations over the last few years in response to changing market developments. There is every reason to think that they will continue to do so in 2018 and beyond. We are potentially entering a new, more interventionist era, as regulators respond to the political and economic challenges created by globalisation. There is growing public concern that competitive success is being concentrated in the hands of a small number of superstar corporations. Similar motivations emboldened the first wave of "trustbusters" in the early part of the 20th century. If history repeats itself, the trustbusters will be armed this time with 21st century economic theory and more analytical firepower than ever before.

Large firms – most obviously the GAFAMs – and merging parties generally would be well advised to cast the net widely in carrying out competition law risk assessments, and should be prepared for ever greater scrutiny of their behaviour and transactions.

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