

COMMENTS ON THE COMMISSION REVISED DRAFT NOTICE ON THE DEFINITION OF RELEVANT MARKET

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Non-Confidential

1 Introduction

1.1 This note summarises our comments on the EC's revised Draft Notice of Market Definition ("**Draft Notice**") of November 2022. The note is not intended to be comprehensive but instead identifies some areas where we think the Draft Notice could benefit from further development. We are grateful for comments and discussion among experts at Compass Lexecon, and detailed suggestions from Sander Heinsalu and Matthias Pflanz. However, the views in this note are those of the authors alone, and do not represent the corporate position of Compass Lexecon or any other organizations.

1.2 We welcome several of the developments in the revised Draft Notice, including the recognition of several of the subtleties involved in market definition in practice, for instance where there are ecosystem and network effects. We suggest though that there is a need for greater clarity and perhaps a somewhat altered approach in some important areas. Our comments are based on the Draft Notice itself, but we note that there are important questions about how it is implemented in practice; based on a review of the database of EC merger decisions between 1990 and 2019, Padilla, Perkins and Piccolo (forthcoming) conclude that:⁴

there is a significant gap between the clear and theoretically-justified approach to market definition embodied in authorities' merger guidelines, and actual practice in deciding cases. Ad hoc and qualitative approaches dominate, often with limited reference to the conceptual framework of the hypothetical monopolist or SSNIP tests established in the guidelines.

1.3 The remainder of this note sets out our comments on the following topics:

- a. Context specificity of market definition (Section 2)
- b. Role of the Hypothetical Monopolist and SSNIP tests (Section 3)

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⁴ Padilla, J., Perkins, J. and Piccolo, S., forthcoming, Market definition in merger control revisited, in Ioannis Kokkoris (ed) Research Handbook in Competition Enforcement, Edward Elgar. See also Perkins, J. (2021), Market definition in principle and practice', available at <https://www.compasslexecon.com/the-analysis/market-definition-in-principle-and-in-practice/11-15-2021/>.

- c. Geographic market definition (Section 4)
- d. Multi-sided markets (Section 5)
- e. Other issues to consider (Section 6).

1.4 We would be pleased to discuss any of our comments further if the Commission finds it helpful to do so.

2 Context specificity of market definition

2.1 The Draft Notice is in our view unclear about whether market definition is context specific. Paragraph 11 states that:

"The outcome of market definition in a given case is usually unaffected by whether it takes place in the context of merger control or antitrust enforcement" (para. 11).

However, footnotes 20 and 48 recognise deviations from this statement, noting that:

"market definition in the context of assessing the change in market power resulting from a concentration involving horizontal overlaps need not always lead to the same relevant market as market definition in the context of assessing dominance under Article 102 TFEU" (footnote 20).

2.2 The view expressed in the footnotes is more consistent with established practice and the academic literature. Market definition is inevitably dependent on the context of a case, and there is no basis for the statement that the outcome of market definition will usually be unaffected by this context.

2.3 This view is commonplace in the academic literature on market definition. For instance, Baker (2007) states that:⁵

"market definition does not take place in a vacuum: in any particular case, demand substitution must be evaluated with reference to the specific allegations of anticompetitive effect in the matter under review." (p. 173)

2.4 Similarly, Glasner and Sullivan (2020) argue that:⁶

"[M]arkets do not exist independent of a problem or inquiry but must be defined in terms of a problem or inquiry. Specifically, antitrust markets are defined in terms of specific theories of anticompetitive harm." (p. 298)

2.5 As footnote 48 of the Draft Notice partially recognises, this issue may be particularly (but not only) important in the distinction between market definition for merger assessment and market definition for the assessment of dominance, because of the well-known cellophane fallacy.⁷

2.6 The claim that market definition is usually context-independent runs the risk of leading case teams into error, for instance by an inappropriate reliance on markets defined in other cases for different reasons. We would therefore strongly recommend revision of the Draft Notice to ensure that paragraph 11 recognises the context specificity of market definition.

⁵ Baker, Jonathan B. "Market definition: An analytical overview." *Antitrust Law Journal* 74, no. 1 (2007): 129-173.

⁶ Glasner, David, and Sean P. Sullivan. "The logic of market definition." *Antitrust Law Journal* 83, no. 2 (2020): 293-345.

⁷ See Gene C. Schaerr, 'The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers' (1985), *The Yale Law Journal* 94, no. 3, 670-693

3 Role of the Hypothetical Monopolist and SSNIP tests

3.1 The Draft Notice retains the SSNIP test as a useful concept in defining product markets but also acknowledges its limitations and practical difficulties in implementation (section 2.2.1). We recognise that the SSNIP test approach cannot be applied mechanically to every case, and that practical application in particular is often difficult.

3.2 Nevertheless, the Commission might usefully set expectations that the SSNIP test, and more broadly the Hypothetical Monopolist Test ('HMT') approach, is the core conceptual organising framework when assessing substitutability among consumers. The current draft states that:

*"while the Commission may rely on the principles of the SSNIP test in its assessment of the relevant market, there is no obligation on the Commission to apply the SSNIP test empirically, and other types of evidence are **equally valid** to inform the market definition, as further described in section 3. In fact, in many cases the SSNIP test serves **only as a conceptual framework for the interpretation of available qualitative evidence**" (para 33 - emphasis added).*

3.3 It might be inferred from this that there is an obligation to apply the SSNIP test as a conceptual organising framework, but this is not explicit. A failure to organise the process of product market definition around the hypothetical monopolist test would be inconsistent with practice in other leading jurisdictions, for instance as expressed in Section 4 of the 2010 US Horizontal Merger Guidelines.

3.4 The current draft also appears inconsistent with the literature on market definition. For instance, Bishop and Walker (2010) state that:⁸

"It cannot be stressed enough that defining relevant markets on a basis that is not consistent with the principles of the Hypothetical Monopolist Test will, almost by definition, fail to take properly into account demand-side and supply-side substitution possibilities. In consequence, any market shares calculated from such market definitions will not provide, except purely by chance, a good proxy of market power. Although the Hypothetical Monopolist Test is often proposed as one possible way of defining relevant markets, no alternative that is consistent with the principles of assessing demand-side and supply-side substitutability has been proposed."

3.5 Similarly, Glasner and Sullivan (2020) argue that:⁹

"[A]ny relevant market must satisfy something like the HMT, and any proposal failing such a test refutes the underlying theory of harm" (p.327).

3.6 We would therefore recommend that, as in the US Guidelines, the underlying criterion for considering demand-side substitutability should be the Hypothetical Monopolist Test approach. There may be instances where this is less applicable, such as markets with non-substitutable products but similar conditions of competition, but such cases should be identified explicitly as exceptions.

⁸ Bishop, Simon, and Mike Walker. "The economics of EC competition law: concepts, application and measurement." Sweet & Maxwell (2010), ISBN: 9780421931909.

⁹ Glasner, David, and Sean P. Sullivan. "The logic of market definition." *Antitrust Law Journal* 83, no. 2 (2020): 293-345.

- 3.7 Furthermore, we would recommend that the Draft Notice clarify if and when the SSNIP test is applied to all products in the candidate market(s) or some subsets thereof, in relation to footnote 46, which states that:¹⁰

“The SSNIP considered is normally a price increase in the range of 5% to 10% implemented on one or more products in the candidate market including at least one product of the undertaking(s) involved.”

4 Geographic market definition

- 4.1 The Draft Notice continues to rely on the concept of sufficiently homogenous conditions of competition when it comes to geographic market definition (para. 21).

- 4.2 Despite giving more emphasis to geographic market definition, the Draft Notice would benefit from clearer guidance on the definition of the relevant location(s) on which the geographic market is to be based (sections 2.2.2 and 3.3). In particular, the Draft Notice should provide guidance on when evidence should be based on customers’ locations versus suppliers’ locations. While the Draft Notice opens its discussion of geographic market definition by taking customer location as a *“usual starting point”* of the geographic market definition exercise (para 40), it may be helpful to clarify that, depending on the circumstances of the case, either customers’ or suppliers’ locations may be a relevant basis for defining the geographic market.

- 4.3 An obvious and economically coherent basis for determining this question would be to follow the approach of US antitrust law, which relies on the presence of price discrimination as the key criterion for the choice between customers’ and suppliers’ locations.¹¹ The 2010 Horizontal Merger Guidelines state:

“[I]f price discrimination based on customer location is feasible as is often the case when delivered pricing is commonly used in the industry, then the Agencies may define geographic markets based on the locations of customers”.¹²

“[T]he Agencies normally define geographic markets based on the location of suppliers if the product is generally being picked up by the customer at the supplier location and there is no “price discrimination based on customer location.”¹³

- 4.4 Using the presence of price discrimination as the key to selecting either supplier or customer location, the 2010 Horizontal Merger Guidelines remove ambiguity in assessing evidence for geographic market definition. It would be helpful if the approach taken could also be reflected in an appropriate amendment to the wording of para. 88, which currently suggests that price discrimination based on customer location *“can also”* be a reason to define the relevant geographic market in accordance with these locations; as noted above, a more coherent approach would be to make clear that such price discrimination is indeed the core (or indeed sole) criterion for basing the geographic market definition on customers’ rather than suppliers’ locations.

¹⁰ Some relevant considerations in this context are discussed by Autio, T., Padilla, J., Piccolo, S., Saaskilahti, P. and Vaananen, L., 2020, On the Risk of Using a Firm-Level Approach to Identify Relevant Markets, available at <https://www.csef.it/WP/wp581.pdf>.

¹¹ See, e.g., Elzinga KG, Howell VM. Geographic Market Definition in the Merger Guidelines: A Retrospective Analysis. Review of Industrial Organization, 2018; 53(3):453–475.

¹² United States Department of Justice and Federal Trade Commission. [Horizontal merger guidelines](#). Washington D.C: DOJ and FTC; 2010, p.13.

¹³ United States Department of Justice and Federal Trade Commission. Horizontal merger guidelines. Washington D.C: DOJ and FTC; 2010, p.14.

- 4.5 On this basis it would also be possible to provide guidance as to the circumstances under which the SSNIP test could be applicable as a relevant criterion for geographic market definition. In particular, where price discrimination based on customer location is not possible (e.g. “bricks and mortar” retail), the geographic location of supply effectively becomes an element of the product or service supplied and the principles of the SSNIP test can readily be applied to a group of supply locations. It could be clarified that in such cases the SSNIP test should provide the principal criterion for determining the extent of the relevant market and that there is no need for a separate exercise of considering the existence or otherwise of “homogeneous conditions of competition”. The latter could thus explicitly be identified as applicable to situations where markets are to be defined on the basis of customer locations.

5 Multi-sided markets

- 5.1 The much-awaited section on multi-sided platforms (section 4.4) takes into consideration several key topics, such as the presence of indirect network effects, the assessment of demand substitution and non-price elements of zero monetary products.
- 5.2 In addition to the covered topics, we would recommend:
- A more definitive approach, or at least general indications, on platform-level versus side-level market definition, i.e., when it is appropriate to (i) define each side as a market or (ii) define all sides as one single market. We note that practice in the UK has moved towards defining each side as a relevant market, which we suspect will typically be more appropriate, though it will of course remain important to take into account effects on both sides of the market. In its judgement on *Compare the Market v. the Competition and Markets Authority*, the UK Competition Appeal Tribunal concluded that:¹⁴

The economics literature suggests that two-sided markets can be analysed as either a single market or two separate markets. However, when it comes to market definition, to treat them as a single market runs the risk that the analysis of the degree of substitution will be incomplete, and that a single SSNIP on one side of the market is insufficient to test the competitive constraints on the other (para. 146).
 - Guidance on cases when monetization happens in a market different from the market where the conduct happens, especially in relation to the concept of digital ecosystems, cluster markets, and aftermarkets.
 - Guidance on how to test consumer preferences in zero-monetary-price settings and hence on types of relevant evidence for market definition in such cases.
 - More examples of evidence and quantitative tests on non-price elements to assess substitution possibilities (e.g., homing decision).
- 5.3 Comments on the coherence between the Draft Notice and ongoing initiatives concerning the contestability of digital markets (Digital Services Act and Digital Markets Act) will be very helpful.

¹⁴ *Compare the Market v. Competition and Markets Authority*, 8 August 2022, case 13801/12/21, available at <https://www.catribunal.org.uk/judgments/138011221-bgl-holdings-limited-others-v-competition-and-markets-authority-judgment-2022>.

6 Other issues to consider

6.1 We would suggest more detailed areas where the Commission may want to clarify its approach, in particular:

- a. Explanation of the incentive compatibility relationship between groups of consumers in the context of **second-degree price discrimination**, which is not currently considered in the approach suggested in paragraph 88. For a seller to successfully price discriminate, no buyer must have the incentive to switch to a combination of product, price, quantity, etc that the seller meant for another buyer. The existence of second-degree price discrimination does not necessarily mean each self-selected customer group constitutes a separate relevant product market: customers in each group may still regard different versions of the product as substitutes and may be ready to switch between them in response to changes in their relative prices. Thus, the hypothetical monopolist's ability to set prices for one group may be constrained by the choice of price for the other group. Market definition in the context of second-degree price discrimination is discussed by O'Donoghue and Padilla (2020), who argue that:¹⁵

the mere fact that one observes menu pricing (i.e., second-degree price discrimination) is not enough to conclude that separate markets exist. The Commission has in many occasions recognised the possibility of substitution between different price/quality combinations in its market definition decisions.

- b. Clarify how the hypothetical monopolist test treats two-part tariffs and more complicated **nonlinear price contracts**. E.g., simultaneously increasing the fixed fee and reducing the per-unit price raises the average price for consumers buying small quantities and reduces the price for large buyers. Small buyers may switch away from the seller, while large buyers may switch to the seller.
- c. Clarify whether the market for a product includes its **earlier and/or later generations**, especially for technology products. Baker (2007) states that:¹⁶

"Whether earlier as well as later generations should be included in the antitrust product market depends on whether a hypothetical increase in the price of later generation products would be made unprofitable as a result of buyer substitution to earlier generation products (or buyers declining to upgrade). This issue is similar to the question of whether a market for new cars should be expanded to include used cars [...]" (pp. 150-151).

- d. Clarity about how **'out of market' competitors** will be considered in the competitive assessment. The Draft Notice helpfully states that *"the Commission takes into account all competitive constraints (immediate or not) in the competitive assessment"* (para 14). But it does not provide any further information about how this might be done. Without clearer guidance, there is in our view a risk that case teams fall into the "binary fallacy" whereby the competition analysis is conducted solely within the context of the defined market, without sufficient reference to constraints from outside the defined market.
- e. Treatment of **tied or bundled products**. Section 4.5 of the Draft Notice includes welcome recognition of the importance of taking tying and bundling into account in market definition, but lacks guidance on how to do so. In particular: a. How to establish if tied or bundled products A and B are distinct products in separate product markets, or whether they (individually) form components of a single "bundled" product market for AB; and b. In the case of mixed bundling,

¹⁵ O'Donoghue, R. and Padilla, J., 2020, *The Law and Economics of Article 102 TFEU*, Hart Publishing, 3rd edition.

¹⁶ Baker, Jonathan B. "Market definition: An analytical overview." *Antitrust Law Journal* 74, no. 1 (2007): 129-173.

whether and under what conditions all of the products A, B and AB compete in a single relevant product market or in separate product markets.

There can also be important asymmetries in market definition between the tied and the tying products, as noted by Glasner and Sullivan (2020):¹⁷

"[T]he value of defining a relevant market for the tying product differs fundamentally from the value of defining a relevant market for the tied product. The former helps assess ability to leverage (a question of current market power); the latter helps assess whether leveraging could harm consumers (a question of the acquisition of market power)" (p.326).

¹⁷ Glasner, David, and Sean P. Sullivan. "The logic of market definition." *Antitrust Law Journal* 83, no. 2 (2020): 293-345.