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European Commission
Directorate-General for Competition
1049
Bruxelles/Brussel
Belgique/Belgie

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Dear Sirs,

We are writing on behalf of a Movement for an Open Web ("MOW"), a not-for-profit organisation which supports an open and decentralised web, in response to the Commission's request for feedback on its draft of a revised Market Definition Notice ("Notice").

MOW is concerned that the updates that the Commission has made to its 1997 Market Definition Notice ("1997 Notice") do not sufficiently address the considerable economic changes that have occurred since 1997. Reference is made to the "growth of digital markets" and "changing market dynamics" which understate the changes that have occurred.

As noted by Nobel Prizewinner, Jean Tirole, in his book "Economics for the Common Good", digitization[1] is a process through which substitution of many goods by digital services is taking place. For example, some people use cameras and torches where others use the torch or camera function on their smartphone.

In 1.2 of the Draft Revised Market Definition Notice (the "Notice") the Commission refers to "The main purpose of market definition is to identify in a systematic way the immediate competitive constraints that the undertaking(s) involved face when offering certain products in a certain area."

What is an "immediate competitive constraint" to a maker of hand torches or digital cameras will naturally include consideration of the substitutability and consumer switching to functions on smartphones[2]. However, market definition and competition assessments that are based on a snapshot in time may be misleading. Looking beyond the immediate is contemplated by references in the Notice to competition dynamics, and the time period for consideration of alternatives is also expected to be forward looking (Para 16). It is envisaged that assessment of products which can be supplied very swiftly may be necessary in some cases. For example, eye trackers are, at the time of writing, embedded in Apple's iPhones but the function is not currently deployed. If enabled, they would operate as substitutes for other independently supplied eye trackers.

We consider the following key points which need to be addressed:

[1] And in "The Big Switch" by Nicholas Carr.
[2] The European Commission Staff Working Document recognises that the 2010 US Horizontal Merger guidelines reference rapid entrants as being in the market definition. Commission Staff Working Document "Evaluation of the Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law of 9 December 1997, SDW/2021/0199 final". This is a different issue to whether suppliers have "swing capacity", since lack of capacity can limit the extent and volume of substitution in practice.

Competitive constraints to be accounted for in the Commission's frame of reference given market realities.

1) In industries where the suppliers are digital companies with very high fixed and very low variable costs, entry may take place overnight. In such cases, to avoid misunderstanding, the frame of reference needs to include both existing products, and potential competition from those adjacent market actors with substantial existing sunk joint and common costs. For example, a metal stamper is a high fixed cost machine that can be used to stamp tin hats, tin cups or hubcaps depending on demand. Similarly, a telecommunication or computer network or technology platform carries very high fixed and common costs and features and functions can be added at the flick of a switch.[3]
2) "Rapid entry" may allow a line to be drawn between supply-side substitution and potential competition can be a middle ground. According to O'Donoghue and Padilla, from an economic point of view, effective supply-side substitution requires consideration of a number of conditions: (1) the assets needed to produce, distribute and commercialise the relevant products are readily available; (2) the firm can purchase or lease additional necessary assets without incurring sunk costs; (3) suppliers of supply-side substitutes have the economic incentive to engage in production of the relevant goods/services; (4) suppliers are able to divert production from supply-side substitutes to the relevant products because, for example, they possess unused plant capacity that can be brought into production at a reasonable cost; and (5) consumers regard their products as valid substitutes for the existing set of products.[4] If the time period over which entry can be considered is taken to be short, rapid entry can be distinguished from entry over time.
3) As noted by the former Chief Economist at the CMA, Amelia Fletcher in a report for the Commission, there is insufficient assessment of "rapid entrants" and swing capacity and capacity shares in the Commission's assessment of relevant geographic markets.[5] That report also references the inconsistency of the EU's position with US merger guidelines which "propose the inclusion of both rapid (potential) entrants and more general swing capacity within the calculation of capacity market shares".

[3] As the Commission has noted, similar issues arise in pharmaceuticals (Case M.7275 — Novartis / GlaxoSmithKline Oncology Business), paragraph 89 ('[the concentration] concerns entities currently developing new products or technologies which either may one day replace existing ones or which are being developed for a new intended use and will therefore not replace existing products but create a completely new demand. In principle, the effects of a concentration on competition in innovation in this type of situation *may not be sufficiently assessed by restricting the assessment to actual or potential competition in existing product markets*." (emphasis added). In terms of digitally-enabled markets, as the submission by the Computer and Communications Alliance to the European Commission's Consultation on the market definition notice affirms, "supply-side substitution is particularly prevalent where products or services are software-based since with software, it is comparably easy to add features or functionalities and compete with a wider range of substitutes". Therefore, in these instances, supply-side competitive constraints become particularly relevant insofar as an overly narrow focus on predominantly-demand side substitutability could also undercount the likelihood of future competition between digital products and services that may not be perfectly substitutable at present'. See also the Windows/Java example, which it references (see European Commission "Case No COMP/M.5904 - SAP/ SYBASE" (20 July 2010). Likewise, the Crémer Report (2019, Competition Policy for the Digital Era), which considers that "a broadening of the concept of potential competition to include all types of products and services that are, on the basis of their current functionalities, not yet close substitutes but could possibly expand in the future such as to become close competitors – e.g. because they serve similar user groups, the functionalities overlap and the markets are somewhat interlinked". This is particularly important in merger cases, where the analysis is forward-looking: see the Amici Curiae of the State of New York submission in FTC v Meta, Case 5:22-cv-04325-EJD, where the Amici reference an older case Proctor and Gamble, 386 U.S. 568, 568-72, 580 (1967) where the Supreme Court blocked dominant household products supplier Procter & Gamble's acquisition of Clorox, the leading manufacturer of a complementary household product, bleach—even though Procter & Gamble was not at the time a competitor in the market for bleach. The Amici highlight the parallels of this precedent with Meta/Within acquisition by looking at the strategies that Meta pursues to counter a competitive threat: " Meta does not currently have its own virtual reality dedicated fitness app, the company's already dominant position and ongoing massive investments in virtual reality and related technologies—totaling more than $25 billion since 202026—give Meta ideal means to develop a competing dedicated fitness app, particularly by adapting its existing leading virtual reality app, Beat Saber, which already has a fitness dimension".

[4] See page 165 of the Staff Working Document- and O'Donoghue Robert, Padilla Jorge (2020), The Law and Economics of Article 102 TFEU, Hart Publishing, 3rd edition.

[5] A.Fletcher, B.Lyons, Geographic Market Definition in Merger Control, A Study for DG Competition, 2016, available at: https://ec.europa.eu/competition/publications/reports/study_gmd.pdf

4) Regardless of whether product markets or geographic markets are at stake, in practice, deferring rapid supply-side substitutability to a later stage in the assessment of competition may relegate its importance and lead to misunderstanding of the competitive dynamics in digital markets. If evidence is not gathered of rapid potential entry at the threshold stage of market definition the subsequent assessment of competition may fail to afford it sufficient importance leading to error.

Types of qualitative evidence sources that can inform the Commission's assessment.

5) Forward-looking assessments require evidence. The Notice could make more explicit the types of qualitative sources in cases where evidence of rapid potential entry needs to be gathered in order to inform its market definition analysis. For instance, one readily available independent and forward-looking source of evidence on public companies and their products are Financial Analysts Reports. We suggest these be gathered as a matter of routine.
6) Jorde and Teece[6] suggest that market experts (and independent witnesses) can help identify a list of key performance attributes of the products under consideration or can be asked to predict substitution effects given significant changes in such performance attributes. In the Staff Working Document[7], the Commission also references "evidence from industry experts as important sources, as quantitative variables are less likely to be available in these cases".

Below, we elaborate and expand on the above key points.

MOW's view that rapid potential competition should be considered in defining digital markets

MOW would strongly encourage the Commission to consider in its finalization of the Notice, rapid potential competition in the market definition stage rather than the assessment stage.

We believe that in dynamic, modern markets, rapid potential competition is increasingly material, and therefore, it is our view that it should be considered at the outset of the enquiry.

This was a point that was raised by a number of stakeholders during the consultation period, who argued that in industries characterized by rapid progress and change, dynamic assessments which put equal emphasis on demand and supply-side substitutability and considered rapid potential competition in defining markets, should be the norm.[8]

The Notice does propose assessing supply-side substitution in some specific cases, particularly, in innovative, digital markets. However, there are some key issues with how it determines whether these factors should be addressed (more below). Moreover, the Notice does not propose assessing potential competition in the market definition phase which takes place at the beginning of an enquiry and frames the competition assessment.

The 2021 'Evaluation support study accompanying the evaluation of the Commission Notice' ("support study")[9] looks specifically at potential competition and how it differs from supply-side substitutability. The Commission assesses non-EEA jurisdictions, like Canada and Japan, which do not aim to bring potential competition into market definition even in the presence of innovation, and jurisdictional merger guidelines where the distinction is less clear. In the UK, for instance, the Commission notes that the 2004

[6] See footnote 488 in the 'Evaluation support study accompanying the evaluation of the Commission Notice' ("support study"), available at: kd0221712enn_market_definition_notice_2021_1.pdf (europa.eu), referencing Jorde and Teece, Harmonizing competition policy in regimes of rapid technological change, 1996.
[7]Cited, footnote 2.
8 See page 40 and 78 of the Commission Staff Working Document.
[9]Cited, Section 4.6.

OFT Market Definition Guidelines blurs the distinction between potential competition and supply-side substitution: 'whether a potential competitive constraint is labelled supply side substitution (and so part of market definition) or potential entry (and so not within the market) should not matter for the overall competitive assessment.' This is slightly confused by later guidelines from the OFT and CC which seem to disaggregate the terms.

The Commission's view based largely on EU case law from 2003 to 2015, confirms that there is a difference between supply-substitution and potential competition in timeliness.[10]

While we accept the distinction exists between demand and supply-side substitution, there is a middle ground, where "rapid potential entry" can be included in the market definition. The current position insufficiently defines what is to be taken into account in forward-looking assessments and where structural changes that affect the general dynamics of supply- and demand-in a market - and as noted by the Commission under paragraph 16 of the Notice, distinct from market entry by potential competitors - arise.

One example noted in paragraph 36 of the Notice is its assessment of the market for steel slabs in M.6471 Outokumpu/INOXUM.[11] Whilst differentiated from a demand perspective as the usage of different grades of steel slabs were not interchangeable, it was possible for manufacturers to switch at limited added cost. The Commission therefore defined these various grades of steel as being in the same market. Accounting for supply-side substitutability without looking at potential entrants is all very well when assessing manufacturing markets. However, in digital markets, we are not dealing with companies which can only switch to products within a similar production market – tech companies can move laterally into entirely different markets with considerable ease. The Financial Conduct Authority in the UK is, for instance, investigating Big Tech's entry into Retail Banking.[12] The current guidance risks not accounting for the wider competitive constraints of supply by limiting a view of a specific market to those already within a narrow product market – like a metal stamping factory which produces metal hub caps but could with limited incremental costs start manufacturing tin cups.[13] In digital markets, production processes are far more adaptable and often at very low marginal costs – search engine or social media companies can and did move rapidly into different product markets, arguably a structural development in the market which could only have been foreseen through a thorough analysis of supply side constraints **and** potential competition.[14]

<u>MOW's view that operational criteria to gauge supply-side substitutability when the assessment is forward-looking could be made more concrete</u>

Further, the Commission's determination of when supply-side factors should be considered in market definition is limited. We note that in section 2.2, paragraph 25, the Commission outlines that 'supply substitution can also be relevant for the definition of the relevant market in some cases, namely when it is as immediate and effective as demand substitution'. In paragraph 35, the conditions for broadening the market to include supply-substitution is based on 'whether most suppliers are able to switch production at minimal additional cost' which we support. However, the Notice falls short in defining what this means in practice. In paragraph 61, the Notice states that it will consider barriers and costs when assessing whether markets should be widened based on supply, outlining that if these costs are 'not insignificant', it will not expand its definition. We would ask that the Commission provide more clarity on what it means by

[10] See page 36 of ibid.
[11] m6471_14915_5.pdf (europa.eu)
[12] FCA launches discussion on competition impacts of Big Tech on financial services industry | FCA
[13] See 1997 US guidance on horizontal mergers: Horizontal Merger Guidelines (justice.gov)
[14] DP22/5: The potential competition impacts of Big Tech entry and expansion in retail financial services (fca.org.uk)

"significant" or "insignificant". Neither paragraph 61 nor paragraph 39, which also refers to this idea of weighing the costs of entry, offer a substantive definition. We would also argue that the Notice falls short in only considering barriers to entry and not reasonably balancing this factor against incentives to entry. Likewise, whilst the Notice outlines in paragraph 16, that the Commission may take into consideration expected transitions in market structure if, according to the Commission's assessment, they are expected to occur in the short or medium-term, no clarity on the distinction between short and medium-term is offered.

Competition judgements and guidelines based on potential competition

One precedent, referenced in footnote 76 of the support study[15] comes from the Brazilian Administrative Council for Economic Defense (CADE), outlines the two different approaches it has taken for market definition in financial sector.[16] One approach defines the relevant market by specific products offered, another defines market by groups of products. CADE favours the latter, as it accounts for potential competition and the dynamic change which the industry has experienced, particularly in the payments sector.

In the UK, the blocking of the Meta/Giphy merger[17] was a decision based on potential competition, in recognition of the fact that in digital markets, the barriers to implementing new competitive products in a different geography are low. In the Giphy case, the CMA's reason for blocking the acquisition was primarily based on its discovery that Giphy had from internal documents planned to expand its ads business, which was already operating in the US to the UK. The acquisition therefore removed potential competition between Meta and Giphy.

Before blessing mergers or acquisitions that combine companies which by a traditional analysis would not seem to be directly competing, the fact that in digital markets competition can arise from a few lines of code, should be acknowledged. This point was raised very recently in the US by the Federal Trade Commission, who challenged Meta's acquisition of Within, the most popular VR fitness app, on the grounds that Meta would likely have developed a competing app if unable to acquire Within, driving the need to innovate.[18]

Non-price factors of competition to gauge demand-side substitutability

The Notice specifically takes account of competition on non-price differentials, such as quality and innovation. The 1997 Notice deals largely with price competition as, traditionally, firms competed on prices. We welcome the clarification that the Commission will consider level of innovation and quality in addition to price, as an acknowledgement that today zero monetary prices to users are part of the ad funded business model of some of the largest firms in the world and that non-price elements cannot be easily calculated using the existing SSNIP provisioned by the 1997 Notice.

This is particularly true with multi-sided platforms which offer a free product on one side of the platform. As an alternative, the Commission's proposed SSNDQ test which instead of assessing the effect of price change on demand, looks at the effect of a reduction of quality in assessing a change in switching behaviour is also welcome.

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16 See The Market for Means of Payment (2019): Mercado de Instrumentos de Pagamento (cade.gov.br)

17 CMA orders Meta to sell Giphy - GOV.UK (www.gov.uk)

18 Meta Platforms, Inc./Mark Zuckerberg/Within Unlimited, FTC v. | Federal Trade Commission.

As Gal and Rubinfeld[19] opine, the use of a quality-focused analysis, centred on the SSNIQ, deviating from the SSNIP test is welcome in some instances in zero price markets where all goods are provided for free. In other circumstances, where the consumer pays for the free good through attention and information, and the decreases in costs can be quantified (such as for example, privacy costs) the test to be applied such as the SSNIC, as Newman opines.[20] However, such approach faces constraints, highlighted by Stucke, insofar as it fails to take into account consumers' heterogenous preferences (in terms of privacy and attention to advertisements), which renders the evaluation of disutility more subjective than a monetary expense[21]. In addition, insofar as consumers may display status quo bias. According to Newman, in some instances[22] in zero price markets, product quality is attained primarily via sunk research and development costs, while the marginal cost of delivering a high-quality instead of a low-quality product may be minimal. Therefore, before deciding that the SSNIQ test is an appropriate proxy to gauge demand-side substitutability, one needs to look at incentives for the firm operating in zero price markets to exercise market power by lowering quality: when this behaviour would result in a negligible cost reduction, the attendant loss of customers would make a SSNIQ irrational – yet, an antitrust market may still be present. Therefore, according to Newman, SSNIQ tests may be more appropriate in the circumstances when marginal costs vary substantially in tandem with quality levels, and less so in other cases. In the light of the above, we welcome the Commission's view that the SSNIQ test 'may be considered as an alternative to the SSNIP framework" under paragraph 98 of the Notice, but need not be such, leaving the details of when this test is more appropriate to the specificities of the case. We also welcome the Commission's reference to factors such as behavioural patterns under paragraph 95 of the Notice and avoid placing reliance on quantitative tests such as the SSNIC, alternative to the SSNIP framework, which may lead to such behavioural patterns being overlooked.

<u>Sources of evidence, including analysts' reports, reviewed as a matter of routine</u>

MOW suggests the evidentiary basis of decisions needs to prioritise qualitative sources of evidence. We understand that the Notice does not propose to impose a hierarchy of sources of information, but nonetheless, we believe it might be useful to expand this point further and mention some useful resources specifically.

For instance, the support study[23] mentions analyst reports, an excellent resource as company valuations and forecasted returns are calculated by an evaluation of profit but also market position. Analysts therefore must necessarily account for potential competition and structural market changes. When detailing different sources of potentially useful information we suggest that analysis reports should be gathered as a matter of routine. While evidence on competitive constraints based of industry views are referred to under Chapter 3.2.1 'Evidence relevant for demand substitution", and are referred to under paragraph 56 of the Notice.

We trust that the above is useful and we are at the Commission's disposal should the Commission have any questions regarding our comments.

Yours sincerely,

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[19] M.S.Gal, D.Rubinfeld, The hidden costs of Free Goods: implications for antitrust enforcement, NYU Univ. Law and Econ Working Papers, Paper No. 14-44, 2015, page 35.

[20] J.Newman, Antitrust in zero priced markets, 164 U Pa. L. Review,

[21] Stucke, M.E. and Grunnes, Big Data and Competition Policy, Oxford University Press, 2016.

[22] J.Newman, Antitrust in zero price markets: applications, 94 Washington University Law Review, 49 (2016), pages 71-72.

[23] Cited.

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