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Experts in Competition Analysis

MEMORANDUM

From	E.CA Economics
To	European Commission, Directorate General for Competition
Subject	Commission Notice on the definition of the relevant market for the purposes of Union competition law
Date	13 January 2023

1 Overview

We welcome the opportunity to comment on the European Commission's (EC's) *Notice on the definition of the relevant market for the purposes of Union competition law* (the "Notice") presented on 8 November 2022.

The Notice reflects developments of the EC's decisional practice that occurred since the 1997 EC Notice and is therefore welcome. The Notice is very detailed and grapples with issues that emerged in full since the 1997 Notice was adopted, such as the growth in digitalisation. We welcome these changes. We also welcome the greater detail and the more thorough thinking that the EC is bringing to the matter of market definition.

We have one general reservation. Unlike in some other jurisdictions, the UK in particular, market definition remains key across the EC's competition portfolio, including in merger control. Issues that can be left unresolved or not fully considered at the market definition stage in UK merger control, cannot easily be left so in the EU context without serious implications for the companies whose cases are being reviewed. For instance, the EC appears to replace in some circumstances relevant geographic market definition based on the SSNIP[1] test with plant-centred catchment areas derived, in a mechanistic fashion, from the data of the investigated companies. The EC also appears to reserve the right to exclude certain substitute products with high diversion ratios and cross-price elasticity from the relevant market without proper explanation why this can be done and how those constraints would be considered at a later stage (i.e. in competitive assessment). Given the EC's decisional practice which (still) places high value on

[1] Small but Significant, Non-transitory Increase in Price ("SSNIP").

market shares,[2] this approach is likely to lead to a skew against investigated companies and an increase in the likelihood of appeal. We discuss these issues and other observations we make in more detail below.

2 Geographic substitutability

2.1 Catchment areas

The EC stated its commitment to the SSNIP framework noting, however, that its empirical application could be difficult.[3] We welcome this commitment to the SSNIP methodology and understand the difficulty. While empirical application of the SSNIP framework might not be feasible in every case, it is also important for the EC to not introduce 'shortcut' techniques that are incompatible or not fully aligned with the SSNIP framework. Catchment areas are one such example of a practical tool which needs to be first aligned with the intellectual framework of the SSNIP before it can be safely used.

The EC explains that catchment areas would be used in situations where markets were geographically differentiated, i.e. when competitive conditions changed as a function of distance. The EC suggests that in such cases, catchment areas covering 80% of sales or customers could be considered as a starting point for market definition with sensitivities at 70% and 90%.[4] Our experience with past EC's decisional practice suggests that such considerations are not a 'starting point' but often the 'end point' of the EC's analysis, including competitive assessment. To have any validity, this analysis has to be fully aligned with the SSNIP framework first otherwise it risks skewing the EC's assessment.

Catchment areas – as helpful as they are for practitioners – **do not answer the SSNIP question**: 'from which areas would suppliers be able to serve customers to defeat a SSNIP?' It is not a given that a radius based on where 80% of **current sales** are made is in any way indicative of the answer of where customers would source their supply **following a SSNIP** in a merger case. Similarly, it will not be helpful in cases where exercise of market power has already taken place in cases of Art 102 TFEU.

The EC compounds the issue by appearing to draw catchments based on the data of the investigated parties, in particular deliveries around the Parties' plants.[5] This makes an already problematic reasoning worse – in many cases, the location of the investigated parties in contrast to competitors and vis-à-vis customers may be such that their customers may not be drawn from very far. However, it does not mean that these customers cannot be served – or indeed are not **already being served** - by competitors located further afield. Omitting these constraints would significantly skew the EC's analysis.

The EC has some choices in how it considers constraints from **potential competitors**. The EC can, for instance, make a choice to not consider suppliers who would start supplying following a SSNIP as part of the market definition and consider them, instead, as part of the competitive assessment as 'potential

[2] In its most recent update of the its Merger Assessment Guidance (MAG 2021), the UK competition authority, the CMA, states clearly that "*The CMA does not apply any thresholds to market share, number of remaining competitors or on any other measure to determine whether a loss of competition is substantial.*" (MAG 2021, para 2.8). Conversely, the EC still applies its own 2004 Horizontal Merger Guidelines (HMG 2004) which state, for example: "*According to well-established case law, very large market shares — 50 % or more — may in themselves be evidence of the existence of a dominant market position.*" (HMG 2004, para 17). The EC reaffirms its commitment to market shares in the Notice: "*Market definition makes it possible to calculate market shares, which the Commission may use to assess an undertaking's competitive strength for the purposes of the competitive assessment.*" (para 9 of the Notice).
[3] The Notice, para 33.
[4] The Notice, para 74.
[5] EC case M.7878 Heidelberg Cement/Schwenk/Cemex Hungary/Cemex Croatia quoted at Footnote 86 of the Notice.

competitors'. This would, however, invalidate the use of market shares based on actual competitors as they would overestimate the market position of the parties. We would expect the EC to make a clear distinction in its Notice between a use of catchment areas in the way currently described, i.e. as a helpful but mechanistic frame of reference for further analysis which does not lead to directly usable market shares, and a SSNIP-based geographic market definition which can lead to meaningful market shares in homogenous product markets.

We also paused at the precise nature of the 80% cut-off with a 70% and 90% sensitivity. We were surprised not to see the EC state that any such cut-off would be judged based on available data rather than mechanistically applied. We note that a simple distance-based ordering of sales can often produce informative catchment areas (though for reasons explained above, not relevant geographic markets). We also note that, based on the Notice, the 70% sensitivity appears to have been used only once and overruled by the EC itself[6]. It is unclear why such a new sensitivity threshold should be introduced in the future. In general, the EC does not appear to motivate any of its thresholds or support them with academic literature. As such, they seem entirely arbitrary.

The use of catchment areas and the 80%/90% cut-off has been popularised by their use in supermarket inquiries, pioneered in Europe by the UK competition authorities. In those inquiries, the UK authorities faced a task of carrying out competitive assessment in a large number of small local geographic areas (sometimes thousands of local areas). Applying a tool which would allow the competition authority to focus on only the most relevant geographic areas was understandable. Catchment areas were indeed used not as a replacement for a relevant market definition, but as a filter for determining the scope for more in-depth analysis of competitive effects. The UK authorities also did not use the 80%/90% threshold as a 'hard rule', but controlled for customer distribution and carried out both store- and customer-centric analyses to avoid bias.

Catchment area analyses have since become popular with European competition authorities in retail merger cases where they are often used – appropriately – as a simple filter. We do not expect, however, the EC to encounter many such cases itself as it tends to focus on larger businesses with pan-European reach. It should therefore not require such a shortcut very often. In our experience with EC-based cases, most involved only few plants/firms being acquired where the relevant market could be reconstructed from market data without excessive cost and using the proper SSNIP methodology.

The use of this shortcut makes sense in a system such as the UK that places higher value on competitive assessment and de-emphasises market definition, since the SSNIP considerations will not be skipped, just rolled into the competitive assessment. The EC's decisional practice places much greater emphasis on market definition and market shares. If the EC skips applying the SSNIP framework at the market definition stage, there is no guarantee that it will pick it up at the competitive assessment phase. Given this risk, we do not believe that the EC can safely embed the use of catchment areas in its future decisional practice without first being very clear that catchment areas neither replace nor implement the SSNIP test and without explaining how the unanswered SSNIP questions will be addressed in the EC's competitive assessment. Indeed, there is no systematic explanation in the EC's Notice as to how exactly competitive assessment will supplement the analysis carried out at the market definition stage. If catchment areas are used as a way to avoid rigorous SSNIP assessment, the EC is likely to usher in an era of lower evidentiary standard for its analysis and risk biasing its analysis.

[6] The Notice states: "[*I*]*n case M.7878 Heidelberg Cement/Schwenk/Cemex Hungary/Cemex Croatia, the Commission found circular catchment areas representing 90% of deliveries around the Parties' plants to be more appropriate than catchment areas representing 70% of deliveries (recital 182) but also considered modified catchment areas based on road distances and delivery patterns (recitals 189-190).*" (FN 86 of the Notice).

2.2 Transport costs v. catchment areas

The EC states that "*transport costs may represent an important fraction of costs for certain products, which may put suppliers that are located at a greater distance from the customer at a significant competitive disadvantage relative to suppliers that are located closer to the customer*."[7] While this statement appears to appeal to common sense, it is based on a number of assumptions that may lead the EC astray.

First, the EC statement assumes that transport costs are the only costs that vary, i.e. all the other input costs of competitors are the same. However, in practice this cannot be assumed. Indeed, some costs within the EU still vary significantly. For instance, labour costs are different between EU territories as are some environmental requirements. Similarly, a competitor located in a different territory may have access to a significantly cheaper raw material. All of those factors mean that mere presence of transport costs should not be perceived as automatically narrowing the scope of the relevant geographic market.

Ultimately, any possible confusion would be avoided if the EC carried out a customer-centric analysis and considered which suppliers were capable of serving each customer. Indeed, in practice the catchment area around each customer is likely to depend on how far different suppliers can deliver given their other costs. This may lead to a different distance identified for each relevant competitor.

The EC states that *"[w]hile it is often preferable to assess competitive conditions at each customer location, it may not be possible to draw catchment areas around customer locations, for example because customers are many and dispersed or because there is no information on the location of customers of competitors. For practical purposes, the Commission may therefore draw catchment areas around supplier locations."*[8] We believe that the EC cannot adopt such a general position. In fact, in many cases it would lead it to committing a significant error in the pursuit of practicability. The EC will always need to cross-check such catchment areas against data on the ability of competitors to supply customers from further afield.

2.3 Imports, trade flows and homogeneity of competitive conditions

The EC appears to emphasise the role of homogeneity of market conditions when taking account of imports and trade flows from outside of the candidate relevant market. The EC is also clear that imports are unlikely to be automatically included in the relevant market definition.[9] While we understand the motivation, we consider that the EC statements require further clarification.

We understand that the EC may not automatically extend the relevant geographic market to include territories with significantly different market structure. The EC states that "*the mere existence of trade flows or their responsiveness to changes in relative supply conditions does not necessarily imply that conditions of competition in the area from which the trade flows originate are sufficiently homogeneous to those in the candidate geographic market to warrant an expansion of the relevant geographic market.*"[10]

In cases of *"significant imports"* but low homogeneity between the EC's candidate geographic market and the importer's domestic market, we would expect the EC to include such imports without necessarily

[7] The Notice, para 73.
[8] The Notice, para 74.
[9] The Notice, paras 44 and 75.
[10] The Notice, para 75.

including consumption in the importer's domestic market. If that is what is meant by the Notice, we agree with the approach. If, however, the EC suggests "*significant imports*" that are showing "*responsiveness to changes in relative supply conditions*" would not be considered in the relevant market definition at all on account of insufficient homogeneity of the market from which these imports originate, we would consider this to be a mistake which would likely bias any calculation of market shares.

We also note that the EC's use of the terms "imports" and "trade flows" is unclear, namely, it is not clear whether these refer to only extra-EU supplies. As written in the Notice, the issue of trade flows and imports can easily be applicable by the EC to any supplier from outside of a 'candidate relevant market' including within the EU and within one member state. In both cases, we would appreciate clarification of the language in the final Notice.

3 Product substitutability

3.1 Factual similarity v. hypothetical substitutability

The EC suggests that mere similarity in "*observable characteristics*" of products or their "*intended use*" may not be sufficient to suggest substitutability and that substitutability of products in the eyes of customers is key.[11] We understand that the EC is responding to a long-standing criticism that it reserves its judgement of what intended use of a product is rather than considering the core issue of empirical evidence on substitutability by customers. We welcome this approach.

We paused on some of the implications the EC appeared to have made from this change. These could be issues of emphasis that might benefit from clarification in the final document. They may, however, also suggest a substantive issue.

The EC suggests that 'factual' similarity of products does not necessarily suggest substitution within the SSNIP framework in the same ways a 'factual' difference does not suggest the lack thereof.[12] While this may appear as a non sequitur, we would caution against such perceived symmetry of conclusions. We would indeed expect the EC to consider a product with a great deal of factual similarity to the product(s) under investigation to be a serious candidate for the relevant product market. It may just not be automatically accepted as part of the relevant product market pending evidence of substitutability by customers.

As the EC itself notes, evidence of reliable substitutability by consumers is not always available and it may need to rely on statements of "*hypothetical substitutability*".[13] We agree that such situations do arise. In such cases, a product with very similar/same characteristics to the product(s) under investigation cannot easily be dismissed since no obviously superior evidence to the contrary exists.

With respect to hypothetical substitutability, the EC rightly expresses caution with respect to asking customers for their views. In our experience, within concentrated markets with simple products/services, a great degree of general transparency and/or vertical integration, strategic answers by customers (often well-informed and well-resourced and competing in another part of the value chain with the investigated

[11] The Notice, para 50.
[12] *Ibid.*
[13] The Notice, para 54.

parties) need to be taken with caution. Similarly, end consumers or small business customers may not find it easy to engage with antitrust questioning.

That said, a well-designed survey may still be helpful. We note that the EC practice of asking customers for their views lags behind best practice. In our experience, the EC case teams ask questions in a way that is meant to be helpful for the administrative proceedings but is often not a neutral or an effective way of eliciting answers. The outcome of such questioning can indeed yield unhelpful or substandard results. We would recommend that the EC invests in higher quality survey/questionnaire techniques and adds that tool to its empirical toolkit rather than discarding customer evidence on the basis that it is inherently difficult to obtain. We note that UK's competition authority has developed a "good practice" guide.[14] Similarly, the US competition agency, Federal Trade Commission, also relies on a formal guide to statistical surveys.[15] The EC obtained some insight into survey issues from the research it commissioned to support its review of the Notice.[16] We would urge the EC to develop a similar guide for its surveys and interview/RFI techniques.

3.2 Diversion to products "outside" of the market

The EC stated that "*Evidence on diversion ratios or (cross-price) elasticities of demand can be relevant for identifying the next closest substitutes to be considered for inclusion in the candidate market and for the application of the SSNIP test. However, high diversion ratios or (cross-price) elasticities to products outside the candidate market do not necessarily imply that the relevant market includes such products.*"[17]

We found this statement confusing. If indeed robust estimates of diversion ratios or cross-price elasticities suggest that a significant proportion of sales would be lost to other products following a SSNIP, it is unclear on which basis these products would not be included in the relevant market definition. We urge the EC to explain this statement as it seems to suggest that strong empirical evidence can be overridden without explanation as to how and why this would happen.

It is unclear to us why the EC would want to retain such discretion. Unlike in a similar discussion of "significant imports" under the geographic market definition where the EC at least acknowledges that these should be included in competitive assessment (and also market shares), there is no such mention of later consideration of such competitive constraints here.

3.3 Market segmentation

We were unclear about the precise tools the EC is planning to use for market segmentation. The EC seems to have been influenced in its thinking by the 2022 Wieland-Werke v. Commission judgment where the General Court suggested that "*the existence of an overall market does not affect the possibility of*

[14] Good practice in the design and presentation of customer survey evidence in merger cases, Revised, CMA, May 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708169/Survey_good_practice.pdf.
[15] Office of Management and Budget Standards and Guidelines for Statistical Surveys, September 2006, https://www.ftc.gov/system/files/attachments/data-quality-act/standards_and_guidelines_for_statistical_surveys_-_omb_-_sept_2006.pdf
[16] Support study accompanying the Commission Notice on the evaluation of the definition of relevant market for the purposes of Community competition law, VVA Economics and Policy, LE Europe, WIK Consult, WIFO, & Grimaldi Studio Legale, 2021 https://competition-policy.ec.europa.eu/system/files/2021-06/kd0221712enn_market_definition_notice_2021_1.pdf
[17] Footnote 72 of the Notice.

identifying different competitive dynamics in some market segments".[18] While this conclusion of the General Court is undoubtedly true, it does not automatically give the EC a 'free pass' to segment the relevant product market as it wishes even in cases of product differentiation.

The EC stated: *"[A]lthough market definition remains an important step, analysing how closely suppliers compete may become more relevant in the competitive assessment of differentiated markets."* We again agree with this statement. However, it does not provide us with sufficient clarity as to what exactly the EC is planning to replace the market definition exercise with. The footnotes corresponding to this statement refer to the Unilever/Sara Lee case (M. 5658) where the EC nonetheless carried out a SSNIP test for two categories of products (male and non-male deodorants).[19] In this case, it would appear that the EC first carried out a value judgement-based segmentation before it applied econometric techniques to establish whether the segments belonged to the same relevant markets. We consider such an approach potentially dangerous – the latter detailed analysis based on econometrics was predicated on what appears EC's initial value judgement about key segmentation. While we recognise that the EC will need to exercise judgement to some extent, we would have expected greater awareness of the need to use empirical evidence at the initial decision-making stages of segmentation as well. If not, the detailed analysis that follows risks being used as a tool to confirm the EC's preconceived definition of the market.

In general, we consider that more clarity is needed to explain how the EC intends to treat competitive constraints within a differentiated product market setting. In particular, we would like to understand which analyses are going to be carried out at the relevant geographic market definition stage and which at the competitive assessment stage to ensure that the SSNIP framework is robustly applied at some stage in all cases. We would also expect the EC to formalise its approach to upward pressure price indices which have been used by the EC in the past and have been used in other jurisdictions to consider, in a systematic way, post-merger changes in market power in differentiated product market settings. These indices allow competition authorities to improve their assessment of closeness of competition and reduce the emphasis on market shares where these may not be an accurate approximation of market power. We would have expected the EC to engage with this issue even if just by reference to the potential use of those techniques under competitive assessment.

3.4 Structural market transitions

The Notice states that the EC will take account of "*expected transitions in the structure of a market when the case calls for a forward-looking assessment*" and further explains that *"[s]tructural market transitions differ from considerations relating to market entry by potential competitors ('potential competition') in that they affect the general dynamics of demand and supply in a market and therefore the general reactions to changes in relative supply conditions*"[20].

We welcome this development. This consideration will allow the EC to take proper account of changes in markets where current structure (and market shares) may not be indicative of future market power.

We would welcome further guidance by the EC regarding the type of evidence that it would accept in support of such structural transitions. The EC specifies that "*The evidence must be reliable and needs to go beyond mere assumptions that observed trends will continue or that certain undertakings would change their behaviour*".[21] In particular, it would be helpful to elaborate on what the EC had in mind by

[18] Footnote 97 of the Notice.
[19] Footnote 98 including cross-reference to footnote 71 of the Notice).
[20] The Notice, para 19.
[21] *Ibid.*

"*assumptions that observed trends will continue*". We would consider that clearly observed trends with no evidence to the contrary would be part of evidence demonstrating market transition.