

Russian Federation
Roundtable on “The Non-Price Effects of Mergers”
OECD Competition Committee
June 6, 2018

In many markets, the merger between an established enterprise and an innovative start-up has little impact on the existing market structure because of the small proportion of a start-up enterprise in the market or the lack of horizontal duplication. However, in the digital markets, such a merger can lead to differentiated access to data and increase the concentration of data related to this market if the start-up company has access to large amounts of data (gained, for example, in another market).

In this case, when assessing possible competition restrictions resulting from a merger, competition authorities may need to carefully examine the advantages of the new organization, gained through combining different sets of data. In particular, a combination of different data sets can create competition problems if the combination of data does not allow competitors to copy (reproduce) information extracted from it.

In assessing the implications for competition as a result of a transaction, it seems important to consider the state of competition in the markets on which merging companies operate, in terms of the ability of other companies to access the data.

As an example, we shall consider the transactions of economic concentration in the agro-industrial complex, where for the last 5 years the advanced achievements in the field of biology and genetics, information technologies, robotics and sensors have been actively introduced, and the volume of investments in high technologies has increased almost 20 times¹.

The development and introduction of innovative technologies in agriculture is accompanied by active structural changes in the industry, which are characterized by high rates of consolidation of assets by world companies supplying high-tech products to the market.

Since the middle of the 2000s, several leaders (5-7 companies) in the agrochemical and breeding industries traditionally accounted for more than 50% of the total volume of market sales².

¹ AgFunder AgriFood Tech Investing Report – Mid Year 2017: <https://agfunder.com/research/agrifood-tech-investing-report-midyear-2017>

² Fuglie K., Heisey P., King J., Schimmelpennig D. Rising Concentration in Agricultural Input Industries Influences New Farm Technologies // Amber Waves. 2012. Vol. 10. Iss. 4. P. 1–6.:

In the period between 2015 and 2016, several major M&A transactions between the industry leaders in the selection and agrochemical sectors were announced. If the merger between Monsanto and Bayer is approved by the competition authorities, three companies - ChemChina-Syngenta, DuPont-Dow, Bayer-Monsanto - will collectively control 60% of the market for patented seeds and 64% of the global pesticide/herbicide market.

These directions of transformation of the world agricultural sector are closely connected with the tendencies of building digital platforms that penetrate the global economy.

The introduction of digital agriculture, in fact, should complete the formation of modern agriculture, based on IT platforms of precision farming, which allows controlling crop yields, including highly productive biotechnological seeds, associated crop protection products, fertilizers and other means of production.

Undoubtedly, the ongoing processes of transformation of agriculture will make it possible to significantly improve the efficiency of this sector of the economy in the medium term.

At the same time, these transformation processes have already led to the creation of a stable oligopoly in this market, the existence of which entails certain risks, including in the context of the protection of competition.

Such risks include:

- increase in prices for seeds;
- reduction of the variety of seeds offered and biodiversity of cultivated crops;
- control by transnational companies of national seed production, inputs and profitability of agricultural producers.

The Russian Federation is a large producer of agricultural products. However, at the present stage it is not ready to fully meet the challenges of digitalization of the agricultural sector.

In order to identify the level of dependence of the Russian market on imported seeds, in 2016, the FAS Russia conducted a survey of about 3,000 economic entities engaged in agricultural activities and receiving subsidies under the State Program for the Development of Agriculture and Regulation of Agricultural, Raw Materials and Food Markets for 2013- 2020 years.

As the main barriers hampering the development of seed production in the territory of the Russian Federation, the respondents named:

- significant costs for breeding a new variety/hybrid (90% of respondents);
- lack of necessary material and technical equipment, technologies and personnel (76%);
- insufficient subsidies from the state (67%);
- lack of necessary variety of breeding material (62%);
- difficulties with registration of breeding achievement (52%).

In addition, among the barriers that shift the choice of seed buyers towards imported seeds, there is their high productivity, the resistance of seeds to certain plant protection products, the availability of prices, the possibility of receiving a deferred payment, and using consulting services.

During the period from 2016 to 2017, the Russian antimonopoly authority examined and agreed on two global transactions: the merger of US companies Dow Chemical and DuPont, as well as the acquisition by the Chinese state corporation ChemChina of the Swiss company Syngenta.

In accordance with the Federal Law "On Protection of Competition", transactions that occur outside the Russian Federation are subject to antimonopoly control under the following conditions:

- achievement of established threshold values and performance of actions with respect to the main production assets and (or) intangible assets, voting shares (stakes) in the territory of the Russian Federation, rights in relation to Russian commercial and non-commercial organizations,
- or if the said actions are committed in respect of a foreign company delivering goods to the territory of the Russian Federation in the amount of more than 1 billion rubles (about 17 million US dollars) during the year preceding the transaction.

These transactions met one of these conditions.

In assessing these transactions, the traditional approach was applied - a prospective analysis of the impact of transactions on seed markets and plant protection products as a result of horizontal integration was carried out. This analysis showed that as a result of these transactions, the emergence or strengthening of a dominant position in the Russian markets of the presence of products participating in the transaction will not occur. This served as the basis for coordinating these transactions.

Therefore, the changing model of doing business predetermines the need to change approaches to the valuation of such transactions, including in the field of seed production, is based on the use of high-tech solutions protected by patents, big data,

the creation of closed systems that unite unconnected horizontal or vertical markets to maximize profits through the use of a dominant position on one of them.

This approach, in the opinion of the Russian antimonopoly authority, suggests:

- consideration of the innovation market in close relationship with the markets of the end product sold to consumers. At the same time, the market for innovations is considered as a world market;
- evaluation of the technologies and know-how available to the companies that enable them to significantly increase their market share in the short and medium term due to the synergetic effect, while assessing the available technologies in the context of horizontal, vertical and conglomerate integration (for example, the availability of unique technologies, databases that allow for accelerated selection, creation of package solutions, including IT solutions that affect the consolidation of demand of the end user and restrict access of potential competitors to the seed market and to the adjacent markets);
- assessment of the impact of the proposed transaction on the innovation market both in terms of the ability to limit the access of potential competitors to innovative products, and of the impact on the development of innovations in the national market.

This approach is currently approved by the Russian antimonopoly body when considering the Bayer/Monsanto merger.

This transaction affects the markets of the following products, the end users of which are agricultural producers: genetic material (seeds), certain crop protection products, in particular non-selective herbicides, as well as digital offers for agricultural producers.

Both Bayer and Monsanto are vertically integrated full-cycle agrotechnology companies active in agrotechnology research and development as well as in the distribution and marketing of their products to agricultural producers.

In the course of this merger review, the FAS Russia organized a series of consultations with the relevant federal authorities, as well as academic and business communities, and foreign competition authorities. The FAS Russia also met the parties of the merger in order to discuss the possible negative effects the merger could have on competition as well as remedies helping to eliminate them.

Having realized that the merger would have a material impact on industry innovation and technological development dynamics in the agricultural sector, the FAS Russia considered a number of program documents and technological foresights adopted by the Russian federal ministers and the government including the National Strategy

for Scientific and Technological Development of the Russian Federation³, Agrotechnology Foresight 2030⁴, Federal Program for Scientific and Technological Development of Agricultural Sector for 2017-2025⁵, Federal Targeted Program on Digital Economy⁶ and etc.

Considering that technological transformations, including digitalization worldwide, have become key to understanding competitive dynamics in the agricultural sector, the FAS Russia has applied new methodological approaches to identify potential anticompetitive effects of the merger both in the Russian and global markets. These new methods were developed in cooperation with reputable academic institutions including the HSE-Skolkovo Institute for Law and Development. The FAS Russia has also relied on its analysis of the best practices developed within other jurisdictions, relevant recommendations of the OECD Competition Committee, and international scholarship, as well as on proceedings of the BRICS Working Group on Global Food Value Chains (formed by the BRICS Competition Authorities in 2015).

The FAS Russia has conducted market analysis for the factors of agricultural production relevant to the merger review including emerging market integrated agrotechnological solutions that has been recently formed in a process of ongoing systemic technological and business transformations within the agricultural sector.

All these markets were analyzed by the FAS Russia in the context of increasing globalization of the world economy and integration of agricultural production into the global food value chains. This required the FAS Russia to assess not only ‘horizontal’ relations between the market competitors but also ‘vertical’ interactions between different segments of the global food value chains.

In the context of the accelerating pace of innovation in the agrotechnology sector, the FAS Russia assessed not only the merging parties’ market shares but also the most probable scenarios for market transformation including changes in their competitive structure and dynamics in the short and medium term perspectives.

Such changes are a consequence of the ongoing systemic transformation of agrotechnological markets, making globally competitive only those companies that have the opportunity to offer integrated solutions to the agricultural producers, including both adapted seeds and crop protection products, and digital management solutions

³ The Decree of the President of the Russian Federation of 01.12.2016 No. 642: <http://static.kremlin.ru/media/acts/files/0001201612010007.pdf>

⁴ https://issek.hse.ru/data/2017/05/03/1171421726/Prognoz_APK_2030.pdf

⁵ The Resolution of the Government of the Russian Federation of 25.08.2017 № 996 <http://static.government.ru/media/files/EIQtiyxIORGXoTK7A9i497tyyLAmnIrs.pdf>

⁶ The Resolution of the Government of the Russian Federation of 28.07.2017 № 1632-p <http://static.government.ru/media/files/9gFM4FHj4PsB79I5v7yLVuPgu4bvR7M0.pdf>

based on the analysis of big data (soil, natural-climatic, etc.), collected and processed in the framework of digital agronomic platforms of precision farming.

Therefore, taking into account the integration of the Russian market of agricultural products and means of production into the world market, structural changes occurring on the world market are predictably and steadily spreading to the corresponding markets of the Russian Federation.

In assessing the impact of the transaction on competition in the Russian market, the FAS Russia based on the assumption that the merged company possesses strong capacities including big genetic data; latest technologies for accelerated genetic selection allowing the development of biotechnology seeds with predicted characteristics not subject to regulatory restrictions aimed at the control of cultivation of genetically modified organisms; as well as big data and algorithms for digital farming. All this may allow the combined company to increase its market power in a technologically changing environment quickly and effectively. This may possibly lead to a fast increase in the merged company's market share up to reaching a dominant position in the affected markets dependent on the abovementioned technological changes; as well as to creation of high entry barriers for market player lacking some of those technological and data capacities at once.

To the FAS Russia's opinion, as a result of the merger of resources of Bayer and Monsanto the following significant threats to competition may be caused:

- a) the risk of appearance of closed digital platform, which will be dominant at the market and will reduce competition by squeezing out from the market the alternative digital solutions of other companies;
- b) the creation of favourable conditions for promotion by participants of the transaction their own products (seeds, crop protection products) in the framework of agro digital platform. The implementation of such opportunities will allow to influence the decisions of agricultural producers to purchase other factors of production (from seeds to agrochemicals). Such management consulting, which includes the element of commitment by company-holder of digital platform, will have negative impact for competition in the associated markets;
- c) the decrease of innovative activity in the field of digital agriculture as a result of creation of barriers to entry into the market for alternative digital platforms, that could lead to the decrease of the R&D activity of competitors, as the incentives of chasing the leaders will be lost;
- d) the very elaboration of closed dominant digital platform will be a sufficient barrier for creating new small innovative projects in the field of selection or agro chemistry which could be integrated into open digital platforms.

Taking the foregoing into account, the FAS Russia supposes that all the mentioned negative effects on competition on the global market could equally appear on the Russian market and, thus, present the threat of restriction of competition.

The FAS Russia considered a number of different options of antimonopoly reaction to those risks for competition.

Consideration of the transaction lasted for a year, and on April 20, 2018, the FAS Russia approved the transaction, issuing a prescription to the merging company.

The FAS Russia managed to achieve non-discriminatory access to the "big data" of the merged company for Russian developers specializing in the field of agrotechnologies and selection, as well as for consumers (the organizations of the agriculture complex of Russia).

The merged company will transfer to Russian participants of the agro-industrial market a certain amount of molecular selection tools and germplasm of the selected crops, which are important for the Russian Federation.

During the whole period of validity of the FAS Russia's prescription (5 years), the scope of supply of seeds and plant protection products of the merged company to the territory of the Russian Federation will not be reduced. At the same time the supply will be executed on a non-discriminatory basis.

Bayer will support the training of Russian specialists in each culture and will create the Training Center in Russia.

The assistance in execution of the obligations assumed by the merged company will be carried out by the specially created Center for Technology Transfer on the basis of one of the leading Russian universities - the Higher School of Economics under the Government of the Russian Federation.

Despite the fact that the decision taken by the FAS Russia on this transaction is a novelty in the Russian practice of antimonopoly regulation, it lies in the general direction of changing approaches to transactions of economic concentration in innovative markets. It also corresponds to the current trends of the development of international competition law in the era of digitalization and the strengthening role of innovation in the world economy.

Therewith, when considering this transaction, the following problems were identified, the resolution of which requires a change in the Russian antimonopoly legislation.

Current business strategies of the participants in the transaction, their global competitors, as well as most other large multinational companies operating in innovative markets (pharmaceutical markets, IT product markets, etc.), suggest the use of various tools based on intellectual rights. Due to the availability in the Federal

Law "On Protection of Competition" of exemptions for anti-competitive behavior based on the use of objects of intellectual property, the control of economic concentration is the only available instrument for the FAS Russia capable of limiting the market power of such companies, which predetermines the need for more stringent requirements when considering transactions of economic concentration in such markets. This is not always justified in the face of the uncertainty of the onset of negative consequences from the transaction and may reduce the positive effect on innovation from the transaction.

Therefore, based on the practice of foreign competition agencies, the balanced application of the mechanisms of preliminary and follow-up control in innovative markets is in the best interests of market participants.

In addition, such transactions in commodity markets with a high innovation component, due to their specifics, require the request and analysis of a large amount of information, the involvement of experts with special knowledge, interaction with other interested federal executive bodies, consultations with participants of the transaction. However, procedural restrictions, including those related to the timing of the transaction and the access of third parties to confidential information provided in the process of negotiating transactions, established by the Federal Law "On Protection of Competition", significantly limit the ability of the FAS Russia to conduct due review of such transactions.

Therewith, at present the Russian competition authority does not have an effective tool for monitoring compliance with the requirements of foreign economic entities, which is a necessary element of a balanced system of competition protection in the markets of the digital economy that is significantly less dependent on state borders.

In this regard, the FAS Russia considers it necessary:

- to eliminate restrictions on the dissemination of the provisions of articles 10 (Prohibition of abuse of dominant position) and 11 (Prohibition of anticompetitive agreements and concerted actions) of the Federal Law "On the Protection of Competition" on actions to implement intellectual property rights;
- to review the established procedure for consideration of transactions, including in terms of extending the consideration period, the possibility of acquainting third parties with confidential information on the basis of non-disclosure obligations, holding hearings on the deal with an involvement of interested parties, etc.;
- in case of non-compliance with the prescription, the granting to the competition authority of the right to go to court on compulsory licensing of objects of intellectual property rights owned by foreign business entities that do not comply with the requirements introduced in the prescription, without their consent, to conditions

defined by the competition authority or on the prohibition of the circulation of goods in the territory of the Russian Federation to such foreign economic entities.

To implement these novelties in the Russian antimonopoly legislation, the FAS Russia created a working group that drafted the law (the "fifth antimonopoly package"), which is planned to be submitted to the Government of the Russian Federation in the first half of 2018.