

**SHAPING COMPETITION POLICY IN THE ERA OF DIGITIZATION
A RESPONSE TO DG COMP'S CALL FOR CONTRIBUTION**

A renewed conglomerate effect approach might be relevant to cope with perennial high-tech innovation - *Fayrouze Masmi-Dazi, Avocat à la Cour, Partner*

On a Monday afternoon in August 2015, markets learned about the restructuring of Google into the technological conglomerate Alpha-bet. And just as Google is indeed no longer only a search engine, Facebook has long ceased to be just a social network, and Amazon has clearly moved beyond being just an e-commerce company. Today's tech giants navigate in fast, everchanging ecosystems where they continuously fight to gain, expand and retain access to current and potential customers both through internal innovation and an apparently inexhaustible thirst for acquisition.

This shift of paradigm has pushed competition authorities to undertake several initiatives to understand the quick technological developments through sector enquiries, joint studies on big dataⁱ, algorithmsⁱⁱ, and online advertisingⁱⁱⁱ.

In early 2018, DG COMP not only announced studies on algorithms^{iv} but it remains to be seen whether algorithmicians (and not only lawyers and economists) will be invited to comment. Numerous exchanges with algorithmicians taught me how precious their technical and operational vision is for the purpose of a sound antitrust analysis and the Commission should be invited to add such professionals to their panel of stakeholders.

DG COMP also called for contributions on reshaping competition policy in the digitization era^v and the present document is an individual response to it on some of the aspects outlined in the call for contribution.

These giants of our times are not only enablers in the digital economy. They are also multiple service providers and are in a permanent trade-off between each of these roles. The quest for diversification is, to some extent, very similar to the conglomerate-like model yet with substantial differences which are worth discussing. The recently announced investigation against Amazon shows that this positioning is worth examining from an antitrust perspective.

From a competition law perspective, the natural playground for a conglomerate effects analysis is merger control. However, there is a sharp contrast between the EU and the US approaches. For example, in 2001, a senior official of the Justice Department made this comment: *"After fifteen years of painful experience with these now long-abandoned theories, the U.S. antitrust agencies concluded that antitrust should rarely, if ever, interfere with any conglomerate merger. We simply could not identify any conditions under which a conglomerate merger, unlike a horizontal or vertical merger, would likely give the merged firm the ability and incentive to raise price and restrict output."* In addition, the Department of Justice cleared the GE/Honeywell merger in 2001 and the Qualcomm/NXP merger in 2017, both without any remedies.

In contrast, in 2016, the European Commission seemed to rediscover the theory of conglomerate harm, as illustrated by its imposing clearance conditions in cases such as the Dentsply/Sirona; Atos/Worldline/Equens/Paysquare; and Microsoft/ LinkedIn transactions. But this approach has been restricted to a limited number of transactions and applied rather traditionally.

The acquisition of WhatsApp by Facebook or Double Click by Google could have been an opportunity to develop a new conglomerate approach. Yet, much of the debate here focused on issues such as jurisdictional thresholds, absence of overlaps, multisided markets, network effects, free services, data and privacy rules. Much less has been written on the potentially anticompetitive conglomerate effects these types of transactions might cause. This is of special concern on the fringe competitors which are often startups - ecosystems that tech giants contribute to creating, absorbing and destroying along their perennial cycle of expansion.

The point here is not to enter the on-going debate whether antitrust policy should shift from allegedly protecting consumer welfare, or competition, or the competitive process^{vi}. Ultimately, there might be a room for all of these concerns to be included in an antitrust analysis. The point is, rather, to revisit the conglomerate effects approach to better understand the potential anticompetitive effects caused by the tech giants' strategies of expansion through both acquisitions and aggressive market behavior. The seeds of this idea germinated with the very interesting point made by Thibault Schrepel on the need to recognize what he calls "predatory innovation" but which is interesting to develop in the context of a more global strategy of tech giants not only vis-à-vis one market but towards a whole ecosystem with multiple related markets.

The present paper will therefore support the case for a renewed approach to conglomerate effects in the field of merger control to address the high-tech market specifically (1). It will also put forward a rather neglected idea in the antitrust literature, but which relevance is confirmed by the recently announced Amazon investigation^{vii}—the case for conglomerate dominance abuse in the tech sector (2).

1. Rethinking the merger approach towards tech conglomerate strategies of startup acquisitions

The pace of acquisitions by Google and Facebook alone would amount to two per month. To say the least, the external growth strategy of these companies rightly raises attention from antitrust enforcers. Most of these transactions do not fall within the EU antitrust radar. This is because Google and Facebook target startups with limited turnover but a high potential for synergies, and that sometimes leads to high strategic valuations for which the European merger control is not fully armed. Beyond the jurisdictional aspect of these transactions, competition authorities, at least in the EU, are struggling to find an appropriate analytical framework to assess the likely effects of such transactions.

1.1. Cross-dataization may be where the value relies and potential anticompetitive concerns

The Facebook/WhatsApp case illustrates the European enforcers' interest in this subject *and* its limitations in terms of jurisdiction^{viii}. The clearance decision relied mostly on the absence of overlap and focused mainly on a horizontal approach to potential effects, with only some minor non-horizontal effects. In fact, the core rationale of the transaction was the ability to cross-subsidize each activity through data and monetize it in a related market. But that critical fact emerged only with the decision sanctioning Facebook for misrepresentations during the formal review.

The potential risks of “cross-dataization” was examined in 20 paragraphs out of the 200 of the clearance decision in relation to online advertising markets. The Commission excluded any of these effects based mainly on the facts (1) that WhatsApp did not provide online ads (absence of complementary activity), (2) that cross-dataization would require changing WhatsApp’s privacy policy (contractual barrier), (3) that there were relatively low incentives to cross-dataize for Facebook; and (4) that there was no indication that it would reinforce Facebook’s market power on advertising services.

The Commission’s reasoning might have erred because of misrepresentations made by Facebook. But cross-dataization still remains at the heart of tech conglomerate-like models which are data driven, and none of the criteria examined could properly address the issue that was revealed post-transaction.

A similar concern arises with the proposed acquisition of GitHub by Microsoft. This was one of the biggest buys after LinkedIn. GitHub is the world’s most important platform for developers of open software in open sources, while Microsoft’s strategic positioning focused on closed environments.

It remains to be seen whether this transaction is reportable to a competition authority and how it will be assessed. But it is a perfect example of an acquisition, made by a tech giant, of a startup, where the strategic value is access to the legions of developers (users) who use GitHub’s 85 million code base repository products, so that they can be guided into the Microsoft developer environment “*where the real money is made*”¹.

These two examples contrast with the past rationale for forming a conglomerate which was to diversify sources of income. But now, the move towards conglomeration in the tech industry is mostly driven by the race for perennial innovation (and a fear of displacement), the need for further customer engagement and eager for growth^x through cross-dataization which ultimately can bear new usages and new risks of foreclosure.

1.2. The old conglomerate effect analysis is not fully appropriate but offers a path to reexplore

The basic premise underlying the Commission’s conglomerate effect approach is that market power derived from a portfolio of products may exceed the sum of its parts^x. This remains true, but the analytical framework may need to be refreshed because of special factors in the new mergers.

The traditional concern in conglomerate mergers is that the merged entity would have the ability and incentive to foreclose rivals by leveraging a dominant position in one market into a related market. The Commission traditionally uses a three-step analytical framework. It asks *first*, does the merged firm have the ability to foreclose; *second*, could it have the incentive to do so; and *third*, would the strategy have a detrimental effect on competition?

The Facebook / WhatsApp case has shown that a merged company’s ability to foreclose may not be excluded simply because it would require a change in a privacy policy or because there is no existing complementary activity. I would tend to consider that:

¹ Why Microsoft Is Willing to Pay So Much for GitHub, [Paul V. Weinstein](https://hbr.org/2018/06/why-microsoft-is-willing-to-pay-so-much-for-github), JUNE 06, 2018 : <https://hbr.org/2018/06/why-microsoft-is-willing-to-pay-so-much-for-github>

- Changes of privacy policies are undertaken rather regularly, most recently with the GDPR. Many reasons may cause a change in privacy policies, and changes depend on the unilateral decision of the merged company.
- Technical ability or even technological ability may be rather unpredictable, but there might be a strong case for considering that innovations in tech giant mergers are likely. Technological evolution is so quick, and tech giants have so many innovation resources that work best in syncopation. As a result, it is hardly predictable what tech giants might be able to accomplish, even in a single year, that could dramatically change the picture.
- The conclusion is that the tech giants' existing market power and their unparalleled ability to innovate makes their ability to foreclose likely. This is true even though they are constantly challenged in their activities and despite (or thanks to) the risk of displacement caused by the innovation process.
- Incentives to foreclose may be less clear unless we speak about incentives to foreclose through cross-dataization.

Tech giants acquire data not only to serve actual related products or services but to fuel future but as yet unknown challenges with expansion and innovation. Cross-dataization is an essential part of the rationale of these transactions. If leveraging data enables expansion, innovation, or new uses that can displace old ones, then there might well be an incentive to foreclose. However, this may hardly fit into the traditional profit-based analysis of incentives to foreclose. It may, for example, be “profitable” to strengthen customer engagement through cross-dataization. This may ultimately increase online advertising profits, for example. But it is hard to demonstrate during a merger control process how some future and theoretical exploitation of data may change how a market may function or how it may lead to new usages.

Another substantial difference with the traditional conglomerate approach is that foreclosure in high tech markets may occur in several related economic activities, and not only in one market. It may be that a change affects one side of the fringe at some point, another side of the fringe at another. It is the combination of isolated, sequential, but multiple impacts, first on one fringe and then another that may lead to risk of foreclosure.

A fringe competitor's ability to compete may be substantially harmed by a tech giant's arsenal of new data, its unparalleled ability to exploit qualitative information, and its ability to deploy new or modified services which are ultimately monetized either in the same or another related market, including presently unknown markets.

Another challenge for competition authorities in their merger review is to substantiate whether these effects may be anti-competitive. But this challenge is linked to the informational problem they face.

Competition enforcers may conduct a market test. But it is not always undertaken. While market tests are not relevant in all cases, perhaps they should become mandatory in high tech mergers, because of the lack of information the competition authorities presently have on these mergers.

There is another informational problem. When a market test is conducted, it is based on the contacts that the notifying party provides to the competition authorities. But these may be to some extent incomplete –even if not deliberately. Competition authorities cannot see what is not

submitted to their review during the merger control process. There might well be a need for a wider information call in high tech mergers, to collect the most comprehensive data on possible anti-competitive effects in related markets and ecosystems. Without much more information, it would be difficult to analyze or challenge a notifying party claims about proteiform competition at the fringes, which may, in fact, be hurt or destroyed by the contemplated transaction.

In sum, there appears to be a room for a refreshed conglomerate approach in merger control to capture the impact of transactions in high tech markets where most of the business rationale lies in cross-dataization.

On the market conduct side of the problem, competition authorities seem to struggle finding an appropriate way to address market behavior of tech giants. In particular, they seem unclear about what could be new predatory strategies that affect multiple yet related markets where fringe competitors exist.

2. Building a theory of conglomerate dominance abuse in the tech sector

As we just saw, merger control in the tech sector is constrained by several limits. But the antitrust treatment of possible market conduct abuses in the tech sector is even more of a fallow land. Competition authorities may be in the beginning stages, but they struggle to find an appropriate way to address possible issues.

Several commentators notably renowned economists have noted an enforcement gap in this field^{xi}. Antitrust enforcers seem to lack rapid, efficient, and effective means to address these concerns. Market studies are useful to fill an informational problem. But they do not morph into antitrust enforcement.

End-users to whom the services are provided may not feel particularly harmed, since services may be provided, improved, customized to their ultimate benefit, and sometimes may even be given for free. Except for privacy concerns (which are being tackled by regulations such as RGDP), users will probably not be the complainants. But on the other side of the spectrum, there is a wide range of enterprises, from startups to big companies, who may depend on these tech giant's technologies and data.

Those "fringe" competitors who do not intend to displace tech giants from their core activities (at least immediately), use their services and innovations as inputs for their own services. Tech giants act as enablers for them, and even accelerators to some extent. But tech giants will always reserve the option to provide the services directly to the users at some point; or to make users pay even when the services began as free. This is because tech giants constantly cycle between their roles as enablers and their roles as services providers. It is interesting to note that the recently announced investigation against Amazon, precisely on these grounds, has been undertaken. The outcome of such investigation will probably be heteronormative for the future approach towards similar problematics undertaken by comparable market players in other sectors.

2.1. Refreshing the theory of harm

The old theory of harm in conglomerate mergers, described by the Commission in a 1989 study^{xii}, relied mostly on predation, entrenchment strategies and reciprocity. As the study emphasized, "*conglomerates can, more readily than other enterprises, adopt predatory strategies by using their*

financial reserves to eliminate competitors from some of their sectors of activity. Even if a firm does not utilize such a strategy, the fact that it has the necessary means can be enough to discipline smaller competitors. More important however, is the anti-competitive effect arising from mutual forbearance: when conglomerate firms have an overlapping presence in a range of markets, they may be reluctant to compete against each other (the discipline effect)”.

In the digital era, several of these basic premises do not fully apply for the following reasons.

- Until very recent times, and the emergence of a theory of predatory innovation, the conglomerate analysis was focused on tying (even technological tying) and pricing predatory practices. Some of these concepts might still prove helpful to analyze some of the practices undertaken as part of a more global predation strategy.

But now, there is an interesting array of new possibilities to capture the strategic moves of tech giants through the emerging theory of predatory innovation.^{xiii} These include the ability to analyze a multitude of isolated behaviors, that each impact distinct sides of the fringe, and to determine whether they form one single global strategy.

- The discipline effect as conceived may also not fully apply in the digital era. The fact that tech giants grow does not deter smaller firms from innovating at the fringes. This is, because if they win, they can take the whole market, or because they might end up being acquired by these giants.

However, the tech giants have the ability to discipline the market if their enabling services are indispensable to conduct a fringe business and if they decide to change the terms and conditions of those services. Each time any of the tech giants takes a strategic decision, market players who depend on their enabling services need to adjust their own market positioning. The discipline effect may result in all market players (1) needing to accept the unilateral changes imposed by the tech giants as part of their global strategy; or (2) becoming less competitive where there is no effective alternative; or (3) failing. The digital discipline effect may to some extent enhance innovation. But it remains to be seen whether this effect is legitimate, lawful, or “fair”?

- In addition, mutual forbearance does not work effectively in the digital world. Tech conglomerate giants are in a constant struggle to reinvent themselves, to expand in new usages, and to compete using whatever resources can be exploited. Again, since nothing may be considered as *permanently settled*, there is room for mutual attacks, not only at the fringes, but also at the core of their respective activities, as Amazon’s many conquests illustrate.

However because of the increasing scale necessary to be a mainstream player, it appears that tech conglomerates can compete against each other only if they have a major data base; or an enhanced ability to exploit qualitative information; or significant investments in R&D (22.6 Billion USD in 2017 for Amazon for example^{xiv}). Without these assets, all other competitors remain at the fringe.

2.2. Decpartmentalizing the antitrust approach to address global predation strategies

The types of practices captured by traditional conglomerate analysis may not fully fit with digital challenges. Competition authorities regularly mention the availability of actual and potential

alternatives, including the multihoming practices which would reduce the ability to impose traditional tying practices, even for what has been referred as technological tying.

Cross-dataization, not cross-subsidization, is the main issue to address. Data is their core asset and what makes their expansion to new markets and new usages possible. The problem may not be growth -- as it is also a source of great advantages for consumers. The problem may not be new usages -- as it is a source of innovation. The antitrust problem lies in the (ab)use of their power on the markets through constant innovation and possibly through predation.

As mentioned before, each time any of the tech giants takes a strategic decision, market players who depend on their enabling services need to adjust their own market positioning.

If Facebook, for example, decides to prioritize content over quantity, then downstream players may need to rethink their social media strategy and decide if they want to align their editorial content to the new content that are likely to generate the most comments. Antitrust cannot prevent Facebook from adjusting its own strategy based on what seems to reflect user preferences. That would be a case of antitrust being *misused* to limit, not promote, innovation and consumer benefits.

The only exception would be if the change were adopted only to foreclose downstream players who use social media.

Another example would be if there were a fundamental change in a product or service. Assume that, at its introduction, a service or product is developed that enables third parties to provide ancillary services or improve the way the product works. Now assume that the product or service is modified. It may be improved; or access changed from freely accessible to payable; or perhaps the product or service is replaced by a complete, integrated "internal solution" from the tech giant that provides a "more efficient" service to users by incorporating a range of its own proprietary services. This internalization progressively dries up the fringe market. It does not matter whether some of these proprietary services were acquired or developed by the tech giant. The result is the same: some fringe competitors may be disciplined, and others may exit the market entirely.

In both illustrations, there is no interoperability issue, no tying or bundling practice, maybe a form of predatory pricing but only as part of a more global approach. The backbone of the strategy is that it would be global, unilateral, normative, and based on innovation (internal or acquired). From an antitrust perspective, these actions are illegal only if they are abusive or predatory through innovation.

The point here is that a compartmentalized, traditional analysis of a global strategy is not appropriate. Based on changes in technologies it is now necessary to endorse the idea that predation can be undertaken through innovation in the high-tech world. And it is also necessary to endorse the idea that antitrust enforcement must address global, not just fringe, elements.

2.3. What this means in terms of enforcement

A critical step from an enforcement perspective would be to correct the informational problem. Outside the scope of merger control, competition authorities can undertake market investigations, sector enquiries, or joint studies. This is good -- but not enough because it is too compartmentalized. Competition authorities must make a significant effort to better understand where we stand, where we are heading, why ecosystems emerge as rapidly as they disappear, and why it is so difficult for alternatives to emerge.

It is also critical to create a direct interaction between developers and algorithmicians – the antitrust professionals of the 21st century. I recently passed the door of Vivatech, an annual convention dedicated to technological innovation and startups, held in Paris. There, I saw that while artificial intelligence is at the beginning stage, you can already see first applications emerging. The question is not no longer about algorithms (or pure formulas). Algorithm is a binary language and antitrust enforcers certainly need translators, but artificial intelligence goes much further. Antitrust enforcers need direct contact with innovators (people who speak binary and AI) for antitrust enforcement to be relevant.

There might also be a case for speeding up the timing of antitrust enforcers to intervene. Tech startups do not have the luxury of time or money to wait while traditional antitrust proceedings drag on. And even interim measures, on a shortened timetable, may not even have the expected effect, either because the remedies are not correctly adapted or because new technological developments have rendered them obsolete. The unfortunate case of *Unlockd*^{xv} is a good illustration: *Unlockd* won in two courts but is now in receivership. Situations like this may a strong case for changing the procedures.

Ultimately, the competition authorities might consider more widely using the deterrent effect of sanctions. Sanctions can be financial or behavioral. Some financial sanctions have been stratospheric^{xvi}, but most sanctions remain relatively low compared to the turnover of tech giants. And behavioral remedies may be more valuable, but are extremely hard to design, implement and monitor in the long run. If financial sanctions do not deter and if behavioral remedies are insufficient, then there might be some work to undertake on the reputational side, as the impact of revelations regarding data privacy issues had on Facebook stock valuation illustrates

All in all, there is a need for a further and wider dialogue on issues encountered and alternative solutions. Financial sanctions will not help the emergence of alternatives, and a much-debated question remains whether it is the role of antitrust to go beyond a sanctioning purpose.

Finally, competition authorities, data protection authorities, and consumer defense authorities, so that competition authorities get as much input on how markets function and how consumers can be impacted negatively by changes in market behavior.

ⁱ Joint study on big data – French and German competition authorities
http://www.autoritedelaconurrence.fr/user/standard.php?id_rub=629&id_article=2769

ⁱⁱ Joint study on big data – French and German competition authorities
http://www.autoritedelaconurrence.fr/user/standard.php?id_rub=683&id_article=3196&lang=fr

ⁱⁱⁱ Sector specific opinion of the French competition authority on online advertising
http://www.autoritedelaconurrence.fr/user/standard.php?id_rub=684&id_article=3133&lang=en

^{iv} Statement of commissioner Vestager: <https://www.reuters.com/article/us-eu-antitrust-algorithm/eu-considers-using-algorithms-to-detect-anti-competitive-acts-idUSKBN115198>

^v Call for contribution by DG COMP - Shaping competition policy in the era of digitization,
<http://ec.europa.eu/competition/scp19/>

^{vi} See notably “Before After consumer welfare: a response to Professor Wu” by A. Douglas Melamed and Nicolas Petit:
<https://www.competitionpolicyinternational.com/wp-content/uploads/2018/07/North-America-Column-July-Full.pdf>

^{vii} Thomas K. Cheng, *Sherman vs. Goliath? Tackling the Conglomerate Dominance Problem in Emerging and Small Economies—Hong Kong as a Case Study*, 37 Nw. J. Int'l L. & Bus. 35 (2017).
<https://scholarlycommons.law.northwestern.edu/njilb/vol37/iss1/2>

^{viii} Case COMP/M.7217 and M.8228

^{ix} Lim, Yong, *Tech Wars: Return of the Conglomerate - Throwback or Dawn of a New Series for Competition in the Digital Era?* (October 16, 2017). Available at SSRN: <https://ssrn.com/abstract=3051560> or <http://dx.doi.org/10.2139/ssrn.3051560>

^x Smith & Nephew/Beiersdorf/JV Case COMP/JV.54 para. 35.

^{xi} Jorge Padilla during the Conference New frontiers of Antitrust 2018 edition.

^{xii} XIXth Report on Competition Policy (1989) p. 228.

^{xiii} Thibault Schrepel “*Predatory innovation: the definite need for legal recognition*” SMU Sci. & Tech. L. Rev (forthcoming 2017).

^{xiv} <https://www.recode.net/2018/4/9/17204004/amazon-research-development-rd>

^{xv} <http://www.businessinsider.fr/us/hot-tech-startup-unlockd-wins-feud-with-google-2018-5> and <https://www.ft.com/content/99963ace-6e55-11e8-852d-d8b934ff5ffa>

^{xvi} European Commission announced a record fine on Google Android case at 4.3 billion euros on July 18th, 2018 - http://europa.eu/rapid/press-release_IP-18-4581_en.htm