Digital company acquisitions to face closer scrutiny by competition authorities

By Burton Phillips

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The Competition Commissioner during the Commission's Annual Conference (in November 2020), noted that the Commission will take a "decisive and proactive stance to ensure the balance of economic forces favour a shift to facilitating entry and a more competitive digital economy".

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Proposed changes for the industry may be far-reaching and may include a possible requirement for dominant tech companies to inform the Commission of all acquisitions, even those falling below the prescribed thresholds for mandatory merger notification to the authority. All players in the tech / digital markets space will need to be aware of the heightened focus of the competition authorities on this sector. Not only will this bring a change in transaction costs and deal time-lines – but also many more mergers being prohibited or approved with conditions.

The Commission's recently published paper on Competition in the Digital Economy notes that there may have been underenforcement of merger control laws in digital markets to date. One of the ways in which the Commission plans to promote competition, inclusive growth, increased and meaningful employment and shared prosperity in the sector is through more stringent merger regulation of the industry.

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Statistics published by the SA Commission indicate that out of the 87 notifiable mergers relating to digital markets from 2011 to 2019, none were prohibited; 82 were approved unconditionally and 5 conditionally approved. The proposed merger between MIH and WeBuyCars was the first in this space to be prohibited, following a decision by the Competition Tribunal in March 2020. This decision appears to have encouraged the Commission to scrutinize more closely mergers in the digital space.

Some of the common reasons for the perceived underenforcement in the sector are:

- Many transactions in the digital space may fall below the financial thresholds for mandatory notification. This results in numerous small start-up digital companies being acquired without any scrutiny by the competition authorities.

- In South Africa, acquisitions meeting certain prescribed financial thresholds must be approved by the competition authorities and cannot be implemented prior to such approval being granted. Transactions falling below these thresholds (referred to as small mergers) can be notified to the Commission voluntarily - but can be implemented without prior approval. The Commission may, however, call for a notification of a small merger on suspicion that a small merger could result in the substantial lessening or preventing of competition.

- In the UK, the March 2019 report on Unlocking Digital Competition noted that over the last 10 years, the five largest tech firms made more than 400 acquisitions globally – but none of these were prohibited and some not even scrutinised by their competition authorities.

- Parties to tech transactions are often based offshore with no presence and little or no revenue in a particular country at the time of the acquisition to establish jurisdiction. The Facebook/WhatsApp merger is cited as an example of such a transaction. The merger was not notifiable to South African competition authorities as WhatsApp did not generate any turnover in, into or from South Africa.

- The traditional tools and theories of harm used in merger review are not appropriate for tech-related mergers. The consideration of factors such as defining the relevant markets, market shares, foreclosure, barriers to entry and public interest factors need to be suitably adjusted and developed to take into account the fast moving dynamics of digital markets, including innovation, the use of multiple platforms, consumer reach, data usage, the use of free services or platforms and digital advertising.

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The Commission is developing a strategy to address these issues. Key merger control related measures suggested by the authority at this stage include:

- Introducing a requirement for dominant digital firms to inform the Commission of all small domestic acquisitions, including investments in start-ups and global acquisitions of target companies with a local presence (i.e. generating turnover in, into or from South Africa). At this stage, the proposal is for such notification to merely serve to inform of the Commission of the transaction to enable it to decide whether to call for a full merger notification by the parties. If it does, such transaction would be subject to review by the Commission and may be prohibited or have conditions imposed. It is unclear how the Commission will identify these dominant firms as this largely depends on how the relevant markets are defined. The list may include well-known players such as Facebook, Alphabet's Google, Netflix, Naspers, Amazon, Uber, Airbnb, as well as network and telecommunications infrastructure firms such as Vodacom, MTN and Telkom making any acquisition of a local target tech company.

- Adding digital markets to the Commission's list of priority sectors, which means that the Commission will allocate greater resources and subject digital mergers to greater scrutiny. The additional scrutiny on these mergers could result in lengthy merger reviews which will have to be factored into deal timetables. In the case of global digital mergers, the Commission seeks to ensure that global digital mergers that are notifiable in South Africa are notified to the Commission in parallel with notifications submitted to competition authorities in other jurisdictions. This will allow the Commission to engage and collaborate with global competition authorities and consider any conditions imposed by such authorities and its application in South Africa.

- Publishing a practice note on the assessment of mergers in digital markets to deal with the competition and public interest assessments, and a guidance note on how the assets of digital companies should be evaluated for purposes of determining whether transactions fall within the financial thresholds for mandatory notification.

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