

Killer acquisitions: startups, disruptive innovation and antitrust intervention – Where are we and where are we heading to?

Leonardo Rocha e Silva

Marcos Pajolla Garrido

Carolina Destailleur G. B. Bueno

Marina Souza e Silva Chakmati

Abstract: Technology has transformed every industry at an astonishing pace and promoted the emergence of startups and disruptive innovation companies. In this scenario, the acquisition of nascent firms by already established companies enjoying market power, the so-called “killer acquisition”, creates new challenges within the old paradox between protecting innovation and supporting free market values. These challenges will be under debate in this panel.

Resumo: A tecnologia tem transformado as indústrias em ritmo acelerado e promovido um aumento significativo no número de *startups* e empresas de inovação disruptiva. Nesse cenário, as aquisições de tais empresas por outras já estabelecidas e com poder de mercado, as chamadas *killer acquisitions*, trazem novos desafios de conciliação entre o incentivo à inovação e a defesa da concorrência. Esses desafios serão objeto de reflexão no painel.

1. Initial considerations

The evolution of technology has been shaping a different world with greater and unprecedented access to new devices, applications and [features/capabilities]. In response, corporate, legal, political and social systems are all innovating to adapt to this fast-changing world. The way competition works in innovative markets not necessarily replicates how it does in traditional markets. Information and data are an increasingly valuable asset as they are now shaping this new landscape and markets are changing through technology development and innovation at a fast clip.

In these markets, young small companies with considerable access to data and a high innovation potential may become relevant players and, as such, be attractive targets for large incumbent firms. The term “killer acquisitions” arises in this context, especially in discussions involving acquisitions in the pharmaceutical industry, a knowingly highly innovative industry.

Accordingly, large businesses could be intentionally acquiring tech start-ups (innovative targets) solely to discontinue the target’s innovation projects and preempt future competition (CUNNINGHAM et al., 2018, p. 1), consequently blocking innovation by these smaller target players (RICHARDS, 2019). Considering that in many jurisdictions, including Brazil, notification thresholds are based primarily on revenue criteria, these acquisitions may oftentimes occur below thresholds for antitrust scrutiny, and thus be kept out of the radar of antitrust authorities.

Assessing whether a certain transaction would characterize a “killer acquisition”, however, is speculative and depends on the moment in which the acquisition takes place, and also on the uncertain growth, innovation and disruptive potential associated to the target involved. This uncertainty contributes to making decisions on whether and how to deal with this sort of transactions even more complex.

In this scenario, the panel attempts to address a major question concerning the “killer acquisitions” phenomenon: *When and to what extent should antitrust authorities be concerned about startups’ acquisitions?*

2. Challenges related to the so-called killer acquisitions

To achieve this goal, the panel includes debates among lawyers, economists and public authorities about three main questions summarizing some of the most important challenges related to killer acquisitions: (i) To what extent should antitrust authorities be worried?; (ii) Should notification thresholds for merger control be reconsidered?; and (iii) Are there limits for antitrust authorities’ intervention in this context?. Below, we present a non-exhaustive description of some challenges that panelists may address.

2.1. To what extent should antitrust authorities be worried about acquisition of nascent firms by incumbents/large corporations?

The term “killer acquisition” assumes that large businesses could be intentionally acquiring tech start-ups (innovative targets) solely to discontinue the target’s innovation projects and preempt future competition, consequently blocking innovation by these smaller players and, therefore, should be subject to antitrust scrutiny. Some contend, however, that there are relevant arguments sufficiently indicating that antitrust authorities should not necessarily be concerned with such transactions.

The first argument is that the apparent discomfort with small companies’ acquisitions comes from a temporary paradigm shift. Indeed, society often takes time to adapt to paradigm shifts (i.e., a situation in which the traditional and established framework changes completely). Technology – as a broad concept – creates a whole new modern framework that may cause several paradigm shifts. The label “killer acquisitions” could thus be a reflection of this new context (which requires time to adapt) rather than a situation that necessarily raises a real concern.

Secondly, some argue that larger firms would be better off exploiting technology as they are more equipped to invest in innovation when compared to smaller firms, for example.

Moreover, the acquisition may sometimes aim at integrating innovative, complementary services, which often have a plausible efficiency rationale. For instance, the projects of recently acquired start-ups are integrated into the “ecosystem” of the acquirer or into one of its existing products.

On the other hand, larger firms are not usually the most efficient innovators or even inclined to innovate, unless they face a real threat from rivals, which would otherwise be limited by the killer acquisitions.

Further, it is worth noting that killer acquisitions can target (i) future disruptive innovations; (ii) future sustaining (but not disruptive) innovations; or (iii) small firms that do not reach significant innovation. Therefore, the fact that these small acquisitions might turn out not to be relevant at all (in which case the antitrust authorities would be

wasting its time and resources) should also be taken into consideration in the decision on whether antitrust authorities should dedicate their resources to capturing such additional transactions.

2.2. Should notification thresholds for merger control be reconsidered?

The panel aims at discussing how authorities should/could deal with acquisitions that fall below the revenue thresholds for mandatory notification to the antitrust authorities. The panelists will debate important questions about the possibility or need of introducing new thresholds in addition to the companies' revenues, an alternative that is currently being studied by authorities and legislative bodies around the world.

Considering that the current design of revenue-based notification thresholds could lead to a legal gap in the control of relevant acquisitions of young emerging companies, the possibility of defining new thresholds based on the transactions' volume and value is being widely discussed in several jurisdictions. The question is whether these new thresholds would indeed enable the authorities to capture transactions possibly entailing relevant competition concerns which otherwise would not fall under mandatory notification criteria, without creating in itself an undue burden for authorities and/or investors. In this sense, the panel will debate whether the new thresholds introduced by Germany and Austria in 2018 based on the purchase price is a model to be copied/adopted or only observed for now.

The Brazilian Competition Act includes a provision that CADE may, at its own discretion, determine the notification of otherwise non-reportable mergers (based on revenues thresholds) until 12 months after their implementation (article 88, paragraph 7, of Law 12,529 of 2011). Based on the legal framework, in 2018, CADE determined that a transaction involving the acquisition of All Chemistry by SM should be notified, despite its falling below mandatory notification thresholds, considering that SM had, in the past, made repeated acquisitions of small targets that contributed to increase the company's market share in the sector of distribution of inputs for compounding pharmacies.

CADE's approach towards the All Chemistry do Brasil and SM Empreendimentos Farmacêuticos transaction demonstrates that the authority is concerned about non-

notifiable transactions and aware that transactions within innovation industries demand a careful approach, even those not falling under mandatory notification thresholds, which signals that the discussion is on CADE's agenda. CADE has also received recommendations from the Organisation for Economic Cooperation and Development (OECD) relating to improvement of the Brazilian notification thresholds, among other provisions.

Despite the relevance of discussing traditional thresholds in the context of acquisitions of innovative entrants by incumbents, a possible decision on changing or complementing the current thresholds demands an accurate assessment of the associated obstacles and costs. Among these obstacles are (i) the significant transaction costs involved in a legislative change (e.g., bodies that have to be triggered to participate in legislative change discussions); (ii) an increase in the volume of cases reportable to the antitrust authority; (iii) the indication of a more interventionist stand by the antitrust authority; and (iv) the uncertainty about the effectiveness of those measures, which will also be debated in the panel.

2.3. What are the limits for antitrust authorities' intervention in this context?

The specificities of innovation markets and, consequently, of acquisitions involving innovative entrants also demand a reflection on the applicability and effectiveness of the tools normally used by antitrust authorities to handle this type of deal and on the necessity of different review and intervention models by antitrust authorities. The answer to these considerations will depend on the public policy goals defined by each authority and the current economic stage of different markets in each jurisdiction.

In any case, when assessing the limits for antitrust authorities' intervention, it is important to balance the costs involved in an excessive intervention (over enforcement) and the ones involved in a less interventionist approach (under enforcement).

The whole discussion about killer acquisitions considers that existing firms may attempt to acquire innovative targets with the sole purpose of discontinuing the target's innovation projects and preempting future competition; and that these acquisitions usually occur at early stages, when the target has not yet reached its competitive potential. A more interventionist approach, in this potential scenario, could – some defend – be important to avoid that these killer acquisitions take place.

Nevertheless, mergers in innovative markets should be carefully analyzed to avoid the multiple risks from excessive market intervention, especially considering the fast-moving nature of innovative markets. Mergers involving innovative entrants may indeed translate into relevant synergies and efficiencies by combining the innovative ideas of the start-up and the established structure of the buyer. Moreover, the possibility of being acquired by larger companies plays a relevant role in start-up financing, such being among the main paths for venture-capital investors.

Faced with the challenges outlined above, finding a balanced intervention that ensures an environment that is open and willing to protect innovation has become a priority on the agenda of important jurisdictions around the globe. From the European perspective, Commissioner Margrethe Vestager stated that to examine whether the current merger rules allow to sufficiently catch all important deals that can harm competition across borders in the Single Market would be one of her priorities (CROFTS, et al., 2019). In the United States, the Director of the Bureau of Competition at the Federal Trade Commission, Bruce Hoffman, recognized that “(...) established firms may seek to acquire nascent or potential competitors poised to challenge their market position” (FTC, 2019).

In Brazil, CADE has recently launched the “BRICS in the Digital Economy: Competition Policy in Practice” report, during the VI BRICS Competition Conference held in Moscow, Russia. The report includes a specific chapter on “Acquisition of Entrants by Incumbents” which indicates that this topic is high up on the agenda of the Brazilian antitrust authority. The document also consolidates CADE’s awareness of the complexities and risks involved in the assessment of these types of transactions. Accordingly, CADE recognizes in the report that “while acquisitions of new players by incumbents may pose the risk of eliminating potential competition, it may also lead to know-how and technology transfer from the traditional company to the newcomer, which could have positive impacts on innovation and competition.” Concerning the risks of an excessively interventionist approach, CADE also highlighted that a restrictive policy regarding M&A “might discourage innovation, since many new companies perceive the acquisition by a significant player as an important exit strategy.”

How best to balance these risks is still to be discovered and will stand as one of the main challenges discussed in the panel. There are more and less interventionist

methods to approach the subject – and each of them has its own costs and complexities. In this context, it is important to weigh the concerns and benefits of each approach and guarantee that the chosen method (if any) will be in line with the specificities of each jurisdiction.

3. Structure and participants of the panel

The panel is designed in a debate structure, aiming at fostering a dynamic and productive discussion about the multiple challenges involving the so-called ‘killer acquisitions’. We hope this structure creates an environment of brainstorming and confronting ideas from public and private, legal and economic perspectives.

To make this possible, the panel will count on the presence of CADE’s General Superintendent, Mr. Alexandre Cordeiro, who will address the challenges and expectations of the Brazilian antitrust authority in the analysis of mergers involving young innovative targets. The panel will also count on the presence of lawyers and economists involved in complex merger cases, who will contribute to discussions by describing the rationale from the perspective of companies involved in transactions of this ilk. With the presence of foreign speakers, we also hope that the panel may approach the challenges in other jurisdictions, and possible specificities and/or similarities between the different economies around the globe.

4. Final remarks

As anticipated, the panel “Killer acquisitions: startups, disruptive innovation and antitrust intervention – Where are we and where are we heading to?” aims at discussing the new challenges related to acquisitions of nascent firms by already established companies with market power.

The fact that CADE has recently launched the “BRICS in the Digital Economy: Competition Policy in Practice” report, including a specific chapter on “Acquisition of Entrants by Incumbents”, emphasizes the relevance of discussions proposed for the panel.

When and to what extent should antitrust authorities be concerned about startups’ acquisitions? Should notification thresholds for merger control be reconsidered? What

are the limits for antitrust authorities' intervention in this context? Are the tools normally used by antitrust authorities adequate for the analysis of this type of deal? Does it make sense to think about different review and intervention models depending on the current economic stage of different markets in each country? These and other relevant, complex and cutting-edge issues will be under discussion during the panel.

BIBLIOGRAPHY

CROFTS, Lewis; HIRST, Nicholas; NEWMAN, Matthew. Market definition, 'killer' buyouts feature in Vestager's plans for second mandate. September 27, 2019.

CUNNINGHAM, Colleen; EDERER, Florian; MA, Song. Killer Acquisitions. August 28, 2018.

FTC. Prepared Statement of the Federal Trade Commission: "Competition in Digital Technology Markets: Examining Acquisitions of Nascent of Potential Competitors by Digital Platforms". September 24, 2019.

MacLennan, Jacquelyn, KUHN, Tilman, WIENKE, Thilo-Maximilian. Innocent Until Proven Guilty – Five Things You Need to Know About Killer Acquisitions. May 23, 2019, <https://knect365.com/complaw-blog/article/1d971303-8cd7-445c-a782-4c8663dba362/innocent-until-proven-guilty-five-things-you-need-to-know-about-killer-acquisitions>. .

RICHARDS, Matt. Global Competition Review (GCR). Killer acquisitions are a recurring issue, says Vestager. January 17, 2019, <https://globalcompetitionreview.com/article/1179343/killer-acquisitions-are-a-recurring-issue-says-vestager>.