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Merger Control in Fast Moving Markets: Ex Post Assessment

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On June 11 Microsoft announced that it would acquire LinkedIn for $26.2 billion. The transaction will likely be scrutinized by the European Commission ("the Commission") under the European Union ("EU") Merger rules ("EUMR"). As ever, the Commission's assessment will consist in forecasting the competitive landscape, yet with the additional difficulty that the markets under consideration are changing at a rapid pace. With this background, the *Microsoft/LinkedIn* tie-up offers a welcome opportunity to look into the Commission's track record when it predicts the future in fast moving markets. To do this, we have selected four cases: *TomTom/TeleAtlas*, *Oracle/SunMicroSystems*, *Microsoft/Skype* and *Facebook/WhatsApp*. For each case, we compare the Commission's early findings with the post-merger industry evolution.[i]

I. *TomTom/ TeleAtlas*[ii]

In May 2008, the Commission cleared the merger between *TomTom* and *TeleAtlas* following an in-depth investigation of anticompetitive harm, and a consideration of possible efficiencies.

In the definition of the relevant market, the Commission concluded that portable navigation devices ("PNDs") were a market of their own, distinct from mobile telephone with navigation functionality. However, the Commission did not exclude "*that innovation [would], to a certain extent, blur the boundaries between different types of navigation devices in coming years*." The Commission nonetheless proceeded to define a separate relevant market for PNDs.

What follows is well-known business history. Shortly after the clearance, by the last Quarter of 2009, Google Maps was made available for mobile. At the end of 2009, TomTom sales of PNDs declined by 25% year-on-year, and have ever since continued this trend. A look into their annual financial reports shows that revenue derived from consumers (mainly sales of PNDs) had sharply declined during the two following years after the introduction of Google Maps. That is, for the 2010-2012 period from €1.158 mill to €639 mill.[iii]

With this background, the Commission may have underestimated the *pace* – albeit not the existence– of competitive innovation. But the same is true of the merging parties. In its 2011 annual report, TomTom retrospectively explains the "*difficulty to accurately predict the decline in PND demand in Europe and the US*" which was

"*faster than expected*" and which caused the decline of the PND market.

The take away points of the *TomTom/TeleAtlas* decision and post-transaction history are straightforward. On the positive side, a different and more accurate analysis of competitive innovation would have had little consequence. After all, the merger was cleared. On the caution side, the decision displays an underestimation of the intensity and pace of technological evolution. This seems inescapable when the merging parties themselves are not able to predict the evolution of the industry in which they operate.

II. *Oracle/ Sun Microsystems*[iv]

In 2010, the Commission cleared Oracle's acquisition of Sun Microsystems after an in-depth second-phase investigation. A variety of competitive concerns were discussed. Among these was Oracle's acquisition of Sun's IP rights over the Java platform. Java is open software that allows developers to build and deploy software applications.[v]

The Commission tested whether Oracle would have the ability and incentive to degrade the licensing of Java to Oracle's downstream competitors. Relying on Oracle's statements,[vi] it found that the cost of degrading competitors' access to Java IP rights would outweigh the benefits of such action. Due to the strong network effects found on the Java platform, Oracle would lose community support if it ever was to engage into this strategy.[vii]

The Commission cleared the acquisition on January 2010. But contrary to the Commission's forecast, only seven months passed before Oracle sued Google for patent and copyright infringement in relation to the use of Java code in Android.[viii] This dispute is not yet settled. On July 6, Oracle filed a motion for a new copyright trial after Judge William H. Alsup declared that Google's use of Java's API code fell under the fair use exception.[ix]

A retrospective reading of the Commission's decision thus suggests that merging parties' declarations' during the proceedings may not be reliable.[x] We do not contend here that the parties provide misleading information to the Commission. Instead, the point is that in fast moving industries, parties' incentives might change quickly. This, in turn, limits the Commission's ability to safely diagnose the parties' incentives. Besides, it is outstanding that the decision did not give currency to the licensing discussions that had started as early as August 2005 between Sun and Google, and which presaged litigation ahead. In the words of Google's then Senior Vice President Andy Rubin, "*If Sun doesn't want to work with us, we have two options: 1) Abandon our work and adopt MSFT CLR VM and C# language - or - 2) Do Java anyway and defend our decision, perhaps making enemies along the way* (emphasis added)".[xi]

III. *Microsoft/ Skype*[xii]

In 2011, Microsoft took over Skype, leapfrogging a possible acquisition by Google and Facebook. The Commission cleared the transaction in Phase I.

Several providers of enterprise communications services and telecom operators complained that the transaction would create anticompetitive conglomerate effects. Amongst the various theories of harm advanced by the complainants, one of them was that Microsoft would create a preferential connection between Skype's users and its Lync enterprise communications platform, and degrade the interoperability of competing enterprise communications services providers like Cisco with Skype's users. In practice, the concern was that post-merger, enterprises using Lync as the underlying technology for customers' call centres would be – exclusively or preferentially – able to reach out to Skype users,[xiii] and vice-versa. For instance, if MediaMarkt was contemplating

between a Microsoft and Cisco product to run its call centres, only the Microsoft product would entitle it to address Skype users.

The Commission dismissed those concerns. In the first place, it considered that Microsoft lacked the technological *ability* to foreclose the market because Skype did not offer the key functionalities of queuing and routing necessary to run a call centre. The Commission did not reflect any further on whether Skype could, in the future, incorporate such functionalities.[xiv] In the second place, the Commission found that Microsoft had no *incentive* to foreclose given that Skype was not a "*must have*" product.

Ex post merger, however, several of those findings were upset by industry facts. First, less than 4 years after the transaction, Microsoft launched the "Response Group application in Skype for Business Server" providing for the queuing and rerouting functionalities that allegedly impeded Microsoft to "technically" foreclose the market. Interestingly, Microsoft had launched the same application for Lync 2 years before.

Moreover, on the exact day of the hearing of the appeal of the Commission's decision before the General Court, Microsoft announced on Skype's blog that it had enabled the Lync-Skype exclusive connectivity, thereby suggesting that Microsoft had incentives to create a preferential bridge with Skype's users, in contradiction with the findings of the decision.

Microsoft/Skype thus suggests that the Commission may have been overconfident, or that it may have relied excessively on the notifying parties optimistic submissions. An alternative reading is that the Commission has preferred to take an overly cautious approach to 'conglomerate effects',[xv] in line with established decisional practice and judicial precedent.[xvi]

The main take-away point of *Microsoft/Skype* is that a close eye must be kept on post-merger behaviour, even in the absence of a trustee and/or of formal commitments.

IV. *Facebook/WhatsApp*[xvii]

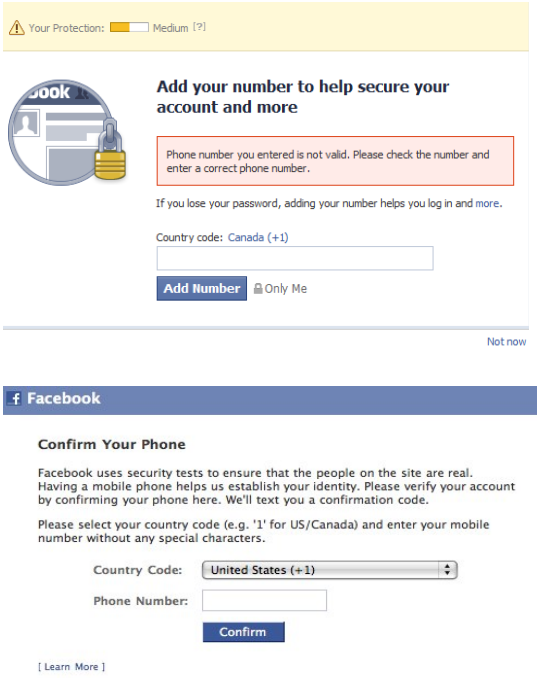
In 2014, Facebook disbursed $19 billion to acquire WhatsApp. This is perhaps the most interesting case of our sample. During the market investigation, several third parties anticipated a risk of anticompetitive integration through cross-platform communication between WhatsApp and Facebook: a Facebook user calls or texts a WhatsApp user through the Facebook messenger; and/or a WhatsApp user calls or texts a Facebook messenger user through the WhatsApp interface.

The merging parties disputed this contention. They said that delivering Facebook text on WhatsApp would require "*matching WhatsApp users' profiles" with their profiles on Facebook (or vice versa*)".[xviii] This would be complicated without users' involvement because Facebook and WhatsApp use different user identifiers: email and mobile phone number respectively. Moreover, this could create a risk of backlash with users that do not want their respective accounts matched. Last, the parties mentioned some "engineering hurdles" that were allegedly too significant to be easily overcome.

The Commission agreed with the merging parties. It considered that "*technical integration*" between WhatsApp and Facebook was unlikely to be straightforward. Moreover, it suggested that integration would not adversely reinforce pre-existing network effects because "*there is already a significant overlap between the networks of WhatsApp and Facebook*", with between 30 and 60% of net users that are common to both platforms. For this, and also other reasons, the Commission cleared the transaction.

With the benefit of hindsight, it is by now apparent that those findings too were overly optimistic. Facebook has already taken many steps to integrate WhatsApp. Here are some examples:

- Through several screens, Facebook systematically requests users to add their phone number to "*secure their accounts and more*";



- New WhatsApp users can avoid creating a profile by linking their Facebook account to WhatsApp;
- When Facebook's contact syncing is enabled on the iPhone, Facebook friends appear in the iPhone's Contacts app, and thus appear in WhatsApp;
- In January 2016, the press reported that an Android developer had noticed the existence of a hidden account settings screen in a Beta version of WhatsApp that invites users to "*Share my WhatsApp account information with Facebook to improve my Facebook experiences*";[xix]
- Every time a WhatsApp user shares his location through WhatsApp the link is sent to the recipient with additional information about the place, using data provided by Facebook.

Besides this, the Commission's market definition analysis is also interesting. The Commission concluded to the existence of a market for consumer communication apps for smartphones, distinct from other platforms like PCs, tablets, gaming consoles and TVs.[xx] Again, the Commission relied on WhatsApp contention that it had no plans to offer its service outside of the smartphone environment.[xxi] However, this finding was contradicted a few months later when WhatsApp enabled in January 2015 a web browser based version of its app and again in June 2016, when WhatsApp launched its desktop app.[xxii] Although the outcome of the decision would have been the same with a larger, all-platform market definition, this shows that the Commission may have overly trusted the merging parties declarations.

A last noteworthy aspect of the *Facebook/WhatsApp* decision is that the Commission never seemed to question the business case behind the $19 billion acquisition. As a result, the issue of data aggregation and data leverage is not discussed in the decision. Inquiring into the "*why*" of the transaction might, however, help competition agencies discover possible anticompetitive risks, and in turn draft more relevant decisions.

Conclusions

To close this short study, we concede that our survey is based on a narrow sample of decisions, which leaves aside many merger cases in which the Commission appropriately forecasted the future. Moreover, within our sample of decisions,

all of the Commission's predictions were not contradicted by subsequent market developments. Last, even if the Commission had made a more accurate prediction, this would not have changed the legal outcome of the proceedings.

Those caveats notwithstanding, we can preliminary make the following findings. *Firstly*, with the exception of *TomTom/ TeleAtlas*, the Commission seems to place much trust in merging firms' stories about their "*ability*" and "*incentives*" to compete in innovation markets. In the light of our *ex post* case studies, the Commission reliance on merging firms' declarations may be excessive, given the risk of opportunistic reporting behaviour. At the same time, we concede that the Commission does not have many other options, in particular in areas where technology evolution is uncertain. This is to be contrasted with areas where innovation processes are well-structured – *e.g.*, like in the pharmaceutical industry – where the Commission may be less exposed to opportunistic conduct.

Secondly, our survey begets the question of the appropriate course of action that the Commission should take when *ex post* merger, the parties behave in ways distinct from what they declared in the context of *ex ante* proceedings. A related, though distinct question, is that of the appropriate course of conduct if a competitive concern that is judged hypothetical during *ex ante* merger proceedings – and accordingly dismissed – becomes an actual market fact *ex post* merger.

If the first question deserves to be treated in line with the principles applicable to the submission of incorrect and misleading information, the second question is more speculative. In our view, there is no obvious reason why the Commission ought not to address post-merger anticompetitive developments under Article 101 or 102 TFEU, possibly with the administration of interim measures. Unlike in *ex novo* proceedings under Article 101 and 102 TFEU, the Commission benefits from a vast amount of readily available market information (that submitted during the merger proceedings), and it can thus leverage this expertise rapidly to restore consumer welfare. Those are small steps towards a more agile competition policy.

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[i] This is not the first attempt to carry out such analysis. Some economic papers have attempted to measure in retrospection the impact of mergers on price levels. *See* for instance Aguzzoni, Luca, Elena Argentesi, Lorenzo Ciari, Tomaso Duso, and Massimo Tognoni. 2016. "Ex Post Merger Evaluation in the U.K. Retail Market for Books." *The Journal of Industrial Economics* 64 (1): 170–200.

[ii] Commission Decision, Case No COMP/M.4854 - *TomTom/Tele Atlas*, 14.05.2008 C(2008) 1859, (hereinafter "*TomTom/ Tele Atlas*")

[iii] The trend continues and according to TomTom annual reports, in 2014 PND volume sales decreased by 11% in Europe and 23% in North America, and in 2015 market volumes have declined by 8% and 22% respectively. TomTom's annual reports are *available at* http://corporate.tomtom.com/annuals.cfm. TomTom's competitor Garmin, saw also a drastic reduction in sales on its PND line. While in 2009 PND sales accounted for 63% of the total revenue, in 2014, that percentage has plummeted to 27%. *See* Garmin Ltd. Form 10-K, Annual Report Pursuant To Section 13 Or 15(D) Of The Securities Exchange Act Of 1934, for the fiscal year ended December 31, 2011, and for the fiscal year ended December 27, 2014.

[iv] Commission Decision, Case No COMP/M.5529, *Oracle/ Sun Microsystems*, 21.01.2010 C(2010) 142, (hereinafter "*Oracle/ Sun Microsystems*")

[v] Whereas Sun provides hardware and software to steer the demand for hardware, *Oracle mainly* distributes software and has a strong presence in the applications market. See, *Oracle/ Sun Microsystems*, at §§2-3 and 844.
[vi] *Oracle/ Sun Microsystems*, at §§849-850.
[vii] *Oracle/ Sun Microsystems*, at §§923-936.
[viii] *Oracle America, Inc. v. Google Inc.,* 810 F. Supp. 2d 1002 - Dist. Court, ND California 2011
[ix] Mueller, Florian, (2016, July 7) Oracle moves for new copyright trial against Google, renews motion for judgment as a matter of law. *Foss Patents*. *Available at* http://www.fosspatents.com/2016/07/oracle-moves-for-new-copyright-trial.html
[x] The case is also well known for its recourse to informal remedies. Oracle publicly committed to a list of ten informal pledges – three of them legally binding vis-à-vis third parties – to keep the MySQL database on the market and open. The Commission took them into account as factual elements that limited both the incentives and ability of Oracle to remove MySQL from the market. See *Oracle/ Sun Microsystems*, at §§616-658. The legality and effectiveness of those informal pledges was later called into question after the decision. In July 2010, Monty Program filed an application for annulment of the *Oracle/ Sun Microsystems* decision. However, the applicant discontinued the action in 2014. *See* GC, Case T-292/10, *Monty Program AB v Commission*, ECLI:EU:T:2014:699.
[xi] *Oracle America, Inc. v. Google Inc*., Dist. Court, ND California 2011 (Order granting in part motion to strike damage report of plaintiff expert Iain Cockburn).
[xii] Commission Decision, Case No COMP/M.6281, *Microsoft/ Skype*, 07.10.2011 C(2011) 7279, (hereinafter "*Microsoft/ Skype*").
[xiii] This would be a massive selling advantage for Lync vis-à-vis competing communications software vendors like Cisco.
[xiv] *Microsoft/ Skype*, at §§214-217
[xv] It seems like the Commission confused what conglomerate effects are about. *Idem*, at §203: "The Commission considers that with regard to enterprise communications services a conglomerate assessment is not relevant since Skype is not active in these markets."
[xvi] Moreover, we note that the question of whether Skype was a 'must have' product should have informed the analysis of anticompetitive foreclosure, not of incentives.
[xvii] Commission Decision, Case No COMP/M.7217, *Facebook/ WhatsApp*, 03.10.2014 C(2014) 7239, (hereinafter "*Facebook/WhatsApp*").
[xviii] *Facebook/ WhatsApp*, at §138.
[xix] Meyer, David (2016, January 26) WhatsApp Account Data Could Soon Be Heading Facebook's Way. *FORTUNE*. *Available at* http://fortune.com/2016/01/26/whatsapp-account-data-facebook/
[xx] In footnote 4 of the decision, the Commission relied on its *Microsoft /Skype* decision to distinguish between PCs, smartphones, tablets, gaming consoles and TVs as different platforms. See also, *Facebook/WhatsApp*, at §§57-59 for the Commission's assessment on market segmentation by platform.
[xxi] *Facebook/ WhatsApp*, at §21.
[xxii] WhatsApp Blog (2016, May 10). *Available at* https://blog.whatsapp.com/10000621/Introducing-WhatsApps-desktop-app?l=en&set=yes