BUSINESS at OECD

**Comments by the**
***Business at OECD* (BIAC) Competition Committee**
**to the OECD Competition Committee**

***The Role of Innovation in Competition Enforcement***

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## I. Introduction

1. BIAC appreciates the opportunity to comment on this important topic.

2. Innovation is an important and legitimate goal of competition enforcement. Innovation is a cornerstone of economic growth, technological advancement, and societal progress. While competition agencies are not responsible for fostering or engendering innovation, they play an important role in ensuring that the actions of companies, either individually or collectively, do not retard or inhibit the opportunities for innovation. Robust competition also encourages investment in research and development, which fuels technological breakthroughs, drives economic expansion, and expands consumer welfare.

3. Competition agencies play a role in preserving innovation competition in several areas, including in merger enforcement, behavioral and antitrust cases. The broad scope of enforcement cases make clear that harm to innovation competition is a fully legitimized basis for enforcement under current competition laws, on equal footing with harm to price or output competition. The ability of agencies to challenge harm to innovation competition is, therefore, well established as reflected in the Secretariat Background Note.[1] There are aspects of enforcement in this area, however, that are less well established, including the standard(s) by which an agency must show an effect on innovation competition.

4. We focus our comments principally on this topic, i.e., the standards applicable to cases based on harm to innovation resulting from mergers or conduct of parties.

5. Competition cases based on innovation theories are different in some respects from cases based on price or output effects. While both cases require some predictive assessment of future competitive impacts, innovation cases rely exclusively on this basis. Merger cases based on price or output effects, for example, can often test (or approximate) the immediate post-merger profit-maximizing price, or optimal output level, of the combined firm, leading to a more immediate assessment of the likelihood of harm on the current market. Innovation merger cases, however, require a counterfactual that predicts whether and to what degree future innovation will impact the future market. These factors are always case-specific and require deep understanding of market dynamics.

6. Innovation theories of harm are particularly challenging because they require agencies to discern and distinguish between probabilities, possibilities, and conjecture. In many cases, reasonable minds can differ on what innovation may result, when it will occur, and the impact it may have. Indeed, the innovating

[1] OECD, The Role of Innovation in Competition Enforcement — *Roundtable Background Note* (2023), https://www.oecd.org/daf/competition/the-role-of-innovation-in-competition-enforcement-2023.pdf.


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parties themselves are often unable to make these predictions or to get them right, with a common theme being a high degree of (over) optimism.[2]

**7.** A key issue in enforcement, therefore, is the standard of proof to demonstrate harm to competition based on innovation theories. As we will see, there is no relaxation of the legal standard of proof required for cases based on harm to innovation. There is good reason to maintain the same burden of proof in innovation cases as in cases involving other type of harm like price effects and output reduction. Otherwise, agencies could more easily prevent mergers with more speculative competitive effects than those with more immediate demonstrable effects, which would be a perverse result. This approach will maintain the predictability, transparency and legal certainty which will not only aid businesses in planning, but also promote investment that is likely to spur innovation.

## II. Legal Standard of Proof for Harm to Innovation: *Meta/Within*

8. A detailed analysis of the legal standard of proof, and factual support, required for innovation competition cases is presented in *Federal Trade Commission v. Meta Platforms* ("*Meta/Within")*.[3] In that case, the FTC sought a preliminary injunction to stop Meta's acquisition of Within Unlimited, Inc., a proposed acquisition in the virtual reality software space involving Within's VR dedicated fitness application. The FTC's theory was based on a "actual potential competition" theory of harm, i.e., that the merger should be blocked to preserve future competition between Meta and Within, and the innovation competition that would result, in that product space.

9. The actual potential competition theory of harm already had been applied by several federal U.S. Courts of Appeal, and the District Court in the *Meta/Within* case applied the theory as it had been proposed by the FTC. Because the FTC was seeking a preliminary injunction, the Court ultimately was required to "1) determine the likelihood that the Commission will ultimately succeed on the merits and 2) balance the equities."[4]

10. But the Court also had to determine what standard of proof to require for the FTC's actual potential competition theory, noting that "[t]here is less consistency among courts as to the proper standard of proof by which the FTC must prove its case on actual potential competition, and it is an issue of first impression within the Ninth Circuit."[5] In a key assessment of this issue, Judge Davila stated:

> [T]he Court begins with [the U.S. Supreme Court's] teaching that Section 7 deals with neither certainties nor ephemeral possibilities but rather "probabilities." In the context of an actual potential competition claim, however, the Court must not only consider the effects of future scenarios where the Acquisition occurs and where it is blocked, but it must also gauge the likelihood—in the second scenario—that the blocked would-be acquirer would enter the relevant market independently. Furthermore, the harm to competition the doctrine aims to prevent is not the loss of present competition but rather the potential loss of a future competitor (the acquiring company). Given the many *a priori* inferences required by the doctrine, the Court is wary of any inquiry that strays too close to the specters of ephemeral possibilities, yet it must nonetheless ensure the standard does not require the FTC to operate on certainties. The Court accordingly holds that the "reasonable

[2] *See, e.g.*, Meta Platforms, Inc. v Competition and Markets Authority, [2022] CAT 26, ¶ 108 (CAT) ("Having identified the nature of the dynamic competition, it is necessary to test whether that dynamic is likely to actually manifest itself. We anticipate that the number of identifiable dynamic elements that actually succeed will be vastly outnumbered by the failures.").

[3] Fed. Trade Comm'n v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238 (N.D. Cal. Feb. 3, 2023).

[4] *Id*. at *8.

[5] *Id*. at *21.

> probability" standard—as clarified by the Fifth Circuit to suggest a likelihood noticeably greater than fifty percent—is the standard of proof that the FTC must present.[6]

11. In short, the Court was unwilling to block the merger on the grounds of actual potential competition without a demonstration that it was *at least probable* that Meta would enter into the market for VR dedicated fitness apps.

12. Digging into that question, the Court went on to discuss the specific evidence it would review to reach this determination:

> [T]he Court will first consider whether the objective evidence presented by the FTC supports the findings and conclusions necessary to satisfy the actual potential competition doctrine. If the objective evidence is weak, inconclusive, or conflicting, the Court will consult subjective evidence to illuminate the ambiguities left by the objective evidence, with the understanding that the subjective evidence cannot overcome any directly conflicting objective evidence.[7]

13. Then, applying the actual potential competition doctrine, the Court posed the determinative question as follows: "Is it reasonably probable that Meta would have entered the VR dedicated fitness app market de novo if it was not able to acquire Within?"[8]

14. In assessing this question, the Court found that Meta unquestionably possessed the financial and engineering capabilities required, but that this was not enough.[9] He found that it was necessary to "counterbalance undisputed financial capabilities with those capabilities unique to the relevant market," ultimately concluding that Meta lacked the "capabilities that are unique and critical to the VR dedicated fitness app market."[10] Those capabilities included critical fitness content and studio production capabilities.[11]

15. The Court also examined Meta's incentives to enter the dedicated VR fitness app market. While it found that Meta had an "undisputed interest in VR fitness," it also noted that Meta's position as a competitor in the VR headset market meant that it "benefits from that growth so long as high-quality VR fitness apps exist in the VR ecosystem; Meta need not itself be a player in that ecosystem."[12]

> This mutually beneficial relationship between the VR platform and third-party VR apps distinguishes this case from other potential competition cases where potential entrants are typically incentivized to enter the relevant market because they are not capturing any of the neighboring market's growth or profitability.[13]

16. After a thorough evaluation of the evidence, the Court concluded that "the evidence shows that all these factors—Meta's capabilities and incentives, both objective and subjective—did not result in Meta ever seriously contemplating a *de novo* entry, i.e., building its own VR fitness app."[14]

17. The Court rejected the FTC's position that it did not have to show that Meta had a subjective intent to enter the market: "To the extent the FTC implies that—based solely on the objective evidence of Meta's

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6. *Id*. at *22 (citations omitted).
7. *Id*.
8. *Id*.
9. *Id*. at *23.
10. *Id*.
11. *Id*. at *24 ("[t]he evidence indicates that Armature is very much a *game* studio, not a *production* studio").
12. *Id*.
13. *Id*.
14. *Id*. at *27.

resources and its excitement for VR fitness—it would have inevitably found and implemented some unspecified means to enter the market, the Court finds such a theory to be impermissibly speculative."[15]

18. The *Meta/Within* Court relied on prior case precedent in reaching this conclusion. It noted a prior case, where the FTC had argued that "[s]imply because no entry had been effectuated at the time the [acquisition] presented itself did not mean that BOC would not have *eventually realized* its 'long-term objectives' of entering the [relevant] market by growth rather than by this major acquisition."[16] But Judge Davila concluded that "[t]he Second Circuit rejected this 'eventual entry' theory as 'uncabined speculation,' holding that 'it seems necessary under Section 7 that the finding of probable entry at least contain some reasonable temporal estimate related to the near future.'"[17]

19. Important lessons emanate from the Court's decision in *Meta/Within*. Extracting from the Court's decision reveals the following points:

- The standard of proof applicable to a particular agency action (e.g., merger, dominance, interim measures) is not changed based on an innovation theory of harm.[18]
- The analysis of potential innovation competition requires evaluation of both the *effects* of future competition as well as the *likelihood* that such competition will evolve.
- To ensure that the evaluation is not focused on "ephemeral possibilities," a reasonable probability of harm is required to meet the standard of proof.
- In analyzing whether a reasonable probability exists, objective evidence is primary to determining the likely relevance of future competition, with subjective evidence relevant only if objective evidence is weak or inconclusive.
- The evidence must reflect more than technical and financial capability and must include "those capabilities unique to the relevant market."[19] Theories based solely on capabilities and potential interest of a party are "impermissibly speculative" to reflect reasonable probability of future innovation competition.[20]
- In evaluating innovation competition from platforms, evidence relating to the net benefits to the platform, as well as the potential desire or profitability of entering into a specific segment, should be considered and balanced.[21]
- Proof of a reasonable temporal dimension of future competition must be provided: a theory based on "eventual entry" may be deemed as "uncabined speculation" that is not in line with a reasonable probability of future innovation competition.[22]

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15 *Id*. at *27

16 *Id*. at *27, citing BOC Int'l, Ltd. v. FTC, 557 F.2d 24, 29 (2d Cir. 1977).

17 *Id*.

18 This is consistent with the decision of the UK Competition Appeals Tribunal in the *Meta/Giphy* case: "We have already considered aspects of this test, and in particular, we have found that substantial lessening of competition can arise through an impairment of dynamic competition. <u>Of course</u>, that impairment must amount to a substantial lessening of competition – the statutory test must be satisfied – but (as we have concluded) the statutory wording is clearly wide enough to include a substantial lessening of competition arising though an impairment of dynamic competition." Meta Platforms, Inc. v Competition and Markets Authority, [2022] CAT 26, ¶ 86 (CAT).

19 Fed. Trade Comm'n v. Meta Platforms Inc., No. 5:22-CV-04325-EJD, 2023 WL 2346238, *23 (N.D. Cal. Feb. 3, 2023).

20 *Id*. at *27.

21 *Id*. at *30 ("As a VR platform developer, Meta can enjoy many of the promising benefits of VR fitness growth without itself intervening in the VR fitness app market.").

22 *Id*. at *27.

## III. European Commission Decisions

20. There is little direction from the European courts on the appropriate standard of proof for cases alleging harm to innovation. Cases brought by the European Commission, however, reflect that the Commission has applied a declining standard of proof over the past decade.[23]

21. As analyzed by Todino, et al., under the traditional analytical framework applied by the Commission: (1) harm to innovation was linked to late-stage pipeline products, (2) time to market was required within a short time horizon, at most within two to three years; (3) prospects for successful market entry were to be based on objective evidence reflecting a consensus of evidence from the market investigation rather than anecdotal information; (4) closeness of competition was analyzed on a product-specific basis; and (5) a symmetric approach was applied when considering potential competition from third parties and potential competition from the merging parties.

22. Beginning in 2014, however, the Commission began to stray from these principles. First, the Commission relied on limited objective evidence in reaching a Phase I resolution decision in *Medtronic/Covidien*, eschewing its former requirement that the consensus of market evidence demonstrate that innovation competition by the merging parties would occur, and that the merger would harm competition.[24]

23. Then, in 2015, the Commission for the first time stretched the timeline for the entry of competing products in order to find harm to innovation and to justify the decision in *Novartis/GSK*.[25] This decision necessarily relied on a significant degree of speculation, because products further up the developmental pipeline have an increasingly limited probability of becoming commercialized. Also, in *Novartis/GSK*, the Commission for the first time discussed general, i.e., non-product specific, innovation factors, like "competition in innovation" and the parties' "incentives" to innovate.

24. Those generalized concerns laid the groundwork for the Commission's decision in *Dow/Dupont*, where the Commission cast off its traditional approach in many respects.[26] First, the Commission looked at innovation, not on a product-specific basis, but on an "overall industry" basis. It considered the potential negative effects on the parties' overlapping R&D efforts in pesticides, where Dow and Dupont represented the two largest suppliers of pesticide products.

25. The Commission cited several areas of concern that led to its decision:[27]

- Removing the parties' incentives to continue to pursue ongoing parallel innovation efforts;
- Removing the parties' incentives to develop and bring to market new pesticides; and
- Preserving price and innovation competition in pesticide markets.

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[23] *See, generally*, Mario Todino, Geoffroy van de Walle &Lucia Stoican, *EU Merger Control and Harm to Innovation—A Long Walk to Freedom (from the Chains of Causation)*, 64 ANTITRUST BULL. 11 (2018), https://journals.sagepub.com/doi/pdf/10.1177/0003603X18816549.

[24] Case M.7326—Medtronic/Covidien, Comm'n Decision (Nov. 28, 2014), http://ec.europa.eu/competition/mergers/cases/decisions/m7326_20141128_20212_4138173_EN.pdf.

[25] Case M.7275—Novartis/GlaxoSmithKline Oncology Business, Comm'n Decision (Jan. 28, 2015), http://ec.europa.eu/competition/mergers/cases/decisions/m7275_20150128_20212_4158734_EN.pdf.

[26] Case M.7932, Dow/DuPont, Comm'n Decision (Mar. 27, 2017), https://ec.europa.eu/competition/mergers/cases/decisions/m7932_13668_3.pdf.

[27] Press Release, Eur. Comm'n, Mergers: Commission clears merger between Dow and DuPont, subject to conditions (Mar. 27, 2017) https://ec.europa.eu/commission/presscorner/detail/en/IP_17_772.

26. Notably, the Commission looked at overlapping R&D efforts without assigning these R&D activities to a particular product market. Indeed, it acknowledged that it "may not be able to identify precisely which early pipeline products or lines of research the Parties would likely discontinue, defer or re-direct."[28] This effectively placed the focus on innovation efforts that had not yet even occurred but that the Commission believed would occur at some unspecified point in the future.

27. The *Dow/Dupont* decision created significant controversy as untethered to the traditional merger analysis framework or the Commission's Horizontal Merger Guidelines. The decision marks a significant shift in the Commission's analytical framework, whereby a new "significant impediment to effective innovation competition" test arguably is expanded to early-stage R&D efforts unrelated to any specific product and where potentially competing products are at least several years away from reaching the market.[29]

28. It is important to note, however, that none of the cases involving an expansion of the innovation theory of harm by the Commission was tested by the courts. Each of them occurred in the context of commitments offered by the parties, which obviated any appeal by the parties, and none was lodged by third parties. Thus, whether the Commission's departure from the traditional framework of evaluating harm to innovation competition is sustainable when reviewed by the European courts remains to be seen.

29. To the extent agencies move away from objective and probabilistic analysis of innovation competition, they necessarily move toward more subjective and speculative analysis. BIAC believes this is not consistent with the requirements of the legal frameworks under which most agencies operate.

30. For instance, in its recent decision in *Commission v CK Telecoms UK Investments*, the European Court of Justice determined that the standard of proof required for the Commission to find a significant impediment to effective competition ("SIEC") under the EUMR is whether mergers are "more likely than not" to give risk to a SIEC, applying the "balance of probabilities" test.[30] While the case was a victory for the Commission, overturning the General Court determination that a "strong probability" was required, it nonetheless affirms that something less than a probability of an SIEC would be insufficient.[31]

31. To that extent, the use of a "balance of harms" approach as suggested by some commentators would not pass muster under the current laws as applied by most jurisdictions.[32] Moreover, a balance of harms approach would permit a heavily speculative approach by relaxing the boundaries of the innovation analysis. Not only would the likelihood of harm be subject to a relaxed standard, but the nature of future competition and the timeframe in which such competition must occur would also be subjected to speculation, resulting in enforcement based more on conjecture than prediction. The net result would be a significant increase in legal uncertainty.

## IV. The UK Competition and Markets Authority (CMA) Case Against Meta/Giphy

32. In 2020, the UK Competition and Markets Authority (CMA) launched a case against Meta, the parent company of Facebook, and Giphy, the popular GIF platform, due to concerns about their impact on

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[28] Dow/DuPont, *supra* note 26, ¶ 3025.

[29] Todino, et al., *supra* note 23, at 22-23.

[30] Case C-376/20 P, Comm'n v. CK Telecoms UK Investments, ECLI:EU:C:2023:561, ¶ 88, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62020CJ0376 (Eur. Ct. Justice).

[31] *Id*.

[32] *See, e.g.*, Unlocking Digital Competition: Report of the Digital Competition Expert Panel (Mar. 2019), https://assets.publishing.service.gov.uk/media/5c88150ee5274a230219c35f/unlocking_digital_competition_furman_review_web.pdf.

innovation.[33] The CMA's investigation centered on the potential implications for stifling competition and innovation. The CMA's worry was that Meta's control over Giphy's extensive GIF library could hinder innovation and limit competition in the digital advertising and social media sectors.

33. Meta appealed the CMA's determination that the merger "resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services."

34. Although the CAT stated that there was no dispute as to the standard of proof required to demonstrate an SLC, it nonetheless disagreed with this statement of the burden of proof.[34] Specifically, the CAT rejected the idea that the "CMA was not obliged to make a finding one way or the other, but simply resolve the question on the basis of whether it was more likely than not."[35]

35. The CAT found that a review of whether the CMA had met the standard of proof "sets the bar too low and is intellectually unworkable." [36] Rather, the CAT held that the relevant test is whether "there **is** an expectation (i.e. a more than 50% chance) that a substantial lessening of competition may be expected to result or not." [37] By emphasizing "**is**," the CAT required proof of a present expectation of future harm, not a speculative future probabilistic expectation. A contrary interpretation "would give the CMA room for manoeuvre in making its decisions that would be difficult to defend."[38]

36. The CAT also identified factors relevant to evaluating whether dynamic competition, i.e., innovation, is likely to be manifest. These factors included the motives and thinking of the merging firms, the market value attached to the dynamic element, the contestability of the market, and the ultimate ability to monetize the dynamic market.[39]

37. Lastly, the CAT also considered the relevant time frame for innovation to occur. While not precise in its assessment, the CAT did set an outer limit on the analysis, stating that "we doubt very much . . . if an impairment to dynamic competition that is not thought to manifest itself within five years at the outside can be considered" to be probable (i.e., "an outcome with a more than 50% chance").[40]

38. Ultimately, the CAT dismissed three of Meta's four grounds of appeal, including all of the substantive grounds. The CMA ordered the divestiture of Giphy, which Meta reached an agreement to sell on May 23, 2023.[41]

## V. Maintaining Equivalence in Analysis of Innovation Competition

39. In evaluating potential innovation effects, agencies must necessarily devise a counterfactual in which the potential for innovation is considered. This will necessarily assess the innovative potential of the subject(s) of the investigation, e.g., the merging parties in a merger analysis or the dominant party in a

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[33] For background, *see* CMA Final Report on the Completed Acquisition by Facebook, Inc (now Meta Platforms, Inc) of Giphy, Inc. (Oct. 18, 2022), https://assets.publishing.service.gov.uk/media/635017428fa8f53463dcb9f2/Final_Report_Meta.GIPHY.pdf.

[34] Meta Platforms, Inc. v Competition and Markets Authority, [2022] CAT 26, ¶ 91 (CAT) ("It was also common ground between the parties that the question of whether a merger 'may be expected to result' in a substantial lessening of competition was to be resolved by the CMA on the balance of probabilities.").

[35] *Id*.

[36] *Id*.

[37] *Id*. ¶ 92(3)(ii).

[38] *Id*. ¶ 92(1).

[39] *Id*. ¶ 109.

[40] *Id*. ¶ 105.

[41] *See* Yuvraj Malik, *Meta sells Giphy to Shutterstock to Comply with UK Regulator Order*, REUTERS (May 23, 2023), https://www.reuters.com/markets/deals/shutterstock-acquire-giphy-inc-53-million-cash-2023-05-23/.

dominance investigation. To be properly conducted, the development of a counterfactual in an innovation competition case must consider the broader scope of innovation and must not be subject to a myopic focus on the subjects. And it must evaluate not only whether future competition is probable but also whether that competition is likely to be effective. Otherwise, ephemeral possibilities will overtake competitive realities.

40. A proper counterfactual will consider not only endogenous but also exogenous forces on innovation. Thus, agencies should consider not only the potential innovation originating from the subject company(ies), but also the potential for innovation to come from other parties.

> [Because] the same standard of balance of probabilities applies across the board, that is, to any finding of the Commission in connection with its assessment, including the likely occurrence of postmerger developments in a counterfactual scenario. . . the threshold applicable for standard of proof purposes— that is, amount of quantitative and qualitative evidence required to demonstrate that an event projected in the future is more likely than not to materialize—cannot change depending on whether potential competition is an offensive or a defensive argument in the context of a merger assessment.[42]

41. This equivalence principle, therefore, must be applied in several respects. First, if the agency is to consider a longer timeframe for potential innovation effects, it must also consider a longer timeframe for potential third-party innovation or entry. Likewise, it must also allow a longer timeframe, and serious consideration, of potential efficiencies, which should be balanced against potential harms. If the agency is to hold parties to a high standard to demonstrate that efficiencies should be quantifiable and passed-on, it likewise should meet that same standard as to innovation benefits in the counterfactual.

42. Agencies should recognize that an unrestrained approach to enforcement on innovation theories of harm would create significant legal uncertainty and the risk of arbitrary enforcement. This is particularly true in jurisdictions where judicial review is limited, untimely or ineffective to address issues in "real time." It does not follow that, where less is known about the real potential for competitive harm, agencies should have greater freedom to intervene. Indeed, the opposite is true. Any other approach threatens economic freedom, which itself is likely to discourage, rather than encourage, innovation for the benefit of democratic societies.

## VI. Conclusion

43. The unifying theme of analysis of innovation competition in all three jurisdictions is the notion that in order for competition enforcement to be appropriate, innovation must lead to a probability of future effective competition. This standard of proof is warranted to ensure that enforcement is based both on sound economics and sound factual analysis. Although the counterfactual is often hard to determine with exactitude, it should nonetheless be incumbent upon agencies to establish a probability of harm rather than operating on mere possibility or conjecture. The issue of innovation also calls for cooperation among agencies and consistency in analysis of innovation competition, particularly where innovation issues and potential competitive effects have cross-border implications.

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[42] Todino, et al., *supra* note 23, at 27.