The European Commission's revised draft market definition notice (November 2022)

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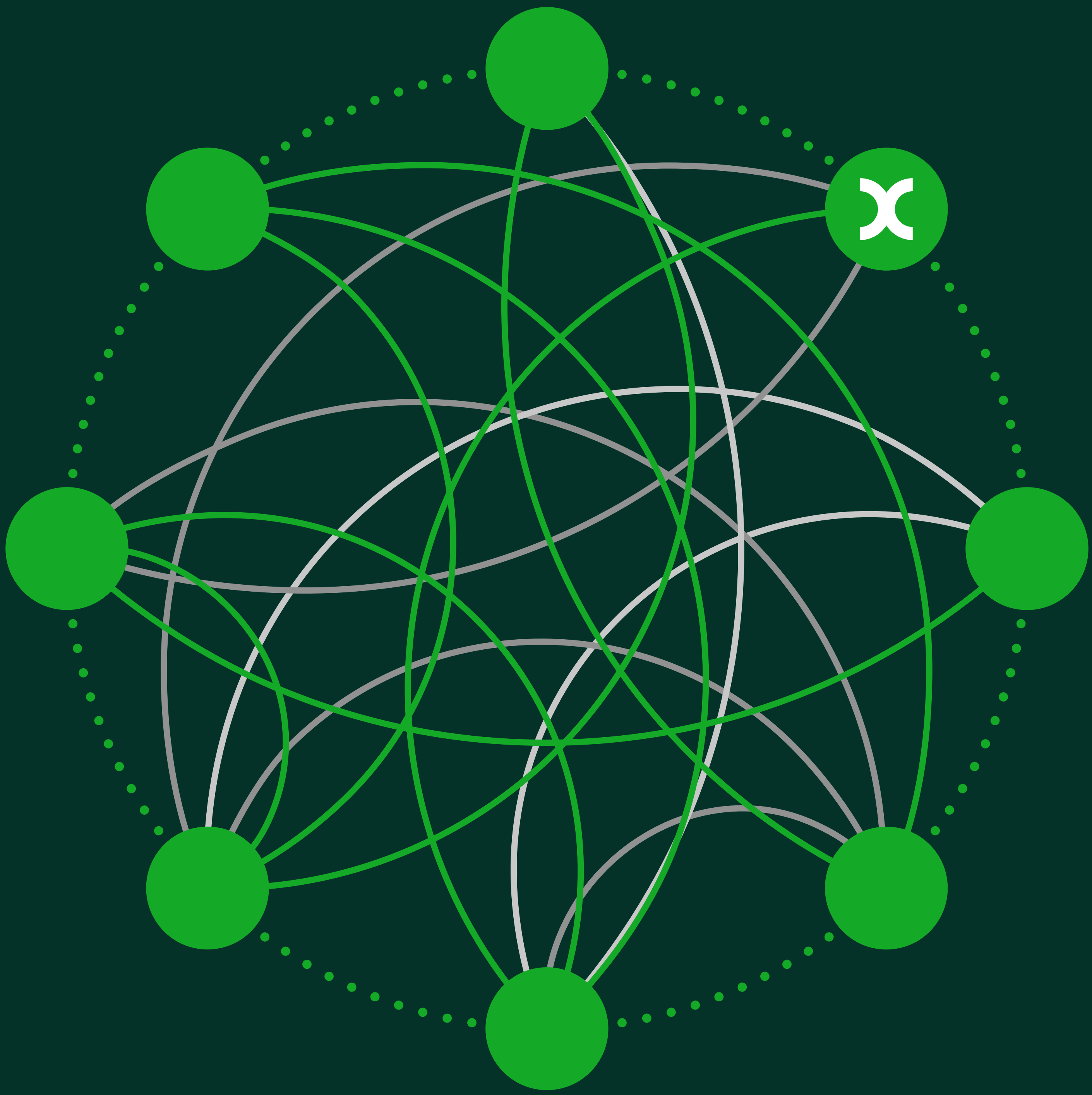
Oxera consultation response

13 January 2023



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In praise of the new notice

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We consider the revised draft notice to be a welcome improvement on the existing guidance. It captures current best practice, and is comprehensive, yet concise and clear.

The many references to relevant case law are helpful. Importantly, in the notice, the SSNIP test remains as the key thought-framework in defining relevant markets, while complementing it with reference to non-price parameters (including SSNDQ as the quality variant of the SSNIP).

We do see some scope for further clarification or improvement of this revised draft. In this response, we provide some concrete suggestions. These are specifically from an economic perspective, and based on our direct experience with market definition in Europe and beyond.

Concept and methodology (Sections 1–2)

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1. The notice should provide at least some clarification of what is meant by 'market power'.

Market power, as a fundamental economic concept underlying market definition (first used in para. 7), is not defined anywhere. Given the fundamental role of 'market power' in competition law (and indeed market definition), we suggest providing at least some definition.

Our draft proposal for a potential footnote definition would be as follows:

> Market power is the degree to which a seller can profitably increase prices, reduce output, or reduce quality compared to the competitive level for a sustained period of time. A characteristic of market power may be the ability of a seller to distort competition or foreclose competitors.

Moreover, the way that the term is currently applied, it appears to miss the fundamental economic logic that market power is not binary, but a matter of degree. Para. 31, for example, refers to the SSNIP principle as 'whether a hypothetical monopolist in the candidate market could exercise market power'. We suggest changing this to '[…] could exercise a small but significant degree of market power relative to a competitive scenario'.

2. The notice should clarify upfront that there may be more market dimensions than only product and geography.

We notice that many other dimensions to competition are covered in the draft (e.g. time in para. 22; distribution channels in para. 51; and customer segments in para. 88). It can be helpful guidance to make these dimensions more explicit upfront (in practice they are often considered implicitly under the product dimension, but doing so risks overlooking them—see Niels, G., Jenkins, H., and Kavanagh, J. (2016), *Economics for Competition Lawyers*, 2nd Edition, Oxford University Press, Section 2.2).

Generally, we consider the ability of firms to price discriminate as a necessary (though not sufficient) condition for a distinct market definition along any dimension. We suggest replacing para. 22 (which is only on the temporal consideration) with this more general point which applies to all dimensions of market definition; and to include a cross-reference here to section 4.2 (on price discrimination); and a cross-reference to this at para. 12 (on the principle of product and geographic market definition).

3. The notice should emphasise that the SSNIP test is, in the first instance, a thought-framework.

The SSNIP test is first mentioned in para. 31. Here, the notice currently refers to the SSNIP test as a 'theoretical criterion', i.e. not limited to a quantitative test. However, we suggest emphasising more explicitly that the SSNIP (and SSNDQ) test is, in the first instance, a thought-framework, or principle, that precedes potential quantification. Alternatively, or additionally, it may help to refer to the hypothetical monopolist test (HMT) as the thought-framework (rather than the SSNIP test), to help distinguish it from the critical loss analysis (CLA). We suggest adding a cross-reference to para. 59 on the CLA.

4. The notice should omit the addition 'most, if not all' when referring to suppliers in supply substitution.

In para. 35, it is stated that 'most, if not all' suppliers must meet the required criteria for supply substitution to be considered. We do not see any economic basis for excluding any supplier that meets these criteria—regardless of whether this constitutes 'most, if not all' suppliers. Moreover, there is no guidance on how the set of suppliers would be defined in the first place. We suggest omitting the addition of 'most, if not all'.

Process and evidence (Section 3)

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5. The notice should recognise that the absence of actual substitution does not necessarily imply separate markets.

Paras 52–53 point to evidence of past substitution as potential key evidence. However, it is well-recognised in economics that the threat of diversion to a close second-best option may still impose a strong competitive constraint on the best option, even if actual substitution does not take place. This is clearly shown in, for example, standard spatial models of oligopoly in industrial organisation (e.g. Hotelling models). We suggest recognising the point that competition can occur even without actual substitution. Ultimately, what matters is not actual substitution but substitutability or the threat of potential substitution (of which actual substitution can be indicative).

6. The notice should explain why high cross-price elasticities or diversion ratios do not necessarily imply a wider relevant market.

Footnote 72 notes this, but omits clarifying why. We suggest explaining this with reference to how elasticities and diversion ratios feed into a SSNIP test or the CLA (para. 59).

7. The notice should clarify the merits of also having access to evidence on hypothetical substitution, and refer to conjoint surveys (in addition to straightforward customer opinions or factual surveys) as a potentially helpful tool to increase reliability.

In para. 54, it is rightly pointed out that evidence on hypothetical substitution may constitute the only available direct evidence on substitutability or potential substitution, 'for instance in cases calling for a forward-looking assessment'. Based on our experience, the simple absence of reliable real-world data on substitution or demand is an equally relevant instance where evidence on hypothetical substitution has strong merit. In fact, as noted above, the variable of interest is not actual substitution but potential substitution (or substitutability), of which actual substitution can be indicative. As such, evidence on hypothetical substitution is of general relevance. We suggest clarifying this.

We also suggest noting that evidence on hypothetical substitution is generally complementary to data on actual substitution: both aim to answer the same question, but from different methodological approaches, and each with its own relative merits. In fact, data on actual substitution is a form of evidence on hypothetical substitution.

Finally, we suggest referring in para. 54 to conjoint surveys as a potentially helpful tool to increase reliability over surveys that simply ask respondents for their direct valuation. A cross-reference can then be added in para. 80 (on evidence gathering using surveys).

8. The notice should explain how the CLA (as a tool for the implementation of the SSNIP test) is conducted.

In para. 59, the CLA is given as an example of quantitative implementation of the SSNIP test, but is only explained in general terms. We suggest clarifying that the critical loss is calculated as $SSNIP / (SSNIP + m)$, where m is the gross margin (or contribution margin). This simple formula is now omitted, in our view, unnecessarily.

Based on experience in practice, we also consider it valuable to provide at least some definition of gross margin (as the only other input parameter of the CLA not yet defined in the notice) and some guidance on how a reliable gross margin may be derived or inferred from financial data. Alternatively, it may be useful to note that gross margins may, under profit maximisation and absent capacity constraints, be theoretically inferred from observed elasticities (through the Lerner index). However, these elasticities would then also have implications for, and should be consistent with, the analysis of actual loss. The caveat also applies when, conversely, actual loss and gross margins are used to infer elasticity.

Finally, we suggest identifying the CLA as the primary and accepted mathematical implementation of the SSNIP test, rather than 'an example'.

9. The notice should clarify what is meant by 'percentage profit margins' and should acknowledge that high variable cost margins need not be an indicator of market power.

In para. 59 and footnote 77 the draft suggests that there is a link between high-percentage profit margins and low levels of switching following a SSNIP. First, we note that it is important to define the correct profit margin to use in the SSNIP test. This should be the variable cost or avoidable cost margin. Second, in industries with high fixed costs and low variable costs the variable cost margin may be high even though firms do not possess significant market power. We suggest that para. 59 and footnote 77 should reflect this.

10. The notice should clarify that a CLA considers a SSNIP in the original candidate market only.

If the SSNIP test is not passed on the first iteration, it may make a difference for subsequent iterations whether the SSNIP is applied only to the original candidate (or 'focal') market, or to a potentially enlarged candidate market. We suggest clarifying that for each iteration the SSNIP should, in principle, apply only to the original focal market (unlike the 1997 market definition notice; para. 18, final sentence). Otherwise, the concern is that you may conclude on a wider market based on a chain-of-substitution logic even though this chain is not sufficiently strong. For example, if A is only constrained by B, and B is constrained by C, a SSNIP on an enlarged market of A+B would lead you to include C. However, this would then occur despite the absence of constraint from C on A.

Specific circumstances (Section 4)

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11. The notice should point out that uniform pricing may lead to wider markets (for the same reason that price discrimination may lead to narrower markets).

Section 4.2 currently explains when price discrimination may lead to narrower, distinct markets. We suggest noting here that, on the same token, a policy of uniform pricing (e.g. national pricing) may lead to wider markets despite an absence of demand substitution.

12. The notice should emphasise that if separate markets are defined in the presence of multi-sided platforms, the constraints from the other side(s) must still be taken into account.

Para. 95 states that in such a case, the other side 'may still be taken into account in the competitive assessment'. We consider this to be too weak, and suggest changing 'may' to 'must'.

13. The notice should note that multi-sided platforms can also supply a product at negative monetary prices.

Para. 97 currently notes that 'zero monetary prices are an integral part of multi-sided platforms' business strategy'. First, we suggest changing 'are' to 'may be' in the above quote (as not all multi-sided platforms have zero monetary prices). Second, we suggest noting (e.g.

in parentheses) that prices may even be negative. We consider this helpful to emphasise the point that a user group that is paid by the platform can still be considered a customer. It is also aligned with the economics literature on platforms.

14. Section 4.1 should recognise that market definition is typically a less useful tool in the presence of significant product differentiation.

The draft notes, in para. 86, that when products are differentiated, market shares may provide a less reliable indicator of market power. This is correct, but does not tell the whole story. The previous paragraph (para. 85) notes that in the presence of differentiation, the Commission can identify separate relevant markets within a continuum of differentiated products, or it can define a single broad market and then take into account differences between market segments within that broad market. This flexibility in the approach taken serves to highlight that in situations where products are significantly differentiated, it is more difficult to come to a clear-cut and objective conclusion on how markets should be delineated.

15. Section 5 should note that in many cases, market shares based on the flow of customers, rather than the stock, can provide a better reflection of market dynamics.

A firm may accrue a large customer base, for example due to it being an early entrant into a new market. However, this stock of customers may not reflect the firm's importance as a competitive force in the market in later periods. A large firm that is not actively competing for new customers, but is simply profiting from its existing customer base, may well be a less important competitive force than a smaller firm that is actively targeting new customers. Market shares based on the flow of new customers over a period of time can therefore provide a more accurate reflection of competition than those based on the stock of customers.

About Oxera

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Oxera is one of Europe's leading economic consultancies. Since our founding in 1982, we have played a critical role in regulatory debates—such as through our seminal study on quantifying damages for the European Commission, as well as regular engagement with policymakers through the Oxera Economics Council.

Today, we advise law firms, authorities, corporations, governments, and courts in Europe and beyond on merger reviews, public/private antitrust investigations, and state aid enforcement from our nine European offices. Effective market definition plays a vital role in these cases.

Contact

Dr Gunnar Niels
Managing Partner
gunnar.niels@oxera.com

Matthew Johnson
Partner
matthew.johnson@oxera.com

Dr Timo Klein
Senior Consultant
timo.klein@oxera.com

oxera.com