Theories of Harm for Digital Mergers

1. Legal background

The basis of the effective legal regime in Hungary is the Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices (Competition Act). In order to provide explanations to the provisions of the Competition Act and to summarise the practice of the GVH, the President of the GVH and the Chair of the Competition Council of the GVH has delivered Notices,[1] for instance regarding conditions and obligations, the requirements of initiating a proceeding and prenotification.

In the Hungarian merger control regime, mandatory and voluntary notification is differentiated.

When the parties have a joint net turnover of 20 billion HUF (approximately 53.3 million EUR) and at least two of the groups of undertakings have a net turnover of 1,5 billion HUF (4 million EUR), the parties are obliged to notify the transaction (mandatory notification thresholds).

If the parties' turnovers do not fulfil the criteria of mandatory notification thresholds but their joint turnover is above 5 billion HUF (13.5 million EUR) (voluntary notification threshold), the parties have to notify the merger if it is not immediately apparent (or not obvious) that the transaction would not significantly reduce effective competition in the market concerned, in particular as a result of creating or strengthening a dominant position (Article 24 (4) of the Competition Act). The Competition Act also empowers the GVH to initiate a proceeding even if such transactions are not notified, but the GVH obtains information about them, and they fulfil the above-mentioned voluntary notification thresholds.

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[1] Notice 7/2017. of the President of the GVH and the Chair of the Competition Council regarding the obligation of notification of concentrations, initiation of competition control proceedings and the interpretation of the term "not obvious" in the initiation of Phase II proceedings clearly outlines at which market shares or increase in size the concentration obviously does not reduce effective competition. Such Notices are soft law instruments, they have no binding force, they serve as a guideline, gathering the GVH's best practices and main principles. The purpose of the Notice is to clarify the conditions for initiating merger proceedings without providing a more detailed methodological framework for the assessment.

This voluntary notification regime is applicable in all sectors; however, it enables the GVH to catch acquisitions aimed at start-up undertakings, which is a common occurrence in the digital sector. Since it is enough if only one of the parties meets this threshold, it covers transactions involving a small target or even one that is not yet generating turnover – if the turnover of the acquirer meets the threshold.

Some specificities related to the assessment of digital mergers are also reflected in the Competition Act. Article 30 (2a) states that in the assessment of a merger in digital markets, the impact of the merger on innovation and on competition resulting from the parties' access to competitively relevant data, as well as their financial power and leverage, economies of scale, data aggregation capacity and the aggregation of data sets of the parties, should be examined in particular.

2. Key features of digital markets

In general, digital markets have certain characteristics which affect the dynamic of competition and compel undertakings to compete in a different way than in traditional markets. Digital markets are usually multi-sided, bringing together different groups of users via a platform, and characterised by strong network effects. The multi-sided nature of digital markets leads to special business models, where at least on one side of the market (generally on the consumer side) products and services are provided at zero price.

Since consumers usually pay with their data in these markets, acquiring data can be an important motivation for transactions. The numerous characteristics of digital markets, such as business models and the lock-in effect are mainly based on the vast amount of data that undertakings collect and process from their users and customers, using advanced algorithms. The information thus generated enables the customisation of products and services, targeted advertising and the provision of free services.

Therefore, high concentration in the digital economy, significant economies of scale, data advantage of incumbents, network effects and switching barriers reduce competition in the market and challenge the traditional theories of harm. The rapid change of these markets makes the assessment of market power less reliable than in traditional markets.

H-1026 Budapest, Riadó u. 1-3. 1534 Budapest, Pf. 958 KRID: 213396918

Phone: +36 1 472-8900 E-mail: ugyfelszolgalat@gvh.hu

Moreover, some of the undertakings active in the digital field may exercise control over whole platform ecosystems in the digital economy, making it challenging for new market participants – no matter how innovative – to compete with them. Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector (the Digital Markets Act, DMA) and related directives aim to regulate digital platforms with significant economic power that act as intermediaries in such markets. It is of paramount importance to keep track of the developments regarding the application of the DMA and to find ways to seamlessly integrate this experience into the field of merger control, as mergers involving so-called gatekeepers are becoming increasingly frequent, and the tools at competition authorities' disposal may not be effective enough to handle such cases or to counterbalance the competitive distortions they may pose.

However, certain characteristics of digital markets may increase competition compared to traditional markets. For example, the phenomenon of "multi-homing" eliminates some switching costs and allows for easy comparison of prices and services. Furthermore, in the digital economy, consumer preferences can change rapidly, which can force market players to innovate continuously, in addition to leading to the emergence of new services and new market players.

Consequently, in the GVH's experience, the specificities of digital markets challenge competition authorities in two respects. On the one hand, when defining the relevant markets and assessing market power, and, on the other hand, with regard to the potential harm that may arise from such transactions.

3. The GVH's experience related to examining competition effects and theories of harm

The GVH assessed three mergers in which digital aspects were considered – online accommodation mediation (VJ/16/2019. – Szállás.hu / Utazok.hu), online insurance brokerage (VJ/12/2019. – Netrisk / Biztosítás.hu) and online retail sale of electronics (VJ/14/2019. – eMAG / Edigital) –, the experience of which are presented below. For an easier understanding of the background, a short summary of the cases is provided in the annex.

It must be noted that due to the constantly changing nature of markets and the blurring of the boundaries between markets, the GVH has found in its previous cases that the assessment of

H-1026 Budapest, Riadó u. 1-3. 1534 Budapest, Pf. 958 KRID: 213396918

Phone: +36 1 472-8900 E-mail: ugyfelszolgalat@gvh.hu

competitive effects in digital markets requires a more dynamic approach than in traditional markets, and increased attention should be paid to the competitive pressure exerted by other sales channels (even if they may not be part of the relevant market) when assessing competitive effects. This may be especially relevant in markets where there is a particularly high proportion of consumers who use the site or platform for comparison purposes only.

3.1. Application of traditional theories of harm in digital markets

Based on the GVH's experience in bilateral transactional markets, traditional concerns about horizontal theories of harm and traditional analytical tools may still be applicable in digital markets, although with some modifications.

Theories of harm related to pricing

First, the use of the platform by consumers typically does not involve any payment obligation, which can make it difficult to identify price movements through the platform. Depending on the chosen operating model, the compensation for the platform's service can be realised in numerous different forms, making it difficult to clarify the impact of the merger on the price of the product or service.

The GVH investigated theories of harm related to algorithmic pricing in the online retail case; however, the GVH found that algorithmic pricing is not commonly used in Hungary yet, and pricing and the monitoring of competitors is only partially automated. It must be kept in mind, though, that as the use of algorithms becomes more widespread, coordinative effects related to the transparency of markets will gain an ever-increasing importance, since algorithms enable market players to easily coordinate their behaviour even in complex systems, whereas it would not be possible to do so manually.

Second, when examining the effects of mergers, special attention should be paid to non-price related theories of harm, particularly regarding the impact of mergers on quality, variety and innovation.

These questions arose in two merger cases where bilateral transactional markets were concerned, in the online accommodation mediation and the online insurance brokerage case. The GVH found in both cases that the price increase was conceivable on that side of the market

H-1026 Budapest, Riadó u. 1-3. 1534 Budapest, Pf. 958 KRID: 213396918

Phone: +36 1 472-8900 E-mail: ugyfelszolgalat@gvh.hu

from which the platform derived its revenues. Since in both cases the price is determined by the business side (accommodations and insurers), platforms have no influence over this, therefore only indirect price increase seemed to be rational by the platform operators. However, a fee increase for domestic accommodation providers would not have affected the fees charged by international sites (e.g., Booking.com), which would have made it likely that accommodation providers would shift their business to international platforms that operated with lower fees. In the case of insurance brokerage, such an indirect price increase was hindered by the buying power of insurers and the fact that neither of the merging parties' platforms was considered indispensable by insurers.

Finally, competition authorities must keep in mind the intertwined nature of price and quality, as consumers may be willing to pay a premium price if the quality of the product or service increases. The GVH encountered this phenomenon in the market for online ready-to-eat food ordering, when Wolt, a then-new entrant into the market managed to gain a significant market share due to having a level of service better than its competitors, despite operating with higher fees.

Theories of harm related to innovation and quality

It should be noted that based on the GVH's experience in digital markets, price seems to be less of a relevant factor of competition – or in case of zero-price markets, to not be one at all –, so special attention should be given to quality and innovation. Besides mergers between actual competitors, even potential competitors may harm dynamic competition when they remove the incentives for an incumbent firm to innovate and improve the quality of its services or products.

The dynamic nature of Schumpeter's theory on markets characterised by innovation seems to have been proven in the GVH's practice, as before the introduction of Article 24 (4) of the Competition Act, there was a non-notifiable merger affecting the market for online ready-to-eat food ordering. The incumbent market player (Netpincér – now Foodora) acquired sole control over its only competitor, called pizza.hu, hence Netpincér became a monopolist.

However, around a year after the merger, Wolt – the actor referred to in the previous subheading – entered the market and has gained a considerable market share since then. This is most likely

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due in large part to the coronavirus pandemic, which promoted a large amount of newfound demand for food delivery services, and at the same time necessitated innovation on the market.[2]

This is in accordance with Schumpeter's theory, as the emergence of new and innovative market players could and did in fact end the monopoly on the market and resulted in a new market structure. The recent emergence of new actors on the market suggests that there are benefits in promoting new entries to the market.

Non-horizontal theories of harm

It should also be noted that non-horizontal theories of harm are a crucial aspect of evaluating most digital mergers, as vertical or conglomerate effects in these cases often show a significant degree of similarity. This is especially true in cases involving complex ecosystems, where attempting to differentiate the vertical and conglomerate effects of transactions may pose a great obstacle.

This allows the incumbent to provide its users with a broad range of services and products and enables them to find solutions to all of their problems within a single platform – the ecosystem. Such platform operator incumbents, leveraging their market power, the characteristics of the digital economy (as outlined above), and their positive reputation, can more easily expand into other markets, making it challenging for existing market players to maintain fair competition. The GVH, however, has not yet identified specific digital ecosystems in its practice.

[2] 'Falatozz.hu', one of the delivery agent services available in several cities in Hungary published its findings in 2021, which seem to corroborate this assumption. Based on its own experience, there was a 150% increase in restaurants seeking to work with such agents, as they were forced to start offering delivery services in order to stay in business. Conversely, only 10% of these restaurants ceased offering deliveries once the pandemic-related restrictions were eased. On the other side of the market, there was a 59% increase in users who had not used food delivery agent services before.

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3.2. Special theories of harm in digital markets

Data related theories of harm

In digital markets, data has a key role in competition by creating value for the platform and becoming an important source of maker power. The idea behind this consideration is that data is often identified as a rare input that grants market power, thus the potential market power derived from data can be leveraged and used on other markets. Acquisition of unique and rare data can raise questions related to for example interoperability, and lead to vertical concerns. Cumulation of data and datasets, on the other hand, usually raises horizontal concerns in digital markets. The GVH only investigated horizontal types of data-related theories of harm so far, and while it considered all relevant aspects, the most detailed assessment was related to the expansion of databases. The GVH's assessment was based on the framework elaborated by the European Commission in the M.8788 Apple/Shazam case, and the GVH evaluated the importance of data by the characteristics of 4V (velocity, volume, value, variety), particularly considering the reproducible nature and accessibility of data.

These aspects appear in the online insurance brokerage case in detail, where the GVH assessed whether the data concerned could be qualified as commercially sensitive information, which provides a unique competition advantage for the merging parties.

As regards value and variety, the GVH found that the collection of data was primarily limited to the personal data of users that are indispensable for the provision of the service (e.g., name, address, age of the user), and to the comparison of the insurance product to be purchased – therefore, they did not constitute a barrier to entry or expansion, since they were not unique. Nor did the GVH identify any circumstances in the course of the proceeding which would have indicated that consumers would not voluntarily make the data available to the parties and to other undertakings as well. Furthermore, data protection rules presented an obstacle to the transfer of detailed personal data, and the sale of the aggregate data to other undertakings was made less attractive by the reproducibility of the data, as evidenced by the fact that the parties involved in the merger received little or no revenue from the sale of such data.

So based on the above, data gathered from users could be a relevant factor only if multi-homing and interoperability are not present on the relevant market.

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The interconnection of databases of significant size may prove to be valuable also by enabling the merged entity to target a large number of customers with personalised offers. The GVH considered that aspect too, but it found that considering the nature of the product concerned, the data collected and stored were not suitable for targeted marketing; and for general marketing purposes, Meta or Google provided more detailed and better targeted databases. Since the undertakings collected the same type of data on their users, the merger did not result in a merger-specific change by enabling the merged entity to provide a service based on the newly acquired and expanded data that it would not have been able to provide before the merger. Therefore, any potential market power derived from data could be used on other markets.

Finally, the GVH considered whether the merging of databases could provide a significant competitive advantage for the merged company to make its data system and data structure an industry standard. If this happens, there is a risk that the undertaking will become an indispensable player in the market and will make it impossible for other competitors to compete, as beyond a certain size, undertakings using the merged entity's data will not be interested in developing their own services in a way that is capable of using multiple data delivery systems.

The GVH concluded on the basis of the data obtained that such harm to competition is unlikely to arise, given that the merged entity would not have such a prominent weight in the insurers' distribution channels post-merger that would make it indispensable for insurers.

Killer acquisitions

Killer acquisition theory is also considered where relevant, but it has not proven to be realistic so far in the GVH's practice. It must be noted in this regard that it is often challenging to catch a merger where the target has little turnover or generates none at the time of the transaction, yet it has great future potential.

As mentioned in the legal background section of this paper, the Competition Act contains a voluntary notification threshold which allows the GVH to investigate mergers which meet this threshold and may lessen competition on the relevant market. This provision makes the GVH able to investigate digital mergers more thoroughly, particularly acquisitions by dominant companies. The Competition Act has no explicit provision which would define the threshold from which an undertaking should be considered dominant; it is analysed case by case, based

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on the specificities of the given market. However, the GVH considers the 40% threshold to be generally applicable as it is reflected on in the European Commission's Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings and also in the European Commission's Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings.

This is also reflected in the previously cited Notice 7/2017. of the GVH, which states that the GVH initiates a competition supervision proceeding when the acquirer and its group of undertakings possesses an outstanding market power on the relevant market (which is mainly presumed above 40% share) and wants to merge with a target (and its group of undertakings) that has a minimal market share or that is not yet present on the relevant market, in which case the circumstances (e.g. innovation, the size of the future customer base) of a significant future development (e.g. entry and/or expansion) regarding the target can be considered.

4. Conclusion

The Hungarian Competition Authority has had relatively limited experience in dealing with digital mergers, but in the course of the cases it examined, it had to deal with the most commonly arising relevant aspects of digital mergers. Even though most of the examined theories of harm did not prove to be an issue, and the cases were unconditionally cleared, this was not due to the lack of effort or investigative powers of the authority, but rather to the structure of the affected markets and the behaviour of the players on them.

Mergers on digital markets raise new types of challenges competition enforcers must meet, and this will likely lead to further developments of competition regimes around the globe. However, diligent use of tools already at authorities' disposal (with a problem-centered approach and greater flexibility) may prove to be just as efficient in dealing with competition issues in digital markets – especially for non-zero price business models – until more advanced methods aimed specifically at mergers in the digital field are developed.

This was in part confirmed in the GVH's own experience as well, as the GVH conducted a market analysis on the creation of data assets and their role in online commerce (the study, however, focussed on competition policy and consumer protection aspects rather than mergers)

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and published its results in 2022 – long after it closed the cases mentioned in this paper –, which supported the main findings and approach the authority took when examining the digital mergers it encountered before.

The dynamic nature of digital markets may present a challenge when it comes to the burden of proof as well, but since the relevant decisions of the GVH were not challenged in court, the authority has no experience yet in this regard.

To effectively respond to the challenges posed by the digital age it may be necessary to redefine conceptual frameworks and foundations so that competition authorities can confidently walk before they run. Subsequently, boldness, questioning the current regularly applied framework, including the teachings of the traditional Chicago School, and potentially applying a more interventionist approach may be needed in the future to prevent the harm that digital mergers may pose to competition, and thus to the entire digital and non-digital economy. Competition enforcers should rethink their established stance on killer acquisitions as well. A more rigorous approach may be needed in order to prevent serious market distortions brought about by the expansion of digital giants by way of buying out actual or potential smaller competitors.

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ANNEX

In this chapter the GVH provides information with respect to the authority's previous experience in digital merger cases. Up until the present date the GVH has investigated three transactions in which the specificities of digital markets were taken into account.

1. *Netrisk / Biztosítás.hu*

According to the notification received by the GVH, Netrisk, which is mainly active in online insurance brokerage, was seeking to acquire direct sole control over Biztosítás.hu, which was also active in this field. As the two undertakings were the largest players in the online market, the GVH has opened a Phase II investigation to analyse the potential adverse competitive effects of the merger. In addition to analysing the data submitted by the parties, the GVH also consulted a number of other insurance intermediaries and insurance companies, as well as professional associations and insurance IT solutions providers.

The GVH focussed its investigation on the market for online insurance brokerage and the likely effects of the merger on the market for online insurance brokerage, but also took into account the competitive constraints of traditional insurance intermediation (in person or by telephone) and of insurers' own online platforms.

2. *Szállás.hu / Utazok.hu*

Szállás és Utazás Kft., the owner and operator of the online accommodation mediation platform szállás.hu intended to acquire 100% of the shares of Utazok.hu Kft. and the accommodation mediation business unit of PK Travel Kft. and D-Card Marketing Kft., which were non-independent from Utazok.hu.

In the proceeding, the Competition Council, having regard to the activities of the merging parties, has established online travel agency services and accommodation mediation services as the relevant product markets. With regard to online accommodation intermediation, the Competition Council also examined whether it could be further segmented according to the nationality of the bookers (travellers), and whether the market definition could be limited to the mediation of bookings by Hungarian travellers within Hungary.

H-1026 Budapest, Riadó u. 1-3. 1534 Budapest, Pf. 958 KRID: 213396918

Phone: +36 1 472-8900 E-mail: ugyfelszolgalat@gvh.hu

3. eMAG / Edigital

According to the notification received by the GVH, Dante International Kft., the operator of the online shop eMAG.hu, intended to acquire control over Extreme Digital Zrt., the operator of the online shop edigital.hu and 16 physical shops nationwide.

The turnover of the online stores operated by the undertakings involved in the transaction was significant, in particular in the domestic online retailing of technical products; the GVH therefore investigated the potential adverse competitive effects of the merger in a Phase II investigation. In addition to analysing the data submitted by the parties, the GVH also contacted competitors, suppliers and market research companies.

H-1026 Budapest, Riadó u. 1-3.   1534 Budapest, Pf. 958   KRID: 213396918

Phone: +36 1 472-8900   E-mail: ugyfelszolgalat@gvh.hu